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# Stock Market Development in the Philippines: Past and Present

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## ABSTRACT

This paper explores the origins and development of the Philippine stock market. Specifically, it looks at the structural and regulatory development of the stock exchange, and the growth of the stock market in terms of size, liquidity, and other key market indicators. The Philippine stock market has undergone a number of reforms and development since the 1990s. These include the unification of two stock exchanges, the demutualization of the Philippine Stock Exchange (PSE), and the enactment of the Securities Regulation Code. As a result, the Philippine stock market has experienced a phenomenal growth over the years. Measured by market capitalization ratio, the world ranking of the Philippine stock market has improved from 44th in 2009 to 12th in 2014. Although the PSE has developed fast over the years, it still faces a wide range of challenges, including a less diversified investor base, a lack of competition on the PSE when compared with its regional counterparts, weak corporate governance, and weak legal framework for financial sector development.

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## INTRODUCTION

Stock market is an important component of the financial sector in promoting economic development. By reducing the cost of mobilizing savings, the stock market may channel investments into the most productive technologies, therefore leading to economic growth (Greenwood and Smith 1997). As the stock market develops, it may improve corporate governance by addressing the principal-agent problem, which is beneficial to economic growth (Jensen and Murphy 1990). Also, the stock market provides market liquidity that enables the implementation of long-term projects with long-term payoffs, thereby promoting a country's economic growth (Bencivenga et al. 1996; Levine 1991). According to Arestis et al. (2001), stock market development makes financial assets less risky, and gives companies easy access to capital through equity issues. This leads to improvement in capital allocation and serves as a channel for economic growth. Given all the important functions provided by stock markets, its key role in the economic development of emerging market economies, such as the Philippines, cannot be overlooked.

The Philippine Stock Exchange (PSE) is one of the oldest stock market exchanges in Asia. It was established in 1927 (PSE 2015a; Visda et al. 2013). At that time, the general market activities in the PSE were regarded as insignificant and essentially speculative (Tan 1981). However, the PSE has transformed rapidly since the 1990s, mainly owing to extensive reforms. In the early 2010s, particularly, there has been a steady growth in the momentum of the PSE. In 2012, the PSE was recognized as one of the best performing stock markets in the world by the World Federation of Exchanges (WFE). Its stock market index, the PSE Index (PSEi), outperformed other markets. As reported by the WFE, the PSEi was in the top three best performing benchmark indices in the world (PSE 2012). The PSE was one of the only two out of the 64 member-exchanges of the WFE that experienced growth in stock market indices for six consecutive years during the period 2009–2014. The PSEi had grown by 286 percent in total during this period (PSE 2014). Despite its low ranking among the ASEAN-5 countries,[2] the PSE has experienced a phenomenal growth in its global ranking, when measured by market capitalization ratio. According to the World Development Indicators (WDI) (World Bank 2015), in terms of market capitalization ratio, the PSE has substantially improved in ranking from 44th in 2009 to 29th in 2010. In 2014, the PSE was ranked the 12th largest in the world (World Bank 2015).

Because of the importance of the stock market in economic development as shown by empirical evidence and because of the impressive development of the stock market in the Philippines, it becomes appealing to conduct an exploratory study on the development of the stock market in the Philippines. To the best of our knowledge, no such study has been made for the Philippines. This paper therefore fills this gap by providing a historical perspective on the development of the Philippine stock market. This paper may serve as a basis for further research on the stock market development in the country. This paper is organized as follows: Section 2 traces the origins of the stock market in the Philippines while section 3 outlines the reforms that have been implemented to strengthen the stock market. Section 4 analyzes the growth of the stock market by various indicators. Section 5 discusses the challenges facing the stock market and section 6 concludes the paper.

[2] The Association of Southeast Asian Nations (ASEAN) was established in 1967 with the signing of the ASEAN Declaration by the founding countries, namely, Indonesia, Malaysia, Philippines, Singapore, and Thailand (ASEAN-5). Later on, five other countries joined the association. These are Brunei Darussalam, Viet Nam, Lao PDR, Myanmar, and Cambodia, making up the 10 member-states of the ASEAN. It is currently undertaking a regional economic integration that aims to increase the potential of bargaining in trade and to share resources among its members (ASEAN 2015).

