

## Chapter 25

# The Viability of Establishing Capital Market in Developing Countries: The Case of Ethiopia

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### ABSTRACT

*The outlook concerning worthiness and significance of establishment of stock market to nations in general, to developing nations in particular, have assorted to a great extent over time. Developing countries are trying towards improving and stepping up financial systems, by way of amplifying their security markets in order to perk up their ability to bring together resources to economy and fruitfully allot them to highly productive segments of the economy. This paper attempts to examine the feasibility of launching a stock market in Ethiopia. Regulatory framework, financial sector development and privatization and private sector development have been covered to analyze practicability of organizing “capital market”. The regulatory framework at hand is not adequate to establish a stock market and despite the boom in privatization, the country’s huge companies still remain under control of the state. Nonetheless, it has been jeopardized by deficiency of financial liberalization and dominance of state banks.*

### INTRODUCTION

The outlook concerning the worthiness and significance of the establishment of the stock market to nations in general, and to developing nations in particular, have assorted to a great extent over time. “Capital markets” play an ever increasing role in private sector through befitting fixed capital needs. They act as a source of fund for governments, companies, banks, and huge-scale or extensive projects. Besides, “capital markets” facilitate the improvement of the mobilization and allotment of medium and long-term funds for productive investment by providing an effortless mechanism for the transfer of funds. These enable companies to get chance to a great number of internal and external investors and

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broadening the range of financial instruments accessible to savers and investors. Likewise, they increase the variety and rivalry in the financial systems and provide market warning signs on the existing state of affairs and future prospects.

Generally, the existence of an exchange, clearing and settlement system are the main prerequisites for the successful implementation of “capital markets” in an economy. In addition, it needs a legal scheme to put into effect contracts, accessibility of information on financial reliability and future outlooks of companies as well as governance of corporations in a manner that gives investors assurance that their funds will not be misappropriated or desecrated.

Developing countries are trying towards improving and stepping up financial systems, by way of amplifying their security markets in order to perk up their ability to bring together resources to the economy and fruitfully apportion them to the highly productive segments of the economy. Setting of privatization enables a considerable policy amendment, which have made probable decline in public debt, improved enticement and efficiency in the maneuvers of the privatized bodies, and smoothed the progress of better access to capital in the course of the floating of shares to the general public.

This paper tries to examine the practicability of establishing stock exchange in Ethiopia. In order to do so, regulatory framework of establishing stock exchange, the development of financial sector and privatization and private sector development have been given due consideration.

## **Chaos and Complexity in Stock Markets**

Chaos theory has recognized an innovative level of understanding concerning the idea of “capital market”. In general, “capital market” is one of the most prolific and accessible areas to pertain chaos theory. Through its essential distinctiveness, a “capital market” is even more fitting. A chaotic system, as it is a “capital market” offers certain attributes such as: capriciousness, unsteadiness, muddle, noise and lack of control. Chaos symbolizes a condition of intricate, capricious, nonlinear dynamics. Furthermore, a chaotic system emerges to be accidental when in fact is a developed type of order. In other words, a chaotic system is a exceptional patchwork consists of a deterministic and an arbitrary process. Chaos theory provides a justification for the fact that multifaceted and erratic results can and will arise in systems that are susceptible to their initial conditions. In addition, chaos theory is perceived as a qualitative study of complex and unbalanced irregular behavior regarding deterministic nonlinear systems such as “capital markets” (Birau, 2010).

Besides, according to Peters (1994), the “capital market” is a multifarious and vibrant system with strident, non-stationary and disordered data sequence. Some researchers are signifying that such complication is a fundamental feature of such system. The fascinating thing about the disorganized dynamics of security markets is its enormous capability to produce remarkable movements which emerge to be haphazard, with advanced frequency than linear models. Apparently, this muddled manners of “capital markets” in general, but especially of “capital markets” is a non-linear deterministic process. The non-linear models are much more intricate and can engender a much more wide-ranging forms of behavior. Therefore, while establishing “capital markets” in developing countries, the chaos and complexity of the prospect “capital market” should be taken into consideration.

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