

Challenges and Prospects of Establishing Stock Exchange Market in Afghanistan

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***Akmal Saddique**

**** Shahzad Anwar**

Abstract

Currently Afghanistan does not have stock exchange market, and the objectives of this study are to explore the major challenges, government commitment, and to evaluate the current legal system for establishing stock exchange market in Afghanistan. The study conducted interviews based on purposive sampling with six senior financial sector authorities; Textual analysis methodology was used to analyze interviews (Swanson and Holton 2009). Further analysis was based on coding technique for themes, subthemes, codes development. The study found that current legal and regularity structure is not adequate for stock exchange market establishment, due to the challenges like lack of rules, regulation and procedures, sever security issues, instable economy, low literacy rate, lack of specialized accountants and auditors, weak financial system infrastructure, absence of technology platform, low corporate governance and corruption for it is development, government is committed toward its establishment, as primary studies are conducted that suggested to work on the foundations of the stock market and the central bank initiated capital paper trading limited to banks only. The study recommends it is not the right time to commence stock market in the country, instead to focus and use resources on the banking and other financial institutions development, rules and regulation reforms, macroeconomics policies and public educations which will pave away for the stock exchange market establishment in the future.

Keywords: Stock Market, Current legal & regulatory structure, Government commitment, Textual analysis.

*Akmal Saddique, is Alumni of Kardan University, Kabul Afghanistan.

**Mr. Shahzad Anwar, Assistant Professor at Kardan University, Kabul Afghanistan.

Introduction

Stock exchange market refers to public markets that exist for selling, issuing and buying stocks that trade on a stock exchange or over-the-counter. Stocks, also known as equities, represent fractional ownership in a company, and the stock market is a place where investors can sell and buy ownership of such investible instruments (Madura, 2014). An efficiently functioning stock market is considered critical to economic development, as it gives companies the ability to quickly access capital from the public (Brealey, 1995) .

(Burger & Warnock 2006) stock exchange market is a great mean to attract foreign investors to invest in the country's projects and integrate the countries and shared risks across countries, as a result, financial system which has a strong and dynamic stock exchange market will improve financial stability and ability to manage risks, allocate capital, invest productively and integrate nations, as per (Turner 2002) government can use stock market instruments to raise capital as a substitute to the foreign borrowings, which is very much helpful in financing huge government projects for which government needs capital .

Stock exchange market is an important segment of financial system, which plays a vital role in the development of economy, it is a mean through which the resources are mobilized, allocate efficiently in productive investments, an ocean of opportunities to investors, corporations and government, such as risk sharing, allocation of money, investment facilities, funding of business, and raising of money for big and huge projects (Madura, 2014) .Stock market paves away for circulation of money and allocation of resource which are very essential for the economic development and sustainability, African countries establish stock markets to trade in shares and allocate resources, emerging countries establishes stock market to mobilize a long term capital to use it for the huge industrializations to that leads to economic growth and development, developed countries also used it to their corporations to be financed, and all these countries have reached to their stock market establishment goals as well) Mulatu, 2016.(

Afghanistan economy had significant improvement in all the sectors, with the help of international aids and technical assistance, despite all the aids and one trillion-dollar value, untapped mineral and many other natural resources, but still the country remains in the list of poor and least developed countries.

Even though the financial sector also had improvement with the aim for a sustainable economy and proper money management, but still the country does not have stock exchange market which plays a very important role in the economic growth and capital creation. The purpose of this study is to determine the challenges, current legal system and government commitment for establishing stock exchange market in Afghanistan.

1.2 Question of the research

What are the pre-requisites for establishing stock exchange market in Afghanistan?

1.3 Objectives of the research

This study is an effort to find out the following objectives :

- To determine the challenges faced by the government in establishment of stock market.
- To see the current legal and regulatory infrastructures, for stock market of Afghanistan.
- To explore the government commitment for the establishment of stock market in Afghanistan.

