

Topic 8: Financial Markets and Market Participants (Investor-Borrowers).

Introduction.

A Financial Market is a broad term describing any marketplace where buyers and sellers participate in trade of assets such as equities, bonds, currencies and derivatives.

A Financial Market is a market in which financial instruments or assets are traded.

Types of Financial Markets.

A financial market consists of different major segments and these include,

Private Markets vs Public Markets.

1. Private Markets.

Private markets refer to financial transactions that occur outside public exchanges, where investments are directly negotiated between involved parties rather than being openly traded. These markets typically cater to institutional investors, high-net-worth individuals, and businesses seeking tailored financing solutions.

2. Public Markets.

Public markets are financial markets where securities such as stocks, bonds, and other financial instruments are openly traded on exchanges, making them accessible to a wide range of investors. These markets are highly regulated to ensure transparency, fairness, and investor protection. Public markets provide liquidity, enabling investors to buy and sell assets easily. Common examples include stock exchanges like the New York Stock Exchange (NYSE), Nasdaq, London Stock Exchange (LSE), Nairobi Stock Exchange and Uganda Securities Exchange (USE). Public markets play a crucial role in capital formation, allowing companies to raise funds through initial public offerings (IPOs) and secondary market trading.

Money Market and Capital Market.

3. Money Market.

Money Market is a financial market where short term financial instruments are traded i.e. instruments considered to be highly liquid and with a short maturity period (less than a year). These financial instruments include treasury bills, deposits, collateral loans

(Short-term) and bills of exchange, commercial papers. These are normally operated through banks and acceptance houses.

4. Capital Market.

Capital Market are for buying and selling long-term securities like bonds and equity shares. In general, the capital market is the market for securities where either the company or the government can raise long-term funds, and these markets target the borrowers and savers who are willing to commit their funds to long-term productive use.

The Primary and Secondary Markets.

5. A Primary Market.

A primary market is where newly issued securities are traded for example when the Airtel, MTN and New Vision, UMEME, National Insurance were issuing their shares for the first time, they appointed receiving agents and anybody wishing to buy shares went to these agents, paid money for shares required and waited for allotment.

6. A Secondary Market.

A secondary market deals with securities which were already bought in the primary market. The primary market lasts a short period after which shares are listed on the stock exchange. Examples of secondary markets include, Uganda Securities Exchange (USE), Nairobi Securities Exchange (NSE) and New York Securities Exchange (NYSE)

Differences between Money Markets and Capital Markets.

Difference	Money Markets	Capital Markets
Term	Short-Term funds	Medium and Long term funds.
Securities	Treasury bills, Commercial Paper, Trade bills, Certificates of Deposits.	Treasury Bonds, Debentures, Shares and other government securities
Participants	Central Bank, Commercial Banks, non-banking financial companies	Stockbrokers, underwriters, Mutual funds, Financial institutions and individual investors.
Regulation	Regulated by Central Bank (Bank of Uganda)	Regulated by Capital Markets Authority - CMA

FINANCIAL MARKET PARTICIPANTS.

There are a number of participants in the financial markets with different roles and these include, The Brokers, Investment Banks, Individuals, Listed Corporations, Central Bank and Institutional Investors.

1. The Brokers.

These are mainly financial analysts who monitors the performance of stock in the financial markets, advises potential investors and help to link buyers and sellers of securities in the secondary market. Examples in Uganda include, Equity Stockbrokers, Crested Capital (U) Ltd, SBG Securities and UAP Old Mutual.

2. Investment Banks.

These are intermediaries between the security issuers and the potential investors at a fee. However where the investment bank is an underwriter of a firm's security, it acquires the firm's shares at a negotiated price which enables the firm to get the total amount of capital it requires and subsequently sell the shares to the general public at an agreed on-offer price. Examples in Uganda include, Equity Stockbrokers, Crested Capital (U) Ltd, SBG Securities and UAP Old Mutual. These examples double as brokers and investment bankers.

