ZAMBIA

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Key Data Points (as at end-December 2023, unless otherwise stated)	
Total Population	20.72 million
Equity market capitalisation (total billions and % of GDP)	ZMW80.7 (USD4.12), 16%
Mutual fund assets under management (millions)	USD68
Estimated debt market, including bank loans (billions)	ZMW288.62 (USD14.95)
Estimated debt market (% of GDP)	57.2%
Number of publicly listed companies	23
Number of marketable corporate debt issuers	2
Annual average inflation	11%
Nominal GDP (billions) and annual growth rate	ZMW504.4 (USD29.8), 4.7%

Sources: World Bank; Lusaka Securities Exchange; Zambia Statistics Agency; Ministry of Finance and National Planning; Securities and Exchange Commission – Zambia.

1. Introduction and Context

Introduction

Zambia's modern capital market stems from economic and structural reforms initiated during the 1990s under the IMF's Structural Adjustment Program. These reforms resulted in the establishment of the Lusaka Securities Exchange (LuSE) in 1993 and the revision of the Securities Act, facilitating the creation of the Securities and Exchange Commission (SEC) in 1994 for market regulation. These reforms aimed to establish a versatile platform for government, corporations, and SMEs to access both domestic and international capital markets. Despite more than two decades of development, Zambia's capital markets still significantly lag behind its emerging market peers. Notably, as of December 2022, the LSE's market capitalisation amounted to only 16% of GDP, compared with the 62% average for emerging market counterparts (Ministry of Finance and National Planning 2023).

Zambia's capital market growth, especially in the private sector, is constrained by many challenges. Like other African countries, Zambia faces crowding out caused by government borrowing in the domestic market, which has driven up interest rates and thereby elevated borrowing costs for private enterprises. For Zambia, this situation is compounded by its sovereign default, which has hampered access to international capital markets. Additionally, unclear regulations; elevated sovereign risk, which deters offshore investors; and increased illiquidity risk in secondary markets, particularly for equities and long-term securities, impede capital market growth. Despite a substantial national savings rate of 35.5% of GDP (compared with sub-Saharan Africa's overall average rate of 24%), MSMEs face restricted access to capital markets. To tackle these issues, Zambian authorities mooted the Capital Markets Master Plan (CMMP) in early 2023, aiming to stimulate the growth of Zambia's capital markets.

In this chapter, we discuss the role of capital markets, especially private capital, in capital formation in Zambia, focusing on the challenges and solutions that could help unlock the potential of capital markets.

Historical Context

Government capital market fundraising policies have evolved with the prevailing political and economic ideologies. After Zambia's 1964 independence, David Kaunda's UNIP regime adopted a Soviet-style socialist approach, involving extensive state intervention. Fundraising focused on enabling state access to capital markets for public infrastructure and state-owned enterprises. This situation changed, however, with the Soviet Union's collapse in 1991. By then, Zambia's debt exceeded 200% of GDP, leading to failed attempts to seek financial assistance and debt relief with Bretton Woods institutions in the mid-1980s (Andersson, Bigsten, and Persson 2000). These economic challenges ultimately led to the UNIP government's downfall in 1991.

Under Fredrick Chiluba's MMD government, Zambia addressed the debt crisis by engaging the IMF, leading to a Structural Adjustment Program. This initiative aimed to transition to a private sector–driven economy. Fundraising policies shifted from solely government financing to creating opportunities for the private sector to raise capital. Recognising the need for further capital market growth, the government is now proposing additional reforms through the CMMP to improve private sector access to financing, particularly for SMEs.

2. Raising Funds in the Public Markets

Government dominates public fundraising, particularly in debt markets, with a 73.4% share of the ZMW288.62 billion (approximately USD14.95 billion) total outstanding local-currency debt, while the private sector accounts for the rest. To finance its funding needs, the government taps both private and public capital markets, using commercial bank loans and tradable instruments. Domestically, it regularly issues treasury securities to meet financing needs. Additionally, the government seeks foreign-currency debt in international capital markets through issuance of securities and commercial loans despite its stated objective of borrowing concessionally.

The private sector plays a minor role in public fundraising. High-quality corporations occasionally raise funds through debt and equity offerings on the LuSE, although equity offerings have been minimal. Only one rights issue occurred, by ZAFFICO Ltd., which raised ZMW299.1 million (USD16.2 million), in 2020, and since then, no new IPOs have taken place. Meanwhile, private entities, such as Bayport Financial Services Group, continue to leverage the public debt market.