2 Literature Review

(Filer, Hanousek and Campos 1999) argued Stock market increases economic growth, if it is focused by government, practice better policies and smooth regulatory framework, in developing countries, it will also generate more income and finance big projects. Where (Samuel 1996) concluded that in developing countries stock market development will not increase trade growth, unless they have a strong regulatory system and stable economy.

2.1 Legal Infrastructure and Institutions

(Lopez et.al 1997, 1998) argue that legal protection is the main determinant for the development of stock exchange market in every country, the countries, who have better regulations investors will invest with trust and confidence as they are being protected, compare to the countries who do not have better protective regulations for investors and creditors, they will not invest in the stock exchange market due to lack of protection .(Mulatu, 2016) concluded his study that due to lack of regulatory institutions for trade in stock, judicial law, and procedure, corporate governance in Ethiopia it is not the right time to establish stock market, instead the government needs to bring reforms in it is policies for regulatory framework, monitory and governance, at the same, it time

should increase the numbers of other financial institutions to control the circulation of money and fluctuation of exchange rates and then the establishment will push the economy of country positively.

(According to Solé 2008 (the legal framework of Kuwait needs up gradation for the development of stock market, which will lead the country as the most efficient and active player in country where Mensah, (Awunyo and Sey 2012 (concluded, despite sound political environment for investments and better tax policies the country faces the challenges of low performance of firms, liquidity, low earning, strict regulations and low media attentions, which are hitting negatively the efficiency of the stock market.

2.2 Banking Development

Stock market establishment for many African countries will be harmful more than benefiting, as it required huge cost, which may not be afford by these countries, it's better for them to use their scarce resources in banking development and bring reforms as these banks will meet the requirements of local firms, and saver, where the development of banking will pave away for the development and establishment of the stock market (Singh, 1999.(

2.3 Macroeconomic stability

Stable economy and stable macroeconomic environment is very essential for the establishment of stock exchange market as they have very positive relation to each other the more the stable the environment the better the stock market performs, the more volatile the macroeconomic environment the more uncertain the performances of the stock market, there are two approach for stock market development, institutional approach and macroeconomic approach, where transparency, taxation issues, accounting standard, property rights are covered by institutional approach, and macroeconomic approach focus on investment, inflation rate, income growth, savings and financial development, these two approach are the key drivers for the stock market, the better, stable and strong are they, the better, higher the result would be, as institutional factors will impact the functioning of the stock market, where the macroeconomic factors will impact the fluctuation in the stock market, like the firm's reliable information disclosure will eager the investors to purchase certain share of firms, and it will also increase trust of the investors that our rights are protected by regulatory boards)Pagano, 1993.(

According to Adam & Tweneboah, 2008 there is integration among stock market prices and macroeconomic variables, where inflation and

exchange rates affect the prices of stock market in short term while interest rates and inflation rates impact the stock market prices significantly in long run in Ghana .Stable economy is the key of stock market, the more the stable the economy the better the result, the more volatile the economy the riskier and uncertain the results are, shares prices fluctuate in a high rate, (Modigliani and Miller 1958 (further argued that firms value is not depending on the capital structure, and according to the findings of the (Gracia and Liu 1999) high level of income, domestic saving, domestic investments, high per capital are the determinants of stock market development.

