FACTORS INFLUENCING THE ZIMBABWE STOCK EXCHANGE PERFORMANCE (2002-2007)

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ABSTRACT: *This paper assesses the factors that influenced the Zimbabwe Stock Exchange's performance from 2002 to 2007. The study seeks to identify and define the major drivers of the bourse during this period and use them to guide an investor on the ZSE or any other stock exchange in a developing economy. Despite the shrinking of the economy since 2000, the stock market inversely reacted to the factors that affected the economy negatively. The ZSE was driven mainly by speculation as investors sought to hedge against hyperinflation. The decline of the Zimbabwe economy during that period caused capital flight to the stock market pushing prices up hence huge profits. The real factors that affect share investment and the stock market in general were addressed, giving insight to the stock investors. The study recommends that stock investors should keep track of the general and unique factors that have an impact on their investments.*

KEY WORDS: *ZSE Performance, Speculation, Hedging, Investment, Inflation*

1. INTRODUCTION

The ZSE performed extra ordinarily well despite the expectations of the economist and stock market analysts who perceived it to crumble together with the economy. The stock market actually outperformed any of its previous achievements in the economy even though many investors were sceptical. The stock market's unusual performance was beyond the economist and analyst predictions whose perception was that it would go down with the economy. Factors such as speculation and the need to hedge investments against inflation have played a bigger role to upgrade the performance of the ZSE. The hyper inflationary conditions discouraged many investors without a deeper technical knowledge as to whether investing in such an economy can

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yield anything tangible. Fear and greed influenced the decision made by other investors in disposing and acquiring stocks on the bourse.

The fact that investment on its own needs critical understanding of the major drivers of the ZSE performance creates the need to clarify how and why these factors should be considered. A lot of investors do not know how to interpret prevailing factors that constantly arise in the stock market. Many end up making impulse decisions due to panic after hearing information that they do not know its significance to the stock market. The research gives informative literature for insight to investors on factors and drivers to be considered in their dealings on the any stock exchange in the world. The study is set to clarify major factors driving the ZSE performance, thus giving investors the most needed information on the effects of such drivers. It may act as a guideline to those investors who do not know when to sell and buy shares. The paper also gives information on the benefits of the stock exchange investment in any economy and hence potential investors making informed decisions to produce optimal results. The research identified and defines the major drivers of the ZSE. It then assesses the effects brought about by these drivers on the performance of the bourse.

2. RESEARCH QUESTIONS

The paper thus strives to provide answers to the following questions:

- What are the main factors that affect the stock market performance?
- Why was the ZSE performing extra ordinarily well in an economy that was melting down?

3. METHODOLOGY

To answer the research questions, case study research was conducted. This paper used direct observation, questionnaires, unstructured interviews, and document review to gather data. Data for the research was gathered from financial consultants, economists and bank managers based in Harare, Zimbabwe. The research is a study designed to explore the problems bedevilling the stock exchanges in developing markets with ZSE as the case study. Questionnaires, personal interviews and document review were used to obtain data for this study. A sample of six asset managers, ten stockbrokers and four research analysts was used to gather information for this research. Five volunteer stockbrokers reviewed the questionnaire for readability, clarity, and completeness. In addition, a faculty member specializing in banking issues examined the questionnaire.

4. LITERATURE REVIEW

A stock exchange is essentially a market place for stocks and bonds; with stockbrokers earning a small commission on each transaction they make (Farlex, 2003). According to Ibrahim and Aziz (2003) the performance of a stock market can be affected by influence. Influence can be defined as a power to affect persons or events based on prestige thus causing something without any direct or apparent effort.

Influence is basically causative factor that exert pressure on a person or events to drive them to perform in a certain way (Seyhun, 1998). A factor is anything that contributes casually to a result and drives a certain performance in an event (Wikipedia, 2008).