Infrastructure Financing

Zambia's inadequate infrastructure is a serious drag on growth and economic diversification. Foster and Dominguez (2013) estimated that Zambia needs USD600 million to close the infrastructure gap so as to boost annual GDP growth by at least 2%. To address this need, in 2011 the Zambian government initiated an ambitious plan to close this gap. Funding was diversified, including accessing commercial debt markets alongside concessional borrowing from bilateral and multilateral lenders. During the last decade and a half, Zambia issued three Eurobonds (in October 2012, April 2014, and July 2015) worth USD750 million, USD1.25 billion, and USD1 billion, respectively, to finance infrastructure development. Additional funding sources have included donors and government appropriations.

Lately, the government has promoted public–private partnerships for greenfield projects in energy, transportation, and border infrastructure. Additionally, most public roads have toll stations to fund maintenance. However, noneconomic prices remain a hindrance to PPPs in the energy sector.

MSMEs and Early-Stage Company Financing

According to the 2017 annual report of Financial Sector Deepening Zambia, micro, small, and medium-sized enterprises are crucial to Zambia's economy, contributing 70% of GDP while employing 88% of the workforce and making up 97% of businesses. Despite their economic significance, MSMEs in Zambia lack access to formal lending institutions and capital markets. Hence, most MSMEs rely on personal savings, family, and friends to initiate and sustain their operations. This reliance on informal funding can constrain their growth potential.

To assist MSMEs, the government has over the years established funding opportunities through the National Technology Business Centre (NTBC), the Zambia Development Agency (ZDA), and the Citizens Economic Empowerment Commission (CEEC). It has also created the Development Bank of Zambia (DBZ) for cost-effective long-term financing. Unfortunately, these initiatives faced issues of adverse selection and moral hazard, leading to low levels of repayment. As a result, on 17 July 2023, the government placed DBZ under receivership because of its longstanding credit portfolio underperformance.

In addition to government-led funding arrangements, increasingly many MSME startups are now accessing initial funding from the capital market through debt or private equity. There is growing hope that this direct access to capital, driven by market forces, will provide more effective assistance to these burgeoning businesses, fostering greater economic dynamism.

Private Foreign Direct Investment Flows and Trends

As part of IMF reforms in the mid-1990s, Zambia liberalised its capital account to attract foreign capital into its newly privatized state-owned enterprises. Recently, the focus has been to attract capital into agriculture, mining, energy, and tourism. Despite these efforts, although FDI flows peaked at USD2 billion in 2013, they have since experienced a notable decline, hitting a 10-year low of –USD122.1 million in 2022 because of mining sector debt repayments (Balance of Payments Statistical Committee 2022). In our view, in addition to the outflow-side factor, the sustained drop in FDI is also linked to concerns about Zambia's high debt burden, which led to a sovereign default in October 2021. This default raised concerns among investors about the country's economic stability and fiscal sustainability, leading to a more cautious approach towards investment.

In terms of sectoral allocation, natural resources—primarily copper mining—dominate private FDI, accounting for 49.5% of total inflows. Manufacturing follows at a distant 11.2%, while agriculture and trading represent only 2.3% each. Private FDI inflows are a form of debt—primarily from foreign associates—and equity investment.

The concentration of private FDI in the primary sector underscores Zambia's heavy dependency on primary products. This reliance exposes the country to the inherent volatility of commodity markets and limits its potential for broader economic development. The barrier matrix (Exhibit 2), presented in the earlier section of this report, illustrates the severity and interconnectedness of these challenges. Deliberate efforts towards economic diversification are needed for Zambia.

This reliance emphasizes the need for diversification.

3. Debt

Government Fundraising Framework

The Zambian government uses both public and private markets to finance its excess expenditure needs, guided by the national budget deficit financing needs. The Medium-Term Debt Strategy (MTDS) outlines the mix of instruments (public and private) for annual fundraising and adheres to the Public Debt Management Act No. 15 of 2022.

The current MTDS (covering 2023–2026) aims to curtail debt accumulation, extend maturities of existing debt, and reduce debt service costs by favouring concessional borrowing from multilateral lenders over the more expensive commercial debt. Other key documents governing the fundraising framework include a white paper on a medium-term budget plan (Ministry of Finance and National Planning 2025) that solidifies the budget for a year and provides fiscal forecasts for the following two years. According to the 2022 Public Debt Management Act, the director overseeing debt management is tasked with creating an annual borrowing plan (ABP) by considering the MTDS, debt sustainability, and financial forecasts from the annual budget.

The ABP consists of total borrowing needs for the next financial year, the purpose of the loans to be contracted, the debt instruments to be used, the broad terms of the borrowings, the maximum limit that government wants to borrow in that year, and timing of the borrowings. It clearly outlines government fundraising in public and private markets, requiring parliamentary approval before any decisions are executed.

