UNITAR TRAINING PROGRAMMES IN THE LEGAL ASPECTS OF DEBT AND FINANCIAL MANAGEMENT

A NEW DIRECTION FOR AFRICAN CAPITAL MARKETS

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A NEW DIRECTION FOR AFRICAN CAPITAL MARKETS: FACILITATING CAPITAL-RAISING OPPORTUNITIES FOR SMALL AND MEDIUM-SIZED ENTERPRISES

Paper written following a joint UNITAR/MEFMI High-level Retreat for
Heads of Financial and Capital Markets in Eastern and Southern Africa
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PREFACE

This publication has been developed by Professor Stuart R. Cohn, who is Professor of Law at the University of Florida and a Senior Special Fellow for UNITAR. This extremely rich document highlights the dynamics of the Capital Markets on the African continent, and more specifically, the role of Small and Medium-Sized Enterprises (SMEs) in the development of these markets. This document's main premise is that stock exchanges provide capital growth in domestic enterprises, and in turn, improve the capital-raising environment of SMEs.

The first part of the document deals with potential sources of new company listings on an exchange, namely privately-held companies and family-owned enterprises. These types of enterprises are numerous in Africa; unfortunately, these new exchange listings have not materialized on the continent, resulting in slow stock exchange growth.

Next, Professor Cohn discusses trends that are occurring in African listings, such as the de-listing of companies from exchanges, and the large number of African companies that have chosen to list their shares on foreign markets. These unfortunate trends are crippling African Capital Markets.

In Professor Cohn's thorough discussion of SMEs, he suggests that the success of SMEs is vital to the future economic growth of developing countries in Africa. SMEs are predicted to be tomorrow's stock listings on the African continent. In this discussion of SMEs, Professor Cohn also highlights the main company and securities restrictions affecting SMEs as well as the problems these enterprises face vis-à-vis capital-raising.

Lastly, Professor Cohn examines the risks that investors run when investing in SMEs. While these investments may be quite high in risk, their rewards can be extremely profitable when the SMEs grow in size.

The content of this publication is extremely rich and comprehensive. For readers who are government or finance-sector policy makers, are planning on investing in African businesses, or for those who are simply interested in the topic, this document will be extremely rewarding. This document is also a direct product of a jointly organised UNITAR/MEFMI high-level Retreat: "Joint MEFMI/UNITAR Retreat for Heads of Financial and Capital Markets in Eastern and Southern Africa" which invited policy makers from Kenya, Lesotho, Namibia, Tanzania, Uganda, Zambia and Zimbabwe (see Annex).

I hope that this document is useful as well as challenging to the readers.

Marcel A. Boisard
Assistant Secretary-General of the United Nations
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A New Direction for African Capital Markets: Facilitating Capital-Raising Opportunities for Small and Medium-Sized Enterprises

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I. Introduction

A common lament heard throughout the stock exchanges of Africa's developing countries is that there is too little investment product and too little investor demand. The number of new stock listings has not grown significantly in recent years. The principal growth in listings has come from cross-listings of shares among exchanges. While this practice has increased investment opportunities for domestic investors, and provided increased stability for the exchanges, it is a process that gives a false sense of progress. Stock exchanges are, or should be, an integral element in a country's capital market. The capital market is intended not only to provide investment opportunities, but more importantly for domestic economic growth, stock exchanges should provide incentive and assistance to the capital growth of domestic enterprises. That this is not occurring is a cause for concern, yet it is a matter that can be addressed through public and private sector measures. These measures, aimed at creating an improved capital-raising environment for Small and Medium-Sized Enterprises (SMEs), form the nucleus of the recommendation contained in this article.

II. The Lack of New Issuances

There are two sources of new company listings on an exchange: (i) parastatals and State-owned Enterprises (SOEs) that could sell some or all of the government's equity interest to the public through privatisation offerings and (ii) privately-owned companies (often family-controlled) that undertake public securities offerings in order to raise capital. Neither of these sources has created a material number of new listings in recent years.

The privatization movement that began 15-20 years ago in many developing countries was the result of several factors, to wit (a) continuing pressures on governments by the World Bank and IMF to move enterprises from inefficient government control to more market-oriented private control (b) burgeoning debt obligations imposed on governments by SOEs that are operated more for political purposes than fiscal integrity (c) the collapse of the Soviet Union, exposing economic weaknesses incurred through centralized economic governance (d) growing financial strength of Western countries and their stock exchanges and (e) recognition by many African leaders that new steps needed to be taken to break of their dismal economic cycles.

Privatization programs required the existence of a stock exchange to facilitate post-offering secondary trading, which in turn required the adoption of more modern company laws and securities laws, and the creation or reincorporation of a securities commissions or analogous supervisory agencies. These foundational requirements were in large part met, as the structural elements of an efficient system for the public offering of securities was put into

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place in most countries. The handful of countries that do not yet have formal exchanges are all taking steps in that direction.

