Survey Brief: Rwandan Businesses Share Their Priorities for Capital-Market Development

In partnership with the Rwandan Capital Market Authority and the Rwanda Private Sector Federation

This paper was prepared for the Rwanda Capital Market Authority's (CMA) Strategic Planning Roundtable on Capital Market Development, held October 14-16, 2015, in Rubavu, Rwanda. The survey was a joint research effort of the CMA and the Milken Institute Center for Financial Markets.

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Prepared by Moutusi Sau, senior program research analyst at the Milken Institute Center for Financial Markets (CFM) and John Schellhase, a research consultant for the Center for Financial Markets. The authors would like to thank Staci Warden, executive director of CFM, for guidance and comments.

Executive Summary

With approximately 12 million citizens and a nominal GDP of just under $9 billion, the Rwandan economy is small. However, through a series of well-designed and well-managed national policy reforms, the government has maintained macroeconomic stability, created a business-friendly environment, and sustained an average of 7.7 percent annual GDP growth since 2000. In light of this progress, Rwanda is developing a policy agenda to strengthen its financial markets. In particular, the government regards capital-market deepening as an essential component of maintaining rapid economic growth.

It was in this context that the Capital Market Authority of Rwanda and the Milken Institute Center for Financial Markets commissioned a survey of Rwandan businesses about their financial-market policy preferences. Distributed by the Rwanda Private Sector Federation, a Rwandan business association, the survey asked businesses about their current access to financing, perceptions of Rwanda's capital markets, and priorities for the development of these markets. Here are the survey's key findings, based on responses of 219 Rwandan businesses:

Only 22% of companies have succeeded in raising the capital they need over the last three years

1/3 of companies are not at all able to access the funding they need

65% of companies have used bank term loans as a financing source in the last three years, making loans the most common option for raising funds among businesses surveyed

51% of companies that were unable to raise funds cite insufficient collateral as the major financing obstacle

<7% of companies raised capital through a private placement of equity

51% of companies that cannot find financing are unable to expand their operations

74% of companies want the government to prioritize making entry into the Rwanda Stock Exchange (RSE) easier

Only 13% of companies are interested in listing shares on the RSE

In short, most businesses do not consider issuing capital-market securities as an option for meeting their financing needs. Nearly half of companies see themselves as too small to issue corporate bonds, and around the same number have no interest in listing on the Rwanda Stock Exchange (RSE). However, these businesses are eager to learn more about the advantages these markets might offer the Rwandan economy as the financial markets continue to develop.

This report provides a description of the sample and a full accounting of survey results. The final section raises important questions for financial-sector development that emerge from the survey findings. Those questions are as follows:

- Are there effective ways to responsibly bring down the prohibitive collateral levels currently required by banking institutions?
- What are the right strategies for stimulating the development of greater private-equity and venture-capital investments in Rwanda?
- What can be done to expand awareness of relaxed listing requirements for small and medium-sized enterprises (SMEs) on the Rwanda Stock Exchange (RSE) and promote early success stories among SMEs that join?
- How will business leaders receive the financial-market training they need to more fully take advantage of the Rwandan capital markets as they develop?

Description of the Sample

All businesses that participated in the survey are members of the Golden Circle networking group of the Rwanda Private Sector Federation. Around two-thirds of survey participants belong to the commercial services sector, with 10 percent in manufacturing. The Rwandan economy is composed mostly of small to medium-sized companies that are relatively young, and this sample reflects this fact. Over 80 percent of businesses surveyed have fewer than 100 employees, and approximately half of that group have 10or fewer full-time employees. On average, these businesses have been established for seven years. Two-thirds report annual revenues of 500 million Rwandan francs (Rwf) or less (about $700,000 or less at the current exchange rate), with about 15 percent bringing in between Rwf 500 million and 1 billion, and 23 percent earning more than Rwf 1 billion annually in revenues.

Though Rwanda has been expanding trade with other countries over the last 15 years, the majority of survey respondents are not involved iinternational trade. Thirty percent import raw materials from abroad, while 70 percent do not. Seventeen percent export products to other countries, while 83 percent of the sample are not involved in exports. Charts 1 and 2 below show a breakdown of the sample by age of the company, number of employees, and sector. Box 1 (on page 4) expands on the methodology behind the survey.

