

Exploring demutualisation of stock markets: A case study of the Zimbabwe Stock Exchange

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Abstract: Since the start of the demutualization wave in early 1990s, debate ensued about the impact of this program and while many researchers and policy makers have praised the demutualization of stock exchanges, others have been more sceptical and tended to be reluctant in undertaking the demutualization decision. Zimbabwe has not been left out. For the past 3 years, the debate about the demutualisation of the Zimbabwe Stock Exchange (ZSE) has been gaining momentum over time about the likely impact on the performance of the demutualization program. While assessing the performance of demutualized stock exchanges provides useful insights for policy makers on the usefulness and value of this program, it remains important for policy makers to link the implementation of this program to the nature of the stock exchange, including its existence, behaviour and its relationship with the market and the external factors. It is on this background that a mixed study utilising qualitative and quantitative research methods will be carried out. A sample of 19 stockbrokers, 10 Individual and 29 Institutional investors were used to assess the debated impact of demutualisation program in the Zimbabwean economy.

Keywords:

Self-Listing: This occurs when a stock exchange entity, gets listed on its own stock market.

Bullish, bearish: Words used to describe investor attitudes. Bullish refers to an optimistic outlook while bearish means a pessimistic outlook.

Business failure: A business that has terminated with a loss to creditors.

Churning: Excessive trading of a client's account in order to increase the broker's commissions.

Comprehensive due diligence investigation: The investigation of a firm's business in conjunction with securities offering to determine whether the firm's business and financial situation and its prospects are adequately disclosed in the prospectus for the offering.

Exchange: The market place in which shares, options and futures on stocks, bonds, commodities and indices are traded.

I. Introduction

This research sought to shed more light on demutualisation and its likely impact on the Zimbabwe stock exchange (ZSE). Demutualisation is a process by which a member-owned Exchange is converted to a shareholder-owned Exchange. With demutualisation, it is believed that the ZSE will be exposed to robust corporate governance; enhanced efficiency and transparency associated with publicly quoted companies.

1.1 Background to the Study

The Zimbabwe Stock Exchange plays a crucial role in raising capital funds and also as a bridge between firms and the investing public. It is one of the oldest stock markets in Africa. The (ZSE) was established as a statutory body in terms of Section 3 of the repealed Zimbabwe Stock Exchange Act. The Securities Commission of Zimbabwe (SECZ) regulates the capital markets (Securities Act, Chapter 24:25). An exchange provides a facility for its member's to trade securities. The successful functioning of any economy demands the mobilization of all capital resources available and their productive utilization in the development of all sectors of the economy.

Demutualisation means “segregation of membership right in a recognised stock exchange into a distinct ownership right through the ownership of shares and distinct trading and/or clearing right of that recognised stock exchange”(Sandeep Singh, 2013).It entails the detachment of trading rights and ownership. Demutualisation denotes that an exchange has become a for-profit firm in a competitive financial markets environment. It has greater capacity for profit, and also for failure, than previously as it must stand alone for its financing like any other business. A mutual exchange provides services for the primary benefit of its members, often times at the expense of other stakeholders.

Internationally, the first stock market to demutualise was the Stockholm Stock Exchange of Sweden in 1993.Today, all major stock exchanges around the world such as exchanges in Japan, Germany, United States of America, Singapore, are demutualised.

Government has stepped up efforts to transform ZSE into a private company under a demutualisation plan.It should be noted that the major weakness of the ZSE is its constitution (Mutual Exchange). At the moment, the three characteristics or functions of ownership, management and trading are concentrated into a single group. Here, the broker members of the Exchange are both the owners and the traders on the Exchange and they further manage the ZSE as well.

This study draws its inspiration from the current Government drive to demutualise the ZSE. It seeks to provide insights into demutualization and its implications to all stakeholders inter alia members, investors, government, brokers. Reference is made to other stock markets which were demutualised.

The ZSE has a mutual structure where the ownership and management rights of the exchange are bundled with trading rights as a broker and all three are represented by ownership of share of the exchange.

1.2 Statement of the Problem

During the past decade, the financial sector has encountered a lot of challenges and service delivery has declined to unacceptable levels. The Zimbabwe Stock Exchange, which plays a pivotal role in the financial service industry, has not been left out. The local bourse has been home to marked abuses, malpractices and insider trading by layers. Pushing a share price or collapsing a share price were some of the other challenges the exchange was plagued with. Grave concerns on improved corporate governance, competition, investor participation have been raised. The research aimed on examining demutualisation of Zimbabwe Stock Exchange against the backdrop of the mutual structure.

1.3 Research Objectives

The research objectives of the study are as follows:

- i. To describe the major features and characteristics of the existing mutual structure of the Zimbabwe Stock Exchange.
- ii. To establish how a mutual exchange is converted into a demutualised exchange, that is, demutualisation process.
- iii. To establish the factors driving demutualisation of ZSE.
- iv. To ascertain the importance of demutualisation in the Zimbabwean context.
- v. To ascertain the downside impact of demutualisation on exchanges

1.4 Research Questions

- i. What are the major features and characteristics of the mutual structure?
- ii. How will the demutualised process go?
- iii. What are the key factors driving demutualisation of ZSE?
- iv. How important is demutualisation in the Zimbabwean context?
- v. What are the possible drawbacks in the post demutualisation period?

II. Related Literature Review

1.5 Defining Demutualisation

According to the World Federation of Exchanges (WFE, 2005), the demutualisation of an exchange is a process by which a non-profit member-owned organisation is transformed into a for-profit shareholder owned corporation. Ownership is somewhat open. The process often entails, first obtaining the appropriate regulatory and governmental consents, then converting membership rights into shares, which may be followed by public issuance and listing of the exchange, with immediate or eventual freely tradable shares (Hughes and Zargar, 2006, p: 6-7).According to Scullion (2001), demutualization is not merely converting into for profit organization owned by its members. An exchange is really demutualized when it optimises its potential of market capitalization to the fullest and alongside it also increases its shareholders` value. The term was used initially for the conversion process of insurance companies only but later evolved into a more generic term. Demutualization has been widespread since the 1980s (Chaddad, 2003). When done properly, a change in the

status of the exchange should provide the needed capital to build the market place, lower costs to members and better serve investors (Abdel Shahid, 2002, p.1).