The hope in most countries was that the privatization process would provide a constant flow of new listings to the exchange. When the Uganda Stock Exchange was created in 1997, eight SOEs were on the list for near-term privatizations.[1] That list, and those hopes, failed to materialize. Today, seven years later, only one of the eight companies on that list has had a public offering. The Ugandan experience is typical. Through a combination of political and economic factors, privatization programs have seen only a trickle of public offerings instead of the anticipated stream. In many instances, governments found it more convenient to off-load SOEs through private means, sometimes through measures that bordered upon self-dealing and corruption. Whatever the reasons, privatizations have not been a major fuel for stock market growth.

A second source of potential company listings was, and still is, the numerous family-owned enterprises existing in every country. Family-owned businesses flourish in areas such as hotels, media, beverages, and construction. To date, very few of these companies have chosen to become publicly held. The reasons vary. Some businesses are so eminently successful that there is no need to seek external funding. Some businesses have little need for additional capital because they have no plans for major expansion. Two additional factors also clearly impact in this area. One is a concern that a public offering will cause or eventually lead to a loss of control by the family.[2] A second principal concern is the problem of transparency, that is, a desire by company owners to remain private and beyond the demands of public disclosure. Moreover, a societal problem also exists in many countries by reason of the fact that a large percentage of the more established, successful family-owned businesses are owned by members of the non-native population, such as Asian-owned businesses in East Africa. In such circumstances there is also resistance to public offerings because of the fear that such minority groups are opening themselves up to a potential eventual loss of economic dominance.

The net result is that in most countries the prime candidates for new exchange listings have not materialized. Stock exchanges have slowed or stagnated in their growth and have not been the catalyst for domestic economic development as initially hoped.

The slow growth pattern of stock exchanges is reflected in figures developed in 2003 by the United Nations Development Programme and distributed at the 2003 African Capital Markets Forum.[3] The number of initial public offerings (IPOs) in reported Sub-Saharan countries for the two year period 2001-2002 was:

[1] The Chairman of the Uganda Capital Markets Authority stated in 1997 that the following SOEs were expected to make public offerings in the "near future": National Insurance Corporation, Uganda Commercial Bank, Uganda Consolidated Properties, Ltd., Uganda Airlines, the government's 30% holding in BAT, Uganda Grain Milling Corporation, The New Vision, and Uganda General Machinery. The New Vision (July 26, 1997, p. 27), interview with Leo Kibirango, Chairman of the Capital Markets Authority.

[2] The loss of control concern is one that can be readily avoided by careful planning and measures that assure the retained control of the founding family. For a discussion of such measures, see Stuart R. Cohn, *The Development of Micro-Cap Securities Markets in Sub-Saharan Africa: New Approaches to Fostering Enterprise Growth*, in Promoting Growth in African Capital Markets, UNITAR Doc. No. 18 (2002).

[3] African Stock Market Handbook, United Nations Development Programme (2003).

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Country	Initial Public Offerings
Botswana	4
Ghana	3
Kenya	1
Malawi	1
Mauritius	0
Namibia	2
Nigeria	7
Swaziland	0
Tanzania	1
Uganda	1
Zambia	1
Zimbabwe	4
West Africa	1

If the largest exchange, Nigeria, is eliminated from these figures, the result is an average of less than two IPOs per year per country. Seven countries did not even experience two IPOs in that two-year period. The low numbers of IPOs came during a period of substantial stock market success in some markets. Botswana's Index, for example, showed one of the highest growth rates in the world, rising 96% over the two-year period. Nigeria's index rose 38% during this period. However, the rise in indices was not uniform, as other exchanges experienced substantial losses, including Namibia (down 44%) and Zimbabwe (down 60%). The disparities among exchanges is further proof that one must be very careful in discussing African markets, for generalizations run the risk of overstatement. The disparities also point out that market regulators must concentrate on what is on the ground in their own country and adopt policies particular for their own economies rather than follow policies adopted elsewhere, even policies adopted in successful markets.

The slow growth in African listings is not a recent phenomenon. The following table, again taken from the 2003 UNDP survey, shows the relatively slow growth pattern in the number of company listings on the following exchanges:

Country	1992	1997	2002	10-Year Gain	5-Year Gain
Botswana	11	12	19	8	7
Ghana	15	21	24	9	3
Kenya	57	58	50	-7	-8

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Malawi	---	3	8	8	5
Mauritius	22	40	40	18	0
Namibia	3	13	13	10	0
Nigeria	153	182	195	42	13

These figures show a combined net gain of only 46 new listings over the five year period of 1997-2002, an average of less than three per country. If Nigeria and Zimbabwe are taken out of the list, the net gain is only 20 new listings. These numbers are even more disturbing from the standpoint of market growth when one realizes that they include cross-listings, which do not reflect any gain in new company capitalizations.

