

**IMPACT OF CAPITAL MARKET PERFORMANCE ON
ECONOMIC GROWTH IN TANZANIA**

**By
Masumbuko Rashid**

**A Dissertation Submitted to Mzumbe University Dar es Salaam Campus
College in Partial Fulfilment of the Requirements for the Award of Degree of
Master of Science in Accounting and Finance (MSc A & F) of Mzumbe
University.**

2014

CERTIFICATION

We, the undersigned, certify that we have read and hereby recommend for acceptance by the Mzumbe University, a dissertation entitled Impact of Capital Market Performance on Economic Growth in Tanzania: in partial fulfilment of the requirements for award of the Masters of Business Administration Corporate Management.

Major Supervisor

Internal Examiner

Accepted for the Board of

DEAN/DIRECTOR, FACULTY/DIRECTORATE/SCHOOL/BOARD

**DECLARATION
AND
COPYRIGHT**

I, Masumbuko Rashid hereby declare that this dissertation is my own work and has not been presented and is not being presented at any other university for a similar or any other degree award.

Signature_____

Date_____

© 2014

This dissertation is a copyright material protected under the Berne Convention, the Copyright Act 1999 and other international and national enactments, in that behalf, on intellectual property. It may not be reproduced by any means in full or part, except for short extracts in fair dealings, for research or private study, critical scholarly review or discourse with an acknowledgement, without the written permission of Mzumbe University, on behalf of the author.

ACKNOWLEDGEMENT

I would like to express my sincere appreciation for the many helpful contribution and suggestions I have received over the whole period from different people

Most importantly, I would like to thank my supervisor Mr. J Saburi for his commitment to guide me through my research. His critical commentary on my work has played a major role in both the content and presentation of my work.

I also extend my appreciation to several sources which provided various kinds of information for me during my study of Masters of MSc accounting and Finance; DSE Chief executive Officer Mr Moremi Marwa, DSE Operations Manager Emanuel Francis Nyalali

I am obviously very much indebted to my family for providing valuable atmosphere conducive to the completion of this research.

DEDICATION

This piece of work is dedicated with lots of love to, My wife Mrs Restituta Raphael, for her moral, guidance support. She is the ones who encouraged me to grow in a professional career by encouraging me to work hard in my studies.

LIST OF ABBREVIATIONS AND ACRONYMS

ADR	-	Authorised Dealer Representative
ATS	-	Automated Trading System
CMSA	-	Capital Market and Securities Authority
CRDB	-	Trade name for CRDB bank PLC
DCB	-	Dar Es Salaam Community Bank Ltd
DSE	-	Dar es Salaam Stock Exchange
DSEI	-	Dar es Salaam Stock Exchange Index
EADB	-	East Africa Development Bank
EGMS	-	Enterprise Growth Market Segment
IPO	-	Initial Public Offer
LDM	-	Licensed Dealer Representative
NICO	-	National Investment Company Ltd
NMB	-	National Micro Finance Bank PLC
PTA	-	Eastern, central and Southern African trade Development Bank
SIMBA	-	Brand name for Tanga Cement Company Ltd
SMEs	-	Small and Medium Enterprises
TATEPA	-	Tanzania Tea Packers Ltd
TBL	-	Tanzania Breweries Ltd
TCC	-	Tanzania Cigarette Company Ltd
TOL	-	Tanzania Oxygen Limited
TWIGA	-	Brand name for Tanzania Portland Cement Company Ltd

ABSTRACT

Stock market promotes economic growth is not in doubt. It serves as an important mechanism for effective and efficient mobilization and allocation of savings, a crucial function, for an economy desirous of growth. Capital markets can ensure the efficient and sustainable funding of governments, corporations and banks for large-scale or long-term projects.

The main purpose for undertaking this study is the interest in understanding the impact of capital market on Tanzania economic growth.

The data was collected from a Dar es Salaam Stock exchange and Tanzania Bureau of statistics.

By the use of some notable stock market development indicators, the impact between capital market and economic growth in Tanzania was found to be positive. However, this impact is not so significant. This in essence means that the impact of capital market on economic growth is weak and insignificant. The findings conclude that the Tanzania capital market contribution to gross fixed capital formation was very minimal fluctuating between 1.5 percent and 3.2 percent between 2006 and 2012.

TABLE OF CONTENTS

	Page
CERTIFICATION.....	i
DECLARATION AND COPYRIGHT.....	ii
ACKNOWLEDGEMENT.....	iii
DEDICATION.....	iv
LIST OF ABBREVIATIONS AND ACRONYMS.....	v
ABSTRACT.....	vi
TABLE OF CONTENTS.....	vii
LIST OF TABLES.....	x
LIST OF FIGURES.....	xi
CHAPTER ONE.....	1
BACKGROUND INFORMATION.....	1
1.1 Introduction.....	1
1.2 Background of the Problem.....	1
1.3 Capital market and Economic Growth.....	2
1.4 Emergence of Capital Market and Establishment of DSE in Tanzania.....	3
1.4.1 Trading at the DSE.....	4
1.4.2 Indices of the DSE.....	5
1.4.3 The Role of the Stock Exchange.....	5
1.4.4 Determinants of Capital Market Development.....	6
1.5 Statement of the Problem.....	7
1.8 Research Objectives.....	7
1.5.1 General Objectives of the Study.....	7
1.6.2 The Specific Objectives.....	8
1.7 Research question.....	8
1.6.1 General research question.....	8
1.7.1 Specific Research Questions.....	8
1.8 Scope of the Study.....	8
1.9 Significance of the Study.....	8
CHAPTER TWO.....	10
LITERATURE REVIEW.....	10
2.1 Introduction.....	10
2.2 Theoretical Literature Review.....	10
2.2.1 Conceptual Definitions.....	10
2.2.2 Capital Markets.....	10
2.2.3 Stock Exchange.....	10
2.2.4 Initial Public Offering (IPO).....	11

2.2.5	Value of Transactions or Trading Turnover.....	11
2.2.6	Volume of Shares Traded.....	11
2.2.7	Market Capitalization.....	12
2.2.8	Liquidity.....	12
2.2.9	Financial Development and Investment Productivity Theory.....	13
2.2.10	Capital Market in Emerging Markets.....	14
2.2.11	Development of Stock Market and Economic Growth.....	14
2.3	Empirical Literature Review.....	17
2.3.1	Capital Market Development in Africa.....	17
2.3.2	Brief history of Oldest Stock Exchanges Worldwide, Africa and East Africa .	19
2.3.2.1	Amsterdam Stock Exchange.....	19
2.3.2.2	Casablanca Stock Exchange (La Bourse de Casablanca).....	20
2.3.2.3	Nairobi stock Exchange.....	20
2.4	Research Gap.....	22
CHAPTER THREE.....		23
RESEARCH METHODOLOGY.....		23
3.1	Introduction.....	23
3.2	Research Design.....	23
3.3	Area of the Study.....	23
3.3.1	Secondary Source.....	23
3.3.2	Data Collection Methods.....	24
3.3.3	Documentary Review.....	24
3.3.4	Interview.....	24
3.4	Research Tools.....	25
CHAPTER FOUR.....		26
RESEARCH FINDING AND ANALYSIS.....		26
4.1	Introduction.....	26
4.2	Tanzania Economic Growth.....	26
4.2.1	Gross Value Added.....	26
4.2	DSE General Performance.....	30
4.2.1	DSE Turnover Annual Growth.....	31
4.2.2	Operational Efficiency in enhancing Liquidity at DSE.....	33
4.2.3	DSE liquidity ratio by Value Traded Ratio Method.....	35
4.2.4	DSE Local Listed Companies.....	
CHAPTER FIVE.....		41
CONCLUSION AND RECOMMENDATION.....		41
5.1	Introduction.....	41

5.2 Conclusion.....41
5.3 Recommendations42
REFERENCES.....44

LIST OF TABLES

	Page
Table 2.1: Africa Stock exchanges and number of listings.....	18
Table 4.1: Gross Value Added by Activity at Constant 2001 Prices.....	27
Table 4.2: Gross value added by activity at constant 2001 prices in million Tshs	28
Table 4.3: Gross Value Added by Activity at Constant 2001 Prices – Percentage Changes	29
Table 4.4: DSE General Performance for Last 8 Yeas.....	31
Table 4.5: DSE Turnover Annual growth.....	32
Table 4.6: DSE Local Market Capitalization Annual Growth.....	34
Table 4.7: DSE liquidity Ratio by Value traded Ratio Method	35
Table 4.8: DSE Liquidity Ratio by Turnover Ratio.....	37
Table 4.9: DSE Number of New Listings from 2006	39
Table 4.10: Capitalization Ratio	39

LIST OF FIGURES

	Page
Figure 4.1: DSE TURNOVER Growth rate from 2007	33
Figure 4.2: DSE Capitalization Ratio in Tshs	40

CHAPTER ONE

BACKGROUND INFORMATION

1.1 Introduction

This chapter gives the background information of the study which includes an overview of Capital Markets and Economic growth in Tanzania and it also explains the statement of the problem, objectives, and significant of the study.

1.2 Background of the Problem

A capital market is a market for securities - debt or equity, where companies and governments can raise long term-term funds. It is defined as a market in which money is provided for periods longer than a year, (Sheffrin, 2003).The well-functioning of country's capital market is a dominant condition for economic development.

Stock markets are essential because they allow competition between various instruments of a bank-based financial system and the non-bank financial intermediaries. In addition, stock markets allow risk sharing on an individual basis, without the need for a government guarantee. Furthermore, stock market offer instruments which do not suffer from a cash-flow mismatch; and facilitate the development of other financial markets such as derivative markets.

By allowing competition between various instruments, stock markets are well positioned to satisfy each investor's risk, return on investment and horizon preferences (maturity matching). In most of Africa's bank-based financial system, the choices for lenders (savers) and borrowers are very constrained. Investment is often constrained to safe but low, and sometimes negative rates of return in tightly regulated financial markets or to the higher, riskier rates of return in the unregulated markets. On the other hand borrowers are restricted to the high rates of interest charged by banks or are constrained by the amount of credit available on the high-risk unregulated financial markets. In stock markets there are no stipulated ceilings on return on investments. As a consequence they offer an alternative safe but low, sometimes negative rates of return. In developing countries, they provide investors with a greater range of risk and return opportunities

than a bank-based financial market. They also allow for a better matching of the risk and return features of lender and borrowers.

Stock markets allow risk sharing, without the need of government guarantees. Most bank loans in African countries require implicit or explicit government guarantees. In contrast equity market returns are not guaranteed by the government. Expected returns are driven by the performance and prospects of the company itself, and not by government guarantees.

