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The Ethiopian Securities Exchange (ESX): A Review of Global Best Practices and Policy Lessons

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ABSTRACT

This review article provides an extensive analysis of global stock market best practices in the establishment, operation, and growth of securities exchanges and derives market-related policy-relevant lessons for the Ethiopian Securities Exchange (ESX). Using a narrative and integrative article review methodology, the review synthesizes stock market-related academic literature, international market regulatory standards, and practical market experiences from well-developed, emerging, and frontier markets. The review article is organized around the main aspects of stock exchange development, including market regulatory governance, stock market-related infrastructure, financial investor protection, market liquidity formation, financial product sequencing, market transparency, modern technological adoption, international market integration, market sustainability, and institutional capacity building. The analysis greatly emphasizes market regulatory credibility, gradual institutional market sequencing, and context-sensitive adoption of state-of-the-art technology as critical success factors in emerging economies. By aligning global stock market evidence within Ethiopia's evolving financial markets and institutional context, the review article provides a practical roadmap for market policymakers, market regulators, and market participants by contributing to the developing local literature on capital market development.

Keywords: G*lobal best practices; Ethiopian Securities Exchange; frontier markets; narrative review; capital market development*

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1. INTRODUCTION

Capital markets are broadly known for their role as an engine for long-term economic growth by mobilizing savings, allocating capital, improving company governance, and facilitating balanced risk sharing among the market participants (Levine, 2005). Properly functioning securities exchanges boost the growth of innovation and productivity of the nation by enabling businesses to gain access to long-term financing and by providing investors diversified financial investment opportunities (World Bank, 2020).

In developing countries and in countries having emerging economies like Ethiopia, capital markets development encourages market transparency, the formalization of businesses, and the support of the development of financial culture as a whole (Demirgüc-Kunt et al., 2015). In this regard, the establishment of ESX indicates a significant financial institutional shift within the country's overall financial sector reform agenda.

Historically, Ethiopia has had a bank-dominated financial system in which capital market or stock market instruments were limited and the access to long-term finance was largely restricted (Allen & Gale, 2000; World Bank, 2020).

This structure limits the private sector growth and limits the availability of diversified and risk capital in the market. The ESX establishment in Ethiopia shows a strategic move to a more diversified and modern financial architecture aligned with the global and international stock market development experience. Nevertheless, global stock market development experience indicates that the establishment of a securities exchange alone does not guarantee market depth, liquidity, or resilience (Yartey & Adjasi, 2007). Many emerging capital markets have greatly experienced stalled or inactive stock exchanges as a result of weak market or exchange regulation, low investor confidence, inadequate exchange infrastructure, and inappropriate sequencing of financial products. In this context, this review article combines the global best practices with regard to the securities exchange development and assesses their relevance for the effective growth path of ESX. Rather than suggesting a single optimal growth model for stock exchange growth and expansion, the review article identifies a more adaptable principles that reflect Ethiopia's institutional capacity and development stage.

Though numerous reforms and preparations have been made prior to the establishment of ESX, existing initiatives remain dispersed and lack a unified, policy-oriented focus adapted to Ethiopia's current stock exchange implementation stage. As ESX moves to early functioning, there is an appropriate need for a coordinated literature review that combines global stock market best practices and evaluates their significance to Ethiopia's market regulatory and institutional context. This review paper addresses this literature gap by providing a well-structured and adaptive roadmap to guide market policymakers, market regulators, and market participants.

2. REVIEW METHODOLOGY

This review article employs a narrative and integrative literature review approach. This type of approach is employed because it is appropriate for examining stock market policy-orientated and institutionally complex phenomena like the financial market development aspect (Tranfield et al., 2003; Snyder, 2019). Previously issued academic literature sources were identified by the use of systematic searches on Google Scholar and major international journal article databases, while institutionally related review materials were drawn from top and known international organizations, securities exchange regulators, and established and developed securities exchanges.