3. Individuals.

These are people who are trading in securities either for long-term or short-term purpose. Individuals holding shares and wishes to dispose them normally do so through the secondary market with assistance from stockbrokers.

4. Listed Corporations.

These are companies that are involved in trading their securities in the financial markets. They are the deficit unit that accesses the financial markets to secure funding and for corporations to be able to sell their shares to the public, they must be registered with the security exchange.

5. Central Bank.

The central bank acts as a regulator in the financial market to ensure the safety and integrity of the financial markets. Every firm intending to operate in the financial market is required to apply to the regulatory authority and vetted before they can be accepted to participate in the market.

6. Institutional Investors.

These are mainly the buying side who are considered to be the surplus unit who are willing to provide capital or funds to the corporations seeking finances in the financial market. Examples of known institutional investors include, National Insurance Corporation (NIC), National Social Security Fund (NSSF).

FUNCTIONS OF THE FINANCIAL MARKETS.

The financial market provides three major economic functions and these include;

1. Price Determination.

Price determination function is achieved through interactions between buyers and sellers of financial instruments in a financial market. Firms issue financial securities to the market and depending on its attractiveness, the forces of demand and supply dictates its trading price.

2. Provision of Liquidity.

This function provides an opportunity for investors to sell a financial instrument at any time in the stock market/money market. Investors are able to turn their stock into cash at any time they desire through the operation of stock market.

3. Transaction Costs Reduction.

The financial market performs the function of reduction of transaction costs by bringing together many sellers and buyers eliminating the monopolistic market behavior that is associated with high cost of transaction.

Investor Expectations in Financial Markets

Investors participate in financial markets with specific expectations that influence their decisions. These expectations revolve around financial returns, risk considerations, liquidity, and market transparency.

a) Return on Investment (ROI).

Return on Investment (ROI) is a crucial metric for investors to evaluate the profitability of their investments. It consists of capital gains and income, with higher-risk investments offering higher returns. However, ROI is influenced by market conditions like economic growth, inflation, and company performance. Investors must analyze these factors to optimize ROI and align their investments with their risk tolerance and financial goals.

Risk management.

Risk management is crucial in investment decision-making to protect capital from potential losses. Market risk, credit risk, liquidity risk, and political and regulatory risk can impact returns. To mitigate these risks, investors should diversify their investments across different industries, asset classes, and geographic regions. By carefully assessing and managing these risks, they can enhance the stability and resilience of their investment portfolios.

Liquidity Risk.

Liquidity is a key factor in investment decisions, determining the ease of conversion of assets without price fluctuations. Major stock exchanges offer high liquidity, while asset liquidity varies depending on investment type. Investors may accept lower returns for easily tradable assets, while those in low-liquidity assets demand premiums. Balancing liquidity with return expectations and risk tolerance is crucial in portfolio construction.

Transparency and regulation.

Transparency and regulation are crucial for maintaining investor confidence and market stability. Financial disclosure, regulatory oversight, and strong corporate governance foster accountability and ethical business practices. Investor protection mechanisms like compensation schemes and deposit insurance mitigate losses in financial institution failures. These measures enhance market efficiency and economic growth, making financial markets more attractive to both local and foreign investors.

STOCK LISTING.

Stock Listing refers to the company's shares being considered for official trading on a given stock exchange. A listed security is a financial instrument that is traded through an exchange such as the Uganda Securities Exchange (USE), Nairobi Securities Exchange (NSE) and London Securities Exchange (LSE).

BENEFITS OF LISTING ON THE STOCK EXCHANGE.

⇒ Ease of Sourcing for Funds.

Listing on a stock exchange allows a company to raise capital by issuing shares to the public. This provides an alternative to borrowing from financial institutions, which may come with high-interest costs and repayment obligations. Companies can use these funds for expansion, research and development, or debt repayment, ensuring financial flexibility.

⇒ Facilitates Transfer of Ownership.

