

SOE LISTINGS — IS THERE A BUSINESS CASE FOR AFRICA?

Introduction

This note is a follow-on analysis to the World Bank's *Listing State-Owned Enterprises in Emerging and Developing Economies Report* (2021). It is based on the findings of the report and identifies the strengths, weaknesses, as well as opportunities and threats (SWOT) for listing state-owned enterprises (SOEs) across Africa. Given the continent's rich diversity, we do not aim to provide an in-depth analysis but highlight a few, selected cross-continental trends.

For any country-specific recommendations, further analysis will need to be conducted.

Finally, we would like to note that neither the report nor this note intends to advise governments on whether or not they should divest their SOEs. Rather, our objective is to evaluate whether the listing route could be one potential mechanism for implementing SOE divestments, once the decision to divest has been made.

Box 1. Summary of the SOE Listing Report's findings

The WB's *Listing State-Owned Enterprises in Emerging and Developing Economies Report* (2021) investigates EMDEs' experience with SOE listings over the past 30 years and the conditions under which some have succeeded, while others have failed. The report combined a thorough literature review with a case study analysis of 14 frontier and emerging markets, including interviews with key stakeholders from the public and private sectors. Some of the key findings were:

SOE listings can provide a significant boost to capital markets development in the short-term. And yet, only under certain circumstances, those effects are sustainable with developmental effects over the long-term. Thanks to their large size and value, SOE listings can significantly boost market capitalization and broaden the investor base, especially retail and foreign investors. Across our case study countries, some of the largest SOE listings allowed local equity markets to grow their market capitalization by up to 170 percent. Similarly, SOE listings have attracted a broad shareholder base — sometimes over one million investors — many of which represent first-time retail investors. At the same time, SOE listings have provided governments with a great opportunity to attract foreign investors. For example, SOEs constitute about 60 percent of the MSCI emerging market index in energy and about 40 percent in the financial sector. However, beyond the direct effects, SOE listings seem to encourage other private companies to

float their shares only in rare cases. For such an effect to materialize, multiple drivers need to be aligned that often only can be achieved if SOE listing programs are integrated into a larger capital markets reform plan.

Not every EMDE may be ready to list SOEs successfully and reap the benefits for capital markets development.

Our analysis distinguishes between the conditions to list SOEs successfully and the drivers necessary to create a positive impact on capital markets development. We define SOE listings to be successful when i) the listing has been oversubscribed, ii) the shares were successfully settled and iii) trade with sufficient liquidity, i.e., narrow bid-ask spread. Further, a listing is considered impactful, if its direct and indirect effects on market capitalization, listings, liquidity, and investor base development are positive over the short, medium and long-term. Some of the most important factors for successful and impactful listings are:

- Strong institutional competence and high-level political support
- A well-functioning capital markets infrastructure (including good accounting and corporate governance standards)
- A pipeline of large and profitable SOEs
- A large domestic institutional investor base
- Good timing (i.e., listing according to market conditions, including low interest rates)

Context

Over the past 30 years, SOE listings have played only a marginal role in the development of Africa's economies. According to our own estimates, more than one thousand SOEs currently operate across the continent, only about 30 of which are listed at an exchange.¹

At the same time, many African governments have launched capital market reforms to support the development of their local exchanges. However, the results have been mixed. With the exception of South Africa, Nigeria, Egypt and Morocco, African exchanges have remained relatively small with market capitalizations between US\$ 1–30 billion. One of the main challenges continues to be the limited number of listed companies. Initial public offerings (IPOs) have been overall limited and on a downward trend since 2017, with only five IPOs in 2020.²

Therefore, where a decision to divest exists, listing could offer a potential divestment solution that not only would allow governments to raise funding and harness the value of their SOEs but also contribute to the development of the local capital markets.

Opportunities

A large proportion of African SOEs remains unlisted. According to our estimates, Morocco houses the largest number of unlisted SOEs, followed by South Africa and Egypt (see Exhibit 1). Some of those unlisted SOEs continue to be a driving force within the respective economies, contributing a significant proportion to the country's GDP or providing fundamental public services (e.g., OCP in Morocco, or Eskom in South Africa). In other African countries, there are, on average, between 10–15 unlisted SOEs.

From a sector-perspective, most unlisted SOEs continue to operate in the financial services industry — an estimated 37 percent of the total number of unlisted SOEs (see Exhibit 2). As the findings of the SOE listing study (2021) show, SOE listings in the financial sector have overall been successful and created a positive impact on EMDEs provided state monopolies were removed and market competition installed.

