CENTER FOR FINANCIAL MARKETS
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Capital Markets in Developing Countries
The State of Play

JUNE 2014

John Schellhase, Moutusi Sau, and Apanard (Penny) Prabha

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A nonprofit, nonpartisan economic think tank, the Milken Institute believes in the power of finance to shape A nonprofit, nonpartisan economic think tank, the Milken Institute works to improve lives around the world by advancing innovative economic and policy solutions that create jobs, widen access to capital, and enhance health. We produce rigorous, independent economic research—and maximize its impact by convening global leaders from the worlds of business, finance, government, and philanthropy. By fostering collaboration between the public and private sectors, we transform great ideas into action.

Capital markets for development

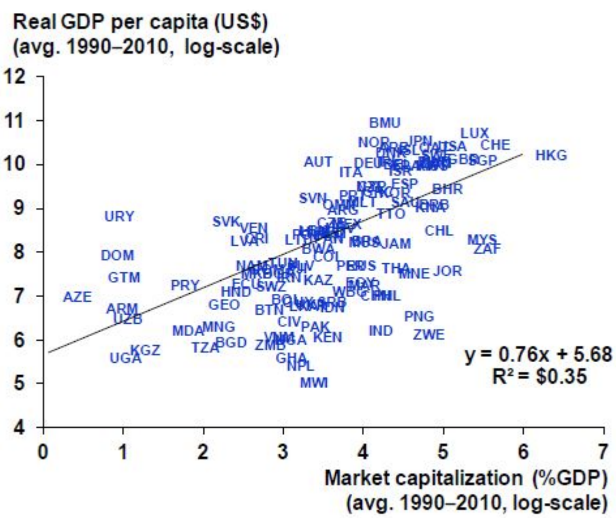
Economists have repeatedly demonstrated a relationship between financial sector sophistication and economic growth. "Hesitantly and with ample qualifications, the preponderance of theoretical reasoning and empirical evidence suggests a positive, first-order relationship between financial development 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…").

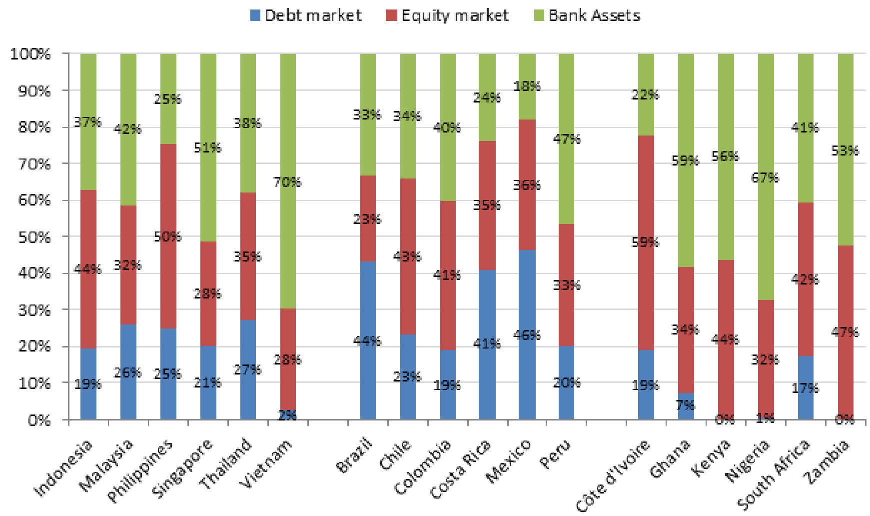
This document briefly surveys recent capital-market activity in developing countries. It focuses on the experiences of three regions in particular: Southeast Asia, Latin America, and Sub-Saharan Africa. The sections that follow examine developments in public equity markets, private equity, bond markets,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

Stock market development and growth



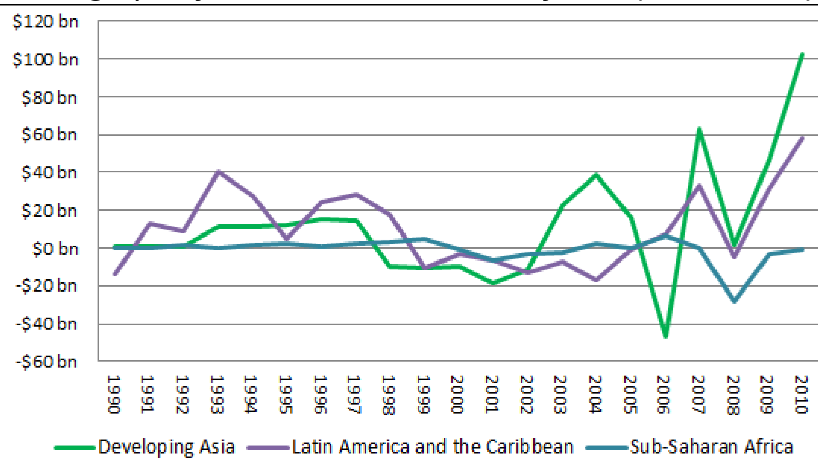
Sources: World Bank—World Development Indicators; *Financial Development and Structure Database*; Milken Institute.