## ORIGINS AND EARLY DEVELOPMENT OF THE STOCK MARKET IN THE PHILIPPINES

### From the origins to the 1960s

The PSE is one of the oldest stock exchanges in Asia. Its predecessor, the Manila Stock Exchange Inc. (MSE), was established in 1927 during the American colonial period by some businessmen (PSE 2015a; Visda et al. 2013). Initially, the pioneer members gathered in a brokerage firm during their leisure time to start trading securities. Later in 1930, the exchange leased an office, operated in a trading floor, and promulgated its rules (De los Angeles 1995). As public interest in securities trading grew, the number of listed securities increased. The securities listed in the MSE during this period were mainly from the mining and oil exploration sectors. The MSE experienced a market boom in the 1930s. The mining sector prospered thereby providing incentives for more mining companies to list their shares in the MSE. Increasingly, some mining companies over-issued their stocks prompting the MSE to seek government intervention, which led to the enactment of the Securities Act in October 1936. One of the interventions following the Securities Act of 1936 was the establishment of the Securities and Exchange Commission (SEC) to safeguard the public interest in the stock market. The SEC started operating in November 1936 under the supervision of the Department of Justice (De los Angeles 1995). To cater for the increasing volume of transactions, the ticker-transmitting service was introduced by the MSE in 1937. This was a communication system for stock trading that transmitted international business and industry news reports brought by the news services in Manila to the MSE. By the end of 1945, there were 14 companies listed in the MSE (PSE 2015a). These companies were in the following sectors: banking, commercial and industrial, insurance, mining, and sugar. By 1947, there were 33 brokers of which 20 were active (Visda et al. 2013). In 1958, the first performance index on the MSE, the Industrial Share Average, was introduced. The index measured the movement of industrial issues by selecting the active commercial and industrial shares. In addition, the Mining and Oil Index was also introduced to capture the importance of the mining and oil industries in the country (PSE 2015a).

### From the 1960s to the 1980s

In 1963, the second stock exchange, the Makati Stock Exchange, was organized by some businessmen. It started to operate in November 1965 in Makati, then an emerging financial center (PSE 2012; World Bank 1992). Since the establishment of the Makati Stock Exchange, the government has made efforts to standardize its trading activities. For example, two presidential decrees were passed in 1973 to improve the operation of the two stock exchanges, the MSE and the Makati Stock Exchange. The first was Presidential Decree (PD) 167, which required the automatic listing of a particular security when one of the exchanges listed and traded it. In practice, this was an automatic dual listing (Visda et al. 2013; World Bank 1992). The second was PD 282, which authorized members of an operating stock exchange through members of another stock exchange to execute customer's orders (PSE 2015a). By doing so, it allowed cross-trading between the two exchanges via some kind of correspondent broker-member relationships between the exchanges. In addition, in 1975, the SEC implemented the uniformity of price fluctuations, board lots, and trading symbols for the two stock exchanges (Visda et al. 2013).

Despite all these changes, the Philippine stock market remained largely insignificant both in absolute and relative terms to other financial sectors during the 1970s. The trading volume was small and many listed companies were inactive for a significant period of time. Listing companies mainly consisted of mining and oil issues, where purely speculative movements took place (World

Bank 1992). Only a limited number of blue chips were listed. It included mainly the well-established companies, such as San Miguel Corporation, Atlas Mines, and Philippine Long Distance Telephone Company. More than half of the companies were listed in the small board, and these were stocks of new mining and oil companies that were in the exploratory stage (Tan 1981). In addition, the financial market in the Philippines during 1970s was dominated by the commercial banks, while the market for equity remained thin. The total assets of securities dealers accounted for only 1.2 percent of the total assets of the financial system in 1974, while commercial banks accounted for 56.7 percent of them. The percentage of securities dealers remained low during the late 1970s. In 1978, securities dealers only accounted for 0.7 percent of the total assets (Tan 1981). During the early 1980s, the stock market remained underdeveloped and provided an almost insignificant share of the total funds for private investment (Llanto and Intal 1998). In 1983, there were 184 companies listed in the two exchanges. The total stock market capitalization amounted to USD 800 million, which represented roughly 2 percent of the country's gross domestic product (GDP). The number of public offerings was low as well, averaging approximately 30 per year (Dohner and Intal 1989).

There were several explanations for the limited development of the stock market in the Philippines during the early period. One explanation was the financial policies pursued by the government. The rediscounting facilities and the ceiling rates on deposits profited the banking institutions by providing them with cheaper sources of funds to their prime commercial borrowers, who were most likely to issue primary securities (Tan 1981). Also, there was a lack of government support in terms of regulatory control for secondary trading in the stock market, which hindered the growth of the market (Tan 1981). Potential investors were discouraged by the speculative nature of stocks in the exchanges, which explained why there was limited growth in trading volume. In addition, the listing of companies was limited by the tax advantages of loan financing, the reluctance of many family-controlled firms to relinquish any control to outsiders, the seemingly lengthy process and numerous disclosure requirements, the additional rules and undertakings required to access the capital market, and the disclosure requirements of interest both to investors and tax authorities to be listed in the exchanges (Dohner and Intal 1989; Tan 1981). Furthermore, the cost of debt financing was relatively cheaper than issuing equity because of the high hurdle rates of equity financing (Tirole 2006). Therefore, companies preferred debt to equity funding. Lastly, the high tendency toward relationship building in the country implied that it was procedurally easier to obtain debt funding via the relationship manager in the bank than the public style fundraising (i.e., equity funding), which was subject to the listing and disclosure process.