Institutional investors have become increasingly important for both asset management and the development of capital markets in any economy. In fact, institutional investors are likely among the most important conduits of private and public savings, supplying capital for firms and countries to grow. Among institutional investors, pension funds have played a crucial role across countries (Davis, 2001).

Pension funds face the regulatory requirement to allocate a large fraction of their capital domestically and given the large size of their capital, they are expected to invest in a broad range of domestic assets and diversify risk as much as possible within the country. Therefore relative to other institutional investors, pension funds are thought to be the ones which contribute the most to the development of domestic capital markets (Raddatz and Schmukler, 2008).

1.3 Capital market and Economic Growth

At any stage of a nation's development, both the government and the private sectors would require long-term capital. For instance, companies would need to build new factories, expand existing ones, or buy new machinery. Government would also require funds for the provision of infrastructures. All these activities require long-term capital, which is provided by a well functioning stock market. Stock market may also affect economic activities through the creation of liquidity. Liquid equity market makes available savings for profitable investment that requires long-term commitment of capital. Hitherto, investors are often reluctant to relinquish control of their savings for long periods. As asserted by Bencivenga, Smith and Starr (1996), without liquid capital market there would be no industrial revolution. This is because savers would be less

willing to invest in large, long-term projects that characterized the early phase of industrial revolution.

Accelerated economic growth may also result to acquire information about firms. Rewards often come to an investor able to trade on information, obtained by effective monitoring of firms for profit. Thus, improved information will improve resource allocation and promote economic growth. The nature and economic significance of the relationship between stock market development and growth vary according to a country's level of economic development with a larger impact in less developed economies (Filler, Hanousek and Campos, 1999). The proponents of positive relationships between stock market development and economic growth hinged their argument on the fact that the stock market aids economic growth and development through the mobilization and allocation of savings, risk diversification, liquidity creating ability and corporate governance improvement among others.

1.4 Emergence of Capital Market and Establishment of DSE in Tanzania

The development of capital markets has been considered an important aspect in the achievement of the economic recovery programme. The emergence of capital market in Tanzania had to undergo various stages before it stood as it is now.

The first stage in developing capital market was the establishment of Capital Markets and Securities Act of 1994 to supervise, regulate and develop capital markets and security businesses in Tanzania. It commenced its operations as a unit under the Bank of Tanzania on 8th April 1994. The Act makes provision with respect to stock exchanges, stock brokers and other persons dealing in securities. The Act provides a framework for the regulation of Securities business in the country. The case for regulations is needed to protect investors and market integrity by ensuring liquidity, capital adequacy as well as good behaviour by market participants.

The second stage was to establish Dar es Salaam Stock Exchange (DSE) as the secondary market in Tanzania. DSE was incorporated in September 1996 as a company limited by guarantee without a share capital. The DSE is a non-profit making body created to facilitate the Government of Tanzania implementation of the financial reforms

and in the future to encourage wider share ownership of privatized and all the companies in Tanzania (DSE handbook, 2008). The exchange did not operate until April 1998 with the listing of the first company.

More than 180,000 Tanzanians currently own shares in various companies Listed at DSE. Foreign participation is capped at 60% of the listed companies with a balance of 40% reserved for Tanzanian Nationals.

1.4.1 Trading at the DSE

From April 1998 to November 2006 trading was conducted at the DSE Trading Floor under a continuous open outcry auction trading system. This trading system is whereby representatives of the Licensed Dealing Members (LDMs) converge at the trading floor and trade by shouting their orders to the board writers who records the orders on the board. The trading is commenced and ended by the ring of a bell.

From December 2006 up to now the DSE trading system changed to Automated Trading System (ATS). This trading system is where by the orders from Authorised Dealer's Representative (ADR) are entered in the computer based system and then matched automatically by the system when trading time starts. Execution of matching orders continues to take place for the rest of trading session before the trading session comes to an end at 12:00 hours. Advantages of Automated Trading System among others includes: Increasing productivity due to increase in capacity to handle many transactions accurately; freeing LDMs and the DSE to concentrate on other key business activities e.g. marketing, public education and research; widening the client base for LDMs as it can be easily implemented country wide; reducing human intervention which lowers transaction costs and reduces the chance of errors, thereby cutting out one area of operational risk; enabling the conduct of longer trading sessions as there are no human limitations due to automation; ensuring that every buy or sell order receives maximum exposure; and giving equal treatment to market participants i.e. LDMs and strictly observes pre-defined Trading Rules as prescribed by the DSE.

1.4.2 Indices of the DSE

A share Index is a tool that can be used by investors to judge portfolio performance, computation of security's systematic risk and examining factors that influence aggregate securities' price movements within a stock market. It is sufficient to say that the use of stock market indices is the standard method of assessing the performance of a stock exchange (DSE 10th Anniversary, 2008).

From its inception in 1998 till June 2007, the DSE had not established formal indices to gauge the performance of the stocks in different sectors. Individual investors and fund managers for corporations relied on their own ways to determine and decide which stocks they should invest in. Alternatively, there were privately developed indices by CORE Securities Company Limited, an LDM and a member of the Dar es salaam Stock Exchange. The indices were COREDEX Composite Index (CCI) and COREDEX Average Index (CAI).

The DSE launched its All Share Index on 21st August 2007 abbreviated as DSEI. The DSEI includes all listed companies (local and cross listed securities). The facts that cross listed securities are inactive at the DSE, it is evident that the index did not reflect the true performance of Tanzanian stocks. Furthermore, the DSEI does not take into consideration sectorial performance of stocks. Therefore, in January 2009, DSE introduced 5 more indices to measure sectorial stock performance, locally listed securities performances and foreign cross listed securities. The indices introduced were Tanzania Share Index (TSI), Industrial and Allied (IA), Banks and Insurance/Investment (BI), Commercial Services (CS) and Foreign Share Index (FSI). All indices started at 1000 as a base value.

1.4.3 The Role of the Stock Exchange

The main function of a stock exchange is to raise capital and, as such, a stock exchange is vital to the growth of an economy. It has implications for the flow of capital and the savings. Investment industries of the entire country are directly affected by the stock exchange. The channelling of savings into industries, green fields projects, job creation activities, the provision of housing, education and health care services, as well as the

development of the infra-structure, are all affected to a greater extent by the workings of the stock exchange.

In broad economic terms a primary role of a stock exchange is to gather a portion of the savings from the nation and pass them on as efficiently and effectively as possible to the users of capital, thereby creating productive capacity, employment and wealth and thereafter to provide a market in which investors may trade the securities of the listed companies. Thus, according to the (DSE Handbook, 2011) the main activities of a stock exchange can be seen as:

- (i) A market for raising capital in its primary form to develop new and to expand existing business;
- (ii) Creating the opportunities in which securities can be issued and investors may participate in the primary market;
- (iii) Providing a secondary market is not only important in itself but, without an effective secondary market, the primary market is impaired;
- (iv) An efficient mechanism for matching the supply and demand for capital. This is of benefit to those wishing to issue new securities; and
- (v) Providing a measure by which securities can be valued for the purpose, among others, of reflecting listed securities in financial statements; the valuation of “trust” type portfolios (such as pension funds) and the granting of credit against a security.

The development of Capital Market in Tanzania and the DSE in particular is expected to play a vital role in the evolution of the country’s economy.

1.4.4 Determinants of Capital Market Development

Measuring stock market development is important because it is the guideline for predicting economic growth. In broad terms, it is found that saving rate, financial intermediary, stock market liquidity and the stabilization variable are the important determinants of stock market development (Naceur, Ghazouani & Omran, 2007). Also, there are additional variables useful for measuring stock market development. These includes; number of listed companies at the exchanges, market capitalization, value of

shares traded, volume of shares traded, deals concluded and value of the central securities depository.

1.5 Statement of the Problem

It is seventeen years since Capital Markets and securities Authority became operational in 1995/1996 as an autonomous body. Likewise it is fourteen years since DSE became operational in April, 1998. The establishment of these two bodies aimed at spreading stock market activities in the country for individual gains and economic growth of Tanzanians. It has to facilitate the development of the small entrepreneurs and the small individual investors.

They have to focus further on sensitizing people and institutional investors to participate in buying and selling shares as well as encouraging firms and companies to go public and listing. Moreover, an effective information disclosure is very important in the stock exchange that will make public be aware of what is taking place in the market.

The attraction of investing in securities is liquidity. Investors generally like to be able to alter their positions (buy or sell) without an excessively long wait or moving the price against them. Do the DSE activities such as listed securities (equities), value of shares traded per annum, volume of shares traded per annum, deals per annum, market capitalization, liquidity and the value of central securities depository suggest a development of stock market in Tanzania? It has been argued that many stock exchanges in Africa are still in the process of developing, modernizing, or streamlining operational procedures. Therefore, Trading and pricing mechanisms, clearing and settlement, and share registration and custody practices remain outdated (Makonnen, 2001). Given that the stock market provides some services that stimulate economic growth, this study, therefore, investigates whether there is impact of capital market performance on economic growth in Tanzania

1.8 Research Objectives

1.5.1 General Objectives of the Study

The general objective of this research was to establish if there are impacts of capital market performance to economic growth in Tanzania.

1.6.2 The Specific Objectives

The specific objective of the study was:

- (i) To examine relationship between capital market performance and economic growth in Tanzania
- (ii) To identify capital market important factors that predict economic performance in Tanzania

1.7 Research question

1.6.1 General research question

What is the impact of capital market performance to economic growth in Tanzania?

1.7.1 Specific Research Questions

- (i) Is there any relationship between capital market performance and economic growth in Tanzania?
- (iii) What are capital market important factors that predict economic performance in Tanzania

1.8 Scope of the Study

The study was conducted at Dar es Salaam Stock exchange looking for the level of activities of capital market for last six years. Therefore, the study will confine but not limited to the following inter related issues:

- (i) Tanzania Economic growth in terms of overall GDP for last six years
- (ii) DSE total market Capitalization last six years
- (iii) DSE total new issue of bonds and equities for last six years
- (iv) DSE value of transactions for bond and equities for last six years
- (v) DSE total listed securities for last six years

1.9 Significance of the Study

It is understood that the existence of positive effect of capital market development on growth has its main theoretical support in within the economy growth models whereby more liquid and efficient stock markets increase the incentives for long run investments, thus increasing economic growth.

Apart from the recommendations that provided in the study, this research will help regulators CMSA, SSRA, BOT and DSE, a self-regulatory organization (SRO) to put in place investment guidelines, trading rules and regulations that enhance capital market activities, which in turn accelerates economic development of Tanzania.