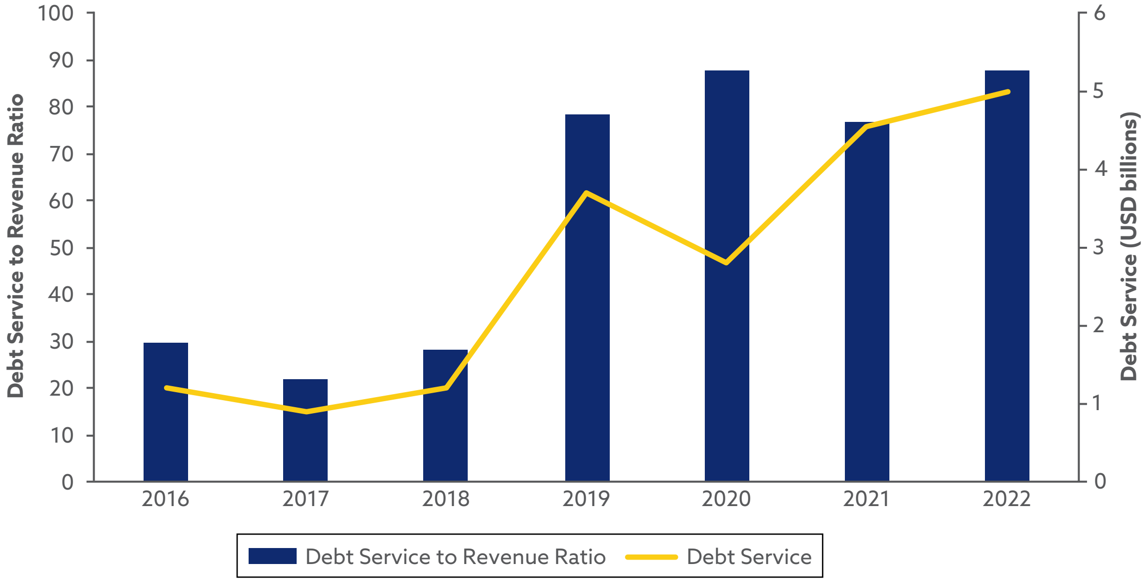
Government Debt

After the Heavily Indebted Poor Countries debt forgiveness in 2005, Zambia's debt dropped below USD2.7 billion (32.4% of GDP). Expansionary fiscal policies created significant financing gaps, however, often funded mostly by expensive commercial debt. By the end of 2020, Zambia's debt surged to more than 150% of GDP, while debt service was consuming 88% of government revenue (see **Exhibits 15 and 16**). These rising debt levels underscore serious financing risks, exacerbated by policy shortcomings that failed to address fiscal sustainability.

As a result of elevated debt service pressure, the government placed a moratorium on external commercial debt payments in October 2021, becoming the first sub-Saharan Africa sovereign defaulter. This situation is likely to have negative consequences, including a loss of credibility, contagion risk, and broader sovereign ramifications.

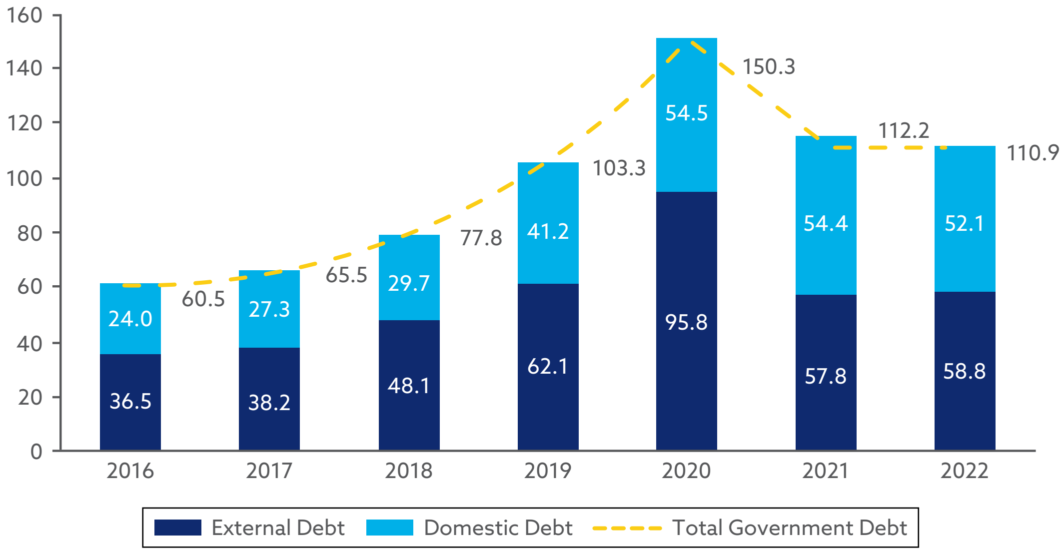
At the end of December 2022, Zambia's total public debt, including arrears, stood at USD30.68 billion (110.9% of GDP). External debt accounted for USD15.65 billion, while domestic debt reached USD15.03 billion (52.1% of GDP).

