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Assessment and Way Forward of the Douala Stock Exchange in Cameroon

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Introduction

This chapter discusses the assessment and the way forward of the Douala Stock Exchange (DSX) in Cameroon based on the results of empirical research. In the first part, the historical background of the market is discussed, with the focus on shareholding. The second part presents the methodology used to conduct the research, and the last part gives the results.

Historical Background of the Douala Stock Exchange

Having launched in 2001 and with trading beginning on 30 June 2006, the Douala Stock Exchange is a financial market, a public limited

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company with a Board of Directors and capital of 1.8 billion francs CFA, distributed as follows: 63.7 % by banks and financial institutions, 23 % by spin-offs from the state, and 13.3 % by insurance companies. The Douala Stock Exchange is the sole agent authorised to carry out stock exchange transactions and functions within the territory of the Republic of Cameroon (Douala Stock Exchange Website 2015).

According to Douala Stock Exchange (2015), the principal functions of the market include to create, organise and manage the stock market; to monitor and supervise the smooth running of negotiations on the stock market; and to administer the negotiation of negotiable public stocks and securities (OTZ). The final function of the DSX is to establish the rules which regulate access to the market; admission of listed stocks; the organisation of transactions; the suspension of negotiations of one or several stocks; the recording and advertising of negotiations; the delivery of share certificates and settling of accounts; the custody of shares; and the invoicing and collection of commissions. Unfortunately, nearly 14 years after its creation, the DSX is struggling to fulfil its noble objectives.

Theoretical Framework: The Stock Exchange Purpose and Operation

According to Ndedi (2009), the major reason for the development of stock exchanges in recent years has been government privatisation programmes. In order to sell stock in state-owned enterprises to the public, there must exist a secondary market for the public to later trade the shares among themselves. That is the role of an exchange, as a secondary market. Here, the securities that are bought and sold on an exchange are bought and sold by shareholders, not by the issuing company. A company sells its shares in a primary offering directly to shareholders through the use of underwriters and other intermediaries. The sale by the company is a direct transaction between the company and the shareholder and is not done on an exchange. This is true even for companies that already have shares listed on the exchange and then decide to sell more shares. Even companies with shares already listed on an exchange do not sell new, additional shares on the exchange.

Those shares are also sold in direct transactions off the exchange (Ndedi 2009).

Because an exchange is a secondary market, it is not absolutely necessary to have an exchange in order for companies to sell their shares. Companies can sell shares in the primary market and let the investors figure out on their own how they will later trade and sell those shares. Obviously this is not a happy prospect for investors, and that is why exchanges are formed early in the capital market development process. If there is no exchange, investors will be reluctant to buy shares in privatisations or other offerings, because the investors will not have a ready and available forum in which to sell their shares at a later time. However, an over-the-counter (OTC) market can operate as a forum for trading shares in the secondary market. The OTC market can exist with or without an exchange. There are very few countries that have OTC markets without exchanges. Some countries, such as Zimbabwe and Nigeria, have exchanges and no OTC market. In most developed countries, exchanges and OTC markets both operate concurrently.

Some questions generally arise regarding the stock exchange. The first of these is 'Who owns a stock exchange and who makes its rules?' Most statutes require that exchanges be non-profit entities, as it is considered most appropriate from a public policy standpoint that an exchange serves the public investors and keeps costs of trading as low as possible. In most countries, the model followed is that an exchange is formed as a not-for-profit company by licensed broker-dealers. Although an exchange is usually a not-for-profit corporation, this does not mean that it has no revenues. All not-for-profit organisations are permitted under law to charge for their services and to pay salaries to employees. The exchange therefore charges a small fee for every transaction. The fee is generally a small amount, no more than is necessary to provide for exchange expenses and expansion plans. Although a stock exchange begins its existence through a government-issued license, it is treated as a self-regulatory organisation (SRO). That means that the exchange selects its own Board of Governors and officers and determines its own rules of membership and trading subject to review and approval by the securities commission. Exchanges have the authority to discipline, suspend or expel members or floor traders for violation of exchange rules (Ndedi 2009, 2012).

