



Global Development Finance

The Globalization of Corporate Finance in Developing Countries

I: REVIEW, ANALYSIS, AND OUTLOOK

2007



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2007



THE WORLD BANK

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Foreword

THE ECONOMIC ENVIRONMENT facing developing countries remained highly favorable in 2006. Global gross domestic product (GDP) expanded by 4 percent, although signs of moderation emerged toward year-end. Developing economies grew by 7.3 percent, and international financial markets remained supportive of their financing needs despite several episodes of heightened volatility. Oil prices appear to have peaked, while markets for most other commodities produced by developing countries remained high—or rose still further. Combined, these conditions created the context for the continued expansion of private capital flows to developing countries, which reached a record \$647 billion in 2006—5.7 percent of the aggregate GDP of these countries.

Strong private capital flows to developing countries reflect both these cyclical elements and improvements in the fundamentals of these economies. A wide range of middle-income countries has benefited from these flows, but access to private capital in many low-income developing countries remains limited and is dominated by trade financing and the resource sector. Sub-Saharan Africa, for example, was the destination of only 6 percent (\$292 billion) of the \$4.9 trillion in private capital that flowed to developing economies between 1990 and 2006. Low-income countries, benefiting from recent international debt-relief initiatives, must face the challenge of adopting prudent borrowing practices to ensure long-term growth and debt sustainability. Complementary efforts to increase aid flows have stalled—the amount of official development assistance provided by the 22 members of the Development Assistance Committee of the Organisation for Economic Co-operation and Development declined by almost \$3 billion in 2006, following a large \$27 billion increase in 2005. Donors must enrich development assistance significantly over the next few years in order to meet their commitments, notably the pledge made by G-8 and other

donor countries to double the amount of aid provided to Sub-Saharan Africa by 2010.

Although oil import bills have risen, the past five years have presented a highly favorable mix of economic and financial conditions for most developing countries: low international interest rates, ample global liquidity, and strong global demand for exports. Many middle-income countries have taken advantage of this opportunity to enhance their creditworthiness by accumulating foreign exchange reserves, improving current account balances, reducing external debt burdens, and improving debt management by issuing longer maturities. Several large borrowers have bought back significant amounts of outstanding debt using abundant foreign exchange reserves. Many governments have turned from external to domestic markets, where most debt is denominated in local currency. Partly as a consequence, creditors' assessment of developing countries is very positive, as reflected in near record-low spreads on emerging-market bonds and bank loans.

These favorable conditions and the gains that have accrued are not grounds for complacency in assessing future risks. History suggests that market conditions and sentiment can shift with dizzying speed. Sustaining the discipline and sound policy that have contributed to the current favorable phase must remain in the forefront of decision makers' objectives.

The increasing share of corporate finance in emerging-market economies' external borrowing has introduced its own risks. For much of the postwar era, foreign borrowing by sovereigns has been the dominant feature of development finance. Since 2002, however, a different picture has emerged. The past few years of strong developing-country growth has brought the leading companies of the developing world to the attention of an ever-wider set of investors. Together with the liberalization of capital controls and the pressures facing international portfolio managers to enhance returns, the globalization of corporate finance is

now reaching a larger segment of the developing world. This in turn strengthens the case for a more coherent and global approach to regulating cross-border public offerings and securities listings. Domestic regulators must pay greater attention to the transparency and stringency of accounting standards, the credibility of financial reporting, and the integrity of corporate governance. In all cases, there must be a balance between official regulations and market incentives for enhancing the efficiency of global capital allocation.

The globalization of corporate finance also points to other challenges. As emerging-market corporations have expanded their international operations, they have increased their exposure to interest rate and currency risks. Concerns are growing that several countries in emerging Europe and Central Asia are experiencing a credit boom engendered by cross-border borrowing by banks of untested financial health and stamina. Some of these banks have increased their foreign exchange exposure to worrisome levels, a concern that warrants special attention from national policymakers. Given banks' critical role in domestic monetary systems, policy makers should step up their regulation of foreign borrowing by banks.

The projected slowdown in global growth and tighter monetary policy in high-income countries are expected to make financing conditions for developing countries somewhat less favorable in

coming years. While a soft landing is the most likely outcome, there are risks. For example, if the economic downturn in the United States is deeper than forecast, demand for developing economies' exports (and commodity prices) may fall enough to contribute to reduced confidence and induce financial sector disruption. Conversely, should growth fail to moderate, financial stability in some fast-growing developing economies could be threatened by rising inflation and high current account deficits.