Exhibit 15. Debt Service as a Percentage of Revenue and Total Debt Service (USD billions)



Source: Author compilation using data from Ministry of Finance and National Planning, *Debt Sustainability Analysis Report July 2023* (2023), www.mofnp.gov.zm/?wpdmpro=debt-sustainability-analysis-dsa-report-july-2023.

Exhibit 16. Central Government Debt as a Percentage of GDP



Source: Author compilation using data from Ministry of Finance and National Planning. *Debt Sustainability Analysis Report July 2023*. 2023. https://www.mofnp.gov.zm/?wpdmpro=debt-sustainability-analysis-dsa-report-july-2023.

High levels of indebtedness and sovereign default in 2021 led the IMF and the World Bank to categorize Zambia's debt profile as unsustainable and in a state of debt distress. As a result of this classification and the associated risks, Zambia has found it increasingly difficult to tap into international capital markets. This withdrawal from the international financial scene has forced Zambia to rely increasingly on domestic markets for fundraising, which may limit its ability to meet significant funding needs and could exacerbate financial pressures in the economy.

Debt Terms

The Zambian government mostly borrowed on commercial terms, and hence, its debt is nonconcessional because interest significantly exceeds 3%. At the end of December 2022, Zambia's nonconcessional debt accounted for 63.6% of total debt, while the rest was concessional loans from the IMF, the World Bank, and AfDB and other multilateral debt. All domestic debt (comprising treasury bills, treasury notes, and bank loans) is nonconcessional. In fact, the recent debt rise was caused by domestic borrowing, with average yield rates in excess of 24%. As indicated earlier in the barrier matrix (Exhibit 2), high interest rates have been a major barrier for Zambia.

Maturity Profile

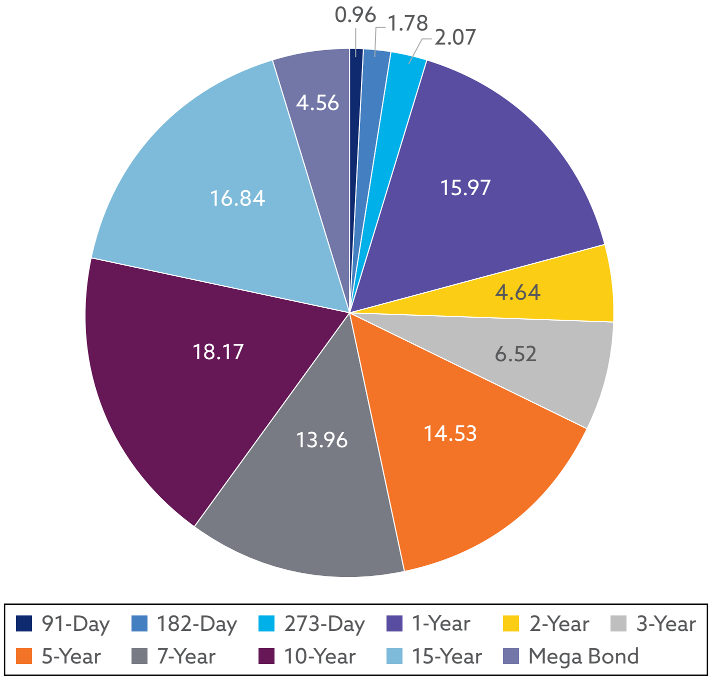
At the end of March 2023, considering the tenor at issuance, 76% of Zambia's debt had a long-term tenor, but much of it has become short term as it nears maturity. Specifically, 58.7% of the debt was due in less than one year, indicating upcoming pressure to repay nearly USD17.4 billion in the coming year (see **Exhibits 17 and 18**).

For domestic debt, maturity at original tenor indicates that Zambia's debt profile consists largely of long-term securities, such as treasury notes (with tenor at issue of two years or more), accounting for 72.2%, while short-term treasury notes accounted for 28.8% at the end of March 2023. In terms of instruments, the 10-year treasury note accounts for 18.2%; the 15-year note, 16.8%; the 5-year bond, 14.5%; 7-year notes, 14.0%; and the 1-year treasury bill, 16.0% (see Exhibit 17).

Interest Rate Type

A significant portion of Zambia's public debt consists of fixed interest rate loans. As of March 2023, government debt with fixed interest rates made up 78.7%, while variable interest debt constituted 21.3%. In the domestic debt category, most debt consisted of fixed-rate tradable instruments, such as treasury notes or bills, with only a small portion being commercial bank loans with variable interest rates. Notably, the weighted average yield rate for domestic tradable debt was 13.4% for treasury bills and 24.2% for treasury bonds, indicating high financing costs. In terms of external debt, 63.75% was fixed-rate debt and

Exhibit 17. Domestic Maturity Profile of Debt at Issuance



Sources: Compiled by author using Ministry of Finance and National Planning data.