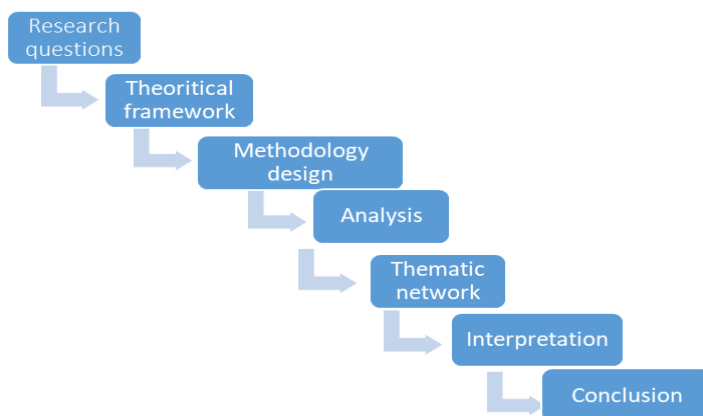
2.4 Market size

(Eichengreen, Borensztein, and Panizza 2006 (said despite the technical, institutional and regulatory barriers in emerging countries face a problem of sufficient number of investors for the liquidity and depth for the stock market, in such case the authorities can attract foreign investors to invest in local stock market, and according to (Cifuentes, Desormeaux, and Gonzalez 2002 (the pension money could be used for long term financial instruments for asset-liability purposes, which can provide a smooth foundation for stock exchange market, that has a positive impact and help in the liquidation of the stock market, and that generate more income as well.

2.5 Research Methodology

This section includes the research process, that what types of data is collected, how its collected, what is the sample technique and how the data is analyzed. The whole study is conducted based on below figure 1.

Figure 1: Research Process



Source :Author's compilation

2.6 Nature of the study

The nature of the study is qualitative and exploratory, to gain more information and go in depth of the study, semi structured interview questions were developed based on literature study with the best consultation and guidance of supervisor were, an attempt to give flexibility to the respondents to explore the challenges and prospects to the stock market and recommend feasible options to establish stock market in Afghanistan.

3 Population and Sampling technique

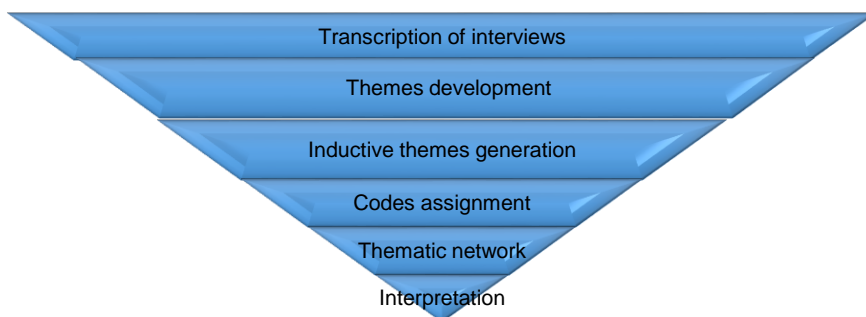
Population for this study is financial sectors authorities, government of Afghanistan, and The sample size for the study is 6 respondents 'Senior managements , from the central bank of Afghanistan, ministry of finance, ministry of trade and commerce, ministry of economics and economic committee of cabinet, where non-probability Purposive sampling technique is used , because it required the respondents whom have the knowledge and experience in the topic of the study which involves identifying and choosing respondents that are expertise and have more experienced with a phenomenon of interest.

3.1 Interview Protocol

Interview method is used for collecting primary data, to gain more information and go in depth of the study, supervisor has guided semi structured interview questions that are to be properly in line with the objectives of the study were developed, an attempt to give flexibility to the respondents, to explore the challenges and prospects to the stock market and recommend feasible options to establish stock market in Afghanistan.

3.2 Procedure of data analysis

Figure 1: Procedure of data analysis



Source: Author's Compilation

For assessing the interviews, thematic analysis methodology, (Swanson and Holton, 2009) coding technique is used for the research report analysis, which is a process of generating predetermined themes and further generate subthemes from the interviews textual answers and later subthemes are assigned codes that represent both themes and subthemes. Conducted and recorded interviews are transformed to the table 1 through transcribe process, pre-determined A priori codes themes are developed which are later generated inductive subthemes, from the table 1.

Textual data and these inductive subthemes are being assigned codes which represent themes and inductive subthemes and based on these inductive subthemes thematic network are generated, and the thematic networks graphs are being used for interpretation of patterns. Figure 1 represents it graphically.

4 Data Analysis

This section talks about the analysis and findings of the interviews, the answers of the respondents are transcribed to table through transcribe process, and it also highlights themes, sub themes development, codes generation and thematic network. Interviews answers are transcribed into table 1, from that, pre-determined themes are developed and from those inductive subthemes are generated, later subthemes are given codes which represent both, and from sub themes thematic network is developed in line with objectives of the study for interpretation of patterns.