The energy sector is the second largest industry with a significant number of unlisted SOEs across Africa. But compared to listings in the financial sector, the track record in the energy sector is more mixed — better for oil and gas companies than for energy production. Other sectors with continued large SOE participation are infrastructure sectors, such as telecom and transport, but also manufacturing and services — the latter includes large tea, coffee and chocolate producers as well as agri-chemical SOEs. Across those sectors, the SOE listing report found that especially telecom SOEs (e.g., Maroc Telecom, Sonatel, Safaricom) had been among the most successful and impactful listings across EMDEs, but also larger agribusiness and manufacturing companies could list their shares successfully at local or international exchanges (e.g., East African Breweries).³

Although many of those unlisted African SOEs operate in sectors with a good track record for listings, not all of them will be ready to float their shares immediately. Because SOEs will have to be profitable before they can be listed, or at a minimum show a strong trajectory to become profitable, some African SOEs will need to be restructured first. Especially African SOEs operating in the energy and transport sectors often have struggled with weak balance sheets (e.g., the Tanzania Electric Supply Company Limited or South African Airways). Thus, for these SOEs, listings are likely to be a longer-term objective.

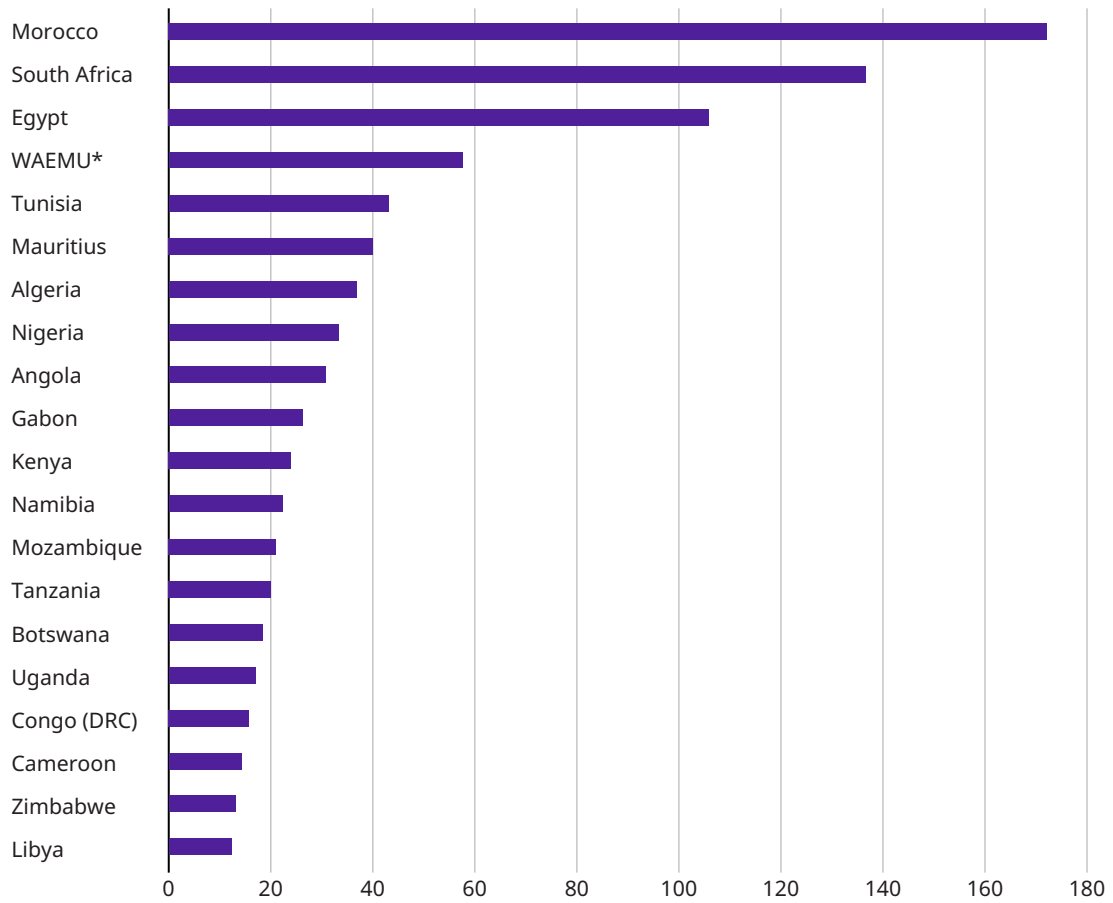
In the aggregate, we see listings as an appropriate divestment solution for a specific subset of SOEs, all of which are large and already profitable, operating in a market with a certain degree of market competition (e.g., financial institutions, manufacturing companies and agribusinesses) or technological disruption (e.g., telecom). For this subset of SOEs, the listing at a stock exchange could not only benefit capital markets development but also further improve the SOEs performance, among others, by setting standards of transparency and corporate governance while raising awareness for their brands. In the long-term, also non-commercially viable SOEs could be listed, provided governments are willing to restructure the companies and, where necessary, address fundamental sector inefficiencies through reform.