Exhibit 1: Structure of the financial markets of selected countries in 2012



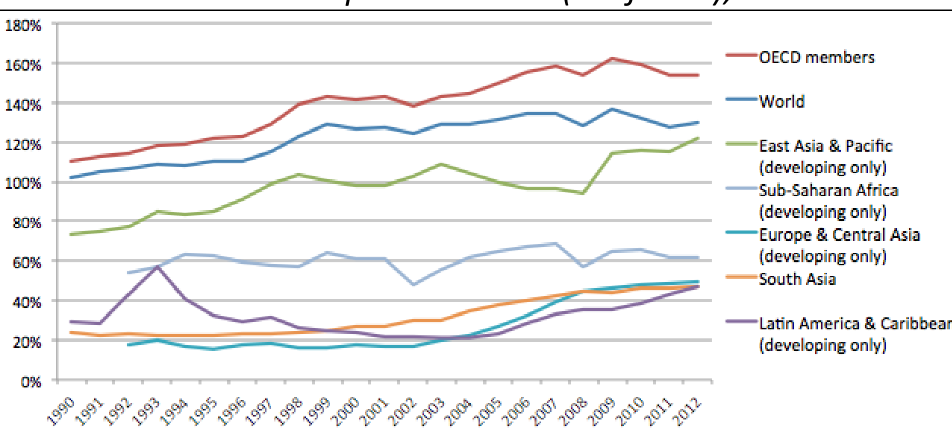
Sources: Bank for International Settlements, Bloomberg, BankScope, Milken Institute

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



Source: IMF—World Economic Outlook

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



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

	Southeast Asia						*Latin America*						*Sub-Saharan Africa*					
	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam	Brazil	Chile	Colombia	Costa Rica	Mexico	Peru	Cote d'Ivoire	Ghana	Kenya	Nigeria	South Africa	Zambia
1990	125	282	153	150	214	NA	581	215	80	NA	199	294	23	NA	54	131	732	NA
1991	141	321	161	166	276	NA	570	221	83	82	209	298	25	13	53	142	688	NA
1992	155	369	169	163	305	NA	565	245	80	93	195	287	27	15	57	153	683	NA
1993	174	410	178	178	347	NA	550	263	89	118	190	233	24	15	56	174	647	NA
1994	216	478	189	240	389	NA	544	279	113	116	206	218	27	17	56	177	640	NA
1995	238	529	205	212	416	NA	543	284	190	118	185	246	31	19	56	181	640	2
1996	253	621	216	223	454	NA	551	283	189	114	193	231	31	21	56	183	626	6
1997	282	708	221	303	431	NA	536	295	189	114	198	248	35	21	58	182	642	7
1998	288	736	221	321	418	NA	527	287	163	97	194	257	35	21	58	186	668	9
1999	277	757	225	355	392	NA	478	285	145	22	188	242	38	22	57	194	668	9
2000	290	795	228	418	381	NA	459	258	126	21	179	230	41	22	57	195	616	9
2001	316	809	232	386	385	NA	428	249	123	22	168	207	38	22	57	194	542	9
2002	331	865	235	434	398	NA	399	254	114	23	166	202	38	24	57	195	450	11
2003	333	897	234	551	421	22	367	240	114	20	159	197	38	25	51	200	426	12
2004	331	962	233	625	464	26	357	239	114	21	152	194	39	29	47	207	403	13
2005	335	1020	235	685	504	33	381	245	114	19	151	196	39	30	47	214	388	15
2006	344	1027	238	461	518	102	392	244	114	16	131	193	40	32	51	202	401	14
2007	383	1036	242	472	475	121	442	238	96	12	125	190	38	32	51	212	422	16
2008	396	977	244	455	525	171	432	235	96	11	125	199	38	35	53	213	379	19
2009	398	960	246	459	535	196	377	232	86	9	125	195	38	35	55	214	363	19
2010	420	957	251	461	541	275	373	227	84	9	130	199	38	35	55	215	360	19
2011	440	941	268	462	545	301	366	229	79	9	128	202	33	36	58	196	355	20
2012	459	921	268	472	502	311	353	225	76	9	131	213	37	34	57	192	348	20