Two other trends are also disturbing. One is the de-listing of companies from exchanges, which has occurred in Kenya, Nigeria, and elsewhere. De-listings occur when companies decide that the advantages of public listing are outweighed by the disadvantages, such as listing fees, continuing disclosure and transparency concerns, and professional expenses necessary to meet periodic reporting requirements. Although the number of de-listings has not been high, one does not know how many discussions regarding such possibility are taken place in boardrooms of companies that are no longer seeing advantages to their market listings. A second problem area is the number of strong African companies that have chosen to list their shares on markets outside of Africa, particularly in the United States. The list is long, including such major companies as Ashanti Goldfields (Ghana) and Zambia Consolidated Copper (Zambia). Most of such companies are from South Africa and Egypt. The ability of strong companies to list on foreign exchanges or OTC markets means that local exchanges are not able to develop a large trading base of foreign investors interested in their major companies. Overseas listings also diminish the likelihood of those companies seeking cross-listings on other African exchanges.

III. A New Direction

As the above discussion indicates, there has been relatively little growth over the years in most African stock exchanges. The hopes that had been placed on privatisations, sales of some shares in SOEs, and public offerings by domestic family-owned businesses have not materialized. If measures must be considered to facilitate exchange and company capitalization growth, we must start to look in new directions.

Fortunately, SOEs and dominant family-owned businesses do not represent the totality of African enterprises. In nearly every country there are numerous small and growing businesses in many business sectors. The entrepreneurial spirit and energy is apparent to anyone who has taken the time to look. Most of the native-owned, local businesses are very small. But some have grown into businesses that regularly employ 20 or more persons and that generate growing revenues. These businesses may not be big by absolute standards, but they have promise. What they invariably lack is capital.

In recent workshops across Africa, one hears repeatedly that the future economic growth of developing African countries is dependent upon the success of the small and

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medium-sized enterprises.[4] From rural areas to the cities, the growth of small businesses will generate increased employment, wages, goods and services, and tax revenues.

It is therefore in the direction of SMEs that developing countries should turn their attention. Not only is the growth of SMEs a vital element to a nation's economy, today's SMEs will become tomorrow's stock listings.

IV. The Capital-Raising Problems of SMEs

The capital needs of SMEs are both constant and sporadic. That statement is not as self-contradictory as it appears. Capital needs are constant because an SME that desires to grow never has enough capital. Small companies can survive for weeks or months with band-aid approaches to financing, but inevitably major financial needs arise. Those times of financial crisis are often not foreseeable and can be sudden, hence sporadic.

SMEs cannot borrow significant funds from banks. Banks regard them as too risky and with too little collateral to support a loan. Small amounts might be borrowed on a personal account, but not for long and not for any sizeable amount.

SMEs have very few sources of capital to use for expansion purposes. Their owners are often already fully invested in the company, often having borrowed from family and friends as well. Trade creditors and suppliers might give them some leeway, but in time they too must be paid.

The primary hope for expansion capital comes from investors, persons willing to make long-term financial commitments in return for the opportunity to profit from the company's hoped-for success. SME entrepreneurs will prefer that these are equity rather than debt investors, for debt carries with it mandatory interest payments and looming maturity dates. That is not to say that an SME might not want to offer company notes for sale, but debt financing is often not a viable option for a small company or an attractive opportunity for potential investors. If investors are willing to take a risk on an SME, they generally prefer an investment that offers significant profitable returns, something that debt offerings do not.

How and where will an SME sell a substantial amount of equity securities? Under most company laws, an SME could remain as a private company and restrict sales to no more than 50 shareholders. However, shares in a private company are not transferable, which hardly comports with an investor's long-term desires. Moreover, the SME might already have a number of small shareholders, consisting usually of family, friends, and employees, and the chances might be small of raising significant capital from new investors while staying below the 50 shareholder maximum. Thus, raising capital while staying within the limits of private company status is a much too limited course for many SMEs.

[4] The challenges facing SMEs and measures necessary to meet those challenges was a principal theme, for example, at the Joint UNITAR/MEFMI Retreat for Heads of Financial & Capital Markets in the MEFMI Region, held in Namibia in October, 2004.

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V. Company and Securities Law Restrictions Affecting SMEs

Company and securities laws in nearly every developing African country provide for only one capital-raising procedure, which is the formal registration and filing process with the Securities Commission or analogous supervisory agency.

The registration process is not conducive to SME capital-raising. As noted, SMEs are in frequent need of capital infusions for additional hiring, equipment, facilities, and marketing programs. Revenues rarely meet capital demands, especially in early growing years. Registration of securities for a formal public offering is a time-consuming process, yet time is usually not on the SMEs side. Moreover, the amounts of capital needed from time to time are much too low to justify the large expenditures required by registered offerings, including lawyers, accountants, underwriters, transfer agents, subscription agents and printers. These are not only high costs, but they are incurred without knowing whether the offering will be fully subscribed. In short, the delays, costs, and risks of a formally registered public offering are beyond reasonable bounds for most SMEs in need of capital to sustain their growth.