Furthermore; the study will stimulate further researches about economic growth and capital markets development in Tanzania, to the areas where the researcher will not give much attention.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

Having looked at background of the problem of this study in chapter one, this chapter reviews the literature on evolution of Pension Funds and development of capital markets. In order to make a detailed review the chapter is divided in two main sections that is theoretical literature review and empirical literature review.

2.2 Theoretical Literature Review

2.2.1 Conceptual Definitions

2.2.2 Capital Markets

Capital markets are the markets for long-term loan able funds as distinct from the money markets, which deals in short-term funds. However, there is no clear-cut distinction between the two markets. In principle, capital market loans are used by industry and commerce mainly for fixed investment. The capital market is an increasingly international one and in any country the market is not one institution but all those institutions that supply and demand for long-term capital. In this respect, stock exchanges could be defined as the central point of the capital market. (Economic Commission for Africa, 1999)

2.2.3 Stock Exchange

Organized and regulated financial market where securities, bonds and shares are bought and sold at prices governed by the forces of demand and supply.

Stock exchanges basically serve as:

- (i) Primary markets where corporations, governments, municipalities, and other incorporated bodies can raise capital by channelling savings of the investors into productive ventures; and
- (ii) Secondary markets where investors can sell their securities to other investors for cash, thus reducing the risk of investment and maintaining liquidity in the system.

Stock exchanges impose stringent rules, listing requirements, and statutory requirements that are binding on all listed and trading parties. Trades in the older exchanges are

conducted on the floor called the 'trading floor' of the exchange itself, by shouting orders and instructions (called open outcry system). On modern exchanges, trades are conducted online as it is a case of Dar es salaam Stock Exchange. Almost all exchanges are 'auction exchanges' whereby buyers enter competitive bids and sellers enter competitive orders through a trading system.

2.2.4 Initial Public Offering (IPO)

An initial public offering (IPO) describes the first sale of stocks issued by a privately owned company. The main purpose for floating shares to the public market is the company's high demand for capital. Often companies intend to raise large amounts of capital for particular purposes as for example the expansion of business. An IPO can be used by company owners to exit their current investments and cash out. Particularly, private equity and venture capitalists often use an IPO as a reasonable strategy to exit their investment. In addition, a public offer does not require the seller to exit the investment entirely. The current business owner has the opportunity to sell the company only partially and, as a result, gain access to capital markets while maintaining a controlling stake in the company (Rudor, Schoon, 2006). In Tanzania so far, initial public offering has been used in two aspects, by the government to exit business from state owned companies and by new companies wishing to raise capital from the public.

2.2.5 Value of Transactions or Trading Turnover

Value of transactions refers to the cumulative total of each transaction quantity multiplied by transaction price for all securities for a given period of time. Value of shares traded is commonly reported as a trading turnover in currency terms. Value of shares traded is an important factor in determining the liquidity of the market.

2.2.6 Volume of Shares Traded

Volume of shares traded refers to the cumulative total of each transaction quantity for all securities for a given period of time. Volume of shares traded and the number of deals completed are important factors to show the activeness of the market.

2.2.7 Market Capitalization

Market capitalization shows the overall size of the stock market in currency terms and sometimes as a percentage of GDP (World Development Indicators, (2010)). The number of domestic listed companies is another measure of market size. Market capitalization can simply be defined as the cumulative total of the products of current share price for each individual listed company multiplied by its issued shares of the company.

2.2.8 Liquidity

Basically, liquidity refers to the ease with which assets (in this case security) can be turned into cash through an efficient market. That is, the ability to easily buy and sell securities.(Demirguç-Kunt & Levine, 1996) identified two main reasons why liquidity is important in any stock market. The first is that liquidity relates to the riskiness of the investment. An investment is deemed to be less risky where investors are able to alter their portfolios quickly and cheaply. While the second, theoretically, allocation of capital is more efficient and as such liquid market enhances long-term economic growth. Added to the points above (Osinubi,2007) pointed out that liquidity of the stock market facilitates profitable interaction between the stock market and the money market in that shares become easily acceptable as collateral for bank lending thereby boosting credit and investment.

According to (Wuyts, 2007) a market is liquid if traders can quickly buy orsell large numbers of shares without large price effects.

(Harris, 1990) distinguishes four aspects. The first one is width, referring to the bid-ask spread for a given number of shares and commissions and fees to be paid per share. Secondly, depths the number of shares that can be traded at a given bid and ask prices. The third one, immediacy, refers to how quickly trades of a given size can be done at a given cost. The final aspect is resiliency. It characterize show fast prices revert to former levels after they changed in response to large order flow imbalances initiated by uninformed traders.

There are two main measures of liquidity; total value traded ratio and turnover ratio.

- (i) Total value traded ratio is the total value of shares traded on the Stock market exchange divided by GDP. It measures trading of equities as a share of national output. Normally, it should positively reflect liquidity on an economy wide basis.
- (ii) Turnover ratio is the value of total shares divided by capitalization. High turnover reflects low transaction costs.

2.2.9 Financial Development and Investment Productivity Theory

The theories linking financial development and investment productivity are based on the financial repression hypothesis, (Shaw, 1973). Advocates of this hypothesis suggested that many financial systems in Africa had been subjected to financial repression characterized by low or negative real interest rates, high reserve requirements, mandatory credit ceilings; directed credit allocation to priority sectors, which undermined a locative efficiency; and heavy government ownership and management of financial institutions. Financial repression in the African economies laid a basis for major financial reforms, including reforms in the capital market.

Shaw, advocated for financial liberalization, which they argued contributes to increased possibilities of risk diversification by financial institutions, particularly if it involves the opening up of domestic markets to foreign competition. This helps reduce the cost of capital and improve the efficiency, (Shaw, 1973).

Since the Mckinnon and Shaw hypothesis, extensive theoretical literature focusing on the capital market has been developed. Some of the authors for instance (Senbet & Otchere, 2005); (Blair, 2000);(Levine & Zervos, 1996),have used the multifunctional approach of stock markets to link stock markets to investment efficiency. According to these authors, first, stock markets facilitate price discovery, price has information content and transmits signals to various stock holders in the market which facilitates decision making thus allowing allocation of resources to their best use. Second, stock markets promote efficient governance and control mechanisms by exerting external pressure and discipline in its operations. The market serves as a signal to managerial performance. In an environment of uncertainty, contractual parties cannot easily observe or control one another and enforcement mechanisms are costly. Stock markets provide price-based monitoring mechanisms for suboptimal behaviour by management and

hence put pressure on management to take corrective action. This is evident in the facilitation of takeovers by stock markets through price information, in which case, inefficient management is replaced by supposedly efficient management through accumulation of shares in the open market by the new owners.

Other authors however disagree with the above arguments contending that, due to dispersed stock ownership, individual investors are relatively small and they neither have the ability nor the incentives to acquire the costly yet necessary information for achieving efficient resource allocation, (Stiglitz, 2000); (Singh, 1997). Furthermore, while stock markets can facilitate the collection of information on investment opportunities, they also make this information accessible to all market participants. This creates a free-rider problem which may discourage investors from expending resources to collect information (Stiglitz, 2000). Thus, according to these authors the positive linkages between stock markets and investment efficiency through information advantages may not increase.

2.2.10 Capital Market in Emerging Markets

Emerging markets are working towards reforming and deepening financial systems, through the expansion of capital markets in order to improve their ability to mobilize resources and efficiently allocate them to the most productive sectors of the economy. A significant policy change has been established on privatization programs, which have facilitated reduction in public debt, improved incentives and efficiency in the operations of the privatized entities, and facilitated better access to capital through the floating of shares to the general public (Claessens, Klingebiel, & Schmukler, 2005). Over the past two decades, capital markets in emerging markets have experienced a rapid evolution. The aggregate market capitalization of the countries classified by the IFC as emerging markets rose from \$488 billion in 1988 to \$2,225 billion in 1996. Trading on these stock markets rose in similar magnitude, growing from \$411 billion to \$1,586 billion in that period, (Perotti & Van Oijen, 1999).

2.2.11 Development of Stock Market and Economic Growth

Stock market is expected to accelerate economic growth by providing a boost to domestic savings and increasing the quantity and the quality of investment (Singh,

1997). The stock market is expected to encourage savings by providing individuals with an additional financial instrument that may better meet their risk preferences and liquidity needs. Better savings mobilization may increase the savings rate (Levine & Zervos, 1998). Stock markets also provide an avenue for growing companies to raise capital at lower cost. In addition, companies in countries with developed stock markets are less dependent on bank financing, which can reduce the risk of a credit crunch. Stock markets therefore are able to positively influence economic growth through encouraging savings amongst individuals and providing avenues for firm financing.

The stock market is supposed to ensure through the takeover mechanism that past investments are also most efficiently used. Theoretically, the threat of takeover is expected to provide management with an incentive to maximize firm value. The presumption is that, if management does not maximize firm value, another economic agent may take control of the firm, replace management and reap the gains from the more efficient firm. Thus, a free market in corporate control, by providing financial discipline, is expected to provide the best guarantee of efficiency in the use of assets. Similarly, the ability to effect changes in the management of listed companies is expected to ensure that managerial resources are used efficiently (Kumar, 1984).

Efficient stock markets may also reduce the costs of information. They may do so through the generation and dissemination of firm specific information that efficient stock prices reveal. Stock markets are efficient if prices incorporate all available information. Reducing the costs of acquiring information is expected to facilitate and improve the acquisition of information about investment opportunities and thereby improves resource allocation. Stock prices determined in exchanges and other publicly available information may help investor make better investment decisions and thereby ensure better allocation of funds among corporations and as a result a higher rate of economic growth.

Stock market liquidity is expected to reduce the downside risk and costs of investing in projects that do not pay off for a long time. With a liquid market, the initial investors do not lose access to their savings for the duration of the investment project because they can easily, quickly, and cheaply, sell their stake in the company (Bencivenga & Smith,

1996). Thus, more liquid stock markets could ease investment in long term, potentially more profitable projects, thereby improving the allocation of capital and enhancing prospects for long-term growth. It is important to point out, however, that, theory is ambiguous about the exact impacts of greater stock market liquidity on economic growth. By reducing the need for precautionary savings, increased stock market liquidity may have an adverse effect on the rate of economic growth.

Critics of the stock market argue that, stock market prices do not accurately reflect the underlying fundamentals when speculative bubbles emerge in the market (Binswanger, 1996). In such situations, prices on the stock market are not simply determined by discounting the expected future cash flows, which according to the efficient market hypothesis should reflect all currently available information about fundamentals. Under this condition, the stock market develops its own speculative growth dynamics, which may be guided by irrational behaviour.