Table 1: Codes and themes development results

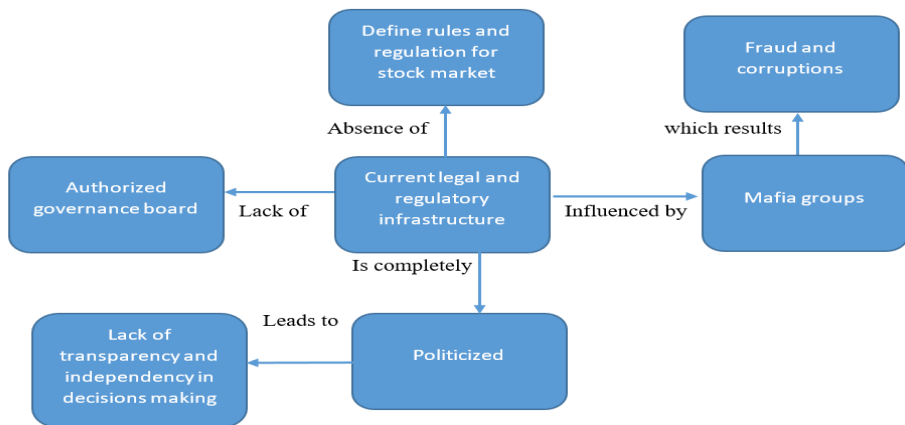
| 4.1 Theme | A priori codes | Extracts | Sub theme | Codes |
|-------------------------------------------------|----------------|--------------------------------------------------------------------------------|------------------------|-------|
| 4.1 Current legal and regulatory infrastructure | CLI | ➤ CLI is not adequate | Not adequate | CLI1 |
| | | ➤ The absence of particular act and procedures | Act and procedures | CLI2 |
| | | ➤ There is no particular rules and regulations defined yet | Rules and regulation | CLI3 |
| | | ➤ Security exchange board is not available yet in the country like)SEC of US(| Board | CLI4 |
| | | ➤ Interferences of Mafia groups in financial sector | Interference | CLI5 |
| | | ➤ Weakness of government in policies making and governance | Weakness of government | CLI6 |
| | | ➤ Absence of sufficient number of financial institutions | Institutions | CLI7 |
| | | ➤ Lack of specialized human capital | Human capital | CLI8 |

Source: Author's Compilation

Thematic network for theme 4.1

Graph 1 shows the current legal and regulatory infrastructures, for stock market of Afghanistan. There has been lack of define rules and regulation for stock market operations in Afghanistan along with that there is no authorized board of stock for governance yet in the country. The current legal system is completely politicized which leads to lack of transparency and independency in decisions making process. The current legal system is highly influence by Mafia groups which gives birth to frauds and corruptions, due to disharmony among heads of the politicians and that shows weakness of the government.

Graph 1 :Current legal and regulatory infrastructures, for stock market of Afghanistan



Source : Author’s compilation

Table A .Codes and Themes Development Results

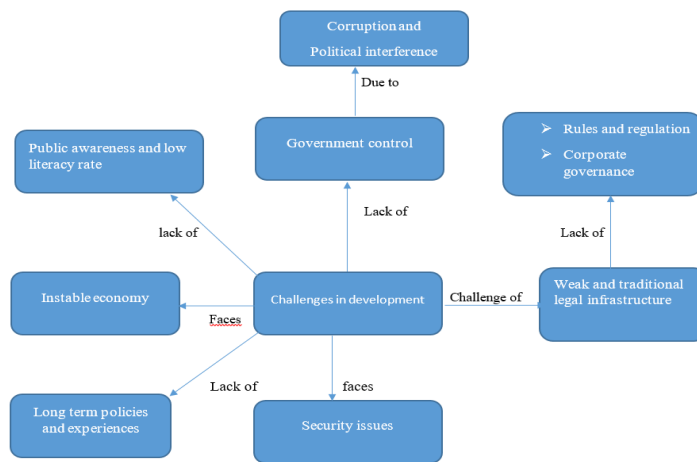
| 4.2 Theme | A priori codes | Extracts | Sub theme | Codes |
|-----------------------------------------------|----------------|-------------------------------------------------------------|----------------------------|-------|
| 4.2 Challenges in development of stock market | CDS | > Lack of foundation for stock market is the main challenge | Foundation | CDS1 |
| | | > Weak and traditional infrastructure | Traditional infrastructure | CDS2 |
| | | > Low government control on financial institutions | Government control | CDS3 |
| | | > Instable economy is hitting the country | Economy | CDS4 |
| | | > Insecurity issues are very high | Security | CDS5 |
| | | > Low rate of literacy in the country | Literacy | CDS6 |
| | | > Lack of investors trust | Trust | CDS7 |
| | | > Lack of political harmony | Political harmony | CDS8 |
| | | > Lack of specialized accountants and auditors | Accountants and auditors | CDS9 |