In choosing the journal articles to be reviewed, this review article prioritizes the use of peer-reviewed journal articles and authoritative stock exchange reports published between the years 2005 and 2026, supported by the selected seminal works that remain influential in the stock market literature. Then, the selected sources were properly analyzed by using the thematic c and organized around recurring dimensions of securities exchange development. This type of analysis facilitates conceptual synthesis and comparative interpretation, which further enables the translation of global evidence into practical policy insights for the emerging market, ESX.

In total, this review paper reviewed several references, such as the study, which draws on 20 relevant sources: 9 peer-reviewed articles, 4 books and research monographs, and 7 institutional reports and policy documents. The reviewed academic literature covers key points, such as market regulatory governance, market liquidity, market transparency, and market financial literacy in developing stock markets. In addition, institutional literature review sources such as the World Bank (WB), Organization for Economic Co-operation and Development (OECD), Ethiopian Capital Market Authority (ECMA), United Nations Conference on Trade and Development (UNCTAD), International Organization of Securities Commissions (IOSCO), World Federation of Exchanges (WFE), and the Bank for International Settlements (BIS) ensure alignment between the international best practices in the areas of securities exchange development.

3. GLOBAL BEST PRACTICES IN SECURITIES EXCHANGE DEVELOPMENT

3.1 Regulatory Governance and Institutional Credibility

Regulatory governance is one of the foundations of a successful securities exchange in a given country. To build financial investor trust and confidence, it is important to have an autonomous regulatory authority, transparent regulation-setting process, and trustworthy law execution mechanisms (La Porta et al., 2000; IOSCO, 2023). Empirical studies on this issue shows that weak law enforcement is the main reason for low financial investor participation and low market liquidity in developing countries' emerging capital markets (Claessens & Yurtoglu, 2013).

In developing countries, due to the heightened sensitivity to policy uncertainty, regulatory credibility is particularly critical. In this regard, predictable regulatory environments reduce perceived market risk, promote long-term investment, and greatly support market stability.

For ESX, market regulatory credibility should first be established through the provision of clear roles between the regulator - Ethiopian Capital Market Authority (ECMA) - and the exchange – Ethiopian Securities Exchange (ESX); transparent market rules; and consistent law enforcement. Given Ethiopia's limited capital or stock market experience, proper market regulation and institutional independence are considered the most essential to build investor confidence and encourage early market participation.

3.2 Market Infrastructure and Technological Development

Efficient market infrastructures such as settlement and clearing systems, trading platforms, and central securities depositories (CSD) are essential for the securities exchange markets to become operationally reliable and have efficient market integrity (BIS, 2012). In this regard, the modern-day state-of-the-art technological advancements have reduced much of the exchange transaction costs and improved market transparency across the global stock markets.

Nevertheless, the international stock exchanges experience alerts against the early adoption of those state-of-the-art and sophisticated market technologies in shallow or illiquid stock markets. For this, a phased and step-by-step technological development consistent with the stock market depth and user investor capacity is largely associated with the outcomes, which are more reliable and stable (World Bank, 2019). Thus, it is essential to conduct capacity building for market regulators and investor market participants to complement infrastructure investment.

For ESX, a phased or step-by-step approach to the adaptation or implementation of technological infrastructure is crucial. Modern technologies available on trading, clearing, and settlement systems must be supported by market regulatory capacity, market intermediary readiness, and investor education to manage operational risks in a developing capital market.

3.3 Investor Protection and Financial Literacy

In the capital market development in emerging economies, investor protection frameworks play a central role. Strong market and company information disclosure standards, high-quality IFRS-based financial statement reporting, and effective protection of minority stockholders reduce market information asymmetry and lower the cost of capital (Healy & Palepu, 2001; Bushman et al., 2004).

Moreover, financial literacy training initiatives for investors enhance capital market participation by investors by enabling them to understand and operate the market risks and returns on a balanced way. On this matter, research studies suggest that stock markets that invest more in investor financial literacy education and training experience stable trading behavior and widespread participation (Lusardi & Mitchell, 2014; OECD, 2020).