Critics further argue that stock market liquidity may negatively influence corporate governance because very liquid stock market may encourage investor myopia. Since investors can easily sell their shares, more liquid stock markets may weaken investors' commitment and incentive to exert corporate control. In other words, instant stock market liquidity may discourage investors from having long-term commitment with firms whose shares they own and therefore create potential corporate governance problem with serious consequences for economic growth (Bhide, 1994).

Critics also point out that the actual operation of the pricing and takeover mechanism in a well-functioning stock markets lead to short term and lower rates of long term investment. It also generates perverse incentives, rewarding managers for their success in financial engineering rather than creating new wealth through organic growth (Singh, 1997). This is because prices react very quickly to a variety of information influencing expectations on financial markets.

Therefore, prices on the stock market tend to be highly volatile and enable profits within short periods. Moreover, because the stock market undervalues long-term investment, managers are not encouraged to undertake long-term investments since their activities

are judged by the performance of a company's financial assets, which may harm long run prospects of companies, Binswanger (1999). In addition, empirical evidence shows that the takeover mechanism does not perform a disciplinary function and that competitive selection in the market for corporate control takes place much more on the basis of size rather than performance (Singh, 1997). Therefore, a large inefficient firm has a higher chance of survival than a small relatively efficient firm.

These problems are further magnified in emerging markets especially sub-Saharan African economies with their weaker regulatory institutions and greater macroeconomic volatility. The higher degree of price volatility on stock markets in emerging markets reduces the efficiency of the price signals in allocating investment resources. These serious limitations of the stock market have led many analysts to question the importance of the system in promoting economic growth in African countries.

2.3 Empirical Literature Review

2.3.1 Capital Market Development in Africa

In the past 20 years (1990 – 2010), liberalization and privatization have become dominant themes in development strategies in Africa. The changing attitudes towards the role of the private sector in the development of African economies have facilitated the development of the capital markets. In the 1990s many countries in Africa set up stock exchanges as a precondition for the introduction of market economies under the structural adjustment programs propagated by the international monetary institutions and to facilitate the privatization of state owned enterprises. Currently, Africa has twenty six securities exchanges, eleven of which began operations in the 1990s.

The majority of the countries establishing new exchanges in Africa have established new legal and regulatory regimes. International financial institutions such as the International Finance Corporation of the World Bank and various bodies of experts belonging to national securities exchanges of industrialized countries have provided important assistance with a view to building the legislative, regulatory, and accounting basis for the proper running of African securities exchanges (Sheehan & Zavala, 2010).

The growth has not only been in market capitalization, but also in innovation such as the integration of regional markets in the francophone countries of West Africa. Eight (8) French-speaking members of the West African Economic and Monetary Union (UEMOA), namely, Benin, Burkina Faso, Côte d'Ivoire, Guinea Bissau, Mali, Niger, Senegal and Togo created the world's first regional exchange, the Bourse Regionale des Valeurs Mobilières (BRVM- Regional Stock Exchange) (Mbendi Information for Africa, 2010). The objective of the integration was the consolidation of the value of developing a common hub for capital market development in the geographical zone where these countries are located. The BRVM – Regional Stock Exchange has been innovative in using the most modern electronic and satellite communications equipment, which has enabled it to maintain performance despite the under-developed communications infrastructure in the individual countries comprising the exchange (Sheehan & Zavala, 2010). Another example of integration is in the East African Countries of Tanzania, Kenya, Uganda, Rwanda and Burundi which are currently in the process of integrating their stock markets into a regional East African stock market.

The jobs, businesses, prosperity and future of the Africa lie in the stock markets' ability to mobilize capital for economic development and growth. The securities exchanges can be a powerful tool for growing indigenous capital that will attract international capital if they are well designed and set up, properly regulated and supported by appropriate governmental policies (Sheehan & Zavala, 2010). At present, there are about twenty six stock exchanges in the continent (See Table 3.1).

Table 2.1: Africa Stock exchanges and number of listings

Exchange	Location	Founded	Listings
Bourse Régionale des Valeurs Mobilières	Abidjan	1998	39
Bourse d'Alger	Algiers	1997	3
Botswana Stock Exchange	Gaborone	1989	44
Douala Stock Exchange	Douala	2001	2
Egyptian Exchange	Cairo, Alexandria	1883	150
Bolsa de Valores de Cabo Verde	Mindelo	2005	4
Ghana Stock Exchange	Accra	1990	28
Nairobi Stock Exchange	Nairobi	1954	50

Libyan Stock Market	Tripoli	2007	7
Malawi Stock Exchange	Blantyre	1995	8
Stock Exchange of Mauritius	Port Louis	1988	40
Casablanca Stock Exchange	Casablanca	1929	81
Namibia Stock Exchange	Windhoek	1992	34
Abuja Securities and Commodities Exchange	Abuja	1998	12
Nigerian Stock Exchange	Lagos	1960	223
Rwanda Stock Exchange	Kigali	2005	4
Johannesburg Stock Exchange	Johannesburg	1887	410
Khartoum Stock Exchange	Khartoum	1995	53
Swaziland Stock Exchange	Mbabane	1990	10
Dar es Salaam Stock Exchange	Dar es Salaam	1998	17
Bourse des Valeurs Mobilières de Tunis	Tunis	1969	56
Uganda Securities Exchange	Kampala	1997	14
Agricultural Commodities Exchange of Zambia	Lusaka	2007	12
Lusaka Stock Exchange	Lusaka	1994	16
Zimbabwe Stock Exchange	Harare	1993	81

Source:

2.3.2 Brief history of Oldest Stock Exchanges Worldwide, Africa and East Africa

2.3.2.1 Amsterdam Stock Exchange

The Amsterdam Stock Exchange is considered the oldest in the world. It was established in 1602 by the Dutch East India Company (Verenigde Oostindische Compagnie, or "VOC") for dealings in its printed stocks and bonds. It was subsequently renamed the Amsterdam Bourse and was the first to formally begin trading in securities.

The European Option Exchange (EOE) was founded in 1978 in Amsterdam as a futures and options exchange. In 1983 it started a stock market index, called the EOE index, consisting of the 25 largest companies that trade on the stock exchange.

In 1997 the Amsterdam Stock Exchange and the EOE merged, and its blue chip index was renamed AEX, for "Amsterdam Exchange". It is now managed by Euronext Amsterdam.

2.3.2.2 Casablanca Stock Exchange (La Bourse de Casablanca)

The oldest stock exchange in Africa is Casablanca Stock Exchange (La Bourse de Casablanca) in Casablanca, Morocco. It was established in 1929 and currently has 16 members and 77 listed securities with a total market capitalization of \$66.3 billion as of December, 2011.

The Casablanca Stock Exchange (CSE), which achieves one of the best performances in the region of the Middle East and North Africa (MENA), is Africa's third largest Bourse after Johannesburg Stock Exchange (South Africa) and Nigerian Stock Exchange in Lagos. The exchange is relatively modern, having experienced reform in 1993. The CSE installed an electronic trading system, and is now organized as two markets: the Central Market and a Block Trade Market, for block trades. In 1997 the CSE opened a central scrip depository. Originally, CSE had the Index de la Bourse des Valeurs de Casablanca (IGB) as an index. IGB was replaced on January 2002 by two indexes:

MASI - Moroccan All Shares Index, comprises all listed companies, allows to follow up all listed values and to have a long-term visibility.

MADEX - Moroccan Most Active Shares Index comprises most active companies listed continuously with variations closely linked to all the market serves as a reference for the listing of all funds invested in shares.

2.3.2.3 Nairobi stock Exchange

Nairobi Securities Exchange (NSE) is considered the oldest in East Africa.

It was established in 1954; constituted as a voluntary association of stockbrokers registered under the Societies Act. Africans and Asians were not permitted to trade securities at the NSE. Business was conducted by resident Europeans only until 1963 when Kenya attained independence from Britain. Before 1963, there were about 10 listed companies. Activity at the stock market slumped at the dawn of Kenya's independence due to uncertainty about Kenya's economic future. However, the first three years of independence were marked by steady economic growth and the restoration of confidence in the market, with that result the NSE handled a high number of subscriptions of public issues.

By 1966, the NSE had begun measuring daily trading activity by computing the NSE Index. The index measured daily average price changes in 17 companies that were considered the most active stocks in the market. It was computed as a weighted average of price changes in the selected stocks and 1966 was used as the base year and set at 100 points

In 1984, the Government of Kenya through the Central Bank of Kenya in conjunction with the International Finance Corporation (IFC) conducted a study dubbed “Development of Money and Capital Markets in Kenya”. This study became a blue print for structural reforms in Kenya’s financial markets and culminated in the establishment of the Capital Markets Authority (CMA) in 1989 as a regulatory body that would enable the development of Kenya’s capital markets and the creation of a conducive environment for economic growth.

In 1988, the first privatization through the NSE was implemented when the government sold 20% of its stake at the Kenya Commercial Bank

In 1991 NSE was registered under the Companies Act and also adopted a 20-share index and changed the computational method of the index to a geometric mean.

The number of stockbroker’s also increased from six to fourteen when eight more were licensed. Subsequently, the IFC rated the NSE as the best performing market in the world with a return of 179% in dollar terms.

In 2000, Kenya, Uganda and Tanzania signed the Joint Stock Exchange taskforce to report on cross border listing. Subsequently, the East African Breweries Limited and the Kenya Airways proceeded to cross list at the Kampala and Dar es Salaam Stock Exchanges. There after three other companies from Kenya also cross listed to DSE.

In terms of empirical studies, there is a general consensus in most of them that stock market development enhances investment efficiency. In some of these studies, the authors examined the impact of financial sector development on the quality of investment and they established that the main channel through which stock market

development affects growth is through investment productivity (Caporale, Howells & Msoliman, 2005).

2.4 Research Gap

The focus of most of the studies that have been conducted in Tanzania has been mainly on financial market aspect as whole. Few qualitative studies have either concentrated on the emergence of capital market in Tanzania and the establishment of Dar es salaam Stock Exchange (DSE) and ignored the development and growth of capital market in Tanzania and its impact in economic growth; also, most studies, have not distinguished the development of capital markets in terms of DSE market capitalization and turnover vis avis other direct capital market investments. This study attempts to bridge this gap.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter is about the research methodology design, and it explains how the study will be conducted, and explains how various methods will be used in the study. Different scholars have defined the research methodology concept. Kothari, defines research methodology is a way to systematically solve the research problem or is a science of studying how research is done scientifically (Kothari, 2000). The author further indicated that when we talk of research methodology we are not only talking of the research methods but also consider the logic behind methods we use in the context of our research study.

