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Measuring Value®
The Market Side of Global Capital Markets

This edition of Measuring Value is the first of two dedicated to the topic of evolving equity markets, especially the market side versus the regulatory side of equity markets development, and the opportunities for Asia as a region.

Background

In preparation for the Asian Financial Forum 2013, we have been looking into ways to compare financial markets with data on their listings and supporting services. Our focus is on quality of growth over time that best serves investors and listing companies, rather than the short term growth and volatility of major indexes, and our objective is to identify the implications for Asian capital markets.

The development of equity markets to world standards is absolutely essential for a city to assume a role as a financial center. In turn, stable financial centers around the world create the web through which the region actually integrates. Equity markets in Hong Kong and Singapore, which have developed in parallel with strong growth in trade and asset-based wealth, will be particularly key institutions in the process of Asian regional integration.

The short-term movements of markets are highly complex and often described as chaotic, responding to a number of forces, including information flows, global events than are non-economic in nature, the interaction of a range of different traders, and liminal ups and downs of flagship enterprises or sectors that are amplified in swings of investor sentiment. Long term developments of specific exchanges are a different matter.

The globalisation of equity markets outside of North American and Western Europe is a relatively recent phenomenon, especially encompassing companies and investors from emerging economies. The World Federation of Exchanges provides data on 52 exchanges, 9 in the Americas, 17 in Asia Pacific, and 26 in Europe, Africa, and the Middle East. At the end of 2012, we find the global landscape of capital markets, which by November had US$52.7 trillion in combined assets, to be complex, with many boards around the world operating in many different regulatory frameworks, at different scales, within different economic models, with different currencies, offering different products, and pursuing different strategies.

In discussing the role of capital markets in the integration of the Asia region, our interests are in long-term movements, including sustained changes in total market capitalisation, total number of listed companies, characteristics and trends of companies joining or leaving the boards, and the range of financial products traded. Long-term movements are shaped by a range of regulatory policies, as well as a range of non-regulatory issues, like the overall support structure for financial services, growth and sustainability prospects for the economy of the hosting country, and the overall quality of domestic listed companies, which always constitute anywhere from 75 percent to 100 percent of the listings on any major exchange.

The discussion of equity markets often focuses on regulations and laws and their enforcement. While there has been no shortage of debate about global capital markets since the financial crisis of 2008, almost all of it has been focused on regulation, specifically about approaches to establishing and reporting asset values and financial performance. There has been very little discussion about the market side, what makes one capital market more successful than another.

In the end, it is the market side of markets that make them world class and successful. It is the demonstrable efficiency of their operations, productive allocation of capital, agility and innovation in product development and process improvement, and receptivity to new sources of capital and new companies seeking capital. Markets with the right pieces in place to draw a steady stream of major funds and enterprises into their sphere are essential to grow regional wealth and make real the benefits of closer regional integration.

Growth, scale and diversity

Our general view is that markets gain stability through diversity - both diversity in listed companies and diversity in supporting services (legal, financial, linguistic, and even cultural). We would expect a healthy development trajectory of a globally competitive market to see some material relationship between growth of market cap and listings with various measures of diversification.

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Measurable kinds of diversification in listed companies include sector distribution of listed companies, geographic distribution of listed companies, product diversification (such as ETFs, REITs, SPVs and CPCs), market cap range and finally marketing activities and market visibility in home country and in countries where they seek investor support.

The headline differences evident in bourse data provide a high level view of where we are as 2012 comes to a close. As of November, in markets covered by the World Federation of Exchanges, market capitalisation ranges from the New York Stock Exchange – Euronext (US) at US$13.6 trillion to Bermuda, at US$1.27 billion. Across this entire group, if we look at one measure of diversification, geographic distribution of listed companies, Bermuda, with a total of 52 listed companies, leads the pack with 75 percent of its listings from outside Bermuda.

But if we look at the top fifteen markets in the world, a group that in November 2012 represented all of the world's exchanges with market capitalisations over US$1 trillion, we see a large range. NYSE-Euronext has a total of 2,346 listings, with slightly over 22 percent from outside the US. The three bourses in China are at the other end of the spectrum, with no listings as yet of companies from outside China. The same situation prevails in Tokyo and BSE India, no non-domestic listings.

The table below shows a selection of measures for the top fifteen exchanges in the world, and it is only these top 15 who had market caps in excess of US$1 trillion by November 2012.

