FACTORS AFFECTING THE PERFORMANCE OF CAPITAL MARKETS IN UGANDA

BY

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DEDICATION

I dedicate this work to my lovely parents especially my mum Mrs. Rose Etit Winfred for their love, support and tolerance at the time of my study, as for that I have reached this far.

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ABSTRACT

This study assessed the factors affecting the performance of capital markets in Uganda. The specific objectives were to investigate the effect of interest rate policy on the performance of capital markets in Uganda, to examine the effect of financial knowledge on the performance of the capital market in Uganda, and to assess the impact of market liquidity on the performance of capital markets in Uganda.

The study was conducted at Kampala City and involved a sample size of 52 respondents drawn from Top Managers and the personnel from the Uganda Securities Exchange (USE), the Capital Market Authority (CMA), and Brokerage Firms, who were selected through random and purposive sampling techniques. The data were collected through a combination of techniques namely; questionnaires. The collected data were analyzed through the use of SPSS, discussed and presented through the use of figures, tables as well as text.

The study reveals that there are challenges for the capital market development that remain unsolved since the establishment of the CMA and the USE, despite the prospects experienced to the market. Hence the study recommends for more reforms to our laws and policies governing the capital market business, demutualization of the USE, Stock Markets integration so as to make the market flexible hence rapid development of the market. The findings further revealed that market is illiquid as there are few trade able securities and few investors too. That major players in the business are the pension funds, which hold assets at certain ratio at marketable prices.

LIST OF ACRONYMS

ALSI	All Shares Index
BOU	Bank of Uganda
CMA	Capital Markets Authority
EAC	East African Community
GDP	Gross Domestic Product
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offer
KCB	Kenya Commercial Bank
PEs	Public enterprises
RSL	Relative Strength Index
SMES	Small and Medium Enterprises
UIA	Uganda Investment Authority
UNCTAD	United Nations Conference for Trade and Development
USE	Uganda Securities Exchange
UTL	Uganda Telecommunication Limited

CHAPTER ONE

GENERAL INTRODUCTION

1.0 Introduction

The role of long term capital in the economic development of a nation cannot be over emphasized. Most economic managers recognize that a well organized capital market is crucial for mobilizing both domestic and international capital. In many developing countries, however capital has been a major constraint in economic development.

Capital markets are vital to the functioning of an economy since capital is a critical component for generating economic output. As Pardy (1992) argues, securities markets have an important role to play in financial liberalization and deepening.

The chapter will present the background to the study, the statement of the problem, the purpose of the study, objectives of the study, the research questions, the scope of the study, the significance of the study, the conceptual framework, the operational definition of terms and concepts used in the study.

1.1 Background

It is universally accepted that no modern economy can do without an efficient financial system due to the reason that the role of the financial system in the economy is like a bone marrow to the backbone of human being, enabling all the movements and so making it move and work efficiently. Taking that into consideration, Governments throughout the world have found it necessary to develop capital markets in their countries. That is due to the reason the financial systems are the ones that play a role of Intermediation by facilitating the movements of funds from those who have surplus money to save, to those who are in need to use the money and therefore increasing the efficiency of economic resources allocation and deployments.

Historically, the origin of capital market in the world can be traced back from the periods in which the world economy was open to trade and factor mobility, where people and capital moved to countries, regions and cities that offered better jobs, more profits and higher wages than those encountered at home. These were the periods of increased trade and capital mobility that had been also accompanied by more intense labor mobility across national borders. Conversely, in periods of global instability, stagnation, nationalism and more restrictive policies toward migration and capital mobility had observed less action in global factor markets. The first wave of globalization from around 1870 to 1913 was a period in which capital and labor were both free to move internationally, as a consequence international labor and capital markets became more integrated than in any period afterwards. The interwar period with its economic turbulence, political disarray and rising nationalism witnessed both a movement towards reduced intercontinental migration and more chaotic and diminished capital flows.

After the World War II, the Bretton-Woods system restricted international private capital mobility and national governments gave more priority to the achievement of domestic policy goals. In the early1970s, the Bretton-Woods dollar-gold standard was abandoned and international capital mobility surged.

On the part of Africa, the development of capital market business can be traced in early 1990s as the history of African Capital Market proves that prior to the year 1989, there were just five stock markets in sub Saharan Africa and only three in North Africa. As by the year 2003, there were more than 19 stock exchanges. Stock market development has been central to the domestic financial liberalization programs of most African countries. It seems any program of financial liberalization in Africa is incomplete without the establishment and development of stock markets. But since the early 1990s, there had been a considerable big change in the African capital markets sector.

The collapse of the Soviet Union and increased globalization, cross border financial transactions had been among the factors that highlighted the significance of capital markets on the continent. Also with the strong emphasis on regionalization, it was considered by many to be inevitable in the development of African capital markets, as they struggled to consolidate in order to overcome poor liquidity and to attract more foreign investment. By those times, many of the African stock markets were characterized by relatively low liquidity, well below that of the most emerging capital market. Part of this stems were from facts and circumstances such as relatively low trading volumes, lack of information flow about securities to both institutional and individual investors, lack of investor awareness of the opportunities in these markets, and the relatively unstable economies in these countries. To a large extent, this could be put to the lack of proper governance and legal structures to deal with capital market dynamics.

The creation of capital markets in the African continent was initially made under the impetus of the political will, to mobilize national resources and channel them to productive investments towards deriving the economic and social growth of the continent.

Like other African countries, by early 1990s, Uganda had adopted the system as one among the measures in economic liberalization. The capital markets industry in Uganda came into being in the year 1996 with the enactment of the Capital Markets Authority (CMA) Act Cap 84. The CMA Act established the Capital Markets Authority which paved the way for the licensing of the Uganda Securities Exchange (USE) in 1997. It is correct to say that development of capital markets in Uganda was a part of the package of reforms which also included; trade liberalization, relaxation of exchange controls, and deregulation of interest rates as well as divestiture of public enterprises. The Uganda Securities Exchange (USE) was made a company limited by guarantee and incorporated in Uganda under the Ugandan Companies Act. The Uganda Securities Exchange was licensed to operate as an approved Stock Exchange in June 1997 by the Capital Markets Authority of Uganda under the Capital Markets (Licensing) Regulations 1996 and is governed by the Uganda Securities Exchange Limited Rules 2003. The principal activity of the Exchange was to provide a central place for trading of securities and regulation of the licensed brokers/dealers.

In June 1998, the Uganda Securities Exchange (USE) became operational as a unit under the jurisdiction of Uganda's Capital Markets Authority, which in turn reports to the Bank of Uganda (BOU), Uganda's central bank. At the time, the exchange had just one listing, a bond issued by the East African Development Bank. Trading was limited to only a handful of trades per week. As of August 2015, the USE trades 18 listed local and East African companies and has started the trading of fixed income instruments. There are however, several equity and debt instruments listed and traded on the Exchange. Debt instruments in the form of corporate and government bonds are among those traded at the USE. East African Breweries and Kenya Airways are cross listed on the Nairobi Stock Exchange and the Dar es Salaam Stock Exchange. Centum Investment Company Limited, Equity Group Holdings Limited, and Jubilee Holdings are listed primarily on the Nairobi Stock Exchange and are cross listed on the USE. Kenya Commercial Bank Group and Nation Media Group are listed primarily on the Nairobi Stock Exchange and are cross listed on the USE, the Dar es Salaam Stock Exchange, and the Rwanda Stock Exchange. Uchumi Supermarkets, a regional supermarket retailer with headquarters in Nairobi, Kenya, is listed on the Nairobi Stock Exchange, is cross listed on the USE and the Rwanda Stock Exchange, and plans to cross list its shares on the Dar es Salaam Stock Exchange. Umeme, the largest electric power distributor in Uganda, is listed primarily on the USE and is cross listed on the Nairobi Stock Exchange. Equity Group Holdings Limited is listed primarily on the Nairobi Stock Exchange (2006). It is cross listed on the USE (2009) and the Rwanda

Stock Exchange (2015). In February 2015, Ugandan media indicated that both the Housing Finance Bank and Crane Bank, which had intended to list their shares on the USE, have since changed their plans and put their IPOs on hold.

The debt instruments include: 4 Government bonds (2,3,5 and 10 year bonds), EADB Bond (UGX 10 Billion, redeemed), PTA Bank Bond (UGX 8.4 Billion, redeemed), UTL Bond (UGX 54 Billion, 24 Billion raised to date) .The listing of the East African Breweries Ltd represented the first cross listing of shares in the East African region. Other products have also been introduced namely the Collective Investment. The exchange is a member of the African Stock Exchanges Association. The USE operates in close association with the Dar es Salaam Stock Exchange in Tanzania, the Rwanda Stock Exchange, and the Nairobi Stock Exchange in Kenya. According to published reports in 2013, there are plans to integrate the four exchanges to form a single East African bourse. In January 2000, the Uganda Securities Exchange (USE) began secondary trading. However, the number of listed companies and the volume of trade were still low (Rutega, 1999 and Katto, 2002).