3.2 Research Design

Research Design is a conceptual framework (structure) in which a research has been conducted and can be thought as the “glue” that holds together all of the elements in a research project (Chamwali, 2006). In this study, the researcher extracted data from Dar es salaam Stock Exchange by going through markets reports generated daily by the exchange after the completion of trading activities.

3.3 Area of the Study

This study was conducted at Dar es Salaam where DSE is located. DSE is an important information provider for this study due to the fact that, DSE is the only stock exchange in Tanzania. All secondary market transactions for equity and bonds took place at DSE and are electronically kept. Taking into account time constraint and limitation of resources, it was more convenient for the researcher to carry out this study at Dar es salaam so that the research project is completed within given time frame.

3.3.1 Secondary Source

Secondary source is a document or recording that relates or discusses information originally presented elsewhere (Ghauri et al, 2005).

Secondary data obtained through extensive review of existing information, published and unpublished documents from DSE, Licensed dealers, regulators, investment advisors and pension funds. According to Yin (1984), secondary data are those which had already been collected by someone else and which had already been passed through the statistical process. The study will also use documentary sources. Yin defines documentary source as a source of data for a research purposes that includes published books, manual script, journals, research report, newspapers and other unpublished books.

3.3.2 Data Collection Methods

This refers to the specific methods that are used to collect data. Secondary data method used collect data through documentary review and analysis of reports, both hard copies and soft copies.

The research used Quantitative approach aiming to discover the underlying impact and possible expectations.

3.3.3 Documentary Review

Documentary review is a process of critically analysing information obtained in documents or publications (Kothari, 1996). In this research, documents reviewed will be records stored in office files or computer systems commonly referred as database. The basic aim of conducting documentary analysis and performing queries to the database was to establish facts about the relationship between the capital market performance in Tanzania and economic growth.

3.3.4 Interview

Interview is a process of communication or interaction in which the subject or interviewee gives the needed information verbally in a face-to-face situation (Koul, 1996). In descriptive or exploratory studies, interview aims at obtaining uninterrupted description where by the subjects describe as precisely as possible what they experience and feel, and how they act (Kvale, 1996). Interviews are preferred due to its nature of being flexible, where interviewer could re-adjust questions to probe for in-depth response from the interviewee.

In this study, the researcher used complement data from DSE obtained through trading and CSD platform and documentary analysis.

3.4 Research Tools

Research tools used in analysing data was simple computer spread sheetin computation of averages, frequencies as well as totals in determining impact of the capital market performance on actual overall economic growth in Tanzania. Again, actual proportion of amount of funds invested out of available fund resulted from economic growth. Spread sheet is a computer program that uses a set of functions such as multiplication, division, subtraction and addition to analyse quantitative data for the purpose of having comparative conclusion.

CHAPTER FOUR

RESEARCH FINDING AND ANALYSIS

4.1 Introduction

The main concern of this study was to assess impact of capital market on Tanzania economic growth. National bureau of statistics and Dar es Salaam Stock Exchange was visited several times to obtain the required information that addressed the research questions. The aim of this chapter is therefore to present analysis of the data obtained from the field and to discuss the results.

4.2 Tanzania Economic Growth

4.2.1 Gross Value Added

Gross value added (GVA) is a measure in economics of the value of goods and services produced in an area, industry or sector of an economy. In national accounts GVA is output minus intermediate consumption; it is a balancing item of the national accounts' production account.

In simple term, Gross value added is the grand total of all revenues, from final sales and (net) subsidies, which are incomes into businesses. Those incomes are then used to cover expenses (wages & salaries, dividends), savings (profits, depreciation), and (indirect) taxes.

Gross value added is linked as a measurement to gross domestic product (GDP), as both are measures of output.

Table 4.1: Gross Value Added by Activity at Constant 2001 Prices

Table 4.1: Gross Value Added by Activity at Constant 2001 Prices in

Year	Ag	Fi	Ma	E	Co	WR	Ho	Tr	Tota	
2000	2,636,19	153,66	159,97	762,40	240,70	475,38	1,182,79	250,97	599,84	6,461,93
2001	2,766,47	164,04	187,00	819,20	254,08	431,74	1,281,54	267,16	640,54	6,911,80
2002	2,850,95	173,89	219,00	893,00	271,08	405,00	1,405,69	275,83	885,94	7,380,40
2003	3,017,98	185,54	254,00	977,00	290,26	483,35	1,486,93	285,73	957,73	7,938,54
2004	3,148,38	196,67	295,00	1,071,00	314,91	452,34	1,585,90	301,87	828,85	8,494,95
2005	3,268,23	206,51	341,00	1,162,00	313,25	423,65	1,736,63	314,92	900,53	9,066,73
2006	3,399,64	215,73	377,55	1,263,43	344,98	403,54	1,906,82	328,85	991,64	9,732,23
2007	3,554,48	226,52	386,99	1,388,51	364,31	498,41	2,097,50	343,65	1,099,19	10,459,60
2008	3,669,64	232,63	391,64	1,499,59	393,16	1,073,29	2,254,81	358,77	1,220,26	11,093,84
2009	3,824,42	236,12	402,33	1,618,06	430,68	1,182,58	2,439,71	380,66	1,369,49	11,884,08
2010	3,960,67	238,96	411,18	1,744,27	438,89	1,289,01	2,637,32	398,17	1,524,71	12,643,21
2011	4,129,43	245,89	443,15	1,887,30	464,79	1,389,55	2,840,40	417,28	1,715,86	13,533,67
TOTA ²	40,226,55	2,476,19	3,868,84	13,085,78	4,121,14	10,707,87	22,856,08	3,923,92	12,334,64	125,601,04

key

- Ag Agricultur
- Fi Fishin
- Mi Mining and
- Ma Manufaciuri
- E Electricit
- Co Constructio
- WR Whole sale and retail
- Ho Hotel and
- Tr transport and
- C communication

Table 4.2: Gross value added by activity at constant 2001 prices in million Tshs

Year	FI	RE	PA	E	OS	FI ind	All Basic	Tax	GDP M
2001	140000.00	936440.00	640649.00	188733.00	200520.00	-80000.00	8488274.00	612000.00	9100274.00
2002	154108.00	1003260.00	699561.00	202000.00	212515.00	-87000.00	9096252.00	655926.00	9752178.00
2003	170643.00	1068732.00	766760.00	207606.00	225372.00	-97154.00	9721363.00	701372.00	10422735.00
2004	184775.00	1141014.00	871169.00	215910.00	238831.00	-106931.00	10483313.00	756422.00	11239735.00
2005	204694.00	1226790.00	970786.00	224547.00	253337.00	-119497.00	11255608.00	812482.00	12068090.00
2006	228000.00	1316000.00	1033488.00	235774.00	270581.00	-137287.00	12013294.00	867868.00	12881162.00
2007	251280.00	1408120.00	1102951.00	248742.00	289140.00	-158292.00	12874170.00	927751.00	13801921.00
2008	281120.00	1508097.00	1180158.00	265905.00	309499.00	-175704.00	13828682.00	999664.00	14828346.00
2009	306339.00	1610647.00	1232313.00	284704.00	326795.00	-190990.00	14663656.00	1057645.00	15721301.00
2010	337356.00	1723392.00	1312414.00	305402.00	345774.00	-208370.00	15700056.00	1128507.00	16828563.00
2011	373453.00	1835413.00	1401658.00	328002.00	361909.00	-231708.00	16711944.00	1201860.00	17913804.00
2012	422748.00	1958386.00	1482954.00	349322.00	380216.00	-261135.00	17866169.00	1289596.00	19155765.00

FI Financial intermediation
RE Real estate
PA Public administration
E Education
OS Other services
FI ind Financial intermediation services indirectly measu
AllBasic All industry at basic prices
Tax Taxes on products
GDP M GDP at Market prices

Table 4.3: Gross Value Added by Activity at Constant 2001 Prices – Percentage Changes

Year	FI	RE	PA	E	OS	FI ind	All Basic	Tax	GDP M
2001									
2002	10.1	7.1	9.2	7	6	8.8	7.2	7.2	7.2
2003	10.7	6.5	9.6	2.8	6	11.7	6.9	6.9	6.9
2004	8.3	6.8	13.6	4	6	10.1	7.8	7.8	7.8
2005	10.8	7.5	11.4	4	6.1	11.8	7.4	7.4	7.4
2006	11.4	7.3	6.5	5	6.8	14.9	6.7	6.8	6.7
2007	10.2	7	6.7	5.5	6.9	15.3	7.2	6.9	7.1
2008	11.9	7.1	7	6.9	7	11	7.4	7.8	7.4
2009	9	6.8	4.4	7.1	5.6	8.7	6	5.8	6
2010	10.1	7	6.5	7.3	5.8	9.1	7.1	6.7	7
2011	10.7	6.5	6.8	7.4	4.7	11.2	6.4	6.5	6.4
2012	13.2	6.7	5.8	6.5	5.1	12.7	6.9	7.3	6.9

FI Financial intermediation
RE Real estate
PA Public administration
E Education
OS Other services
FI ind Financial intermediation services indirectly measu
AllBasic All industry at basic prices



4.2 DSE General Performance

A common index often used, as a measure of stock market performance is the market capitalization. Market capitalization equals the total value of all listed shares. In terms of economic significance, the assumption is that market size and the ability to mobilize capital and diversify risk are positively correlated. For the period covered by the study (2006 -2012) the average market capitalization was TZS1845 billion with highest capitalization of TZS 3354 billion in 2012 and lowest capitalization of TZS 807 billion in 2006. The trend is shown in Table 4.4. As per DSE chief executive officer number of factors that account for lack of interest by Tanzania companies in being listed in the exchange: (i) high cost of public quotation, (ii) reluctance to dilute ownership and control through public quotation, (iii) the interest rate structure in the past which favored debt financing over equity financing, and (iv) stringent requirement for listing.

