ARTICLE IN PRESS

Economic Systems xxx (xxxx) xxx–xxx

Contents lists available at ScienceDirect

Economic Systems

journal homepage: www.elsevier.com/locate/ecosys

Firm financing and growth in the Arab region

Juan J. Cortina, Soha Ismail, Sergio L. Schmukler*

World Bank, Development Research Group, 1818 H Street, District of Columbia, NW, Washington, 20433, United States

ARTICLE INFO

JEL classification:
F21
F65
G00
G10
G15
G23
G31
L25

Keywords:
Arab countries
Capital raising
Corporate bonds
Domestic and international debt markets
Equity
Firm financing
Global financial crisis
Issuance activity
Middle East and North Africa region
Syndicated loans

ABSTRACT

This paper documents how firms in Arab countries use equity, corporate bond and syndicated loan markets to obtain financing and grow. Working with a new dataset on issuance activity in domestic and international markets and firm performance, the paper finds that capital raising through these markets has grown rapidly since the early 1990s and involved an increasing number of firms. Whereas the amounts raised in equity and loan markets (relative to gross domestic product) stand well relative to international standards, bond issuance activity lags behind. However, bond financing has gained importance over time. Equity issuances take place primarily in domestic markets, whereas bonds and loans are mostly issued internationally, display long maturities and entail low levels of credit risk. Issuing firms from the Arab region are very large compared to international standards. They also tend to be larger, faster growing and more leveraged than non-issuing firms in Arab countries.

1. Introduction

Since the early 1990s, many countries in the Arab world have embarked on significant financial and economic reforms, involving internal and external financial liberalization as well as efforts to increase the depth, scope and efficiency of their financial systems. At the same time, Arab financial systems have shown considerable improvements over the last two decades.[1] In this context, the use of equity, bond and syndicated loan markets has rapidly expanded in the region since the 1990s, even relative to GDP, which stands in contrast to the relative stagnation in traditional bank credit.[2]

This paper uses a unique dataset to provide a first documentation of the extent to which firms in the Arab region use capital

* Corresponding author.
E-mail addresses: jcortinalorente@worldbank.org (J.J. Cortina), sismail2@worldbank.org (S. Ismail), sschmukler@worldbank.org (S.L. Schmukler).

[1] See Elsafti (2007) for a historical documentation of financial sector development in the Arab region.

[2] Despite this growth, financial markets are still mostly bank-based, thin, tightly regulated and dominated by government ownership. Moreover, financial systems in the Gulf Cooperation Council (GCC) tend to be more developed and globally integrated than those of other countries in the Arab World. A recent report by the Arab Monetary Fund (2015) shows that the total Arab stock market capitalization was around $1,255 billion in the second quarter of 2015, with 1,503 listed firms. The GCC countries account for almost 87 percent of stock market size in the region. Market capitalization in Saudi Arabia alone was reported at $537 billion for the second quarter of 2015; a figure that was more than 3 times the market size of all the non-GCC countries together (The GCC states include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates).

https://doi.org/10.1016/j.ecosys.2017.09.002
Received 7 July 2016; Received in revised form 12 June 2017; Accepted 1 September 2017

Please cite this article as: Cortina, J.J., Economic Systems (2018), https://doi.org/10.1016/j.ecosys.2017.09.002

(equity and bond) and syndicated loan markets to obtain financing and grow. No previous studies have tackled this issue for countries in the Arab region using transaction-level as well as firm-level data. In particular, the paper addresses three main questions, as follows. (1) What is the total amount raised in equity, bond and syndicated loan markets by firms in the Arab region and how does their issuance activity stand with respect to the rest of the world? (2) How many and which firms actually issue equity, bonds and syndicated loans? (3) How do the assets, turnover and number of employees evolve for issuing relative to non-issuing firms?[3]

To address these questions, we assemble a comprehensive transaction-level dataset on equity, corporate bonds and syndicated loans issued in domestic and international markets over the 1991–2014 period. The data include 4372 individual security issuances conducted by 1630 firms from 12 Arab countries. We then match these data with balance sheet information on publicly listed firms. This allows us to document new patterns of comparative behavior regarding the size and growth of issuing and non-issuing firms.