Local investors in Uganda have had difficulty in obtaining long term finance even as opportunities exist for accessing cheap financial resources through the USE. To access financing through the USE, companies have to meet the regulatory requirements of the stock exchange. These requirements included prospectus and listing requirements for the public issue of securities, accounting standards, disclosure requirements, regulations of capital flows and investor protection regulations (Rutega, 1999 & Weigh, 1998). Further, to boost investor interest in obtaining a listing on the USE, incentives are given (Uganda Capital Markets Authority, 2001). Incentives include tax waivers, tax exemptions and tax differentials. In a Survey carried out by the IOSCO's, it was revealed that incentives strengthen investor confidence in the stock exchange and foster investor participation (IOSCO, May 2002).

However, the current status of capital markets in Uganda can still be described as an "emerging market". Bank financing and government subsidies have for a long time been the source of finance for public corporations and companies. There is a noticeable absence of public companies (i.e., companies allowed to invite subscriptions from the public). Many companies are private, whose right to transfer shares is severely restricted. The number of securities is rather limited, with government debt instruments being the only securities in the market (i.e., stocks and treasury bills). A secondary market for government securities is in the process of being established. Pension and provident funds are the only major collective investment schemes, while there are no unit trusts.

1.2 The problem statement

Uganda has worked hard to achieve all the necessary determinants for the success of the capital market in the country by making various legal frameworks and reforms. That includes the establishment of the Capital Market Authority and Uganda Securities Exchange. These are there to ensure sustainable capital market prevails in the country.

Financial markets constitute an important part of the infrastructure for every society that has passed the stage of largely domestic economies. Stock markets which is part of the financial markets, contribute to the country's economy by raising long-term finance for productive investment, diversifying investors risks, and improving the management of firms. That is reason why the government, industry and even the central banks of the country keep a close watch on the happenings of the stock market. In addition, Littman (1994) and Levine (1997) argue that well developed stock markets promote higher economic growth through their ability to attract international investments and mobilize domestic savings. Therefore, stock market performance acts as the barometer of the economy as a whole.

Bohnstedt (2000) and Fama (1970), however, noted that if performance of an economy is good then the stock market performance is also good and bull markets are inevitable. If the economic performances are not up to the mark, then the stock market is most likely to underperform and might see a downward trend. Opportunities exist to access financial resources through the capital markets, local investors have not sought to use the avenue. Although the USE has been in operation since 2000, the volume of trade is still relatively low (Rutega, 1999). Very few firms have been listed and the items for trade are few (Bank of Uganda, 1999). Local investors may not be in position to meet the regulatory requirements of the stock exchange (Rutega, 1999 & Weigh, 1998) yet the regulations are perceived to be vital to boast investor confidence. Further, the potential investors have not taken advantage of the incentives on the stock exchange.

1.3 Main objective

To assess the extent of how the market liquidity, interest rate policy, and financial knowledge have affected the performance of capital markets in Uganda.

1.3.1 Specific objectives

I. To investigate the effect of interest rate policy on the performance of capital markets in Uganda.

II. To examine the effect of financial knowledge on the performance of the capital market in Uganda.

III. To assess the impact of market liquidity on the performance of capital markets in Uganda.

1.4 Research questions

I. To what extent has the level of interest rate policy affected the size of capital markets in Uganda?

II. To what extent has financial knowledge affected the performance of capital markets in Uganda?

III. To investigate the extent at which market liquidity has affected the size of capital markets in Uganda?

1.5 Conceptual frame work

In order to investigate the research questions, the following conceptual framework was adopted.

Fig 1: Conceptual framework of the study.

Independent Variables

(Factors affecting the performance of capital markets.)

- Financial knowledge
- Market liquidity
- Interest rate policy

Dependent Variables

(Stock market performance)

- Transaction cost
- Market depth
- Information availability

Moderating variables

Environment

- Limited technological progress
- Structural bottlenecks
- Poor governance

Source: Developed by researcher

It can be inferred from figure1 that the market liquidity, financial knowledge and interest rate policy are key ingredients in the performance of stock markets. This is achieved through bolstering investor confidence. It is important to note that interest rate policy and level of awareness can directly induce their intention to participate in the stock markets, thereby determining the performance of the stock market.

For purposes of this study, the market liquidity, financial knowledge and interest rate policy comprise the independent variables. The environment is the moderating variable and the dependent variable is the performance of the stock exchange market at the USE.

1.6 Significance of the Study

The study will help Uganda Securities Exchange to review regulatory requirements, awareness campaigns and their stand on tax incentives for them to accommodate the interests of potential entrants into the market.

The findings arrived at in this study will help the Capital Markets Authority, Ministry of Finance, and Uganda Investment Authority to develop policies to promote local investors participation in the capital market.

The study results will help local investors to widen their investment Portfolio or access a wider pool of finance available at the Uganda Securities Exchange.

1.7 Scope of the study

1.7.1 Sampling scope: The research was conducted in Kampala that has the largest concentration of local potential and actual investors in Uganda's capital market.

1.7.2 Conceptual Scope: Because capital markets are a very wide area, the research was confined to the analysis of the three variables, which affect local investors' participation on the

Uganda Securities Exchange. These variables are the low liquidity, financial knowledge and interest rate policy.

1.8 Operational definitions

Capital markets: Are an arena in which firms and other institutions that require funds to finance their operations come together with individuals that have money to invest. These are markets that deal in shares, bonds i.e. the markets for long term capital.

Equity finance: In accounting, it's the ownership interest in a company as determined by subtracting liabilities from assets. It can also be referred to as the sale of stock to raise money.

Debt finance. It's the sale of bonds so as to raise money. The activity is mainly carried out by the government.

Debenture. A certificate that certifies an amount of money owed to someone i.e. a certificate of indebtedness. It's also a certificate of a loan made to the government i.e. a government bond.

Shares of stock. It's a portion of ownership in a company

Bond. It's a loan from an investor to a corporation or a government. Bonds don't give investors an ownership stake in a company, like stocks do.

Commercial papers. These are short term unsecured promissory notes issued by a company to raise short term cash.

Treasury bill. These are short term obligations issued by the government.

Primary market. Is one in which a borrower issues new securities in exchange for cash from an investor (buyer). New sales of Treasury bills, stocks, bonds all take place in the primary market.

Secondary markets. When the original purchasers of securities sell their securities, they trade in such a market. These securities may subsequently trade repeatedly in the secondary market, but the original issuer will be unaffected in the sense that they receive no additional cash from these transactions. In the secondary markets the seller of the securities receives the proceeds, not the issuer.

Financial instruments. These are tradable assets of any kind. They include cash, evidence of an ownership interest in an entity, or a contractual right to receive or deliver cash.

Liquidity: This is the ability to buy or sell an asset quickly at a known price. Selling quickly means marketability of an asset. Known price is important to show there is price continuity. Prices do not change much from one transaction to the next unless substantial new information comes in.

Transaction costs (Internal efficiency): For a market to be attractive all aspects of transaction entail low costs. These include the costs of reading the market, brokerage cost, commission and the asset transfer costs.

Depth: This refers to the number of buyers and sellers. To ensure that the market is continuous, there must be many buyers and sellers. The many buyers and sellers also help to ensure market liquidity.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This section is subdivided into three sub themes, namely: financial knowledge and financial market participation, market liquidity and stock market performance, interest rate policy and local investor participation on a securities exchange.

According to Ziorklui, S. Q. (2001), most of the previous researches show that the development of a viable capital market depends on a viable private sector firms that are willing to participate in the stock exchange in the form of listing firms to raise long-term capital. That a viable and developed capital market relies on individuals, institutions, and corporate demand for securities issued in the capital market. These institutions include institutional investors, insurance companies, financial institutions, mutual funds, pension funds, and other corporate bodies. His survey resulted on the confirmation that the demand for securities in Uganda is affected by various factors that have been identified in other studies. These include the level of financial knowledge of the local population, perception of risk in the market, tax considerations, and attractiveness of yields on capital market products as compared with alternative investment products. The level of public confidence in the financial sector also affects the demand for securities in the stock exchange. The study by Ziorklui (2001) is of the past ten years hence this study wishes to find out if the mentioned findings on the factors affecting the performance of the capital markets do still subsist to date, and if yes how they have been tacked so far.

2.1 Financial knowledge and Financial Market Participation

Standard models of finance and portfolio choice often assume that prospective investors have adequate knowledge about financial market activities and make rational asset allocation decisions to maximize their welfare in both the short and long term. Studies on determinants of financial market knowledge and participation including Guiso & Jappelli (2004) conclude that awareness of stocks, bonds, mutual funds, and investment opportunities in financial instruments has a positive relationship with education, household incomes and wealth, long term bank relations and social interactions. Awareness of market operations is crucial for the success of a securities market. In the capital market, the first step in confidence building is creating a critical mass of informed investors. In pursuit of this, the USE has put in place an education program that includes public campaigns, road shows, free circulation of educational material and advocacy at various levels.

