Overcoming ethnic divides key to fueling stock market growth in emerging economies

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On the heels of President Barack Obama's trip to Kenya this summer, in which the U.S. president called on Kenya to overcome ethnic divisions, a new study provides insights into the economic cost of segregation in developing countries and how to overcome it.

The study, published in *Administrative Science Quarterly*, looks at how actors from diverse and competing social groups can come to identify as members of a common market.

In "Mobilizing a Market: Ethnic Segmentation and Investor Recruitment into the Nairobi Securities Exchange, University of Chicago Booth School of Business Professor Christopher B. Yenkey, finds that the negative effects of social segmentation in Kenya - ethnic divides, political tensions, and distrust of institutions - can be reversed when potential investors learn about new market opportunities from neutral third parties or when policymakers frame such practices in socially neutral language.

"In developing countries, divisive ethnic and social groups can hinder the growth of financial exchanges," said Yenkey. "When social groups distrust one another, that hurts the free flow of information and, in turn, stifles economic growth. We need to bring the groups together in order to stimulate investing."

Potential investors living in a country with widespread corruption turn to their ethnic peers for advice on investing, which in turns drives the segmentation of that market. Indeed, Kenyans are actually deterred from investing in the stock market when rival ethnic groups are earning profits or when the market is identified with political rivals. Kenya comprises 42 distinct ethno-linguistic groups divided by disputes and distrust.

Using data on new-investor recruitment into Kenya's nascent capital market, Yenkey identified mechanisms driving social segmentation as well as integration of disparate groups. The data for the study spans 2005 through 2008 when about 1.2 million new investors bought into the exchange. The research tracks the location and date of each new investor's first share purchases, where the investors lived, and exposure to radio advertising for initial public offerings.

The results suggest that the most effective way to overcome ethnic divides is through advertising campaigns that use socially neutral, national language—rather than language associated with specific tribes or ethnic groups—to reframe the market as a common social identity.

"It is counterintuitive because we most typically think that we need to advertise a product in the local language in order to signal its local legitimacy," said Yenkey. "But, paradoxically, that fuels increased segmentation."

British colonial businessmen established the Nairobi Securities Exchange in 1954, but indigenous Kenyans were prohibited from participating in the exchange until Kenya's independence from Great Britain in 1963. But even then, participation in the exchange was restricted to the elite. It wasn't until the Privatization Act of 2005 that barriers to entry for small-scale shareholders were directly addressed.

While focused on Kenya's Nairobi Securities Exchange, the research has lessons for other emerging economies, including, most recently, Greece. More than half of the worlds' 140 stock exchanges have been established in the last 30 years, with about two-thirds located in developing countries.

More information: *Administrative Science Quarterly*, asq.sagepub.com/content/early/ … 597269.full.pdf+html

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