CHART 1 Size and age of surveyed businesses

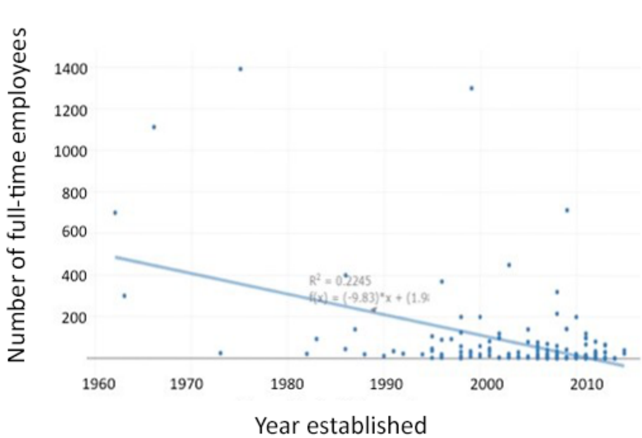
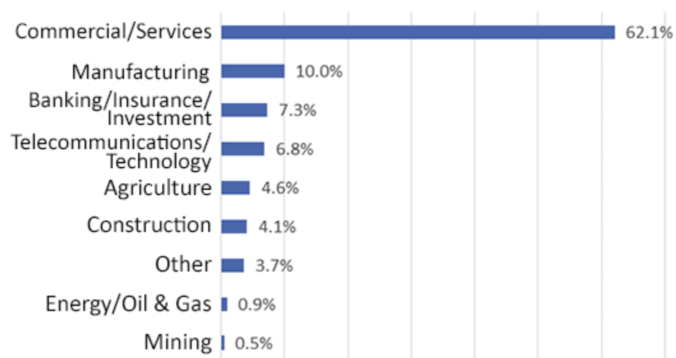


CHART 2 Surveyed companies, by sector



Survey Results

The survey investigated the current financing landscape for Rwandan businesses, the sources of capital they access, and how their success or failure to raise funds affects their business decisions. The survey also asked respondents about the financial risks they face, their perceptions of the bond markets and the Rwanda Stock Exchange, and their priorities for capital-market development policy. Their perspectives on these topics, as well as their open-ended responses to prompts included in the survey, are presented here.

Meeting Financing Needs

Less than a quarter of surveyed businesses have reliable access to the capital they need. Almost 35 percent report having mixed success in raising capital, while a third of businesses have been unable to access financing for at least the past three years. Chart 3 illustrates these results in further detail.

Rwandan businesses rely heavily on banks for funding. As shown in Chart 4, over the last three years, 65 percent of companies have used bank term loans as a source of finance. During the same period, 44 percent reinvested retained earnings. Other important funding sources are revolving lines of credit at banks, supplier credit and private loans from friends and family. Interestingly, although the private equity/venture capital market in Rwanda is in its infancy, about 7 percent of companies report accessing capital through a private placement of equity.