1 Calculation is based on data from Thomson Reuters Refinitiv.

2 www.pwc.co.za/en/publications/africa-capital-markets-watch.html

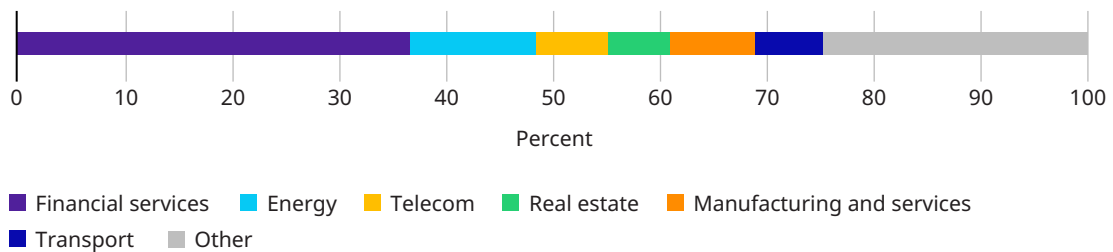
3 WB (2021): SOE listings in emerging and developing economies.

Exhibit 1: Estimated unlisted SOEs by country



* The focus is on Cote d'Ivoire
Source: Refinitiv Eikon

Exhibit 2: Unlisted SOEs in Africa by sector



Source: Refinitiv Eikon

Threats

Although a good number of SOE listing opportunities exist across Africa, the success and impact of those listings will be at risk if those sell-offs are rushed, without sufficient time to ensure that the required conditions are established. As the WB's SOE listing study (2021) shows, successful and impactful listings take time and are usually done incrementally, through multiple offerings. For example, African countries with small capital markets and limited experience of SOE listing at the local exchange have to ensure their government institutions have the appropriate competence and credibility to execute a public offering and attract reputable investors that are willing to take long-term equity positions. Further, a country's financial market infrastructure must be adequate to manage large transaction volumes. That said, even experienced countries with larger capital markets may not be able to sell their SOEs immediately. To achieve a good share price and ensure an overall successful absorption of the offered shares by investors, governments will have to observe investor appetite and list according to market conditions. Without those conditions in place, SOE listings are likely to see inadequate pricing (i.e., "selling a country's family jewels too cheaply") and potential other adverse effects. Africa has seen some examples of "rushed selloffs": For example in Egypt, over 50 SOEs were listed in a relatively weak financial market infrastructure environment during the 1990s. Instead of boosting the development of the local exchange, concerns over insider trading and unbridled speculation resulted in a large number of delistings as Egypt's regulator saw itself forced to increase listing requirements, among others disclosure and accounting standards.⁴ Therefore, for SOE listings to be successful and impactful in Africa, governments will have to ensure that the pre-conditions of success and drivers of impact are in place.

The COVID-19 crisis poses another threat. A weakened and uncertain global economy has hurt the balance sheet of some SOEs while leaving their growth trajectory unpredictable. For those SOEs that remain profitable, IPO prices could be subdued as investors remain cautious. On the other hand, for those SOEs that have already struggled with weak balance sheets prior to the pandemic, restructuring is likely to become unavoidable, at least for

those governments that intend to eventually list one or several of their SOEs. Restructuring SOEs may become even more difficult than they already are during periods of economic expansion because governments are likely to have fewer resources at hand, due to the pandemic demanding a strong government response across various fronts. At the same time, reputable investors that are willing to take a strategic stake in a struggling SOE may be hesitant and will wait until the pandemic's outcomes have become more predictable. Lastly, any restructuring will probably result in job cuts, which risks to directly translate into an increase in poverty due to the economic contraction caused by the pandemic.