## THE STOCK MARKET DEVELOPMENT

### Structural changes in the stock exchange

The stock market in the Philippines has undergone a series of structural changes since the 1980s. The structural changes were necessary to elevate the stock market to international standards. One of the major changes was the unification of the two stock exchanges—the MSE and the Makati Stock Exchange (PSE 2015a). Since the establishment of the Makati Stock Exchange, efforts have been made to standardize the trading activities. For example, in 1975, SEC implemented the uniformity of price fluctuations, board lots, and trading symbols for the two stock exchanges. In 1987, the two exchanges agreed to use a common set of index stocks and adopt the variable multiplier method. Although they were regarded as two separate entities, they were basically trading the same listed issues (PSE 2015a; World Bank 1992). However, the coexistence of the two exchanges caused confusion among prospective investors. This was because the two exchanges retained different policies, different members, and, most importantly, different stock prices for the same listed stocks (PSE 2015a). Hence, there was a need to unite the two exchanges so that the new stock exchange would be professionally managed. Another reason for the unification of the exchanges was to achieve economies of scale by reducing operations costs. Given that the market was quite small nominally and relatively, it was more cost-effective to consolidate the two exchanges. Indeed, the operational practice of one exchange per country was also evident in other Southeast Asian exchanges.

In 1992, the unification became a reality when the government declared a policy of consolidating the operations of both exchanges to develop a more efficient capital market. In July 1992, a unified stock exchange, the Philippine Stock Exchange (PSE), was incorporated. Later, in 1993, the executive management teams of the two exchanges agreed to unify under the PSE (PSE 2015a). This movement further consolidated the logistics; largely reduced the technology cost involved in software, hardware, licenses, and related maintenance; and improved the development toward a more efficient capital market. In 1994, the SEC granted the PSE a license to operate as a securities exchange in the country, stating that "a unified stock exchange is vital in developing a strong capital market and a sustainable economic growth" (PSE 2015a). The unification of the two exchanges ensured a level-playing field for all investors by eliminating different policies and different stock prices for the same listed stocks. In addition, it boosted the trust and confidence of both foreign and domestic investors in the stock market. Since the unification in 1992, the market capitalization has grown by 355 percent, the value of transactions by 385 percent, and the foreign portfolio investment by almost 300 percent from 1992 to 1994 (De los Angeles 1995).

Another fundamental structural change was the demutualization of the stock exchange. During the process of demutualization, the exchange evolved toward a new corporate, legal, and business model, which transformed member's associations into for-profit stock corporations (Alinsunurin 2002). Working toward this goal, the Securities Regulation Code (SRC) was enacted in 2000. It affected the structure and operation of the stock exchange. Upon demutualization, the stock exchange experienced a series of changes in terms of ownership structure, trading rights, corporate governance, the business of the stock exchange, and its statutory regulatory role (Alinsunurin 2002). On ownership structure, demutualization involved the conversion of a member-organization into a stock corporation. Under the conversion plan, each of the 184 brokers was allowed to pay for 50,000 shares in the stock exchange. This conversion resulted in a shareholder-based company, which was wholly-owned by brokers. Its subsequent listing took place in 2003—by way of introduction—with an aim to significantly reduce broker ownership (Akhtar 2002). Demutualization also brought changes in the trading rights. The ownership of shares in the PSE and the access to its trading facilities were separated after the demutualization. In recognizing the existing 184-seat ownership by members, one trading right was conferred to each of the members entitled to subscribe to shares. Trading rights could be acquired through purchase from an existing trading participant (Akhtar 2002; Alinsunurin 2002).

In addition, there was a series of reforms in the corporate governance of the PSE after the demutualization. Changes were made in the board structure and composition in compliance with the SRC. For example, less than 50 percent of the voting rights to the broker-members were granted to gradually reduce broker influence on the board. Of the 15 members of the board, eight were nonbrokers, while seven were brokers. The nonbrokers consisted of the strategic holders and industry representatives, while broker representation comprises large and small brokers. The president of the PSE was also a nonbroker. The PSE had three independent directors, which included the chairman. The overall organization was restructured to reflect the strategic directions of the PSE (Alinsunurin

2002). However, there was an important governance issue of equity ownership concentration after the demutualization. The SRC prohibited shareholders from having more than 5 percent of the voting rights; it also prohibited any industry to own more than 20 percent of the shares in the PSE after the demutualization (Alinsunurin 2002). In spite of this, the SRC did not specify the timeline for this to be achieved. Instead, in 2004, the PSE sold 6,077,505 shares from its unissued stock to five strategic investors[2] by way of private placement that was approved by the SEC. As a result, the PSE had five strategic owners controlling approximately 40 percent of the company (PSE 2014).