CHART 3 Success in raising capital

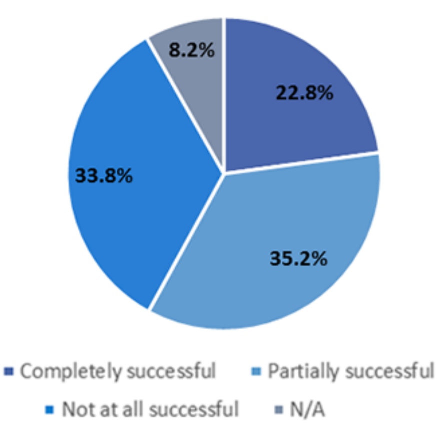
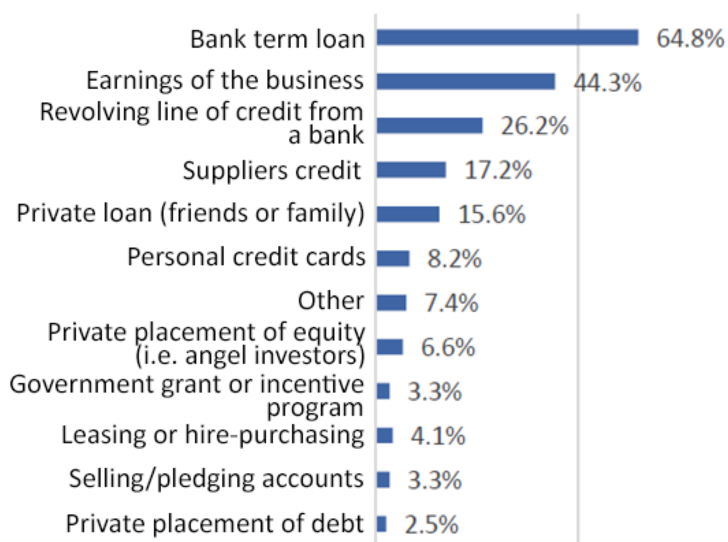


CHART 4 Financing sources in the last three years



Note: Survey participants were asked to mark all answers that applied

The inability to access capital has significant consequences for Rwandan businesses. More than half of businesses that have been unsuccessful in raising capital cannot expand their operations. About 28 percent are unable to make critical investments, and the same percentage have not hired new employees because of their inability to find funding. On the other hand, those companies that are successful or partially successful in raising capital experience important benefits. Sixty-two percent have maintained the working capital their businesses need. Half have expanded operations, and around a third have made critical investments to advance their strategic goals. Chart 5 shows how firms with access to finance use the funds, while Chart 6 summarizes the main consequences of a lack of funding.

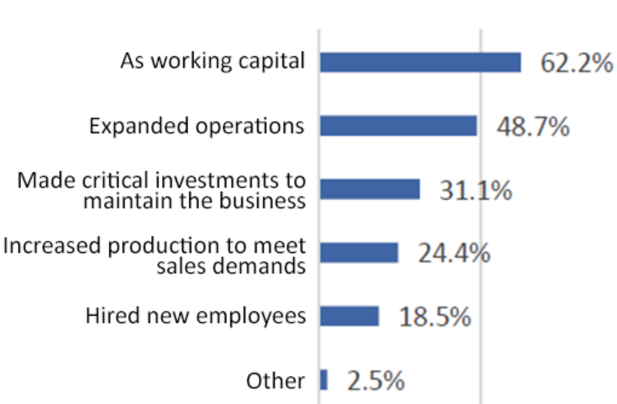
Box 1: Survey distribution and collection process

The Milken Institute Center for Financial Markets (CFM) and the Capital Market Authority (CMA) worked closely with the Rwanda Private Sector Federation (PSF), a prominent Rwandan business association, to design and conduct the survey. During the survey process, businesses in PSF's Golden Circle networking group received printed copies of questionnaires and returned the completed surveys to PSF staff. In some cases, PSF followed up by phone. Milken Institute researchers also, in a few cases, wrote respondents by e-mail to request further information.

At the end of the three-week survey period, 218 companies had completed and returned survey questionnaires. Almost all surveys were completed by C-suite level executives (CEOs, managing directors, general managers, etc.), with a small number filled out by company accountants. The questionnaires asked respondents a series of multiple-choice questions about their companies, the current financial landscape, and their priorities for further capital-market development. Respondents were given two opportunities to provide open-ended responses about their preferences for capital-market development. Respondents were not provided with definitions of technical vocabulary nor were they assisted in understanding financial concepts while completing the survey.

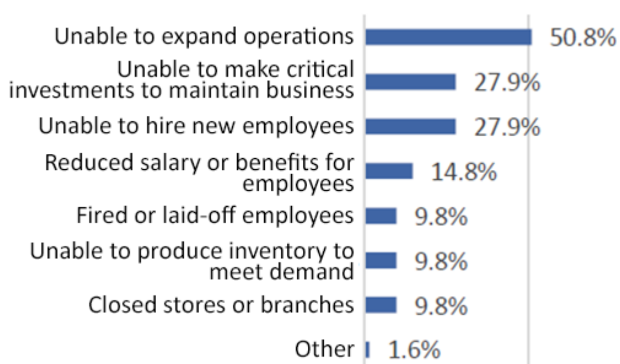
Eric Bundugu of the CMA provided essential support and guidance throughout the survey process. John Schellhase and Moutusi Sau of the Institute's CFM prepared this survey brief.