Unfortunately, there are no statutory or regulatory alternatives to the registration process. Exemptions from registration for limited offerings, or modified registration requirements, do not exist in most statutory and regulatory schemes.[5]

The absence of exemptions is understandable, although not necessarily justifiable. Company and securities laws were developed in earlier years with stock exchange listing criteria in mind. SOEs were to be the principal source of listings, plus major privately-owned companies. Small companies might aspire to exchange listing standards, but until they meet those standards they are not prospects for public offerings. In addition, there is the ever-present concern that opening the door to lesser requirements could lead to dangerous, abusive situations. Corruption and fraud are too much a part of African history for government policy-makers to ignore, and there was (and still remains) a fear that a securities offering based on standards anything less than the full-fledged process set forth in the statutes and regulations is too great a risk for young and inexperienced capital markets. This fear might have been justified in earlier times when there was very little experience with securities transactions, but today nearly every country has a cadre of experienced administrators and professionals knowledgeable about the ins and outs of securities offerings. Substantial experience and know-how exists to tailor offering provisions in ways that continue to protect investors while providing some relief to small companies from the rigors of the full registration process.

Current law gives SMEs have no alternative other than the formal restriction process if they want to raise a substantial amount of capital from more than a handful of private investors. To put this in context, suppose that a family-owned manufacturing business needs to replace obsolete and worn-out machinery. The owners estimate that $200,000 of new capital is needed, and it is needed as quickly as possible to avoid continuing repair and breakdown problems. To raise that capital will require a broad marketing program, as there is

[5] At a recent workshop involving representatives from nine sub-Saharan countries, I asked the representatives if any of their countries has a process that allows SMEs to undertake limited public offerings of securities without going through the formal registration process. The answer was none.

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not a group of major investors able to take up the offered amount. The money is needed now, not several months from now when registration materials and auditing matters are resolved. The company cannot be certain that the offering will succeed, and it can scarcely afford the risk of spending $30-$40,000 in professional fees and other costs that will be incurred in a registered offering. These are circumstances that call for some kind of exemption or relief from the formal registration process.

VI. A Discussion of Potential Reform Measures

The future of capital markets in developing countries depends upon fostering the formation and economic growth of SMEs. There is a pressing need for some form of registration exemption of modified process applicable to SMEs to enable them to raise capital in a quicker and less costly manner than the full registration process. In addition, there needs to be a concerted, coordinated program directed at SME economic development. These areas of reform are discussed as follows:

A. *Registration Exemption*

This is the most important, although not sole, reform measure that can be taken to facilitate capital raising by SMEs. The current registration provisions are too costly, too time-consuming, and contain too many technicalities for smaller companies. What is needed is some form or forms of exemption from registration that permit capital raising without going through the entire registration formalities.

The United States has developed what is probably the most extensive set of registration exemptions intended to assist smaller companies. In each of the following circumstances, companies can raise capital without going through the formal registration process:[6]

(A) *Local offerings* (the “intrastate exemption”): Offerings made by a local company solely to persons located within that local geographic region (states, in the U.S.) are exempt from federal registration. This so-called “intrastate exemption” is based upon the notion that local people know the owners and business of the local company, and investors in local areas can seek effective recourse for any disclosure problems. Thus, the formal provisions of registration are unnecessary.

(B) *Offerings up to $1 million* (the Rule 504 exemption): Offerings up to $1 million do not have any formal disclosure requirements and can be made to any persons regardless of where they are or their level of financial sophistication. There are limitations, however, on the method that such securities can be marketed to the public.[7]

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[6] These exemptions are set forth for illustrative purposes only and in no way are meant to be recommendations for African countries. Each country must analyze its own market and come to its own determination as to whether registration exemptions are appropriate and, if so, what makes the most sense given current legal and economic circumstances. In the United States, for example, the very well developed judicial system permits ready access to enforcement efforts if offerings are not made with full transparency. Furthermore, the existence of state securities laws acts as a supplement to federal laws and further protections to local populations.

[7] The offerings cannot utilize general advertising or widespread solicitation measures unless they have been registered in states in which offers are made. Inasmuch as African countries do not have concurrent federal

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(C) *Offerings up to $5 million* (the Rule 505 exemption): Offerings up to $5 million may be made, pursuant to a disclosure document, to no more than 35 non-accredited investors plus an unlimited number of accredited investors.[8] Here too, there are limitations on advertising and general solicitation.

(D) *Private Offerings* (the Section 4(2) exemption): An unlimited amount can be raised in an offering that is directed solely to sophisticated, experienced investors who are given full disclosure or complete access to the company's records.