Furthermore, the demutualization brought changes in the business of the PSE. Since it has transformed into a for-profit corporation, it sought opportunities to improve returns and minimize costs (Alinsunurin 2002). In terms of the exchange's revenues, these were mainly derived from listing-related fees for initial public offerings (IPOs) and additional listings, and for annual listing maintenance. Other sources of revenue were derived from membership, transaction, data feed, and service fees (PSE 2014). Unlike the experiences of other Asian stock exchanges upon demutualization, the financial viability of the PSE was of some concern. The net income of the Australian Stock Exchange increased from AUD 16.7 million in 1998 to AUD 59.1 million in 2002 after demutualization. The net income of the Hong Kong Stock Exchange also improved from HKD 521 million in 1999 to HKD 740 million in 2001. The Singapore Stock Exchange and the Tokyo Stock Exchange also experienced an improvement in financial viability upon demutualization (Akhtar 2002). On the other hand, the PSE's net income declined significantly from PHP 70 million in 2000 to PHP 18.3 million in 2001 after demutualization (PSE 2000, 2001). The PSE has only started improving from 2004 onward when the net income surged from PHP 22.2 million in 2004 million to PHP 119.8 million in 2005 (PSE 2004, 2005). In addition to demutualization, other considerations affected the financial viability of the PSE. These included the Asian financial crisis in 1997, the global economic slowdown due to the meltdown of the United States (US) technology sector in 2001, and the domestic political circumstances during this period.

Lastly, the demutualization brought changes to the statutory regulatory role of the PSE. The regulatory responsibilities of the PSE were defined under the SRC. The SRC defined the role of the PSE as a frontline market regulator, and has power over the listed companies. In addition, the organizational structure of the PSE was enhanced to solve the potential conflicts of interest, which separated the regulatory activities from commercial ones while centralizing regulatory activities with independent oversight from the SEC (Alinsunurin 2002).

In addition to the unification and demutualization of the stock exchange, technology has played a great role in the transformation of the stock market in the Philippines. Trading in the MSE was improved by the implementation of a fully computerized match trading system—the Stratus Trading System with Equicom in January 1993. Later on, in June 1993, the Makati Stock Exchange also launched its automated trading system—the MakTrade System. After the unification of the two exchanges, the Unified Trading System was launched in 1995. It was a single-order-book system based on the MakTrade System to post and match all orders in one computer (PSE 2015a). In 1996, the Communication Front-End System went online. It provided the gateway that allowed member-brokers to directly connect their own private trading systems to the MakTrade System (PSE 2015a). In 2000, the Securities Clearing Corporation of the Philippines started operating. Later in 2004, it became a wholly-owned subsidiary of the PSE and a new Clearing and Settlement System

[2] The five strategic investors are the Government Service Insurance System (GSIS), Philippine Long Distance Telephone (PLDT) Benefit Trust Fund, San Miguel Corporation Retirement Fund, Kim Eng Investment Limited, and KE Strategic Pte. Limited (PSE 2014).

was acquired in the same year. The market structure of the stock market is built around the PSE, with the support of the Philippine Central Depository and the Securities Clearing Corporation of the Philippines for clearance and settlement of trading activities (IMF 2004; PSE 2015a).

In 2005, the PSE implemented the Online Disclosure System, which provided online system access for the submission and announcement of all types of disclosures. A year later, the Securities Clearing Corporation of the Philippines migrated from trade-for-trade processing to a multilateral netting system, with the establishment of the Central Clearing and Central Settlement System (PSE 2015a). Further collaboration with the world's largest stock exchange was accomplished in 2008 when the PSE entered into a memorandum of understanding with the NYSE Euronext. It launched a new trading system provided by the NYSE Euronext Technology in 2010 (PSE 2015a). The new trading system, known as PSEtrade, was launched to replace the Maktrade System (PSE 2015a). In 2014, the PSE selected NASDAQ OMX as its new service provider for the exchange trading system to replace the previous trading system. This trading system was widely adopted by over 100 marketplaces across the globe, including Singapore, Malaysia, and Indonesia (PSE 2014). It went live in 2015 to enhance trading capacity and increase risk management parameters to cater for more products and services that would be introduced by the PSE.

In addition to the improvement in the trading platform, the PSE also launched the mobile trading application to enhance stock trading. At the end of 2013, a portal for the new disclosure system, known as Electronic Disclosure Generation Technology, was implemented to replace the PSE Online Disclosure System. It was a fully automated system to facilitate the efficient processing, validation, submission, and distribution of disclosure reports submitted to the PSE. It also standardized the disclosure reporting process of the listed companies and, therefore, enhanced the transparency of overall issuers in the market. Alongside the implementation of the new disclosure system, there was also a mobile platform where relevant information of listed companies could be accessed in a dedicated website. The mobile trading application gave investors easier access to the disclosures of issuers and thus improved the transparency of the PSE (PSE 2013, 2014). Later in 2014, the mobile application for trading called PSETradex mobile was launched to provide investors easy access to the stock market and to enable them to conveniently trade Philippines stocks by always staying connected to the market (PSE 2014)

With these various structural reforms, the PSE made major achievements. In 2013, the PSE was recognized as the best stock exchange in Southeast Asia by the financial magazine *Alpha Southeast Asia* (PSE 2013).