In the words of Michael Larbie, (July 2011), demutualisation is a legal process of changing a mutual or cooperative association into a public (for-profit) company by converting the interests of members into shareholdings which can be traded, either through a stock exchange or on a private basis. He proposes the following key drivers for demutualisation-

- Streamline and rationalize exchange ownership.
- Enhances corporate profile.
- Enhances corporate governance and various exchange committees.
- Position the exchange for potential listing.
- Could potentially create liquidity / allow members to monetise their stakes
- Removes barriers to entry for new brokers
- Raise capital for expansion and/or acquisitions - provides acquisition currency
- Improves operational efficiency.
- Addresses competitive and global market pressures.

1.5.1 Demutualized Stock Exchanges

The first stock exchange to demutualise was the Stockholm stock exchange in 1991. Since the beginning of the 1990s several stock exchanges have been demutualized. Prior to that most of the exchanges were mutualised. The ownership and membership of an exchange were bundled together. The natural organization form for early exchanges was a membership club with exclusive privileges to trade in specific geographic locations (Aggarwal and Dahiya, 2005).

As of August 2012, twenty-three member stock and derivative exchanges of World Federation Exchanges (WFE) were publicly listed corporations.

1.6 The Demutualisation Process

According to Michael Larbie, (July 2011), demutualisation takes place in stages and can take several different forms. Initially, member “rights” are exchanged for shares in the entity and become legal owners of the organisation. Entities seeking to raise capital for growth or acquisitions raise capital, typically from outside investors as well as members. An IOSCO survey, (2005) established that the process of demutualization has been uneven between developed and emerging markets.

In new markets, the decision-making process is largely policy-led while in developed markets it is market-led. Because the impact of market forces may not be at the same level as a developed market, exchange restructuring issues are considered from the perspective of national policy (IOSCO, 2005). Strong buttressing by the government is necessary to resolve thorny issues such as how to appropriate ownership of an exchange that was limited by guarantee before demutualization, and the relationship between the regulator and a demutualized exchange (Arwa Morsy, 2007).

BTA consulting (2005), developed a demutualisation methodology which it dubbed “Metarmorphosis”

Table 1.0: BTA's metamorphosis methodology

Stage	Description	Comments
Egg Stage	Starting point (mutualised)	If starting now, start as a commercial entity, like ECNs
Caterpillar Stage	Getting fatter, earthbound and vulnerable - victim of circumstance	Demutualised - up to step 3 - a legal manoeuvre
Pupa Stage	Massive internal changes in process, still vulnerable	Demutualised - implementing steps 4-7
Butterfly Stage	Highly mobile, very attractive, able to mate - master of own destiny	Highly commercialised - steps 8 and 9

Source: BTA Consulting, 2005

According to BTA consulting these are the stages that a stock exchange undergoes when demutualising.

In many cases recommendations on the demutualization design and the model of the new exchange are evaluated and approved by the government. For example, in Malaysia, there was a working group chaired by the regulator, comprising members of the exchange, the association of stock brokers and the Capital Markets Advisor Council to facilitate the demutualization process (Hughes and Hagar, 2006). The process of demutualisation raises a number of key considerations as follows;

1.6.1 Corporate and Legal structure

A distinguishing characteristic of mutually-owned exchanges is that owners of the enterprise, its decision-makers and direct users of its trading services usually are the same entities- its member firms (Tom Horngren, 2008). Rights of ownership are not freely tradable and terminate with cessation of membership. Specific ownership issues for demutualised exchanges include (LSE, 2007):

- Specific targeting of an investor class.; and
- Ownership restrictions such as sectoral distribution, percentage limits or foreign ownership restrictions.(provided the part the exchanges play in capital formation, allocation, and redistribution (hence domestic employment and savings)

1.6.2 Ownership issues and access rights: According to Peter Epp (2011), it is argued that ownership issues and access rights comprise of the following;

- Transferring current interests or “seats” of members into shares
- Access rights to trading rights
- Restrictions on ownership
- To list or not to list

1.6.3 Regulations: It is crucial that securities markets are regulated to ensure probity, efficiency, and fairness of the market and to safeguard investor interest and confidence. Hughes and Zargar (2006) propose the following

- The regulator of a demutualised entity must balance the profit motives of the Stock exchange with the greater goal of investor protection.
- There are conflicts of interests which need to be addressed that arise when a for-profit exchange also regulates certain dimensions of the primary and secondary market.
- The regulator must also maintain adequate oversight on the rules governing primary and secondary market trading, must ensure investors remain protected and that transparency of market transactions prevails.
- Demutualised entities have historically made changes to the organizational structure in order to address some of the regulatory concerns.
- Regulators ought to be responsive and supportive of the restructuring of exchanges within the national jurisdiction or formation of their alliances with overseas exchanges – rule changes approved by regulator.

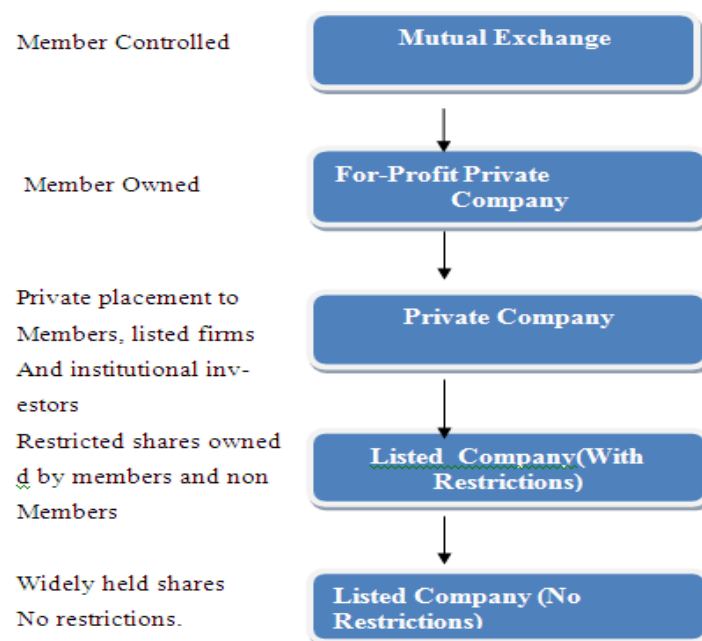


Fig 1.0: Demutualisation Process Organogram

Source: Michael Larbie (2011)

1.7 Features and Characteristics of a Mutual Exchange.

Stock exchanges started as a mutually governed, self-regulated structures where profit was not a very strong motive. The stock exchanges were authorized to promulgate by-laws to govern their functioning. They were physical locations with trading floors. The stock exchanges had a mutually dependent, co-operative structure (Saha, 2005). Interests of members are non-transferrable and cease on termination of membership.