CHART 5 How firms used capital raised



Note: Survey participants were asked to mark all answers that applied

CHART 6 Consequences of lack of financing



Note: Survey participants were asked to mark all answers that applied

Risk Management

Almost all of the businesses surveyed confront some type of financial risk. Sixty-eight percent face interest rate risk, while nearly half have to manage exchange-rate risk. A third of surveyed businesses face commodity price risk. While almost every company must manage some sort of financial risks, only 7 percent report purchasing financial derivatives to manage risks. These figures stand in contrast to the much more frequent use of derivatives in advanced economies. In the United Kingdom, for instance, over 70 percent of publically traded, non-financial firms hedge foreign exchange risk, over 60 percent hedge interest rate risk, and over 15 percent hedge commodity price risk.[1]

Dependence on bank loans clearly raises financing challenges for Rwandan businesses. Among those companies unable to raise the capital they need, half point to insufficient collateral for a bank loan as the most significant financing challenge they face. Additionally, a 2011 World Bank survey found that over 90 percent of loans in Rwanda require collateral and that the average value of collateral demanded

1. Hany Ahmed, Alcino Azevedo, and Yilmaz Guney, "Agency Conflicts and Hedging Financial Risks Decisions: Evidence on Corporate Governance Influence," presented at the 2015 Annual Meetings of the European Financial Management Association, June 2015.

is 270 percent of the loan amount.[2] Both of these figures are higher than the averages for Sub-Saharan Africa.

Bond Market Development

With only two corporate bonds issued to date, virtually no companies in Rwanda have experience issuing long-term debt. Perhaps prudently, 45 percent of survey participants believe they are too small to issue bonds (Chart 7). Though many perceive bond issuance as the wrong choice for their company, respondents see value in issuing long-term debt (Chart 8). Only 3 percent claim there is no benefit in issuing bonds. More than a quarter of survey participants believe that bonds provide long-term financing unavailable from bank financing. Roughly the same percentage see debt issuance as a cheaper form of financing than other sources.

CHART 7 Barriers to bond issuance

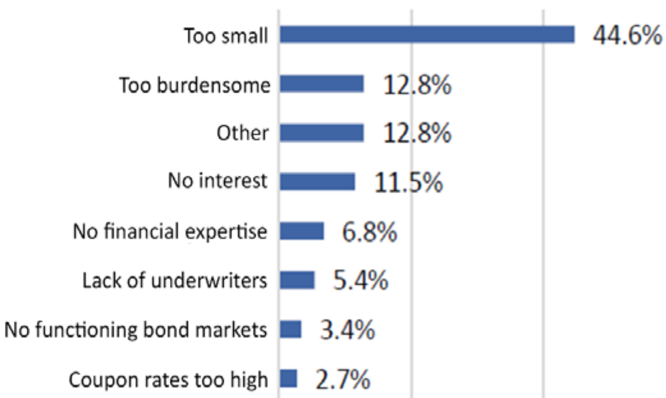
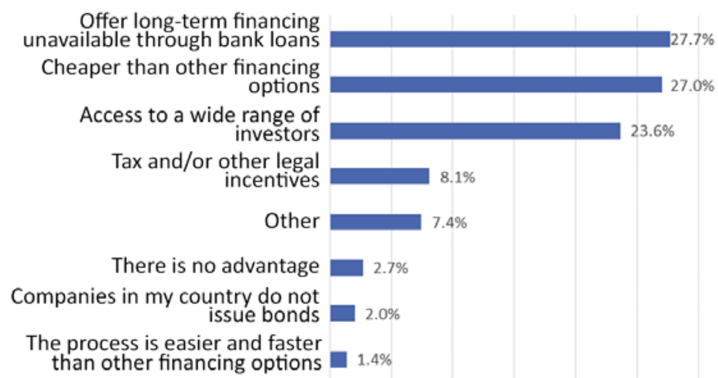


