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Colombian's Stock Market: Comparison to Other Emerging Markets

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Abstract
The stock market in Colombia, despite its great breakthrough, it is still small internationally. If you compare it to other emerging markets, the number of companies listed on the stock is really small, as well as the trading volume as a proportion of GDP. Additionally, it is a market where few papers represent a high proportion of the total value traded. This paper reviews and compares the recent evolution of size, liquidity and concentration of the stock market, to know its structure, similarities and differences with other markets in the region and internationally. We found that Colombia's market remains small, concentrated and illiquid, relatively speaking.

1. Methodology

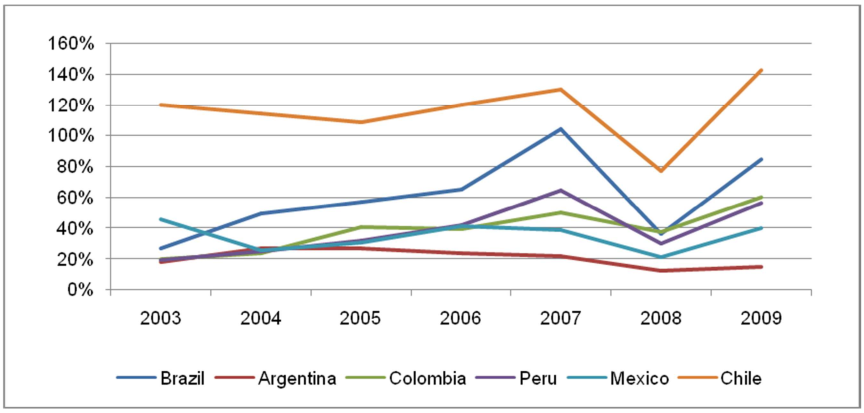
In their study, Demirgüç-Kunt and Levine (1995) consider that a larger market, is positively correlated with the ability to mobilize and diversify risk, and if more liquid, allows participating agents to operate at lower costs. They also believe that it is better if less concentrated because the decrease in potential conflicts of interests between small and large shareholders of the firms.

Arbelaez and Zuluaga (2002) highlighted some aspects where the local market lines up with trends in emerging markets, specially Latin American markets. Their study concluded that Colombian stock market is still small compared withthe its neighbors. In addition, exhibits little sectoral diversification and it´s not that liquid.

Escalante, Foeng, and Mejia (2010), in the same way one can assume strong indications that lead us to think that demand for investment is not only growing, but exceeds the available supply. In fact, the positive evolution in time of the Colombian market has been such, that today it is no longer a lagging market in Latin America, but a market with a level of development comparable in relative terms to those of Mexico and Peru, exceeding that of Buenos Aires and Caracas.

While Colombia's stock market has advanced in recent years, other countries in the region have moved faster. Brazil, for example, decided more than six years ago to be the largest and most attractive emerging market in the world, being more flexible with its regulations on foreign investment and providing tax incentives. Plus it's also been created “Best Brazil”, an entity charged with promoting the Brazilian stock market internationally, organizing road shows in major financial centers like London, Geneva, Luxembourg and Dubai. Other countries such as Chile, are following this initiative.

The main findings of this study are summarized in Table 1, which shows that despite the great advance, the stock market in Colombia is still small at international level, reaching a Market Capitalization Relative 60.46% in 2009 . Additionally, it is the market that has the least number of companies listed on the stock in the sample for the region, only 87 firms were registered in 2009, compared to Mexico, Brazil and Chile who had 406, 386 and 236 firms enrolled, respectively. And if the above is compared to more mature markets such as Canada, Japan and the United States, the gap becomes huge. This is problematic, because the Colombian market has very little diversity of papers, because of the small number of emitters and, of course, this is a big problem for market's expansion and fulfill the function of reducing the risk for investors.



Source: Authors' calculations based on data from World Federation of Exchanges (WFE)

Chart 1. *Relative capitalization Selected countries 2003 - 2009*

In terms of liquidity, the situation is similar to the size, being the fourth country with the most liquid market in the region according to the rotation of volume and rotation rate (13.26%). More specifically, the stock market in Colombia, exhibits a very low trading volume to GDP, only the 8.02%. Comparing this relation to Brazil (39.78%) and Chile (23.58%), we have a clearer idea of the low market liquidity, which is slightly over Peru and Argentina, which are the most illiquid markets in the region. Again, the international comparison turns abysmal, for example, United Kingdom, the United States and Canada, have rates of volume of 155.64%, 125.96% and 92.81%, respectively. As a reflection, one might say that the Colombian stock market has strong liquidity constraints, and it is a vital aspect for the market, because it measures the ease with which agents can buy and sell papers, to move resources to other papers or other activities.