1.7.1 Mutualisation and History of Stock Exchanges

Mutual stock exchanges taking London as an example began as curbside or ‘coffee shop’ where traders met at a specific time and place to trade with one another. This grew into a club, with members coming together to trade amongst themselves, eventually developing rules governing their trading. Subsequently ownership formalised into a system of ‘seats’ or a right to trade based on a subscription basis. The markets were self-governing; only members were allowed to trade in the bourse (Peter Epp, 2011).

In a mutual organisation, owners are also customers of the exchange and are not able to freely dispose of their stakes (Tom Cowan, Ray da Silva Rosa and Terry Walter, 2001). In mutual exchanges, the rights to profits and losses belong with its customers and so the customers share the risks that the organisation has not diversified away (Tom Cowan et al, 2001).

1.7.2 Problems faced by Mutualised Exchanges

Mian Shakeel Aslam (2010) lists the common challenges that are experienced in mutual exchanges globally as follows:

- Insufficient growth in market capitalization
- Market size below international benchmark
- Too few listings
- Low quality of many listed companies
- Limited free float and supply-demand imbalance
- Narrow base of investors
- Minimal share ownership
- Stagnation in number of shareholders
- Small number of unit holders in mutual funds
- Lack of the market awareness
- Lack of balance in governance structures
- Weak professional management
- Ineffective regulation of members
- Ineffective regulation of listed companies
- Unequal access to corporate announcements
- Mixed performance of non-member directors
- High degree of speculation and concentration
- Large number and low quality of intermediaries
- Weak criteria to become a member
- Weak criteria to become a broker

1.8 Factors driving for Demutualisation

According to Andrew Morrison, (2001) demutualisation raises the likelihood of the exchange acting in the interests, of not just its members, but all its various stakeholders (such as companies seeking capital, investors of all types, employees, stockbrokers, the users of stock exchange information, government and public at large). Long established, bourses are run by their members and function to preserve owner’s interests. Demutualization would restructure governance at the stock exchanges on a sustainable basis as the ownership rights will be delinked from trading rights (London Stock Exchange -LSE, 2007).It would increase the role of non- member stakeholders in the affairs of the exchange.

Secondly, Andrew Morrison (2001) proposes that demutualisation provides a governance structure more likely to result in quick and effective decision making. This is considered significant considering the growing competitive milieu that stock exchanges find themselves in. The objectives of a demutualised exchange are far clearer-to make a profit. Demutualised stock markets can be run with better aimed, stream-lined management structures, able to react quickly and decisively to challenges. A clearer focus makes management more accountable by increasing the transparency of its performance (Andrew, 2001). The success of a stock exchange can be gauged by its bottom-line results-value increase for shareholders.

Thirdly, Andrew Morrison, (2001) proposes that demutualisation makes it easier for a stock exchange to raise capital for investment in technology, necessary to meet competitive pressures. An organisation owned by shareholders would find it easier and cheaper to raise capital than one backed by legislation and with ownership limited to members. A further reason for demutualisation is that it is often a necessary step for mergers between stock exchanges.

A study by BTA consulting (2010) discovered that many stock exchanges were demutualising without a clear idea of what this was meant to achieve. Although demutualised, they continued to have the “mutual mind set”. According to BTA, the ‘happiest’ demutualised exchanges were fully-listed, had clear agreements with clients about what level of services they were offering, and had customer relations programs in place.

Demutualization makes it easier for an exchange to attract listings. Better and efficient system of a demutualized exchange would increase the confidence of other companies and this would result in greater listings (Hart and Moore, 1996). Demutualized exchange can easily go for international alliances (Akhtar, 2002). In support of Akhtar (2002), Hughes and Zargar (2006) argue that such alliances provide openings for investments and cross border listings.

According to Sam Mensah, (2005) the demutualisation trend can be attributed to a number of factors that include-

- Improved governance
- Investor participation
- Competition
- Globalization and consolidation

a) Improved Governance

The mutual association model functions well if an exchange is a provider of trading services with limited competition and the interests of members are homogeneous. Where greater competition subsists and the interests of members differ from one another and from the exchange, the mutual governance structure consensus decision-making becomes slow and cumbersome. Although demutualized stock exchanges will continue to offer most similar services, they will have different governance structures in which shareholders are represented by boards of directors.

b) Investor Participation

According to Sam Mensah, (2005) a bourse must be responsive to the needs of its many stakeholders, including participating organizations, listed companies, and institutional and retail investors. Exchanges may perceive a need to shift power within the exchange from one group of members to another and to afford institutional customers direct access to exchange facilities. Separating trading rights from ownership may be a politically and economically feasible way to effect such a shift.

c) Competition

According to Benn Steil, (2002), automated auction trading dynamics are for the most part, different from antediluvian traditional floor based exchanges. The placement and matching of buy and sell orders can be executed through computer systems, which are not limited by location or number of desired access points. The traditional concept of membership becomes unviable in a competitive market for ‘markets for electronic markets’. As the extra cost of an additional member gravitates towards zero, it becomes infeasible for an exchange to impose a membership fee. Benn Steil, (2002) further argues that historically, mutualised exchanges have sought to fix commissions and prevent price competition.

