



ACCOUNTANTS FOR BUSINESS

Capital markets in emerging and frontier economies

FIVE MINUTES ON...

Capital markets in emerging and frontier economies



Since the global economic downturn began in 2008, it has been clear that the world must look to the emerging economies of Africa, Asia and Latin America for growth. Despite a multitude of challenges, these regions have not only led the recovery, but are also increasingly claiming a greater role for themselves in global economic governance.

Going forward, businesses in these regions will need to be able to finance themselves more efficiently, and from multiple sources, as they continue to outgrow the narrow savings bases of their home countries and their still-developing banking systems. Without more cost-effective and diverse sources of finance, not only will emerging and frontier economies grow more slowly than they could, they will also become increasingly vulnerable to a new global banking crisis. And without access to the excellent investment opportunities available in these countries, savers and

investors both locally and globally will be denied some of the best opportunities the world has to offer.

Policymakers have other reasons, beyond encouraging economic growth, for promoting the growth of capital markets: market scrutiny can lead to enhanced corporate governance and accountability, and governments in emerging economies have an interest in making sure a greater share of output, employment and tax revenues are linked to firms that are transparent and/or accountable to the public.

The accountancy profession is instrumental to capital market development, which can be stunted or unbalanced without its support. As the preparers, users or auditors of financial reports, they have an interest in upholding confidence in the rules

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About the report

ACCA's new series of publications on capital markets, formally launched at the 2012 Council Meeting in Nairobi, Kenya, consists of two parts.

The discussion paper, *The Rise of Capital Markets in Emerging and Frontier Economies*, provides a review of the academic literature on capital market development and proposes ways of enriching the global debate on this subject.

Making Capital Markets Work in Emerging and Frontier Economies, a compendium of case studies, provides first-hand accounts of critical episodes in the development of capital markets in Africa, Asia and the Caribbean from senior professionals in capital markets authorities, exchange operators and accountancy practices.

Together, the two papers provide an overview of the theory and practice of market development and an appreciation of the challenges for emerging economies and the stakes involved. Without some of these key insights presented in these, it is impossible to understand many the policy and market developments in emerging markets:

- Financial disclosure and assurance are critical to the health of capital markets and play a substantial part in determining whether their growth will benefit or hurt domestic economies.
- Markets fail because of lack of liquidity – but they can also become unstable when liquidity outgrows their institutional frameworks
- Capital markets are brands – reputations are hard won and easily squandered, but yield rewards
- Capital market development is a regional agenda – no regulator, exchange operator or government operates in isolation
- Dominant family firms and formerly state owned organisations are the norm, not the exception, in emerging capital markets. Governance arrangements need to reflect this and cannot simply be borrowed from practices in more established markets.
- Market development is a learning experience for everyone involved, be they regulators, market participants, or the general public. Some lesson take a long time to learn, or must be learned the hard way.

You can find the full Capital Markets discussion paper and ACCA's compendium of case studies on our Access to Finance micro-site: www.accaglobal.com/en/research-insights/access-finance.html

Lessons from (and for) emerging and frontier markets

BUCKING THE TREND

The leading emerging capital markets have resisted the loss of confidence in financial disclosures that afflicted most developed markets around the world. In the latter, confidence in disclosures dwindled well before the magnitude of the coming crisis was understood, making it a leading indicator of market dysfunction. Clearly, financial disclosures are valuable, though not all information creates value proportionate to the costs imposed on business. In emerging and frontier economies particularly, there is little room for relaxing disclosure and assurance requirements. Investors cannot be expected to assume the risk that comes with investing in what is often a novel and illiquid asset class without the best quality information possible, nor can they be expected to participate in markets where crucial information remains private.

Policymakers and the accounting profession must champion the value of disclosure and assurance tirelessly to ensure high-quality listings, but also recognise that companies may at first struggle to adjust to these requirements. Policymakers need to allow for this learning process by encouraging would-be issuers to seek the guidance of competent and independent advisers. Fiscal incentives have an important role to play in balancing out the one-off learning costs assumed by early investors and issuers. The key is to ensure that the applicability of incentives is well defined and tightly aligned with policy objectives.

BRANDING CAPITAL MARKETS

There is such a thing as the 'brand' of a capital market: business, government and the accounting profession can work together to establish a reputation that attracts more participants and liquidity to their markets. Businesses in emerging economies actively seek out the kudos from listing in better-branded markets, and a reputation for strict and consistent enforcement of the rules is embedded into the regulatory capital of domestic capital markets.

In fact there is a great deal of often-overlooked infrastructure on which markets rely, both tangible and intangible. Payments, clearing, settlement and custody systems are crucial for ensuring the correct function of markets, and connecting these systems is a prerequisite for good market

function and integration at the regional level. Frontier markets need to prioritise these elements before moving on to more visible investments. Exchange automation is another challenge for frontier markets, with countries often requiring careful planning, even external assistance, to help them cope with the substantial investment required.

REGIONAL INTEGRATION

Integration at the regional level is an important trend among emerging capital markets around the world, and one to which the naturally globalised accounting profession can contribute a great deal. Much of this agenda is about capacity building and best practice, with more established exchanges and regulators providing a valuable source of expertise and good practice for their peers. While this process works well on a regional basis, it depends on personal relationships between thought leaders and is therefore much less developed at the global level. This is regrettable. Clearly some of the challenges of regional integration are very similar across regions; for instance, it is common for grand designs of a centralised regional market structure to give way to multi-speed, peer-to-peer models of collaboration; this lesson keeps being re-learned around the world as different regions pursue their integration agendas in isolation.