Financial literacy enables individuals to save money towards their retirement and to earn income during their retirement periods. As investors invest in financial assets they increase their future wealth. At such a time that they are unable to work to earn regular incomes, the incomes from the financial assets serve as substitutes and reduce old age poverty. Lusardi & Mitchell (2008) write that those who are more financially literate are more likely to plan for retirement and as a result they accumulate more wealth. Despite this, Guiso & Jappelli (2008), confirm that consumer knowledge about basic financial principles and products is scarce and may not be sufficient to guarantee that households make sound financial decisions. Financially illiterate households are, for example, more prone to a lack of retirement planning, portfolio under-diversification, and excessive indebtedness. D'Ambrosio, McDermed, & Sawant (2002) observe that the need for financial education to improve financial literacy was a recent and important policy issue facing the United States of America. Federal Reserve Chairman, Alan Greenspan (2002), commented that helping Americans understand basic concepts about budgeting and financial markets through financial education programmes will enable Americans to make more appropriate short and long term saving decisions.

Rooij, et al. (2007) supports the view that knowledge about financial markets is important for household behavior and capital market participation. In their paper on financial literacy and stock market participation, they find that a lack of understanding of economics and finance is a significant deterrent to stocks ownership. They also showed that welfare loss from non participation in the stock market can be sizable thus implying that the role of financial literacy should not be underestimated.

Brown, Ivkovic, & Weisbenner (2008) establish a causal relation between an individual's decision to own stocks and the average stock market participation of the individual's community. They note that word of mouth communication has a strong effect on market participation in sociable communities. Thus, an individual's community members who invest in stocks can influence that individual's participation in the stock market. Individuals may, in other words, find it easier to learn how to buy stocks, or open a mutual fund or brokerage account by talking to their friends and relatives than through other mechanisms. This, although an informal form of education suggests that effective educational programmes, other things being equal, will promote stock market participation.

According to the peer effects theory, the impact of individuals who interact with their neighbors and attend church (sociability) on stock market participation is stronger in states where stock markets participation rates are higher. Thus, any "social" investor finds the market more attractive to participate in when more of his peers participate in the market (Hong, Kubik, & Stein, 2004).

One may argue, however, that low financial literacy does not necessarily imply that households are bound to make poor financial decisions given the availability of financial advisers who can make appropriate investment decisions on their behalf. Alternatively, word of mouth education offered by acquaintances through social interactions may support rational investment decisions. As long as households can resort to the advice of experts and peers, external financial advice may act as a substitute for learning by one's self. It is also important to note that financial advice is also sought and required by knowledgeable investors, not only financially illiterate prospective investors. Financial advisers themselves operate in imperfect financial markets and the fact that qualified investment advisers are available does not necessarily translate into high-quality decision making on the part of an investor.

Although not always the case, a financially literate individual has a better chance than a financially illiterate individual of discerning between a good investment and a bad investment. Comerton (1999) adds that the advice offered by financial advisers can be affected by conflicts of interest. When financial intermediaries are at the same time acting as advisers and selling financial products, they may sell products that do not match customers' needs. For Carlin (2009), what is of greater concern is the fact that investor ignorance may be exploited in retail financial markets as a source of market power by firms that increase the complexity of their financial products for strategic reasons. Calcagno & Monticone (2011) further write that as financially literate investors have a better understanding of financial products and concepts, one might expect them to have an easier access to financial markets and this in turn suggests that they may have a lower need for financial advisers and hence lower cost of investing in financial market instruments. It is important here to reiterate that educating the public on the welfare implications of capital market participation does not necessarily have to be through formal means of education, but can also be through non formal means such as word of mouth. In spite of the education on the benefits of investing in financial assets and the availability of financial assets, inculcating the culture of saving in individuals from infancy is the key to whipping up individuals' interest in financial instruments.

2.1.1 Information efficiency and stock market performance

Empirical investigations elsewhere provide evidence on the relationship between information efficiency and stocks market performance (Fama, 1970). Market efficiency is largely influenced by information efficiency and it is measured by the amount and speed with which information is incorporated into prices. In an efficient market, stock prices incorporate all the available and relevant publicly known information hence on profit opportunities are left unexploited. In semi strong efficiency, stock market performance represents the best measure to estimate the creation of value for shareholders (Brealey and Myers, 1991), and a positive relationship exists. The free flow of information to all participants is a necessary condition for market efficiency. Studies on the stock market have generally found that stock prices incorporate market information, even though the magnitude of changes in stock prices does not reflect the magnitude of changes in stock market performance.

Kothari (2001) and Madhavan (1992), focusing on the transactional properties of the market, argue that the quality of information possessed by the market makers and traders significantly influence market depth. But Griffn and Tversk's theory (1992) suggest that individuals might underweight the information contained in isolated quarterly earnings announcements, since a single earnings number seems like a weakly informative blip exhibiting no particular pattern or strength on its own. In doing so, they ignore the substantial weight that the latest earnings news has for forecasting the level of earnings, particularly when earnings are close to a random walk.

At the same time, individuals might overweight consistent multiyear patterns of noticeably high or low earnings growth. Such data can be very salient, or have high strength, yet their weight in forecasting earnings growth rates can be quite low. Jones (2001) found out that trading volume reflects the quality of trader's information. However, this is centrally with De Long et al. (1990), who put it forward that an important reason why arbitrage is limited is that movements in investor sentiment are in part unpredictable, and therefore arbitrageurs betting against mispricing run the risk, at least in the short run, that investor sentiment becomes more extreme and prices move even further away from fundamental value.

2.2 Market liquidity and stock market performance

Ngugi (2003) argued that one of the key roles of the stock attribute liquidity to the adopted trading system, observing that greater transparency in the trading process enhances market liquidity by reducing the opportunities for taking advantage of less informed or professional participants. However, Schwert (1989) suggested that an infrequently traded stock may not necessarily be considered as illiquid in any particular period, if the market liquidity as a whole is low during the same period. He further said that “apart from illiquidity of stocks, the variability in the level of liquidity is considered to be risky to the investors as the more the stock liquidity fluctuates the higher the uncertainty in trading returns which leads to erosion of investor’s confidence in the trading activities.

Several researchers have provided evidence of the significant effect of market liquidity on stock market performance. For example, practical findings by Broner and Gaston (2006) show that uncertainty in execution delays grows with the order size, and declines with liquidity, while uncertainty in the price impact growth with size, and declines with liquidity and depth.

However, Kyle (1985) noted that market liquidity have a positive link with stock market performance since depth, width and immediacy as a measuring variables can be used as elements in calculating the all share index (ALSI) and relative strength index (RSI) to measure stocks performance. This is inconsistent with Andrew and Craig (2007) who suggested that stock market performance is an important aspect of the economic interactions in financial market among different investors that bases their trading on liquidity reasons. According to Cornell and Sim (1992), stock market performance and liquidity increase when insiders are active. Amihud et al. (1997) presented evidence that improvement in stock liquidity leads to increased stock prices. But Barclay and Warner (1993) model stated that liquidity may depend on trade size. They found out that medium sized trades tend to be the most informed and defined trade size as the average number of shares traded over all eligible trades. Yet Lemmon, (2000) disagreed with his view of considering liquidity to mean trade volume since during "trading windows" when insiders are allowed to trade liquidity may dry up yet volume traded is increasing.

De long et al. (1990) tested market liquidity effects and its correlation with stock prices and returns. Their results found that this link was statistically significant and that market liquidity is proved to be the major determinant of returns and correlates highly with investor sentiment. Similarly, Inderst, R and Ottaviani, M (2009) who stated that market liquidity of a public ownership facilitates trading and lowers the cost of capital, but introduces volatility in a firm's shareholders base. However, Osei (2007) stated that without a large number of shares in public hands, trading will be illiquid, and shareholders will have trouble in selling their shares when they want or need to sell them, leading to reduction of investor sentiment in the market.

2.2.1 Market liquidity and information efficiency

Glen (1994) defines market liquidity as the ability to buy and sell a particular security with minimal market impact. This means that the efficiency of trading systems determines the ease with which investors can buy and sell their shares thus, macroeconomic and political environments affect market liquidity. Researchers (Kyle, 1985) noted that there is a positive relationship between market liquidity and information efficiency. Admati and Pfleiderer (1988) suggest that informed traders camouflage their information by trading during high volume periods. Barclay and Warner (1993) propose the stealth trading hypothesis and argue that informed traders who want to avoid detection will break up their trades into several medium-sized trades because small sized trades increase the likelihood that their private information will be revealed too quickly, and large sized trades may have an excessively large price impact.

Madhavan (1992), while focusing on the transactional properties of the market, argues that the quality of information possessed by the market makers and traders significantly influence market depth. This argument corroborates the information asymmetry paradigm of Kyle (1985) and Admati and Pfleiderer (1988), suggesting that adequacy of the institutional infrastructure, including the tightness of disclosure rules and the accounting standards, matter in gaining market liquidity. For example, Ahna and Cheung (1999) observe that low liquidity is implied by a negative relationship between the spread and market depth. In addition, Pagano and Roell (1996) attribute liquidity to the adopted trading system, observing that greater transparency in the trading process enhances market liquidity by reducing the opportunities for taking advantage of less informed or professional participants. On the other hand, Simaan et al (2003) observed that decrease in transparency reduces liquidity in the market. According to Ross and Sera (1995), legal, regulatory, accounting, tax, and supervisory systems influence stock market liquidity. For example, while considering the impact of liberalizing controls on international capital flows through reduction of impediments to repatriating dividends or capital, Levine et al (2005) found that stock market liquidity rose significantly in 12 out of 14 countries that liberalized restrictions on the repatriation of dividends by foreign investors. None of the 14 countries experienced a statistically significant drop in liquidity following liberalization.