Methodology

Unlike quantitative research which uses a random sample generalisable to a larger population, qualitative research uses a purposive sampling method. Purposive sampling involves the selection of informants based on an important characteristic under study, such as what they know about the subject under study, or where they live in order to ease the task of the researcher (Nayab in Bowen 2009). Triangulation (confirmation of the same information by different methods or sources) is used to indicate that two (qualitative and quantitative) methods are used in the study in order to check the results of the various methods of data gathering used during the study. The purpose of triangulation in qualitative research is to increase the credibility and validity of the results.

According to Nayab (in Bowen 2009), validity shows the soundness of the research methodology and the results generated, based on the extent to which the research remains in congruity with universal laws, objectivity, truth and facts. The validity of statistics-driven quantitative research depends on the soundness of the instrument adopted. Validity in qualitative research, however, depends on the ability and effort of the researcher, as the researcher is the instrument.

For the current research, data were derived from both primary and secondary sources. Secondary data consisted of articles and reports on the development of the Douala Stock Exchange in Cameroon; these included government policy documents, consultancy reports, community-based financial market reports and other financial reports, and the historical background on financial market development in Africa.

To really understand the issues pertaining to the Douala Stock Exchange, empirical research was conducted with a sample of 75 business managers, academics and other financial analysts acquainted with the activities of the institution. These informants, purposively chosen, both in Cameroon and abroad, constitute the sample under a cross-sectional study. The data gathering consisted of a questionnaire of seven items aiming at interrogating these informants on their reluctance, and that of the public in general, to trade at the DSX. The research also used the Likert Scale Questionnaire for questions 4 and 6.

Results and Discussion

This section discusses the data gathered during field research along with the results obtained and recommendations that need to be implemented to achieve desirable goals at this important capital market. Based on the empirical research, the following information was gathered.

- 1) The first question was: ‘Launching the capital market, what Cameroon as a country wanted to achieve?’ The goals and the motivations when launching a capital market are multiple. It is very tempting to rush into the maze of securities laws, stock exchange rules and licensing regulations without asking the basic question, which is ‘why are we doing this?’

This basic question should be the starting point of analysis. In the case of the Douala Stock Exchange, based on the information gathered, almost all informants said that the Cameroonian government launched the DSX after the launching of the Libreville Capital Market. Therefore, the launching of the DSX was not genuine as it was not based on local and/or regional needs of a stock exchange.

In general, the principal objectives for the DSX were supposed to be one of the following: privatisation programmes that could not be undertaken without a capital market infrastructure; the desire to create investment opportunities for Cameroonians; or, finally, the desire to stimulate the growth of small and medium-sized businesses in Cameroon.

- 2) The second question discussed with respondents was: ‘Should government regulation precede or adapt to the trading market?’

Some countries have adopted full-scale securities laws, licensing requirements, registration provisions and so on, before a single company was listed on the local stock exchange. This was true of the DSX. In this case, there is a danger that market forces will be hindered by rules that are not responsive to local conditions. Market forces include such factors as the supply of capital, the supply of investment opportunities, the competition from foreign capital markets, the impact of government fiscal policies, and the number and activities of broker-dealers and investment advisers.

The point raised through this research question is that capital markets should not refrain from regulation. But the recommendation made for this point is that regulation should consider trading practices that have been developed informally, that conform to the efficient practices that have developed, and that cover areas where potential problems could arise.

- 3) The third question asked was: ‘Should regulations be developed for an over-the-counter (OTC) market?’

An OTC is a secondary trading market that is not on an exchange. The OTC is usually operated by broker-dealers among themselves. The broker-dealers are market makers because they put out quotations as to the price at which they will buy or sell specific OTC securities. Almost all the respondents (90 %) were keen on such a move.