The advancement in technology has eroded the significance of the physical national exchange with a trading floor (Sam Mensah, 2005).

d) Globalization and Consolidation

The growing process of globalization and internationalization of financial markets has cut across the access boundaries and has put stock exchanges in direct competition with each other as well as with newly emerged electronic trading platforms, commonly referred to as “Electronic Communication Networks” (ECNs). The definition provided by SEC of the ECN is “any electronic system that widely disseminates to third parties orders entered into it by an exchange market maker or over-the-counter (“OTC”) market maker, and permits such orders to be executed in whole or in part”. Competitive pressures have triggered a wave of restructuring and mergers and alliances among securities markets to maximize economies of scale and scope, accessibility and market reach while providing global trading facilities (Securities Exchange Commission, SEC, 2005).

e) Resources for Capital Investment

According to Ramaseshan, (2002), expansion and investment in technology are important for survival of stock markets. This requires resources of substantial magnitude. The willingness and ability of the members to fund expansion and technological upgradation in a mutualised exchange is rather limited. In sharp contrast, demutualized organisations like to take investment decisions faster and have access to funds from a large pool of investors. Traditional exchanges have to explore new funding avenues and hence demutualisation and the subsequent listing of shares give them the market image and access to funds from a wide spectrum of investors.

Demutualization offers an opportunity to buy out trader interests since they are no longer necessary and shift power to other firms, while raising capital for continued modernization of trading information systems (Sam Mensah, 2005).

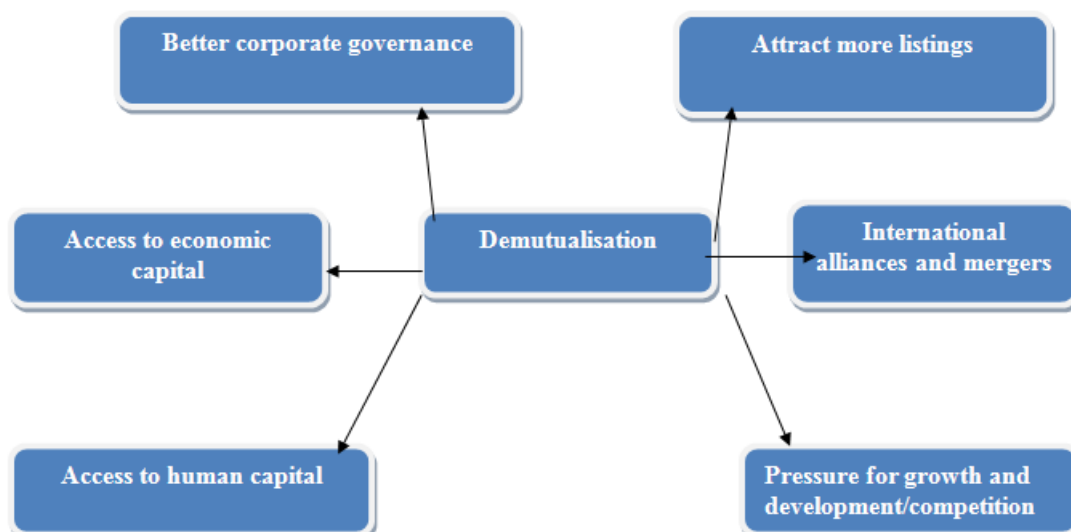


Fig 1.1: Benefits of demutualisation

Source: Sarah Ahmed, Babar Zaheer Butt, and Kashif-Ur-Rehman, 2010

1.9 The Downside to Demutualisation

According to Mian Shakeel Aslam,(2011) the under listed are the major concerns after demutualisation of a stock exchange:

- Lack of Focus on Regulatory responsibilities
- Higher costs for investors, brokers, and listed companies to increase profits
- Listing standards may be relaxed to maximize new listing and listing revenue.
- Unfair penalties imposition for revenues
- Risk management & surveillance may be compromised to increase trading activities and revenues

Demutualization does not have to be an “all-or-nothing” model. Stock exchanges that do not have the necessary justification and preconditions for demutualization at this time should consider demutualization as a long-run objective. The factors that have fuelled demutualization in developed and the larger emerging markets are largely absent from Africa. In addition, the key preconditions such as a sufficiently liberalized market and critical mass of stock exchange trading and related services do not exist in most markets (Sam.E.Mensah, 2005). He further argues that the reasons for great proclivity of African governments to promote stock markets are ‘technocratic’ and ‘political’.

McDowall (2004) argues that although exchange demutualization may attract capital and have several benefits, it does pose challenges in terms of governance, reconciliation and management of a wider range of interests and stakeholders. Consequently, demutualization is not in itself a long-term solution. In some instances, the mutual structure was considered to be a better business model. Wolasso L. Kumo (2008), argues that in Africa, the expected gains from demutualization can easily be offset by, inter alia, high costs associated with an exchange IPO, incomplete market liberalization, the need for exchange financial sustainability, conflict of interests, low liquidity, market size and underdeveloped infrastructure. Demutualization would be more relevant and useful after African stock markets have improved liquidity, fully liberalized the markets, strengthened cooperation and improved other infrastructure.

III. Research Methodology

The research undertook a mixed research methodology as detailed below:

1.10 Research Process

The research took the form of a case study offering an opportunity to address specific issues within the context of ZSE. The expectation is that users of the research findings get more insight into demutualization, its relevance, benefits and demerits and supporting regulatory framework.

The research follows both qualitative and quantitative research methodology based on the functionalist paradigm in order to ensure consistency between the research methodology and the nature of the study being undertaken. The primary and secondary data was collected from investors, stockbrokers, ZSE, SECZ (Securities Commission of Zimbabwe) and media.

1.11 Research Subjects

1.11.1 Population

The targeted population for this study was limited to ZSE, stock brokers, SECZ, Investors (Publicly listed companies) and other stakeholders. Access to the primary population was done through over the phone interviews, face to face and via email.

