PROSPECTIVE PERFORMANCE OF A DEMUTUALISED STOCK EXCHANGE

A case study of Johannesburg Stock Exchange.

By

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A Dissertation Submitted in Partial Fulfillment of the Requirements for the Award of Masters Degree of Science in Accounting & Finance

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CERTIFICATION

We, the undersigned, certify that we have read and hereby recommend for acceptance by the Mzumbe University a dissertation entitled, "***Prospective performance of a demutualised stock exchange''***: *A case study of Johannesburg Stock Exchange*, in partial fulfillment of the requirements for the of Masters of Science in Accounting and Finance of Mzumbe University.

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I **Unguu Ramadhani**, declare that I am the sole author of this dissertation, that during the period of registered study I have not been registered for other academic awards or qualification, nor has any of the material been submitted wholly or partly for any other award. This dissertation is a result of my own research work and where other people's research was used, they have been dully acknowledged.

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Date -- 2013

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Glory goes to God who gave me wisdom, guidance and the strength to complete this work. Without His powers nothing would have been done.

DEDICATION

To my beloved Mother **Asia Ally Hassan** who sent me to school and my treasured wife **Fatma Masoud** and my lovely daughter **Irfan’a Unguu Sulay**, last but not least my brother **Jumanne Feruzi** and **Sister Grace Kasumba**.

ABSTRACT

Interest in the subject of demutualization of stock exchange in African stock markets is fairly growing but still at nascent stage. Only two stock exchanges have formerly demutualized namely Johannesburg Stock Exchange and Nairobi Stock Exchange (Lumumba, 2013). Nigeria Stock Exchange has recently embarked on the demutualization process (www.nse.co.ng). At present, most African stock exchanges operate as mutual companies (see table below). Mutual funds were once the most important vehicles of investment. For instance, in the United States, ownership of stock, bond and money market mutual funds rose from 6 percent of the US households in 1980 to 37 percent in 1996 while the total assets held by mutual funds soared by 2,100 percent from $135 billion to $3.5 trillion at the end of 1996 (Alexander et al. 1998). The basic characteristics of a mutual company are those companies which do not have shareholders and share capital. The mutual company is a company owned and managed by the members.

The study analyzed the post demutualization stock performance and operating performance of JSE in comparison with pre-demutualization period. A case study design of JSE was used in analyzing data by using descriptive statistics and hypotheses tested by using Chi square test.

In this study the demutualized governance structure coupled with directors' performance revealed that the same add value to the overall performance of a stock exchange, this has been supported by improved performance of JSE soon after demutualization.

The findings in transparency and disclosure as obtained from the case study and responses to questionnaire by respondents suggest that for a demutualized exchange to achieve its demutualization objectives the same has to comply with regulatory bodies' transparency and disclosure requirements and strive to raise the bar in a continuous improvement basis. Also the study indicates internal control policies and procedures must be adequate to identify potential errors, fraud, or illegal acts.

In concluding this research report the researcher earmarked the importance of appointment/selection of new directors and advised that the boards should seek to ensure potential appointees best match the needs of the stock exchange

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ABBREVIATIONS

ASX	Australia Stock Exchange
BESA	Bond Exchange of South Africa
BoD	Board of Director
BRVM	Bourse Regionale des Valeurs Mobilieres
CBT	Chicago Board of Trade
CME	Chicago Mercantile Exchange
CSX	Chicago Stock Exchange
DSE	Dar es Salaam Stock Exchange
ETS	Electronic Trading System
FSB	Financial Services Board
FDI	Foreign Direct Investment
IPO	Initial Public Offer
JSE	Johannesburg Stock Exchange
LSE	London Stock Exchange
NSE	Nairobi Stock Exchange
RSS	Registrar of Securities Services
SRO	Self Regulatory Organization
TCC	Tanzania Cigarette Company
TCCL	Tanga Cement Company Limited
TSE	Toronto Stock Exchange

CHAPTER ONE

1.0 INTRODUCTION

1.1 Demutualization of stock exchanges

Until early 1990's most of World stock exchanges were non-profit, mutual organizations with monopoly power owned by their members. The demutualization of stock exchanges is therefore a recent new phenomenon in the economic world. Demutualization is therefore the process by which the member/broker-held exchange will change its legal existence from a mutually-held organization to a competitive joint-stock company whereby its shares will trade publicly.

The most important characteristic of mutually owned stock exchange is a very strong and close identity between the owners of the stock exchange and its clients, final consumers of its trading services, because usually, the owners are at the same time its clients, sharing the profits of the company in accordance with the level of their participation in the ownership.

Due to the recent years' technology improvements and competitive environment changes, new opportunities alongside with new threats were created for stock exchanges. As an answer to these new threats stock exchanges began to change their ownership organizational form. This study used descriptive statistics analysis using the examples of Johannesburg Stock Exchange to show that demutualized exchanges have a better post listing share and operative performance than mutual exchanges.

1.2 Statement of the Problem

Tanzania's Dar es Salaam Stock Exchange (DSE) was incorporated in 1996 as a company limited by guarantee without a share capital. It became operational in April, 1998. The DSE is a non-profit making body created to facilitate the Government implementation of the reforms and in the future to encourage wider share ownership of privatized and all the companies in Tanzania. (www.dse.co.tz).

The securities currently being traded are Ordinary Shares of 14 listed companies, 5 corporate bonds and 8 Government of Tanzania bonds.

In May 2012 the DSE circulated a memo to its stakeholders showing its interest to demutualize, in this memo it requested member companies to state the possible benefits that it thought would come out of demutualization process. Being a manager of Financial Planning and Analysis at Tanzania Cigarette Company (TCC) by then, the researcher was involved in responding to the memo. In the process he could not answer one critical question, which triggered his interest in undertaking this study.

As a researcher he intended to answer the following question; Does the effectiveness and performance of a stock exchange increase after it changes its ownership form from mutual to for-profit? To answer this question he analyzed the post listing performance of Johannesburg Stock Exchange and evolution of its main performance indicators using descriptive statistics.

Now that DSE is thinking of demutualizing and the fact that the general public has very limited knowledge about the benefits of the same in ensuring effectiveness and performance of a stock exchange, The researcher found it necessary to bridge this gap by carrying out a study.

1.3 General objective of the study

The main aim of this study was to evaluate the impact of corporate ownership structure on the overall performance of the stock exchanges. This study would in particular distinguish between mutual versus demutualized ownership.

1.3.1 Specific objectives of the study

This study was guided by the following specific objectives:-

- To examine the governance structures in pre and post demutualization periods
- To examine the extent to which the new ownership structure provides leadership, control of the businesses, monitoring managerial performance and optimization of shareholder’s value.
- To examine whether shareholders and other stakeholders are satisfied with transparency and disclosure of stock exchange performance.

1.3.2 Research Questions

In order to address the above specific objective the following research questions were asked:

- What is the governance structure in pre and post demutualization periods?

i. Are there any changes in the governance structures (Board of Directors and its committees) after demutualization?

ii. Does the company have a succession plan for key positions including board chair and chief executive officer?

iii. Does the Board have in place an effective Corporate Governance committees constituted in accordance with best practice?

- Does the post demutualization structure provide sufficient leadership, control of the business, monitoring of managerial performance and optimization of shareholders' value?

i. Do the company directors (post demutualization) understand their roles and responsibilities in the running of the stock exchange?

ii. Does the new board undertake a review of its effectiveness?

- Are shareholders and other stakeholders of stock exchange satisfied with post demutualization transparency and disclosures?

i. At what extend has demutualization improved transparency in stock exchange affairs?

ii. Which actions are taken by the demutualized stock exchange to improve investors' confidence?

1.4 Research Hypotheses

Based on the above research questions, the following hypotheses were formulated and tested.

H_1: Changes in governance structures of stock exchange and its directors' performance enhances overall performance of stock exchange.

H_2: Transparency and disclosure of stock exchange's information enhances its performance.

1.5 Significance of the Study

The study has the following significance:-

- To assess Ownership structure's roles in enhancing stock exchange performance
- To come up with suggestion on how to approach demutualization process
- To stimulate further researches in demutualization of stock exchanges in Tanzania
- As partial fulfillment of Master of Science in Accounting and Finance of Mzumbe University

1.6 Research scope

The research study covered on how changes in ownership structure of stock exchange enhance its performance. In this study the researcher used the case study of Johannesburg Stock Exchange (JSE) which fully demutualized July 1, 2005. The insights obtained from the study can be used as preparatory advice to DSE which has shown interest in demutualization.

1.7 Measurable variables

The researcher conducted his research on the following variables:

- The set up of post demutualization governance structures (independent variable)
- Stock exchange director's performance (independent variable)
- Stock exchange performance (Dependent variable)
- Transparency and disclosure (Intervening variable)

1.7.1 Measurement procedure

The following procedures were followed in measuring the above variables:

a) Set up of post demutualization governance structures

This was measured by assessing the governance structure of JSE soon after demutualization in comparison to pre-demutualization one. Assessment on structural effectiveness to support JSE's performance was also earmarked.

b) Stock exchange directors performance

This was measured by evaluating JSE's post demutualization performance and how the board members understand their roles and responsibilities in attracting new investors, as well as reviewing the integrity and adequacy of the company's internal controls and understanding the competitive environment in which JSE operates.

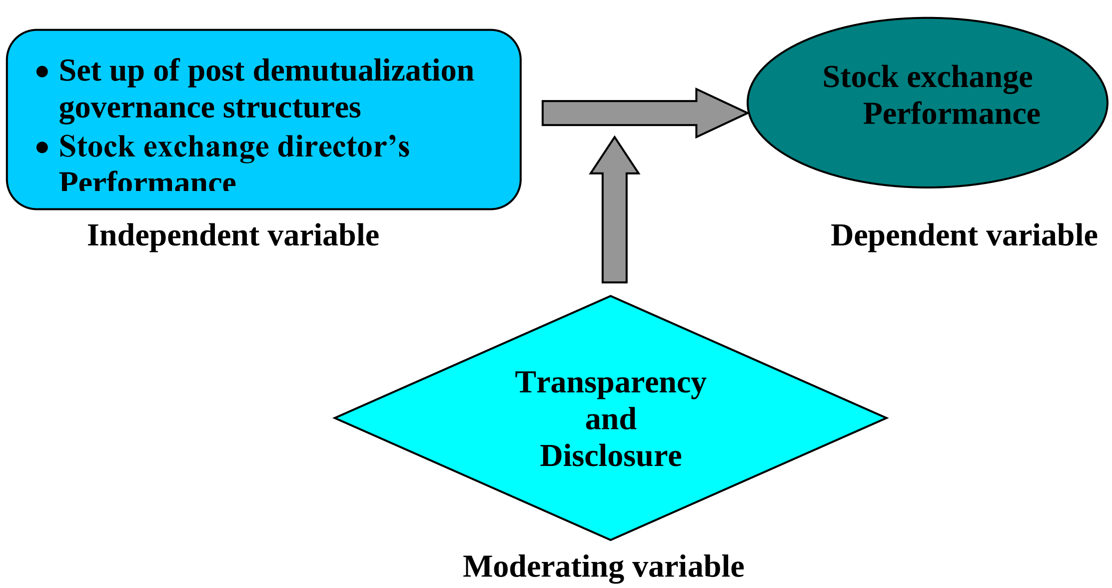
c) Stock exchange performance

This was measured by assessing the stock's share price and operational performance after demutualization process.

d) Transparency and disclosure

This was measured by assessing the flow of information regarding JSE as well as if there are proper internal controls policies and procedures in identifying potential errors and fraud.

Figure 1: Measurable variables (Source: Researcher's own design)



CHAPTER TWO
LITERATURE REVIEW

2.1 Theoretical literature review

2.1.1 Forms of stock exchange ownership

At present, most African stock exchanges operate as mutual companies. Mutual funds were once the most important vehicles of investment. For instance, in the United States, ownership of stock, bond and money market mutual funds rose from 6 percent of the US households in 1980 to 37 percent in 1996 while the total assets held by mutual funds soared by 2,100 percent from $135 billion to $3.5 trillion at the end of 1996 (Alexander et al. 1998). The basic characteristics of a mutual company are that the company does not have shareholders and share capital. The mutual company is a company owned and managed by the members.

