EXECUTIVE SUMMARY

Liquid equity exchanges offer extensive benefits for investors and policymakers in developing markets. However, the importance of liquidity is perhaps less appreciated by those who could uniquely influence the supply side of liquidity: holders of unlisted equities, representing the state, MDBs/DFIs[1], or local firms. This report not only seeks to ease the usual IPO-related concerns, but also to stress the significant upside of a virtuous economic cycle, ignited by a liquid equity market, putting developing countries on the path of sustainable growth.

Improving liquidity in frontier markets is a matter of urgency. At present, median trading volume in frontier stock exchanges[2] is a meagre $8m a day[3]. This is only 2.6% of the global emerging markets (GEMs) and 0.6% of the developed market exchanges' median daily trading volume, respectively. The outlook is even more concerning. If Vietnam graduates into the GEM universe by 2025 as planned, the frontier universe will lose more than 40% of its trading volume.

There are no shortcuts: Building liquid capital markets requires a patient, multi-pronged, well-coordinated, long-term approach. Deep, institutional-ised domestic savings industry, well-regulated public trading venue, stable and welcoming legal environment, and consistent flow of viable company listings are all important factors to create a liquid trading platform with well-balanced supply and demand.

The right sequencing is also crucial. Policy priorities should be different at the early-stage of capital market development as opposed to policy emphases at the mid- or late-stage. Effective prioritisation and sequencing could mean the difference between success and failure for firms, the market, and the economy.

Controversial issues need to be confronted head-on, based on meticulous learnings from other markets. For example, despite their questionable reputation, short-selling and foreign ownership limits could play a positive role, if carefully implemented reflecting historical experience. However, in the pursuit of liquidity, margin trading and technological progress may need to be handled with more care than conventional wisdom suggests.

In addition to offering an action plan for policymakers, this report highlights how MDBs/DFIs can help to realise the full benefits of a liquid equity market. Our analysis shows quality companies can command favourable valuations in even relatively illiquid public equity markets, demonstrating that full or partial domestic listing could be considered by default when holders of private equity look to exit. These holders include official development finance actors, for whom equity exit strategies through IPOs and growth in their equity portfolios more generally could enhance their contribution to sustainable development.

1 Multilateral Development Banks and Development Finance Institutions

2 In defining frontier markets we have used the MSCI Frontier Index classification.