Exhibit 18. Actual Debt Maturity Profile, Q1 2022–Q1 2023

	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023
Gross Central Government Debt (USD billions)	29.49	30.13	31.93	30.68	29.58
By Maturity and Type of Debt Instrument (USD billions)					
Short-term by original maturity (less than 1 year)	6.74	6.73	7.46	6.77	7.11
Long-term by original maturity	22.19	22.83	23.91	23.32	21.88
Due within one year	1.98	1.33	1.33	10.78	10.25
Due in more than one year	20.21	21.5	22.58	12.54	11.64
% of Debt Due in One Year and More Than One Year					
Due within one year	29.6	26.7	27.5	57.2	58.7
Due in more than one year	70.4	73.3	72.5	42.8	41.3

Sources: Compiled by author using Ministry of Finance and National Planning data.

Exhibit 19. Government External Debt by Interest Rate Type

	Q1 2022 (USD bn)	Q2 2022 (USD bn)	Q3 2022 (USD bn)	Q4 2022 (USD bn)	Q1 2023 (USD bn)	Percentage of Total Outstanding Debt
Variable rates	4.59	4.57	4.64	5.06	5.11	36.25
Basis adjustment	0.00	0.00	0.00	0.40	0.44	3.09
LIBOR 6-month plus margin	4.00	4.00	4.08	4.09	4.10	29.08
LIBOR 3-month plus margin	0.44	0.44	0.44	0.44	0.44	3.14
EURIBOR	0.14	0.13	0.12	0.13	0.13	0.93
Fixed rates	8.63	8.68	8.73	8.90	8.99	63.75
0%–0.75%	2.09	2.03	2.11	2.17	2.18	15.49
0.76%–2.49%	2.90	3.03	2.97	3.05	3.11	22.04
2.5%–4.99%	0.55	0.52	0.56	0.59	0.61	4.31
5%–9.99%	3.09	3.09	3.09	3.09	3.09	21.92
10%+	0.00	0.00	0.00	0.00	0.00	0.00

Source: Ministry of Finance and National Planning.

36.25% had variable interest rates, as shown in **Exhibit 19**. This high prevalence of fixed interest rate loans in Zambia's debt mix minimizes the impact of interest rate fluctuations on the country's debt servicing capacity.

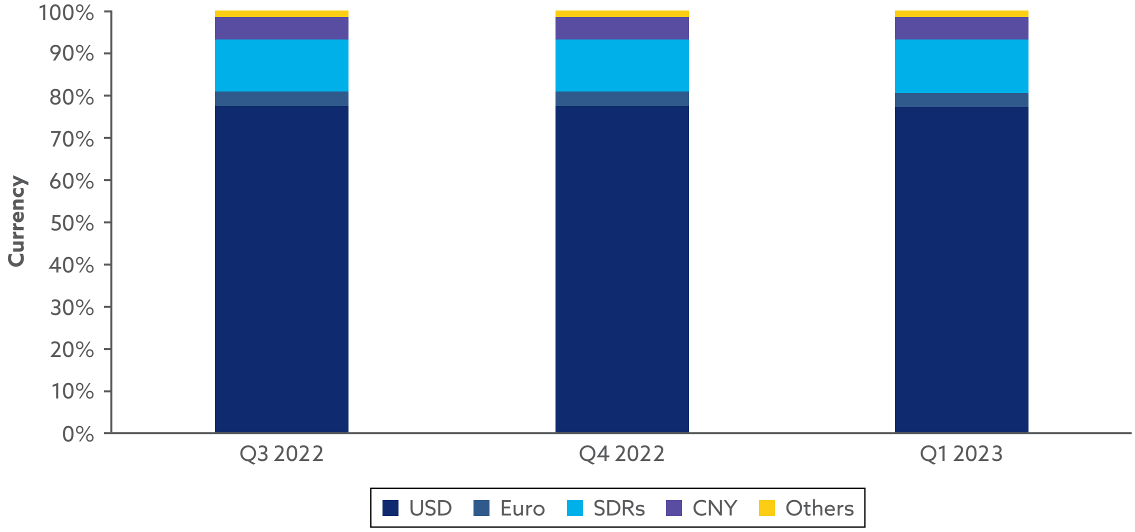
Currency Composition

At the end of March 2023, 53% of public debt was denominated in foreign currency. Of the external debt, 77.2% was denominated in US dollars, followed by special drawing rights (SDRs; 12.6%), Chinese yuan (5.3%), and euros (3.5%; see **Exhibit 20**). Significant exposure to the US dollar exposes the country's debt service capacity to dollar fluctuations.