Table 4.4: DSE General Performance for Last 8 Years

Year	Turnover Tshs	Local Market capitalization TShs	Total Market capitalization Tshs
2006	25,637,893,504	807,252,000,000	3,154,280,000,000
2007	28,367,389,405	932,950,000,000	4,865,320,000,000
2008	32,335,480,825	1,668,150,000,000	5,030,340,000,000
2009	48,378,602,013	1,925,500,000,000	4,895,470,000,000
2010	35,709,453,090	1,836,800,000,000	11,577,050,000,000
2011	51,223,530,143	2,395,420,000,000	13,069,345,000,000
2012	50,431,082,990	3,354,040,000,000	14,087,050,000,000
2013	252,389,529,758	3,602,672,000,000	17,300,660,000,000

Source: DSE ATS
Report

4.2.1 DSE Turnover Annual Growth

The relatively low turnover ratio for markets could be partly due to the fact that there exists a strong trading interest from institutional investors. In addition, high turnover ratios could also be explained by the fact that a significant portion of the shares in these exchanges were held by families or strategic investors. Therefore, the actual free float of shares available for trading in the exchanges is much lower. In contrast, where the market is characterized by relatively large pool of active retail investors trading turnover ratios for shares are much higher.

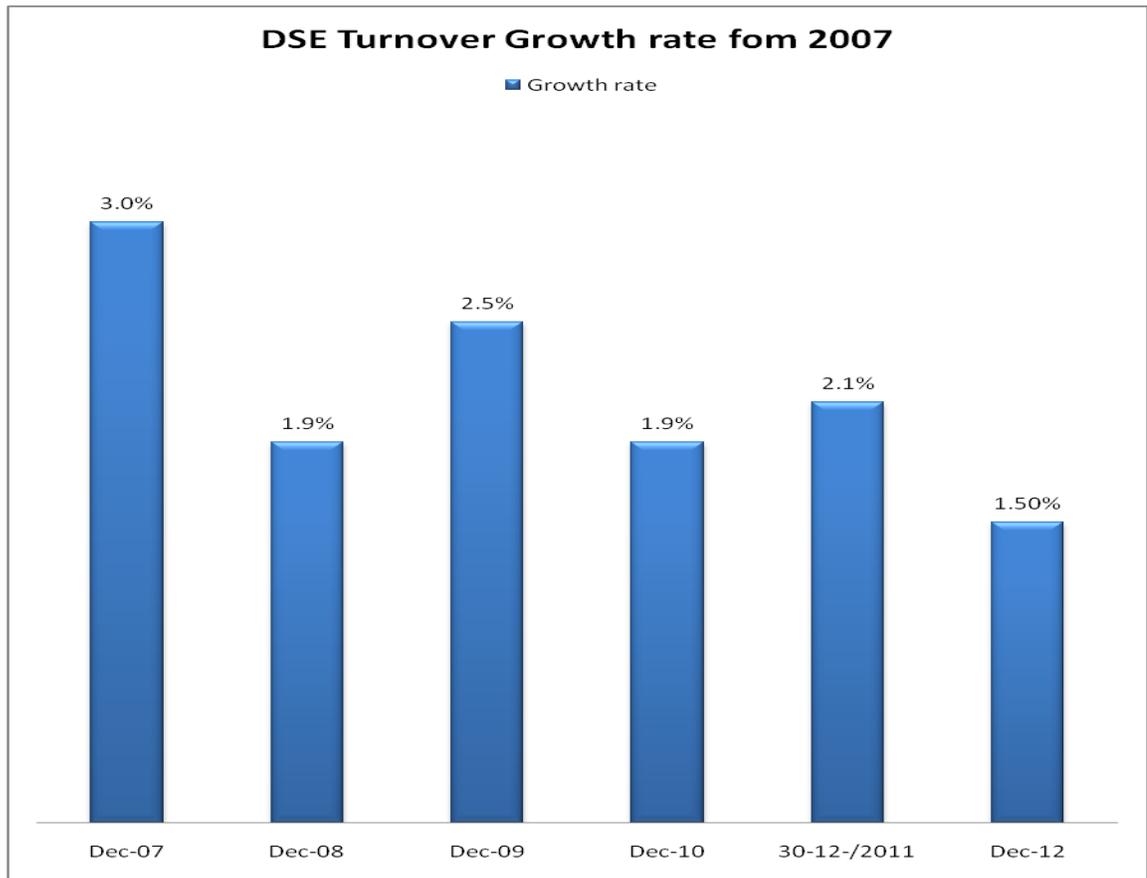
Table 4.5: DSE Turnover Annual growth

Year	Turnover Tshs	Added value in Tsh	Growth rate
2006	25,637,893,504	0	
2007	28,367,389,405	2,729,495,901	11%
2008	32,335,480,825	3,968,091,420	14%
2009	48,378,602,013	16,043,121,188	50%
2010	35,709,453,090	(12,669,148,923)	-26%
2011	51,223,530,143	15,514,077,053	43%
2012	50,431,082,990	(792,447,153)	-2%

Source DSE ATS Report

The market turnover in 2012 at the Dar es salaam stock exchange closed at TZS 50 billion up by 97 % of value of shares traded in 2006. This represents a breakthrough in the Exchange controls of the stock market, at the same time enhancing opportunities for portfolio diversification by domestic investors.

Figure 4.1: DSE TURNOVER Growth rate from 2007



Source: DSE ATS Report

4.2.2 Operational Efficiency in enhancing Liquidity at DSE

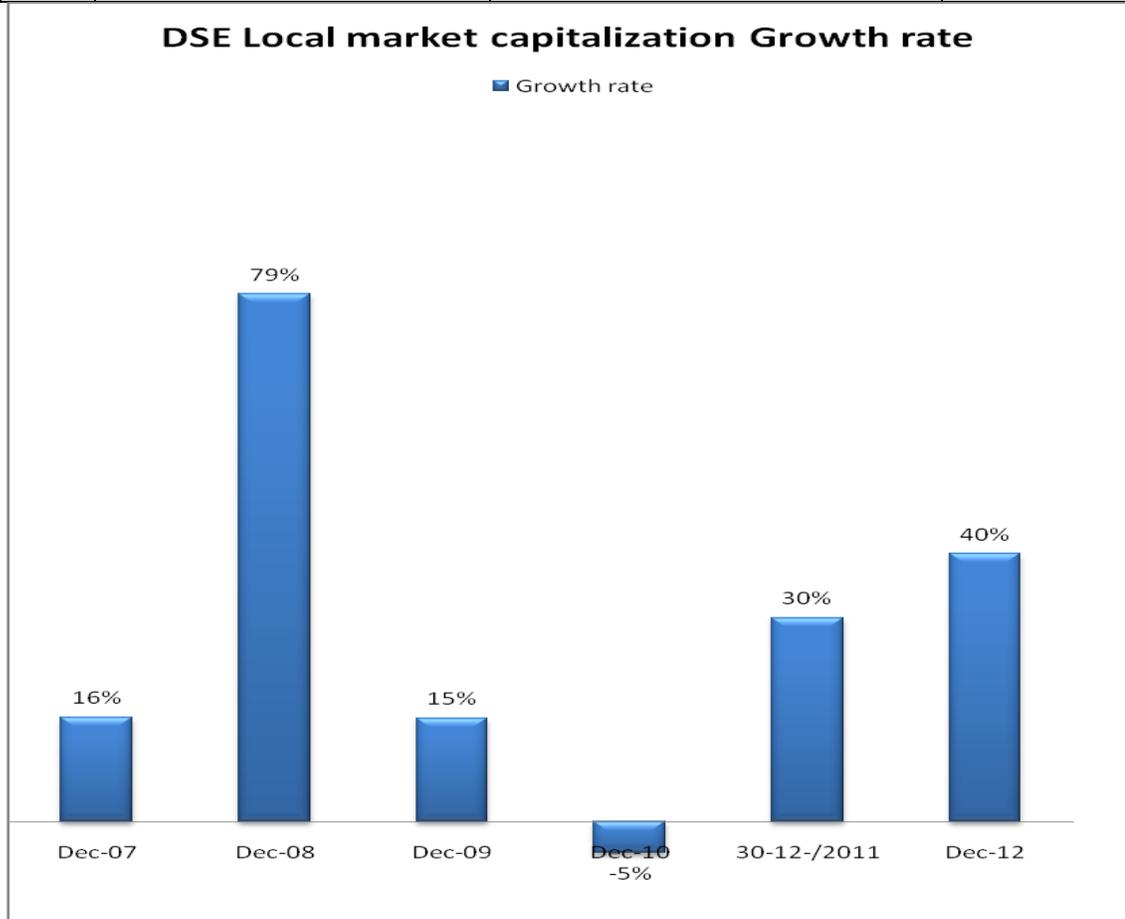
We use standard approaches in measuring indicators of functional efficiency in liquidity of Dares Salaam Stock exchange of which are highlighted below:

The ratio of total value of shares traded on the exchange to GDP. This indicator measures the market's trading activity relative to the size of the economy;

The ratio of total value of shares traded to the total capitalization of the market. This indicator is known as "turnover ratio", and it measures the market's overall trading activity relative to the size of the market itself. These indicators do not directly measure the stock market liquidity in the sense of the ease at which investors can buy and sell securities at posted prices, but they are rough measures of the overall trading activity relative to the size of both the economy and the stock market.

Table 4.6: DSE Local Market Capitalization Annual Growth

	Local Market capitalization TShs	Added capitalization p.a	Growth rate
2006	807,252,000,000		
2007	932,950,000,000	125,698,000,000	16%
2008	1,668,150,000,000	735,200,000,000	79%
2009	1,925,500,000,000	257,350,000,000	15%
2010	1,836,800,000,000	-88,700,000,000	-5%
2011	2,395,420,000,000	558,620,000,000	30%
2012	3,354,040,000,000	958,620,000,000	40%