Therefore, SOE listings offer no quick fix to the challenges provided by the COVID-19 pandemic. While a few African SOEs that continue to operate with a profit could potentially be listed over a relatively short period, for many African SOEs, they are likely to be long-term solutions. Having said that, where governments are willing to undertake the necessary reforms to create a supportive enabling environment, listing SOEs can provide an excellent divestment solution with positive effects for the domestic capital market and the wider economy.

Strengths

The strengths and weakness of African countries to list their SOEs can be assessed against the preconditions of success and drivers of impact as identified in the WB's SOE listing study (2021). In the following, we will conduct a short analysis of the conditions and drivers, highlighting those that tend to be better developed across a majority of African countries (strengths) and those that need to be strengthened (weaknesses).

The conditions that seem better developed are the following:

- **Robust corporate governance (CG) standards for listed companies, especially in English-speaking Sub-Saharan Africa and parts of the MENA region.** The WB SOE listing study (2021) shows that robust CG standards for listed companies is one of the drivers that impact, among others, the performance of listed SOEs. Thanks

⁴ Lieberman, Ira W., and Christopher D. Kirkness, eds. Privatization and emerging equity markets. World Bank Publications, 1998.

to wide-ranging capital market reforms, many African countries introduced such CG standards over the past ten years. For example, comparing the World Economic Forum (WEF)'s *Corporate Governance Sub-Index*⁵ between EMDEs that have successfully listed their SOEs and selected African countries, we find only a small difference, especially for those countries with a significant SOE listing potential, such as Morocco, Egypt, and South Africa (see Exhibit 3). However, room for improvement remains for several frontier markets across Sub-Saharan Africa. For instance, Ethiopia, Mozambique and WAEMU continue to rank relatively low on the WEF's corporate governance sub-index. Further, even where African countries have successfully introduced robust CG standards, enforcement often remains challenging. Many regulators lack the resources to effectively monitor the standards' implementation and enforce penalties where necessary.

- **Lower transaction costs, especially in larger African capital markets.** For SOE listings to achieve strong development effects on domestic capital markets, transaction costs related to i) the listing of a company at the primary market and ii) the trading of those shares at the secondary market need to be economical. Regarding the first category, we find that underwriting costs are reasonable and, in some cases, even cheaper than in some advanced economies (see Exhibit 4) and yet, overall listing costs may be higher for some African countries due to certain regulatory requirements. For example, in Kenya, listing costs have been perceived as high because regulation requires listed companies, among others, to publish their audit reports in the local newspapers. According to market participants, this has discouraged many private companies to follow the example of the government and list at the local exchange.

But although listing costs seem overall in line with companies' experience in advanced economies, secondary market costs remain extremely high. According to Oliver Wyman research, trading costs remain three times higher in EMDEs, including Africa, when compared to advanced markets and six times higher when compared to the USA.⁶ These costs are largely driven by the limited liquidity in EMDE's secondary markets. Africa is no exception. According to the Absa Financial Market Index 2020, secondary market liquidity remains one of the top challenges across most African countries.⁷ And although SOE shares tend to have better liquidity levels compared to private sector shares,⁸ overall low levels of market liquidity tend to reduce investor interest, especially from abroad. Thus, boosting secondary market liquidity will be important to increase a SOE listing's chances of success.

One potential way to boost liquidity across Africa's equity markets could be the reduction of entry barriers for retail investors. This could be achieved, for example, by promoting proven digital tools, such as digital asset management platforms.⁹ Further, we find that various market infrastructure firms across EMDEs started to become involved in enabling a broader set of electronic transactions and registrar capabilities for payments — e.g., Brazil's B3 provides infrastructure for electronic payments and loan registration. Such solutions could potentially be leveraged to reduce the overall transaction costs for share trading. In that regard, ASEA market infrastructure providers could look to replicate the more successful initiatives to lower intermediation costs for equity markets. Knowledge and information sharing across ASEA members could ensure that lessons learned are efficiently captured while common market infrastructure initiatives could be developed to further lower costs.

