Capital Markets in Developing Countries
The State of Play

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Capital markets for development

Economists have repeatedly demonstrated a relationship between financial sector sophistication and economic growth. "Hesitantly and with ample qualifications, the preponderance of theoretical reasoning and empirical evidence suggests a positive, first-order relationship between financial development and economic growth," Ross Levine asserted in 1997. By 2009, in a review of recent literature, researchers from the Asian Development Bank produced a more confident conclusion: "There is now a consensus that financial sector development plays a vital role in facilitating economic growth" (Zhuang et al., 2009).

While developing countries have often emphasized establishing a sound banking sector, as economies grow and become more sophisticated, capital markets are increasingly important for providing the long-term capital that firms need to invest and expand. Deep, liquid capital markets channel domestic savings into projects and companies based on market principles, not political motives. Furthermore, as Daniel Mminele, deputy governor of the South African Reserve Bank, recently noted, capital markets can provide real-time feedback on the merits of policy decisions as perceived by the economic actors driving a country’s growth (Mminele, 2013).

Across developing regions, businesses have identified access to finance as the largest barrier to their success. According to the World Bank’s Enterprise Survey, this concern outweighs corruption, access to electricity, political instability, and tax rates, suggesting capital-market development merits greater attention among policymakers (World Bank, 2014, “Enterprise…”).

This document briefly surveys recent capital-market activity in developing countries. It focuses on the experiences of three regions in particular: Southeast Asia, Latin America, and Sub-Saharan Africa. The sections that follow examine developments in public equity markets, private equity, bond markets, and efforts to integrate capital markets at the regional level.

Stock market development and growth

Sources: World Bank—World Development Indicators; Financial Development and Structure Database; Milken Institute.
**Exhibit 1: Structure of the financial markets of selected countries in 2012**

![Graph showing the structure of financial markets in selected countries in 2012.](image)

*Sources: Bank for International Settlements, Bloomberg, BankScope, Milken Institute*

**Exhibit 2: Foreign portfolio investment, net inflows (US$ billion), 1990-2010**

![Graph showing foreign portfolio investment net inflows from 1990 to 2010.](image)

*Source: IMF—World Economic Outlook*

**Exhibit 3: Domestic credit to the private sector (% of GDP), 1990-2012**

![Graph showing domestic credit to the private sector as a percentage of GDP from 1990 to 2012.](image)

*Source: World Bank—World Development Indicators*
Developments in public equity markets

Southeast Asia: New players emerge alongside strong standard-bearers
From 2003 to 2012, the market capitalization of listed companies in the Association of Southeast Asian Nations (ASEAN) grew from $597 billion to $1.967 billion (World Bank 2014, “World Development...”), a compound average growth rate (CAGR) of 12.7 percent. Malaysia continues to have the largest market capitalization as a percentage of GDP, reaching over 150 percent in 2012, as a result of a strong capital-market planning process in the 1980s and 1990s. In the same year, the Philippines, Singapore, and Thailand also had market caps as a percentage of GDP higher than 100 percent, while for Indonesia this measure equaled 45 percent. Other developments in Southeast Asia include the rapid growth of Vietnam’s Ho Chi Minh Stock Exchange, which launched in 2000. In 2005, the HCMSE had 33 listed companies, with market cap at 1 percent of GDP; in 2014, it has around 300 equity listings and a market cap of over $48 billion, roughly a third of GDP (Ho Chi Minh Stock Exchange, 2014). The region’s two newest stock exchanges opened in Cambodia and Laos in 2011. Each currently lists three companies.

Latin America: Record IPO year in 2013 even as stock prices fall
Over the last decade, Latin American’s stock market capitalization grew more rapidly than ASEAN’s, as market cap rose from $450 billion in 2003 to $2,217 billion in 2012 (CAGR of 17.3 percent). Brazil, Mexico, Chile, and Colombia represented the largest markets. 2013 was a record year for initial public offerings (IPOs) in Latin America, with 22 IPOs raising over $16 billion (Bamrud, 2014). The biggest was in Brazil, where the insurance firm BB Seguridade raised nearly $6 billion. Mexico had the highest number of IPOs, with 10, compared with Brazil’s eight. Despite these offerings, 2013 was a dismal year for Latin America’s stock exchanges. In 2013, the Peruvian IGBVL Index fell by 23.6 percent, Chile’s IPSA index by 14 percent, and Colombia’s IGBC by 11.2 percent. The loss of 2.2 percent for Mexico’s IPC index was considered a bright spot (Lewis, 2014).