Table 1. *Size, liquidity and concentration indexes in 2009*

Country	Size		Liquidity		Concentration
	CapitalizationRelative[1]	**Number of companieslisted**	**Volume Ratio**[2]	**TurnoverRate**[3]	**Market cap of 5% of larger companies**
Regional Market					
ARGENTINA	14,75%	106	0,97%	6,54%	56,80%
BRASIL	84,96%	386	39,78%	46,83%	64,81%
CHILE	142,76%	236	23,58%	16,51%	52,60%
COLOMBIA	60,46%	87	8,02%	13,26%	50,57%
MÉXICO	40,24%	406	9,63%	23,93%	50,13%
PERÚ	56,53%	241	3,58%	6,32%	65,79%
International Markets					
ALEMANIA	38,71%	783	65,49%	169,18%	79,56%
CANADÁ	125,50%	3700	92,81%	73,95%	81,94%
CHINA (Shanghai)	54,26%	870	101,54%	187,14%	62,85%
EEUU (NYSE)	83,84%	2327	125,96%	150,24%	48,81%
ESPAÑA	97,73%	3472	102,94%	105,33%	n.d.
INDIA (NSE)	99,02%	1453	63,60%	64,23%	71,82%
JAPÓN	65,22%	2335	78,73%	120,71%	60,09%
REINO UNIDO	128,34%	2792	155,64%	121,26%	86,39%

Source: Authors' calculations based on data from World Federation of Exchanges (WFE), and the International Monetary Fund (IMF)

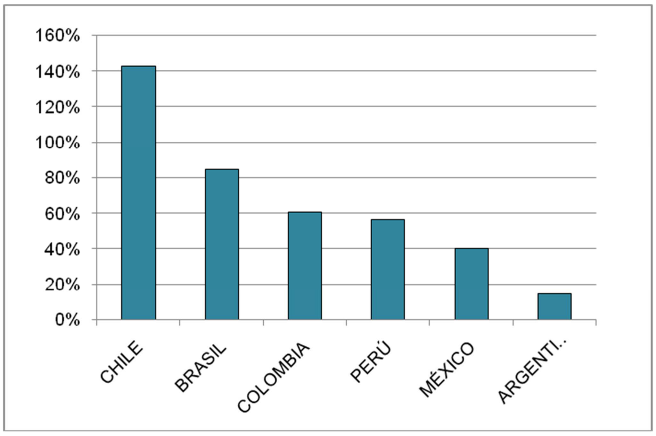
1 by capitalizing on means reinvestment of results, profits or reserves, the assets of the company. Can also be seen as the extension of paid capital through new share issues.
2 trading volume / nominal GDP
3 Volume Traded / Market Cap

As for the concentration, Colombia ranked first according to the IFLA, with 77.55% of market capitalization held by 10 companies. Just take a look at Ecopetrol to confirm the figure, the state oil accounts for about 40% of total capitalization and a large percentage of daily volume traded on the CSE. In 2009, the Colombian stock market concentration was 50.57%; all markets in the region, show high levels of concentration, as well as major international markets. It appears that the concentration is a global characteristic of capital markets. Later, the subject of concentration is taken up in the case of the 10 most important papers in the total market capitalization and value traded.

The Colombian market, despite its experienced advance in the last years, still being small in terms of the international market size, not even to compare it to markets like United Kingdom (128,34%), Canada (125,5%) and Spain (97,73%).

