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Financial Sustainability and Regulatory Proportionality of African Capital Market Regulators
-
Executive Summary

Dalberg

Introduction

In Africa, regulators are tasked with a dual role: *developing* a financial market as well as *regulating* it.

To fulfil this role, regulators must determine the right strategic focus, activities and capacity. This is particularly important in resource-constrained economies where the regulator has a limited team and budget.

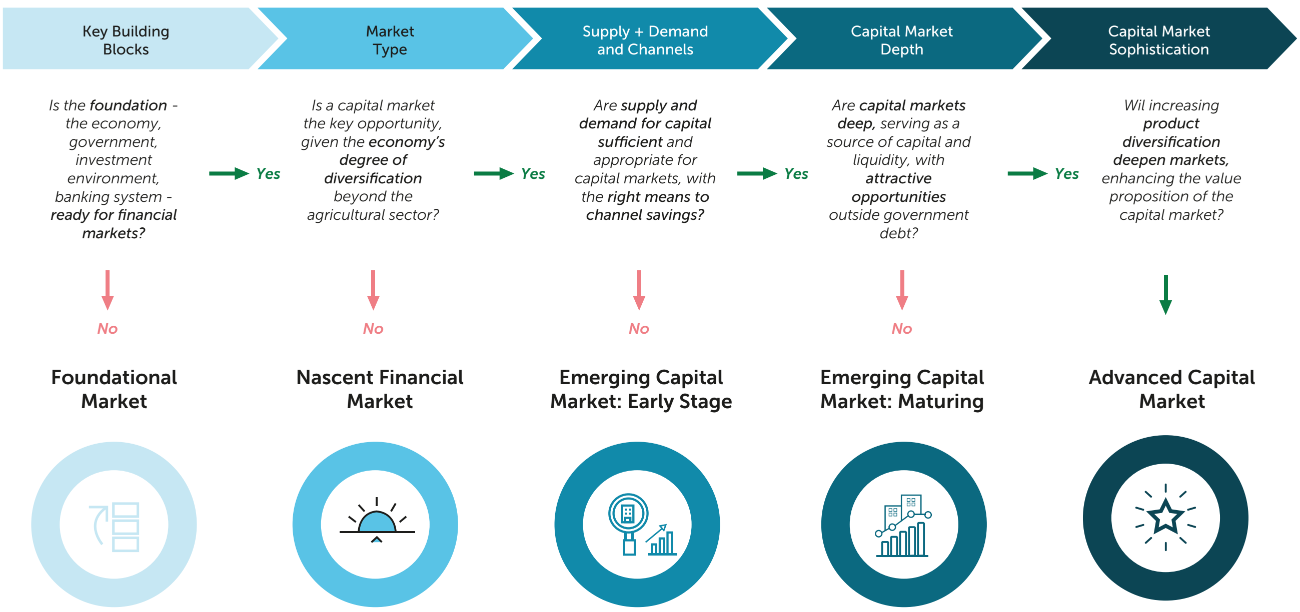
This paper proposes an analytical framework to assess the state and stage of a country's financial market. This provides guidance for how the market regulator should approach its mandate, focus areas and funding model.

Stages of financial market development

Assessing the state of a given market can help identify the stage of its financial market development. The sequential questions below are a first step in this analysis:

1. **Building blocks:** Are the foundations in place and ready to support financial markets?
2. **Financial market type**: Is a capital or commodity market the right driver for growth?
3. **Capital supply-demand:** Are supply and demand for capital sufficient?
4. **Capital market depth:** Are capital markets deep, providing a source of capital and liquidity?
5. **Capital market sophistication:** Will increased product diversification and sophistication deepen markets and enhance their value proposition?

Each question functions as a screen for the next stage, as illustrated in the figure below.



An approach for the regulator

Regulators in Africa must adopt proactive, consultative approaches to shaping the market.

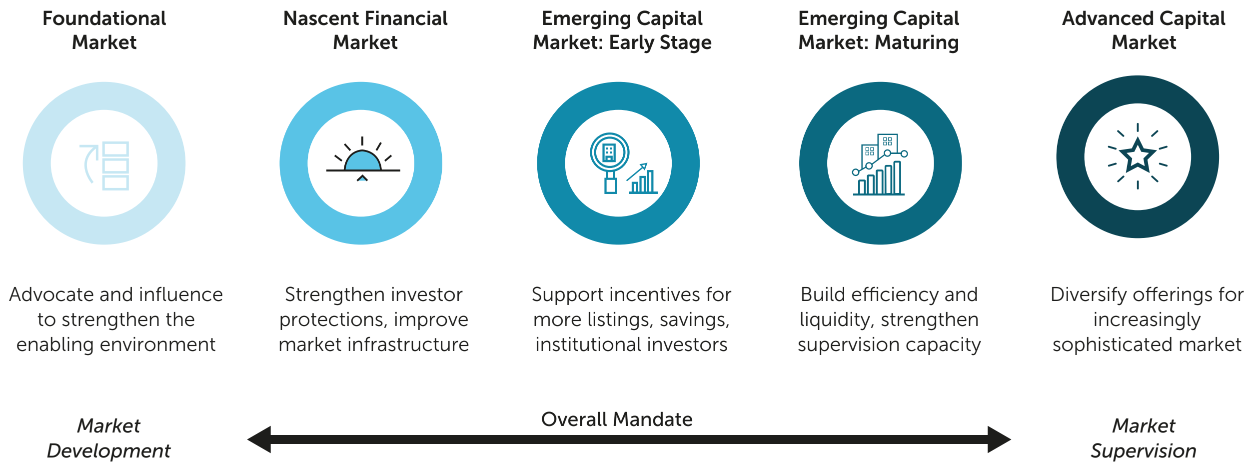
In earlier-stage markets, regulators should focus on basic foundational and infrastructural investments. In the later stages, the regulator's role shifts from influencing the foundations of a market to building and supervising the market itself.

Evolution of focus

Shifts in focus are necessary as the regulator moves through different stages and begins to engage with market participants.

Early establishment of a strong investor protection framework is especially important. As a practical measure, the regulator of an earlier-stage market may also focus on investor education.

As the market matures, the regulator may collaborate with other government entities to mobilise more domestic investment. It may also pivot towards attracting more foreign capital.



Evolution of capacity and funding model

As the market advances, the regulator must develop its own capacity to grow. The right funding model is critical to this.

In the early stages, regulators primarily depend on the government to fund their operations, as well as donor contributions.

As the capital market evolves into the 'emerging mature' and 'advanced' stages, the regulator will increasingly rely on industry fees and other income.

Typically, African regulators have budgets proportional to the size of their capital markets. A detailed review of regulator budgets shows that operational deficits can exist across different funding models and development stages.

Given the risks of both the industry and government funding models, and the financial unsustainability of regulators, a more fluid mix between industry and government contribution may be a sensible approach. This would allow regulators to generate industry fees, while maintaining access to more certain funding flows.

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