(E) *Private Offerings* (the Rule 506 exemption): An unlimited amount can be raised in an offering that is limited to no more than 35 non-accredited investors plus an unlimited number of accredited investors, provided that full disclosure is given and that the non-accredited investors have financial experience and understanding or are represented by persons who have such experience and understanding.[9]

(F) *Modified Registered Offerings up to $5 million* (the Regulation A exemption): Companies can offer up to $5 million by going through a modified form of registration with the SEC, which basically involves the preparation of an offering document that contains fewer requirements as to technical information and audited financial statements.[10]

One would think that with so many exemptions available, small companies in the United States would have little trouble raising capital. That is not so. Unfortunately, the various exemptions are so ringed with technical conditions that they too pose very difficult, sometimes impossible, challenges for smaller companies. For example, most of the exemptions (other than Regulation A) do not allow companies to advertise the offerings to the public. This prohibition materially limits a company's ability to seek out potential investors. The advertising limitation has been broadly criticized by many commentators in the United States, but the Securities and Exchange Commission has remained firm in insisting that limited offerings should not be broadly marketed.

Each country must consider whether and to what extent the registration of securities rules can be altered for SMEs. I propose the following elements as a package for a potential exemption:

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and state securities laws, issues of advertising and solicitation with respect to exempt offerings must be addressed at the national level.

[8] Accredited investors are defined to include, principally, persons with high net worths or annual incomes, as well as institutional investors.

[9] The representatives of non-accredited investors are referred to as "purchaser representatives" and cannot be a director or officer of the offering company. If an issuer has any doubt as to the financial sophistication of a non-accredited investor, the issuer should not enter into the sale unless the purchaser is represented by an appropriate purchaser representative. Curiously, accredited investors are presumed to have financial know-how, although the fact that someone has a high net worth or annual income is scarcely evidence of one's ability to understand private offerings.

[10] No audited financial statements are required unless the company already prepares such statements. This can be a considerable cost savings over registered offerings, which require a minimum of two years of audited financials for companies that are registering no more than $10 million of securities.

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1. Maximum Offering Amount. The exemption would be applicable for SMEs making public offerings up to a specified amount within a 12-month period. The maximum figure would be a matter of local consideration. The maximum amount, whether $50,000, $100,000 or more, should be determined by considering at what level it becomes more feasible for a company to engage in a registered offering.

2. SME Eligibility. To qualify for the exemption, the SME and its owners should meet basic conditions, such as compliance with all licensing requirements, no tax delinquencies, and prescribed corporate governance standards. A maximum annual revenue would assure that eligible companies have an ongoing, viable business. The use of the proceeds of the proposed offering must be clearly delineated.

3. Modified Disclosure Document. The offering document given to prospective investors should contain essential material information about the company, its history, products and services, management, existing transactions, if any, between the company and management, and intended use of proceeds from the offering. Financial statements should of course be included, but if a 3 year audited history is required as for most registered offerings, much of the time and cost savings would be lost. Unaudited financials if well prepared might suffice, or perhaps one year of audited financials if historical figures are adequately disclosed.[11]

4. Mini-Max Offerings: All exempt offerings should be conditioned on the issuer selling a minimum amount of securities within a fixed period of time, e.g. 60 days, in order for the offering to be effective.[12] The minimum amount should relate to the company's working capital needs and should be reviewed by the securities agency as part of its review process, noted below. If the minimum figure is met within the prescribed period of time, the offering can proceed up to the full amount. Until the minimum is met, all offering proceeds must be retained in an escrow account with an established bank or other financial institution.

5. Merit Review. In order to protect against abusive offerings, the offering documents should be reviewed by the securities commission prior to the start of the offering. If the commission believes that disclosure is inadequate, or that the company's business and plans are without any reasonable chance of success, the commission should be empowered to deny the company the right to go forward with the offering. The commission might make mistakes in judgment from time to time, but it is best at least initially to provide this kind of screening process to attempt to eliminate clearly unworthy offerings.

6. Restricted Securities. Purchasers of securities in an exempt offering should not be able to freely re-sell them unless and until the company begins to provide periodic

[11] All of the exemptions in the United States can be based on unaudited financial statements. That has not proven to pose serious disclosure concerns with exempt offerings. Many companies hire outside auditing firms to review their unaudited statements and procedures.

[12] Conditions for meeting the minimum amount should exclude from computation any sales made to the company's affiliates, employees, and other related persons.

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reports to the public similar to those provided by listed companies. The secondary market requires transparency no less than the primary market. Thus, re-sales should be prohibited until the SME begins to provide public information.[13] Re-sales are likely to occur in an over-the-counter market. Regulators should ensure that OTC regulations are in place so that buyers and sellers can rely on the same standards imposed upon brokers dealing in listed securities.

These are the principal elements of the proposed limited offering exemption. Each country will of course need to adopt provisions consistent with its own circumstances. The only caveat I offer is that the greater the technical requirements, the more the conditions begin to look like a registered offering, the less the exemption will be utilized and SMEs will remain frozen out of the capital market.