Berg and Rietz (2005) posted that information structure with regard to public and private information may affect liquidity of markets. The survey results show that only 76% of the market participants reported basing their trades in at least 50% of cases on information. This explanation is in line with Blanchard and Wolfers (2000) model which shows market price in stock markets tend to be very close to the mean of market participant's beliefs on liquidity of the stock. But Chan (2000) noted that when the supply of a stock is limited, the most optimistic investors will bid up the price and end up holding existing shares.

In addition, De long et al. (1989) stated that, given the fact that the noise traders that act on the market are making unpredictable decisions, prices can be significantly different from the fundamental values. In this context, it is relatively difficult to prove the existing differences between a fair market value and a current price for assets as long as these values are based on current expectations for future earnings. But prices of stocks can follow a random walk, but this random walk can be completely independent of the relevant available information implying that if prices do not fully reflect all available information, the market can over or under react to inaccurate information. Demirguc-Kunt and Levine (1995) also argue that stock trading transmits information about a firm's prospects to potential investors and creditors.

However, Brown et al. (2008) presented that informed traders take on the role of liquidity providers we presume that the significant increase in liquidity combined with a decrease in informed liquidity taking could be associated to informed traders changing behavior in providing liquidity more aggressively in an anonymous environment.

However, Comerton-Forde (1999) find an increase in pre-trade anonymity increases liquidity, while displaying broker identities leads to a decrease in liquidity. But earlier Brockman and Chung (2002) presented that stock liquidity increases incentives for getting information about firms. Brooner (2006) also conducted an experimental analysis concerning the effects of pre trade anonymity. He finds that disclosure of trader's identities reduces the incentive to acquire information, and as a consequence reduces liquidity and volatility. This is in line with Foucault (1999) theoretical model which predicts that anonymity leads to a narrowing of bid-ask spreads. He argues that in a market setting that provides broker identification, informed traders who supply liquidity provide information regarding future price movements.

Datar et al. (1998) suggested that when a stock is traded more frequently, it is easier for traders to close their position and thus more liquidity. But Toni (1999) noted that when the order of a stock can be executed faster, that stock is more liquid. Ngugi (2003) added that there is empirical support for the hypothesis since an increase in the effective supply of securities enhances market liquidity. However, Tinic (1972) states that trading activities of illiquid stocks tend to be more concentrated during the month of earnings announcements than those of liquid stocks. Furthermore, Ying (1996) suggested that investors may have to sell their shares in the future due to liquidity reasons. He assumed that, these investors who trade with informed investors end up losing money on average. In fact, it is their trading loss that compensates the informed investors for their information acquisition cost. He further, noted that, "competition among the informed investors causes their expected trading profit to equal their information acquisition cost". When the volatility of the firm's earning is high private information about the firm is more valuable, and more investors become informed.

Ngugi (2003) also noted that foreign investors are mainly institutional investors and it is argued that institutional investors are attracted to firms with more informative disclosure practices if such disclosures reduce the price impact (the liquid firms). In addition, it is observed that foreign investors" participation result in higher volume traded especially if the entry is coupled with reduced information asymmetry as the regulatory system is strengthened. For example, De Santis and Imrohoroglus (1997) argue that foreign investors broaden the market dampening the effect of order flow shocks on prices, as a result making the prices more efficient by increasing the precision of public information regarding fundamental values. Together with market liquidity, investor sentiment is a significant predictor of stocks performance.

2. 3 Interest rate policy (lending rate and taxation) and performance of the stock markets

According to Santiso (2007), interest rate is a rate which is charged or paid for the use of money. An interest rate is often expressed as an annual percentage of the principal. It is calculated by dividing the amount of interest by the amount of principal. In general, interest rates rise in times of inflation, greater demand for credit, tight money supply, or due to higher reserve requirements for banks. A rise in interest rates for any reason tends to lessen business activity because credit becomes more expensive and the stock market because investors can get better returns from bank deposits or newly issued bonds than from buying shares. .

The first precondition for sound securities market development put forward by Pardy (1992) recognizes the importance of taxation (fiscal environment). The author finds that differential effective tax rates on either income or capital gains from different financial instruments will distort capital raising and investment decisions.

Pardy (1992) supports this conclusion by observing that quite a number of developing countries with state ownership of commercial banks have tax rates that discriminate in favor of savings and demand deposits as opposed to securities investment, and in favor of borrowing from banks as opposed to raising capital from the public. For capital market development, these taxation differentials must be removed. Demirgitc-Kunt and Huizinga's (1992) study has implications for the design of tax policy related to foreign portfolio investment in developing countries. They indicate that the existence of foreign tax credits for dividend taxes paid suggests that a country should tax capital gains lightly in comparison with repatriated dividends.

Brown and Taylor (2010) finds that differing tax treatment of equity and debt can create divergent costs in the use of retained earnings, new share issues and debt finance.

2.3.1 Financial performance of banks in the region

According to Ddumba (2011), ever since Bank of Uganda increased the Central Bank Rate to a staggering 23% from 13% in 2010, banks have taken advantage of the situation and hiked their prime lending rates accordingly. Business Sense has exclusively learnt that Stanbic Bank increased its lending rate to 34%, Centenary Bank from 19% to 23%, Crane Bank from 23% to 28%, Dfcu bank from 23% to 27%, Standard Chartered from 18% to 34%, Barclays Bank from

17.5% to 30% and KCB from 18% to 28%. But by the end of the year, 2011 following the easing of inflationary pressures across the EAC region, EAC central banks reduced their policy rates during 2012/13. However, this did not translate into a similar re-pricing of lending rates by banks. Partly as a result of this, coupled with reduced aggregate demand, bank lending in all the East African countries slumped to lower levels for the period 2012/13 as compared to 2011/2012 with Uganda witnessing the least growth in private sector credit at 6 percent for the period under review. The annual growth rate of credit to the private sector in the year to June 2013 reduced to a regional average of 12 percent as compared to 19 percent recorded in June 2012. There is the risk that any continued stagnation of credit growth may translate into low corporate activity and economic growth.

In the period between June 2012 and June 2013, the ratio of nonperforming loans (NPLs) to total gross loans rose for all the East African countries with Burundi registering the highest NPL ratio of close to 10 percent. As banks continue to reduce lending rates going forward, it is expected that loan performance will improve.

Lending is the principal business activity for most commercial banks. The loan portfolio is typically the largest asset and the predominate source of revenue. As such, it is one of the greatest sources of risk to a bank's safety and soundness. The level of interest risk attributed to the bank's lending activities depends on the composition of its loan portfolio and the degree to which the terms of its loans (e.g., maturity, rate structure, and embedded options) expose the bank's revenue stream to changes in rates. (Comptroller's hand book, 1998: 9)

The key idea of the "credit view" is that due to information and incentive problems in financial markets, a large class of borrowers (particularly households and small firms) cannot readily obtain non bank forms of credit, hence they must rely primarily on banks for external finance. An important implication is that any kind of disruption in the flow of bank credit potentially has important real effects. First, tight policy which causes a drain of reserves from the banking system, may lead banks to contract their loan supply, which reduces investment activities by bank dependent borrowers (the lending channel). Second, tight policy weakens firm balance sheets, thereby increasing adverse selection and moral hazard problems. This leads to decreased lending and hence investment spending (the balance sheet channel). It is anticipated that a credit channel would be relevant in the Ugandan economy, given that all borrowers were primarily dependent on bank lending due to the underdeveloped nature of capital markets. Further, though the banking system underwent restructuring during the review period, bad debts remained a major problem in bank portfolios. For example, non performing loans as a ratio of total loans averaged 27 percent per bank, while some banks recorded ratios of over 80 percent.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

As research methodology refers to a systematic way applied to solve the research problem. This part identifies the general characteristics of the study and the research methods which were used in collection, processing and analysis of data regarding to the assessment of the implementation. It focuses on the research design which briefly explains the plan which used in conducting this study and the methodology which carry the following parts, area of the study, the population of the study, sample size, sampling techniques, methods of data collection and techniques of data analysis and presentation.

3.2 Research Design

The study was a cross-sectional. The unit of inquiry was individuals while the unit of analysis was companies. It was also descriptive to the extent of measuring the level of financial knowledge of the local investors and their perception of the market regulation and incentives. The design was chosen because it was the most appropriate for data collection in this study that was focused on perceptions, facts, feeling, experiences and emotions of the participants. The research questions generated required an analytical perspective in order to describe the current state of affairs, as the participants perceived them. It was also analytical, co relational and explanatory since the relationship between the variables had to be tested.

3.3 Survey population and Sample size

Sample size is a subgroup of the population you are interested from the total population Kumar (2004). According to the Krejice and Morgan (1970) table, the researcher selected a sample size of 52 from a study population of 60 that is (22) from the Capital Market Authority (CMA), (08) from the Uganda Security Exchange (USE), and (30) from the brokerage firms. Kothari (2001) observed that the sample size of the study should be neither excessively large nor too small.

3.4 Sample area and Sampling frame.

The sample area covered the district of Kampala, given that most of the stakeholders in this study are located there. For the purpose of this study the population of the study was from Capital Market Authority (CMA), and the Uganda Security Exchange (USE). Which included (USE) management, (CMA) management, and personnel from the Brokerage Firms were also approached. The mentioned population was chosen because they were the targeted group of this study and key informant for the success of this study.