Table 1

Exchange	Market cap US$M (Jan 2012)	Market cap US$M (Nov 2012)	2012 YTD market cap	Total listings	% foreign	2012 YTD listings
NYSE Euronext (US)	12,625,648.15	13,613,345.3	21%	2,346	21%	1.5%
NASDAQ OMX	4,152,813.91	4,576,855.0	19%	2,585	11%	-3.9%
London SE Group	3,397,125.81	3,571,896.4	8%	2,765	21%	-4.4%
Tokyo SE Group	3,468,875.64	3,334,918.8	1%	554	0%	-0.4%
NYSE Euronext (Europe)	2,561,963.61	2,752,856.0	10%	1,076	13%	-3.9%
Hong Kong Exchanges	2,480,178.01	2,714,201.7	24%	1,540	6%	4.3%
Shanghai SE	2,457,334.10	2,219,896.8	-9%	954	0%	2.7%
TMX Group	2,014,474.22	2,034,211.5	4%	3,974	2%	-7.5%
Deutsche Börse	1,303,589.54	1,428,806.0	13%	758	11%	-1.6%
Australian SE	1,303,806.59	1,349,206.1	8%	2,056	5%	1.7%
BSE India	1,225,472.20	1,238,847.9	14%	5,180	0%	1.5%
SIX Swiss Exchange	1,122,741.33	1,215,140.6	11%	271	11%	-3.6%
National Stock Exchange India	1,200,735.95	1,213,899.2	14%	1,661	1 only	1.7%
BM&FBOVESPA	1,393,769.04	1,140,624.1	-9%	921	1%	-1.9%
Korea Exchange	1,091,504.63	1,132,057.9	12%	1,785	1%	-1.3%

North America US$ 22.5 T   Asia-Pac US$ 16 T   Europe US$ 14.2 T

This is a very preliminary comparative look at a bit of data from the wealth of data that invites analysis. But this already shows some interesting facts. First, if we look at individual boards, there is a large gap from largest to smallest. The NYSE-Euronext US board is nearly 12 times the size of the smallest of the top 15, the Korea exchange. But if we look regionally, at total market cap for North America, Asia Pacific, and Europe, there is a much smaller gap in total market capitalisation, with North America as the largest region being less than twice the size of Europe, the smallest. Asia Pacific is squarely in the middle, showing how big but much more fragmented current market capitalisation is among Asia's largest boards. If we think in terms of cities, New York's US$16.7 trillion is nearly five times Asia's largest city, which presently is Tokyo in terms of market capitalisation of exchanges. Data suggests that the ability of Asia as a region to mobilise capital is essentially on a par with other regions, but the sources are far more fragmented, and mechanisms to facilitate flows within the region need to evolve.

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One more contrast is evident from this data. North American markets in this group are far more international and open to non-domestic listings. The NYSE-Euronext in US shows 22 percent of its listed companies are not US-based, with London not far behind with 21 percent. Europe as a group is somewhere in the middle, while Asian markets have a very low rate of non-domestic listings. Hong Kong leads in this regard, with 6 percent, followed by Australia, but as a group Asian markets are more bound to their domestic companies and, as a consequence, to the vicissitudes of their domestic economies.

Directionally these data are correct, but there is a level of uncertainty that itself relates to one feature of globalisation. The definition of what is domestic and what is not has changed, most notably for listings in Asia. In economies like China, regulation constrains foreign ownership in many sectors of interest to foreign investors. As a result, complex ownership stuctures, like the widely discussed VIE structure, are used, where an entity's business activity and assets might be in the Chinese Mainland, while they are listed in a non-Mainland market and registered in the Cayman's, for example. By a stricter definition of what is domestic, Hong Kong may have as few as 8-10 foreign listings.

That the two longest established big exchanges are also the most international is not surprising, but it does tell us something important about the characteristics of the two cities that are universally and indisputably considered global financial centers.

The IPO landscape for 2012 was not particularly strong, but Hong Kong added the most new listings on a percentage basis of any market in the group, a 4.3 percent y-o-y increase in listings. Overall, the IPO market returned to its historic situation, with the NYSE-Euronext leading all markets in IPO capital raised, for the second straight year. In the US, the New York Stock Exchange (NYSE) and NYSE MKT combined led the market with 79 IPOs and 16 transfers. In Europe, NYSE Euronext welcomed 25 new listings, with approximately €2.7 billion ($3.5 billion) in proceeds raised. Expectations of currency concerns over the US dollar do not seem to have impacted this trend. The persistent media theme of a very slow and unsteady recovery of the US and European economies appears not to have impacted market growth, suggesting that in New York the broad international dispersion of listed companies serves to decouple the NYSE boards from the US economy overall. In contrast, with only two deals completed, IPOs in China reached the lowest since 2003 for an 83 percent decline from 2011 and a 95 percent decline from 2010.