Corporate Debt

It is difficult to estimate the amount of private corporate debt in Zambia. Data from the Bank of Zambia show that at the end of September 2023, domestic commercial bank credit to the private sector stood at USD4.1 billion (13.74% of GDP). At the same time, private sector debt owed to external lenders amounted to USD3.3 billion (11% of GDP; see **Exhibit 21**).

Exhibit 20. Currency Composition of Zambia's External Debt



Source: Ministry of Finance and National Planning.

Challenges of Fundraising in the Debt Market

Fundraising in the debt market comes with challenges. First, heightened sovereign credit risk following the country's October 2020 default has made fundraising difficult for both the government and private institutions. Other factors include a lack of liquidity in the secondary market for both

Exhibit 21. Trends in Commercial Bank Credit and External Debt

	2019		2020		2021		2022		As at End-Sep. 2023	
	USD bn	% of GDP	USD bn	% of GDP	USD bn	% of GDP	USD bn	% of GDP	USD bn	% of GDP
Private domestic credit	4.03	17.30	3.31	17.09	3.08	14.56	4.28	14.34	4.10	13.74
Loans and advances to government	0.02	0.08	0.34	1.74	0.86	4.05	0.44	1.48	0.21	0.72
Total commercial loans and advances	4.05	17.39	3.65	18.83	3.94	18.61	4.72	15.82	4.32	14.46
GDP	23.27		19.38		21.16		29.85		29.87	
Domestic commercial bank credit	4.03	17.30	3.31	17.09	3.08	14.56	4.28	14.34	4.10	13.74
External private debt		12.50		12.30		8.90		10.00		11.00

Source: Bank of Zambia.

corporate and government-issued debt; discouraging broader participation; a limited range of debt instrument issued by tenor, with the longest being a 15-year tenor, as well as an absence of inflation-protected notes; and a low per capita income level (USD1,400 as of 2022), which limits savings and, consequently, the government's fundraising capacity. Corporate borrowers also face a significant challenge associated with the crowding-out effect of public sector borrowing on the domestic market, which has, in turn, elevated the cost of debt.

4. Raising Funds in the Private Markets

Zambia's private capital market exhibited limited activity between 2012 and 2022, recording a total of only 50 deals. This figure underscores the nascent stage of private market development within the country. It's important to acknowledge that data on Zambia's private capital market are limited and challenging to verify. Consequently, insights provided in this chapter rely on surveys by the Zambia National Advisory Board for Impact Investment (NABII). According to NABII's 2022 impact investing report, an estimated 124 impact deals worth USD508 million closed between 2015 and 2021 (NABII 2022). According to the CMMP (Ministry of Finance and National Planning 2023), 35 private equity/venture deals valued at USD350 million closed between 2016 and 2021. Furthermore, NABII (2022) reveals that private capital primarily targeted the agriculture, energy, financial services, environment, tourism, health, and education sectors over the years.

Over time, Zambia's private capital market has evolved. It now features a diverse investor mix that includes private equity funds, venture capital funds, development finance institutions, pension funds, and high-net-worth individuals. Many of these investors originate from outside Zambia, with limited participation from local investors, especially pension funds. Challenges affecting the private capital market include limited options for exiting investments, low involvement by pension funds and local investors, high regulatory costs associated with fundraising, and a lack of financial literacy among investors—all of which hinder the development of collective investment schemes.

Investment Activity

Southern Africa ranks as Africa's second-largest recipient of private capital investments, behind West Africa. AVCA (2023) data reveal that between 2012 and 2022, Southern Africa attracted a total of 687 private capital investment deals, amounting to USD9.01 billion. After South Africa, Zambia emerged as the second-largest recipient, with 50 deals, followed by Mauritius, with 34 deals.

Detailed and granular data on Zambia's private capital market are limited, relying on aggregated information from NABII. According to NABII (2022), between 2015 and 2021, there were 124 deals completed, totalling USD580 million, with an average deal size of USD5 million. Much of these investments were directed towards renewable energy, agriculture, and financial services.

NABII (2022) also highlights that most private market investors have a long-term investment horizon, with more than 84% willing to commit capital for more than five years. Although the proportion of investors willing to invest beyond three years decreased between 2021 and 2022, more than 50% remained open to investments exceeding five years. This long-term commitment makes private capital a favourable source for startups and early-stage firms in need of lasting financial support.

Survey results further indicate that private investors predominantly target growth firms (44%), followed by startups (23%), early-stage ventures (20%), and mature firms (15%). This suggests a preference for less risky investments (mature/growth), although the 23% interest in startups demonstrates investors' willingness to undertake more risk.