Asquith and Mullins (1983) maintain that the payment of a liberal portion of earnings in dividends adds the attractiveness of a stock. Shriller (1991) also recognized that this involves a curious paradox: Stock value increases when taking away value from the capital and surplus fund, i.e the more the shareholders subtract the larger is the value placed upon what is left. Shriller further argues that it is safe to purchase stocks, not only because of their intrinsic value or expected future dividends but because they can be sold to someone else at a higher price. A significant stream of prior research in the United States of America has empirically documented that unexpected increases (decreases) in regular cash dividends generally elicit a significantly positive (negative) stock market reaction (Fama , 1981 and Petit, 1992). Since managers have some information that outside investors do not have, dividend policy is a costly-to–replicate vehicle for conveying positive private information to the market players (Miller and Rock, 1985). Bhattacharya (1979) stated that dividend increases convey information about the firm's current and future cash flows that has an impact on the stock market performance. Serletis (1993) documented that dividend cuts are followed by earnings increases, consistent with dividend cuts marking the end of a firm's financial decline and beginning of its re-structuring. Stock dividends or bonus issues effectively award existing shareholders a free share of common stock for all shares currently owned. Bonus issues constitute a finer slicing of a given value and should have no direct wealth effects to shareholders if they do not have cash flow implications (Seyhun, 1986). Petit (1992) found that there is a positive stock price response to stock dividend (and stock split) announcements. Dhakal et al (1993), provide empirical evidence that is consistent with firms employing stock dividends and stock splits in order to shift share prices to an optimal trading level. Shriller (1991) states that dividend movement is not nearly enough to rationalize stock price volatility, this therefore means that expectations about future dividends can not be responsible for stock price movement.

According to Serletis (1993) there are two competing hypothesis on the effect of money supply on stock prices. The monetary portfolio hypothesis suggests that as a result of changes in the money supply, investors adjust the proportion of their asset portfolios represented by the money balances to establish new equilibrium positions with respect to their other various assets. These new equilibrium positions are established through changes in the prices of other various assets. The second hypothesis is the efficient market hypothesis. The quantity theory of money assumes that an increase in the money supply is expected to create excess supply of money balances and, in turn, excess demand for shares (Dhakal et al, 1993). This in turn, would result in an increase in the price of shares. Reisman (1999) stated that the increase in demand for stocks is a result of repeated pouring into the market of large sums of new and additional money. According to Farma (1981), this implies that monetary changes lead to stock prices based on the assumption that all relevant information known about the money supply is fully reflected in the share prices. Empirical evidence supports this theory that there is a direct casual relationship between money supply and stock prices (Ibraham and Aziz, 2003). Jensen and Runback (1983) documented that an increase in the quantity of money exerts its positive effect on stock prices only when the increase is concentrated in the stock market and has not yet sufficiently spread throughout the rest of the economic system.

Inflation has been described by Lee (1992) as not the rise of prices but rather is the undue increase in the quantity of money, which operates ultimately to cause a rise in prices. Research into inflation and stock market returns has mostly documented a negative casual relationship between the two, especially for developed economies, due to the theory that high and variable inflation rates add to uncertainty which directly effects investment through reduced confidence and thus lowers stock prices (Fama, 1981; Lee, 1992). Choudhry (2001) has investigated the relationship in India a developing country and documented that a positive relationship between current stock market returns and current inflation is possible during short horizons under conditions of high inflation. Caporale and Jung (1997) reject Fama's hypothesis for the negative relationship and deemed that the relationship remains a puzzle. According to Caporale and Jung (1997), financial economies hold that stock represents a hedge against inflation. This was backed up by Fisher and Statman (1997) who suggest that identifying macro variables that influence aggregate equity returns may indicate hedging opportunities for investors. Taylor and Allen (1992) argued that once inflation begins to substantially raise prices, it would undermine the capital formation and result in a badly depressed stock market.

Fama (1981) explained Efficient Market Hypothesis (EMH) as the reflection of information in security prices. The EMH asserts that financial markets are "informationally efficient" and stocks already reflect all known information and therefore are unbiased in the sense that they reflect the collective beliefs of all investors about future prospects. The strong form suggests that securities prices reflect all available information, even private information. Seyhun (1998) provides sufficient evidence that insiders profit from trading on information not already incorporated in prices. The semi-strong form asserts that security prices reflect all publicly available information. The availability of intraday data enabled tests which offer evidence of public information impacting on stock prices within minutes (Lease et al, 19994). The weak form of the hypothesis suggests that past prices or returns reflect future prices or returns which is consistent with technical analysis. Fama (1981) expanded the concept of the weak form to include predicting future returns with the use of accounting or macroeconomic variables. The reaction of stock market to announcement of various events such as earnings, stock splits and takeovers has been evidenced to be consistent with EMH (Jensen and Runback, 1983). Fisher and Statman(1997) in their analysis of the aggregate stock market argued that there is little, if any, correlation between the greatest aggregate market movements and public release of important information.

Shleifer and Summers (1990) came up with two types of investors in the market; 1) Rational speculators or arbitrageurs who trade on the basis of information and 2) Noise traders who trade on the basis of imperfect information. Since noise traders act on the imperfect information, they will cause prices to deviate from their equilibrium values. Edwards (1993) also investigated investor behaviour and discovered that most investors traded because of price changes rather than due to news about fundamentals. Lease et al (1994) stated that high prices are sustained, temporarily, by investor enthusiasm rather than real fundamental factors. He further argues that stock prices are driven by self-fulfilling prophecy based on the similar beliefs of a large cross-section of investors.