Source: World Bank—World Development Indicators

Exhibit 5: Market capitalization of listed companies (% of GDP) in select developing countries, 1990-2012

	Southeast Asia						*Latin America*						*Sub-Saharan Africa*					
	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam	Brazil	Chile	Colombia	Costa Rica	Mexico	Peru	Cote d'Ivoire	Ghana	Kenya	Nigeria	South Africa	Zambia
1990	7%	110%	13%	95%	28%	NA	4%	43%	4%	NA	12%	3%	5%	NA	5%	4%	123%	NA
1991	5%	119%	25%	111%	36%	NA	11%	77%	10%	NA	31%	3%	5%	1%	6%	7%	140%	NA
1992	9%	159%	29%	100%	52%	NA	12%	67%	12%	6%	38%	7%	4%	1%	8%	4%	80%	NA
1993	21%	329%	74%	221%	105%	NA	23%	94%	17%	5%	39%	15%	4%	2%	18%	7%	132%	NA
1994	27%	267%	89%	194%	91%	NA	35%	124%	17%	NA	24%	18%	5%	34%	43%	15%	166%	NA
1995	33%	251%	80%	183%	84%	NA	19%	104%	19%	NA	26%	22%	8%	26%	21%	7%	186%	1%
1996	40%	305%	97%	159%	55%	NA	26%	87%	18%	7%	27%	22%	8%	22%	15%	10%	168%	6%
1997	13%	93%	38%	102%	16%	NA	29%	87%	18%	6%	32%	30%	11%	17%	14%	10%	156%	18%
1998	23%	137%	49%	99%	31%	NA	19%	65%	14%	9%	18%	21%	14%	18%	14%	9%	127%	9%
1999	46%	184%	51%	231%	48%	NA	39%	93%	13%	15%	26%	26%	12%	12%	11%	8%	197%	9%
2000	16%	125%	32%	159%	24%	NA	35%	76%	10%	18%	18%	20%	11%	10%	10%	9%	154%	7%
2001	14%	129%	54%	129%	31%	NA	34%	78%	13%	19%	17%	21%	11%	10%	8%	12%	118%	7%
2002	15%	123%	48%	112%	36%	NA	25%	67%	10%	15%	14%	24%	12%	12%	11%	10%	166%	6%
2003	23%	153%	28%	246%	85%	0%	42%	111%	15%	13%	17%	26%	12%	19%	28%	14%	159%	17%
2004	29%	152%	32%	253%	72%	1%	50%	116%	22%	8%	22%	29%	13%	30%	24%	16%	208%	8%
2005	28%	126%	39%	256%	71%	1%	54%	110%	31%	7%	27%	45%	14%	15%	34%	17%	229%	14%
2006	38%	145%	56%	199%	68%	14%	65%	113%	35%	9%	36%	65%	24%	16%	51%	23%	274%	11%
2007	49%	168%	69%	210%	79%	25%	100%	123%	49%	8%	38%	99%	42%	10%	49%	52%	291%	20%
2008	19%	81%	30%	101%	38%	10%	36%	74%	36%	6%	21%	43%	30%	12%	36%	24%	180%	NA
2009	33%	127%	48%	160%	52%	20%	72%	122%	57%	5%	38%	54%	27%	10%	35%	20%	248%	22%
2010	51%	166%	79%	170%	87%	18%	72%	157%	73%	4%	43%	63%	31%	11%	45%	22%	175%	17%
2011	46%	137%	74%	126%	78%	14%	50%	108%	60%	4%	35%	44%	26%	8%	30%	16%	130%	21%
2012	45%	156%	106%	151%	105%	21%	55%	116%	71%	4%	45%	48%	32%	9%	36%	21%	159%	15%

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).