CHART 8 Perceived benefits of bond issuance



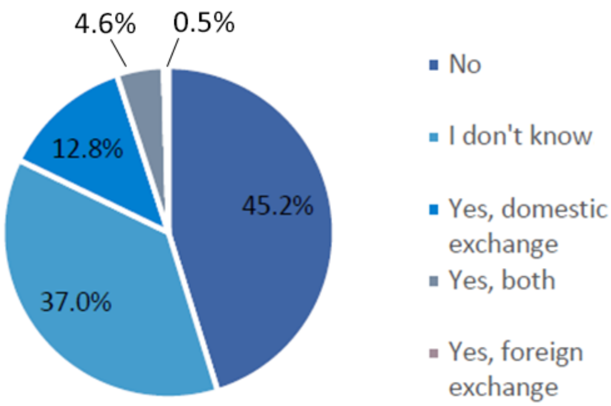
The Rwanda Stock Exchange

The Rwanda Stock Exchange (RSE) is the youngest public equities exchange in the East African region. Currently, seven equities trade on the RSE, three domestic firms and four Kenyan firms cross-listed from the Nairobi Securities Exchange. Ninety-nine percent of survey participants have not issued stocks on the RSE or any other exchange. Among this group, only 13 percent want to list on the RSE. As Chart 9 shows, 5 percent of companies would like to join both the domestic exchange as well as a foreign exchange, perhaps like those Kenyan firms cross-listed on the RSE. Nearly half of the firms have no interest in listing on the RSE. The remaining third are ambivalent to the idea.

For the small percentage of companies that want to issue stock on the RSE, the most significant barrier cited is meeting the minimum listing requirements. Forty percent of these companies point to this challenge as their primary obstacle, as shown in Chart 10. An additional 29 percent find fault with a burdensome administrative process. As Chart 11 illustrates, a large percentage of surveyed companies want to relax the listing requirements on the RSE.

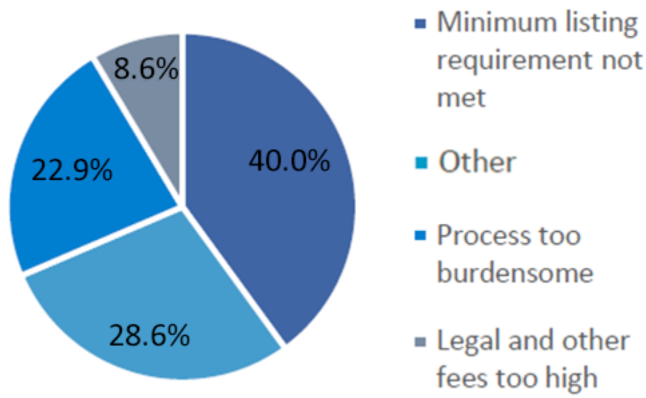
2. "Enterprise Surveys: Rwanda Country Report 2011," The World Bank and the International Financial Corporation, July 2012.

CHART 9 Desire to list on the public stock exchange



Note: Total does not equal 100% due to rounding

CHART 10 Main obstacle preventing listing

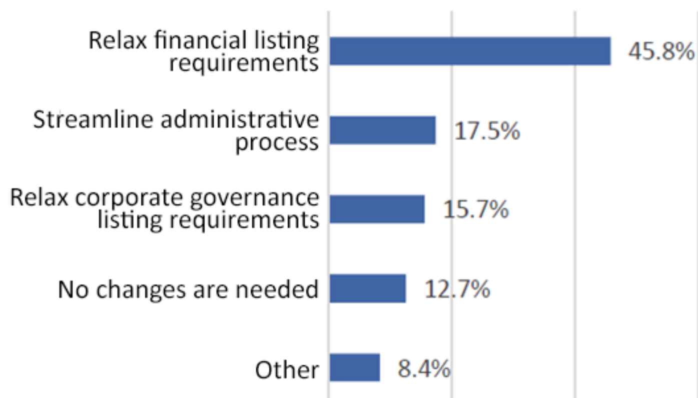


Note: Total does not equal 100% due to rounding

CHART 11 Perceived benefits of listing on the Rwandan Stock Exchange

Note: Total does not equal 100% due to rounding

CHART 12 Preferences for improving the listing process



Note: Total does not equal 100% due to rounding

Box 2: Listing requirements for the main market segment of the Rwanda Stock Exchange