However, since recently due to globalization, competition and advances in technology of trading securities, stock exchanges have been involved in the process of demutualization. Demutualization is a process by which a mutual company changes to a company with shareholders and share capital. In other words, it is a process of change from a member-owned and managed to a For-profit, shareholder-owned corporation. During this process stock exchanges streamline governance issues relating to ownership and management, improve and expedite decision-making, and raise new capital. In sum, demutualization

refers to the entire process of changing the legal structure of a stock exchange from a mutual association, with one-vote per member and usually consensus based decision-making to a company limited by shares, with one-vote per share and with majority decision-making (Onyuma, 2006).

Akpesey (2008) argues that mutually owned exchanges have served their purposes, and markets are increasingly recognizing that a trading infrastructure, as well as modern corporate and governance structure, is essential to reducing transaction costs, attracting the funds of investors, and attracting new firms to raise their capital requirements. Accordingly, globally, stock exchanges have been involved in massive demutualization exercises particularly since the beginning of the 21st century. However, changes in the governance structure through demutualization are not with out challenges. McDowall (2004) argues that while exchange demutualization may unlock capital and bring attendant benefits in terms of responsiveness to customers, rewarding participants for usage and improved decision making, it does pose challenges in terms of governance, reconciliation and management of a wider range of interests and stakeholders. Thus demutualization is not in itself a long-term panacea. In some instances, the historical mutual structure was considered to be a better business model.

Ownership Characteristics of African Stock Exchanges

Country	Ownership Characteristics
Botswana	• Established by statute (Botswana Stock Exchange Act, 1994) as body corporate • Statutory body Committee of Botswana Stock Exchange manages exchange • 3 members appointed by Minister of Finance • 2-6 elected from membership of stock exchange
BRVM	• Private corporation • 13.5% owned by the West African Economic and Monetary Union (WAEMU) • Remainder distributed among brokerage firms, chambers of commerce and industry, subregional institutions and other private institutions or WAEMU companies
Egypt	• Mutual; Member-based
Ghana	• Company limited by guarantee • Member owned
Kenya	• Registered under the Companies Act in 1991 as a company limited by guarantee • Demutualized in 2011
Mauritius	• Shareholder owned • Trading membership separate from ownership
Namibia	• not for profit • comprises 43 associate members (banks, listed companies, investment institutions, etc.) • Executive Committee of nine members of the business community, representing different business sectors, and the tenth member represents(Namibia Financial Institutions Supervisory Authority, • Regulated by the Stock Exchanges Control Act (1985, amended 1992)
Nigeria	• Limited by guarantee

	• Mutual, member based • Recently embarked on demutualization (2012)
South Africa	• Demutualized in 2005
Tanzania	• Incorporated in September 1996 as a private company limited by guarantee and not having a share capital under the Companies Ordinance (Cap. 212).
Zimbabwe	• The ZSE is regulated by the Zimbabwe Stock Exchange Act Chapter 24:18 of 1996. It operates under the supervision of a nine member Committee comprising of 2 members appointed by the Minister of Finance and not less than 4 and not more than 7 members elected from within the stock broking fraternity.

Source: Developed form Mensah's report

2.1.2 Global trends in exchange demutualization

Due to a growing competitive environment, globally stock exchanges are overhauling their corporate governance structures. This involved the demutualization of an increasing number of stock exchanges in EU, United States, Asia and Oceania. This process saw the decline in conventional mutually owned stock exchanges in favour of those non mutually owned and operated. According to Onyuma (2006), between 1999 and 2003, the number of exchanges organized as mutuals fell from 40 to 25 while the sum of those demutualized and publicly listed rose from 10 to 25 in the same period.

Although, the wave of demutualization started after 2000, some stock exchanges felt the need to demutualize earlier. In this regard, the Stockholm Stock Exchange is often cited as the pioneer in this area as it demutualized and restructured its corporate governance in 1993. Several other exchanges in Oceania (ASX), Canada (TSE), Europe (LSE), Asia Pacific (HKEs. SGX) and Africa (JSE) followed suit later (Onyuma, 2006). In Europe Deutsche Borse demutualized in February 2001 and led the way for the most recent wave of demutualization. It was followed later the same year by Euronext and the London Stock Exchange. Both the Chicago Mercantile Exchange (CME) and the Chicago Stock Exchange (CSX) have also demutualized, in 2002 and 2005 respectively (Delany, 2005).

Delany (2005) further states that there are three reasons advanced by exchanges for demutualization. Firstly, the desire to be more commercially nimble and respond to market needs more quickly, unimpeded by member committees and their diverse interests. Secondly, demutualization would give access to the capital markets for fund raising. Thirdly, being publicly quoted would also give exchanges and their management a clearer idea of what exactly they were worth. In addition to these, demutualization has increased competition between exchanges for market share, as investors demand a return on their investment.

However, demutualization also brings potential problems. One of such problems is the divergence of interest between shareholders and members. What a shareholder wants and what a member wants are not the same thing. The loyalty of the new share holders in the national stock exchange is questionable.

Empirical research evidence on the effects of the loyalty of shareholders on the stock return volatility is limited. However, the pressure to maximize return for demutualized funds investors may have contributed to the current global financial turmoil by encouraging business decisions with higher risks. However, further research is needed to provide supporting evidence.

2.1.3 Forces behind demutualization of stock exchanges

Technology improvements, increasing economic competition and the associated costs led stock exchanges to revise their entrepreneurial strategies. As an answer, a large number of stock exchanges have demutualized (Aggarwal, 2002). Besides, the increasing conflicts in the stock exchanges member's interests and tough competition led to a reduction in the stock exchanges wealth. As a result, this led to a change in the stock exchanges governance structure, or saying it otherwise to demutualization (Serifsoy, 2006). At the beginning, stock exchanges were conducted as non-profit firms with significant membership fees being charged for the access to trading floors. The rise of electronic trading systems (ETS) allowed a reduction of the marginal cost close to zero for accepting a new member which at its turn is a motive for demutualization. In addition many of the largest institutional traders have developed capabilities to "internalize" a large volume of trade wherein they can match the buy and sell orders without going to the exchange. These developments have strained the traditional organizational structure of stock exchanges.

Alongside with other factors that fastened up the demutualization, for example such initiatives as the Single European Market, and the Big Bang reforms in United Kingdom, made securities trading much more competitive.
African stock exchanges have followed suit of what happened in the developed world, this is because the world economy is now integrated with FDIs coming to Africa.

2.1.3.1 Increasing role and competition from alternative trading systems

The technological improvements from the last decade offered the possibility of conducting trades using remote connections and thus a number of alternative trading platforms have risen. This fact put a lot of pressure on the traditional stock exchanges in the way that they were pushed to adopt new and more efficient electronic trading systems. One interesting fact is that in Europe where the process of demutualization started much earlier than in the rest regions of the world the weight of the ECN's is still very small and not significant (Serifsoy, 2006). By following the demutualization path the European stock exchanges were able to gain more operational freedom. The new electronic trading systems which were adopted by stock exchanges allowed them to reduce the importance of regional location in the process of executing trades. In return this put a lot of pressure on small regional exchanges, because the liquidity began to move towards larger exchanges. As a result the change in the organizational structure from mutual to publicly-listed companies opened for these exchanges the opportunity of undertaking mergers and acquisitions just to face this growing threat. Also by adopting the new technological developments the stock exchanges could thus integrate better their trading activities with clearing and settlement, which in turn also led to consolidation in the securities industry.

2.1.3.2 Mergers among financial exchanges around the world

Mergers and acquisitions also can be viewed as a factor that fastened the process of demutualization, because this give the opportunity for stock exchanges to face reality of the changes in the economic environment, enhance available synergies and even to survive. From the most recent merger news NASDAQ Stock Market declared that it is now in the last stage of definitive agreement with Philadelphia Stock Exchange concerning the acquisition of the later one. This step definitely points that NASDAQ at the moment is seeking alternatives of diversifying its activities from only cash equity trading to also the equity option trading. Also alongside with Philadelphia Stock Exchange acquisition, NASDAQ was engaged in a deal with Borse Dubai concerning the takeover of Scandinavian exchange operator OMX. On May 25, 2007 NASDAQ agreed to buy the Swedish-Finnish financial company that controls 7 Nordic and Baltic stock exchanges OMX for USD 3.7 billion to form NASDAQ OMX Group. As of February 27, 2008, the deal has just been completed. This deal supposes that Borse Dubai after the acquisition of OMX will pass it to NASDAQ for 19.9% of the newly created company alongside with the 28% of NASDAQ share in London Stock Exchange. Also during the recent years world's biggest futures exchange was created as a result of the merger of the Chicago Board of Trade (CBT) with the Chicago Mercantile Exchange (CME). From other mergers plans there were announced some rumours about a possible partnership of Bursa Malaysia with CME. The possible partnership with Bursa Malaysia is explained by the fact that Bursa Malaysia at the moment is looking for new sources for expanding its business just in order to face the competition from Singapore Exchange, its neighbour, which had a very high growth in option trading in the recent years.

The present tendencies show that the factors that have supported the demutualization of stock exchanges are going to be important in the future as well. The non-profit organization structure is in many aspects too limited and is frequently driving to decision blocking as competing interests influence the stock exchange strategy. Most of stock exchanges have accepted this and already transformed themselves into for profit corporations (Aggarwal, 2006).

2.1.4 Managing post demutualization conflict of interests

Many observers believe for-profit exchanges exacerbate the conflicts of interests between the business of operating a market and the responsibilities of acting as a frontline regulator and that the core regulatory issue that demutualization raises is whether for-profit exchanges will continue to effectively perform their regulatory and public interest responsibilities.(Carson,2003)

Concerns about conflicts of interest are generally lower in futures markets because the markets are not as regulated as securities markets. Futures markets participants are mainly professionals and made up of sophisticated players. Retail investor participation is small. Also, the regulatory framework is different because futures exchanges have no capital formation role, and the contracts are a product created by the exchanges. The difference in approach is more evident in the U.S. where futures exchanges are governed by a separate regulatory regime. Elsewhere one regulator prevails, and securities and futures exchanges are merging, leading to a harmonized approach to the two market segments.

An emerging high-level consensus of views between regulators and exchanges

The primary reasons cited by exchanges for retaining regulatory functions are that they support the exchange's reputation and "brand name"; improve market integrity and quality which are central to the product; enable the exchange to control the features and standards of its products and services through its rules and policies; give the exchange the ability to significantly influence the substance, quality and cost of regulation; and ensure self-regulation is maintained.

The majority of exchanges tended to dismiss the conflict debate, partly because they know conflicts have always been present. They view the conflict issue in relative terms, and feel the concern is overblown because it is not new. In fact, the prevalence of this comment suggests that exchanges may have been subject to greater pressure from members on regulatory issues and resources than many realize. Exchange executives on the front line of regulatory programs often said that the conflict is probably greater in a membership organization. The view that accountability to a board of directors in a corporate model is preferable to the governance and management pressures in a mutual was widespread.

Exchanges are asking several significant questions:

- What functions are core to the business and directly add value to the exchange's products and services?
- Where does the exchange have a comparative advantage in terms of knowledge, skills and expertise over alternative regulators?
- Does the exchange have the necessary jurisdiction and powers to carry out the function?

- Do the exchange’s functions overlap with activities of other regulators?

When exchanges drill down in their analysis of their regulatory activities, some are concluding that functions such as broker-dealer regulation and listing rules that govern corporate conduct (as opposed to standards for admission to the official list of the exchange) are really not strongly related to their product and service standards. From a business standpoint, these regulatory functions can also create unnecessary friction in customer relationships which can be avoided if the functions are transferred to another regulator. As a result, these types of functions are migrating from exchanges to government authorities in many countries. Exchanges are increasingly focusing on core regulatory roles that are directly tied to business operations, such as trading supervision.

In discussing the issue with exchanges, managements tend to prioritize business needs such as product development, IT needs and finance. Regulation is a secondary consideration, and is often somewhat of a protected area because of its historic place in the organization, its quasi-public character and the high degree of scrutiny from regulatory authorities. (Carson,2003)

In some respects, exchanges are coming full circle – they are retreating to regulation based on their commercial interests, which was the origin of their regulatory activities. Demutualization therefore raises legitimate questions about the degree of reliance regulators should place on exchanges’ self-regulatory roles, especially functions that are quasi-public in nature, such as dealing with insider trading or corporate disclosure.