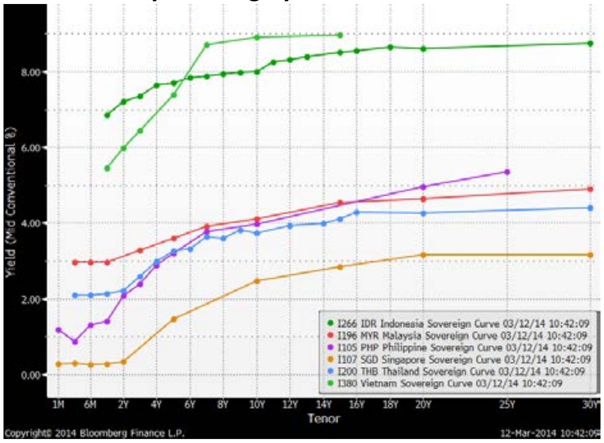
Latin America: Healthy appetite for bonds, but Brazil dominates market
The demand for Latin American bonds has been strong over the past few years, with bonds mostly oversubscribed. According to the Economist Intelligence Unit, Latin American bond issuances reached $120 billion in 2013, and the market 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

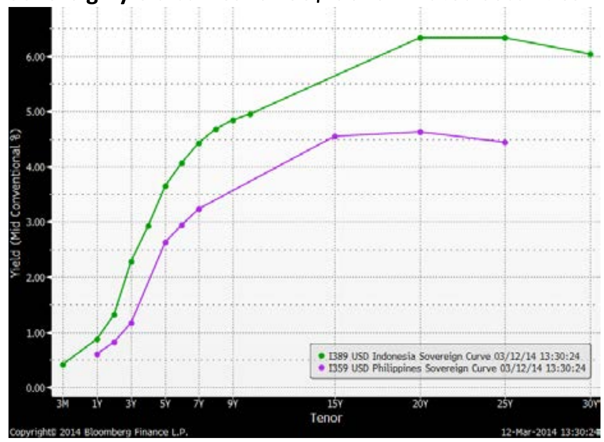
Local currency sovereign yield curves



Source: Bloomberg

Select Southeast Asian nations

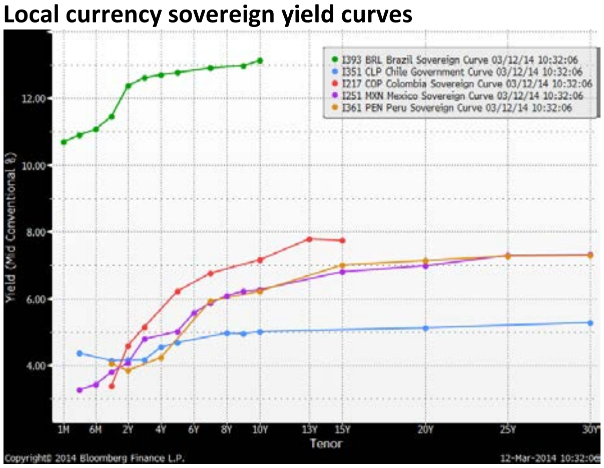
Sovereign yield curves for US$-denominated securities



Source: Bloomberg

Select Latin American nations

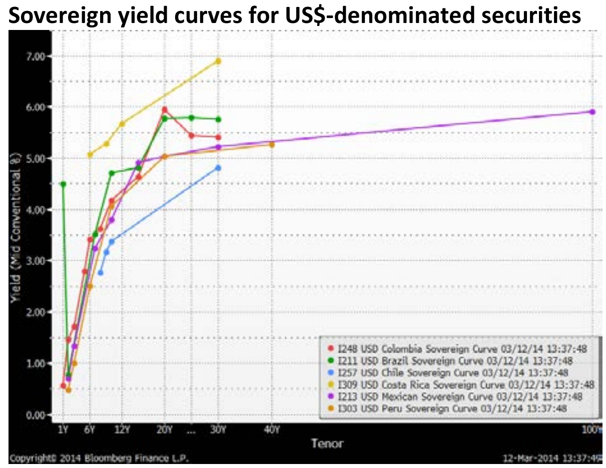
Local currency sovereign yield curves



Source: Bloomberg

Select Latin American nations

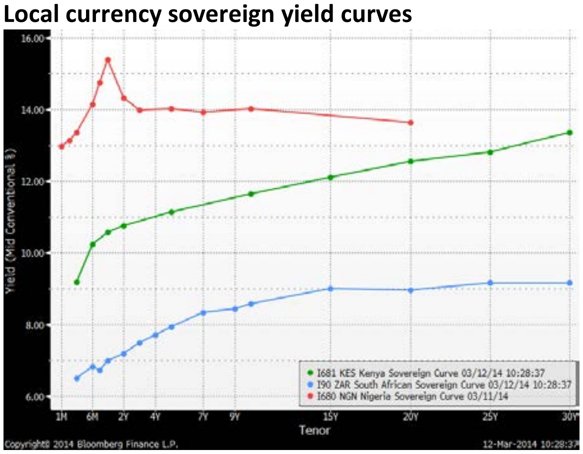
Sovereign yield curves for US$-denominated securities



