What are Capital Markets?

Capital markets are like any other markets, but differ in terms of the products traded and their organization. Capital markets deal with the trading of securities. Capital markets provide avenue where companies can raise funds to expand on their businesses or establish new ones by issuing securities owned by the companies. Like businesses in the private sector, Government issue its securities to raise funds in capital markets to build electricity damn, construct new roads, bridges by issues.

What are Securities?

Securities are financial instruments or legal documents signifying either an ownership position in a company (i.e. shares) or a creditor relationship with a company or government (i.e. Stocks and bonds).

What are Stocks, Bonds and Shares?

Stocks and bonds are long-term fixed interest bearing securities issued by Government and companies. When one invests in stocks and bonds, one gets interest income, which is paid periodically until the loan matures or is called back by the issuer. The holder of stocks and bonds gets interest even if the issuer does not make a profit.

Shares represent part-ownership in a business concern. Shareholders, therefore, between them own the company, have a vote in how it's affairs are run and if the company makes profit, they are entitled to a share of it. However, the dividend which shareholders receive is dependent on the company's profitability and management decisions such as company shares, bonds issued by governments in private companies, units in Collective Investment Schemes, debentures, commercial paper and notes.

How are shares bought and sold?

Shares can be bought either from the primary or secondary market.

Primary Market refers to the purchase of shares in an Initial Public Offering (IPO), whereby a company offers its shares to members of the public for the first time. During an IPO, shares are bought through the selling agents or banks of the company issuing the shares.
In the secondary market, the purchase and sale of shares is done through the Stock Exchange.

What Is A Stock Exchange

The Stock Exchange is one of the institutions in the Capital markets. It is an organized market in securities (shares, stocks and bonds). On this market, individuals and companies can buy shares of companies through Licensed Dealing Member (Stockbrokers) of the Stock Exchange and hence become part- owners or shareholders of these companies. Similarly, individuals or companies through Stockbrokers can buy stocks and bonds of other companies and the Government, and become lenders to or creditors of these companies or the Government.

Any individual or company who at one time or the other lent money or bought shares through the Stock Exchange can also sell back the relevant shares or stocks through the stock Exchange at any time.

The Stock Exchange has its rules and regulations which govern it. These rules and regulations are designed to protect all market participants, including the individual who puts up some funds to invest.

Are there any other Schemes available in Capital Markets?

Yes, Collective Investment Schemes (CIS) such as Mutual Funds or Unit Trusts. These are formalised system of Community Savings Schemes otherwise known as Osusu. The CIS allows individuals to make periodic contributions of various amounts.

What Is A Unit Trust Scheme?

It is a vehicle established to enable many small investors pool their funds together and enjoy the benefits of diversification and professional management at low cost without impairing the liquidity and safety of the investment. In some jurisdictions it is called Mutual Fund.

There are two types of unit trust schemes: open-ended and close-ended.

What Is The Difference Between Unit Trust And Mutual Fund?

Mutual Fund is another name for Unit Trust in some jurisdictions e.g. the United States.

What is Community Savings Scheme?

Community Savings Schemes otherwise known as Osusu is the informal way of capital formation by traders or other individuals by making periodic contributions of various amounts. These schemes are used by low income earners to acquire assets, initial capital for petty trading, etc. However some people have lost their meagre savings in these schemes as some of the collectors vanish after collecting the money of their victims.

The Osusu schemes will therefore stand to benefit from the development of a capital market which will provide the enabling environment for the effective and secure operation of the schemes which are registered with recognised regulatory body, like the Bank of Sierra Leone.

What Are The Benefits To Be Gained By A Formalised Community Savings Scheme?

- The business will be recognized by Government
- Access to free investment and financial advice
- Opportunity to participate in capital market operations
- Builds confidence and attracts more contributors.

What Does The Saver Stand To Gain By Saving With A Registered Collector?

- Savings will be more secured by maintaining proper records by the collectors.
- A saver will be assisted in locating his collector should he abscond
- A saver will have a wider choice of collectors.