5 The index considers the strength of auditing and accounting standards, conflict of interest regulation and shareholder governance and rights; source: World Economic Forum Corporate Governance Index methodology (component G of Pillar 1 of the global competitiveness index): reports.weforum.org/global-competitiveness-report-2018/appendix-c-the-global-competitiveness-index-4-0-methodology-and-technical-notes

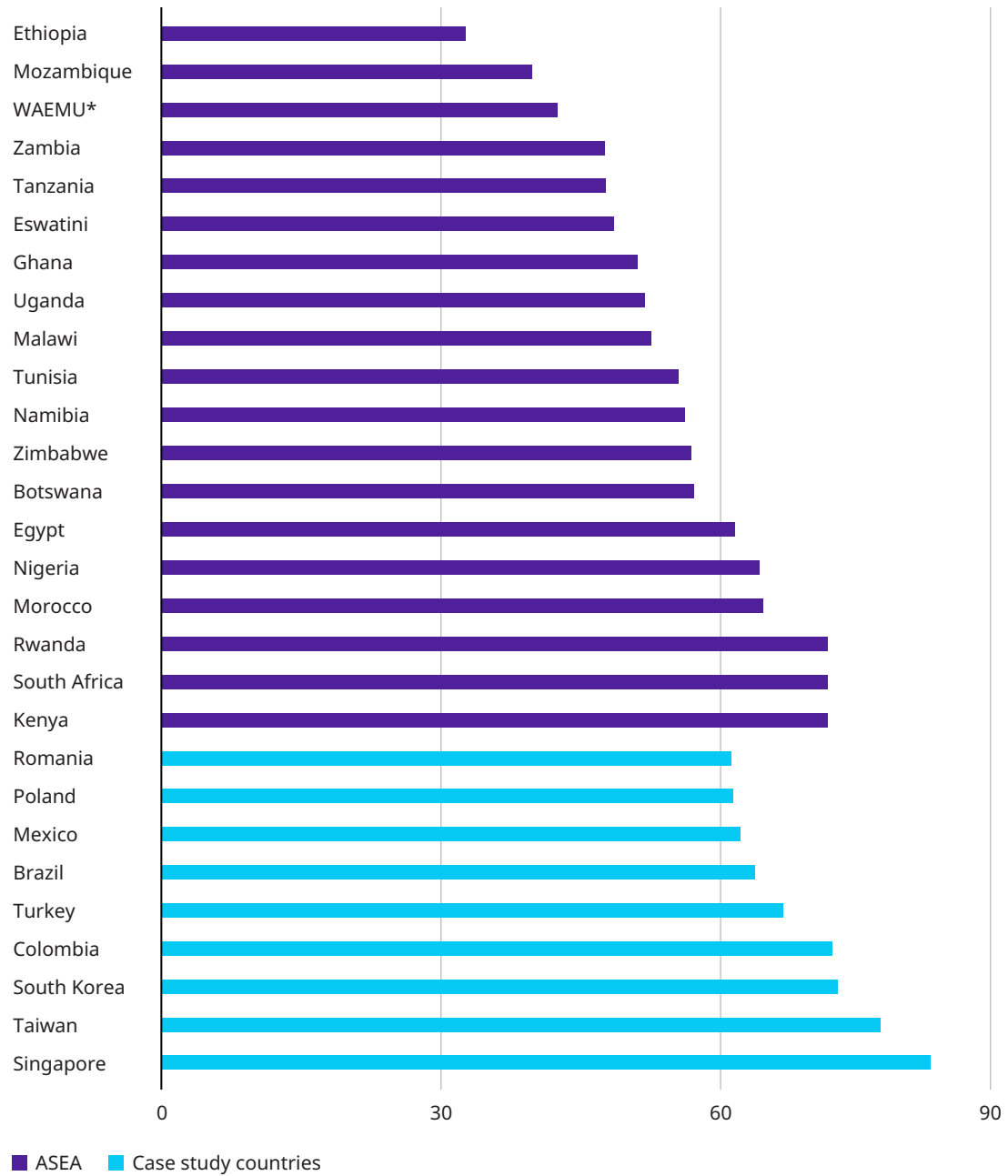
6 Oliver Wyman analysis.

7 www.omfif.org/wp-content/uploads/2020/10/Absa-Africa-Financial-Markets-Index-2020.pdf