**Regulatory development of the stock market**

Since the establishment of the Manila Stock Exchange, investors have been generally protected by the Blue Sky Law against speculative schemes and the sale of stock in fly-by-night concerns, and fraudulent oil and mine exploitations. However, the Blue Sky Law was inadequate in regulating the over-issuance of stocks, price manipulations, and artificial market caused by false information. It also failed to make provisions for a specialized regulatory agency to monitor trading activities and enforce securities laws (De los Angeles 1995). In 1936, the government, therefore, enacted the Securities Act to regulate securities trading activities and create a Securities and Exchange Commission to enforce the regulations (World Bank 1992). The Securities Act was the first securities law that was enacted mainly to (i) prevent exploitation of the public by the sale of fraudulent securities through misrepresentation, (ii) provide adequate information for investors to make informed decision, and (iii) to protect honest enterprises seeking capital through valid presentation (World Bank 1992). However, the Securities Act only required disclosure of certain information in the original registration statement that was filed with the SEC. It failed to require the disclosure of all material facts related to an offering. In addition, the penalty imposed for violations of the Securities Act was low (De los Angeles 1995).

The SEC, established in 1936, was responsible for safeguarding public interest during the first local stock market boom in the country. It acted as the primary regulatory authority over the capital markets and their participants. The principal laws administered by the SEC were the Investment Company Act of 1960, the Financing Company Act of 1969, the Corporation Code of 1980, the Revised Security Act of 1982, and PD 902A (Field and Hanna 1999). The Investment Company Act provided for the licensing and supervision of leasing companies while the Financing Company Act provided for those of mutual funds. The Corporation Code provided basic rules for the establishment and governance of companies. The Revised Securities Act provided for registration of securities, licensing, and regulation of stock market intermediaries. PD 902A granted quasi-judicial powers to the SEC, which covered investigation and prosecution of fraud, adjudication of corporate disputes, and interpretation of laws administered by the SEC (World Bank 1992). Based on these laws, the main responsibilities of the SEC entailed the registration of companies; registration of stock that would be offered to the public; authorization for listing stock on the exchange; authorization and regulation of stock exchange, securities brokers, and dealers; adjudication of corporate disputes; examination of annual financial statements of listed companies; and investigation and prosecution of breaches of related laws (World Bank 1992).

Despite all these regulatory initiatives, there was a need for organizational change and capacity building to allow the SEC to function effectively. According to the recommendation by the World Bank (1992), the SEC would become more effective if it divested itself of recourse-intensive tasks and received sufficient assistance in terms of staff training and management reorganization. In line with these recommendations, a fundamental shift in the SEC occurred in 2000 with the enactment of the Securities Regulation Code (SRC) (IMF 2004). The SEC mandate shifted from focusing on company registration and monitoring, and performing quasi-judicial functions, toward developing a transparent, efficient, and fair capital market (IMF 2004; SEC 2015a). Under the SRC, the following reforms were implemented to strengthen the SEC's role in capital market development and regulation. First, SEC powers, such as the resolution of intracorporate disputes and corporate recovery cases, were transferred to the courts. Second, the SEC was reorganized to streamline its structures and operation, and upgrade its human resources. Third, positions in the SEC were standardized and reclassified to retain and attract qualified individuals. And last, the SEC was granted the power to self-fund its operations. It was allowed to retain and utilize PHP 100 million from its annual income. These new organizational changes and capacity building had been important in allowing the SEC to start functioning fully under the SRC (IMF 2004; SEC 2015a).

The major achievements brought by the SRC were confirmed by the assessment conducted by the IMF on the principles of security regulation. The report revealed that the country performed very well against the principles of the International Organization of Securities Commissions (IMF 2004). On principles relating to the regulator, these were fully implemented. The SRC transformed the SEC into a more effective regulator with clear objectives and procedures. Given that the duties of the SEC were narrowed, it was better empowered with resources to enforce the law (IMF 2004). Besides, principles for cooperation in regulation were implemented satisfactorily, according to the IMF (2004). The SEC was given authority to disseminate public and nonpublic information with both domestic and foreign counterparts, provided that the Memoranda of Understanding were signed with willing counterparts. The rules of confidentiality of information in this regard were sound. In addition, the Anti-Money Laundering Act was implemented in 2002 to overcome obstacles created by the Bank Secrecy Law (IMF 2004). The principles for issuers were implemented with the high standards of disclosure regime. This was an important move from a merit-based system, wherein subjective judgments by regulators would be required, to a disclosure-based regime. Furthermore, the SEC played a significant role in ensuring that the minority shareholders were well-protected, amid the strong hindrance created by the strong founder family ownerships. The principles for market intermediaries were also implemented with clear eligibility criteria and procedures of registration. Model Internal Supervision, Control and Compliance Procedures were clearly established. Overall, the procedures to deal with failure of market intermediaries became sound as a result (IMF 2004).