Sub-Saharan Africa: Thin trading despite proliferation of new exchanges
In Sub-Saharan Africa (SSA), the market cap of listed companies has grown over the last decade, but more slowly than in other regions. From $295 billion in 2003, market cap reached $732 billion in 2012 (CAGR of 9.5 percent). South Africa’s Johannesburg Stock Exchange (JSE) accounts for almost all of this activity. Excluding South Africa, the capitalization of listed companies stood at $123 billion in 2012, with the Nigerian Stock Exchange and Nairobi Securities Exchange weighing in respectively at $56 billion and $15 billion (World Bank, 2014, “World Development...”). Since 1990, 16 new stock exchanges have appeared in Sub-Saharan Africa. Half of them list fewer than 20 companies. The newest, the Rwanda Stock Exchange, lists five, three of which are cross-listed Kenyan firms. In general, African stock markets remain small and illiquid. Even the relatively advanced exchanges in Nigeria and Kenya have turnover ratios below 10 percent. Still, stock prices on these two exchanges have seen large, steady gains over the past several years.
### Exhibit 4: Number of listed companies in select developing countries, 1990-2012

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**Source:** World Bank—World Development Indicators
Developments in private equity

Southeast Asia: Rebound from the global financial crisis driven by the consumer and financial sectors
Private equity (PE) activity in Southeast Asia dropped noticeably during the global financial crisis. Pre-crisis, 2007 saw 128 deals for a total value of $12.1 billion, according to McKinsey, but by 2010, the private equity market had contracted to $5.6 billion (Ahn et al., 2011; Bhagat et al., 2012). In 2011, though, the market turned upward, with 73 deals, totaling $9 billion. Since 2010, notable deals have included CVC’s buyout of the Matahari retail company for $616 million; Stanley Black & Decker’s purchase of Infastech in Singapore for $850 million; and Mitsui & Co.’s purchase of Integrated Healthcare in Malaysia for $1.1 billion. Last year, 95 percent of investors and bankers surveyed by Ernst & Young anticipated increased deal-making in 2014. Investors see opportunities in the growing consumer sector and financial services (Ernst & Young, 2013, “Asia-Pacific…”). Trade sales and IPOs are the most common exits from positions in the region.

Latin America: Deals in Brazil drive record year
As with IPOs, 2013 set records in Latin America for private equity. PE funds closed 233 deals in the region (Latin America Private Equity and Venture Capital Association, 2014). These deals were worth just under $9 billion in total. Roughly $6 billion went into deals in Brazil, where the financial markets are more sophisticated. Across the region, investors put over $3 billion into infrastructure, with roughly half of that figure targeted at the oil and gas sector. In a $1.1 billion transaction, Advent International acquired a minority stake in the Oscensa pipeline in Colombia. Interestingly, Latin American pension funds are becoming more important PE actors, as countries such as Peru relax regulations on pension fund investment abroad and in alternative assets, including PE (Ernst & Young, 2013, “Private equity roundup…”).

Sub-Saharan Africa: Impressive 2013 due to two large deals in Nigeria
Private equity deals in Africa totaled $4 billion in 2013 (Private Equity Africa, 2014). While still less than pre-crisis figures of around $6 billion to $7 billion annually, the total value was up from $1.1 billion in 2012. Over 60 deals closed, but two accounted for more than 60 percent of the total value. Helios and BTG Pactual invested $1.5 billion in Petrobras Africa, a Nigerian energy firm, and Emerging Capital Partners and Investec Management placed $1 billion in IHS, a telecommunications infrastructure firm, also in Nigeria. Other recent large transactions include $284 million from the Carlyle Group, Standard Chartered Private Equity, and Pembani Remgro for Export Trading Group in Tanzania in 2012 and Deutsche Investitions and Duet Capital’s $90 million infusion into Dashen Brewery in Ethiopia the same year. One recent study documented 118 PE exits from positions SSA between 2007 and 2012 (Ernst & Young and Africa Venture Capital Association, 2013). Half of exits were trade sales, mostly to local and regional buyers.
Developments in bond markets