A stock exchange provides a structured and transparent platform for buying and selling shares. Investors can easily transfer ownership of shares without disrupting the company's operations. This liquidity encourages investment, as shareholders can exit their investments when needed.

⇒ **Improves Marketability of Shares.**

Listing increases the visibility and attractiveness of a company's shares to a wide range of investors, including individuals, institutions, and foreign investors. The increased demand often leads to better valuation and liquidity of shares, making them more appealing in the market.

⇒ **Enhances Company Reputation and Image.**

A listed company is perceived as more stable, credible, and financially sound due to the rigorous regulatory and financial disclosure requirements imposed by stock exchanges. This enhances trust among stakeholders, including customers, suppliers, and potential business partners.

⇒ **Creates Investor Confidence.**

Stock exchanges require companies to adhere to high levels of transparency and corporate governance. Regular financial reporting and disclosures assure investors of the company's performance and compliance with regulations, boosting investor confidence in the company's management and future prospects.

⇒ **Promotes Growth.**

Access to public capital allows companies to invest in expansion opportunities, acquisitions, new product development, and innovation. The ability to raise additional funds through subsequent public offerings further supports long-term growth and competitiveness in the industry.

UGANDA SECURITIES EXCHANGE (USE).

The Uganda Securities Exchange (USE) serves as Uganda's primary stock exchange, playing a crucial role in the country's capital markets by enabling companies to raise funds through the issuance of shares and bonds. Established in 1997 as a private company limited by guarantee, the USE operates under the regulatory framework of the Capital Markets Authority (CMA) of Uganda, ensuring compliance with financial market regulations and investor protection measures. Initially structured as a member-owned exchange, the USE underwent demutualization in 2015, transforming into a public company limited by shares. This transition enhanced its governance structure, improved efficiency, and positioned it among the few self-listed stock exchanges in Africa. By fostering liquidity, transparency, and investor confidence, the USE contributes significantly to Uganda's economic growth and financial market development.

ROLES OF UGANDA SECURITIES EXCHANGE.

1. Facilitating Capital Raising for Companies.

The Uganda Securities Exchange (USE) facilitates capital raising for companies through IPOs and share issuances. This reduces dependence on traditional debt financing, allowing companies to expand operations and invest in new projects. Issuing shares improves corporate visibility, governance, and market credibility. Future issuances provide sustained growth and financial flexibility, strengthening Uganda's private sector and overall economic development.

2. Providing a Platform for Trading Securities

The Uganda Securities Exchange (USE) is a vital platform for trading securities, facilitating market liquidity and enhancing investor confidence. It operates an Automated Trading System (ATS), reducing manual inefficiencies and improving transparency. This system enhances trade execution, minimizes errors, and enhances price discovery, making the market more attractive to local and international investors, fostering an efficient, well-regulated, and investor-friendly capital market in Uganda.

3. Enhancing Transparency and Investor Protection.

The Uganda Securities Exchange (USE) is a regulatory body that enforces strict disclosure and reporting requirements for listed companies, ensuring investors have access to accurate, timely, and reliable financial information. It also prevents market manipulation and fraudulent activities. Under the supervision of the Capital Markets Authority (CMA), the USE fosters trust and confidence in Uganda's capital markets, attracting both local and foreign investors.

4. Promoting Economic Growth and Investment

The Uganda Securities Exchange (USE) is a vital platform for economic growth and investment, offering long-term financing for businesses to expand, innovate, and create jobs. It reduces reliance on bank loans, enhances financial stability, and attracts investors, boosting economic activity and infrastructure development. A well-functioning stock market boosts investor confidence, entrepreneurship, and contributes to Uganda's long-term economic progress.

5. Facilitating Price Discovery and Market Efficiency

The Uganda Securities Exchange (USE) enhances market efficiency by allowing supply and demand forces to determine securities' fair market value through continuous trading. This transparent mechanism helps investors assess company value, track financial health, and make informed investment decisions. Efficient price discovery minimizes information asymmetry, reduces market manipulation, and fosters confidence in capital markets, contributing to a competitive investment environment in Uganda.