- 4) The fourth question was: ‘What does transparency really mean and require at the DSX?’

The informants, all 100 % of them, said that the Douala Stock Exchange is not transparent. Figure 12.1 presents the results of the respondents in the Likert scale from 1 to 5, with 5 agreeing that the DSX is transparent, while 1 means the financial market is not transparent. According to the respondents, to be an effective doctrine at the DSX, transparency must be defined by notions of materiality, and there must also be an acknowledgement of company interests regarding the timing of disclosure and confidentiality of some matters.

Without doubt, transparency is an indispensable element of an efficient securities market. Although transparency is clearly accepted as a common good, when applied to government actions, transparency does not extend to matters for which public disclosure is contrary to national interests.

What is the goal of the transparency requirement at the DSX? From the perspective of government regulators, transparency is required so that the reviewing and supervising agencies can determine whether government-established investor protection goals are met. For potential investors, transparency is required so that they can determine the potential risks and rewards of the investment—something that most respondents mentioned. Generally, government and investor interests in transparency

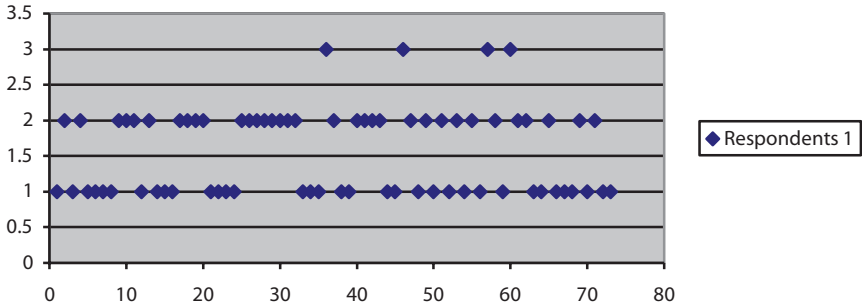


Fig. 12.1 Scattered plots from respondents' responses

overlap, and transparency standards serve both interests. However, there might be differences in emphasis.

What are the standards for transparency at any financial market? One might think that transparency is equated with full disclosure. Full disclosure of material facts and events is a standard that gets one closer to the goal of transparency. A fact is material when it is important. In the securities world, two types of material information exist side by side. One is called hard information, the other soft information.

5) The fifth question discussed with the sample of managers was: What is your assessment of the corporate governance at the Douala Stock Exchange.'

In the case of the DSX, and in the light of the recent history of economic crimes in Cameroon, almost all respondents (87 %) raised the issue of lack of corporate governance.

The role of corporate governance in any institution is increasingly important. Good corporate governance might not assure the success of a company, but bad corporate governance will often destroy or severely limit a company. Moreover, good corporate governance engenders public confidence that management is devoting itself as best it can to the best interests of the company. Public confidence translates into a willingness to invest capital. For many investors, certainly for unit trusts and other institutional investors, good corporate governance is one of the primary factors leading to an investment decision. Good corporate governance includes transparency with regard to board decisions and periodic full

disclosure to shareholders of corporate results and plans. Without an effective enforcement procedure, good corporate governance standards alone are insufficient.

6) The sixth question raised with respondents is: ‘The Douala Stock Exchange manipulation.’

It was appropriate to discuss with our respondents the public confidence in the DSX, and in particular in the buying and selling of securities. Many respondents (76 %) raised the issue of lack of public confidence due to market manipulation, which is the single greatest problem with regard to the DSX. The scattered plots (Fig. 12.2) represent respondents’ views on the market manipulation with the Likert scales, with 5 being totally agree, and 1 totally disagree.

Market manipulation probably began the day the first stock market opened, and it has continued to this day. In every country in the world the temptation exists to make money through deceptive and unfair measures.