Regulators see many public policy reasons for reducing exchanges’ regulatory responsibilities, including the need to minimize conflicts of interest; recognition that many areas of regulation are more effectively delivered by public regulators; the opportunity to promote market development by improving regulatory efficiency and reducing an exchange’s costs; and removing obstacles to competition in securities trading. Also, where multiple SROs exist, opportunities to consolidate SROs, harmonize standards and increase efficiency may arise.

However, a significant factor for many regulators is that transferring, or requiring significant changes to, exchanges’ regulatory roles is not an option, because the exchange’s SRO role is enshrined in law. For instance, U.S. securities and futures exchanges have a legal obligation to regulate their markets under applicable legislation, and the SEC and CFTC are obligated to ensure the exchanges carry out their responsibilities diligently. In the case of the CFTC, the Commission concluded that the overall regulatory risk level was no higher post-demutualization, although the nature of certain risks changed and they adjusted their oversight accordingly. The SEC appears to have concluded that conflicts are greater, but has stepped back from demanding complete separation of SRO functions from the business.

Of course, exchanges' and regulators' responses must reflect local conditions and circumstances, which are important determinants of the scope of conflicts of interest. It is also possible for regulators and exchanges to conclude that the conflicts can be managed from a regulatory point of view, but for some exchanges to conclude that they are not manageable from a business point of view – that regulatory roles need to be reduced or transferred elsewhere to enable the exchange's board and management to devote their energy and resources to achieving commercial success. One of the most interesting findings of our study is that exchanges' and regulators' responses to the issue of what regulatory roles are appropriate for demutualized exchanges, and what safeguards should be put in place to deal with conflicts of interest, vary dramatically**.** The approach is not at all consistent across jurisdictions. In fact, many responses are unique, reflecting both local conditions and local ideas about conflicts and how they might be managed. We are too early in the demutualization trend for countries' responses to have converged, notwithstanding the fact that both exchanges and regulators are following events in other jurisdictions.

From a public policy standpoint, the fact that exchanges are highly regulated entities is a significant source of protection in itself. The requirements and powers set out in the law and regulations can be deployed to address conflict of interest issues.

Regulators have extensive tools to deal with any concerns raised by demutualization. In this regard, both regulators and exchanges recognize ongoing oversight of exchanges as an important safeguard, because it is a continuous and responsive process. Exchanges cannot simply obtain approval for demutualization, and close the book on the question. In most jurisdictions, close contact between the regulators and exchanges, especially the SRO section, is a feature of the system. An additional layer of scrutiny by the government is also present in many jurisdictions.

Types of conflicts of interest

Observers categorize conflicts of interest in different ways. We have identified the following sources of conflict of interest between the business operations and SRO responsibilities of an exchange. Some are “old conflicts” that have always existed (but may be exacerbated or reduced by demutualization); others are “new conflicts” that arise with demutualization of exchanges.

1. Conflict between Business and Regulation Mandates

- Acting in shareholders’ interest by maximizing value vs. acting in the public interest as an SRO.

2. Conflict in Funding Regulation

3. Conflict in administration

- Maintaining high regulatory standards and rules
- Thoroughness of regulatory programs
- Independent administration of rules and requirements
- Independent decisions on investigations and enforcement
- Regulation of owners and key customers who provide business and revenue
- Regulation of membership association whose interests the exchange’s rule is to promote and protect

4. Conflict in regulating competitors

- Regulation of members of trading participants that compete with the exchange in providing liquidity of trading services
- Regulation of listed companies that compete with the exchange in providing business services (or conversely, favouring business partners)

- Rulemaking that favours the exchange’s business or is biased against a competing business.

- Using investigation and enforcement powers in a biased manner

- Making administrative decisions affecting firms that compete with the exchange in a biased or unfair manner.

- Predatory regulatory practices such as delays in responding to complaints or imposition of burdensome procedures.

- Improper use of confidential information about regulated firms for business instead of regulatory purposes.

5. Self-listing conflict

- Exchange assessing whether it meets its own listing requirements
- Exchange monitoring trading in its own stock and making decisions on the need to review or investigated it.

6. Conflicts in specific regulatory functions

- Listing rules:

- Exchange competes with listed companies
- Exchange has business relationship with listed companies
- Customer relationship with major listings customers
- Cross-subsidization of trading business

- Market surveillance and regulation

- Exchange competes with regulated broker-dealers
- Customer relationship with major broker-dealer customers

- Member regulation

- Exchange competes with regulated broker-dealers
- Customer relationship with major broker-dealer customers

- Clearing and settlement

- Competing markets must use Exchange's clearing services
- Monopolistic pricing of utility services

Conflict between business and regulation mandates

Conflicts can arise between an exchange's role as market operator with responsibilities for supervising trading and monitoring listed companies' disclosure on its markets and its role as a commercial entity.

Exchange view: While perspectives vary, most exchanges argue that reputation is their stock in trade, and that as commercial enterprises they can ill afford regulatory problems that would jeopardize confidence in their markets and threaten their brands. They argue that regulation is integral to their business, and they would continue to do the job even if they were not required to.

Some listed exchanges believe the pressure to regulate well is much greater for a commercial entity than a club, because while brand damage and loss of business are threats to both, a public company is subject to greater scrutiny, is more sensitive to the threat of loss of business, and has greater incentives to practice sound risk management. Risk management is a corporate governance issue and the board is responsible to shareholders to ensure that risk management programs address the threat posed by inadequate regulation. The view is that regulatory risk will be reflected in the exchange's share price and cost of capital.

A minority of exchanges acknowledge that conflicts are significant and that a strong business orientation requires regulatory functions and powers to be minimized.

Regulator view: The majority of regulators believe conflicts are likely to be exacerbated in for-profit exchanges, but feel the conflicts are manageable. Generally regulators believe that better scrutiny and oversight is called for, at a minimum. At the other end of the spectrum, a few regulators saw conflicts as significant enough to reverse the demutualization trend. As the implications of commercial pressures for regulatory functions become evident, they believe exchanges will revert to non-profit utilities.

The overall conflict between the two mandates can only be addressed by broad safeguards that address an exchange's overall handling of its regulatory responsibilities, as opposed to measures intended to address specific types of conflict.

Responses in this category of conflict include:

- Organizational separation of regulation functions from business operations, or transfer of functions to another regulator.
- Corporate governance mechanisms, such as composition of the board and board committees to oversee regulation.
- Regulatory oversight of board of directors' and management decisions on policy and programs.

- Regulatory oversight of performance of regulatory functions and public interest obligations.

Specific conflicts are frequently managed by escalating decisions or ensuring appropriate corporate governance stewardship or management supervision, but these responses only move management of the conflict to the highest level, where arguably the conflict is greatest because it is the responsibility of the board and senior management to reconcile the two mandates. This kind of response places a high degree of reliance on the integrity of people and processes at the top, and on supervision of their management of conflicts by the regulator.

Conflict in funding regulation

As exchanges concentrate on financial performance, questions about their willingness to adequately fund regulation functions arise. Regulation is a cost centre and functions that do not produce revenue are often subject to proportionately larger reductions when a corporation decides to reduce costs.

Exchange view: Exchanges say that this conflict has always existed – members were also interested in efficiency and keeping a lid on costs. In fact, several exchanges indicated there was a greater conflict when members controlled the exchange because they not only favoured lower costs; they also had an interest in limiting the scope of regulation. These exchanges argue that a corporation and its shareholders actually have a greater interest in maintaining sound regulation as a matter of risk management: any regulatory failure could severely damage the business.

Regulator view: According to the SEC, it is vital for an exchange to believe that its reputation, and consequently its investment in regulation, is crucial to its business and an essential component of its strategy, if this conflict is to be managed successfully.

Overall, regulators are not highly concerned about this conflict because they have not seen evidence of a greater problem yet. If one arises, they believe their oversight powers are sufficient to deal with it.

How to address the conflict:

- Transfer and streamlining of regulatory functions
- Oversight of regulatory programs, budgets and resources

- Corporate governance mechanisms, such as public interest / independent directors or board committees to oversee regulation

The question is whether the conflict is increased in a for-profit environment. Business pressures intensify scrutiny of costs, and it is generally accepted that for-profit exchanges manage costs better and keep all forms of costs under the microscope. Business case analysis questions the rationale for any costs that do not produce business benefits. Mutual exchanges are not as disciplined in this regard because financial performance is not their central measure of success, it is merely one of a number of objectives and often the target is simply to cover costs.

Some exchanges admitted their commitment to regulatory funding could change based on the fortunes of the company and market – the real question is what happens when exchanges are under financial pressure and losing money. This has yet to be tested, although the current market environment is grim. Going forward we should expect exchanges to apply a more rigorous approach to measuring the performance of staff and use of resources. But the application of business disciplines is not necessarily a negative.

It will improve efficiency and performance, and the allocation of regulatory resources.

Conflict in administration of operating rules

Conflicts arise in the ongoing administration of rules and programs since exchanges have the authority to make administrative decisions that affect the interests of customers in all areas of SRO operations. Even if business and regulatory goals are broadly aligned, they clearly can diverge in individual cases, for example when considering whether to investigate or discipline a major customer, or what sanction to apply.

Exchanges administer enforcement programs and have discretionary authority over investigations, case management and discipline. An exchange's handling of sensitive decisions and cases may call into question the thoroughness and integrity of its regulatory operations, or whether it is administering them in a neutral and unbiased fashion.

An issue that is often overlooked in assessing the incentives that influence regulatory decisions is whether regulatory staff will be compensated in part based on the exchange's profits or financial performance. Compensation is designed to influence behaviour. If regulatory staff receives bonuses and stock options based on the exchange's financial performance, it appears to be a clear conflict of interest because regulators' compensation is linked to customer interests. Exchanges are in a difficult spot because they do not want to drive a cultural wedge between business and regulatory staff. They argue that if business and regulatory goals are in alignment, conflict is not an issue.

Exchange view: Exchanges generally acknowledge this conflict. Some cite it as a major reason to reduce or transfer regulatory functions. Others suggest it can be managed with appropriate safeguards, including organizational separation of regulation departments.

Regulator view: Regulators see the potential for greater conflicts as exchanges are subject to greater commercial pressures, which requires stricter oversight. But few regulators commented on how conflicts might influence the exercise of regulatory discretion.

Many regulators appeared to have limited means to identify case specific conflicts. At a minimum, the threat of increased conflict in exercising regulatory authority demands that new safeguards be put in place to reduce the possibility of either the business units or customers attempting to influence regulatory decisions, to identify potential conflicts of interest in specific regulatory decisions, and to ensure they are handled appropriately. Responses include:

- Organizational separation of regulation and business functions
- Conflict committees and similar internal procedures at exchanges
- Internal policies on handling potential conflicts
- Regulatory oversight of handling of potential customer conflicts
- Transfer of case files to the regulator if necessary to address conflicts
- Outsourcing of regulatory functions.

Strong measures are required to ensure that the integrity of an exchange's regulatory program is maintained and that it handles regulatory issues and decisions in a neutral and unbiased manner. This should be a priority for regulators in addressing demutualization and oversight programs.

Conflict in regulating competitors

There are two types of conflict:

1. The conflict arising between an exchange and a participating broker-dealer that provides competing trading services and is subject to the exchange's supervision. The primary example is an alternative trading system (ATS) that is a member or participant in an exchange. Large broker-dealers also compete with exchanges as liquidity providers, mainly by internalizing the matching of orders.

2. The conflict between an exchange and a listed company that provides any services in competition with the exchange. Conversely, an exchange may favour a company that it has a business relationship with. As exchanges broaden their businesses the number of these conflicts increases. The broader an exchange's listing rules and regulation program, the greater the conflict is.

These conflicts can in turn arise in several areas including:

- Rulemaking that favours the exchange's business or is biased against a competing business. Exchanges make policy and rules that can affect the interests of customers.
- Using investigation and enforcement powers in a biased manner.
- Making administrative decisions affecting firms that compete with the exchange in a biased or unfair manner.
- Predatory regulatory practices such as delays in responding to complaints or imposition of burdensome procedures.
- Improper use of confidential information about regulated firms for business instead of regulatory purposes.