What Are The Potential Advantages Of Investing In Collective Investment Schemes?

There are many advantages for investing in Collective Investment Schemes.

Diversification

Investing in a number of different securities helps reduce the risk of investing. When the investor buys a share/unit in a fund, he/she buys an interest in a portfolio of dozens of different securities, giving him/her instant diversification, at least within the type of securities held by the fund. For example, a portfolio made up of shares from various companies is a good example of diversification.

Affordability

With many funds, the investor can begin buying shares/units with a relatively small amount of money (e.g. about Le.50,000 for the initial purchase). Some funds allow investors to buy more shares on a regular basis with even smaller monthly instalments.

Professional Management

Mutual funds/Unit trusts are managed by professionals who are experienced in investing money and who have the skills and resources to research many different investment opportunities. Investors in these funds, therefore, get access to the professional management of their funds.

Liquidity

Shares of CIS can be redeemed at any time.

Flexibility

Many fund management companies administer several different funds. (e.g. money market, fixed-income, growth, balanced and international funds) and allow the investor to switch between funds within their ‘fund family’ at little or no charge. This can enable the investor change the balance of his portfolio as his personal needs or market conditions change.

Performance Monitoring

The bid and offer prices of CIS are reported in the press and on many internet sites as obtains in other markets, allowing the investor to continually monitor the performance of his/her investment.

How are Investors Protected

There are rules and regulations governing all participants in the market. Companies must meet certain conditions before approval to issue shares or debt instruments to the public and list on the Exchange, is granted.

What role do capital markets play in an economy?

Capital markets have an important role to play in stimulating economic development. The following are some of the examples:

- Capital markets help mobilize domestic savings, hence facilitating the reallocation of financial resources from dormant to more productive activities.

- Capital markets provide an avenue for the divestiture of State Owned Enterprises (SOEs), whereby shares in these companies may be sold through the Stock exchange, allowing members of the public to participate in the ownership of these companies. The privatization of SOEs through a stock exchange helps to broaden the asset base by providing a means through which ordinary citizens can acquire a share in the country's assets.

- Companies have the opportunity to raise long-term finance through equity and debt financing (issuing shares and bonds respectively).

- Members of the public are given an opportunity to buy shares or bonds providing them with an alternative method of investing their savings.

- Capital raised through the issue of shares, bonds or other instruments can be invested by the company to expand production, invest in more efficient productive processes and improve competitiveness.

- Increased investment by companies will lead to employment expansion, income generation, and with a larger percentage of the population earning income, savings and consumption will increase resulting in a cycle of increased investment, increased production, enhanced economic growth and wealth creation.

- Through full disclosure requirements, companies are encouraged to observe better accounting and management practices, hence leading to greater transparency in the business sector and lower incidences of corruption. This will lead to good corporate governance.

- Capital markets enhance the inflow of international capital when international investors participate in debt and equity instruments.

What developments have taken place in the Sierra Leone's Capital Markets Industry so far?

The capital markets industry in Sierra Leone is in its infancy. There are however, shares of at least six public companies that can be traded in the capital market. These companies include:

- Rokel Commercial Bnak (SL) Ltd)
- Sierra Leone Brewery Ltd.
- Standard Chartered Bank (SL) Ltd
- Aureol Insurance Ltd.
- Reliance Insurance Ltd.
- Freetown Cold Storage Ltd.

Two discount houses, First Discount House and Capital Discount House have been established to serve as players in the market. First Discount House has already done Over The Counter Trading (OTC) in shares of Rokel Commercial Bank (SL) Ltd. and Sierra Leone Brewery Ltd.

Going public and trading on the OTC market is normally seen as a stepping stone to seeking trade on the stock exchange.

How do companies benefit from capital markets?

A share issue allows companies to increase the equity base of the company and raise capital without bearing the burden of interest payments associated with borrowed funds.

Full disclosure requirements encourage companies to observe good business and management practices and ensure better corporate governance, benefiting not just the firm but the economy as a whole.

The public profile of the company is improved thus attracting greater business opportunities.