Source: Author’s Compilation

Thematic network for theme 4.2:

Graph 2 shows the challenges in development of stock exchange market in Afghanistan, country is facing sever security and instable economy, along with that the current legal infrastructure is traditional and weak that is lacking of certain rules and regulation and corporate governance for stock market, government control is very less and that leads to fraud and corruptions in the country, long term policies and experiences are another challenge, apart from that people is lacking awareness of stock market as it is a new phenomenon for them due to low level of education and literacy.

Graph 2 :Challenges in establishment of stock market in Afghanistan



Source :Author's compilation

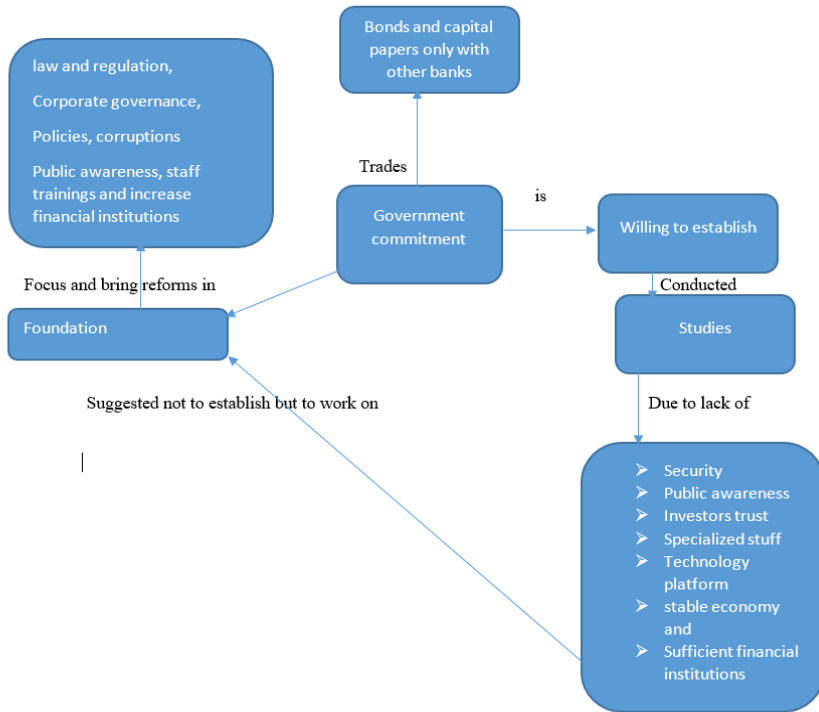
Table A .Codes and Themes Development Results