Source: DSE ATS Report

4.2.3 DSE liquidity ratio by Value Traded Ratio Method

Liquidity

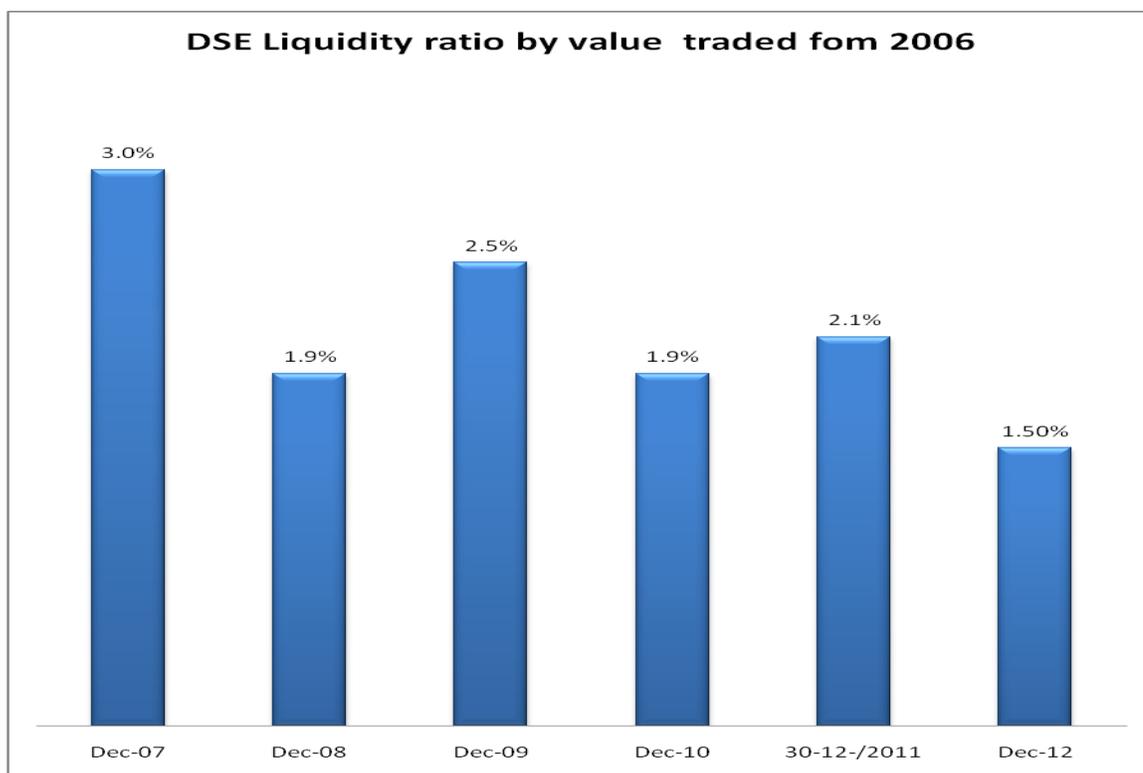
Liquidity is used to refer to the ability of investors to buy and sell securities easily. It is an important indicator of stock market development because it signifies how the market helped in improving the allocation of capital and thus enhancing the prospects of long-term economic growth. This is possible through the ability of the investors to quickly and cheaply alter their portfolio thereby reducing the riskiness of their investment and facilitating investments in projects that are more profitable though with a long gestation period. Two main indices are often used in the performance and rating of the stock market: total value traded ratio; and turnover ratio.

Total value traded ratio measures the organized trading of equities as a share of the national output. For the period 2006 -2012 it averaged 0.24 per annum with the highest of 0.3 in 2009, 2011 and 2012; and lowest of 0.20 in 2006-2008 and 2010. It is expected that it will positively reflect liquidity on an economy-wide basis. Year by year break down is shown in Table 4.7.

Table 4.7: DSE liquidity Ratio by Value traded Ratio Method

Year	GDP in Tshs	DSE Turnover in Tshs	Traded ratio in %
2006	12,881,162,000,000	25,637,893,504	0.2%
2007	13,801,921,000,000	28,367,389,405	0.2%
2008	14,828,346,000,000	32,335,480,825	0.2%
2009	15,721,301,000,000	48,378,602,013	0.3%
2010	16,828,563,000,000	35,709,453,090	0.2%
2011	17,913,804,000,000	51,223,530,143	0.3%
2012	19,155,765,000,000	50,431,082,990	0.3%
Average liquidity by value traded ratio			0.24%

Source: DSE ATS Report



Source: DSE ATS Report

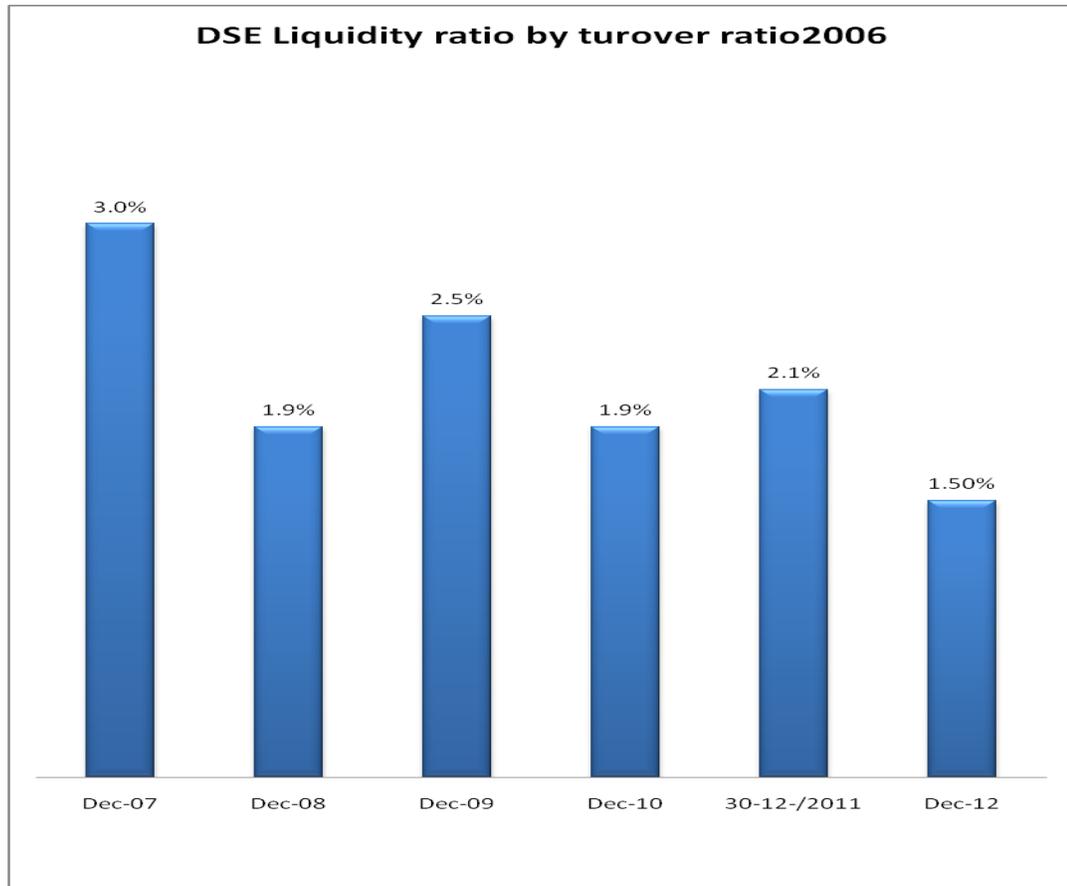
Turnover ratio is used as an index of comparison for market liquidity rating and level of transaction costs. This ratio equals the total value of shares traded on the stock market divided by market capitalization. It is also a measure of the value of securities transactions relative to the size of the securities market. The Dar es Salaam Stock Exchange had an annual average turnover ratio of 2.3 between 2006 and 2012. This low index is an indication of relative illiquidity and stunting of the overall growth of the market. Table 4.8 gives the trend for the study period.

This is basically a measure of stock market activity in relation to economic activity. This ratio does not directly measure the costs of buying and selling securities at posted prices. Yet, averaged over a long time, the value of equity transactions as a share of national output is likely to vary with the ease of trading. In other words, if it is very costly or risky to trade, there will not be much trading.

Table 4.8: DSE Liquidity Ratio by Turnover Ratio

Year	Market capitalization growth In Tshs	DSE Turnover in Tshs	Turnover ratio
2006	807,252,000,000	25,637,893,504	3.2%
2007	932,950,000,000	28,367,389,405	3.0%
2008	1,668,150,000,000	32,335,480,825	1.9%
2009	1,925,500,000,000	48,378,602,013	2.5%
2010	1,836,800,000,000	35,709,453,090	1.9%
2011	2,395,420,000,000	51,223,530,143	2.1%
2012	3,354,040,000,000	50,431,082,990	1.5%
e liquidity by turnover ratio			

Source: DSE ATS Report



4.2.4 DSE Local Listed Companies

The average number of local listed companies in the Dar es salaam stock Exchange for 2006-2012 period was 12 companies. Table 4.9 gives the trend for the study period.

Table 4.9: DSE Number of New Listings from 2006

Year	Number of listings	Cumulative listing
2006	1	7
2007	0	7
2008	3	10
2009	1	11
2010	0	11
2011	1	12
2012	0	12

Source: DSE ATS Report

Table 4.10: Capitalization Ratio

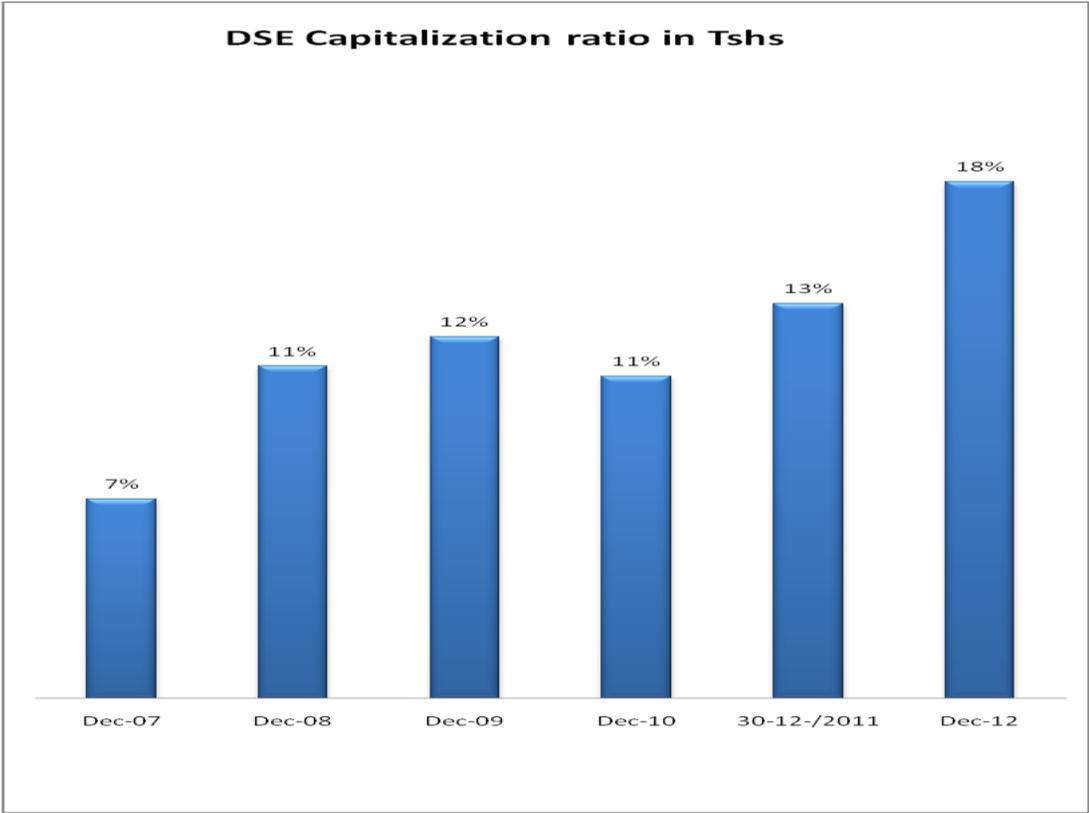
Year	Market capitalization growth In Tshs	GDP in Tshs	Turnover ratio
2006	807,252,000,000	12,881,162,000,000	3.2%
2007	932,950,000,000	13,801,921,000,000	3.0%
2008	1,668,150,000,000	14,828,346,000,000	1.9%
2009	1,925,500,000,000	15,721,301,000,000	2.5%
2010	1,836,800,000,000	16,828,563,000,000	1.9%
2011	2,395,420,000,000	17,913,804,000,000	2.1%
2012	3,354,040,000,000	19,155,765,000,000	1.5%

Market liquidity by turnover ratio

Source: DSE ATS Report

The relatively low turnover ratio for most markets could be partly due to the fact that there exists a strong trading interest from institutional investors. In addition, high turnover ratios could also be explained by the fact that a significant portion of the shares in these exchanges were held by families or strategic investors. Therefore, the actual free float of shares available for trading in these exchanges is much lower. In contrast, where the market is characterized by relatively large pool of active retail investors trading turnover ratios for shares are much higher.