Investment Exits

From 2012 through 2022, the Southern Africa subregion witnessed the highest number of investor exits on the continent, totalling 187 exits. These exits were prevalent in such sectors as industrials (38), consumer discretionary (29), materials (26), and financials (24). The most common exit method during this period was trade sales, followed by financial buyers, management buyouts (MBOs), IPOs, and capital markets.

In the case of Zambia, NABII (2022) revealed that 38% of private capital investors had successfully exited their portfolios, while the remaining 62% were either still involved in their current investments or in the process of exiting. The primary exit route for Zambian private investors was through strategic M&As, accounting for 43% of exits. Other methods included payouts by investee companies or MBOs (29%), asset sales (14%), and alternative means (14%). Notably, the report mentioned that IPOs were not a preferred exit method because of cost considerations.

Main Investment Forms and Strategies

Key players in Zambia's private capital market include private equity funds, development finance institutions (DFIs), fund managers, and high-net-worth individuals (HNWIs) or family offices. NABII (2022) indicates that private equity funds and DFIs represent 29% and 17% of the private market, respectively, with HNWIs/family offices and collective investment schemes making up the rest. Notably, 33% of investors source their funds from Europe, 29% from other African regions, 13% from North America, and 25% from Zambia. This suggests a significant reliance on foreign markets, possibly because of limited pension fund involvement. The report highlights that the most common strategy is private equity, accounting for 48% in 2021, followed by private debt (23%). In 2022, however, allocations to equity investments decreased to 29%, mainly because of difficulties associated with exiting such investments, as well as challenges with fundraising experienced globally.

Although investors prefer mature firms, they have a long-term investment horizon. In 2022, 84% of private capital investors aimed for a five-year investment horizon, making them attractive for early-stage and startup firms that have a longer maturity period. The survey also revealed that the average deal size was relatively small, with 43% of investors allocating USD1 million or less, 35% allocating between USD1 million and USD5 million, and the remainder allocating ticket sizes of USD5 million and above.

The Impact of COVID-19 on the Capital Markets

The global COVID-19 pandemic initially caused significant uncertainties across major asset classes on major exchanges, leading to asset devaluations. For instance, in early February 2020, as the pandemic unfolded, both the Dow Jones Industrial Average and the S&P 500 Index lost 4.4%. Global debt markets also faced uncertainty, resulting in higher yields and capital losses because of reduced investor demand.

Although Zambia's integration into global financial markets is limited, its financial markets were not immune to the pandemic's effects. In 2020, the LuSE All Share Index lost 8.2% of its value, while the weighted average yield rate surged by 280 bps to reach 34.3%. In the private capital markets, the pandemic impacted firms' fundraising ability because of investor pessimism about asset valuations. For Africa as a whole, the value of private capital deals dropped by 17.1%, and Zambia saw a 63.7% decline in foreign equity inflows in 2020. Prior to the pandemic, Zambia had experienced a rising trend in foreign direct investment flows, which has disappeared in the post-COVID-19 era.

Lockdowns to curb COVID-19 led to a global economic recession caused by supply chain disruptions and reduced demand. These factors caused the price of copper, Zambia's major export, to plummet, thereby impacting earnings. Investor pessimism led to capital flight from emerging economies, totalling USD59 billion in February and March 2020, which surpassed the level experienced during the 2007–09 financial crisis. Consequently, the Zambian kwacha depreciated by 50.6% in 2020. Exchange rate volatility may have also hindered private equity fund fundraising.

5. The Challenges to Capital Market Formation

Unclear Regulatory and Policy Regime

The regulatory environment has been repeatedly cited in various investor surveys as a significant obstacle to capital formation. Key challenges include poor coordination among regulators (Securities and Exchange Commission, Pensions and Insurance Authority, and Bank of Zambia) in the financial services industry, leading to increased fundraising costs. Additionally, such issues as policy harmonisation gaps across sectors, pricing inconsistencies in vital areas such as agriculture and energy, unfavourable labour laws, export policy disparities for certain products, and protracted approval processes have been identified (NABII 2022). These challenges collectively impact asset valuation and the overall attractiveness of investment opportunities in Zambia. Moreover, existing legislation does not provide for the creation of limited partnerships, which would support capital formation.

Stringent regulatory asset allocation rules have limited pension funds' capacity to invest in higher-risk assets, such as private equity, particularly in early-stage companies. Instead, the pension funds tend to favour public debt, equities, and large infrastructure projects.

Illiquidity of Investments

Zambia's securities market is relatively illiquid compared with its peers in Africa. For instance, in October 2022, the market turnover ratio on the Lusaka Stock Exchange for equities stood at 3.3%, while the Nairobi Stock Exchange and the Mauritius Stock Exchange each had a 6% ratio and the Namibian Stock Exchange boasted a 35% ratio. This illiquidity extends to private capital markets. High illiquidity not only increases the cost of capital because of greater liquidity premiums but also deters international investment firms from allocating capital to Zambian investments.