Technical factors are a mix of external conditions that alters the supply and demand of company's stock (Coperale and Jung, 1997). These play a major role in determining the stock market performance. In financial theory interest rate as a measurement of time value of money is one of the determinants in stock returns. Titman and Warga (1989) state that changes in interest rates have earnings effects on firms. They maintain that the interest rates lead available cash to borrow to be less which in turn, decreases spending. When spending is getting less, earnings for the companies go down and their prices drop. Carter and Van Auken (1990) in their research concluded that when interest rate falls stock returns become more attractive and a shift from fixed –term investment instruments to shares was observed, leading market value of the shares to increase. They have discovered that expectations can reflect the prices of the futures and options written in equities.

In viewing the stock market performance, there are several other factors that mainly affect individual investors to invest and whose reaction also has great impact on the overall performance of the stock market. Potter (1991) identifies six factors: dividends, rapid growth, and investment for saving purposes, quick profits through trading, professional investment management and long term growth, as main factors that influence investors' decision to trade. Wong and Cheung (1999) argue that investors are primarily concerned with expectations about the future, considering earnings projections and historical data to be of high interest to investors. Many researchers have illustrated that the impact of the inflation, money supply, interest rates and speculation in conjunction with efficient market hypothesis are of paramount importance in determining the stock market performance.

5. RESULTS

The data was acquired from fifteen questionnaires and five interviews from research analysts, stockbrokers and asset managers. Document review was also used to obtain data for this research. On the extent some factors contributed to the ZSE performance respondents were to mark on the given factors in a table, the factors that they think where of much influence to the stock market performance. The main objective was to enable the collection of data that would give the researcher a greater understanding on the extent of the impact that certain factors posed on the stock market. Respondents were supposed to rate the factors using rates that started from 5(five) –very strong to 1(one)-very weak. Majority of the respondents (67%) rated speculation 5(five) and inflation received 100% rating five and the same with depreciation of the Zimbabwean dollar. Money supply was rated five 58% of the respondents and 42% of the respondents rated the intensity of its impact 4(four). Government policies received a 41% for rating three and the remaining 16% rated it two. Individual firm performance received 50% for rating four and 41% for rating three and the last 9% for rating two.

The research found that public announcements also had an influence on the ZSE performance. When the government announced on the 29th of June 2007 that all prices were to revert to those prevailing on the 18th of June, the stock market plunged a massive 37% in two weeks. Price controls had negative effects on the stock performance. Retail and wholesale companies were heavily hit by these price slashes which then translated to their dismal performance during that period, hence the resultant effect on the whole stock market was unavoidable. The most affected stocks include OK Zimbabwe, Truworth, Edgars, Redstar and CFI.

On other factors that influenced the performance of ZSE the respondents suggested a number of them. Capital adequacy of listed companies was found to be influential on the ZSE. Majority of the respondents agreed that share repurchase by firms due to excess funds has an effect of souring up share price of that certain counter. Unavailability of other sources of finance or inability to access funds from the formal sector (banks) leading to many resorting their funds to the stock market has influence on the stock market. All respondents agreed that the need to store value of funds also drives the market.

Majority of respondents (90%) indicated that profit making is the major factor that influenced investors to buy stocks. Hedging against inflation has also been given much credit as one of the major drivers of investment in stock market. A few pointed that the need to invest for the future is also one of the main drivers to buy stocks.

Most response have shown that the selling of stocks is mainly stimulated by the need for profit realization, managing liquidity, having a bearish opinion, that is, expectations that prices would fall. Refocusing or redirecting investment due to poor performance of such stocks and also negative sentiments about the stock or economic outlook are some of the reasons given for the need to sell stocks.

Sixty seven percent of the respondents indicated that the liquidity nature of the stock market securities and their less risky nature to be one of the reasons why they find the stock market more viable than other forms of investment. The research found out that companies found it easier to use the stock market to meet the tax obligations and other commitments faster than if they had invested in other markets like the property market. It was said to be an investment option that provides a real rate of return at investor's disposal in a shorter space of time as compared to other investment options.

All interviewees have outlined global and regional trends to have an effect on the stock market. Global trends were found to be of greater effect on the general stock market performance of our own local stock market. Regional trends are also of paramount importance as they directly affect the stock market just as the global trends.

