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The liquidity cost implications arising from the attraction of regional primary listings: Evidence from West Africa

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ABSTRACT

This study reviews the liquidity costs for firms in outlying regions in primary listing on a centralized stock exchange. Using a unique hand-collected sample comprising all listed firms from across West Africa we find evidence that firms from outlying regions do have higher illiquidity costs although these can be mitigated from improvements in transparency that are associated with increasing familiarity amongst investment community of central exchange. This evidence has implications regarding the integration of stock exchanges in developing regions where this is likely to result in a greater concentration of liquidity mitigating intended optimal redistribution of capital and resources.

1. Introduction

The worldwide wave of mergers of national stock exchanges that has resulted in formation of agglomerated entities such as Euronext in Europe and Scandinavia has been largely motivated by notions of cost reduction through exploitation of economies of scale and scope in the provision of trading and related support activities that leads to enhanced competitiveness of these integrated markets in attracting ever increasingly footloose global investment capital. Similar arguments regarding

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increased scale and scope efficiencies in exchange operations leading to competitive attraction of otherwise scarce global investment capital have underscored the formation of integrated regional capital markets in the developing world. One example is the 1998 extension of the existing capital market in Cote d'Ivoire to all other member states of the Francophone UMEAO[1] region in West Africa through the establishment of regional BRVM.[2] However more recently the Anglophone markets of Ghana and Nigeria have developed an increasingly regional orientation through the attraction of primary listings of firms in neighbouring countries. Consequently we ask whether stock exchanges adopting a strong regional focus can provide effective liquidity to firms listing from more distant outlying regions or nations within an integrated framework.

The nascent literature on implications of regional capital markets in acting as a source of sustainable finance and liquidity to firms from more distant regions in a centralized marketplace is centred in three distinct strands. The first is rooted in economic geography literature where Klagge and Martin (2005) introduce notions of a lack of spatial-neutrality which is particularly prevalent in centralized capital markets leading to a funding gap and rationing of both credit and equity to firms located in more distant provinces. The second focusses on the study by Loughran and Schulz (2005) contrasting liquidity of urban as opposed to rural based firms within largely centralized capital market of United States. The findings attribute the significantly higher liquidity of urban stocks over their rural counterparts through greater familiarity of urban stocks to institutional investors that are predominantly urban-based as well as their enhanced information access to urban-based firms. The third and final strand of literature relates to informational access differentials between local as opposed to foreign analysts. Bae et al. (2008) find evidence from study of local and foreign analysts across 32 countries that the former produce more accurate earnings forecasts and that locally-based analysts are especially important in institutionally deficient environments where there is less disclosure and greater earnings smoothing. Consequently our first theoretically based contribution to literature is in undertaking a unique assessment of the impact of regional primary listings in terms of their liquidity-based transactions costs which captures the dynamics of informational asymmetry.

West Africa's formal business environment is largely dominated by listed firms made up from former state owned enterprises (SOEs) as well as locally incorporated subsidiaries of foreign (mostly European) multinational enterprises (MNEs). However a unique nuance of the region is the recent emergence of local indigenous emerging MNE firms such as the Moroccan-Malian Bank of Africa and Togolese Ecobank. These have engaged in rapid expansions across Africa and Middle East through the very recently reported phenomenon of south–south foreign direct investment (FDI) (see Sun et al. (2012) and Liu et al. (2011) for discussions on south-south FDI emanating from India and China respectively) while the external funding and regulatory capital requirements of their subsidiaries is reliant on primary and joint-primary listings across West Africa's nascent stock markets. As such our study provides a unique insight into the informational asymmetries present across integrated regional markets such as BRVM as well as regionally focussed markets such as Ghana and Nigeria that underscore liquidity-based transactions costs incurred by large well known firms from distant outlying regions on centralized exchanges. This is particularly pertinent in the case of Togolese Ecobank with unique joint-primary listing between BRVM, Ghana and Nigeria where all have common composition of senior management and boards of directors as well as the Burkina Faso, Niger and Benin subsidiaries of Bank of Africa.

The literature regarding liquidity within Africa's capital markets primarily focusses on the attribution of pricing premiums to liquidity in size and liquidity factor augmented variations of the capital asset pricing model. Hearn and Piesse (2009) find evidence of size and liquidity premiums across a broad sample of African listed industrial sectors while Hearn et al. (2010) find similar evidence from a smaller sample comprised of Egypt, Morocco, Kenya and South Africa. Finally Hearn and Piesse (2010)

[1] The Francophone West African Economic and Monetary Union (also known Union Monétaire et Économique de l'Afrique de l'Ouest (UMEAO)) countries include Cote d'Ivoire, Benin, Togo, Burkina Faso, Mali, Niger, Senegal and Guinea-Bissau.

[2] La Bourse Régionale des Valeurs Mobilières (BRVM) is a regional stock exchange established in 1998 in place of the former national Bourse d'Abidjan and is based in Abidjan, Cote d'Ivoire. Antennae de bourse offices have been established in capital cities of all eight UMEAO member states to assist in technical aspects of trading and promoting centralized market while a separate network of Societe de Gestion et d'Intermédiation (SGI) or licensed brokers precipitates order flow.