This is a small sample of the data analysis that reveals the characteristic the shape the appeal and prospects of capital markets, on a national and regional basis. Openness to listings from outside a market's domestic geography is a key form of diversification that supports sustainable growth.

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Counter examples

But we need to concede that there are examples that challenge this thesis, not necessarily in terms of geographic reach of listing but in terms of sector diversification. For example, the Toronto exchanges are relatively not diversified by industry measures or geographic reach. On the Toronto exchanges, including both the Toronto Stock Exchange and the Toronto Venture Exchanges, only 2 percent of the listed companies are not domiciled in Canada, one tenth of the New York Stock Exchange. Of course, in reality the underlying assets of many Toronto listings are abroad, especially in Latin America.

More interestingly, from an industry standpoint, the Toronto exchanges are relatively undiversified, focusing heavily on mining. A full 44 percent of its total 3,832 listings are in mining, a very high level of sector concentration. This focus has been successful, and in 2011 the exchanges claim to have provided 40 percent or all mining capital raised globally and were home to 90 percent of the transactions in the sector.

There are major benefits and risks from a high level of sector concentration. The discernible benefits of sector concentration are primarily in the overall ecosystem supporting the capital markets. The depth of service capabilities in Toronto serving the mining sector—banks, law firms, consultancies, auditors, insurers—is unparalleled anywhere in the world. This profile has drawn half of the world's listed mining companies to Toronto. But we also witnessed the downside when the mining companies that constitute such a large share of its total capitalisation were badly hit by the sagging prices of energy and mineral commodities in the recent quarters of 2012, and the Toronto exchanges lost 7.5 percent of their value through November of this year, the biggest percentage loss of any of the top 15 exchanges.

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Toronto appears to be pursuing a growth strategy that does not abandon the benefits of its strong profile as a mining specialist. But directionally, Toronto is moving toward geographic diversification and product diversification, if not sector diversification. By October of 2012, 173 new companies had been listed, 28 of them international. These included new companies from the US, Latin America, Africa, Australia, and three from Hong Kong. In aggressive steps toward product diversification in Toronto, of 304 new tradable assets, close to half were not primary companies; 70 were Capital Pool Companies (CPCs), 40 Exchange Traded Funds (ETFs), and 21 structured products.

Beyond the measurable

There are obviously factors in the ecosystem supporting sustained and healthy equity market growth that go beyond market regulation and the measurable characteristics of markets we have discussed above. These would include the kind of educational system critical to meeting the talent needs of a vibrant financial center, quality of life issues that attract talented professionals, reliable and transparent regulation and supervision, and a tax system that is not a disincentive for high earning individuals and companies.

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Perhaps most important, and most overlooked, is the openness of the borders and receptivity to expatriate employment. It is no accident that New York, London, Hong Kong, and Singapore are the world's most globalised banking centers and also have what are arguably the world's most diverse populations, from a cultural, linguistic, and ethnic standpoint. Although the four cities have come to their current state of high levels of population diversity via different historical paths, their population compositions are distinct advantages in achieving financial service leadership in a globalising world. Innovation and growth in financial services is supported by dense human networks that branch outward into other economies and financial centers. These networks organise themselves around centers that have relatively open policies for immigration, travel and work permits.

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Considering these kinds of supporting factors, Hong Kong and Singapore have strong demographic platforms in place to drive integration of East, Southeast and South Asian economic activity.

Implications for Asian financial markets

With the increasing integration and inter-relatedness of Asian economies, there is a surge in systems interactions, with very different but successful business ecosystems coming into contact. The major annual conferences focused on the region are increasingly focused on discussions of the importance of regional integration and the steps needed to achieve win-win outcomes.

Free trade agreements that enable integration and optimisation of trade in resources and manufactured goods have already contributed substantially to integration of the real economies. Within the very large size of the aggregate market capitalisation of Asia's exchanges, the relative fragmentation, if not isolation, of the major exchanges raises a question which we believe is increasingly relevant. To what extent are the major capital markets and broader financial services in Asia keeping up with the diversification of the real economies in the drive to achieve regional synergies? Ultimately, the diversification through opening of listing rules, currency flows, and core financial services commensurate with the real economy is the only assurance that regional integration will reach its potential.

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Conclusion

Our objective in writing these notes is to open up the subject of the market side of equity markets for discussion, not to reach conclusions. We are hopeful that opening this discussion and pursuit of this kind of analysis will provide valuable support to market promoters in terms of guiding future listings, shaping the "personality" of the boards, and defining distinct competitive advantages that will promote specific exchanges to the global investment community. These are keys to successful growth in a competitive global industry.

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