1.11.2 Sampling

A sample refers to a part of a larger body specially selected to represent the whole population and the process by which this portion is chosen is referred to as sampling. A sample should be representative of the total population by reflecting similarities and differences found in the total group. A minimum sample of performance figures of three years on ZSE was used and utilized for the purposes of obtaining data for this study. The use of some basic selection rules guided the intercepts. The interviews were done during the week. The day was then divided into time slots and a time slot was randomly selected to commence interviewing.

A stratified random sampling technique was used in drawing up samples under the respective categories. The classification consists of the major stakeholders to ZSE (Brokers, Investors and Regulators). This was done to ensure that all major categories of stakeholders were incorporated in the sample. The population of stakeholders was stratified into the following strata:-

- i. Stock Brokers
- ii. Investors
- iii. Government
- iv. Supervisory/ Regulatory Authorities

The nature of the sample is presented in tabular form on the next page.

Table 1.1: Targeted Sample

Stock Broker	Investors	Others	Supervisory/ Authorities	Regulatory
19 Stock Brokers	10 Individual investors 29 Institutional Investors	CBZ ZB FBC STEWARD	SECZ	

Source: Survey report 2013

Stock Brokers

The Sample of Stockbrokers involved the following companies:

Mast Stockbrokers (Private) Limited, Inter Horizon Securities (Private) Limited, Platinum Securities (Private) Limited, MMC Capital, ABC Stockbrokers (Private) Limited, Kingdom Stockbrokers (Private) Limited, FBC Securities (Private) Limited, Imara Edwards Securities (Private) Limited, M Lynton-Edwards Stockbrokers, Prime Stockbrokers, Remo Investments (Private) Limited, Lynton-Edwards Stockbrokers (Pvt) Ltd, New Africa Securities (Private) Limited, Southern Trust Securities, Old Mutual Stockbrokers (Private) Limited, ReNaissance Securities (Private) Limited, Remo Investments (Private) Limited, ZB Securities (Private) Limited, Bethel Equities (Private) Limited.

Judgmental sampling method was used to select specific respondents to the questionnaires in the respective institutions. The respondents, mainly brokers, investors and regulators were selected with the aid of senior management of a given institution.

A stratum of 19 stockbrokers was used from which its officials were conveniently selected for the purposes of the research. For the investors a stratum of 39 investors was used consisting of 10 individual and 29

institutional investors, there is only one regulatory authority for ZSE so only 5 SECZ officials were considered under supervisory and regulatory authorities.

A combination of judgmental sampling and systematic sampling techniques were used in sampling the stakeholders for a 60-day period running from 03 August 2013 (Monday) to 03 October 2013 (Friday). A weekly fieldwork during the 60-day period was necessary because it allowed all the requisite stakeholders to be contacted.

1.12 Research Instruments

In order to collect the necessary primary data for the research study formal telephone and face to face interviews were utilized. In addition, questionnaires were directly administered to the respondents being given assistance were necessary. This approach enabled responses to be given immediately and increased significantly the number of respondents to the questionnaires.

IV. Data Presentation, Analysis And Discussion

1.13 Demographics of Respondents

1.13.1 Response Rate of Stakeholders

A total of 55 respondents were interviewed using the random sampling technique (refer to table 4.0 below). A similar questionnaire was administered to all respondents. 15 stockbrokers successfully responded out of a population of 21, from a sample of 19 making a total response rate of 60%. A total of 39 investors were considered of which 10 individual and 20 institutional investors were respondents, making a total response rate of 67%. Under regulatory authorities there were 5 respondents out of a total of 6 questionnaires distributed at SECZ which is the sole regulatory authority for ZSE, with a response rate of 83% to questionnaires circulated. 5 banks were also considered which made a response rate of 100% to questionnaires. Overallly the questionnaires circulated were 81 and 55 were returned, giving a total response rate of 68%. The areas covered included major features and characteristics of a mutual exchange, the demutualization process, drivers for demutualization, downside to demutualization and relevance of demutualization in the Zimbabwean context. Data was then presented in tables, graphs and pie charts and analyzed as follows:

Table 1.2: Composition of the Distributed and Collected Questionnaires

Target Group	Number Of Institution(s) To Which Questionnaires Were Distributed	Field Work Breakdown		
		Total Questionnaires Circulated	Total Questionnaires Collected	Response Rate (%)
Investors	39	45	30	67
Regulator(s)	1	6	5	83
Stockbrokers	19	25	15	60
Others (banks)	5	5	5	100
OVERALL TOTAL	64	81	55	68%

Source: Survey report 2013

Table 1.3: Composition of Respondents

Stakeholder	Respondents	Percentage
Stockbrokers	15	27
Investors(Individual and institutional)	30	55
Supervisory authorities (SECZ)	5	9
Others	5	9
Total	55	100

Source: Survey Report 2013

Fifteen Stockbrokers responded out of a sample of 19 targeted for research purposes. Overall there is a total number of 21 stockbrokers licensed by SECZ, who are also the members under the subsisting mutual structure of ZSE making up 27% of the respondents. 55% of the respondents were investors who are the ones directly affected by ZSE. Regulatory authorities and others (banks) made up 9% respectively. It should be noted that there is only one regulatory authority for ZSE, which is SECZ, consequently it was the only one considered under regulatory authorities. SECZ operates under the guidelines of the Ministry of Finance and, therefore, it also represents government's position. 5 banks making 9% of the respondents were also interviewed.

1.14 Mutual Structure of ZSE

Tale 1.4: Responses on features and characteristics of ZSE

Statement	SD		D		PD		NS		PA		A		SA		T	
	no	%	no	%	no	%	no	%	no	%	no	%	no	%	no	%
1. Mutual structure ideal	35	64							10	18			15	28	55	100
2. Investors interests considered			25	45					10	18			20	37	55	100
3. Professional management of ZSE.	30	56							10	18	5	8	10	18	55	100
4. There is no need to restructure ZSE.			33	60					4	7			18	33	55	100

Source: Survey report 2013

Key: SD=Strongly Disagree
 D=Disagree
 PD=Partially Disagree
 NS=Not Sure
 PA=Partially Agree
 A=Agree
 SA=Strongly Agree
 T=Total

1.14.1 Effectiveness and efficiency of ZSE mutual structure

The table shows that 64% of the respondents strongly disagreed that the mutual structure is conducive for effectiveness and efficiency this figure excluded all brokers (18%) who were strongly in support of the currently obtaining structure. 9 % apiece somehow concurred that the mutual structure was effective..