Southeast Asia: Stronger markets in the wake of the Asian crisis
One lesson that Asian countries learned from the 1997 Asian crisis was that a heavy reliance on banks for financing increased vulnerability to shocks. After the crisis, countries in ASEAN made considerable efforts to develop bond markets as alternatives for financing. The progress varies depending on the country. From 1997 to 2012, the share of bonds relative to total financial system assets increased the most for Thailand, from 14 percent to 27 percent. For the size of domestic bond markets relative to GDP, the largest market in ASEAN is Malaysia’s, with total bonds outstanding of 127 percent of GDP in 2012, up from about 70 percent in the late 1990s. Indonesia has the smallest bond market size relative to its own economy, at 20 percent of GDP in 2012. At a wider regional level, in 2003 and 2004, the Executives’ Meeting of East Asia-Pacific Central Banks (EMEAP) dedicated small percentages of their foreign reserves to the Asian Bond Fund (ABF) Initiative. In 2003, ABF1 invested in U.S. dollar-denominated bonds from Asian sovereigns, and in 2004, ABF2 put $2 billion into local currency sovereign bonds. This activity occurred alongside the Asian Bond Market Initiative of ASEAN+3 (ASEAN plus Japan, China, and South Korea), which was initiated in 2003 to develop local currency (LCY) bond markets. From less than $1 trillion in LCY bonds in 2001, emerging Asian countries had attained an aggregate of over $5 trillion in LCY bonds by 2010 (Asian Development Bank, 2012).

Latin America: Healthy appetite for bonds, but Brazil dominates market
The demand for Latin American bonds has been strong over the past few years, with bonds mostly oversubscribed. According to the Economist Intelligence Unit, Latin American bond issuances reached $120 billion in 2013, and the market is anticipated to grow even larger in 2014 (Economist Intelligence Unit, 2014). Brazil is likely to continue leading the market, accounting for over 55% of the total raised by Latin American issuers in the first half of January. Mexico and Colombia are the other major players. Similar to Sub-Saharan Africa, the majority of the market is composed of government bonds, with corporate bond markets constituting a small portion compared to GDP. Latin American corporations continue to be attracted to issuing bonds in the United States, instead of domestically, due to the abundant liquidity in the U.S. market and the number of sophisticated investors interested in Latin American debt securities. In 2013, Latin American firms raised over $80 billion in U.S. markets (Rodrigues, 2013). Meanwhile, Latin American sovereigns have taken advantage of recent low yields to tap international credit markets. Both Bolivia and Paraguay issued $500 million in U.S. dollar-denominated bonds with yields-at-issue of under 5 percent. Honduras has also issued a $500 million Eurobond, and Costa Rica has recently made its own $1 billion Eurobond debut (Rodriguez, 2014).

Sub-Saharan Africa: Growing Eurobond market for sovereigns, but little corporate activity
Domestic debt markets remain shallow in Sub-Saharan Africa. While the banking sector still dominates the financial structure of many African countries, the amount of local debt securities issued has increased from $11 billion in 2005 to $31 billion in 2012, according to data from the African Financial Market Initiative (African Development Bank, 2014). Growth, though, is led by government securities, which constitutes about 75 percent of the total market. The majority of government securities have short-term maturities, which create a frequent debt refinancing risk. South Africa, Nigeria, and the Republic of Congo are the only countries that have had a surge in corporate bond issues, the latter two primarily because of strong growth in the oil industry (Masetti, 2013). Sub-Saharan African countries have also recently been successful in attracting foreign capital through Eurobond issuances, with $5 billion raised in 2013. Kenya is likely to be the next country to tap the international market with a $1.5 billion-$2 billion Eurobond issuance in 2014.
Exhibit 6: Snapshot of bond markets in developing countries

Select Southeast Asian nations

Local currency sovereign yield curves

Source: Bloomberg

Sovereign yield curves for US$-denominated securities

Source: Bloomberg

Select Latin American nations

Local currency sovereign yield curves

Source: Bloomberg

Sovereign yield curves for US$-denominated securities

Source: Bloomberg

Select Sub-Saharan African nations

Local currency sovereign yield curves

Source: Bloomberg

Eurobond issuance (US$ billions), 2006-2013

Sources: IMF, Moody’s, DealLogic, Bloomberg, Milken Institute.
Developments in regional integration of capital markets

Southeast Asia: Escaping marginalization through integration
Datuk Ranjit Ajit Singh, managing director of the Securities Commission of Malaysia, has written that the “threat of marginalisation,” whereby investors choose more developed, liquid markets over ASEAN exchanges, should spur an effort to integrate ASEAN capital markets, adopting international standards in the process (Ranjit, 2009). Integration efforts have included the ASEAN Capital Markets Forum, a semiannual meeting of market regulators focused on harmonizing capital-market rules and regulations. The Capital Markets Forum recently put forward the “ASEAN Disclosure Standards,” an “opt-in” disclosure regime. To date, Singapore, Malaysia, and Thailand have adopted the standards. In 2006, ASEAN also launched the FTSE ASEAN 40 index leading to a USD-denominated exchange traded fund listed on the Singapore Exchange. Annual returns over the past five years, from January 2009 to January 2014, have averaged 19.8 percent. In addition to the regional efforts in bond market development described above, ASEAN+3 created the Asian Bond Market Forum in 2010 to drive harmonization and integration efforts across the region.