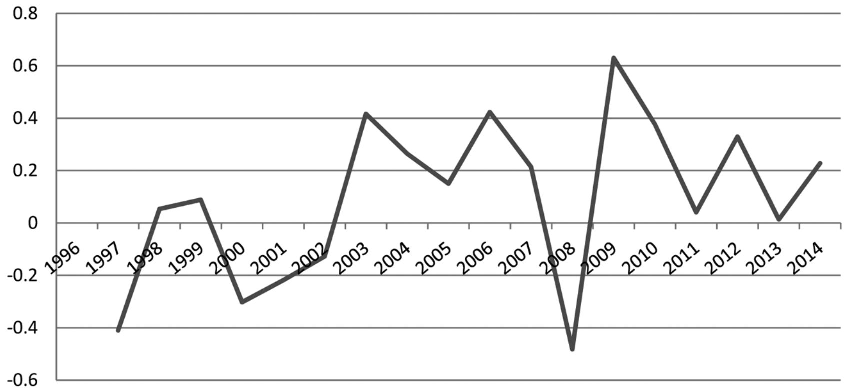
## GROWTH OF THE STOCK MARKET

The growth of stock market is a multifaceted concept that can be measured by various indicators, such as the stock market index, number of listed companies, the concentration ratios of top 10 listed companies, and liquidity of the market. These are discussed in the following section.

**Growth of the Philippine stock market as measured by key market indicators**

A natural measure of stock market activity is the share price index. In the case of the PSE, this is the PSE Index (PSEi), which was originally the Composite Index. Figure 1 shows the annual growth of PSEi during 1996–2014 and Table 1 shows the performance of the PSEi and its annual growth for the period 1996–2014. The PSEi showed generally upward trends with three troughs during 1996–2013. The first trough happened in 1997, with the onset of the Asian financial crisis. Stock markets in the region including that in the Philippines suffered significant losses during the crisis. The PSEi dropped by 41 percent from 3,171 points in 1996 to 1,869 points in 1997, measured at yearend (PSE 2000). When the market seemed to have recovered, setbacks occurred that affected the markets, such as the political protests against then-President Joseph Estrada, which led to his downfall, and the September 11, 2001 terrorist attacks in the US. Prior to his downfall, the impeachment trial of Estrada seemed to have lasting negative impact on the stock market as the investors perceived that the stock market could suffer from the alleged stock price manipulation of the listed companies that were linked to Estrada and his allies. This led to a massive loss of investors, and the PSEi dropped from 2,143 points in 1999 to 1,018 points in 2002, which was the lowest level in the period discussed (PSE 2000, 2002; Visda et al. 2013). The stock market recovered slowly from its troubles and experienced growth along with most other stock markets from 2003 to 2007. The PSEi increased from 1,442 points in 2003 to 3,622 points in 2007. However, the market path was derailed by the subprime crisis in the US, which set off a chain effect on the global stock markets. The depressed global market sentiment during the global financial crisis in 2008 caused the PSEi to plunge from 3,622 points in 2007 to 1,873 points in 2008, representing a 48-percent drop in a year (PSE 2003, 2007, 2008). While the Philippine stock market recovered relative to those of the Western countries, the Philippine economy was toughened by the Asian financial crisis in the late 1990s. After bottoming out in 2008, the stock market started an unprecedented growth to become one of the best performing emerging markets. The PSEi soared from 1,873 points in 2008 to 7,230 points in 2014 (PSE 2014; Vista et al. 2013). The PSE was one of only two out of the 64 member-exchanges of the WFE that had experienced growth for six consecutive years during 2009–2014 (PSE 2014). The PESi has grown by a total of 286 percent in these six consecutive years.