B. <u>*Government Assistance*</u>

In order to ensure that adequate attention, guidance, and support are provided to SMEs, small business development agencies should be established within the Central Bank, Ministry of Finance, or wherever else appropriate. The agency could provide any and all of the following services:

1. *Regulatory Coordination*: “One-stop shopping” for all licensing and other bureaucratic requirements imposed on businesses in formation and thereafter.

2. *Education and Training*: Training programs for SME owners in matters of finance, taxation, corporate governance, trade regulations, and other relevant subjects.

3. *Financial Assistance*: Development and execution of government financial assistance programs. These could range from direct grants to guaranteed loans and could provide the means, however small, for critical “seed capital financing” for SMEs.

4. *Market Evaluation*: Coordination with the securities commission to continually analyze the SME situation in the country in order to consider appropriate measures that would allow greater access to capital markets.
5. *Private Fund Development*: Communication with and assistance to venture capital and private equity funds within and outside the country to encourage the creation of seed capital funds and their investment in qualified SMEs. The development of indigenous funds, however small, could be an important start to improving resources within the country’s own capital market.

[13] A serious problem of liquidity will arise if the company never begins to issue public reports, thus locking in shareholders who cannot sell their shares on the market. If investors know that this risk exists, they will be reluctant to buy any SME securities. To ameliorate their concern, regulations should be adopted to permit non-control persons who own shares in SMEs to sell their shares through brokers or other means after those shares have been owned for some minimum period of time, even if public reports have not been made by the SMEs. In the United States, the minimum time frame is 2 years.

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VII. Do the Proposals Carry Too Great A Risk for Investors?

The principal criticism one may expect to the proposal to enlarge the capital-raising opportunities of SMEs is that the risk of loss for investors may be too great. There is no doubt that there is a high risk of loss. SMEs are not as solidly established as listed companies and there will undoubtedly be some investor losses. But there are investor losses in listed companies too, and with adequate disclosure to potential investors there is no reason to think that investors will not be able to understand the risks and make their own judgments. Investing in an SME is, to be sure, a high-risk transaction. But some investments will succeed, and when they do, those who invested early in growing SMEs are likely to have substantial economic rewards. That is exactly the pattern that keeps venture capital companies going ---- the hope that successful investments will create greater economic benefits than the losses incurred in the investments that fail.

It is not enough, however, simply to advise investors that they might be taking higher-than-usual risks by purchasing equities in SMEs. It is necessary that structural programs be put into place that will provide added measures of security. Those programs include:

— *Professional Training*: Training of professionals who advise SMEs, such as lawyers, accountants, and investment advisers, to improve their ability to give sound advice and guidance;

— *Corporate Governance*: Establishment of corporate governance standards to be met by all companies, large and small, who wish to raise funds from the public market;

— *Improved Judiciary*: Training and education programmes for judges and prosecutors on securities law matters so that violations can be prosecuted and resolved in prompt and effective manners.

— *Merit Review*: Granting to securities agencies, such as Capital Market Authorities, the ability to conduct "merit review" of SME offerings so that some level of scrutiny is made prior to any public offering;

— *Effective Enforcement*: Assuring that effective enforcement provisions are in place, including administrative actions by government, criminal prosecution powers, and civil remedies for investors, and that agencies are sufficiently funded and staffed to afford investigative and enforcement actions;

— *OTC Standards*: Developing standards for broker-dealers in the over-the-counter market, so that investors who buy and sell securities in non-listed SMEs have the same protections regarding broker-dealer obligations as are given to persons who trade in listed securities.

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Conclusion

It is time for a new phase in capital market development of sub-Saharan and other relatively new and under-developed economies. Phase one saw the infrastructure for capital markets put into place. Phase two saw the growth of stock exchanges through privatizations and some domestic IPOs. But that growth has stagnated. Were it not for cross-listings, most exchanges would not be experiencing material growth.

A new phase is needed to direct attention to the most likely source of economic growth and future exchange listings, i.e. the numerous SMEs in every country that are rich in entrepreneurial talent and energy, but poor in capital resources. Company and securities laws are currently too restrictive in limiting the capital-raising opportunities of SMEs. A coordinated government effort is needed to "prime the pump" for the future by reforming current laws to facilitate improved opportunities for SMEs to raise capital. The recommendations proposed in this article are, in my judgment, neither radical nor dangerous. For certain they are timely, and it is hoped that policy-makers throughout the developing countries will turn their attention to this neglected yet fruitful source of future economic growth.

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PROFILE OF THE AUTHOR

Professor Stuart Cohn

Stuart R. Cohn is a Professor of Law and Associate Dean for International Studies at the University of Florida Levin College Of Law, Gainesville, Florida, and a Senior Special Fellow of the United Nations Institute for Training and Research (UNITAR). Professor Cohn specializes in business law matters, including the formation and structure of business enterprises, capital formation through private and public financing, the trading of securities in the secondary market, and major transactions including mergers, acquisitions, and takeovers. He received law degrees from Oxford University, Oxford, England, and Yale University in the United States.