Exchange view: Few exchanges outside the U.S. recognize conflict issues in regulating competing trading entities because ATSs are not a significant source of competition for order flow. Because of market structure and liquidity differences, internalization of order flow by ATSs and major dealers is not as big an issue in markets outside the U.S. Australia has experienced broader potential for conflicts in this area because of the number of new business initiatives ASX has pursued, including share registry services, order routing and market data services, futures trading and clearing, a trading linkage with the Singapore exchange, and ASX World Link to provide access to US and other international markets.

Regulator view: Regulators' views are similar to the exchanges' in each jurisdiction, according to the likelihood or experience of each type of competitive conflict. Some regulators that are particularly concerned with competition policy feel they must address the impact of conflicts on the behaviour of exchanges, especially where the exchange has monopoly power. In other jurisdictions the issue is primarily within the purview of competition regulators. Competition issues tend to be a lower priority in emerging markets.

Responsive suggestions:

- Conflicts Committees at exchanges to review handling of potential conflicts
- Regulator review of handling of sensitive cases
- Transfer handling of specific files to the regulator
- Reduce scope of Exchange's Listing rules and authority
- Separation or outsourcing of market regulation functions from exchange.

This seems to be one of the most serious areas of conflict faced by for-profit entities, because business diversification can create unforeseen new conflicts. Furthermore, competition in core exchange services is expected to grow. Conflicts that arise in specific cases are often difficult to both identify and manage appropriately.

Self-listing conflict

Two areas of conflict arise:

1. The conflict involved in an exchange assessing whether it meets its own listing requirements.

2. The conflict arising when an exchange monitors trading in its own stock and makes decisions on whether to review or investigate trading for any reason.

***Exchange and Regulator view**:* Exchanges and regulators universally recognize the conflicts that arise when an exchange lists its securities on its own market.

Responses:

Virtually all jurisdictions with listed exchanges have taken steps to address these conflicts. Approval of the listing pursuant to the listing rules has been the responsibility of the regulator. Administration of the listing rules in respect of the exchange's listing has either been transferred to the regulator, or is subject to close

oversight by the regulator. Similarly, surveillance of trading in the exchange's stock is either the regulator's direct responsibility or is closely supervised by it.
This conflict is fairly narrow in nature and easily defined. As such, the measures needed to manage it are clear.

2.1.5 Corporate governance and performance

2.1.5.1 Definition and theories of corporate governance

Corporate Governance has no standard definition it encompasses a wide range of items and activities, and holds different meanings for different user groups. Singapore's Corporate Governance Committee (CGC)[i] defined Corporate Governance as the processes and structure by which the business and affairs of the company are directed and managed, in order to enhance long-term shareholder value through enhancing Corporate performance and accountability, whilst taking into account the interests of other groups. King's Report of South Africa (King I) (1994) defines Corporate Governance as the process by which organizations are directed and controlled. But in the third Report on Governance in South Africa (King III) (2009) becomes necessary because of the anticipated new Companies Act and changes in international Governance trends. Cadbury Report (1992) defined it as the system by which companies are directed and controlled principally by a board of directors. From these definitions it can be said that regardless of economic orientation or business system, there are four fundamental 'pillars' of Governance, these are accountability, transparency, predictability and participation aimed at providing effective leadership, control and monitoring management performance. Company performance and shareholder value can suffer from a lack of oversight and excessive power among senior executives. The Board of Directors plays the role of being a check on management. The Board is collectively responsible for promoting the success of the company by directing and supervising the company's affairs.

A review of literature shows the availability of a number of consultancy reports, which are the cornerstone of writing guidelines and principles of Good Governance and their implementation worldwide. These include The General Motors Board of Directors

[i] Corporate Governance Committee completed its work and submitted to Singapore Government in March 2001

Guidelines in the United States of America (USA), The Dey Report in Canada and The Cadbury Report of the United Kingdom (UK).

The above reports have been very influential to the subsequent reports. The trend for developing Corporate Governance began in early 1990s in the United Kingdom, United States of America and Canada. This was in response to poor performance of leading companies and pressure for change from institutional investors. It was perceived that lack of effective boards contributed to poor performance, and therefore the emergence of Good Corporate Governance concept.

Over the past decade, Governance guidelines and codes have been issued from stock exchanges, corporations and institutional investor's examples include Toronto Stock Exchange, London Stock Exchange, General Motors and The associations of Directors and Corporate Managers respectively.

Compliance with guidelines or recommendations is normally optional with exception of Stock Exchange were it is normally listing obligation. For example listed companies in Toronto Stock Exchange (TSE) and London Stock Exchange (LSE) may not comply with the recommendations of Dey Report and the Cadbury Report, but they must provide an explanation on divergence. Impliedly disclosure requirement exerts a significant pressure for compliance. On the other hand guidelines issued by Corporate Managers and individual companies are normally voluntary.

2.1.5.1 Corporate failures due to failed governance

At the time of its collapse in December 2001 Enron Corporation was listed as the seventh largest company in the US, with over USD 100 billion in gross revenue and more than 20,000 employees worldwide. It had received a widespread recognition for its transition from an old-line energy company with pipelines and power plants, to a high-tech global enterprise that traded energy contracts like commodities, launched into new industries like broadband communications and supervises a multi-billion dollar international investment portfolio.

Enron's problems did not arise in its core energy operations, rather in other ventures particularly "dot com" investments in Internet and high-tech communications businesses. Enron saw an unlimited future in Internet; during the late 1990s, it purchased on-line marketers and service providers, constructed a fibre-optic communication network and attempted to create a market for trading broadband communications capacity. Enron entered these markets near the peak of the boom and paid high prices, taking on a heavy debt load to finance its purchases. When the dot com crash came in 2000, revenue from these investments dried up, but the debt remained. Enron also recorded significant losses in certain foreign operations.

It is not unusual for business to fail after making bad or ill-timed investments. What turned the Enron case into major corporate scandal was the company's response to its problems. Rather than disclose its true condition to public investors, as the law requires, Enron falsified its accounts. The accounts pretended that losses were occurring not to Enron, but to the so called Raptor entities, which were ostensibly independent firms that had agreed to absorb Enron's losses, but were in fact accounting contrivances created and entirely controlled by Enron's management. In addition, Enron disguised bank loans as energy derivatives trade to conceal the extent of its indebtedness. The board witnessed numerous indications of questionable practices by Enron management over several years, but chose to ignore them to the detriment of Enron shareholders, employees and business associates.

WorldCom is another US firm, which collapsed as a result of accounting fraud and Governance abuse. The WorldCom saga was mostly related to massive use of improper accounting practices, such as the capitalization of billions of dollars of normal operating costs. The capitalization of "line costs", misuse of reserves and other accounting tricks resulted in reporting profits that were overstated enormously. Richard C. Breeden (2003) in his report Restoring Trust says: The best current estimates suggest that income was overstated by at least USD. 11billion. The phony accounting created false impression that the Company's management was highly successful, and this impression undoubtedly helped the company to raise substantial volumes of investment capital.

A contributing factor that allowed the books to be deliberately falsified without attracting much notice was that the company's internal controls over preparation and publication of its financial results were dysfunctional and in some areas controls were missing entirely. WorldCom's accounting systems had not kept pace with the growth of the Company due to its feverish pace of acquisitions and management neglect. Different WorldCom units were operating numerous legacy financial systems and producing consolidated financial statements that required patchwork software and significant manual processing. The process of creating ledger accounts and reconciliation of amounts posted to sub ledgers and general ledgers for the company's external reporting was fragmented and disjointed. Weak control allowed substantial adjustments to be made manually at the company's headquarters without systems preclude or report these changes. Breeden (2003) indicated further in his report that individuals in the headquarters and accounting staff were able essentially to erase or to create numbers without limitations, simply by invoking the wishes of senior staff while these were happening, accounting personnel in other parts were not able generally to review what changes were made, thereby minimizing the chance of detection. It is clear here that senior staff at the headquarters were determined to give wrong information to the shareholders and the public at large.

Weak accounting staff, ineffectual internal auditing capability, and poorly linked computer systems and control alone should not have led to either the deliberate overstatement of income or overstatement of balance sheet values. The Breeden's Report shows that the overstatement was the result of deliberate manipulation and falsification of accounting records at headquarters.

In Tanzania, there is very little literature available related to corporate failures, TOL may be sighted as an example for corporate failure however neither investigation nor report was issued to the public identifying the causes of the failure. But the truth remains that the company is poorly performing and that investors were not told the truth in the prospectus at the time when the company was issuing shares for the first time to the public. In the prospectus, TOL indicated that the funds that would be raised by the sale of shares would be used to modernise the plant. This did not happen and instead the funds were used to pay company debts, about 68% of TOL assets were funded by debts.

Cash flows were severely affected by this action. Likewise production was also affected and finally the company failed to make profits and therefore unable to pay dividends.

Absence of Tanzanian literature on corporate failure should not be considered that what is happening in other countries cannot happen here. In fact we can say it has already happened, examples are parastatal organisations which have collapsed and TOL which has some characteristics, similar to what happened to WorldCom, falsifying the accounts.

The evidence stipulated above supports a view that good corporate governance as evidenced by its structure and pillars is essential for better corporate performance.

2.1.5.2 Demutualization and the general control of the business

The decision to demutualize is expected to bring a corporation that is more capable to act decisively and rapidly to changes – such as competitive challenges - in the business environment. A demutualized stock exchange facilitates the ownership and trading privileges of the members of the exchange, thus permits the stock exchange to achieve greater independence. It brings a management that takes actions that are in the best interests of the stock exchange and ultimately its shareholders. Therefore, the interests of the owners of the stock exchange will be linked to those of the stock exchange as both parties will aim at profit maximization. Further, the demutualized organizational structure will allow for greater transparency because stock exchanges will be obliged to report to their shareholders not only regarding the bottom-line but also on issues regarding corporate governance (Hughes and Zargar, 2006, p. 10-11).

2.2 Empirical literature review

2.2.1 Trends of demutualization in African Stock Exchanges

In Africa, the Johannesburg stock exchange (JSE) was the first to demutualize. It fully demutualized on July 1, 2005 while the Bond Exchange of South Africa (Besa) demutualized in 2007. Among the other bigger stock exchanges in Africa, the Nigerian Stock Exchanges (NSE) has established a committee to oversee the processes f or possible demutualization while among smaller exchanges, Nairobi Stock Exchange (NSE) completed demutualization in September 2011.

Other stock exchanges, such as Mauritius and the Bourse Régionale des Valeurs Mobilières (BRVM), are limited by shares and, in theory, demutualized. However, there is a significant overlap between licensed stockbrokers and shareholders (Onyuma, 2006). The demutualization process can improve the competitiveness of African exchanges. Onyuma (2006) argues that the main motives of and expected benefit from demutualization include tapping new sources of capital through initial public offering (IPO) needed to modernize exchange trading systems. Such capital cannot be obtained through mutualized status. In fact, stockbrokers and governments cannot enable a commercial entity to raise such capital from shareholders, as do corporations.

In the African context where the market size is limited this could be a serious challenge. Second, demutualization can enable exchanges to pursue business opportunities unconstrained by vested interest of members in the continent. The separation of ownership rights from trading rights will enable African exchanges to increase investor participation better than they currently do.

Moreover, demutualization would allow African exchanges to achieve better operational cost control, and to increase flexibility, efficiency and competitiveness through reviewing their commercial strategy. Such exchanges elsewhere have achieved consolidation in their domestic markets by merging the derivatives and cash segments or by including trading, clearing and settlement services under one roof to create economies of scale and scope (Onyuma, 2006).

Furthermore, demutualization is expected to reduce governance problems in mutualized exchanges by opening up trading rights, admitting new trading partners, and broadening ownership to allow the public to invest in exchanges. The absence of these in mutualized exchanges tends to breed poor governance structures. Because traders and brokers in mutualized exchanges enjoy monopoly power through exclusive rights and access to trading systems, their vested interests are protected. Demutualization induces better corporate governance systems because decision making is based on ownership structure and not on trade’s intermediation (Yartey, 2007).

However, challenges of demutualization of African exchanges are still great. Among others, these include, high costs associated with an exchange IPO, incomplete market liberalization, the need for exchange financial sustainability, conflict of interests, low liquidity, market size, underdeveloped infrastructure.