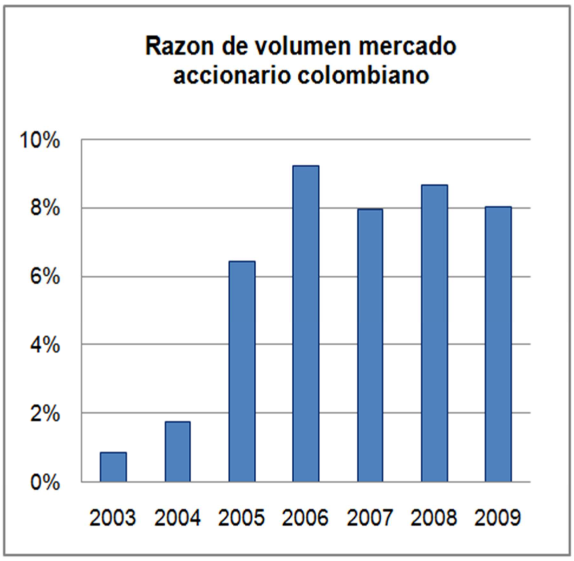
Nevertheless, thanks to the stock market's good behavior in the last five years, the future of the region looks like it's going to be a little better. The market is lagging behind Chile (142.76%) and Brazil (84.96%), but under conditions similar to those of Peru (56.53%) and Mexico (40.24%), rather than Argentina, which is the smallest market in the sample for this study. (See chart 2)

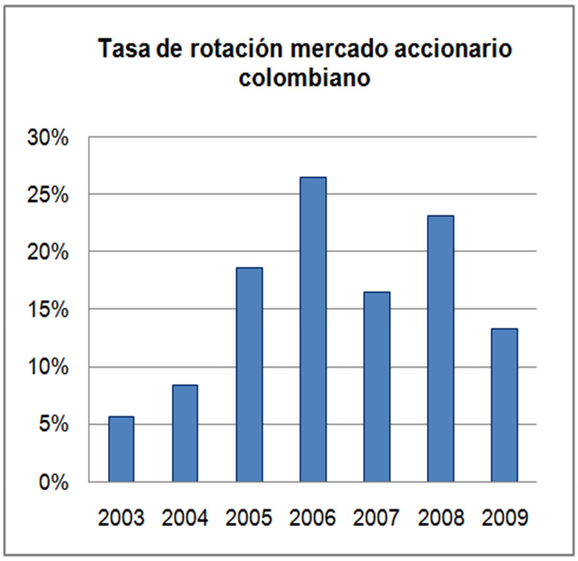
In terms of liquidity, the change has been positive, from a country with one of the less liquid market in 2004 with a volume ratio of 1.75% and a rotation rate of 8.46% in worst conditions than Peru, to have the fourth most liquid market in the region. This good performance could be related to the reduction of transaction costs associated with the use of new electronic trading platforms in recent years (SETI in 2001, MEC-PLUS in 2006, SET-FX for foreign exchange market for actors SIAM, among others) (Uribe, 2007).



Source: FIAB y WFE

Chart 2. *Relative Capitalization Selected Countries 2009*



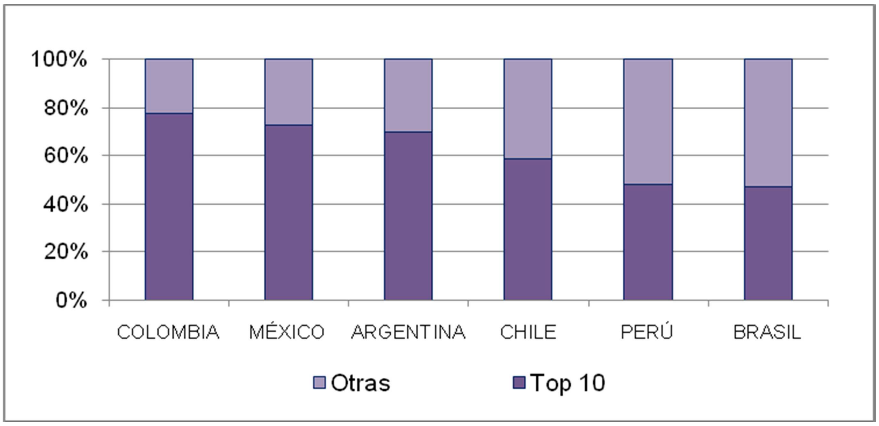


Source: Prepared by the authors based on data from WFE and FIAB

Chart 3. *Volume ratio of Colombia stock market*

In relative terms, Colombia is above the average in Latin America with a strong rebound of the indicators in 2005. Then, as seen from the early nineties, the trend is positive. it could be said that the Colombian stock market has been developed in terms of size and liquidity as Arbelaez, et al. (2002) and Bernal and Ortega (2004) said, and that this development has been one of the most dynamics in the region.

