• Diversification gains vary significantly depending on the level of volatility underlying the global, country, and industry factors. In particular, the benefits of investing abroad tend to be much more meager when global volatility is high.

• Given the correlations between various country portfolios, the benefits of investing abroad are even smaller when international diversification is confined to Anglo-Saxon countries or continental Europe.

• When global volatility is low, it makes sense to diversify equity holdings across national borders. One practical manifestation of this was the massive wave of foreign investment in the years prior to the 1997 Asian crisis.

• Finally, while overall diversification gains are more meager when global and industry-specific volatility both rise (as in the post-1997 period), in such periods investors benefit somewhat more by diversifying across industries rather than along country lines. ■

Copies of IMF Working Paper No. 03/52, "Country and Industry Dynamics in Stock Returns," by Luis Catão and Allan Timmerman, are available for $15.00 each from IMF Publication Services. See page 131 for ordering information. The full text is also available on the IMF's website (www.imf.org).

Forum showcases region's stock exchanges

Africa is "more than ready" for foreign portfolio investment

Given the "striking absence" of local capital in Africa, noted Mark Malloch Brown, Administrator of the United Nations Development Program (UNDP), stock markets have a potentially vital role to play in helping develop local capital markets and encouraging foreign investment inflows. A two-day forum provided an opportunity to showcase some of the high-performing companies listed on African exchanges and the considerable scope for future investment opportunities.

Ndi Okereke-Onyiuke: If Africa could build strong regional exchanges, "perhaps the world will talk to us."

On April 14–15, more than 500 Wall Street analysts, institutional investors, African finance ministers, and high-level representatives from African stock exchanges gathered in New York City to exchange information and explore the potential investment opportunities in Africa and its 18 active stock exchanges. The first African Capital Markets Development Forum, jointly sponsored by the UNDP and the African Stock Exchanges Association (ASEA), in collaboration with the New York Stock Exchange (NYSE), is part of a broader effort by the UNDP to boost foreign investment in Africa—an effort that includes organizing investment dialogues in African countries and providing grant financing to help them secure sovereign credit ratings.

Stock markets—new and old

Ndi Okereke-Onyiuke, Chair of ASEA and Chief Executive Officer of the Nigerian Stock Exchange, noted that both the ASEA and most stock markets in Africa have a short history. The ASEA, she said, was founded in 1993 chiefly to promote the development of African capital markets and to highlight the largely untapped investment opportunities in the sub-Saharan region. The ASEA-UNDP-NYSE forum represents a relative high point because it has been difficult, thus far, to give African exchanges a high profile in the West. Okereke-Onyiuke expressed the hope that if Africa could build strong regional exchanges, "perhaps the world will talk to us."

Neither ASEA nor its member exchanges are "asking for handouts," she stressed. They are extending an invitation to developed countries—particularly their private sectors—to become partners in creating the wealth needed for Africa's long-term development and poverty reduction. This is a potential win-win endeavor since increased investment in Africa's exchanges can benefit all parties, she added, noting that five African exchanges were among the top performers worldwide in 2002.

Bryant W. Seaman III, Vice President, International, New York Stock Exchange, provided the perspective of a major developed country exchange. He noted that Africa offers an "unparalleled opportunity" for high-growth equity investment. The NYSE wants to be a "good partner" with Africa's leading companies and with the home markets of these companies. Dual listings by African companies on their home exchanges and on the NYSE can benefit the home markets of African companies, he explained, pointing out that 56 percent of the total average daily trading volume for the seven African companies currently listed on the NYSE takes place on the home market. Two additional African companies have listed on the NYSE so far this year, and African listings now make up 28 percent of the exchange's new foreign listings. Moreover, more African companies have plans to have dual listings on the NYSE in the coming year.

Attracting financing for development

"It takes money to make money," acknowledged Walter H. Kansteiner, U.S. Assistant Secretary of State for African Affairs, as he outlined U.S. government programs to make financing available in developing African private and capital markets. Africa, for its part, is eager. "To ask if Africa is ready for portfolio investment is to ask a starving man if he is ready for food," declared Yaw Osafo-Maafo, Ghana's Minister of Finance. Wealth creation is crucial for development, and Africa is, he said, "more than ready" for foreign portfolio inflows.

Like many forum participants, Osafo-Maafo lamented the negative media images and lack of information that have hampered Africa's 53 countries in their efforts to attract private foreign investment. A sovereign credit rating, he suggested, can help counter this. "It is better to be rated low than not at all," he said, and added that Ghana plans to secure a sovereign credit rating in the third quarter of this year. Timothy Thahane, Lesotho's Minister of Finance, also spoke strongly in favor of independent sovereign credit ratings. Attaining such a rating, he observed, is critical for African countries' policies and would be essential for borrowing on the international capital markets.

Strong early showing

The performance of many of Africa's stock markets to date suggests considerable promise. Osafo-Maafo reported that 11 exchanges achieved positive returns in U.S. dollar terms in 2002, with the exchanges of Botswana, Ghana, Mauritius, and the West African Economic and Monetary Union countries posting very strong returns ranging from 27 percent to 42 percent. These compared with returns of 24 percent and 19 percent in the U.S. and U.K. capital markets, respectively.