2.2.2 Corporate governance in Tanzania

The history of corporate governance can be traced way back in the reform period which started in the mid 80's. This period had been characterized by the divesture of a number of public enterprises, liberalization of a number of sectors, which were previously reserved for public enterprises only. The banking and insurance are now operating in competitive environment and the establishment of the Dar es Salaam Stock Exchange (DSE) has facilitated the reform process in terms of security trading and exchange.

Public enterprises were primarily owned by the State. However in the reform period new shareholders, individuals, institutions etc. have emerged, with a different outlook, they are value driven. Furthermore the management of these enterprises has now to work in competitive environment, which were not in existence prior to the reform.

There are a number of factors, which influenced the Corporate Governance environment in Tanzania during the period of reform, these are: -

- The role played by third phase Government in enhancing Good Governance.
- The expectations that private sector would inculcate certain standards of behavior.
- The entry of international investors who originate from countries where Good Governance and supporting institutional framework have been a feature of business for some time. For instance South African companies have majority shareholdings in National Bank of Commerce and Tanzania Breweries Ltd are familiar with King's Report of South Africa and in fact they have to comply with it as part of listing requirements of the JSE Securities Exchange (South Africa)
- the establishment of Dar es Salaam Stock Exchange

This steering committee has spearheaded the development of Recommended Guidelines on Corporate Governance in Tanzania, some specific features related to the continued existence of parastatal and regulatory authorities have been considered in formulating the Recommended Guidelines on Corporate Governance in Tanzania.

Capital Markets and Securities Authority has developed Guidelines on Corporate Governance Practices by Public Listed Companies in Tanzania. These guidelines have been developed taking into consideration the work, which has been undertaken by several task force committees worldwide. The objective of these Guidelines is to strengthen Corporate Governance practices by listed companies in Tanzania.

Kiure N.J. (2002) observed that with many guidelines and prescriptions of the Recommended Guidelines for Corporate Governance in Tanzania, companies could easily lose sight of the essence of Corporate Governance. The Board is expected to assume six key responsibilities to facilitate the discharge of its stewardship over the company. These cover the company’s strategic plans, conduct of its business, risk management, succession planning, investor relations and internal control systems.

By fulfilling these six responsibilities the Board will be instituting sound and Good Governance.

2.3 Conceptual Framework

The country’s economy depends to some extent on the drive and efficiency of its stock markets; the effectiveness with which the stock markets operates and discharge its responsibilities determines the country’s competitive position in global investment and capital movements. The performance of a stock market depends on its governance structure; literature suggests that the demutualised governance structure provides a suitable platform for transformation of stock exchanges from their uncompetitive mutual objectives to a rather competitive one under modern governance codes.

The demutualized structure is expected to influence the stock exchange’s compliance with basic principles of Good Corporate Governance which in turn is expected to increase its transparency and disclosures thus playing as an important factor to attract investors both from within the country and from outside the country.

2.4 Research gap

The demutualization trend started in Europe; this resonates well with the fact that stock exchanges are concentrated in Europe. Researches on demutualization of stock exchanges have been Eurocentric and very few depicted the needs and conditions of African stock markets. Onyuma (2006) wrote his paper on demutualization of African stock exchanges at a nascent stage of the first demutualization ever in Africa, that of Johannesburg Stock Exchange. In arriving at his findings Onyuma used experiences of the European exchanges to predict the aftermath of demutualization in Africa.

From the development above, it was eminent that a research based on African experiences was needed to draw inferences in African perspective of stock exchange demutualization. This was the gap the researcher endeavored to bridge by conducting this research. Johannesburg Stock Exchange being the first exchange to demutualize in Africa gave the best case study for the subject matter.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This section describes the methodology used in the study, which consists of coverage of the study, data requirements and measurement, data collection procedures, data analysis, validity and reliability of the data and limitation of the study.

3.2 Coverage of the study

3.2.1 Johannesburg Stock Exchange (JSE)

The study analysed the post demutualization stock performance and operating performance of JSE in comparison with pre-demutualization period. The purpose was to identify the drivers behind demutualization and the expected impact of the process to the performance of stock exchange. The findings from this study would be used to discern African specific demutualization drivers and focus areas for other African stock exchanges considering demutualization.

3.3 Research Design

The study was basically a case study design aiming at examining the role of the governance structure in the performance of stock exchange. The researcher opted for a case study design because he wanted to explore the effect of the subject matter on an African perspective. The fact that majority of African stock exchanges are yet to demutualise instigated a look out for a specific case of demutualization in Africa which could stem out as a best representative of African stock market conditions and variables. Johannesburg Stock Exchange was used as a case study. The study used both qualitative and quantitative data in the analysis.

.4 Population and unit of inquiry

3.4.1 Sample size and sample selection

The study covered only one stock exchange hence a case study design, a case study was purposely selected by the researcher due to fact that the study population would have comprised of only two exchanges as a population i.e. Johannesburg stock exchange which demutualised in 2005 and Nairobi stock exchange (NSE) which demutualised in 2011. Due to a short time lapse between the demutualization of NSE and the research it was eminent that JSE remained the only study unit.

Having had selected the unit of study, the researcher opted to find a group of commercially educated individuals i.e. accounting and finance professionals and people in business management to inquire on the subject matter. This was because the subject matter was not so common to the normal population and it demanded specialized knowledge on stock exchange governance structures.

Having selected the unit of inquiry, the same was grouped into three strata, namely the employees, shareholders and directors. The respondents were obtained from five corporate bodies listed in the Dar es salaam stock exchange namely, Tanzania Breweries Limited (TBL), Tanzania Tea Packers (TATEPA), Tanzania Cigarette Company Limited (TCC), Tanga Cement Company Limited (TCCL) and Swissport.

Because of time availability and the respondents' unwillingness to respond to the questionnaire, the respondents from the 3 strata were purposively selected. The number of respondents from each stratum is indicated in Table 3.1

Table 3.1 Distribution of respondent by companies

	Employees	**Shareholders**	**Directors**
Companies	**n**	**n**	**n**
TBL	2	2	1
TATEPA	1	1	0
TCC	3	5	1
TANGA CEMENT	3	2	1
SWISSPORT	1	2	0
Total	**10**	**12**	**3**

Source: field data

3.5 Measurable variables

The study aimed at testing the following variables

- The set up of post demutualization governance structures (independent variable)
- Stock exchange director's performance (independent variable)
- Stock exchange performance (Dependent variable)
- Transparency and disclosure (Intervening variable)

3.6 Sources of data

This study used both secondary (from published annual reports, websites and other publications) data and primary data derived from the questionnaires to measure the impact of governance structure in JSE stock exchange performance.

The researcher opted to complement the secondary data with cautiously developed questionnaire in order to test the investors and professional's perspective on demutualization process.

3.7 Data Analysis

In this part of the study descriptive statistics were used in evaluating the performance of JSE after demutualization using post listing performance statistics to evaluate the stock performance alongside with the analysis of the most important financial information using the official financial statements of the above-mentioned stock exchange.

3.8 Validity and Reliability of the Data

During data collection the researcher encountered some problems, which may affect quality of data collected and therefore testing of hypotheses as well as interpretation and conclusion. These problems included the use of single questionnaire for all three categories of respondents; the responses so obtained might be affected by biasness as the questionnaire may not have captured different perspectives of these three groups. The secondary data obtained from previous studies and web searches are accurate and thus valid for the conclusions reached.

Another area was directors' unresponsive attitude towards responding to researchers questionnaire, on the other hand shareholders and employees responses were better than directors however not everybody who was supplied with questionnaire responded. This also might have an impact with quality of data, testing of hypotheses and finally interpretation and conclusion.

3.9 Limitation of the Study

Apart from time and financial resources constraints the findings from this study should be considered in the light of the following limitations:

- Responses were limited to Dar es Salaam residents only.
- Only companies listed with the DSE were considered
- Use of one type of questionnaire to all three groups of respondents
- Difficulties in accessing directors of listed companies
- Limited literature on Tanzanian/African stock exchange demutualization process

Despite the above limitations, the researcher believes that the findings portray a fair assessment of the impact demutualization on stock exchange performance.

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND INTERPRETATIONS

4.1 Introduction

This chapter presents the research analysis and findings based on the result of research hypotheses set in chapter One. Out of 25 questionnaires which were sent out 19 were returned properly filled. *Table 4.1* shows the distribution of responses according to 3 categories

Table 4.1 Distribution of responses by category

Category	Number sent out	Number returned	Percentage returned
Employees	10	7	70

Shareholders	12	10	83
Directors	3	2	67
Total	**25**	**19**	**76**

Source: Field Data

4.2 Profile of Respondents

4.2.1 By Level of Education

All respondents came from a group of people who have university education level and above. The researcher believes that the level of education was important because educated ones would respond faster and easier than uneducated. Given the education level of respondents and the introduction into the subject matter given by the researcher before availing them with the questionnaires; the researcher believes that all were capable and knowledgeable on stock exchange governance structures and their evolution.

4.2.2 Profile of Respondents by Gender

Out of 7 employees who responded 2 were women representing 29% the remaining 5 were men. In shareholders category 10 people responded out of whom 2 people were women representing 20% and the remaining 8 were men. Finally under the directorship category the respondents were all men. The overall is 4 women participated in the study representing 21% of overall people responded.

Gender participation in economy is an essential feature in Good Corporate Governance, researcher wanted to have responses from both men and women so that all gender groups' responses are reflected in the study, as well as to understand how both male and female from different employment levels i.e. either employees, directors or shareholders understand how stock exchanges are evolving, managed and operated.

4.3 JSE: Changes in governance structure and directors' performance

This research wanted to find out whether directors' performed their duties effectively and whether the post demutualization structure supported directors' performance. The findings were measured by how stakeholders perceived the performance of the JSE given new governance structure and new directors. Respondents were asked six questions all related to measuring effectiveness of new governance structure and directors' performance.

The research sought to find out whether demutualization led to formal and transparent procedures for appointing directors. The findings were measured by the way in which stakeholders participated in directors' selection process.

Table 4.2 Response on changes in governance structure and Directors' Performance

Questions	Responses				
	Yes	%	No	%	TOTAL
a) Does the JSE's board as explained to you show ability to regularly review the effectiveness of the Internal Control function?	10	53	9	47	**19**
b) Is the explained board structure effective in attracting new investors to the JSE as well as improving their confidence?	11	58	8	42	**19**
c) Does the oversight of FSB as explained provide the formal review of the performance of the Board, individual directors, the chairman and the Chief Executive?	5	26	14	74	**19**
d) In reference to snapshot of post demutualized results shown to you, do you think board monitors JSE's performance with peer stock exchanges financial performance and with industry and other relevant comparative data?	11	58	8	42	**19**
e) Does the board understand the industry in which the exchange operates and implication of competitive factors and current general economic and political trends to their businesses?	15	79	4	21	**19**
f) In reference to information availed to you, do you see an adequate number of regularly-scheduled board meetings held during the year?	15	79	4	21	**19**
Total	**65**	**57**	**49**	**43**	**114**

Source: Field Data

The first question wanted to know if there is effectiveness of the internal control function or not. The above responses indicate that internal controls review by directors is one of the boards' top agenda, hence putting companies at a mitigated risk position. The business environment in stock exchanges is changing so fast, and the need to evaluate risks is keeping on increasing. Reviewing the effectiveness of internal control is an essential part of the board's responsibilities and effective monitoring on a continuous basis is an essential component of a sound system of internal control. It is actually a process affected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of stock's objectives in terms of effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations

The second, fourth and fifth questions asked if board members understand their roles and responsibilities in attracting new investors to the stock exchange and if they monitor stock exchange's performance with peer stock exchanges' financial performance, as well as if they understand implication of competitive factors and current general economic and political trend to exchange businesses. The findings for all these three questions were very positive, demutualized stock exchanges can easily attract new capital and the response is showing that directors are playing their roles towards stock exchange's performance. It is therefore advised that; for stock exchanges to be able to attract new capital/investors they should consider demutualization as the same imposes a strong governance structure thus supporting Good Corporate Governance practices which in turn enhance timely and accurate information disclosures from which investors can make informed decisions.