This paper presents three main interrelated stylized facts. First, over the two decades leading to 2014, there has been a considerable increase in the issuance activity of equity and debt (bonds and syndicated loans) in Arab countries. The total amounts raised in equity, bond and syndicated loan markets, relative to the region's GDP, grew by factors of 8, 6 and 2, respectively, between 1991-98 and 2007-14. However, whereas the capital raising activity of Arab firms in equity and syndicated loan markets is similar to that of firms from other regions of the world (relative to GDP), the use of corporate bond markets still lags behind in the Arab region. Syndicated loan markets are especially active, with the highest issuance activity (relative to GDP) in the developing world. Nevertheless, the relative importance of corporate bond financing over total debt has increased over time, especially since the onset of the global financial crisis of 2008-09. Within the region, the Gulf Cooperation Council (GCC) countries capture around 80–90 percent of the total amount raised in equity and debt markets. Whereas the bulk of equity is issued domestically, debt issuances mostly take place in international markets, are largely used to finance infrastructure projects, and have long average maturities. Corporate bonds issued by non-financial Arab firms during 1991–2014 ha d the longest (value) weighted average maturity in the world (11.5 years), and syndicated loans the second longest (8.9 years). Corporate bond issuances also entail low levels of credit risk compared to other developing regions, according to Standard and Poor's credit ratings.

Second, only very large firms issue equity, bonds and syndicated loans in the Arab region, which are also very large by international standards. The firm size distribution (FSD) of Arab issuing firms lies to the right of that of issuing firms from the rest of the world. Although just large firms participate in these markets, the number of issuing firms in the Arab region has risen substantially, indicating an expansion in the extensive margin. In particular, the total number of issuing firms has increased 15-fold in equity markets, 6-fold in bond markets, and 3-fold in syndicated loan markets between 1991-98 and 2007-14. These findings stand in contrast to other regions in the world, where the expansion in capital market issuance activity has mainly been associated with growth in the intensive margin (Didier and Schmukler, 2013; Didier et al., 2015). The expansion in these markets has also been associated with a decrease in firm concentration, as illustrated by the decreasing proportion of capital raising activity captured by the top-5 and top-20 issuing firms. Moreover, the increasing use of these markets has largely been driven by firms in the financial and utilities sectors. Arab firms in these two sectors combined absorb more than 60 percent of the total amount issued in equity, bond and syndicated loan markets.

Third, Arab firms that issue either equity, bonds or syndicated loans are larger than non-issuing firms within the region. In particular, they have more assets, turnover and employees. For instance, although Arab issuing firms account for 44 percent of the total listed firms, they comprise around 90 percent of the total assets, 80 percent of the total turnover and 70 percent of the total number of employees registered by those firms. During 2003-11, the median equity-issuing firm had assets of around $179 million, which was almost 3 times as many as the median non-issuer. Debt and especially bond issuers are even larger than equity issuers. Issuing firms are also more leveraged and hold more long-term debt compared to non-issuers. Cox regressions of proportional hazards show that the ex-ante size of the firm is positively associated with the probability of issuing bonds and syndicated loans. Moreover, a difference-in-differences analysis shows that issuing firms are not only larger ex ante, but also grow at a faster rate than non-issuers. For instance, the average growth rates in assets (turnover) for the median equity issuer and non-issuer were around 14 (17) percent and 6 (12) percent per year, respectively, during the sample period. In other words, although both issuers and non-issuers have grown in size over time, issuers have grown at a faster pace, widening the size difference. Similar results are evident along the FSD of listed firms. Although we do not evaluate the causal impact of a firm issuing equity, bonds or loans on its performance, the findings in this paper indicate that the largest, fastest growing firms are the ones actively using capital markets in the Arab region.

The analysis in this paper relates to several strands of literature. First, this research contributes to the active debate on financial market development and its relation to economic growth and firm performance. At the aggregate level, the literature has long argued that well-functioning financial markets can lead to a more efficient allocation of resources and promote economic growth.[4] A number of studies have stressed the role of financial and capital market development in promoting aggregate economic growth in the Middle East and North Africa (MENA) or Arab Region (Bolbol and Omran, 2005; Bolbol et al., 2005; Al-Zubi et al., 2006; Naceur and Ghazouani, 2007; Abu-Bader and Abu-Qarn, 2008a,b; Kar et al., 2011; Al-Malkawi, 2012; Falahaty and Hook, 2013). Nevertheless, no studies have investigated how, and which types of, firms in the Arab world issue equity, bonds or syndicated loans to raise finance, or how this relates to their performance. Deeper and more liquid markets at the aggregate level do not necessarily imply a direct link between firm capital raising and firm performance at the micro level. It is hence important to study capital and syndicated loan

[3] The term "turnover" is used in this paper to indicate any revenue that a firm generates through the trading of its goods and services.

[4] See Levine and Zervos (1996, 1998), Demirgüç-Kunt and Maksimovic (1998), Henry (2000), Beck and Levine (2004), Bekaert et al. (2005) and Levine (2005) for a sample of the literature on finance and growth. Several studies have also highlighted the importance of financial markets for the development of small and medium enterprises, which tend to be underserved in developing countries (e.g. Beck and Demirgüç-Kunt, 2006; Beck et al., 2011; de la Torre et al., 2010).