The recommendation made to deal with this issue is how to prevent the misuse of information. The DSX and securities commission rules should provide for some minimum period of time before which a company or insiders can begin to trade on the basis of publicly released information. Too few people trust the system enough to put their money into it. Many people continue to believe that it is safer to put their money under their bed, or in a bank account, than to give it to a stockbroker to invest in a company listed in the DSX. Unfortunately, this belief sometimes has historical roots in local corrupt practices such as misleading privatisation offerings that have not been effectively prevented or sanctioned. There is probably no greater challenge to government officials than to overcome public distrust. This chapter indicates several issues that should be addressed by government officials who want to create a positive atmosphere for an active public market.

Government ministries have spent much time, money and energy preparing the infrastructure for securities trading, but companies often have not responded with the enthusiasm that was hoped for. In discussing this issue with some small and medium enterprise (SME) managers in Cameroon, the single most important theme that is heard is the lack of public confidence in the fairness of the DSX. Years of corruption in government and financial sectors have taken their toll.

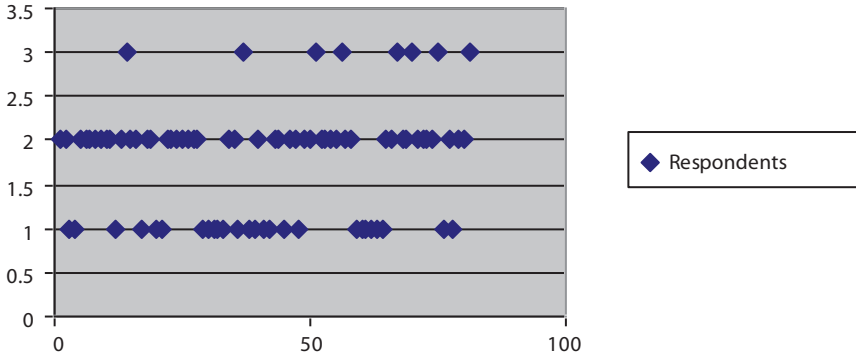


Fig. 12.2 Scattered plots of respondents

Can the DSX be trusted? Despite every effort to develop a securities commission staffed with knowledgeable and dedicated staff, it is nevertheless a government agency and therefore is subject to potential mistrust. Furthermore, the DSX has been created through government action and is managed by a government appointee.

Public confidence is an intangible yet essential element in the infrastructure necessary for a viable DSX. What are the factors that affect public confidence? There are several that appear to be the most important, according to our research.

The first is *market integrity*. No one is willing to buy or trade securities without confidence that they are being treated fairly. Fair treatment means that all investors and potential investors at the DSX are dealing with the same information, and that the information is accurate. This can be achieved through two fundamental requirements: timely disclosure of material information by companies, and prohibition against use of confidential information by insiders. The public must be aware of this development.

The second issue to look at is *broker and investment adviser neutrality*. Customers have an implicit faith in their brokers and advisers, a faith based upon the licensing process and the appearance of good faith and objectivity. If such advisers do not treat their customers with absolute fairness, the DSX will be seriously hurt. For neutrality, strong licensing standards and swift and effective disciplinary sanctions are needed.

The third element required for public confidence is *transferability and liquidity*. The ability to attract investors at the DSX is linked directly to potential investors' perceived risks of liquidity. At the DSX, it is risky enough to buy a stock not knowing how the company will fare in the future. It is even more risky to buy a stock not being sure that it will be readily transferable when the time comes to sell. Experiences show that in many markets, the amount of public investor activity is so low that at any given time there are too few buyers and sellers in the market to ensure immediate liquidity.

The fourth point for public confidence is an *effective enforcement process with the Douala Stock Exchange*. Investors know that occasionally there will be companies or persons who try to make money in the market through illegal means. That is an inevitable but unfortunate part of the securities market. Temptation often proves too great a force for some people.

Investors will not lose faith in the DSX because of a few bad apples, but they will quickly lose faith if there is a lack of effective enforcement.