| 4.3 Theme | A priori codes | Extracts | Sub theme | Codes |
|---------------------------------------------|----------------|-------------------------------------------------------------------|------------------------------------------|----------------------------------|
| 4.3 Government commitment for establishment | GCE | • Government is willing to established stock market | Will | GCE1 |
| | | • Conducted primary studies | Primary studies | GCE2 |
| | | • Lack of security is the threat to the country | Lack of security | GCE3 |
| | | • Instable economy is challenging the government | Instable economy | GCE4 GCE5 |
| | | • Public awareness is very less | Public awareness Education | GCE6 |
| | | • Education and Familiarity to stock market is low | Support | GCE7 |
| | | • Investors trust and support is low | | GCE8 |
| | | • Political pressure is hitting the way to establish stock market | Political pressure | GCE9 |
| | | • Government is working on the foundations of the system | Foundation Reforms Increase institutions | GCE10 GCE11 GCE12 GCE13 |
| | | • Bringing reforms in law rules | | |
| | | • Launching and increasing financial institutions | Bond trading | |
| | | • Initiated bond and capital paper activities limit to banks | Banks | |
| | | • Bonds and capital papers are traded with limit to banks | | |

Thematic network for theme 4.3:

Graph 3 shows the commitment of government toward establishment of stock market in Afghanistan .Government is willing to establish it, due to that central bank has done primary studies as well, which stated that due to lack of security, stable economy, public awareness, investors trust, technology platform, specialized human capital and sufficient number of financial institutions, it would be better to work on the foundation and concentrate on reforms in law and regulation, corporate governance, public awareness and increase institutions, along with that the central bank is trading with bonds and security papers only limited to banks for raising funds and control of currency which are first steps toward paving the way for establishment of stock exchange market.

Graph 3 : Government commitment toward establishment of stock market in Afghanistan



Source :Author's compilation

Table A .Codes and themes development results

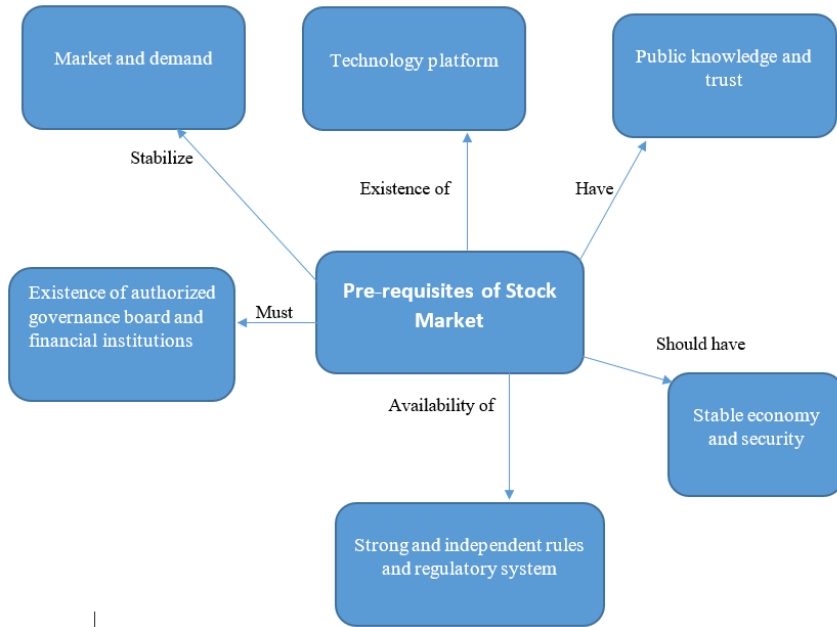
| 4.4 Theme | A priori codes | Extracts | Sb theme | Codes |
|------------------------------------|----------------|------------------------------------------------------------------------------------------------------------------------|-----------------------------------|-------|
| 4.4 Pre-requisites of stock market | PRS | <ul style="list-style-type: none"> • Strong and independent rules and regulatory system is the key | Strong and independent rules | PRS1 |
| | | <ul style="list-style-type: none"> • Stable economy is important | Stable economy Country's security | PRS2 |
| | | <ul style="list-style-type: none"> • Country's security is very much needed | Board and institutions | PRS3 |
| | | <ul style="list-style-type: none"> • Existence of board and many financial institutions | Technology platform | PRS4 |
| | | <ul style="list-style-type: none"> • Technology platform is the core | People knowledge and trust | PRS5 |
| | | <ul style="list-style-type: none"> • Public knowledge and trust | Market and people will | PRS6 |
| | | <ul style="list-style-type: none"> • Availability of Market and WILL of people to trade in stock market | Specialized stuff | PRS7 |
| | | <ul style="list-style-type: none"> • Availability of specialized stuff | Corporate governance | PRS8 |
| | | <ul style="list-style-type: none"> • Strong corporate governance | | PRS9 |
| | | | | |

Thematic network for theme 4.4:

Graph 4 shows the pre-requisites for establishing stock market in Afghanistan.