QUALITIES OF LIQUIDITY

Illiquid markets are failed markets; that said, more liquidity does not translate to greater success. When the rules are more accommodating towards liquidity providers than investors, the resulting volatility can threaten the stability of markets and drive away both businesses (issuers) and investors. Bringing in liquidity by introducing big players such as foreign investors or pension funds can be challenging as the quality of their participation may vary. As a rule, markets benefit little from 'dumb money' and not at all from 'too-smart' money exploiting inside information. The participation of the wider public is necessary for market liquidity; yet without an investment in public financial education, retail investors can be exposed to disproportionate risks. Policymakers have understood and correctly prioritised this, but public education requires patience and the intelligent use of appropriate channels to ensure maximum impact. As the

preparers and interpreters of financial accounts, finance professionals are excellently placed to assist in this process. ACCA has been able to put their skills to use to ensure that the mass media play their part by providing the public with high-quality information.

GOVERNANCE AND MARKET CONDUCT

The systems of control and governance as well as the competitive conditions common to many emerging markets give rise to some unique challenges. While widening the use of professional managers and the protection of minority shareholders are crucial steps towards developed market status, the principal-principal conflicts common to emerging markets are unlikely to be addressed fully by importing best practice from rich countries, where the focus is on principal-agent problems. In many cases the market has evolved parallel systems of controls or even informal markets for governance services, involving such agents as controlling blockholders, auditors, and possibly other service providers.

Far from being outliers or exceptions to the normal function of capital markets, privatisations pursued through public offerings account for a great deal of the activity observed in emerging and frontier markets. It is important, in fact, to treat them as the norm as long as their respective governments continue to pursue their agendas of privatisation. SOEs face unique challenges in conforming to the expectations of investors and need to converge with international best practice in order to convince investors of their viability as going concerns in the private sector.

PROFESSIONAL JUDGMENT AND RESPONSIBILITY IN AN IMPERFECT WORLD

No market enjoys a perfect record of disclosure or assurance. In emerging and frontier economies it is particularly important for the accounting profession to distinguish between problems specific to individual listed firms, which must be challenged strongly by individual accountants and auditors, and systemic problems that must be dealt with at a higher level. Faced with persistent systemic weaknesses, accountants must be ready to exercise professional judgement and assume the responsibility that comes with it.

Making capital markets work

What can policymakers and market participants do to ensure sustainable capital market growth that truly benefits their domestic economies? What can the profession do to support them? The two papers provide some practical suggestions for market-builders in the private and public sector:

- Aim for a reputation for strict and consistent enforcement of market rules in domestic markets.
- Avoid the temptation of relaxing disclosure requirements
- Get the basics (payments, clearing and settlement) right first before engaging in more ambitious agendas
- Establish relationships, at both the institutional and the personal level, with more mature markets in their regions; establish mechanisms for the transfer of knowledge and good practice; use the global reach of the accountancy profession as a connection to other regions
- Identify, encourage and support organisations that could provide high-quality new listings for the markets
- Provide tax and other incentives to issuers and retail investors in fledgling markets in order to compensate for the learning costs on both sides
- Carefully monitor capital flows to ensure transient 'hot money' is not mistaken for true liquidity
- Look out for signs of diminishing faith in financial disclosures or investor behaviour that could be a proxy for fear of poor governance.
- Set up long-term public education programmes aimed at retail investors and maximise their reach by engaging the mass media and the accountancy profession
- Provide the impetus and support for dominant privately owned firms and state owned enterprises considered for privatisation to converge to international reporting, assurance and governance standards
- Emphasise professional judgment among finance professionals; encourage challenge of poor practice at the firm level and or systemic failures at the national level.

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and educate firms and investors where appropriate. In return, they can count on healthy capital markets to attract more business and potential employers to their countries and generate new career opportunities for them. Finally, the accountancy profession is just as global as the capital markets themselves; it is an established network well suited to the task of transferring good practice around the world.

As the most global of the professional accountancy bodies, ACCA feels this responsibility most acutely. Nearly half (48%) of the ACCA membership in non-OECD countries work in regional or global financial centres and their fortunes are linked to those of capital markets, some of them in positions of authority that actively shape their development. Through ACCA they have access to an unparalleled network of local know-how that can guide the development

and integration of capital markets and promote their healthy function.

Disseminating good practice is one thing; seeing it adopted is another. What appears to be common sense on paper can be a difficult process that takes many years in the real world. Building political consensus, human capital and trust in market institutions is a gradual and painstaking process, and one that is unique to each country. Therefore, going forward ACCA intends to bring together policymakers, regulators and market participants in a global dialogue on the future of capital markets, helping build long-term ties on a personal as well as institutional level.



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About ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We seek to open up the profession to people of all backgrounds and remove artificial barriers, innovating our qualifications and their delivery to meet the diverse needs of trainee professionals and their employers.

We support our 147,000 members and 424,000 students in 170 countries, helping them to develop successful careers in accounting and business, with the skills needed by employers. We work through a network of 83 offices and centres and more than 8,500 Approved Employers worldwide, who provide high standards of employee learning and development.

Accountants for Business

ACCA's global programme, Accountants for Business, champions the role of the finance professional in all sectors as true value creators in organisations. Through people, processes and professionalism, accountants are central to great performance. They shape business strategy through a deep understanding of financial drivers and seek opportunities for long-term success. By focusing on the critical role professional accountants play in economies at all stages of development around the world, and in diverse organisations, ACCA seeks to highlight and enhance the role the accountancy profession plays in supporting a healthy global economy.

www.accaglobal.com/accountants_business