Professor Cohn has lectured and conducted regional workshops on behalf of UNITAR and others in Europe, Africa, and the Far East on Capital Market Development and was the opening speaker of the UNDP-NYSE conference on African Stock Exchanges held at the United Nations in April, 2003. He is the author of Capital Market Development in Uganda, published by the International Law Institute, Securities Counselling for Small and Developing Companies, published by WestGroup, and numerous articles in the fields of company and securities laws. He is a member of the Federal Regulation of Securities Committee of the American Bar Association and the Executive Council of Business Law Section of the Florida Bar.

Prior to entering teaching, Professor Cohn practiced law in Chicago, Illinois. His clients included both publicly-held companies and start-up companies. Since entering the academic profession, Professor Cohn has devoted much of his research and public service efforts to improving the capital-raising abilities of small and developing businesses. He has been instrumental in major reforms of company laws and has frequently lectured on business and financing matters.

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ANNEX I

Joint MEFMI*/UNITAR Retreat for Heads of Financial and Capital Markets in Eastern and Southern Africa**

« Promotion and Development of Domestic Financial Markets »

Walvis Bay (Namibia), 28 - 30 October 2004

Thursday, 28 October 2004

Time	Event
0900 – 0930 hours	**Programme Registration** – Sharon Wallett
0930 – 1015 hours	**Session 1:** ***Opening Ceremony*** Welcome Remarks – Director, Financial Sector Management, MEFMI Remarks by Babar Kamal, UNITAR Introduction of Presenters and Delegates
1015 – 1030 hours	**TEA/COFFEE BREAK**
1030 – 1245 hours	**Session 2:** ***Principal Problem Areas- Creating the Enlarged Market*** ♦ Public Offering Standards ♦ Exchange Listing Standards ♦ Limited Offering Exceptions ♦ Regionalization and Cross-Listings ♦ The Over-The-Counter Market ***Presentation – Stuart Cohn*** ***Discussant - John Mandy / Simon Rutega*** ***Questions & Discussions***
1245 – 1400 hours	**LUNCH BREAK**
1400 – 1500 hours	**Session 3:** ***Snapshot Presentations on Recent Developments in Money and Financial Markets*** ♦ Country Experience – Tanzania ♦ Country Experience – Uganda ♦ Country Experience - Zambia
1500 – 1515 hours	**TEA/COFFEE BREAK**
1515 – 1700 hours	**Session 4**: ***Case Study Exercise – Policy Issues for SMEs*** ***Stuart Cohn***

***The Macroeconomic and Financial Management Institute of Eastern and Southern Africa.**

**** With financial support from Development Cooperation Ireland and the Swiss Agency for Development and Cooperation.**

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Friday, 29 October 2004

Time	Event
0900 – 1030 hours	**Session 1:** ***Issues Affecting the Development of the Domestic Financial Markets- Supply Side*** ***Presentation – Justin Chinyanta*** ***Discussant – Stuart Cohn / Eunice Kagane***
1030 – 1045 hours	**TEA/COFFEE BREAK**
1045 – 1245 hours	**Session 2:** ***Issues Affecting the Development of the Domestic Financial Markets- Demand Side*** ***Presentation – Justin Chinyanta*** ***Discussant – Stuart Cohn / Eunice Kagane*** ***Questions & Discussion***
1245 – 1400 hours	**LUNCH BREAK**
1400 – 1530 hours	**Session 3**: ***The Role of Rating in the Development of Domestic Financial Markets*** ***Presentation – Dave King*** ***Discussant – Justin Chinyanta***
1530 – 1545 hours	**TEA/COFFEE BREAK**
1545 – 1645 hours	**Session 4:** ***Role of Primary Dealers in the Development of Domestic Financial Markets*** ***Presentation – Justin Chinyanta*** ***Discussant – Stephen Kaboyo***
1645 – 1730 hours	**Session 5: Institutional Investors** ♦ Pension Funds ♦ Unit Trusts ***Presentations – Stuart Cohn***

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Saturday, 30 October 2004

Time	Event

0830 – 1000 hours	**Session 1:** ***The Importance of Corporate Governance***
	
	♦ Effective Enforcement
	    • Perceptions
	    • Impediments
	    • Reality
	♦ Training of Professionals
	
	Presentation – Stuart Cohn
	Round Table Discussions

1000 – 1015 hours	**TEA/COFFEE BREAK**
1015 – 1145 hours	**Session 2:** ***Role of Government in the Development of the Domestic Financial Markets*** ***Presentation – Stuart Cohn*** ***Round Table Discussions***
1145 – 1245 hours	**Session 4:** ***Participant Recommendations*** • General Discussions and Recommendations • The way forward for the region
1245 – 1300 hours	**Closing Remarks**
1300 – 1430 hours	**LUNCH BREAK**

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ANNEX II

Joint UNITAR/MEFMI Retreat for
Heads of Financial and Capital Markets in the MEFMI Region
28-30 October, 2004
Walvis Bay, Namibia

Report of Participant Proceedings
The Development and Growth of SMEs
Policy Recommendations

Among the numerous issues discussed during the course of the Retreat, the development of growth of small and medium-sized enterprises (SMEs) presented the only occasion for extended study and formal reports from break-out sessions.