Figure 1. Annual growth of the PSEi, 1996–2014




Sources: *PSE Annual Reports*, various issues; World Federation of Exchanges (2015)

Table 1. Performance and annual growth of the PSEi, 1996–2014

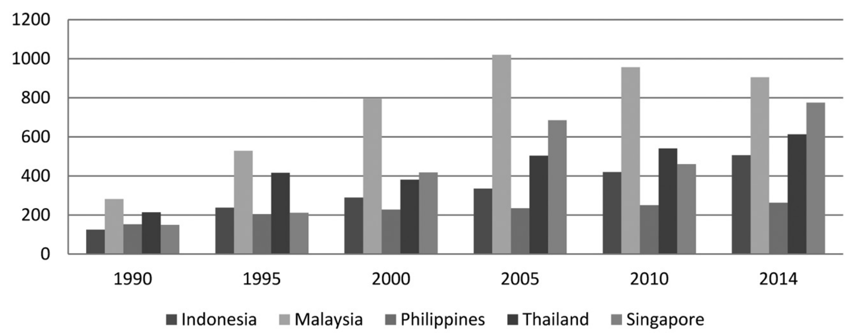
| Year | PSEi | Annual % change of PSEi |
|---|---|---|
| **1996** | 3,171 | NA |
| **1997** | 1,869 | -41 |
| **1998** | 1,969 | 5 |
| **1999** | 2,143 | 9 |
| **2000** | 1,495 | -30 |
| **2001** | 1,168 | -22 |
| **2002** | 1,018 | -13 |
| **2003** | 1,442 | 42 |
| **2004** | 1,823 | 26 |
| **2005** | 2,096 | 15 |
| **2006** | 2,983 | 42 |
| **2007** | 3,622 | 21 |
| **2008** | 1,873 | -48 |
| **2009** | 3,053 | 63 |
| **2010** | 4,201 | 38 |
| **2011** | 4,372 | 4 |
| **2012** | 5,813 | 33 |
| **2013** | 5,890 | 1 |
| **2014** | 7,230 | 23 |

NA = not applicable
Sources: *PSE Annual Reports*, various issues; WFE (2015)

The growth of the Philippine stock market can also be measured by the number of listed companies. The number of listed companies provides some insight on how broadly accessible the stock market is for firms seeking to raise funds. This number had remained low since 1988. Figure 2 shows the number of listed companies on ASEAN-5 stock exchanges during the period 1990–2014. The number of listed companies increased from 141 in 1988 to 263 in 2014, with an average annual growth rate of 2.5 percent (World Bank 2015; WFE 2015). It was observed that despite nearly 800,000 companies being registered and licensed by the SEC to do business in the country in 2012, only 268 companies listed their shares publicly in the PSE, which contributed an insignificant 0.034 percent to the total market. In addition, the Philippines had the smallest number of listed companies during the past two decades compared with the other ASEAN-5 countries. This small number of listed companies can be attributed to several factors. One was the prevalent culture of "family corporation", which hindered the decision of opening up to a more diversified ownership structure through public listing (Visda et al. 2013). Most of the Filipinos preferred maintaining control of enterprises closely within the family group. In addition to the concern over the "control" issue, the companies were deterred by the seemingly lengthy process and numerous disclosure requirements, and the additional rules and undertakings required to access the capital market. It was also alleged that the control of a firm allowed more flexibility in avoiding corporate taxation by structuring its financial records. Another factor was the concern over cost incurred when the firm raised capital through the stock market. The cost of debt financing was relatively cheaper than issuing equity because of the high hurdle rates of equity financing. Debt financing was generally readily available and offers beneficial tax treatment (Dohner and Intal 1989; World Bank 1992). The final factor was the general lack of understanding on how the companies could benefit from the stock market in various ways (Visda et al. 2013).

Another indicator that measures the growth of the stock market is the concentration ratio, which reveals the accessibility of the stock market by firms. One ratio is the proportion of stock

Figure 2. Number of listed companies on ASEAN-5 stock exchanges, 1990–2014




Sources: World Bank (2015); WFE (2015)

market capitalization accounted for by the top 10 listed companies. Another ratio is the proportion of trading accounted for by a country's top 10 listed companies. Table 2 presents the concentration ratios of the Philippines and selected countries in 1999 and in 2013. Similar to most East Asian countries, much of the stock market in the Philippines was accounted for by a few large firms. The concentration ratio of the Philippines was 57 percent as measured by the first indicator, and 53 percent as measured by the second indicator, in 1999. In 2013, there was an improvement: the ratios were reduced to 38 percent and 46 percent, respectively (WFE 2015). However, the PSE still showed relatively high concentration ratios when compared with other ASEAN-5 countries such as Malaysia and Singapore.