8 WB (2021). SOE Listing in Emerging and Developing Economies.

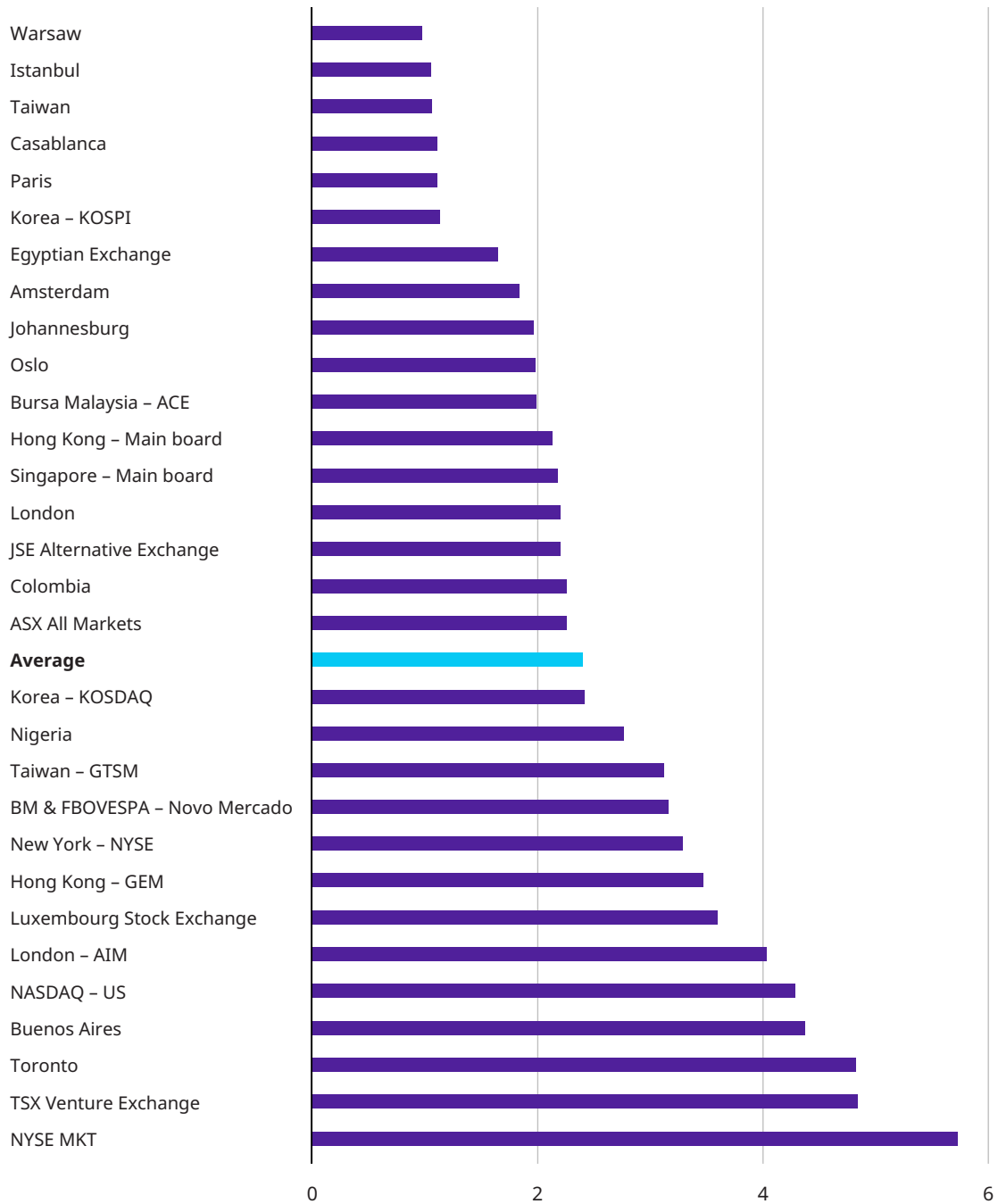
9 Oliver Wyman Fintech NOW competition 2019 in Brazil.

Exhibit 3: Corporate Governance Standards across selected EMDEs



* The focus is on Cote d'Ivoire
 Source: World Economic Forum

Exhibit 4: Underwriting costs across select countries (percent IPO proceeds)



Source: Dealogic

Weakness

Despite those better-developed conditions, there are several hurdles that remain. The key challenges are:

- Limited capacity of public institutions.** Although many governments and international development banks have tried to find short-term, technical solutions to circumvent a country's political and institutional constraints, there seem to be no quick fixes for SOE listings. For SOE listings to be successful, strong institutions and policy frameworks are required pre- and post-listing. Pre-listing, public institutions need the capacity to establish robust legal and regulatory frameworks that define when and how to divest from SOEs. They also need to have the resources to set up and implement fair and transparent divestment and listing processes. During Africa's previous divestment wave, many governments sold their SOEs without these institutions being in place, providing an entry point for corruption, which in return diminished not only the outcome but also the public's support for future divestments. Therefore, any new attempt to divest SOEs, including through listing, will have to be preceded by a credible effort to strengthen the public institutions relevant for the implementation of the divestment process. Besides, any public concerns toward new divestments will have to be publicly addressed through a consultation process that includes all relevant stakeholders. Finally, the objectives, expected benefits and costs of any new divestment, particularly listing, should be well communicated throughout the divestment process.