Global Development Finance is the World Bank's annual review of global financial conditions facing developing countries. The current volume provides analysis of key trends and prospects, including coverage of capital raised by developing country based corporations. A separate volume contains detailed standardized external debt statistics for 136 countries as well as summary data for regions and income groups. More information, including additional material, sources, background papers, and a platform for interactive dialogue on the key issues, can be found at <http://www.worldbank.org/prospects>. A companion online publication, "Prospects for the Global Economy," is available in English, French, and Spanish at <http://www.worldbank.org/globaloutlook>.

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Selected Abbreviations

ADR	American Depositary Receipt	IFRS	International Financial Reporting Standards
ASW	Asset swap	<i>IFS</i>	<i>International Financial Statistics (IMF)</i>
CDS	Credit default swap	IMF	International Monetary Fund
DAC	Development Assistance Committee	IPO	Initial public offering
EMBI Global	JPMorgan Emerging Markets Bond Index Global	LSE	London Stock Exchange
EU	European Union	M&A	Mergers and acquisitions
FASB	Financial Accounting Standards Board	MDRI	Multilateral Debt Relief Initiative
FDI	Foreign direct investment	MSCI	Morgan Stanley Capital International
G-7	Group of Seven (Canada, France, Germany, Italy, Japan, United Kingdom, United States)	mbpd	Million barrels per day
GAAP	Generally Accepted Accounting Principles	NYSE	New York Stock Exchange
GCC	Gulf Cooperation Council	ODA	Official development assistance
GDP	Gross domestic product	OECD	Organisation for Economic Co-operation and Development
GDR	Global Depositary Receipt	OPEC	Organization of Petroleum-Exporting Countries
HIPC	Heavily indebted poor countries	PPP	Purchasing power parity
IASB	International Accounting Standards Board	SIC	Standard Industrial Classification
ICRG	International Consulting Resources Group	UN	United Nations
		<i>WDI</i>	<i>World Development Indicators</i> (World Bank)
		WTO	World Trade Organization

International private capital flows to developing countries reached a record net level of \$647 billion in 2006 as a wave of cross-border mergers and acquisitions boosted foreign direct investment (FDI) flows and much-improved domestic policies and favorable international economic conditions enhanced the ability of corporations based in developing countries to raise unprecedented sums of capital on global debt markets.

In a year characterized by heightened uncertainty over the course of global economic growth and shifting views on global inflationary trends and monetary policy responses, the continued expansion of private capital flows to developing countries speaks well for the resiliency of emerging economies and for the broader investment opportunities that globalization of the corporate sector offers to international fund managers and investors. The manner in which investors retreated from emerging markets during the broad equity sell-off in mid-2006, however, is also a telling reminder of underlying vulnerabilities and lingering weaknesses. As the tide of easy credit ebbs, it is important that emerging market governments renew their commitment to the sound policies of the recent past and recognize the implications of changes in the financial climate.

Supporting low-income countries in establishing access to private sources of capital remains an integral part of financing for development. For poor countries, which have limited access to market-based external financing, the development community should step up efforts to enhance aid flows to meet the development goals articulated under the Monterrey Consensus in 2002 and endorsed by the G-8 in July 2005.

Global Development Finance 2007, I: Review, Analysis, and Outlook is the World Bank's annual review of recent trends in and prospects for financial flows to developing countries. This year's special topics—low-income countries' access to commercial debt markets and financial globalization of the

corporate sector in developing countries—highlight two areas of increasing importance to the future growth and financial stability of emerging market economies.

“Prospects for the Global Economy” is an online companion to *Global Development Finance*. It provides information on the global economic outlook, detailed regional forecasts, and additional features such as interactive graphs, analytical tools, and access to underlying data. This online publication is available in English, French, and Spanish at www.worldbank.org/globaloutlook.

Global Development Finance 2007, II: Summary and Country Tables includes a comprehensive set of tables with statistical data for 136 countries that report debt under the World Bank Debtor Reporting System, as well as summary data for regions and income groups. It contains data on total external debt stocks and flows, aggregates, and key debt ratios, and provides a detailed, country-by-country picture of debt. *Global Development Finance 2007* debt data are also available in electronic format: *GDF Online* (an electronic subscription database) and the *GDF CD-ROM*. Each of these electronic databases provides access to 217 time series indicators from 1970 to 2005, and country group estimates for 2006.

The Little Book on External Debt is a new publication that provides a quick reference to key debt data in aggregate and for individual countries.

With analysis and data extending from short-term bank lending to long-term bond issuance in local and foreign currency, *Global Development Finance 2007* is unique in its breadth of coverage of the trends and issues of fundamental importance to the financing of the developing world, including coverage of capital raised by corporations in developing countries. The report is an indispensable resource for governments, economists, investors, financial consultants, academics, bankers, and the entire development community.



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