For ESX, stock market investor protection should be enhanced alongside countrywide financial literacy training programs for the market retail investors, financial instrument issuers, and market intermediaries. Improving relevant market information disclosure standards and awareness creation is essential in Ethiopia's bank-dominated financial system in order to reduce information gaps and build trust in equity and bond markets.

3.4 Liquidity Formation and Market Depth

Market liquidity is both a driver and an outcome of the efficient and structured stock market development. Liquid stock markets have the tendency to reduce the transaction costs, improve price discovery, and attract a broader investor base (Amihud & Mendelson, 1986). On this matter, the results of empirical research studies show that market liquidity significantly improves when the markets adopt strong market-making mechanisms or systems, promote institutional involvement, and maintain stable market regulatory environments (Bekaert et al., 2007). On the contrary, fragmented stock markets and frequent regulatory changes weaken investor confidence and discourage long-term fixed-income debt instrument investment, particularly in emerging economies and markets.

For ESX, the early market liquidity situation depends largely on attracting institutional investors over individual investors, ensuring market regulatory stability, and minimizing market policy changes. Basic and effective market-making and consistent market information disclosure requirements can help the gradual market liquidity growth and prevent lengthy inactivity in the stock market.

3.5 Product Sequencing and Market Expansion

The reviewed literature highlights the importance of a phased, step-by-step and sequenced introduction of financial products in stock market development. Equity markets provide the foundation for the subsequent efficient development of fixed-income bond and derivative markets (Eichengreen & Mussa, 1998). Attempts to introduce complex financial products in the market before establishing sufficient market liquidity and regulatory capacity have frequently resulted in stock market failure or systemic market risk affecting the entire financial system (Allen & Gale, 2000).

Experience from several emerging capital markets indicates that financial products should be arranged according to institutional and market liquidity readiness. Developing countries like Vietnam and Rwanda focused on equities markets first before expanding the market to bonds and complex financial instruments, highlighting the need for a vigilant, equity-first strategy for ESX.

3.6 International Integration and Sustainability

In order to enhance market visibility, attract foreign financial investment, and encourage integration toward best international standards, it is important to integrate the market with regional and global markets (Pagano et al., 2002). Concurrently, the concept of market sustainability considerations has become important and increasingly relevant. In this regard, emerging empirical literature emphasizes the role of stock exchanges in promoting environmental, social, and governance (ESG) disclosure and supporting sustainable finance in the early growth stages of stock market development (UNCTAD, 2021; WFE, 2022).

International integration for developing stock markets doesn't need immediate implementation of complex state-of-the-art technologies or financial products. For ESX, gradual or step-by-step alignment of market regulations, market disclosure, exchange accounting, and settlement with international best market standards allows global market participation while maintaining stability and manageable institutional capacity.

4. CONCEPTUAL FRAMEWORK

Drawing on the reviewed empirical literature, a conceptual framework is developed linking market regulatory governance, market infrastructure, market investor protection, market liquidity mechanisms, and capacity building to market outcomes such as financial investor confidence, market liquidity, market resilience, and long-term market growth. This type of conceptual framework emphasizes the sequencing and feedback effects, recognizing that securities exchange development is a recurring and sequence-dependent development process. The conceptual framework is presented as follows on figure 1.