Lastly, for SOE listings to be impactful post-listing, governments will have to ensure that fundamental sector inefficiencies are addressed, and a level-playing field created — this is especially important in the infrastructure sectors. This requires strong and independent regulators that are well staffed to create and implement the necessary rules and regulations. Where such rules and safeguards are absent, a listing's impact on a company's performance is likely to be limited because owners, managers and workers will have no or only limited incentives to improve the long-term health of the SOE.

- A relatively small domestic institutional investor base.** For a domestic capital market to develop sustainably, it requires a sufficiently large domestic, institutional investor base, such as pension funds and insurance companies.¹⁰ Yet, such a domestic institutional investor base remains small or non-existent in most African countries. For example, across Sub-Saharan Africa, there are no markets with mandatory pension plans and only three countries have low dependency ratios that could encourage long-term personal planning (see Exhibit 5). Those three Sub-Saharan countries with a low dependency ratio are Botswana, Namibia and South Africa, all three of which successfully developed large pension fund systems. Therefore, for most African countries, the development of a large and diversified domestic institutional investor base, including through pension reform, will be crucial for maximizing the development impact of SOE listings on local capital markets development.

Exhibit 5: Pension assets and workforce coverage in ASEA

Type of pension system	Number of ASEA countries	Pension assets of GDP 2018	Workforce covered
Pay as you go	10	7%	n/a
Provident	3	11%	6%
Voluntary personal	3	8%	9%
Occupational	3	78%	44%

Source: World Bank, Oliver Wyman analysis

¹⁰ Exceptions are financial centers that have made the attractiveness to foreign investors their competitive advantage. In Africa, this is likely to be the case with Madagascar.

But because pension fund reforms are long-term processes, African governments may need to consider hybrid solutions that could, to some extent, substitute for a nascent domestic investor base in the short to medium-term. Singapore's sovereign wealth fund is a good example of such a hybrid solution, whereby the fund would manage various SOEs, selling them slowly and incrementally according to market conditions. Brazil's national development bank (BNDES) is another example, acting as minority investor in various SOE listings ensuring those listings are properly absorbed. Such or more tailor-made solutions could potentially be replicated in African countries with a developing pension fund system but a strong pipeline of profitable SOEs ready to be listed. The funds governance and independence are key for its successful performance, ASEA could hereby play the trusted advisor helping the respective governments to set up such structures.

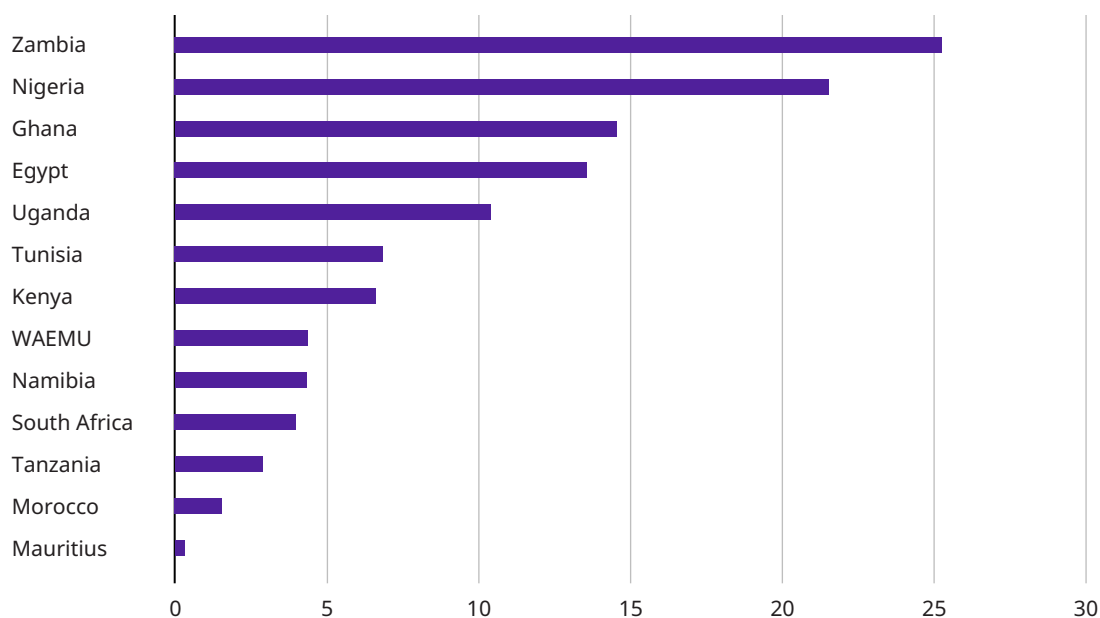
- **A weak pipeline of profitable SOEs.** For listings to have a demonstration impact on capital markets development, there needs to be a pipeline of SOEs that can be sold incrementally over an extended period. But although a large pipeline of SOEs with the potential to be listed exists across Africa, many of these SOEs remain unprofitable. In many cases, governments decree that SOEs operate in a commercial, efficient and profitable manner while insisting that they provide public goods and services at prices below cost-recovery and serve as generators of employment. But, unfortunately, the combination of social and commercial objectives creates tensions that ultimately undermine commercial performance and economic efficiency. A good example is South Africa's *Eskom*, the country's state power monopoly which continues to run