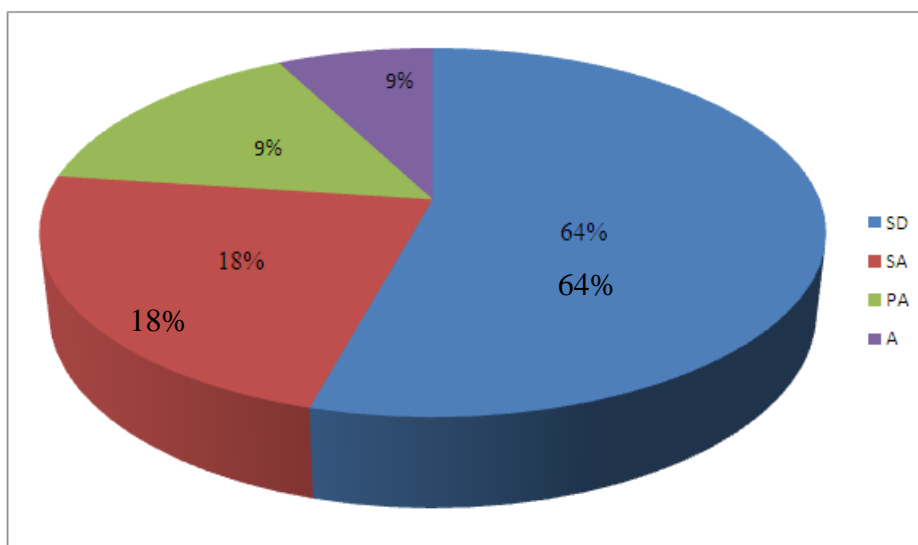


Fig 1.2: Effectiveness and Efficiency of the ZSE Mutual Structure

Source: Survey report 2013

1.14.2 Investors Interests

About 54% disagreed that investors interests were well taken care of whilst 20% partially agreed and 26% strongly agreed. Of the 54% that disagreed the majority were investors and some SECZ officials.

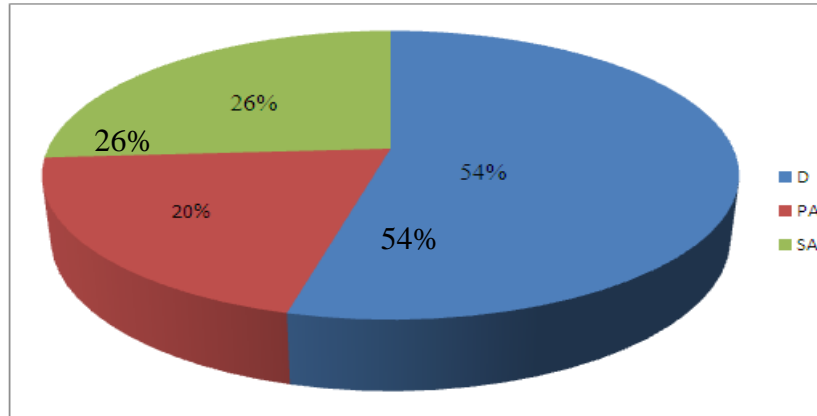


Fig 1.3: Investors Interests

Source: Survey report 2013

1.14.3 The ZSE organizational structure provides for its professional management.

About 56% of the respondents strongly disagreed that the obtaining structure allows for the professional management of ZSE whilst only 8% agreed. 18% percent partially agreed and strongly agreed respectively.

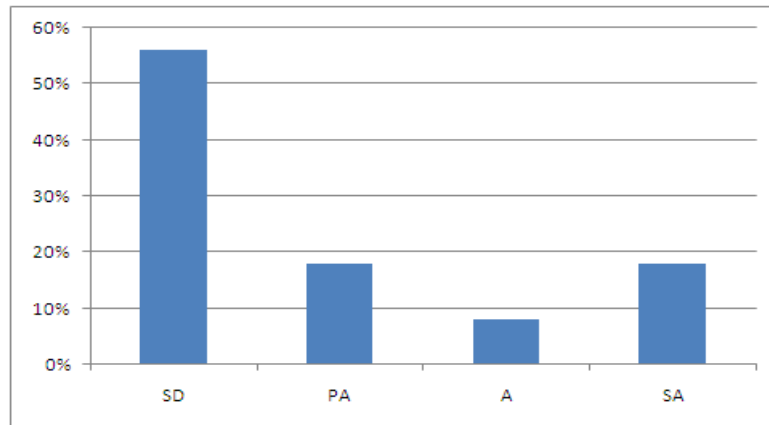


Fig 1.4: Professional management of ZSE

1.14.4 Need to restructure ZSE

About 60% disagreed that there is no need to restructure ZSE. 33% strongly agreed that there was no need to restructure ZSE this figure consisted of 15brokers and 3 banks respectively whilst only 7% partially agreed.

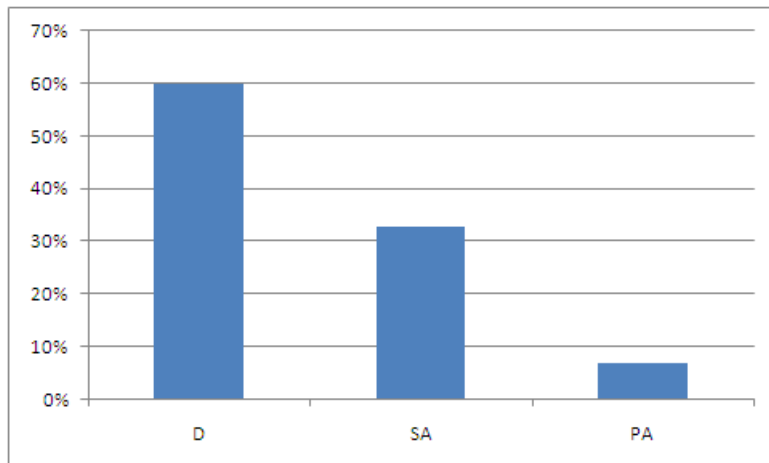


Fig 1.5: Need to restructure ZSE

Source: Survey report 2013

1.14.5 Inferences from responses by Stakeholders on ZSE mutual structure

The findings from questions on features and characteristics of ZSE when collated corroborates what Mian Shakeel Aslam, (2010) proposed as the challenges faced by mutual exchanges he cited inter alia