Figure 4.2: DSE Capitalization Ratio in Tshs



Source: DSE ATS Report

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.1 Introduction

That the stock market promotes economic growth is not in doubt. It serves as an important mechanism for effective and efficient mobilization and allocation of savings, a crucial function, for an economy desirous of growth. Capital markets can ensure the efficient and sustainable funding of governments, corporations and banks for large-scale or long-term projects

5.2 Conclusion

The study examines whether there is impact on capital market and economic growth in Tanzania between the period 2006 and 2012. By the use of some notable stock market development indicators, the impact between capital market and economic growth was found to be positive. However, this impact is not so significant. This in essence means that the impact of capital market on economic growth is weak and insignificant. I therefore conclude that the Tanzania capital market contribution to gross fixed capital formation was very minimal fluctuating between 1.5 percent and 3.2 percent between 2006 and 2012. This result is a reflection of the structural rigidities prevailing in the economy which makes the stock market more of an appendage of the government institutions rather than a market driven by efficiency through the interplay of the forces of demand and supply.

Another major outcome of the study was that if capital market resources are not provided to those economic areas, especially industries where demand is growing and which are capable of increasing production and productivity, the rate of expansion of the economy often suffers.

Through the provision of equity capital, the market enables companies to avoid over-reliance on debt financing, thus improving corporate debt-to-equity ratio of which most Tanzanian companies faced.

5.3 Recommendations

The findings from this study raise some policy issues and recommendations, which will reinforce the link between the capital market and economic growth in Tanzania.

Given that the capital market operate in a macroeconomic environment, it is therefore necessary that the environment must be an enabling one in order to realize its full potentials. The demand for the services of the capital market is a derived demand. With the existence of a positive relationship between capital market development and economic growth, it is pertinent to recommend that there should be sustained effort to stimulate productivity in both the public and private sectors. The capital market is known as a relatively cheap source of funds when compared to the money market and other sources.

Considering the benefits being enjoyed by the stock market through the internationalization of its operations, there should be policy turn around but a sincere pursuit of this policy. Though the recent legislations on the stock market have been hailed in many quarters as one of the best thing to happen to the stock market in recent times, there are still some gray areas.

CMSA and DSE should increasingly play an educational role and embark on a vigorous campaign to market itself and educate potential investors about the opportunities available in the market and how to effectively exploit them. The efforts by DSE and CMSA to improve public awareness of the opportunities available in the capital markets in Tanzania a need to be strengthened by using a variety of means of communication such as media campaigns through the radio, television and newspapers, engaging in one-on-one meetings with eligible firms and potential investors, and distribution of literature to firms and potential investors across the country. The DSE and CMSA should compile a list of potential issuers of both equity and debt and initiate contact with them to educate and improve their awareness of the benefits and relevance of capital markets for their operations. In addition the two institutions should set up branch offices at the district and provincial levels to facilitate outreach to the general public.

Investor education may also be done through incorporating information on investment and the capital markets in the high school and college curriculum to enhance the awareness by the younger generation of Tanzanians who make up more than half of the total population.

Privatization of state enterprises was essential as the most viable source of equity. In this regard, the implementation of the privatization company through the stock exchange will increase the supply of equity in the market and trigger resurgence of primary equity activity. However, weak and non-performing public enterprises should not be dumped in the market in the guise of privatization.

Modernization of the trading system to improve liquidity, attract foreign investors and reduce transaction costs is necessary. Enabling trading system to go mobile will complement the current automation of the depository, settlement and delivery and facilitate the ability of the market to cope with increase in new listings or increased trading and turnover particularly with the imminent privatization of many state-owned companies.

Demutualization of the DSE is essential to ensure proper monitoring and regulation of members and market participants. Demutualization refers to conversion of a member-owned company to shareholder-ownership. Presently, the DSE is a member owned company whose board membership has more representatives of stockbrokers than other market participants. This has poses a challenge to the enforcement of regulations on errant stockbrokers.

REFERENCES

- Asher, (2003) "Governance and Investment of Provident and Pension Funds: The Case of Singapore and India," Presentation at the Second Public Pension Fund Management Conference, May 5-7 (Washington: World Bank).
- Bencivenga, V. R., Bruce D. Smith, and Ross M. Starr (1996): "Equity Markets, Transaction Costs, and Capital Accumulations: An Illustration". The World Bank Review
- Bryman, A. & Bell, E. (2003) Business Research methods. Oxford University Press,
- Catalán, M (2004). Pension Funds and Corporate Governance in Developing Countries: What Do We Know and What Do We Need To Know? *Journal of Pension Economics and Finance* Vol. 3 (2)
- Chalton & Mckinnon (2001). "Pension funds in emerging Markets: Policy implications for LDCS". *Savings and Development*, Vol. 25 (3), PP 257-292.
- Claessens, S., D. Klingebiel, and S. Schmukler. "FDI and Stock Market Development: Complements or Substitutes?" Accessed July 22, 2012. Available from <http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf>.
- Caporale, G., Howells, P. and Msoliman, A. 2005, 'Endogenous Growth Models and Stock Market Development: Evidence From Four Countries', Review of Development Economics, vol.9, no.2, pp.166-176.
- Davis, Philip E., 2005, Portfolio Regulation of Life Insurance Companies and Pension Funds," Discussion Paper PI-0101 (London: The Pensions Institute, Birbeck College, London).DSE Journal, (2008) "DSE 10th Anniversary". Vol. 1, (35)

- Enon, J.C (1998). Education research, Statistics and Measurement: Educational psychology. Department of distance education. Makerere University.2nd edition. Kampala.
- Ghaurie et al (2005), Research Methods in Business Studies: A Practical Guide, Prentice Hall, Hemel Hempstead.
- Goodfellow, C, Bohl, M. T., & Gebka, B. (2009). Together we invest? Individual and institutional investors: International Review of Financial Analysis 18.
- Handbook (2011), Dar es salaam Stock Exchange (DSE).
- Holzmann, Robert, Ian W. MacArthur, and Yvonne Sin, 2000, Pension Systems in East Asia and the Pacific: Challenges and Opportunities, Social Protection Discussion Paper Series No. 0014 (Washington: The World Bank)
- Kothari, C.R. (2000). "Research Methodology: Methods and Techniques". Wishwa Prakashan, New Delhi
- Kvale, S. (1996) Interviews: An Introduction to Qualitative Research Interviewing. London: Sage Publications.
- Koul, B.N (ed) (1996). Research for Distance Education: Collection of Data. Block 2. Indra Gandhi Open University School of education. New Delhi. India.
- Levine, Ross & Zervos, Sara, 1998. "Capital Control Liberalization and Stock Market Development," World Development, Elsevier, vol. 26(7),:"Stock market Banks and growth"
- McKinnon, R.I. 2001. Money and Capital Market in Economic Development. Washington D.C.: The Brookings Institution.

- Mugenda (2003) Research method quantitative and qualitative approaches, Nairobi Acts press
- Naceur, S. B. & Ghazouani, S. & Omran, M. (2007). "The determinants of Stock Market Development in the Middle-Eastern and North African Region". *Managerial Finance*, Vol. 33 No. 7, 2007 page 477-489
- Osinubi et el 2007 Stock market Development and Private Investment Growth in Nigeria; *Journal of Sustainable Development in Africa* (Volume 11, No.2, 2009)
- Perotti, Enrico C. & Pieter van Oijen. "Privatization, Political Risk and Stock Market Development in Emerging Economies ." Tinbergen Institute Discussion Papers . (1999).
- Raddatz, C. & Schmukler S. L. (2008). "Pension Funds and Capital Market Development. How Much Bang for the Buck?" The World Bank, Development Research Group, Macroeconomics and Growth Team.
- Rudor, Michala & Schoon, Stefan (2006). Dual Track Vs. IPO. Seminar Paper
- Shaw, E. 1973, *Financial Deepening in Economic Development*, Oxford University Press, London.
- Sheehan, Michael and Daniel Zavala. (2010) "African Securities Exchanges: Challenges and Rewards"
- Sheffrin Steven M. (2003) *The Making of Economic Policy* ,by Blackwell Publishers
- Singh, A. 1997, 'Financial Liberalization, Stock Markets and Economic Development', *The Economic Journal*, vol.107,no. 442

Stiglitz, J. 2000, 'Capital Market Liberalization, Economic Growth, and Instability',
World Development, vol.28

The National Social Security Policy, Ministry of Labour, Youth Development and
Sports, 2003.

The Social Security Schemes Investment Guidelines, 2012

Voronkova, S. & Bohl, M.T. (2005). Institutional traders' behavior in an emerging stock
market: Empirical evidence on Polish pension fund investors. Journal of
Business Finance and Accounting, 3

Walker, Eduardo & Lefort, Fernando (2000). "Pension Reform and Capital Markets: Are
there any (Hard) Links?"

The World Bank(2010)World Development Indicators, International Bank for
Reconstruction and Development

Wuyts, G., 2007, Stock Market Liquidity: Determinants and Implications, Review of
Business and Economics, Vol. LII, No. 2.

Yermo, J., 2005. The Contribution of Pension Funds to Capital Market Development in
Chile, Oxford University .