Corporate Bonds Market – What isn't working? (III)

This is my last column regarding the state of our bonds market and corporate bonds in particular. To recap, in the previous two articles I indicated and explained factors that may propel or constraint development of our bonds – these factors are such as: an open capital account, banking sector concentration, bureaucracy, interest rate spread, exchange rate volatility, fiscal balance, corruption, quality of accounting standards, and size of domestic credit. Let me explain a few other factors that I did not explain in my last two columns:

Corruption: this is a threat to all investment types of investment (being Foreign Direct Investments, Strategic investments, Portfolio investments – both foreign and domestic, etc) since corruption distorts the economic and financial environment and introduces instability; it also impairs fair judgement in the decision-making process. Corruption within the financial sector also makes it more difficult to conduct business effectively, and could force the withdrawal or withholding of investment, whereas corruption may also undermine law enforcement. So in such situations there is in most cases a negative association between corruption and bond market development.

Economic development: There are a number of reasons why economic development may foster bond market development. For example, less developed countries, like ours, in most cases has volatile investment environments and are typically relatively involved in commercial activity, sometimes despite existence of regulatory frameworks and governance policies that indicates the situation should be opposite. Furthermore, countries like ours often have inadequate transparency, poor corporate governance and sometimes creditors rights – factors that are paramount to the development of the country's debt market.

Investment profile: Bonds of either form are a way for investors to limit and/or diversify their investment risk, since entities issuing bonds are generally of higher credit quality than those issuing equity claims. It may not always be the case, however, that there are sufficient high quality issuers with sound business models and records of financial prudence. And this might be the case for us, yes we have some sizable corporate entities with capacity, credit quality and credibility to issue debt instruments and access public money, but our sovereign is not rated and most corporates within it are as well not rated by international rating agencies. I understand that the Government is the process of ensuring our country is rated with the intent of accessing global financial markets by issuing a sovereign bond. But until then when investment profile of our country and most entities within are clearly profiled and priced, everything will remain the same.

Bureaucracy: This is another key component to the development of our bonds market and if bureaucracy, governance, and regulation are/remain weak, investors will be reluctant to take positions in our market – mainly because unless these matters are significantly addresses we will remain as a market characterized by opportunistic participants and delivery risk rather than being a market characterised by fundamental based investment participants. Moreover, elements of an adequate regulatory framework include disclosure standards, penalties for accountants and auditors providing false information, and sanctions for insider trading and market manipulation – in this regard a clear and consistent implementation of regulations becomes important without sending mixed signals to existing and potential investors.

I presume that this and the other two articles in the topic will contribute to an understanding of the state of our government securities and corporate bond markets. We know that while our Government (like any other Government) relies on government securities for financing fiscal deficits, our domestic securities markets remain underdeveloped and we (like most other Sub-Saharan African countries) are overly dependent on foreign aid, foreign concession borrowing and recently commercial bank borrowing. Our corporate bond market also remains at a nascent stage of development, trades are thin and issuances are relatively small in size. However, I do believe that as we continue with these thought leadership, public education and awareness creation initiatives, corporate bond markets may begin to grow steadily and set to become ever more important as a source of finance in the future, as we also attempt to close the infrastructure and development gap with other frontier, emerging or even more advanced economies.

I also suggest that it is useful to look into a combination of structure, policy, and institutional challenges that affect the development of both government securities markets (especially we should try to address regulatory framework and policy issues that constraint our local governments and municipals from accessing public money by way of municipal bonds or corporate bonds – through SPVs) and private securities market. Factors such as interest rate spread, fiscal balance, exchange rate volatility, capital account openness, law and order, interest rate volatility variables, among other factors needs to be looked at and addressed.

Before I conclude let me reiterate what I always emphasize on when moments permits -- we mostly know capital markets (debt/bonds and equity) promote economic development and growth by allowing the government and firms within the economy to tap large, both domestic and international, pools of savings in order to finance their expansion and growth needs. In order to do so in a sustainable fashion we need to develop our bonds market, this will in turn depend on the skills and competence of professionals in the industry and we need to develop these are still scarce in our market.

Lastly we should all strive to develop our economy and this will in turn lead to greater corporate bond market development and deeper government securities markets, which will have a virtuous influence on economic development. Both corporate and government securities market development benefits from improved macroeconomic policies and institutions, and so it goes.