As the concentration of stock ownership, the situation is not so positive. The market capitalization of the ten largest companies in Colombia in terms of the total, amounts to 77.55%, which makes it the most concentrated market of the sample. However, the problem doesn't seem to be unique to the BVC, but for Latin American markets in general.



Source: FIAB, Yearbook 2010

Chart 4. *Concentration of 10 largest companies in2009*

In short, the high concentration of the stock market in Colombia is alarming and this may be a consequence of mergers and acquisitions of major companies listed on the stock market (Uribe, 2011). To mention some of these important operations, we should remember mergers and acquisitions: Bancolombia, CONAVI and Corfinsura, the Bank BancoCaja Social and Colmena; Inveralimenticias NOEL and the FabricaNacional de Chocolates, the creation of group Éxito, the purchase of the Bank superior by Davivienda, the unification of the cement companies by the GEA Group (GEA), about Argos cements, among other important operations.

2. Market Concentration

Table 2. *Participation of the 10 largest papers the total market capitalization (1997-1999)*

Country	Number of Papers			Participation of the 10 largest papers in the total market capitalization			Participation of the 10 most dynamic roles in value traded		
	1997	1998	1999	1997	1998	1999	1997	1998	1999
Argentina	35	32	28	51,9	49,0	24,2	85,4	89,3	80,9
Brasil	87	100	90	42,4	24,8	32,6	63,7	54,1	23,6
Chile	53	51	48	42,2	43,1	42,3	58,3	60,4	75,9
Colombia	27	24	23	49,8	41,3	49,2	67,8	34,0	54,8
México	75	70	57	35,5	41,4	53,2	45,6	50,8	60,4
Perú	37	35	32	51,1	48,2	50,3	56,4	62,0	47,4
Venezuela	19	19	16	61,5	61,2	56,4	65,8	71,3	64,0
Corea	195	180	162	38,8	37,9	59,1	12,5	24,1	24,1
Taiwan	98	106	106	28,6	27,3	36,4	22,7	19,9	29,6
Filipinas	59	59	58	48,1	55,4	42,2	35,2	54,9	41,5
Indonesia	62	58	55	47,6	61,2	47,6	32,1	50,5	45,8
Malasia	157	147	139	36,4	31,5	33,4	15,5	31,0	23,0
Tailandia	74	64	64	47,6	45,8	46,8	36,0	42,3	39,3

Source: S&P Emerging Stock Markets Factbook (2000).

The number of papers available in Colombia's stock market fell between 1997 and 1999. If the number of papers traded in Colombia is compared to that of countries like Malaysia, Mexico, Chile and Taiwan, it becomes obvius the lack of diversity in papers supply in the market. However, the market in Colombia, regarding the participation of the ten most dynamic papers in the value traded, is less concentrated than the average of the most dynamic emerging markets (Arbelaez et al, 2002). For example, the concentration is particularly high in Chile (75.9%) and Argentina (80.9).

3. Conclusions

The stock market in Colombia, in terms of size remains small, despite of the growth experienced in recent years. The number of papers offered is very limited and this trend seems not to be broken in the short term and may even get worse instead if the mergers and acquisitions continue. The volume ratio, which is the ratio of traded value and nominal GDP is low, very distant from that of countries such as Chile and Brazil, while when compared to countries like UK, Canada and the United States the gap is wider and this makes it a little liquid market. On the other hand, it is a highly concentrated market, since the participation of the ten most dynamic papers represents more than half the market value traded.

In this article, as expressed in Escalante, Foeng, and Mejia (2010), the Colombia Stock Exchange's market capitalization has increased and now represents 60% of GDP, compared to 2008 a in which the market capitalization accounted 37%, this shows the improvements on the mass of the shares as an investment role more common than in previous decades.

Escalante, Foeng, and Mejia (2010), it can also be taken strong indications that suggest that demand for investment is not only growing, but exceeds the available supply. In fact, the positive evolution in time of the market in Colombia has been such that today it is no longer a lagging market throughout Latin America, but a market with a level of development comparable relative to those of Mexico and Peru, exceeding that of Buenos Aires and Caracas.

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