Thus, the study is limited to the Kampala region only because there is where the capital market of Uganda under this study is found.

3.5 Sampling Procedure

Two sampling techniques were used in the study; purposive and simple random sampling.

3.5.1 Purposive sampling

This was used to obtain key respondents for the interviews. Purposive sampling was used for the qualitative part of the study because the researcher specifically wanted particular people e.g. Investment Managers and the proprietors of various investments and specifically sought them out to participate.

3.5.2. Simple random sampling

This was used to obtain respondents for the questionnaires. Simple random sampling was adopted for the quantitative study to give respondents equal chance of being involved in the study.

3.6 Data collection

Data for this study was collected by using multiple methods in order to improve the validity and reliability of data. This is because each method has its own strengths and weakness. The study used both primary and secondary data. Primary data was obtained by the use of a semi structured questionnaire. The researcher was asking the respondent and fill in the questionnaire on behalf of the respondent. The adoption of this technique gave room for the researcher to assure that the respondents has well understood the question and answers according to the question posed. Also, this technique avoids the non response rates as some respondents have no time to fill the questionnaire. But, before data collection exercise, questionnaire pretesting was done. Four (4) respondents were interviewed to test the validity and applicability of the questionnaires. This had allowed the researcher to assess the average interview time, relevance of the questions to be asked, and how easily the questions will be understood by the respondents. The same was done through two respondents from CMA and the other two from USE.

Secondary data was obtained from various newsletters, reports, and accounts. This helped to identify common issues raised to obtain data on the performance of capital markets in Uganda. All relevant literature was reviewed to provide a basis for interpretation of responses.

3.7 Research Instruments

A self administered questionnaire was used to collect quantitative data. The choice of the questionnaire as a research instrument was because questionnaires are a quick method of collecting data. The target population was literate and capable of filing the questionnaires. The questionnaire was pretested in order to eliminate questions that are vague, ambiguous and leading.

3.8 Data Analysis

Data analysis refers to the computation of certain measures along with searching pattern of relationship that exist among data group. In data processing, after collection of data, the questionnaires were edited to determine the degree of response and the number of usable questionnaires. The data were coded and then entered into a computer data sheet for analysis. The data analysis was done in the computer application known as, the Statistical Package for Social Sciences (SPSS) whereby the results are presented in the form of tables, histograms and pictures if any. The descriptive statistics analysis model was applied.

3.9 Validity and reliability

The researcher distributed the same questionnaire to the different departments under study to ensure accuracy of the data. According to the coefficient of validity index (CVI) the questionnaire was 86.5% reliable to the study.

$$CVI = \frac{\text{items rated relevant}}{\text{Total number of items}} * 100$$

When CVI<=50, it’s rated unreliable while when CVI>=, it’s reliable.

3.10 Ethical considerations

These are research procedures carried out to avoid any cause of physical or emotional harm to the people involved in the research process.

A letter from the faculty was acquired to help introduce the researcher to the organization where the study was to be conducted.

Each respondent was given an opportunity to consent whether to provide information or not and to ensure confidentiality, the questionnaires did not necessitate one to disclose his or her name and information acquired was used only for study purposes.

3.11 Limitations of the study

It should be noted that the study was dealing with a sensitive issue of financing often regarded as highly confidential. As a consequence some respondents may have concealed some of the vital information. There was a misconception about the research. Some respondents thought it was intended to unearth their weaknesses yet others thought that the subject was highly specialized best suited for brokers and dealers. This might have affected the responses. However, the respondents were convinced, and finally allowed the researcher to carry out the study.

Furthermore, some methodological problems may have been encountered. Some data collection methods adopted for the studies have inherent disadvantages: questionnaire retrieving requires frequent reminders.

Responses in questionnaires might have lacked details because they were made without emotional and intellectual support of the interviewer. Selection of purposely chosen respondents is based on the researchers' perception of their being knowledgeable on the subject. This too has limitation.

Personal bias of the researcher may influence the selection. Coding is conceptualizing data by constant comparison of incident within incident, and incident within concept to merge categories and their properties. It is observed that individual categories of responses may show variability in terms of degree of and extent of expression, given that the interviewing process was basically open-ended. It is therefore of importance that the kinds of responses provided were substantiated with clarifications and emphasis to stress the meanings, richness and tones of the textual material included.

The study was confined to Kampala and principally covered local investors registered with the UIA.

Similarly, the study may have been limited by the sample size. The participation is limited to 52 respondents. The researcher was conditioned by limited resources to carry out the study beyond the sample size. This excluded the experience, views, opinions, attitudes and concerns of people elsewhere in the country.

CHAPTER FOUR

PRESENTATION, INTERPRETATION AND DISCUSSION OF FINDINGS

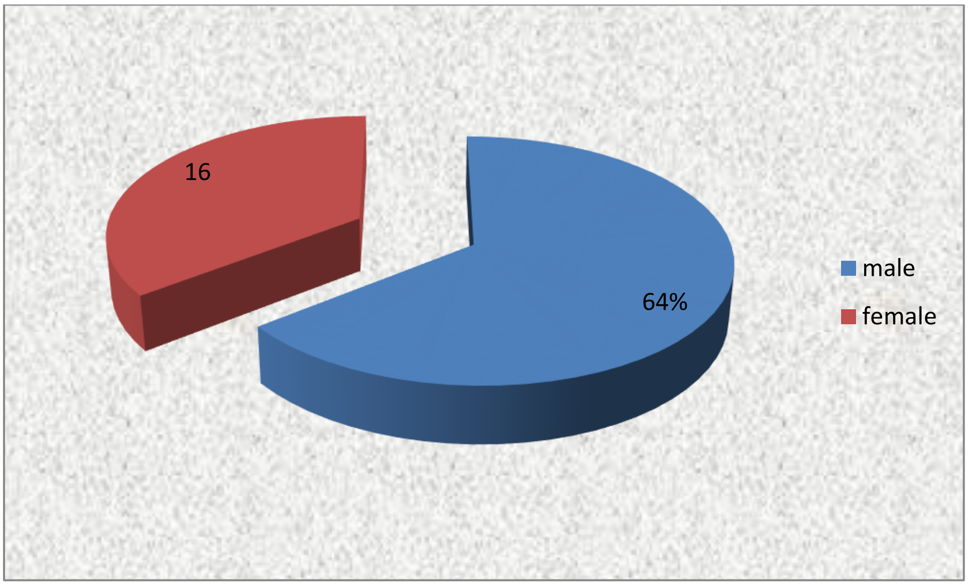
4.1 Introduction

This chapter presents results of the analysis of data that was collected using questionnaires. These results are presented in line with the research objectives. Statistical results presented include frequencies, Pearson's correlation tests. In the same chapter, these results are interpreted.

4.2 Characteristics of the respondents

These are presented using frequency tables below. The characteristics presented include gender, highest education level, and age of respondents.

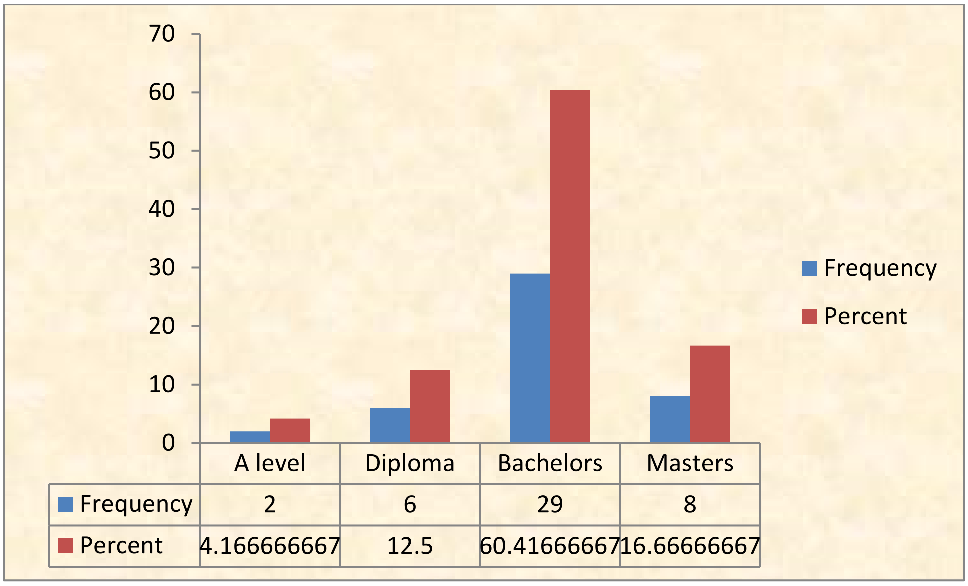
Figure2: Sex of respondents



Source: Primary Data

Results showed that more than half of the respondents are males (64.0%). This implies that Local Investors have more males in positions responsible for finance.