Strong and independent regulation system is very much needed, along with that existence of board of stock exchange and financial institutions are the drivers for the stock market, apart from that stable economy is the base to trade in stock market and stabilize the stocks, technology platform is also very important, public knowledge and trust are also the key for a successful stock market initiation, that makes a demand and market for stock to be traded in the market and people will know and invest in this market .

Graph 4 :Pre-requisites for establishment of stock exchange market, In Afghanistan



Source :Author's compilation.

Table A .Codes and themes development results

| 4.5 Theme | A priori codes | Extracts | Sub theme | Codes |
|-------------------------------------------|----------------|-----------------------------------------------------------------------------------------------------------------------------------|---------------------------------|-------|
| 4.5 Option for stock market establishment | OSE | <ul style="list-style-type: none"> • Country is going through series political and economic issues | Series issues | OSE1 |
| | | <ul style="list-style-type: none"> • Instability of the economy is very high | Instability | OSE2 |
| | | <ul style="list-style-type: none"> • Security is very much low | Low security | OSE3 |
| | | <ul style="list-style-type: none"> • Huge corruptions in financial and non-financial sectors | Corruption in financial sectors | OSE4 |
| | | <ul style="list-style-type: none"> • Low level of public knowledge and awareness | Public awareness | OSE5 |
| | | <ul style="list-style-type: none"> • Conducted studies suggested to work on the pre-requisites of the stock market | Pre-requisites | OSE6 |
| | | <ul style="list-style-type: none"> • Pave away for good environment | Environment | OSE7 |
| | | <ul style="list-style-type: none"> • Infrastructure | Infrastructure | OSE8 |
| | | <ul style="list-style-type: none"> • Strong regulation and infrastructure are required | policies | OSE9 |
| | | <ul style="list-style-type: none"> • Reforms in laws are on the way | reforms | OSE10 |

5.1 Conclusion

A well-developed stock exchange market plays very important role in the economy, as it mobilize resources for productive and huge investments, which will lead to economic growth, it is essential for a country to have a strong regulation system, updated technology platform, stable economy, security, and public knowledge as a pre-requisites for developing stock market to push the country’s economy positively, this study investigates the current legal system of Afghanistan for stock exchange market establishment, the challenges for it is development and the government commitment toward it.

It is clear from the study that current regulatory system of Afghanistan is not adequate due to lack of rules and regulation, absence of authority institutional board of governance, for legal aspects of stock market .Sever security issues, instable economy and lack of public knowledge and awareness are the main challenges for the stock market development, apart from these, there is lack of governance in financial sector due to corruptions

and disharmony among senior management of the country, lack of technology platform and specialized accountants and auditors staff, less number of financial institutions.

Afghan government is committed toward its establishment as the government conducted primary studies, the results of studies suggested to not establish now, instead work on the foundation of financial sector by bringing reforms in the rules and regulations, long term policies, campaign for public awareness and concentrate on financial institutions development to pave away for stock market establishment but apart from that the government initiated bond trading limited to commercial banks only as a step toward reforms and innovations in the system.

As per (Mulatu, 2016), research mentioned in literature review also draw similar conclusion in Ethiopia, as the country is lacking strong legal and institutional infrastructure, public awareness and clear policy for shares circulation, the government should bring reforms in rules and regulation and focus on policies to increase public knowledge and other financial institution, and (Singh, 1999) said stock market establishment for many African countries will be harmful more than benefiting, as it required huge cost, which may not be afford by these countries, it's better for them to use their scarce resources in banking development and bring reforms as these banks will meet the requirements of local firms, and saver and these development of banking will pave away for the development and establishment of the stock market .

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