Latin America: New integrated market, but more work needed
After what The Economist has called two decades of “endless talk,” Latin America took its most significant step yet to integrate its capital markets (The Economist, 2011). In 2011, Chile, Colombia, and Peru formed the Mercado Integrado Latinoamericano (MILA). MILA links Chile’s Bolsa Comercio Santiago, the Bolsa de Valores de Colombia, and Peru’s Bolsa de Valores de Lima on a single trading platform. Mexico may join the platform soon. At present, around 600 companies are listed, and while MILA had a market capitalization of $772 million at the start of 2013, this figure had fallen to $602 million by the end of the year. The S&P MILA 40 Index fell by 22.6 percent during the year. Analysts have pointed to differing tax and tariff regimes, lack of a common currency, and the cooling emerging market environment globally as ongoing challenges to facing MILA (Oxford Business Group, 2012).

Sub-Saharan Africa: Regional economic communities driving various integration efforts
Africa’s regional economic communities are all pursuing regional integration initiatives, mostly focused on boosting intra-African trade and infrastructure development. One prominent example of capital-market integration is West Africa’s Bourse Régionale des Valeurs Mobilières (BRVM), a regional stock exchange founded in 1998, with 38 listed companies and €9 billion in market capitalization as of early 2014. The BRVM serves the eight countries of the West African Economic and Monetary Union that share the euro-pegged CFA franc as a common currency. WAEMU’s neighbors, the West African Monetary Zone (WAMZ), are currently working toward a common currency, to be called the Eco. The East African Community (EAC) on the other side of the continent is also pursuing a monetary union. Relying on the relative sophistication of the Nairobi Securities Exchange, the EAC also takes a cross-listing approach to financial integration, whereby Kenyan firms have cross-listed on other EAC country exchanges. Cross-listing has been a common practice in SSA since 1992, when the Johannesburg Stock Exchange cross-listed Nictus Ltd, a holding company, on the Namibia Stock Exchange (Adelegan, 2009). In 2012, the Common Market for Eastern and Southern Africa (COMESA), a 19-country block, introduced the Regional Payment and Settlement System (REPSS), a platform for cross-border payments and settlements, primarily used by central banks, with the Bank of Mauritius operating as the settlement bank.
**Exhibit 7: FTSE/ASEAN 40 composition by market capitalization, 2014**

![Pie chart showing the composition of FTSE/ASEAN 40 by market capitalization in 2014. Indonesia has the largest share at 18.1%, followed by Singapore at 38.5%, Malaysia at 25.6%, Thailand at 14.6%, Philippines at 3.1%.](image)

*Sources: FTSE Group, Milken Institute.*

**Exhibit 8: Sub-Saharan Africa's regional economic communities**

![Map of Sub-Saharan Africa highlighting regional economic communities.](image)

*Source: Creative Commons*

COMESA: Common Market for Eastern and Southern Africa
EAC: East African Community
ECCAS: Economic Community of Central African State
ECOWAS: Economic Community of West African States (Both WAEMU and WAMZ are subgroups of ECOWAS)
SADC: Southern African Development Community

*Note: As indicated by the striped areas of the map above, several countries belong to more than one regional organization.*
Further reading

“ASEAN Capital Market Integration: Issues and Challenges”


“Capital Market Development: Whither Latin America?”

“Capital markets in Sub-Saharan Africa”

“The G-20 and Financial Regulation in Africa”
Peter Wolff, South African Institute of International Affairs, Policy Briefing No. 78, Nov. 2013.

“How Firms Use Domestic and International Corporate Bond Markets”

“Institutional Development of Capital Markets in Nine Asian Economies”

“Leveraging Capital Markets for Small and Medium Enterprise Financing in Rwanda”

“Monetary and financial cooperation in Asia: taking stock of recent ongoings”

“A Tale of Two Markets: Bond Market Development in East Asia and Latin America”
Barry Eichengreen, Eduardo Borensztein, and Ugo Panizza, Hong Kong Institute for Monetary Research, Occasional Paper No. 3, October 2006.

“Towards strong and stable capital markets in emerging market economies”
Liliana Rojas-Suarez, BIS Papers No. 75, January 2014.


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