	EQUITIES	CORPORATE DEBT SECURITIES
Qualifications for listing	Duly incorporated with minimum three-year financial track record and audited within the last 12 months	Duly incorporated with minimum two-year financial track record and audited within the last 12 months
Minimum listing amount	Initial market capitalization of at least Rwf 500 million*	Rwf 500 million
Initial listing fees	0.15 percent of the value of the securities, subject to a minimum of Rwf 1 million	0.1 percent of the value of the securities, subject to a minimum of Rwf 1 million
Additional listing fees	0.01 percent of the nominal value of additional securities to be listed: Minimum Rwf 500,000 Maximum Rwf 5 million	0.05 percent of value of the fixed income securities Minimum Rwf 1 million
Annual listing fees	0.06 percent of the market capitalization of the listed securities: Minimum Rwf 2 million Maximum Rwf 20 million	0.05 percent of the value of the listed fixed income securities: Minimum Rwf 1 million Maximum Rwf 10 million

*Note: Exchange rate at time of writing: Rwf 732 = US$1. Rwf 500 million roughly equals $685,000.

Source: RSE Rules 2013, Rwanda Stock Exchange

When given an opportunity to provide additional ideas for equity-market improvement, several survey participants elaborated on these concerns. One, for example, wrote that the RSE should "reduce conditions of going public for the first time." Another appealed to the exchange to "reduce the fees." Yet another wrote, "The listing process and requirements are too many [to the effect] that they discourage most companies" from joining the exchange.

Given that most survey respondents qualify as SMEs, these results are surprising because in 2013 the RSE issued new rules that significantly relaxed listing requirements for SMEs. Previously, as presented in Box 2, all companies that wanted to list on the RSE had to have a minimum initial market capitalization of Rwf 500 million and three years of financial records. Under the new rules, SMEs no longer have to meet a minimum capitalization at all and need to provide only the most recent year-end financial records.[3] These relaxed standards went into effect two years ago, and yet no SMEs have joined the stock exchange at the time of writing. Based on their responses, large percentages of the survey participants appear to be unaware of the relaxed listing standards, suggesting the need for further private-sector outreach from the RSE and relevant government agencies.

Rwandan businesses appear to want access to a wider base of investors, and they perceive joining the RSE as means of achieving this goal, even though few actively would like to issue stock. Over 60 percent of the total survey sample identify access to new investors, whether international or domestic retail investors, as a benefit of listing equities on the public exchange. As shown in Chart 12, investor access outweighs other benefits such as publicity or tax incentives.