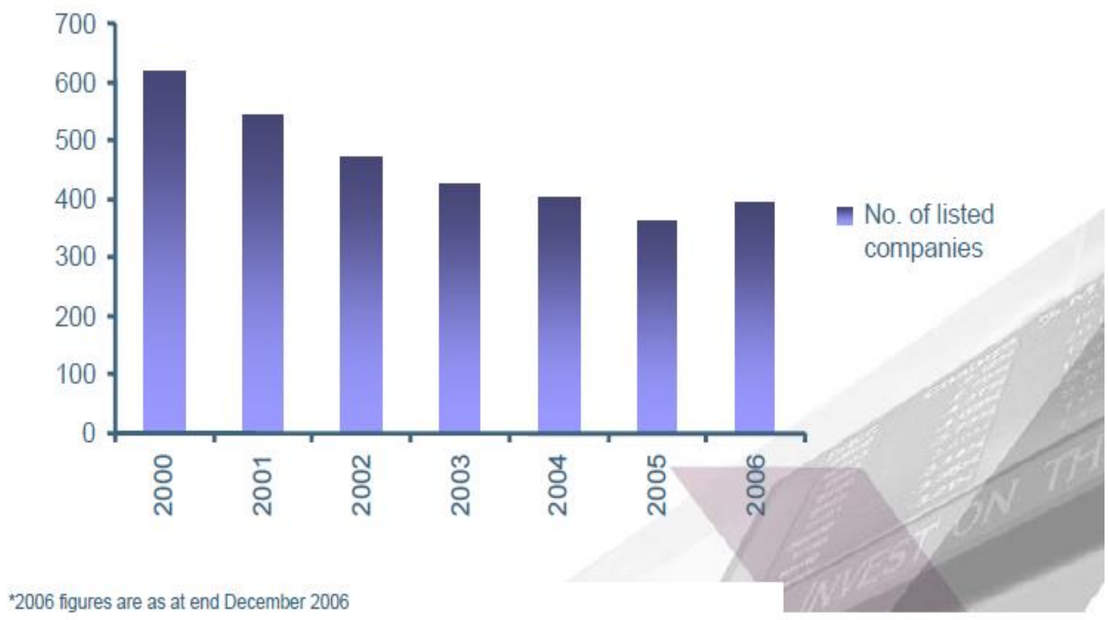
.The third question aimed at assessing whether the FSB is reviewing the performance for individual directors, chairman and CEO. The above analysis indicates that there are no regular reviews performed for the board in general as well as for individual directors. For directors to be effective in discharging their responsibilities regular reviews are important. It is the board's responsibility to ensure that every director receives "appropriate training" so as to enable directors' discharge their duties as directors. The training should cover relevant new laws, regulations and changing commercial risks from time to time and an orientation-training programme to ensure that incoming directors are familiar with the stock exchange business and Governance practices.

The sixth question aimed at assessing if there is adequate number of regularly scheduled board meetings. The response was positive as the board seemed to have regular board meetings. Often board meetings are held publicly, though frequently only the board members attend. Board members vote on decisions regarding the stock exchange and normally a quorum must be in order for the meeting to be considered lawful. A quorum, unless otherwise defined by the board represents at least half of the board members. In some cases, presentation in board meetings is a financial report. This may take place after old business (financial year) is concluded., board meetings then tend to discuss new business, which involve any new concerns or issues raised by the board.

Graphs below show extracts of performance of JSE from 2000 - 2006 in terms of both operational and financial performance. The extracts from 2000 to 2006 had been chosen purposely to accommodate the following:

- The stock exchange was demutualized in 2005
- Information prior to 2005 i.e. 2000 to 2004 provides the performance trends in a mutual structure of governance
- 2006 provides the immediate picture of the impact of demutualization on JSE's performance before dilution of the same by the World economic crisis in 2007/2008
- More current data was available but the same would be complex to link with demutualization as other factors such as usage of information technology, political influence in mining sector and shift of investment focus to African countries have impacted the performance of JSE.

Graph 4.1: Gain on primary market



Source: JSE Limited 2006

Graph 4.2: Improvements in Capital raised

Source: JSE Limited 2006

Graph 4.3: Increase in investors' value (Market capitalization and liquidity)

Source: JSE Limited 2006-

Graph 4.4: Financial performance, soon after demutualization

JSE Group Income Statement: 30 June 2006

	six months ended 30 June		year ended 31 December
	2006 (unaudited)	2005 (reviewed)*	2005 (audited)
	R'000	R'000	R'000
Revenue	313 025	187 460	407 999
Other operating income	**41 745**	6 987	25 307
Personnel expenses	**(60 311)**	(51 725)	(117 414)
Other operating expenses	**(201 131)**	(126 073)	(276 820)
Operating profit before financing costs	93 328	16 649	39 072
Interest received	**254 521**	184 191	409 085
Interest paid	**(231 999)**	(165 579)	(370 246)
Net financing income	**22 522**	18 612	38 839
Share of profit from associated companies	**18 966**	11 881	23 966
Profit before taxation	**134 816**	47 142	101 877
Taxation	**(42 591)**	0	5 120
Profit for the period	**92 225**	47 142	106 997
Basic earnings per share (cents)	**110.4**	56.5	128.3

Source: JSE Limited 2006

Prior to demutualization JSE was governed by members of the exchange as mutuals. The demutualization process changed the governance structure of the exchange so as to achieve its demutualization objectives. A board of directors with its supporting committees was formed. A quick look into the post demutualization governance structure of JSE revealed the following:-

- In June 2006, JSE listed on itself; it remained self regulatory but the South African regulator- Financial Services Board (FSB) through the Registrar of Securities Services (RSS) assumed the JSE's regulatory role in relation to the JSE's own listing. FSB imposed certain restrictions on JSE to ensure good corporate governance.

- In an attempt to meet the regulatory criteria on good governance by FSB, JSE's corporate governance structure changed to accommodate the following:
  - The board consisting of 15 Directors
  - Membership and ownership separated
  - Representative from FSB attends to the board as an observer
  - Only three of the non executive directors are associated with the listed companies, sponsors or authorized users of the JSE but provisions to deal with conflicts were also introduced
  - A number of board committees were formed to facilitate efficient decision making and to assist the board in the execution of its duties, powers and authorities
  - It also established share dealing schemes

Post IPO share performance

Significant increase in share performance was observed soon after JSE demutualization

Graph 4.5: Share performance post IPO

	JSE Ltd	JSE All Share
1 month	(15.46%)	0.38%
6 months	91.79%	15.99%
1 year	228.78%	38.55%
5 years	188.20%	51.41%
Since IPO	190.39%	53.44%

Source: www.jse.co.za

From the above background and extracts of JSE's performance, it is evident that its performance, both operating and financial improved significantly after demutualization. This may be attributed to improved corporate governance brought about by new governance structure as well as systems of control implemented by JSE's management in compliance with King's report as required by Financial Services Board (FSB).

4.4 Transparency and Disclosure

This research also sought to find out whether JSE's directors were disclosing all material information regarding their stock exchange. Material information consists of both material facts and material changes relating to the business and affairs of the stock exchange. The findings were measured by the way shareholders, employees and directors perceived the extent of disclosure. In assessing the extent of transparency and disclosure of JSE, four questions were directed to respondents for them to indicate their choice as either JSE is disclosing material information or not.

Table 4.3: Response on transparency and disclosure

Questions	**Responses**				
	Yes	**%**	**No**	**%**	**TOTAL**
a) As an accounting/finance professional would you be satisfied with post demutualization transparency and disclosure of the JSE's various reports?	14	74	5	26	19
b) Do you think the reports and presentations to the board will be of high quality and sufficient for effective evaluation of the performance of the JSE and its management?	10	53	9	47	19
c) Do you see the post demutualization bringing internal control, policies and procedures adequate to identify potential errors, fraud and illegal acts?	10	53	9	47	19
d) Do you think the post demutualization JSE Board has put in place and communicated the necessary policies defining the scope of power, roles and responsibilities of the management as well as the standards to be adhered to.	10	53	9	47	19
Total	**44**	**58**	**32**	**42**	**76**

Source: Field Data

The first and second questions wanted to know if there are transparency and disclosure of the JSE's various reports as well as if the reports are of high quality and sufficient for effective evaluation of the performance of the stock exchange and management at large. The above analysis suggests that transparency and disclosure of various JSE's reports are significantly disclosed. This is an area where deliberate efforts should be directed to ensure post demutualization JSE is disclosing all reports of interest to stakeholders. The various reports issued by a stock exchange are sensitive in influencing investors' decisions thus they can seriously affect the stock exchange's performance. The reports issued should be of high quality and sufficient to warranty quality decisions by both new and current investors. The reports are expected to guide investors in decisions of whether to invest or disinvest. Investors will only invest where they can foresee opportunities of earning returns in the future.

The third and forth questions aimed at assessing if internal controls policies and procedures are adequate to identify potential errors, fraud and illegal acts as well as if the board has put in place and communicated the necessary policies defining the scope of power, roles and responsibilities of the management as well as the standards to be adhered to. Internal controls policies and procedures is a collection of documents that summarize the regulations and rules which are part of Corporate Governance, the response to these questions were fair.

4.5 Testing of Hypotheses

Two hypotheses had been formulated based on research questions and research objectives. These are:-

H_1: Changes in governance structures of stock exchange and its directors' performance enhances overall performance of stock exchange.

H_2: Transparency and disclosure of stock exchange's information enhances its performance.

Chi – square test (χ^2) was carried out to test these hypotheses. The results of these tests were used to determine whether deviations between expected and observed data could be attributed to chance or to other factors. These tests are indicated in the next sections.

- **Hypothesis 1: This tested as to whether changes in governance structures of stock exchange and its directors' performance enhance overall performance of stock exchange**

In testing this hypothesis, six questions were asked, which required respondents to indicate their choices in relation to issues of changes in governance structure and directors' performance.

The null (H_{0}) and alternative (H_{1}) hypotheses were defined as follows:

Null hypothesis (H_0): There is no relationship between changes in governance structures as well as its directors' performance and overall performance of a stock exchange

Alternative Hypothesis (H_1): There is relationship between changes in governance structures as well as its directors' performance and overall performance of a stock exchange.

Using 1% level of significance

Table 4.4: Governance structure and directors Performance (observed and expected data)

Questions	Observed Responses			Expected Responses		
	Yes	**No**	**TOTAL**	**Yes**	**No**	**TOTAL**
a) Does the JSE's board as explained to you show ability to regularly review the effectiveness of the Internal Control function?	10	9	**19**	11	8	**19**
b) Is the explained board structure effective in attracting new investors to the JSE as well as improving their confidence?	11	8	**19**	11	8	**19**
c) Does the oversight of FSB as explained provide the formal review of the performance of the Board, individual directors, the chairman and the Chief Executive?	5	14	**19**	11	8	**19**
d) In reference to snapshot of post demutualized results shown to you, do you think board monitors JSE's performance with peer stock exchanges financial performance and with industry and other relevant comparative data?	11	8	**19**	11	8	**19**
e) Does the board understand the industry in which the exchange operates and implication of competitive factors and current general economic and political trends to their businesses?	15	4	**19**	11	8	**19**
f) In reference to information availed to you, do you see an adequate number of regularly-scheduled board meetings held during the year?	15	4	**19**	11	8	**19**
Total	**65**	**49**	**114**	**66**	**48**	**114**

Source: Field data

Table 4.5: Comparison of Observed and Expected Data on Governance structure and directors Performance

Observation (O)	Expectation (E)	(O-E)	$(O-E)^2$	$(O-E)^2/E$
10	11	-1	1	0.1
11	11	0	0	0
5	11	-6	36	3.3
11	11	0	0	0
15	11	4	16	1.5
15	11	4	16	1.5
9	8	1	1	0.1
8	8	0	0	0
14	8	4	16	2.0
8	8	0	0	0
4	11	-7	49	4.5
4	11	-7	49	4.5
Calculated Value χ^2				**17.5**

Source: Field data

The table value of chi-square (χ^2) for 2 degrees of freedom at 1% level of significance is 9.21. The computed value is 17.5 and it is greater than the table value, therefore the null hypothesis is rejected. It can therefore be concluded that changes in governance structures and directors' performance have relationship with overall performance of a stock exchange.

Validity Test: The data collected and findings are adequate for testing the validity of the hypothesis.

It was expected that changes in governance structures and directors' performance has relationship with overall performance of a stock exchange; the study has come up with a conclusion similar to the expectations.