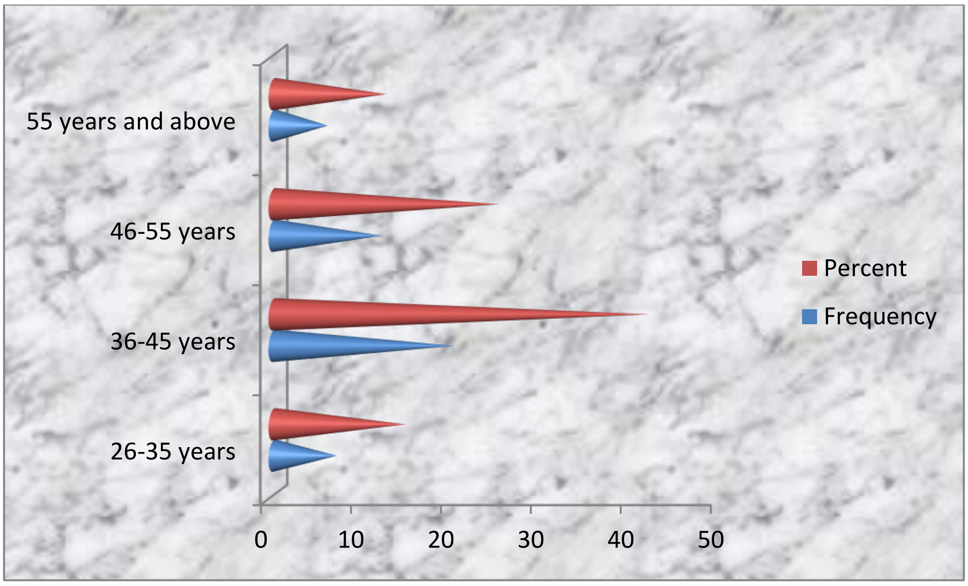
Figure 3: Education Levels of respondents



Source: Primary Data

Results show that more than half of the respondents are degree holders 29(60.4%). This means that local investors recruit highly trained staff with 8(16.7%) having a master's degree.

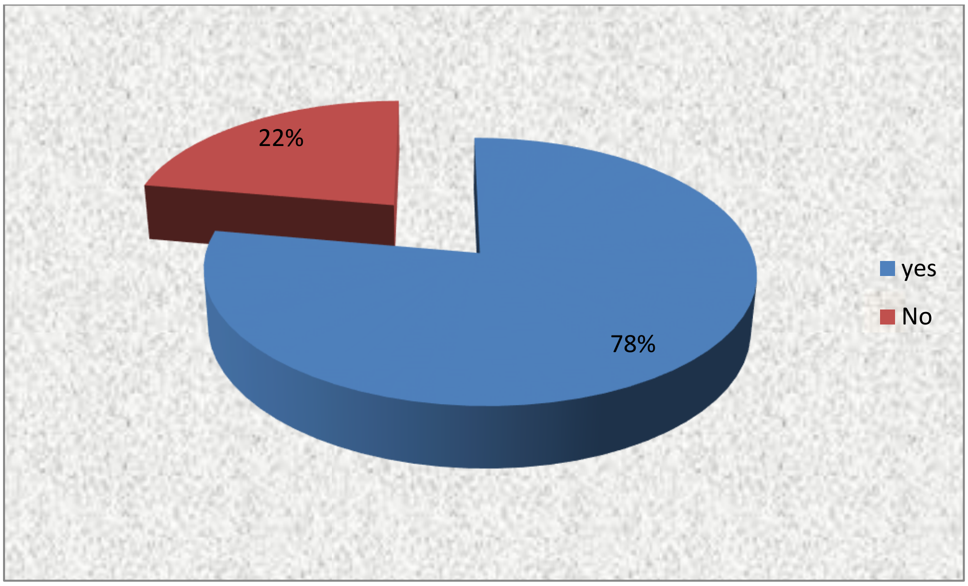
Figure 4: Respondent's Age



Source: Primary data

Results show that more than half of the respondents are above 36 years (41.7%). This means that they have been in the investment field for long and gathered the necessary experience and skills.

Figure 5: Low liquidity in Uganda Security Exchange



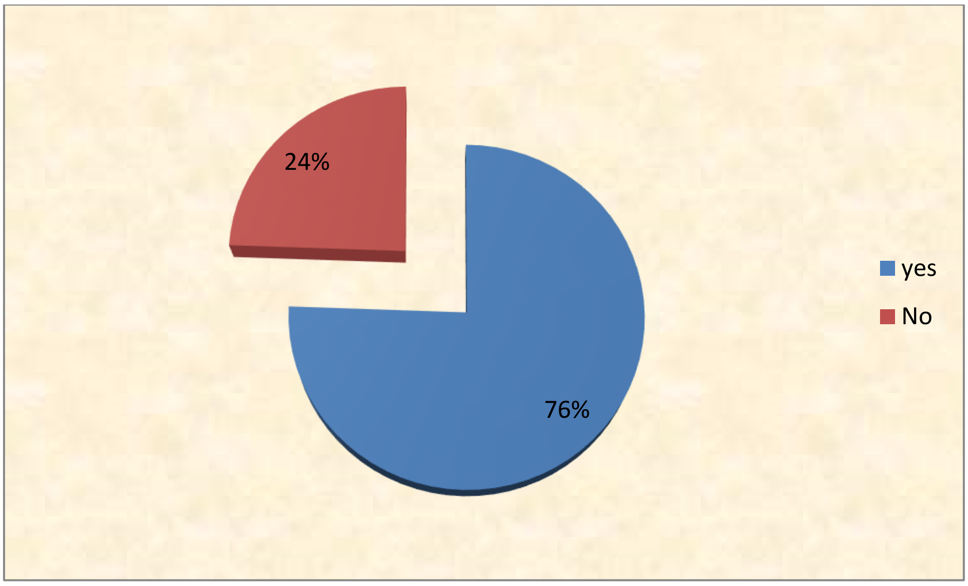
Source: Primary Data

On the problem of liquidity if existing in the USE, most of the respondents from the USE were of the view that the market is illiquid. One respondent indicated that “market is illiquid as there are few tradable securities and few investors too. That major players in the business are the pension funds, which hold assets at certain ratio at marketable prices. Holding assets do not allow easy buying and selling, difficulty in getting new ones. A low free floating hence comes a time that there is no buyer when one wishes to sell.”

4.3 Participation of foreign investors in the Uganda capital market.

Respondents were inquired to provide whether the foreign investors do participate in the Uganda capital market. The findings revealed that, 34 (76%) said Yes, whereas 11 (24%) said NO. For further details see the figure below.

Figure 6: Participation of Foreign Investors in the Capital Market



Sources: field data

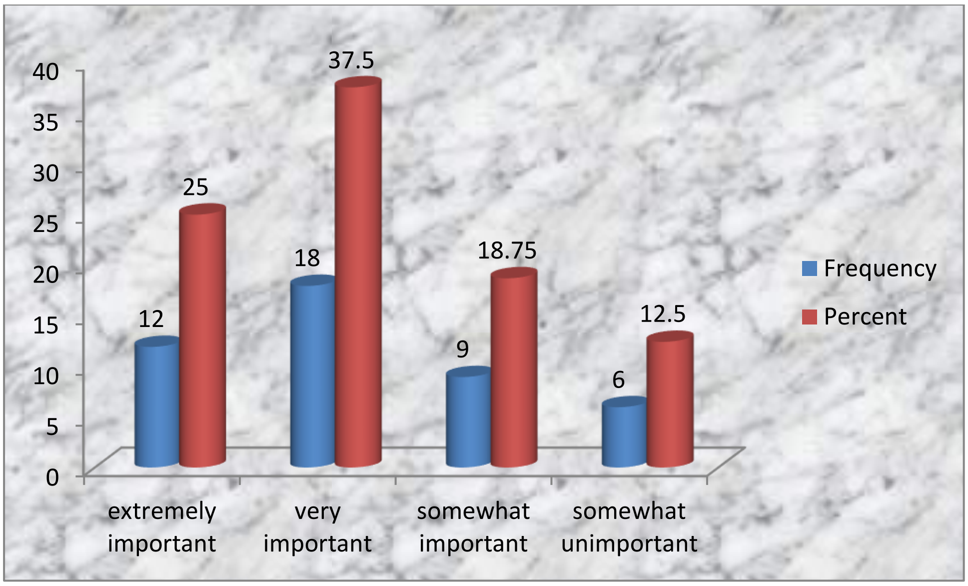
Regarding the participation of foreign Investors in the Uganda Capital Market business, majority of USE stakeholders said there are a certain number of foreign investors in Uganda Stock Exchange, USE. They provided a variety of factors for foreign investors being attracted to the business among them being following the use of Automated Trading System (ATS) in the USE trading patterns. Others indicated that moderation of various areas such as venture capital and institutions, investment banks, corporate bonds, mutual funds, derivative securities led to stable capital market business hence attract foreigners. The number is increasing as from the records of 30th April, 2013.

There are some regulations which hinder further growth like the maximum of holding shares. Some companies may wish to hold more. Like New Vision Printing and Publishing Company Limited have very strategic investors, NVL, participants could be more if the same could be raised. There is a need for further reform of laws so as to attract more foreigners.

4.4 The contribution of Uganda Capital Market to the rise of small and medium enterprises in capital and equity securities.

