FINS2622 – ASIA PACIFIC CAPITAL MARKETS

INTRODUCTION

EMERGING MARKETS (EM)

Definitions

- Emerging markets (EM): the financial markets of economies that are in the growth stage of their development cycle and have low to middle per capita incomes
- International finance corporation (IFC): an intl financial institution that offers investment, advisory and asset mgmt services to encourage private-sector development in developing countries
- Desirable developments for EM – FELT
    - Fair
    - Efficient
    - Liquid
    - Transparent

Reasons to invest in EM

- Growth and diversification
    - EM grow at 6% while developed markets only grow at 2%
    - Sudden spurt of growth is because of population growth
- EM don't have to reinvent the wheel → advantage
    - E.g. China, India, Thailand, Malaysia, Vietnam, Singapore
- Technology/manufacturing
- Infrastructure needed – physical and institutional
    - Institution – stock market/trading mechanisms e.g. capital flows, IPOs, FDI, portfolio investment

Size of these emerging/frontier economies

- Land: 77% of world's land mass
- Population: 80% of world
- FX reserves: 65% of world
- GDP: 50% of world

Classifications

- General classification: emerging and frontier
- Narrow criteria: stock market capitalisation, number of stocks listed, bond market capitalisation
- Stock exchanges for alternatives, small & medium enterprises
- Exchanges for frontier markets in Asia → Bangladesh, Papua New Guinea, Vietnam, Myanmar (2 securities rarely traded), Cambodia, Laos (4 securities)
- More open criteria: economic framework conditions and economic structures
- Investable/less investable
- World market indices
    - FSTE International, MSCI Emerging Markets Index
    - Dow Jones Emerging Markets Index
- Emerging markets: China, India, Indonesia, South Korea, Malaysia, Philippines, Taiwan, Thailand
- Frontier markets: Vietnam, Cambodia, Laos, Myanmar

Issues with classification

- Lack of differentiation between investable markets and investable securities
- Bias in favour of large and liquid stock markets
- Moral hazard implications of country classifications and resulting indexes as a measure of performance

Frontier markets in Asia

- Less developed than Ems
- Early stage of development
- Less regulated
- ‘pioneer’ image/perception
- A small increase in per capita income → disproportionately large return for investors
- Less correlated with developed markets → justifiable portfolio diversification

Investment opportunities in EMs

- Portfolio investment, private equity, venture capital
- Direct establishment
- Buyout local firms
- Mergers and acquisitions
- Considerations/criteria
    - Rule of law
    - Treatment of shareholders
    - Absence of govt interference/shadow economies

Risks

- Taking risks is the best way investors can make profits (in the context of EM)
- Volatility is a characteristic in all markets incl. developed ones
- Sovereign risk
    - Huge reserves of EM → reducing the risk of repatriation
- Frontier markets → the most risky emerging markets → more risk more return?
- Karolyi 6 fundamental risk factors
    - Market capacity constraints
    - Operational inefficiency
    - Foreign accessibility restrictions
    - Corporate opacity
    - Limits to legal protections
    - Political instability
- Reducing risk → diversification
    - Correlation between developed/emerging markets can be low or even –ve with the US (Bahrain, Jordan, Bangladesh, Slovenia)
    - Diversification helped by more to choose from i.e. a larger basket

INSTITUTIONAL VOID

Institutional void

- Institutional voids in EMs: refers to the absence of market intermediaries that promote ease of access between buyer/seller
- Can affect labour market
    - Workers hesitant to relocate to foreign and uncertain country
    - Work enviro may not be guaranteed

- Can affect product market
  - Product distribution being limited
  - Limited consumer market
- Can affect capital market
  - Lack of foreign investments due to uncertainty
  - Difficulty in transfers of funds
- Leads to problems like lack of structure, lack of stability, lack of transparency, lack of efficiency → can hinder growth or cause –ve earnings

How to spot these voids

- Less competition
- If a particular country is isolated from the world – geographically and politically
- Lack of communications
- Bad news about the country
- Absence of specialised intermediaries, regulatory systems and contract-enforcing mechanisms

Strategies to tackle these voids

- Getting insight from ppl working there
- Transfer offices and then recruit ppl i.e. send someone from Aus to overlook it
- Visiting the country before investing

FAMILY RELATIONSHIPS IN ASIA

Relationship-based vs. family-based transactions

- Relationship-based transaction: want to develop trust/loyalty between 2 parties
- Family-based is a subset of relo-based
- Advantages
  - Ease of transactions i.e. flexible acting cos no one checks your books
  - Effectiveness
  - Trust factor
  - Relationship building
  - Easy to get funding

LEGAL SYSTEMS FOR INVESTORS

Common law system (judicial precedents or case law) → safer system

- Tends to have higher creditor rights
- Better anticorruption policies
- Efficiency of enforcement
- Disclosure requirements
- Human interaction
- Common law can be biased and have extended settlement times

Civil law (statutes and subsidiary legislations)

- Accounting standards
- Lower corruption levels