- **Hypothesis 2: This tested as to whether transparency and disclosure of company's information enhances performance of a stock exchange.**

In testing this last hypothesis respondents were asked to indicate their choices on four questions relating to testing whether or not transparency and disclosure influences stock exchange's performance.

The null (H_0) and alternative (H_1) hypotheses were defined as follows:

Null Hypothesis (H_0): Transparency and disclosure of stock exchange's information do not enhance its performance.

Alternative Hypothesis (H_1): Transparency and disclosure of stock exchange's information enhances its performance

Using 1% Level of Confidence

Table 4.6: Transparency and disclosure (observed and expected data)

Questions	**Observed**			**Expected**		
	Responses			Responses		
	Yes	**No**	**TOTAL**	**Yes**	**No**	**TOTAL**
a) As an accounting/finance professional would you be satisfied with post demutualization transparency and disclosure of the JSE's various reports?	14	5	19	14	5	19
b) Do you think the reports and presentations to the board will be of high quality and sufficient for effective evaluation of the performance of the JSE and its management?	10	9	19	14	5	19
c) Do you see the post demutualization bringing internal control, policies and procedures adequate to identify potential errors, fraud and illegal acts?	10	9	19	14	5	19
d) Do you think the post demutualization JSE Board has put in place and communicated the necessary policies defining the scope of power, roles and responsibilities of the management as well as the standards to be adhered to.	10	9	19	14	5	19
Total	**44**	**32**	**76**	**56**	**20**	**76**

Source: Field data

Table 4.7: Comparison of Observed and Expected Data on Transparency and disclosure

Observation (O)	Expectation (E)	(O-E)	$(O-E)^2$	$(O-E)^2/E$
14	14	0	0	0
10	14	-4	16	1.2
10	14	-4	16	1.2
10	14	-4	16	1.2
5	5	0	0	0
9	5	4	16	3.2
9	5	4	16	3.2
9	5	4	16	3.2
Calculated Value χ^2				**13.2**

Source: field data

The table value of Chi-square (χ^2) at 1% level of significance and 2 degree of freedom is 9.21 calculated values is 13.2 which is greater than table value therefore null hypothesis is rejected and alternative hypothesis is accepted. From the analysis, it can be concluded that Transparency and disclosure of stock exchange's information enhances its performance.

Validity Test: The data collected and finding are adequate for testing the validity of this hypothesis.

In analysing this variable it was expected that disclosure and transparency have an impact in enhancing stock exchange's performance.

4.6 Interpretation of the Results

From the responses of the interviewee the following could be interpretations of the results.

4.6.1 Changes in governance structure and directors' performance

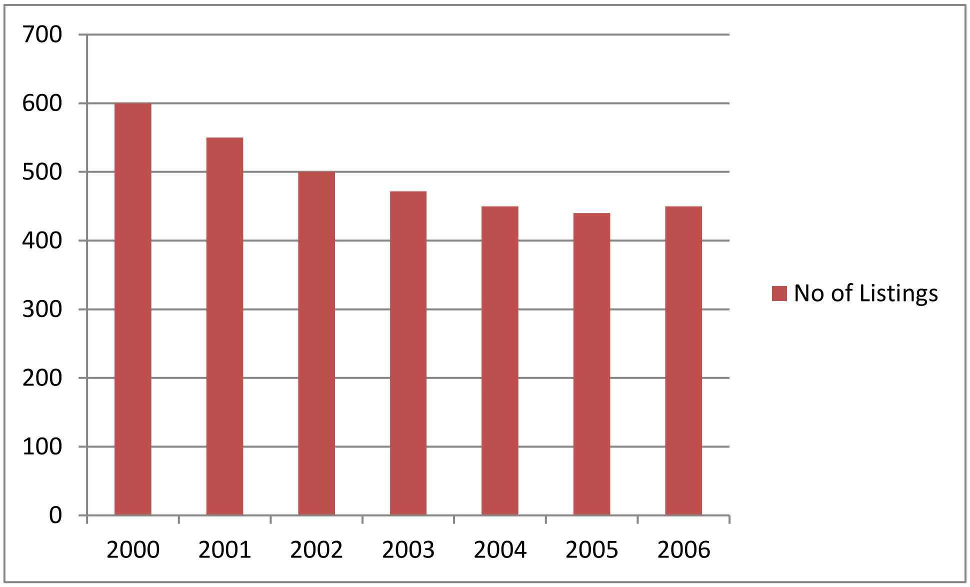
The study revealed that the demutualized governance structure coupled with directors' performance would result into a performing stock exchange. The results are also being confirmed by post demutualization performance of JSE. The following post demutualization performance trends elucidate the above argument:

Number of listed companies

New listings overtook delistings for the first time since 1998

The stock also experience growth in foreign listings

GRAPH 4.6 : JSE: Number of listings

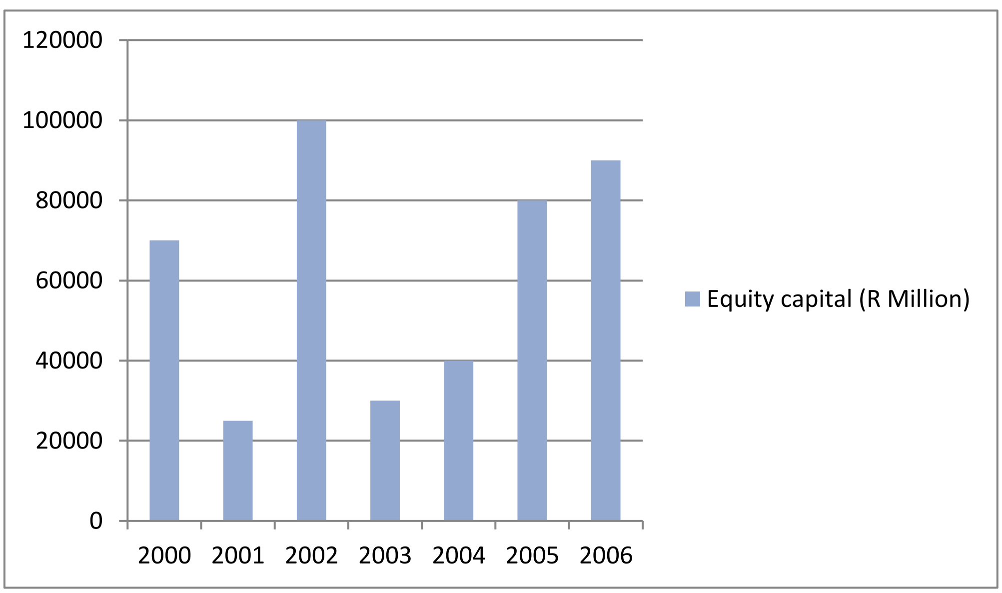


Source: www.jse.co.za

Equity capital

Increase in equity capital after a continuous poor performance in 2003 and 2004

GRAPH 4.7 JSE: Equity capital raised



Source: www.jse.co.za

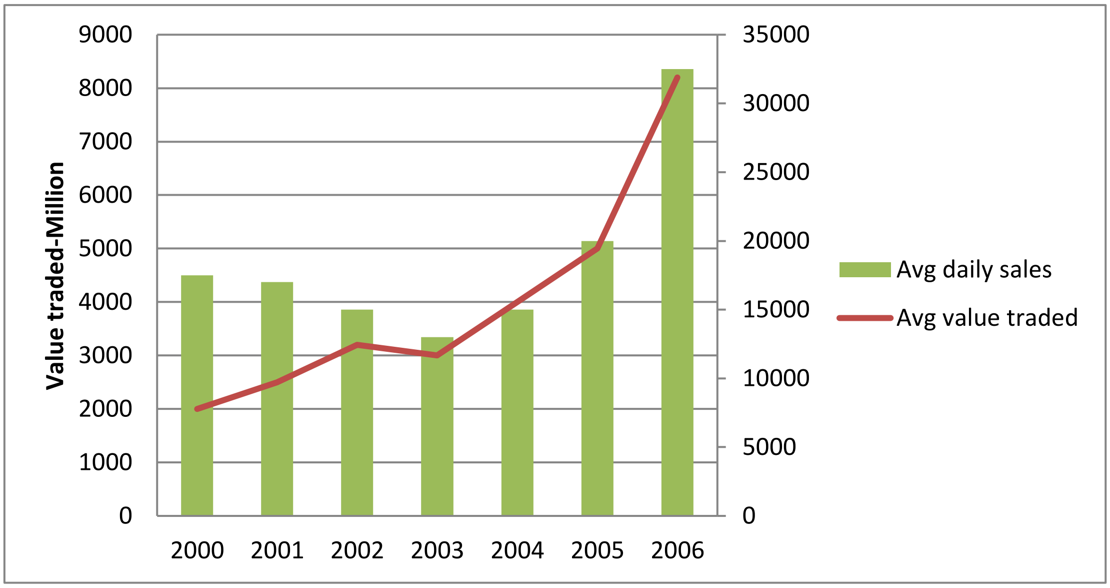
Continued strong performance in secondary markets

Average daily traded value up by 68% in 2005

Average number of deals up 58 in 2005

Net foreign investment at all time high- over R73 Billion

GRAPH 4.8 Secondary Market Performance



Source: www.jse.co.za

4.6.2 Transparency and Disclosure

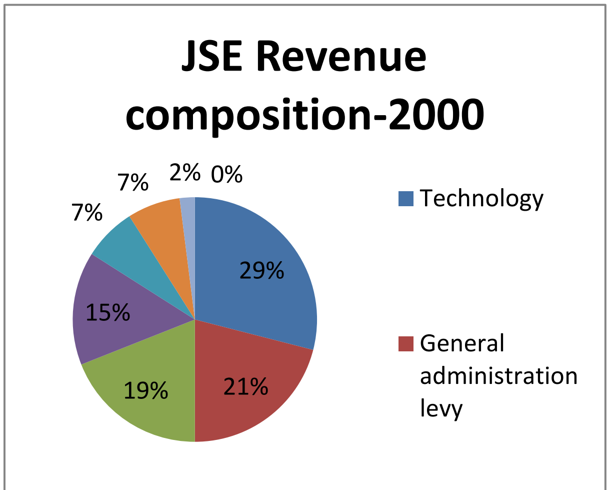
Transparency and disclosure are key phenomena in improving investors' confidence. Investors want analytical and fairly presented information to enable them to do informed decisions.

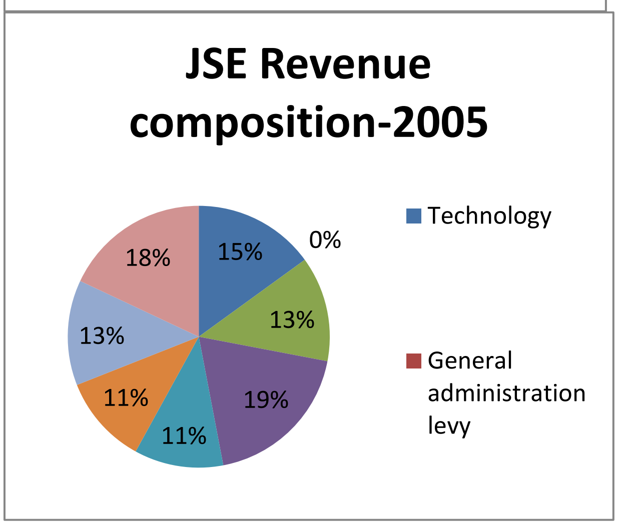
The demutualized stock exchange seems to support the transparency and disclosure requirements necessary for a semi efficient stock exchange. Increased transparency is expected to remove the information asymmetry and thus improve on stock performance.

The study is indicating that there is alertness regarding internal control policies and procedures that are adequate to identify potential errors, fraud, or illegal acts; a stock's system of internal control has a key role in the management of risks that are significant to the fulfillment of its business objectives.