The principal issue addressed was what governments can do to generate capital-raising opportunities and economic growth of SMEs. The participants acknowledged that in every country the future growth of stock exchanges in particular, and capital markets generally, were dependent upon the growth of SMEs into larger, publicly-held enterprises. However, SMEs currently find it extremely difficult to raise adequate capital in order to develop increased economic strength. Given such limitations, the participants concluded that governments should undertake more pro-active measures to assist SMEs. Formal presentations were made by Reporters from each of the two break-out sessions. The following recommended measures are an amalgam of the groups' recommendations for potential areas for reform:

1) <u>Small Business Development Agency</u>: A government agency should be established directly responsible for small business development. This agency should coordinate all of the regulatory, licensing, and business registration requirements into a single department so that owners of small business can have all requirements completed through a kind of 1-stop shopping venue.
2) <u>Modified Requirements for Capital Raising</u>: Some form or forms of micro-finance regulation should be considered as an alternative to the costly, time-consuming process of full-scale registration now required for all public offerings. Professor Cohn, as Director, raised and discussed with participants various conditions for exemption from registration that could be considered.
3) <u>Financial Assistance Programs</u>: Government should establish financial assistance programs fro qualified SMEs. These programs could include one or more of the following:
    a) Direct assistance grants ("seed funding");
    b) Direct assistance loans;
    c) Government-generated loans.

    An SME would be eligible to obtain financial assistance only if it met good corporate governance standards and presented a viable business plan.
4) <u>Tax incentives</u>: SMEs and those who purchase SME securities should be given tax incentives through lower rates, amnesties, and deductions for investment losses.

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5) Venture Capital: Government should encourage and assist the formation of local private venture capital funds. These funds, and their investors, could be given tax incentives for investing in SMEs.
6) Over-the-Counter Market: Securities dealer should be encouraged to create an over-the-counter market for companies that do not qualify for stock exchange listings. The OTC rules should require companies to provide periodic and timely disclosures to the public and shareholders.
7) Capital Raising Assistance Office: A special agency or department should be created within the securities commission or Central Bank to continually review the status of capital-raising by SMEs, to provide guidance to SMEs, and to recommend reform measures to facilitate SME economic growth.
8) Training Programs for SME Officers: Education and training programs in matters such as finance and corporate governance should be undertaken for SMEs. If SMEs were able to form associations among themselves, this would facilitate education and training programs.

As a general overall conclusion, the participants agreed that (1) SME growth is a major issue in today's capital markets and (2) each of the recommended items should be seriously studied and considered by appropriate government officials.

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UNITAR is an autonomous body within the United Nations which was established in 1965 to enhance the effectiveness of the UN through appropriate training and research. UNITAR's programmes in the legal aspects of debt, financial management and negotiation are among a wide range of training activities in the field of social and economic development and international affairs carried out, generally, at the request of governments, multilateral organizations, and development cooperation agencies. UNITAR also carries out results-oriented research, in particular research on and for training, and develops pedagogical materials including distance learning training packages.

UNITAR's **Training and Capacity Building Programmes in the Legal Aspects of Debt, Financial Management and Negotiation** are conducted for the benefit of over 35 partner countries mainly from sub-Saharan Africa and Vietnam. These programmes aim at meeting the priority training needs of senior and middle-level government officials through a wide range of seminars, workshops, and training of trainers workshops. In parallel to training activities, the programme also assists in strengthening local capacities of governmental and academic institutions through distance learning training packages, up-to-date publications as well as networking activities.

During 2004, the programme will focus on:

- Training government officials through short-duration regional seminars and workshops on various aspects of debt, financial management and negotiation;
- Developing On-line Training Courses (in parallel with its traditional regional training) with a view to tapping a wider audience and reducing cost of training per participant;
- Strengthening existing ties with regional training centres and offering joint courses with partners in the field;
- Creating awareness among senior government officials of the importance of the legal aspects in the borrowing process and of putting together a multidisciplinary team for loan management and public administration;
- Providing in-depth training and skills development for accountants, economists, financial experts and lawyers coming from government ministries and departments involved in negotiation, financial management and public administration; and
- Developing and disseminating training packages and 'best practice' materials directly related to the practicalities of legal aspects of debt and financial management, with a view to strengthening existing human resources and institutional capacities at the national level.

A description of UNITAR's latest activities and training programmes in the area of debt and financial management is available on its website at: www.unitar.org/dfm.

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