One respondent from the USE contended: —At the moment no, but he added that in 2010, a study was conducted by Fin scope and the CMA on why the capital market does not grow as expected to be, or what hinders the development of the same. By then, there were only 7 listed companies. The observations of that research were that the country private sector is characterized by SMEs, who do not get shares from the capital market. And that was for the reason of their minimum capitals, number of share holdings, management matters, and tough conditions for the SMEs in listing, etc. From that, it was recommended that the avenues be there for the SMEs to join. The second tier be established, some relaxations hence Enterprise Growth Market.

Figure 7: The general improvement in investor perception of securitization as an investment class



Sources: field data

The findings revealed that, 12 (25%) considered extremely important, 18 (37.5) very important, 9 (18.75%) somewhat important, and 6 (12.5%) somewhat unimportant. Many of the respondents considered investor perception very important in such a way that the government should consider tax incentives to encourage more local investors to participate in the USE.

4.5 The Relationship between financial knowledge, market liquidity and interest rate policy on the performance of the capital markets at USE

To answer this objective, inferential statistics of factor analysis and Pearson's correlation tests was employed

Table 1: Pearson correlation coefficients between financial knowledge, market liquidity, interest rate policy and stock market performance in the USE.

		Market Liquidity	Financial Knowledge	Interest Rate Policy	Stock Market Performance
Market Liquidity	Pearson Correlation	1			
	Sig. (1-tailed)				
	N	45			
Financial Knowledge	Pearson Correlation	.416	1		
	Sig. (1-tailed)	.001			
	N	45	45		
Interest Rate Policy	Pearson Correlation	.261	.003	1	
	Sig. (1-tailed)	.432	.492		
	N	45	45	45	
Stock Market Performance	Pearson Correlation	.344**	.410**	.504**	1
	Sig. (1-tailed)	.000	.000	.001	
	N	45	45	45	45

**. Correlation is significant at the 0.01 level (1-tailed).

*. Correlation is significant at the 0.05 level (1-tailed).

The results given in table 1 above represent the relationships between independent variables and dependant variable (stock market performance). The results are thus interpreted as under:

4.5.1 The relationship between market liquidity and stock market performance.

Results from the same table above revealed that there is a significant positive relationship between Investor's perception of market liquidity and stock market performance in Uganda Securities Exchange ($r = 0.344$, $P < 0.01$). This means that if stock market regulations are made better local investors will be enticed to increase their participation on Uganda security market.

4.5.2 The relationship between financial knowledge and stock market performance at the USE.

The results further shows a positive and significant relationship between investor level of awareness and stock market performance in securities market ($r=0.410$, $P<0.01$).This implies that increased investor's level of awareness is associated with increased companies intention to participate on Uganda securities market. This relationship is consistent with findings of (Harriet Kiwanuka, 2012) who concluded that awareness of market operations is crucial for the success of a securities market and increase in participation of investors in the market.

4.5.3 The relationship between interest rate policy and stock market performance.

Further results indicate a significant positive relationship between the interest rate policy and intention to participate on Uganda security market($r = 0.504$, $P < 0.01$). This means that if companies perceive that there will be market incentives in stock market they will be more willing to participate on Uganda security market. This is consistent with findings in the Lima Stock exchange of Peru, where incentives led to the increase in the amount of trading stock. (IOSCO, May 2002).

4.6 The current status of the capital market development in Uganda.

The researcher asked questions about the current newly emerging capital market challenges and prospects in the Uganda capital market industry. And this explained below is what some of the respondents talked about.

4.6.1 Adoption of sophisticated and automated electronic trading systems in Uganda capital market

On adoption of sophisticated and automated electronic trading systems in Uganda capital market, the researcher asked the respondents to provide whether the Ugandan Capital Market have adopted sophisticated and automated electronic trading system. The findings revealed that 34 (76%) respondents said Yes, whereas 11 (24%) said No. For further details see the table 2 below

Table 2: Adoption of sophisticated and automated e-trading systems

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	yes	34	76.0	75.6	75.6
	No	11	24.0	24.4	100.0
	Total	45	100.0	100.0	

Sources: field data

The findings above from the respondent provide that the Uganda Capital Market has adopted the automated electronic trading system. They indicated that the system was adopted in 2006 which have attracted a number of investors as the statistic data provided by the respondents proves that this led to the increasing number of investors which was 102 in the year 2004 and eventually jumped to 152 in the year 2015.

CHAPTER FIVE

SUMMARY OF FINDS, CONCLUSIONS AND RECOMMENDENTIONS

5.1 Introduction

This chapter is subdivided into summary of findings, conclusions, recommendations and areas for further research.

5.2 Summary of the Major Findings

The findings show that there is low competition in terms of money market, commercial banks, there in mobilizing resources. Most of them see the USE as risk hence they stay away from lending money to the borrowers as they want to raise their capital rapidly. The findings further revealed that "market is illiquid as there are few trade able securities and few investors too. That major players in the business are the pension funds, which hold assets at certain ratio at marketable prices. Holding assets do not allow easy buying and selling, difficulty in getting new ones.

A low free floating hence comes a time that there is no buyer when one wishes to sell. The findings show that those who invest in USE trading companies expect in the immediate or rapid returns, but the expectations of the value or rate of the Uganda shillings are low Comparing to foreign currencies such as the British pound. The purchasing power, for the moment is not much experienced due to the size of the business, if it could be otherwise, it could be worse.

The findings from the study also indicate that the majority of the respondents from USE provided that the government does not give enough support to attract new companies and investors to the stock market. All what the government does is providing a forum at the trade fairs and alike. Based on the challenges the findings show that Court brokers have been complaining on the maximum percentage of the cross listing that the cross listing company cannot share more than 60%. That's according to the current laws, only MIMs may list their shares at the USE, hence the SMEs are not. This is a real challenge to the development.

Moreover the findings of the study reveal that, The CMA respondents indicated that USE have quite a number of professional personnel who work in 5 days in a week, from 10.00 – 12.00 hours, and there is an amendment nearly to be released which will make the working hour be from 10:00 – 14.00 hours for further business expansion.

The findings from the study provide that a majority of the respondents said that the guidelines on corporate governance practices are well adhered. Regarding to the participation of foreign Investors in the Uganda Capital Market business, the majority of the USE stakeholders were of the opinion that there are a certain number of foreign investors in USE. They provided a variety of factors for foreign investors being attracted to the business among them being following the use of Automated Trading System (ATS) in the USE trading patterns. The respondents provided that the East African Community Integration is very much possible and it is in the final stages, as it can be linked through technology, for the current moment what is done is the ongoing harmonization process for the laws of the East African Community countries members. This is expected to be boosted by the establishment of CITI institution which is expected to make all players like Brokers to have the same level of qualification.

The findings above from the respondent provide that the Uganda Capital Market has adopted the automated electronic trading system. They indicated that the system was adopted in 2010 which have attracted a number of investors as the statistic data provided by the respondents proves that this led to the increasing number of investors which was 102 in the year 2002 and eventually jumped to 152 in the year 2013. The study findings therefore revealed that most of the stakeholders see the development of the Uganda Capital market as a growing one, Although the number of listed companies in the stock market is still low being 19, and the number of investors not a big one. The above findings from the study imply that the Uganda Market Capital trade is moderate more than half number of respondents provided so.

5.3 Conclusions:

The findings clearly indicate that there is a significant relationship between financial knowledge and the performance of the USE. The higher the awareness levels the more the possibility of local investors to participate at the USE. Further, there is a significant relationship between market liquidity and stock market performance at USE. To have more local investors participating on the USE, efforts should be directed towards stronger regulation and creation of more awareness.

5.4 Recommendations

From the findings of the study, the following are recommended.

5.4.1 Recommendations to the Government.

Government should provide financial support to Uganda Stock Exchange business to enable them to provide accuracy capital marketing business. Also the government should provide enough education through various media outlets to the stakeholders and the public at large on the importance of engaging in the capital market business for the blossom of business and peoples' financial wellbeing at large.

5.4.2 Recommendation to the Uganda Stock Exchange

The USE should be demutualised as demutualization (the private system of the business being run independently) has proven success among other stock exchanges around the varieties of countries in the world. This will bring independence in decision making for the blossoming of USE in specific and Uganda capital market at large. The diversifying of the products which are available to the potential investors is something very essential to the USE too. For example, the establishments of over the counter market for the small and medium size businesses those who are currently not eligible to list at the USE may easily boost the activities in the market. Even products in the agricultural sector may be of much attraction to the investors.

5.4.3 Recommendation to the CMA

5.4.3.1 Reformation of financial regulations.

As per the IOSCO and its principles, the funds are always essential prerequisites to the proper implementation of rules governing the business and that is why it was argued that establishing the Agencies or institutions require the source of fund to maintain and sustain them in terms of legal, administrative, organizational structure, personnel trainings and other related to its operations.

5.4.3.2 Capacity Building is also essential for the market development.

As at the CMSA and the DSE, capacity building is essential in order to facilitate the effective conduct of their operations and the implementation of the marketing campaigns, the study finds that through hiring staff members who are well trained in marketing, research and market analysis, the same can be easily achieved.

5.5 Areas for further studies

Basing on these findings, the following areas for further studies are suggested;

The possibility of East Africa capital market and its possible challenges.