- Insufficient Growth in Market Capitalization
- Market Size below International Benchmark
- Too Few Listings
- Low Quality of Many Listed Companies
- Narrow Base of Investors
- Minimal Share Ownership

The majority of the respondents (73%) consisting of Investors (institutional and individuals), and Regulators concurred on the need to restructure ZSE citing shortcomings such as:

- Inflexibility to meet challenges (69% agreed that ZSE was inflexible, whilst only 25% argued that ZSE was flexible only 6% were not sure).
- Few listings (to date only 71 companies on ZSE)
- Speculative activities and concentration (50 % agreed that there were speculative activities, 23 % disagreed and 17% partially agreed).

1.15 Demutualisation process and driving factors for demutualisation

❖ Member Consultation in determining demutualization process

About 30% of the respondents agreed that current members of the ZSE should be widely consulted in determining the demutualization process. 25% of the respondents disagreed, 27% were not sure and 18% partially agreed of need to consult members.

❖ Government share appropriation in the demutualized entity

At least 50% of the respondents were opposed to government intervention in determining share appropriation in the demutualized entity, whilst 24% were in favor of the notion. 10% partially disagreed whilst 16% partially agreed.

❖ Demutualisation design and model should be approved by government

38% of the respondents agreed that the government should approve the demutualization design and model, whilst 36% disagreed. 20% partially disagreed and 6% of the respondent were not sure what ought to be done.

❖ Specific targeting of investor class

Approximately 50% of the respondents disagreed that they should be targeting of investors during the demutualization process whilst 35% consented to investor targeting and 15% were not sure on what course of action should be taken.

❖ Stakeholder Interests

About 65% of the respondents concurred that demutualization would raise the likelihood of the exchange (ZSE) acting in the best interests of stakeholders against 20% who disagreed. 15% partially agreed that stakeholder interests would be catered for in a demutualized entity.

❖ Governance structure conducive for quick an effective decision making

60% of the respondents strongly agreed and 25% agreed that demutualization would proffer a governance structure suited for quick and effective decision making against 15% who disagreed.

❖ Investment in technology

70% of the respondents strongly agreed that demutualization makes it easier for a stock exchange to raise capital for investment in technology, necessary to meet competitive pressures whilst 20% disagreed. 5% partially agreed and partially disagreed respectively.

❖ Segregation of ownership and trading rights

Approximately 54% of the respondents strongly agreed and 25% agreed that the segregation of ownership and trading rights, in an exchange will achieve more independence from its members with respect to its regulatory functions. About 21% disagreed about this.

❖ **Greater flexibility to accommodate the needs of institutional investors.**

About 40% of the respondents strongly agreed and 32% agreed that a demutualized exchange will have greater flexibility to accommodate the needs of institutional investors as customers, and potentially, as owners. 8% were not sure whilst 20% disagreed.

1.16 Importance of demutualization in the Zimbabwean context

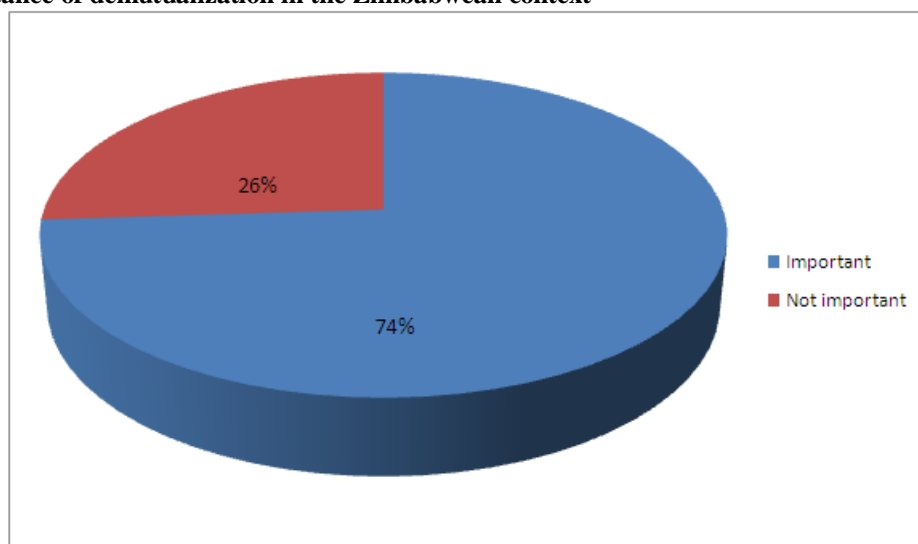


Fig 1.6: Attitude on Demutualization

Source: Survey report 2013

Approximately 74% of the respondents consisting of investors (40%), regulators (20%) and banks (14%) concurred that demutualisation was very important in the Zimbabwean context whilst 26% of the respondent who were all brokers were not positively disposed towards demutualising ZSE. The following are some of the reasons provided by those in favour of demutualisation:

- ❖ Market manipulation through false orders or short selling etc.
- ❖ Insider trading of stocks by brokers before publication of material facts, etc.
- ❖ Suspicious of spreading rumours (false rumour through posting to online bulletin board, e-mail, magazines etc)
- ❖ Dubious disclosure (financial statements, untimely disclosure etc)
- ❖ Suspicious financing (fictitious capital increase, suspicious allottees, etc)
- ❖ Overall problems for corporate activities, including internal control etc.
- ❖ Malpractices by securities market participants Securities Dealers, Securities Exchange, Asset Management Firm, Investment Advisory Firms unsolicited sales, inadequate explanation or risk etc.
- ❖ Difficulties concerning management systems, financial soundness, risk management, customer asset segregation, calculation of capital adequacy ratios.
- ❖ Information on suspicious financial instruments and suspicious funds, etc. (fund-raising that seems to resemble investment fraud, etc.)
- ❖ Information on market participants who may impair the fairness of the market (So- called Speculator groups, etc.)