The impact of transparency and disclosure is further evidenced by revenue diversification improvement soon after demutualization:

GRAPH 4.9 Change in revenue composition after demutualization





Source: www.jse.co.za

Analytical summary: Case study analysis

JSE sought to give its shareholders the benefit of a transparent and easily accessible market in which to trade JSE shares

Demutualisation and listing was seen as a natural progression from the mutual base to enable more effective competition with international exchanges

Demutualization process

- The JSE's demutualisation coincided with subsequent listing on its own exchange

  – Shares traded OTC until listing in 2006
- On demutualisation, the JSE rights were converted into JSE shares and each rights holder received shares for every rights held

- The listing itself required no structural change of the JSE apart from increasing the number of shares in issue by means of subdivision

Change in focus and activities

- Introduction of electronic trading
- Amendment to the exchanges rules to include foreign members
- Established advisory committees to advice the JSE executive committee
- Restructured the composition of the main committees to comply with best practices in corporate governance

Overcoming regulatory challenges

- The introduction of the Securities Services Act acted to facilitate the demutualisation process
- Introduced an independent board of directors
- Membership and ownership of the JSE no longer remained statutorily linked and JSE shares were freely tradable
- Ownership restrictions imposed by FSB of 15% were imposed on any single entity ownership

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents summary of findings, conclusions and recommendations of research questions.

5.2 Summary of findings

The governance structure of a stock exchange determines the level of strategic commitment towards performance. The research has shown that a demutualised structure is more likely to implement good corporate governance principles thus improving its credibility among investors and therefore its performance. The learnings from the case study support the idea that demutualization of stock exchange is expected to boost the operational and economic performance of stock exchange by increasing the level of control and transparency on daily stock transactions. Mandatory disclosures enable the investors to make informed decisions which in turn improve the value of their investments thus growing the economy.

Changes in governance structure

The mutual fund stock exchanges are governed by partnerships of members of respective stock exchanges or a board of trustees if limited by guarantee. The demutualized stock exchange change the governance structure to include a board of directors specifically appointed/recruited to manage the exchange.

The new governance structure has been shown to also consider succession plan for key positions including board chairperson and chief executive officer.

In order for the BoD to effectively perform its functions, the research has also shown that the board must have effective corporate governance committees constituted in accordance with best practices.

The post demutualization governance structure has on the other hand been shown to provide comparatively sufficient leadership, control of business, monitoring of managerial performance and optimization of shareholders' value.

5.3 Conclusions

In concluding this research assignment, the research firmly confirms that the change in governance structure and directors' performance have a greater role in enhancing the overall performance of a stock exchange. Effective and efficient running of a stock exchange would result into improved investor confidence.

- Post demutualization changes in governance structures, the sole purpose of demutualization is to change the governance structure from mutual to share based ownership. The case study has affirmed this concept as the post demutualized structure of JSE saw a new board of directors and new committees formed. The new structure increased effectiveness of directors who in turn improved the exchange's overall performance.

- Exchange boards should focus on importance of succession planning for the key positions to enable them to have highly qualified individuals in all positions as we have seen in the study that competence and qualifications of directors is an essential input to the day to day performance of a stock exchange.

- The study indicates that the case study exchange has effective Corporate Governance committees in place constituted in accordance with best practice. From Corporate Governance point of view, board committees are very important as these committees effectively assist directors' in executing their responsibilities.

- For a stock exchange to perform, the focus should not be on changing the structure alone, but rather on how to undertake a review of board's effectiveness at least in an annual basis.

- Transparency and disclosure of company information is the fundamental responsibility of Board of Directors, who have to ensure fulfillment of this responsibility - timely and accurately to both investors and general public.

- A sound system of internal control contributes on the safeguarding shareholders' investment and the stock's assets. Effective financial controls, including the maintenance of proper accounting records, are important element of internal control. It is actually a process affected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of stock's objectives in terms of effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations.

5.4 Recommendations

In concluding this study there are some recommendation that should be taken into account.

The recommendations stem from the end product of demutualization, which is a new governance structure under oversight of an independent board of directors and third party regulatory authorities.

- Stock exchange's Board of directors should be recruited instead of being appointed/selected this will enable the boards to have competent people at all time. Few factors to be considered by the board when considering a person for recruitment as a director should be that if a person:-

i. is likely to contribute to the overall effectiveness of the Board and work constructively with the existing directors;
ii. the integrity of the person;
iii. whether the person would be prepared to question, challenge and offer critiques;
iv. whether the person had a proven track record of creating value for shareholders;
v. had a commitment to the highest standards of Governance;

- Succession plan should be given high priority; Stock exchange's board should identify access and develop overall talent to ensure continuity of leadership for all key positions. Individuals who should be considered in the succession planning process should be for executive director, members of the board of directors and key staff members.

At least three key elements in the process of effective succession planning should be considered, and these are as follows:-.

i. Recruit right calibre of employees,
ii. Develop their skills and abilities, and
iii. Prepare them for advancement while retaining them, thus ensuring a return on the organization's training investment.

- From Corporate Governance point of view, Board Committees are critically important as these committees effectively assist directors' in executing their responsibilities. There are should be at a least 3 committees to support the board. These three committees will have different objectives.

Audit committee is likely to have the following responsibilities:-

i. oversee accounting and financial reporting processes and audits of the financial statements,
ii. review judgements and decisions affecting financial statements,
iii. review all financial data to be released,
iv. monitor compliance with applicable laws and regulations and review significant cases of misconduct,
v. oversee internal controls and procedures and evaluate performance

Another important committee is compensation committee that will have the following responsibilities

i. recommend directors compensation ,
ii. recommend compensation for CEO and set compensation for executives ,
iii. establish compensation program for employees ,
iv. administer employee benefit and incentive plans,
v. review management development and succession policies

And the last important committee is Corporate Governance committee that will foresee the following issues:-

i. establish criteria for the selection of directors and recommend Board nominees
ii. conduct searches for prospective directors
iii. review candidates recommended by stockholders
iv. recommend committee membership
v. oversee Corporate Governance

- Investors should challenge effectiveness of the institution charged with responsibility to ensure Good Corporate Governance best practices are in place at the JSE. The reports issued to the stakeholders should be of high quality and sufficient to make quality decision for the new investors and public at large. Investors will only invest where they can foresee opportunities of earning returns in the future

- Boards must always be accountable to shareholders and they must act in good faith and ensure integrity of stock’s accounting and financial reporting systems including the independent audit and they must ensure that appropriate systems of control are in place, particularly systems for monitoring risk, financial control and compliance with the law. Its effectiveness is a key for the successful growth and performance of a stock exchange.

- Reviewing the effectiveness of internal control is an essential part of the board's responsibilities and effective monitoring on a continuous basis is an essential component of a sound system of internal control.

- Lessons for African exchanges considering demutualization

We have seen that the reasons and drivers for demutualization, the steps (regulatory, legislative and otherwise) that need to be taken, the on-going make up, structure, aims and regulatory environment in which the exchange operates, and the need to ensure that often disparate stakeholders are consulted and "buy-in" into the process, means that there is no "right" solution. The process is necessarily one that is unique to each jurisdiction and each exchange.

While helpful guidance can be, and should be, drawn from the international experience (both in developed and emerging markets) and best practice, the ultimate solution will be "path-dependent" and shaped by established local conditions and circumstances.

5.5 Areas for Future Research

This study has identified the following areas for future studies: -

5.5.1 The importance of Board Committees to demutualized stock exchange

The future research should try to establish whether the performance of a stock exchange could be improved by the introduction of mandatory Audit Committee in boards after the Companies Act, which replaced Companies Ordinance. Audit Committee is responsible for detailed review of all audit matters, the appointment of external auditors, the review of all financial controls and the review of stock related risks.

5.5.2 Impact of demutualization on alliances and consolidation of East African exchanges

The future of stock exchanges lies in their ability to form alliances and consolidating their undertakings. As demutualization is envisaged to be the trend for the future exchanges, the impact of the same to future stock alliances and consolidation is worth of a detailed study.

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APPENDIX 1: QUESTIONNAIRE

Dear Respondent,

The questionnaire presented to you is intended to collect information on a case study to be conducted to Johannesburg Stock Exchange. The objective of the study is to assess the impact of demutualization on performance of stock exchange whereby JSE is a case study

Due to limitation of knowledge on demutualization and in particular on JSE's history, the researcher shall provide you with a brief introduction on demutualization and then take you through the evolvement of JSE from its inception in 1887 to demutualization in 2005 and post demutualization in 2006. This aims at providing you with an insight enough to link with your prior knowledge of stock exchange governance structures as well as corporate performance.

In this regard therefore only individuals with relevant commercial education (Accounting and/Finance) at a degree level and experience accountants/finance professionals are kindly requested to participate in this study by providing appropriate responses in answering questionnaire to the space provided below. These answers will be used for academic purposes, as fulfillment of Masters of Science in Accounting and Finance (Msc. A&F) degree requirement at Mzumbe University. Your correct responses will enable the researcher to attain her intended objective.

SECTION A: Please provide us with your personal particulars

1. Place of Residence: **……………………………………...**

2. Sex: Female ( ) Male ( )
3. Marital Status: Married ( ) Single ( ) Divorced ( )

4. What organization are you working with?

…**……………………………………………………………**

5. Position

………………………………………………..

6. Age group: Below 20 years ( )

21 to 30 ( )

31 to 40 ( )

41 to 50 ( )

51 and above ( )

7. Please indicate the level of education you have attained:

Primary Education ( )

Secondary Education ( )

College ( )

University ( )

Others (please specify) ………………………………………..

8. (You may tick more than one) Are you a:

Board Member ( )

Shareholder ( )

Employee ( )

Others (please specify) ………………………………………..

SECTION B:

In the following questions please tick where appropriate.

I. Changes in governance structures and directors' performance

a) Does the JSE's board as explained to you show ability to regularly review the effectiveness of the internal control function?

1. No [ ]
2. Not sure [ ]
3. Yes [ ]

b) Is the explained board structure effective in attracting new investors to JSE as well as improving investor's confidence?

1. No [ ]
2. Not sure [ ]
3. Yes [ ]

c) Does the oversight by FSB as explained provide the formal review of the performance of the Board, individual directors, the chairman and the Chief Executive?

1. No [ ]
2. Not sure [ ]
3. Yes [ ]

d) In reference to a snapshot of post demutualization results shown to you, do you think the board monitors JSE's performance with peer stock exchanges' financial performance and with industry and other relevant comparative data?

1. No [ ]
2. Not sure [ ]

3. Yes [ ]

f) Does the board understand the industry in which the exchange operates and implication of competitive factors and current general economic and political trends to their businesses?

1. No [ ]
2. Not sure [ ]
3. Yes [ ]

g) In reference to information availed to you about JSE, do you see an adequate number of regularly-scheduled board meetings held during the year?

1. No [ ]
2. Not sure [ ]
3. Yes [ ]

II. Disclosure and transparency

a) As an accounting/finance professional, would you be satisfied with post demutualization transparency and disclosures of the JSE's various reports?

1. No [ ]
2. Not sure [ ]
3. Yes [ ]

b) Do you think the reports and presentations to the board are of high quality and are sufficient for effective evaluation of the performance of the JSE and its management?

1. No [ ]
2. Not sure [ ]
3. Yes [ ]

c) Do you see the post demutualization period bringing internal controls, policies and procedures adequate to identify potential errors, fraud and illegal acts?

1. No [ ]
2. Not sure [ ]
3. Yes [ ]

d) Do you think the post demutualization JSE's Board has put in place and communicated the necessary policies defining the scope of power, roles and responsibilities of the management as well as the standards to be adhered to.

1. No [ ]
2. Not sure [ ]
3. Yes [ ]

APPENDIX 2: CONTINGENCY TABLE USED

Hypotheses were tested using Chi square test to compare variances between theory and observation. The table below were used to capture observed data.

	Observed (O)	**Expected (E)**	**$(0\text{-}E)^2$**	**Tri = $(0\text{-}E)^2/E$**
1				
2				
3				
TCj				$\Sigma\ (0\text{-}E)^2/E$

From the table the expected frequencies (E) were calculated as follows;

Eij = (Tri x TCj)/GT and calculated

Chi square (χ^2) = $\Sigma\ (Oij - Eij)^2/Eij$

Where Oij = observed frequency in row (i) and column (j)

Eij = expected frequency in row (i) and column (j)

Tri = Total of row (i)

TCj = Total of column (j)

GT = Grand Total

The calculated value was be compared to critical value (value from the X^2 square table defined as χ^2,df, α

Where: df (degree of freedom) = (r-1) (C-1)

r = number of rows in the contingency table

C = number of columns in the contingency table

α = level of significance

Decision Rule: Was to reject the null hypothesis if and only if χ^2 calculated is greater than χ^2, df, α (value from the χ^2 square table)

The Researcher used the same procedure to test all the hypotheses