Priorities for Capital-Market Development

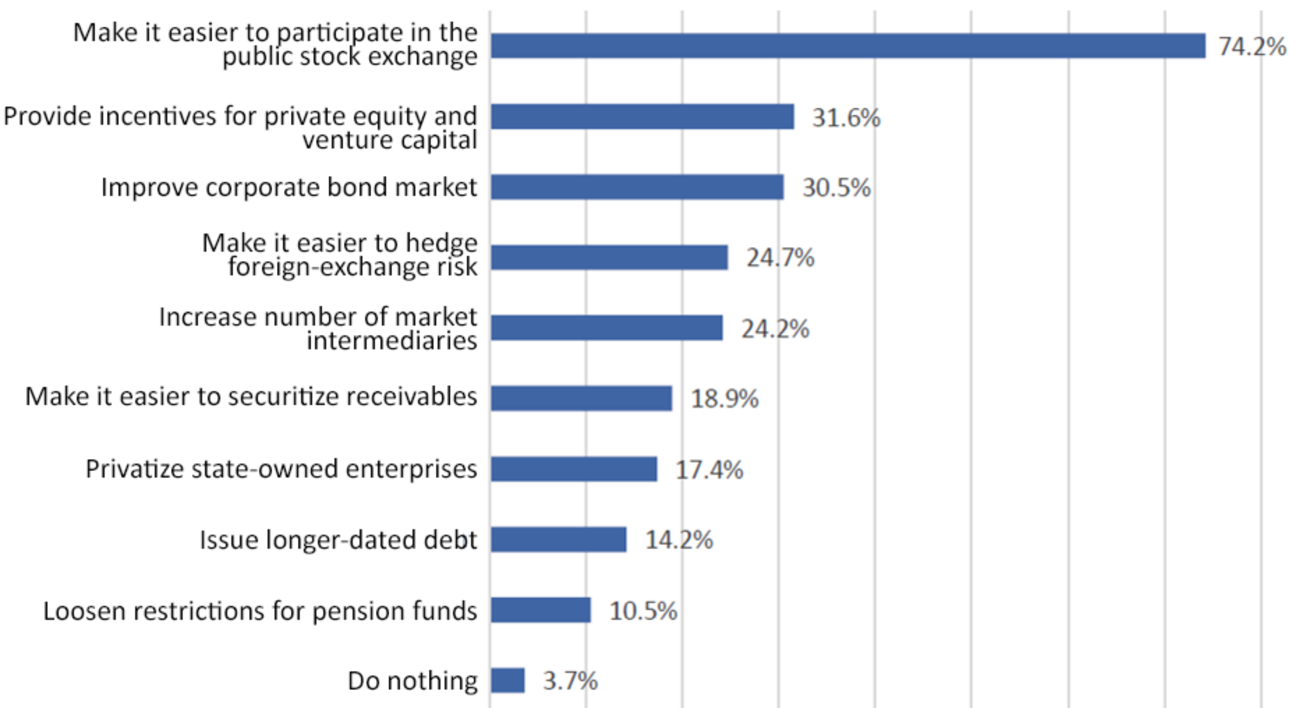
Surprisingly, in light of the general indifference to the possibility of listing on the RSE, Rwandan businesses' primary concern for government capital-market policy is facilitating wider participation in the stock exchange. As Chart 13 illustrates, nearly 75 percent of businesses surveyed want this priority to be on the government's agenda, the only option presented to receive support from a majority of companies. Businesses' second priority, with 32 percent in support, is developing greater incentives for

3. While the new RSE rules fail to provide a definition of SMEs, the Capital Market Authority asserts that the definition of SMEs used by Rwandan government agencies applies – namely, meeting two of the following three conditions: 1) less than 100 employees; 2) an annual turnover of less than Rwf 50 million; and 3) less than Rwf 75 million in capital investments.

private equity and venture capital investments. About the same percentage believe the government should prioritize developing the corporate bond markets.

In addition to these policy goals, Rwandan businesses want to know more about how capital markets work and how they could use the markets to pursue their business objectives. Responding to open-ended questions in the survey, they pointed to the need for greater public education and capital-market training. Representative comments included one participant's call for the government to "accelerate awareness." Another asked that officials "train investors and managers in corporate governance." Another said, "In a growing market such as ours, we need to improve bond market awareness. People do not understand the benefits of the bond market." Such comments appeared repeatedly, and their collective force stands out as a key finding of the survey.

CHART 13 What should the government focus on to improve capital markets in Rwanda?



Note: Survey participants were asked to mark all answers that applied

Implications for Financial-Market Development

In its "Vision 2020" national policy document, the government of Rwanda has committed to transforming the country's economy from a heavy reliance on agricultural production to a knowledge-based services marketplace. Given these aspirations, the businesses that participated in this survey represent precisely the kind of economic actors to benefit from financial-market development. They are primarily service-sector companies, mostly established in the "Vision 2020" era, and well-connected within the Rwandan business community as members of the Private Sector Federation's Golden Circle. It is not an exaggeration to say that they are among the most promising companies in the country.