Source: Bloomberg

Select Sub-Saharan African nations

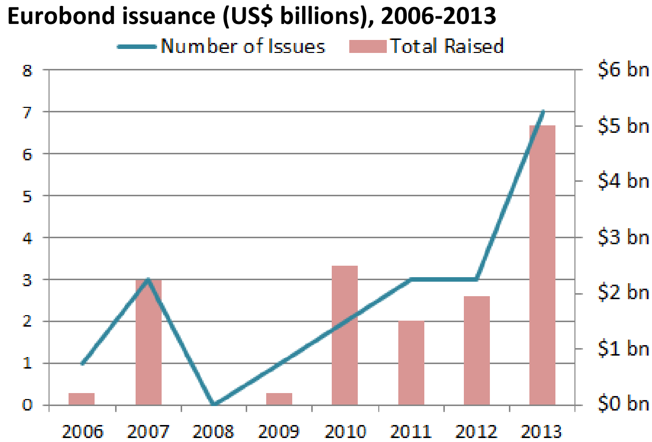
Local currency sovereign yield curves



Source: Bloomberg

Sub-Saharan Africa

Eurobond issuance (US$ billions), 2006-2013



Sources: IMF, Moody's, DealLogic, Bloomberg, Milken Institute.

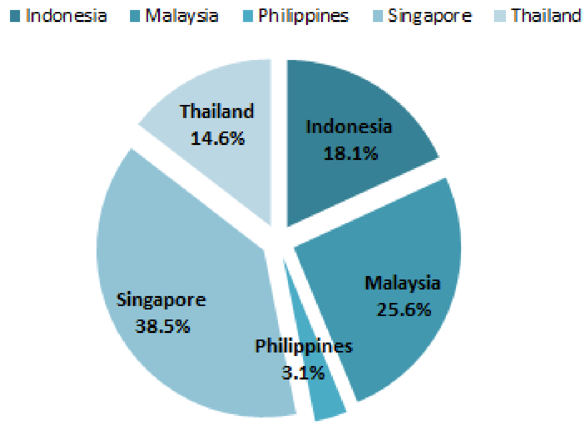
Developments in regional integration of capital markets

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).

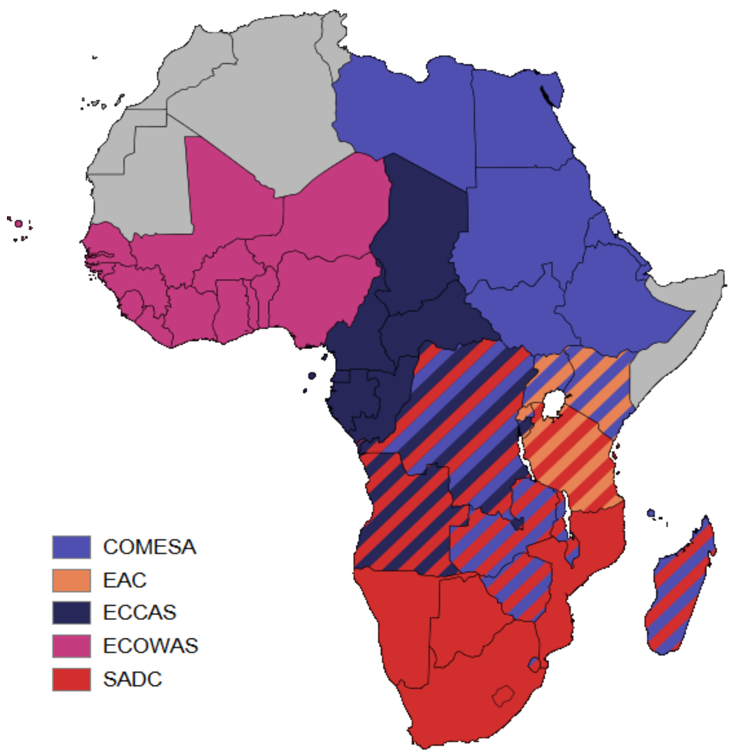
Sub-Saharan Africa: Regional economic communities driving various integration efforts
Africa's regional economic communities are all pursuing regional integration initiatives, mostly focused on boosting intra-African trade and infrastructure development. One prominent example of capital-market integration 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



Sources: FTSE Group, Milken Institute.

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



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

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