Effective enforcement means:

- 1) Criminal prosecution, whenever appropriate;
- 2) Administrative sanctions by the securities commission;
- 3) The availability of private remedies for investors who have suffered losses as a result of the misconduct.

Each of these enforcement mechanisms requires input from the Cameroonian government. There must be adequate funds provided for the investigation and prosecution of criminal conduct, there must be a sufficient budget for the securities commission to afford its own investigators and lawyers, and there must be civil procedure statutes that allow effective private causes of actions. If the public sees that these are in place and that wrongdoers are promptly apprehended and punished, there will be a sense that enforcement will have a deterrent effect and thereby create a fairer marketplace. If the public perceives otherwise, there will be no interest in taking part in the trading market, as all will perceive that such trading will be equivalent to playing poker with persons who 'deal from the bottom of the deck'. There are other factors that also impact upon public confidence, including for example the quality of the companies being offered, and the quality of corporate governance procedures.

- 7) The seventh question discussed was around an effective way to educate and develop an interest of the public on the advantages of investing at the Douala Stock Exchange?

The DSX cannot thrive without active participation by local companies. Institutional traders, such as pension plans, bank trust funds and insurance companies, have neither the commitment nor the capacity to fund the capital needs of an entire market. The movement of investments from private savings accounts to publicly traded companies is a vital element in capital market growth. One may wonder how it is possible to have an active DSX in a country that has a low per capita income like Cameroon.

The problem of educating and attracting potential investors is a global phenomenon. Even in highly developed markets in Europe, for example, less than 20 % of the population participates through investments in the market. Therefore, we should not set our sights too high.

In summary, the findings have shown that unfortunately, despite financial liberalisation and the emergence of new markets and institutions in Cameroon, in the absence of adequate oversight and an adaptive regulatory structure the DSX can only malfunction. According to Chami, Fullenkamp and Sunil Sharma (2009), the development of the financial market occurs when market players are able to reach mutually acceptable compromises regarding the terms of financial transactions. Agents strike grand compromises, such as those between maturity and collateral, and between seniority and control, as well as myriad smaller ones. A financial market will generally fail to develop because the instrument traded does not meet the requirements of some of the players; such is the case with the DSX.

Summary

A number of issues have been discussed in this chapter. In summary, the role of government in establishing, supervising and facilitating the growth of the DSX is complex. It involves much more than simply establishing rules and creating supervising authorities. The content of those rules must be developed based upon both 'what is the on the ground'

and the goals to be achieved. Rules cannot be static, because the market is changing all the time.

Flexibility must be written into the rules, and discretion must be accorded to agencies that support the DSX to act without going back to Parliament. Government regulators will not know what the market looks like or how it is changing without continual examination. Finally, no market will succeed without public confidence. All the factors that affect public confidence must be kept at the top of policymakers' lists, and each factor must be continually examined to assure that its requirements are being achieved. These are challenging tasks. The responsibility placed upon government regulators is high, but the opportunities are great. An efficient, viable DSX will result in significant economic gains, which will in turn have major benefits for the welfare of all of Cameroon and the Central African Economic and Monetary Community (CEMAC) sub-region. The Cameroonian regulators therefore stand at the head of a process that offers enormous promise and opportunity, and their response to these challenges will very much determine the growth and prosperity of Cameroon.

The chapter has developed an appropriate strategy for sequencing the development of the DSX. It has argued that instruments that require simpler and more easily verifiable compromises must be launched in the first place at the DSX. The chapter also shows that the path of development will depend on economic, legal, political, institutional and cultural factors—the framework that prompts policymakers to ask the right questions in diagnosing the deficiencies and hurdles. The chapter finally provides guidance for designing suitable policies for the development and functioning of the Douala Stock Exchange that will contribute to the emergence of Cameroon by 2035. The chapter concludes that when they function properly, financial markets allow the transfer of resources from savers to investors, and contribute to making the economy more robust to shocks by enabling risks to be allocated appropriately—something that is needed in Cameroon with the DSX.

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