On the other hand those in favour cited the following reasons:

- ❖ Challenges experienced by ZSE are independent of the type of organisational structure it operates. Problems at ZSE are a mere reflection of a nationwide problem of which ZSE was not spared.
- ❖ ZSE is now regulated by SECZ thus the question of conflict of interest is not relevant since its part of SECZ mandate to deal with such issues.
- ❖ A for-profit demutualized structure does not guarantee a profitable existence.
- ❖ Zimbabwe does not have a sufficiently liberalised financial market, thus a demutualized ZSE would be inhibited by controls and would not be able to offer anything significantly different.
- ❖ Market size and underdeveloped infrastructure.

Those in favour of demutualising put forth several and strong reasons against the fewer and rather one-sided interests of brokers to maintain the existing mutual structure. The general feeling is that demutualisation is very important and that it will revolutionise the capital markets in Zimbabwe and potentially increase listings on the bourse.

1.17 Downside to demutualisation

Stakeholders across the board felt that demutualization may result (if not properly implemented) in the following:

- ❖ Failure to focus on regulatory responsibilities
- ❖ Steep costs for investors, brokers, and listed companies to increase profits
- ❖ Standards of listing may be lax to capitalize on new listing and listing revenue.
- ❖ Demutualisation would be more appropriate after ZSE improves its liquidity.

The general sentiment was that those responsible for implementing demutualisation are better poised since they can learn from South Africa and other demutualized exchanges. There should be very little prospects of vagaries derailing a well considered demutualisation of ZSE

V. Summary Conclusions And Recommendations

The researchers made the following conclusions and recommendations:

1.18 Conclusions

❖ Stakeholder views on Mutual structure of ZSE

There was a general consensus that the mutual structure of ZSE was no longer relevant and appropriate in line with global trends towards demutualisation of exchanges. Stakeholders felt that demutualizing ZSE would prevent cartels of members from determining the affairs of the bourse which engendered credibility issues and repulsed investors. Other concerns raised were the long running tensions between ZSE and SECZ over jurisdiction and self regulation. It was also felt across the board that the mutual structure has stifled growth as evidenced by the failure to fully automate ZSE.

❖ Stakeholder perceptions about demutualisation process

The demutualisation process should be all inclusive, according to stakeholders, current members of ZSE should be consulted to some extent, there were some reservation about too much government intervention, with a feeling that the success of demutualisation will also hinge on a sufficiently liberalised market with very little statutory interventions. On the other hand, other stakeholders felt that strong buttressing by government is necessary in Zimbabwe where regulatory systems are somewhat fragile. In order to maintain investor confidence in the market, regulators must be an important player in the demutualisation process.

❖ Views on factors driving demutualization.

There was an overwhelming response from stakeholders exclusive of brokers rallying behind the driving factors for demutualization. Stakeholders agreed that demutualization will most likely lead to improved governance, increased investor participation, bring much needed resources for capital investment, unlock stakeholder value, removal of conflicts of interests and make ZSE more responsive to competition. Those who did not agree argued that the challenges experienced at ZSE had nothing to do with the mutual structure but rather were a reflection of a nationwide crisis.

❖ Perceptions on importance of demutualization in the Zimbabwean context.

The general stakeholder mood was that demutualization is very important in Zimbabwe; given the shortcomings of the prevailing mutual structure. It was felt that demutualization needs to be expedited as it is long overdue. Stakeholders argued that inter alia, few listings (79), malpractices, antediluvian methods, regulatory arbitrage were repelling investors. On the other hand a few of the stakeholders mainly brokers felt that demutualization was not necessary because it could never solve a nationwide problem.

❖ Views on downside to demutualization

Stakeholders did not give so many views on downside to demutualisation as it is a relatively new phenomenon in Africa more so to Zimbabwe. The general view however was that with due diligence being taken there should be little occasion for such shortcomings to occur. Stakeholders cited possible shortcomings as failure to focus on regulatory responsibilities, high costs for investors, brokers and listed companies, relaxing of listing standards in order to increase new listings and listing revenue.

1.19 Recommendations

- ❖ Although ZSE has had its heyday its time that we forge ahead as a nation by becoming sensitive to stakeholder needs and remain globally competitive and relevant has come. This calls for parties to be affected by demutualisation mainly brokers to move beyond self interest and realize the greater good that will result by unbundling ZSE's mutual structure.
- ❖ Despite the anticipated attendant benefits to result from demutualising ZSE, government should nonetheless approach it with due caution and should consult widely before initiating it. All stakeholders must be considered.
- ❖ The board of directors of the demutualised ZSE should have a representative from SECZ attend as an observer. At least three of the non executive directors should be associated with listed companies, sponsors or authorized users of ZSE.
- ❖ There should be sufficient market liberalization before the process of demutualizing ZSE is kick started.
- ❖ A mere conversion from a not-for-profit organisational structure to a for-profit structure would neither ensure better regulation nor would it instill investor confidence. Demutualisation can be successful only if the interest of investors, issuers and other stakeholders are of prime concern to shareholders.
- ❖ A demutualised corporate structure provides ample opportunities to diversify and set up other business operations. There could be conflict of interest due to such diversification. Methods to deal with such conflicts and the internal segregation between various business interests have to be evolved.
- ❖ A committee should watch over the whole process both pre and post demutualization to make it a success.
- ❖ An indicative budget for the whole process of demutualisation and the criteria used to determine the budget should be provided.
- ❖ Ensure appropriate and full disclosure of material information about ZSE description of the company's business, financial statements, biographies of officers and directors, detailed information about their compensation, any litigation that is taking place, a list of material properties and any other relevant information.
- ❖ There should be sufficient liquidity on the market before the demutualization of ZSE takes off.

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