6. EFFECTS OF DIVIDEND ON ZSE

Fifty eight percent of the respondents stated that dividend payment had an impact on the value of stocks as far as the investors were concerned. The research established that the dividend that had the greatest impact is the stock dividend, where the investor receives additional shares to the already held as per scrip offer, and yields positive returns for the investor. All respondents agreed that dividends boost investor confidence in the counter as payment of such may indicate a sound financial and cash flow position of that company. It was also established that investors would want to associate with companies that guarantee profitability.

Contrary to what others felt others differed mainly because of the hyperinflationary environment that prevailed. It was ascertained that the inflationary environment frustrated most investors, as the cash dividends were too insignificant that they could not buy anything with such amounts. It was made clear that as the dividend is declared, it is normally paid three months after declaration which leaves it more vulnerable to the effects of hyper inflation. Therefore, dividends were less attractive to investors who think that stock dividends are worthwhile. It was also indicated that the impact of dividend payment is insignificant and do not show a direct relationship with the stock values. Many respondents indicated that investment on the bourse was not because they want to benefit from the dividends paid out but for capital gains.

7. MERGERS AND TAKEOVERS

All respondents indicated that in mergers involving listed companies on the ZSE speculation drove the prices of share prices higher despite the performance of the new company formed. Majority of respondents (90%) concurred that takeovers enable the reduction of competition and operational overhead hence increase financial returns. The anticipated improvements in the operations of the resultant entity will contribute, among other factors, to increase the value of the share price in question. This applied to the merger of Kingdom Financial Holdings, Meikles Africa and Tanganda in 2007, where the share price for Kingdom-Meikles (resultant entity) increased significantly after the merger.

8. MONETARY AND FISCAL POLICIES

All respondents agreed that monetary policy had a huge influence on the ZSE in the determination of money market rates. The interest rates marked on money market instruments have an effect of increasing or decreasing demand for the stock market securities, where this demand and supply is also the determinant of the stock prices. As observed in the literature review, a fall in interest rates causes a shift from fixed term investments to shares hence boosting the performance on the stock market in general. It was also highlighted that the increase in money supply in circulation can pose excess liquidity in the market that would obviously affect the ZSE performance positively as rates tumble. The increased injection of cash was of great effect in Zimbabwe combined with hyperinflation where most investors felt the need to store value of their money in stocks. Fiscal policy also had an impact on the ZSE. Many respondents (89%) concurred that Gross Domestic Product (GDP), Balance of Payments (BOP), Budget deficit and government expenditure would swing the stock index over the period under review. Tax implications also had influence on the performance of the stock market. One of the interviewees gave an example when capital gains tax was first introduced in the stock market, trading volumes reduced significantly.

9. ZSE EXTRAORDINARY PERFORMANCE

For the extra ordinary performance of the ZSE against the odds respondents gave a number of reasons. In a hyperinflationary environment, investors have seen the need to hedge against inflation, hence the positive correlation. On the other hand, uncertainty has contributed to some negative relationship being portrayed on the stock market. Respondents noted that the depreciation of the Zimbabwean local currency influenced the positive performance on the ZSE. In response to the skyrocketing inflation, depreciation of the local currency has seen most investors seeking to store value of their money in stocks.

Majority of respondents pointed out that the stock market remained free from severe government regulations made it be at full swing in most of its activities as it has remained uninterrupted unlike the banking sector. Investors gained confidence in the stock market since the banking sector long ceased to be a viable investment option due to regulatory and other monitory policy instruments that have a tendency to erode one’s funds instead of yielding interest.

The research found out that investors saw the stock market as a viable investment option that would at least store value of money which the banking sector could not do. With the constant phasing out and introduction of new bearer cheques from the Zimbabwean economy, the stock market was very active especially during the month of November and December 2007. Respondents concurred that many investors did not want to lose out completely and the same time they could not go with the money to the bank as there were tight controls upon banking such funds at that particular time. The stock market was the way out as they would gain rather than lose out.

In favour of the stock markets, most respondents indicated that the stock market has been able to keep abreast with inflation unlike the other investment options. The foreign exchange market was also suggested as one possible investment option which yielded better results than the stock market. Due to the stringent regulations in the forex market with prevailing illegal parallel market it has been very risky for investors to take that as an investment option. The respondents also rated the property market lower than the stock market. This was mainly due to the liquidity nature of that type of investment as compared to the stock market. The ZSE was floating above the inflation rate as given by the interviewees but in USD terms the return for the stock market is not real.