large deficits and occasionally has to be bailed out by the government. *Eskom's* long-term financial problems have led to years of neglected maintenance and rolling national blackouts. Similar challenges exist with *Transnet*, the country's airline SAA, and the *South African Broadcasting Corporation*. However, these challenges are not unique to South Africa but exist across many African countries. For example, in 2018, Nigeria suspended plans to relaunch its national airline due to the need for further government support. Hence, African governments will have to engage in serious restructuring efforts before they can list a large proportion of their SOEs. Such restructuring efforts can potentially be cut short for capital-intensive industries, such as telecommunications, financial services or the oil & gas sector. However, they cannot be avoided and will need to be accompanied by reforms that address the fundamental sector inefficiencies.

- **High interest rates.** Although the evidence for the existence of crowding-out effects on equity markets is more ambiguous, there seems to be a strong correlation between high interest rates and the listing behavior of companies.¹¹ Across African countries, interest rates remain high, with an average of eight percent for one-year T-Bills (see Exhibit 6). Because interest rates on government debt securities create a benchmark for "risk-free" investments, they raise the barrier of entry for SOEs and private sector companies to list at the local exchange. Therefore, SOE listings are likely to produce limited demonstration effects for private sector companies in African countries where high interest rates prevail over the medium to long-term. In such countries, any serious effort to list a large number of SOEs will have to be preceded by fiscal and public debt consolidation.

11 WB (2021). SOE Listing in Emerging and Developing Economies.

Exhibit 6: Average weighted yield for 1-year T-Bills across selected African countries (in percent)



Source: Eikon Refinitiv

Recommendations

For most African countries, SOE listings create a dilemma: Although their countries stand to benefit tremendously from SOE listings, the conditions and drivers to ensure that those listings are successful and impactful have yet to be developed. Particularly where institutions remain weak the risk is high that the listing process — and indeed any divestment process — will be mismanaged and produce suboptimal or errant results.

However, this does not mean that African governments should reject SOE listings as a possible divestment solution. Instead, it means that efforts will have to be undertaken

to strengthen Africa's enabling environment. The goal of such efforts should be, among others, to:

- Strengthen public institutions to reduce political risks and attract reputable investors
- Develop market infrastructures and intermediaries that can handle large transaction volumes at low costs
- Reform sector frameworks that support the restructuring of unprofitable SOEs
- Support the development of the domestic pension fund system to increase the absorption capacity of the local markets

Once those reforms show the fruits of success, they could be followed by staged and incremental shifts in ownership patterns. This proposed solution has a prima facie appeal,

but it assumes the existence of the end at which it aims — successful SOE listings that have large, positive effects on the development of local capital markets and the broader economy.

Exhibit 7: SWOT summary

Opportunity	Strengths	Weaknesses	Threats
<ul style="list-style-type: none"> • Over 1,200 SOEs currently not listed • A significant number of unlisted SOEs in competitive and/or capital-intensive sector (e.g., financial services, telecommunications, air and seaports, oil & gas) • Countries with largest listing opportunities: Morocco, South Africa, and Egypt 	<ul style="list-style-type: none"> • Corporate governance frameworks with enforcement to be strengthened • Low listing costs 	<ul style="list-style-type: none"> • Weak institutions • Small or non-existent domestic institutional investor base • High interest rates • Lack of identified pipeline of profitable SOEs 	<ul style="list-style-type: none"> • COVID-19 to worsen balance sheet performance of many SOEs and increase risk of employment shedding, resulting in increased poverty • Rushed sell-off due to pandemic

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