Today, many of them rely on bank loans and lines of credit to fund operations. It seems clear, however, that this situation is not sufficiently meeting their needs. One-third of these promising businesses have been struggling to raise capital for at least the last three years. At the same time, very few of them think of issuing capital-market securities as an option for meeting their financing needs.

The findings of this survey raise four questions that should be addressed as Rwanda further develops its financial markets:

1. ***Are there effective ways to responsibly bring down the prohibitive collateral levels currently required by banking institutions?***
   For most Rwandan businesses, bank loans still constitute the primary source of funding, and a high percentage of businesses that are unable to secure financing cite the inability to meet collateral or other lending requirements as a significant barrier. With collateral requirements ranging close to 300 percent of loan amounts, it is no wonder that many businesses are unsatisfied with their current dependence on the banking sector. Even as other financing sources develop in Rwanda, many businesses will continue to rely on bank term loans to fund themselves, and so addressing limitations to bank financing remains a key challenge for the private sector.

2. ***What are the right strategies for stimulating the development of greater private-equity and venture-capital investments in Rwanda?***
   One-third of survey participants believe private equity and venture capital investments in Rwanda should be promoted, and about 7 percent of respondents report that they have already raised capital through a private equity deal. Expanding the PE/VC market and cultivating other financial products specialized for early-stage businesses would offer Rwandan companies an alternative to bank loans as they raise capital to pursue their strategic goals.

3. ***What can be done to expand awareness of relaxed SME listing requirements on the RSE and to promote early success stories among SMEs that may join?***
   While the RSE acted to reduce minimum listing requirements for SMEs two years ago, otherwise well-informed businesses seem unaware of the relaxed standards. While not a panacea, promoting awareness of these new rules—including clearly defining which kinds of businesses they apply to—may increase the number of listings on the RSE. It will be important, though, that early SME listings be seen as success stories among market participants in order to prompt further participation in the RSE. SME listings could develop in tandem with a more active private-equity environment as public offerings are often an attractive exit strategy for early-stage investors.

4. ***How will business leaders receive the financial-market training they need to more fully take advantage of the Rwandan capital markets as they develop?***
   Rwandan businesses want improved understanding of the financial markets and the options available to them. A better-informed private sector would advance financial-market development by making business leaders stronger advocates of their own financing concerns. The result would be pressure on both financial institutions, including the banking sector, and policymakers to better respond to the needs of Rwandan businesses.

As these questions suggest, there is a great deal of work ahead for both policymakers and the private sector to build Rwandan financial markets into efficient, well-functioning sources of capital for growing businesses. Right now, Rwanda is at the beginning of this journey. As one survey participant wrote in response to an open-ended prompt, “Patience is needed. This market is still new.”

About the Authors

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About the Center for Financial Markets

Based in Washington, D.C., the Milken Institute Center for Financial Markets promotes financial market understanding and works to expand access to capital, strengthen—and deepen—financial markets, and develop innovative financial solutions to the most pressing global challenges.

About Milken Institute

The Milken Institute is a nonprofit, nonpartisan think tank determined to increase global prosperity by advancing collaborative solutions that widen access to capital, create jobs and improve health. We do this through independent, data-driven research, action-oriented meetings and meaningful policy initiatives.

About the Capital Market Authority of Rwanda

The Capital Market Authority (CMA) is the regulator of the Rwandan capital markets. The CMA replaced the Capital Market Advisory Council (CMAC) that had been established by order of the prime minister in 2007 to initially guide capital-market development in Rwanda. In 2011, after the passage of Law N°11/2011 of 18/05/2011, the CMA took over this responsibility. The mission of the CMA is to nurture wealth by facilitating the development of an orderly, fair, transparent, and efficient capital market system.

About the Rwanda Private Sector Federation

The Rwanda Private Sector Federation (PSF) is a professional organization dedicated to promoting and representing the interests of the Rwandan business community. It was established in December 1999, replacing the former Rwanda Chamber of Commerce and Industry. PSF is a key player in enabling the private sector to respond to Rwanda’s vision for its future. As the country’s flagship business institution, private enterprises look to PSF to address or facilitate solutions to business constraints that they face and represent their interests during dialogues with the government.