10. DISCUSSION

The majority of the respondents have made it clear that inflation and depreciation of the Zimbabwean dollar has had a greater impact on the stock market performance. This has been evidenced in the researches made by Choudhry (2001) who have deduced that inflation have a positive relationship with the stock market returns in a hyperinflationary condition within short horizons. Although Fama (1981) have documented a negative relationship between inflation and stock market returns. Zimbabwe has proved to go along with Choudhry's findings where the inflation rate is escalating together with the stock prices. The main reason for all this could be the need to hedge against inflation as there has not been any other liquid means to store value in since 2000, where on the other hand banks have proved to be vulnerable to the threats posed by inflation.

Money supply on the other hand has been influencing the stock market performance in a rather similar manner as the inflation factor has been. This has been supported by many researchers who have documented that increased injections of money supply (M3) into the economy has an effect of rising stock prices as demand increase. Dhakal et al (1993) in his Quantity Theory assumes that an increase in money supply is expected to create excess supply of money balances and, in turn, excess demand for shares. The ZSE has benefited more from these huge cash injections.

The effect of price controls can also explain the rating for company performance 3(three), as it has also influenced the performance of the stock market as a result of these policies put in place during the year 2007. The effect brought about by company performance was felt within the market to an extent as production levels reduced to the government policies. The aspect of company performance though, has failed to completely dominate the ZSE performance on the affected counters due to speculative behaviour by other investors and different perceptions about the future of those particular counters.

The monetary policy had an effect of putting in regulations that would influence the activities of the stock market; these include the regulation put on the banking industry that barred the banking sector from stock trading. This meant they could not invest in shares as they used to, giving a negative impact on the overall performance of ZSE as demand for shares is reduced, hence the decline in prices.

The restrictions put across by the monetary policy authority that duel listed counters on ZSE were not tradable on any other stock market unless they were initially transferred to the ZSE from foreign stock markets. This made it rather unattractive to foreign investors who may be having arbitrage intentions. This has an effect of reducing activity on stock market which probably meant demand for shares was reduced with a certain percentage which would obviously affect share prices.

Share consolidation also has an effect on stock market performance as it reduces shares in circulation and provides convenience in the maintenance of the register. It also influences share price as it increases the price of that particular stock by a certain ratio of consolidation. Consolidation may frustrate the current holders of the stock if they are not all that informed about the meaning of the reduction in the number of shares and on the other hand, the increase in price may attract more investors to invest in the counter as it may appear that its performance has improved.

Speculation has been said to affect the ZSE performance in that it is responsible for price discovery. It also has been said to smoothen disparities in the market and hence they have an impact in the overall stock market performance. The performance of the related companies in the region, country or sector may as well determine the price of shares of the listed companies in that same industry. The effect of the global, regional or sectorial trends can be constituted in the share prices of the locally listed shares through the EMH concept, where all the information in circulation is absorbed into the price. This also gives room for the speculative behaviour of investors as they will start to perceive the positive or negative returns upon the information received.

Profit making is of paramount importance to most investors as evidenced by Potter (1991) who said that investors need quick profits from their trading. In order for companies to meet their various obligations, including the payment of corporate taxes, the stock market normally slightly fall during such a period of tax payments by firms.

Dividends declared became insignificant due to value eroded by inflation. Cash dividend payments were found to be of little effect on price movements on ZSE unless it is stock dividend. Stock dividends are immune to inflationary pressures and insure growth and value to the respective shareholders. Counters known to offer scrip dividends are most likely to perform well especially when trading ex-div. The mergers and takeovers of listed companies on the ZSE influenced the performance of the bourse.

11. CONCLUSION

The ZSE performance has been influenced largely by the monetary policies put forward by the Reserve Bank of Zimbabwe. Money supply played a major role in determining the stock market performance in many ways. The increase in money supply or liquidity in the economy would increase demand for stocks and attract more players. High inflation rates as documented by various researchers had a positive relationship with the stock market performance.

From the research conducted it shows that there is much credit given to the inflationary influence among others. Interest rates showed a significant impact on the price fluctuation on the ZSE as it has an effect of reducing or increasing price of stocks. An increase in interest rates showed a negative relationship with the stock market prices and vice versa. As interest rates in the money market increased, the stock market is negatively affected making the money market more attractive than the stock market.

The ZSE was also affected by information announcements and other various activities taking place. This included political news, monetary and fiscal policies that saw the stock marketing reacting to such. These announcements also caused volatility on the bourse. Speculators and noise traders abused and manipulated the stock market to profiteer or gain from the fact that they knew some information before it was made public. It is worthwhile for shareholders and investors to consider various factors and their effects on the value of stocks.

In as much as the Zimbabwe Stock Exchange is concerned, investors should always take the responsibility to determine whether they are really hedging against inflation or their investment is being eroded by the inflation. It is advisable to always follow up on the information circulating, establishing its effects on the stocks and taking necessary action to safe guard their investment.

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