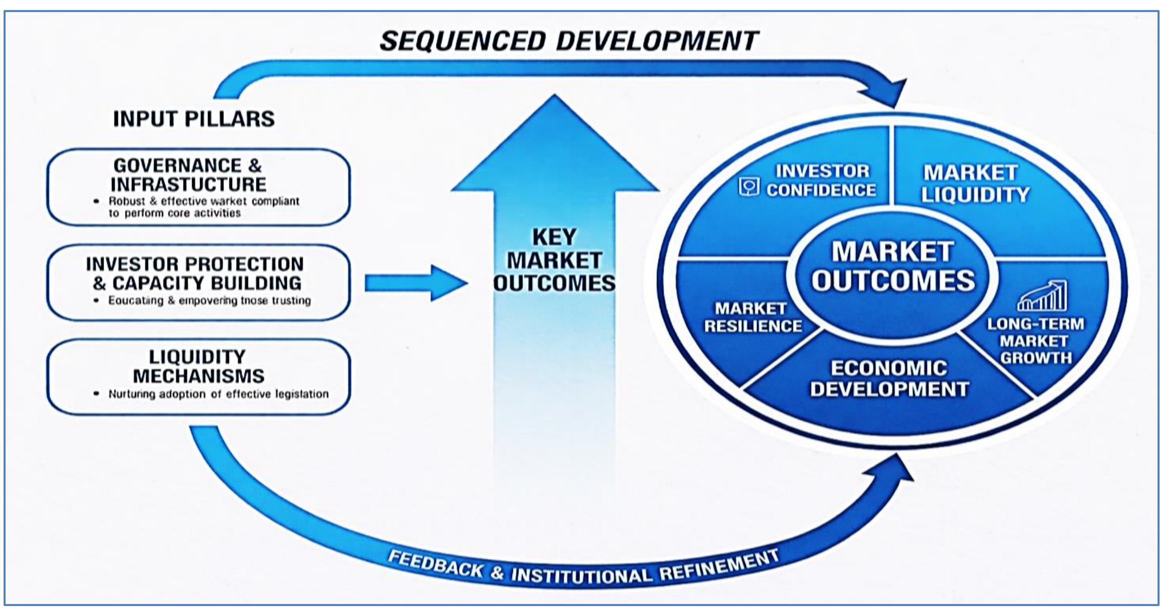

Figure 1: Conceptual framework

Source: Author's own development

5. POLICY IMPLICATIONS FOR THE ETHIOPIAN SECURITIES EXCHANGE

The combination of global best experiences suggests several policy priorities for the success of the emerging market, the Ethiopian Securities Exchange (ESX). First, market regulatory clarity and credible and efficient enforcement should come before rapid stock market expansion in new markets. Second, advanced market technological systems should be implemented gradually by giving strong priority to reliability or credibility, cybersecurity, and user training. Third, wide-ranging investor financial literacy education and transparent stock market disclosure standards are very vital for building market trust in a new and emerging stock market.

Finally, policymakers that are actively working on emerging stock markets should adopt a phased approach to the development of varied market products, focusing and prioritizing the equity financial products and basic fixed-income type of debt instruments right before the introduction of more complex and advanced stock market-traded financial securities products. These types of insights greatly emphasize the relevance of adaptation from advanced markets rather than simply making a direct replication of the advanced stock market development models (Rodrik, 2007).

6. CONTRIBUTION TO THE LITERATURE

This review article has the potential to greatly contribute to the development of emerging capital market-related literature by combining together the most dispersed and fragmented global literature evidence into a single and consistent market framework adapted to a growing economy context. It provides a stock market policy-oriented perspective, which is very much relevant to the Ethiopian and other similar emerging economies launching the capital market development and reforms.

7. LIMITATIONS AND FUTURE RESEARCH

This review article, as a narrative literature review article, is highly exposed to the limitations of source literature selection and evidence interpretive synthesis. Future research should employ or adopt proper empirical research methods to study investors' market behavior, market liquidity dynamics, and market-related regulatory effectiveness as the ESX becomes more operational than today. Moreover, advanced longitudinal and comparative research studies across African emerging stock markets would further enhance the evidence base.

8. CONCLUSION

Beyond the formation of the exchange, the success, growth, and well-functioning of the Ethiopian Securities Exchange (ESX) will mainly rely on the strategic adoption and implementation of the best global stock exchange practices to the Ethiopian local financial institutional realities. With regard to this, the credibility of the stock exchange regulation, a phased approach of financial institutional development, strong market participants and investor protection, and capacity building emerge as vital supports of efficient stock exchange development. With careful and proper stock market design and efficient stock market policy implementation, ESX has the potential to become a resilient stock market that supports the long-awaited country's long-term economic development goals.

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