6. Supporting Government and Corporate Bond Issuance.

The Uganda Securities Exchange (USE) is a crucial platform for government and corporate bond issuance, enabling the state to raise funds for infrastructure projects and businesses to access long-term financing at lower costs. Bonds offer investors a stable investment option with predictable returns, diversifying portfolios and reducing risk. The USE enhances capital market depth, boosts investor confidence, and contributes to Uganda's financial system's stability.

7. Ensuring Corporate Governance and Compliance

The Uganda Securities Exchange (USE) is a key regulator for corporate governance, requiring listed companies to adhere to strict financial reporting and ethical business standards. These regulations promote transparency, accountability, and responsible management, fostering investor confidence and mitigating risks of corporate mismanagement. Compliance strengthens Uganda's capital markets, attracts investors, and promotes sustainable business growth and economic stability.

THE MAIN REQUIREMENTS FOR LISTING ON THE USE.

- ⇒ The general requirements to accompany an application for listing on the USE.
- ⇒ A Prospectus setting out the information.
- ⇒ Letter of no objection from the industry regulator.
- ⇒ Board of Director's resolution to list.
- ⇒ Shareholder's resolution in respect of the offer.
- ⇒ Capital Markets Authority Approval Letter
- ⇒ Certificate of incorporation of the issue or any other incorporation documents.
- ⇒ MOA & AOA of the issuer or any other documents which must comply with the requirements of USE whether required or not required by Law.
- ⇒ Financial Reports for three to five years' period preceding the issue.
- ⇒ A list of existing Shareholders
- ⇒ A reporting entity's Accountants Report for the avoidance of doubt.
- ⇒ A report by the company auditors for the last five completed financial years.
- ⇒ Forecast earnings and dividends
- ⇒ Details of share capital structure, loan capital and borrowing powers of the company.

THE MAIN MARKET SEGMENTS.

The market segments are divided into two, i.e. the main investment market Segment (MIMs) and the Alternative Investment Market Segment (AIMs).

The Main Investment Market Segment (MIMs).

This is the main investment segment with stringent eligibility, disclosure and listing requirements.

The Alternative Investment Market Segment (AIMs). / Growth Enterprise Market Segments. (GEMs).

This is a two-tier market which offers SMEs the requirements for listing. GEMS is designed for small and medium-sized enterprises (SMEs) that may not meet the strict MIMS criteria but seek to raise funds from the public and these requirements are more flexible and less stringent.

LISTING REQUIREMENTS.

Requirement	Criteria for Main Investment Market Segment (MIMs)	Criteria for Alternative Investment Markets (AIMs)
Incorporation Status	A Company Limited by shares, incorporated or registered under the companies Act	A Body corporate or registered as public issuer limited by shares under the companies Act.
Share Capital	Minimum authorized, issued and fully paid-up share capital of shs. 1Billion.	Minimum authorized, issued fully paid-up share capital of shs 200 million.
Net Assets	Minimum Net Assets of Ushs 2 billion before public offering.	Minimum Net Assets of Ushs. 400 million before public offering
Profitability	Positive Profits after tax in atleast 3 of the past 5 years prior to the date of the offer.	
Financial statements	Audited, IFRS compliant financial statements of atleast 5 years of an accounting period ending on a date not more than 6 months prior to the date of the offer	Audited, IFRS complaint financial statements for atleast 2 years. Audited Financial statements should not be older than be older than 4 months before the date of listing.
Loan Covenants	Should not be in breach at date of application	Should not be in breach at date of application
Fees	0.2% of the issue	0.2% of the issue
Letter of no objection.	Issuer should obtain one if subject to the regulations of any regulatory authority.	Issuer should obtain one if subject to the regulations of any regulatory authority.

Share Ownership Structure	Immediately after the IPO, at least 20% of the shares should be held by at least 1,000 shareholders	Minimum number of shareholders after the IPO should be 100
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