The impact of Uganda Capital Market on the rise of small and medium enterprises in capital and equity securities.

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APPENDENCES

APPENDIX 1: INTRODUCTION LETTER

Uganda Martyrs University

making a difference

OFFICE OF THE DEAN FACULTY OF SCIENCE
Email: deanscience@umu.ac.ug

Date...12/ APRIL / 2016...........

To... HUMAN RESOURCE MANAGER....
UGANDA SECURITY EXCHANGE.....
....

Dear Sir/Madam,

Re: Assistance for Research

Greetings from Uganda Martyrs University.

This is to introduce to you ....CHESANG EDNA MARY.......................... **Registration Number;**....2013 - B061 - 10083.........................., a third year student pursuing a Bachelor of Science degree in ....FINANCIAL MATHEMATICS.... of this University. She is carrying out a research on the topic "....FACTORS AFFECTING THE PERFORMANCE ......OF CAPITAL MARKETS IN UGANDA..." as part of the curriculum requirements for the award of Bachelor of Science Degree of this University.

I, kindly, request you to render her such assistance as may be necessary for the research.

Thanking you in anticipation.

Yours sincerely,

Dr. Richard Awichi
Dean

UGANDA MARTYRS UNIVERSITY
12 APR 2016
FACULTY OF SCIENCE
OFFICE OF THE DEAN
SIGN:..

Uganda Martyrs University P. O. Box 5498 - Kampala - Uganda
Tel: (+256)038-410611 Fax: (+256)038-410100 E-mail: umu@umu.ac.ug

APPENDIX 2: RESEARCH QUESTIONNAIRE

Title of the study: Factors affecting the performance of capital markets in Uganda.

Case study: Uganda security exchange

I, CHESANG EDNA MARY, conduct this study for academic purposes only. The purpose of this study is to understand the factors affecting the performance of capital markets in Uganda. You are among the Uganda Security Exchange top management staffs who are well knowledgeable about this Uganda capital market. I therefore kindly request you to respond to the following questions to the best of your knowledge. I promise and assure you that all the answers will remain confidential and will only be used for the purpose of this study.

SECTION A: PERSONAL PARTICULARS

SEX: MALE FEMALE

AGE

25 YEARS AND BELOW

26- 35 YEARS ☐

36-45 YEARS ☐

46- 55 YEARS ☐

55 YEARS AND ABOVE. ☐

HIGHEST EDUCATION LEVEL ATTAINED:

O -LEVE L ☐ A- LEVEL ☐ DIPLOMA ☐

BACHELORS DEGREE ☐

MASTERS DEGREE ☐ OTHER (SPECIFY)

SECTION B: FINANCIAL KNOWLEDGE

1. What is your overall knowledge of investments?

☐ None

☐ LOW

☐ MEDIUM

☐ HIGH

2. Have you participated in the securities market (i.e. bought or sold shares, treasury bills, bonds etc)? Please tick ( ) where applicable

Yes ( ) No ( )

If Yes, please go to question 3 and follow to the end skipping question 3d only. If No, please go directly to question 5a and follow through the end.

3. What proportion of your current investment is in?

Current investment	Proportion (%)
Shares	
Treasury bills	
Bonds	
Others (please specify e.g. buildings)	
Total	100

1. [1%-25%] 2. [26%-50%] 3. [51%-75%] 4. [76%-100%]

3a.One of the factors that influence the choice of investment is the payback period or the case of treasury bills and bonds, the period to maturity. Please indicate your preferred payback/period to maturity.

Area of investment	preferred payback period in years				
	1	2	3	4	5
Shares					
Treasury bills					
Bonds					
Others					

3b. Please indicate in the table below, the estimated proportions of your current investments by the issuer of securities

Category of issuer	Proportion (%)
Gov't/ BOU Treasury bills	
Uganda clays	
British American Tobacco	
E A Breweries Limited	
Kenya Airways	
PTA Bond	
Total	100

If you have participated in the securities market already, please skip Question 3c and proceed with Question 3d

3c. Given the relatively higher returns on investment and the lower cost of capital in the securities market, than return form e.g. a savings account at a commercial bank, would you consider participating in the securities market in future?

Yes (   )   No (   )

If Yes, please go to Question 3d and follow through. If No, please go to Question 3f and stop.

3d. Is your company willing to issue securities on the market?

Please tick where applicable

Yes (   )   No (   )

3e. If yes, please indicate the period from now, when you intend to issue by ticking where applicable

Period in years	
1	
2	
3	
5	
10	
Others (please specify)	

3f. What is the current status of the Uganda capital market? Is it improving? Has the government taken any measures to introduce the automated electronic trading system?

3g. Please give reasons why you would not want to participate in the securities market?

SECTION C: INTEREST RATE POLICY

4. In an effort to grow your wealth, can you afford to lose any money over the next two years?

Yes (   )   No (   )

5. Looking forward, for each of the following, please indicate how important, in your opinion, each is to increasing issuer participation in securitization markets:

1. Extremely important 2.Very important 3.Somewhat important 4.Somewhat unimportant 5.Not at all important

	5	4	3	2	*1*
Increased availability of assets to be securitized					
Improved macroeconomic factors					
Availability of funding alternatives, such as central bank funding, covered and corporate bonds					
General improvement in investor perception of securitization as an investment class					

SECTION D: MARKET LIQUIDITY

6. Do you think there is adequate competition within the financial sector in the country which can affect the prevailing deposit and lending interest rates?

a) YES b) NO

If NO, what should be done to encourage competition?

7. Is the problem of low liquidity in USE still existing?

a) YES b) NO

If YES, why?

8. Has the government taken any measures to attract new companies and investors to the stock market?

a) YES b) NO

If YES, what are those measures?

9. Have the capital market structures of USE increased since its establishment?

a) YES b) NO

If YES, mention all the existing structures!

10. How do you see the weakness of the Ugandan currency and the inflation in attracting long-term investments in the capital market?

11. Does the capital market of Uganda allow small and medium enterprises to raise capital in the form equity securities?

a) YES b) NO

If YES, when did that start?

12. Currently, are there foreign investors participating in the Uganda capital market as attracted by various things such as venture capital and institutions, investment banks, etc?

a) YES b) NO

SECTION E: STOCK MARKET PERFORMANCE

5. Strongly disagree 4. Disagree 3. Uncertain 2. Agree 1. Strongly agree

	Elements	5	4	3	2	1
	Transaction costs:					
	The cost of reading the market (USE) is low					
	The brokerage cost is low					
	The commission paid for securities at the USE is low					
	The asset transfer costs for securities at the USE is low					
	Market Depth:					
	The current number of buyers at the USE is not enough					
	The current number of sellers at the USE is not enough					
	Information availability:					
	Information on the volume of past transactions					
	Information about the prices of the past transactions					
	Information about the current outstanding bids or offers					
	The prevailing price of securities reflects the information available to investors.					

Thank you very much for your time and cooperation!

APPENDIX 3: INDEX

Market listing

COUNTER	ISIN	FULLNAME
ALSI	UG0000000071	USE All Share Index (100@31.12.2001)
BATU	UG0000000022	British American Tobacco Uganda
BOBU	UG0000000055	Bank of Baroda Uganda
DFCU	UG0000000147	Development Finance Company of Uganda Ltd
EABL	KE0009081092	East African Breweries Limited
JHL	KE0000000273	Jubilee Holdings Limited
KA	KE0009081084	Kenya Airways
NVL	UG0000000162	New Vision Printing and Publishing Company Ltd
SBU	UG0000000386	Stanbic Bank Uganda
UCL	UG0000000014	Uganda Clays Limited
EBL	KE0000000554	Equity Bank Limited
KCB	KE0000000315	KCB Group
NIC	UG0000000758	National Insurance Corporation
NMG	KE0000000380	Nation Media Group
CENT	KE0000000265	Centum Investment Company Ltd
USE LCI	UG0000000881	USE LOCAL COMPANY INDEX
UMEM	UG0000001145	UMEME LIMITED
UCHM	KE0000000489	UCHUMI

Source: (September 2015) Uganda Securities Exchange.

APPENDIX 4: KREJICE AND MORGAN (1970) TABLE

N	*S*	*N*	*S*	*N*	*S*
10	10	220	140	1200	291
15	14	230	144	1300	297
20	19	240	148	1400	302
25	24	250	152	1500	306
30	28	260	155	1600	310
35	32	270	159	1700	313
40	36	280	162	1800	317
45	40	290	165	1900	320
50	44	300	169	2000	322
55	48	320	175	2200	327
60	52	340	181	2400	331
65	56	360	186	2600	335
70	59	380	191	2800	338
75	63	400	196	3000	341
80	66	420	201	3500	346
85	70	440	205	4000	351
90	73	460	210	4500	354
95	76	480	214	5000	357
100	80	500	217	6000	361
110	86	550	226	7000	364
120	92	600	234	8000	367
130	97	650	242	9000	368
140	103	700	248	10000	370
150	108	750	254	15000	375
160	113	800	260	20000	377
170	118	850	265	30000	379
180	123	900	269	40000	380
190	127	950	274	50000	381
200	132	1000	278	75000	382
210	136	1100	285	1000000	384

Note.—*N* is population size. *S* is sample size.

Source: Krejcie & Morgan, 1970