Limited Exit Routes for Private Investors

NABII surveys have consistently shown that there has never been an investor exiting through an IPO in Zambia. Exits mainly involve strategic sales and management buyouts, potentially limiting investor returns and deterring investor interest. The high cost and stringent listing rules associated with IPOs may explain this trend, given that meeting these requirements can take years. Difficulty in exiting private equity investments has led many investors to avoid equity capital investments (NABII 2022).

Limited Investment Products for Retail Investors

Compared with its counterparts, the Zambian market lacks accessible investment products for retail investors. Notably, the LuSE has no exchange-traded funds (ETFs) or real estate investment trusts (REITs). The CMMP aims to introduce an ETF market by 2027, initially with USD50 million in assets under management. The absence of diverse investment options hinders the aggregation of savings for investment in various businesses.

Skills Gap

Zambia has a serious skills gap in the market. This gap could explain the limited range of investment products available, especially those accessible to retail investors.

Limited Participation of Retail Investors

Compared with its peers in Africa, Zambia has a smaller retail investor participation in the capital markets. At the end of December 2022, mutual fund assets under management stood at USD68 million, compared with Kenya's USD1.31 billion. This disparity could be attributed to a number of factors, including lack of financial literacy among investors and limited financial products targeted for the retail investor market.

6. Possible Solutions to Accelerate Capital Market Formation and Policy Recommendations

The Securities and Exchange Commission, alongside the Bank of Zambia and the Pensions and Insurance Authority, has collaborated to develop the Capital Markets Master Plan, aimed at addressing challenges impeding the growth of Zambia's capital markets. The CMMP highlights key policy issues, including regulatory harmonisation challenges leading to increased service costs for market access. To foster sector growth, the role played by CMMP policy interventions will be critical, rectifying legal and regulatory challenges that hinder capital market progress in Zambia. Accelerating the legislation that creates a framework for limited partnerships as investment vehicles would be especially beneficial.

Reforming rules and regulations governing asset allocations for pension funds is necessary to expand their investment exposure to private equity, particularly in startups and early-stage ventures. Presently, such entities as the National Pension Scheme Authority and other pension funds concentrate on major infrastructure projects or investments in established companies, complying with stringent asset allocation rules that restrict capital allocation to startups and early-stage businesses that need affordable long-term financing. To address this limitation, minimum private equity exposure requirements should be mandated, with specific allocations specified for startups and early-stage enterprises.

Enhance the Liquidity of Capital Markets

A significant investor concern is the lack of market liquidity, hindering easy position exits. We believe the policy interventions of the CMMP will help boost liquidity. Additionally, we propose introducing a legal mandate for state-owned holding firms (such as Industrial Development Corporation and ZCCM Investments Holdings) to set exit time frames for investee companies through IPOs or alternative methods.

Closing the Skills Gap

The skills gap is among the challenges that the CMMP and earlier surveys identified as impeding Zambia's capital market growth. To close this gap, a need exists for partnerships between providers of professional investment programs, such as CFA Institute; the CAIA Association; and GARP, which awards the Financial Risk Manager Certification, to create a long-term pipeline of future investment professionals. Further, a fund manager incubator program needs to be created to connect junior investment professionals with more senior investment professionals.

Provide Tax Incentives for Personal Retirement Accounts

The Zambian government offers tax incentives for employer-managed pension schemes, exempting contributions from taxes, but no such incentives are provided for personal retirement accounts. We believe extending these incentives to personal accounts would promote private savings, foster retail market growth, and enhance securities market liquidity by attracting more investors. Additionally, we need to reform the pension laws to make a provision for personal retirement savings.

Accelerate the Introduction of REITs and ETFs on the LuSE

The Zambian retail market offers limited investment options, mainly consisting of mutual funds. Although mutual funds provide access to the securities market for small investors, they may not attract risk-averse investors because of liquidity constraints. Accelerating the introduction of tradable retail products, such as REITs and ETFs, would broaden investment choices, attract more retail investors, and encourage savings. The CMMP calls for their introduction by 2027; however, prioritising a more expedited implementation timeline would be advantageous.[27]

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[27]For more information on the topics discussed in this chapter, we refer readers to the annual reports of Financial Sector Deepening Zambia (www.fsdzambia.org/), the Ministry of Finance and National Planning's debt summary reports (www.mofnp.gov.zm/?page_id=3475), and the Ministry of Finance and National Planning's quarterly economic review reports for 2017–2022 (www.mofnp.gov.zm/?page_id=3308).

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