There are several reasons for this relatively strong performance, suggested Cyrille Nkontchou, Managing Director of LiquidAfrica, an innovative private enterprise providing Internet-based financial information and an electronic brokerage infrastructure for African markets. He cited the ability of many African stock markets to offer high dividend yields (even in U.S. dollar terms); the emergence of "pan-African plays" in the 1990s, especially in telecommunications; listed subsidiaries of multinational firms that trade at a significant discount to their parent firms, even though the subsidiaries are often more profitable and growing at higher rates; and risk strategy diversification offered by African markets, which are largely uncorrelated with major world markets.

Zéphirin Diabre (left) UNDP Associate Administrator, confers with Mark Malloch Brown, UNDP Administrator.

And the prospects for these stock exchanges look even brighter. Nkontchou predicted that three major trends will significantly transform these stock markets: improved trading infrastructure, increased participation by local institutions, and increased market liquidity combined with promising future listings.

Osafo-Maafo called on Western exchanges and investors around the globe to join African exchanges in holding annual meetings like this one; provide technical support to African exchanges and help them modernize, develop the necessary financial instruments, and avoid the pitfalls that developed country exchanges encountered in the past; and encourage more listings of African companies on developed countries' exchanges. Thahane joined Okereke-Onyiuke and Osafo-Maafo in noting the importance of developing information and communications technology and other aspects of stock market infrastructure so that, among other things, communication could be improved between African exchanges and more developed exchanges.

Benefits of regional integration

Nkontchou noted the striking contrast between the trend toward regionalization and globalization in major developed country markets and a proliferation of new national exchanges in Africa over the past decade. For African countries, a stock exchange is still perceived as a symbol of national sovereignty, he observed.

But, as Kansteiner and several other forum participants underscored, regional integration—together with further macroeconomic and structural reforms—could help African capital markets develop and overcome some of the impediments that currently constrain them, notably small market size and illiquidity. Integrated financial markets give investors

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From left, Ghana's Minister of Finance Yaw Osafo-Maafo, U.S. Assistant Secretary of State for African Affairs Walter Kansteiner, and Chair of the African Capital Markets Development Forum Claude Bébéar (chair of AXA).

a trusted "signal," Kansteiner said, pointing to how dozens of U.S. stock markets eventually consolidated into three highly successful ones.

Charles Konan Banny, Governor of the Central Bank of West African States, reviewed the achievements of the eight member countries of the West African Economic and Monetary Union. He cited, in particular, harmonized business laws and indirect taxes, standardized banking practices, a free trade area, and a regional stock exchange (the Bourse régionale des valeurs mobilières, founded in 1998). But challenges remain, and he emphasized the private sector's key role in promoting regional integration, economic growth, and stability.

More public-private partnerships

Stressing that the "seed core" of African stock exchanges' business is small and midsized firms, Alan Patricof, chair of Apax Partners, shared impressions of visits he made to 10 African countries last year. While financing for very large projects and for microcredit projects is plentiful, he said, there is a crucial shortage of capital for small and midsized firms, whose financing needs fall in the $200,000–$500,000 range. Africa's biggest challenge, Patricof indicated, would be to nurture this key group of firms, which have great potential to expand and create jobs, contribute to economic growth, and eventually seek listings on exchanges.

To meet their needs, he recommended increased linkages between large international companies and small and medium-sized enterprises. This would allow large companies to take on a mentoring role and share their skills and knowledge, as well as their capital. While conceding that there was still a great need for donor aid, Patricof stressed that this particular effort should be driven by the private sector, perhaps in partnership with the public sector and international donors.

Patricof currently chairs a commission of private sector and African leaders and practitioners, convened by the Corporate Council on Africa (CCA) in partnership with the Institute for International Economics (IIE). Based on his discussions with private sector firms in the region over the past year, Patricof urged African countries to address corruption, poor infrastructure, poor corporate governance inadequacies in basic skills and management training, and onerous registration procedures and other administrative barriers.

James Harmon, a former chair of the U.S. Export-Import Bank and vice chair of the CCA-IIE commission, shared Patricof's view that efforts to attract increased capital to Africa would be most successful if driven by the private sector, in partnership with the public sector and international donors. He termed the Ex-Im Bank "one of the best public-private partner it was doing little business in Africa. Even today, he said, all of the OECD's export credit agencies together provide a relatively tiny amount of export credit to sub-Saharan Africa. There is clearly scope for these agencies, together with agencies such as the U.S. Overseas Private Investment Corporation (OPIC), to serve as large financing sources.

To help redress Africa's needs, Harmon proposed that all OECD export credit agencies be mandated, or at least aim, to lend 2.5–3 percent of their total credits to sub-Saharan Africa. He also provided a preview of some of the recommendations the CCA-IIE commission would present to the U.S. government in June: a 10-year tax holiday for U.S. businesses that invest in Africa and maintain their operations for at least 10 years; liberalization of the African Growth and Opportunity Act to increase trade flows; more OPIC money for African countries; and a more aggressive stance on debt forgiveness. ■

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