Table 2. Concentration ratios of selected countries, 1999 and 2013

| Economy | 1999 | | 2013 | |
|---|---|---|---|---|
| | Top 10 concentration ratio (in market capitalization) (%) | Top 10 concentration ratio (in trading) (%) | Top 10 concentration ratio (in market capitalization) (%) | Top 10 concentration ratio (in trading) (%) |
| **Indonesia** | 58 | 53 | 43 | 38 |
| **Hong Kong** | 68 | 42 | 35 | 26 |
| **Malaysia** | 35 | 18 | 36 | 43 |
| **Philippines** | 57 | 53 | 38 | 46 |
| **Singapore** | 59 | 35 | 27 | 29 |
| **Thailand** | 48 | 31 | 41 | 32 |
| **Memorandum** | | | | |
| **Japan** | 30 | 25 | 18 | 19 |
| **United States** | 23 | 17 | 15 | 44 |

Source: WFE (2015)

**Growth of the Philippine stock market in size and liquidity**

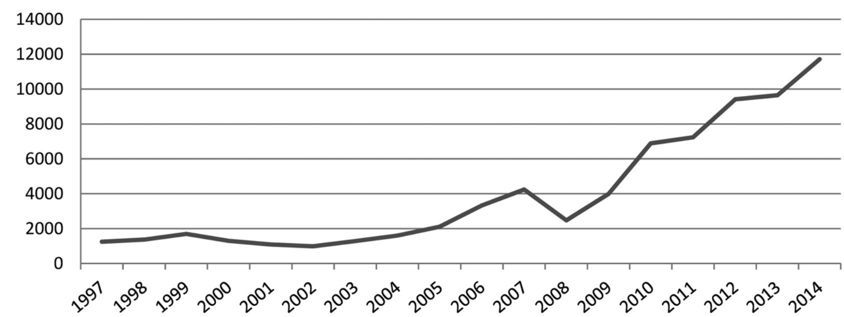
*Size of the Philippine stock market*

The absolute size of the stock market is generally measured by the market capitalization, which reflects how effective the market is in performing its role of intermediating savings and investments. Larger financial markets (in this case, stock markets) are more likely to be deeper and more liquid than smaller markets (Gochoco-Bautista and Remolona 2012). In the Philippines, the market capitalization grew significantly from PHP 1,251 billion in 1997 to PHP 4,245 billion in 2007. Notwithstanding the impact of the global financial crisis in 2008, the PSE recovered swiftly from PHP 2,474 billion in 2008 to PHP 11,713 billion in 2014 (WFE 2015). If the domestic market capitalization by sector is considered, the holding firms sector and the industrial sector tapped more funding from the stock market than the other six sectors (PSE 2014). Figure 3 shows the stock market capitalization of the PSE in billion pesos during the period 1997–2014 and Figure 4 shows the domestic market capitalization by sector in 2014.

It is worth noting that the market capitalization of the domestic companies grew steadily while that of the foreign companies showed a more volatile growth pattern. During the period 2010–2014, the local–foreign ratio remained at the 80:20 level (*PSE Annual Reports*, various issues). This dominance of domestic firms could be explained by the higher valuation of domestic companies. For example, when the Sun Life Financial Corporation (1999) and the Manulife Corporation (2000) were listed in the exchange, these two companies contributed about 50–60 percent of the total market capitalization for several years. The emergence of various conglomerates, together with the mergers and acquisitions, led to the creation of mega domestic companies of higher value. In addition, the improved net income performances also pushed for higher valuation of domestic companies (Visda et al. 2013). Figure 5 shows the breakdown of the market capitalization of domestic companies and foreign listed companies during 2001–2014.

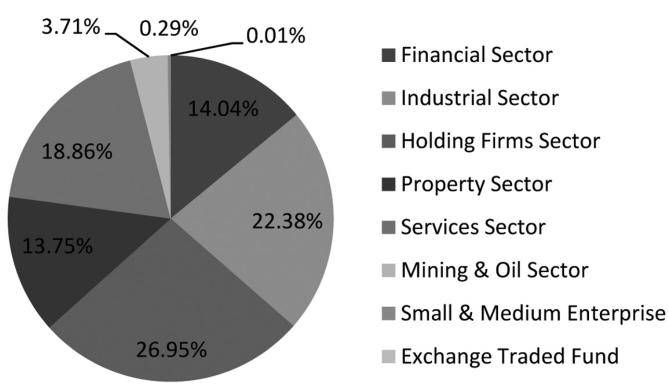
In terms of capital-raising activities, the total amount raised annually was volatile and usually followed the prevailing market sentiment. During the period 1996–2014, the total amount raised annually fluctuated between the lowest amount of PHP 1.7 billion in 2003 and the highest amount of PHP 219 billion in 2012. The total amount raised annually has shown growth momentum since 2009 when it soared from PHP 38.8 billion in 2009 to PHP 153.1 billion in 2014 (*PSE Annual Reports*, various issues). If the capital raised by different categories during 1996–2014 was considered, it can be observed that, firstly, the historical levels of IPOs were more volatile than the additional listings. IPOs were nearly negligible during downturns partly because the listed companies preferred to get the most value of the sales of shares. Also, during volatile periods, it became very difficult to price new issues. In terms of primary offerings, there was usually a larger proportion of fundraising in the form of follow-on than in the form of IPOs (PSE 2014). Secondly, it can be observed that there

Figure 3. Stock market capitalization of the PSE, 1997–2014 (PHP billion)



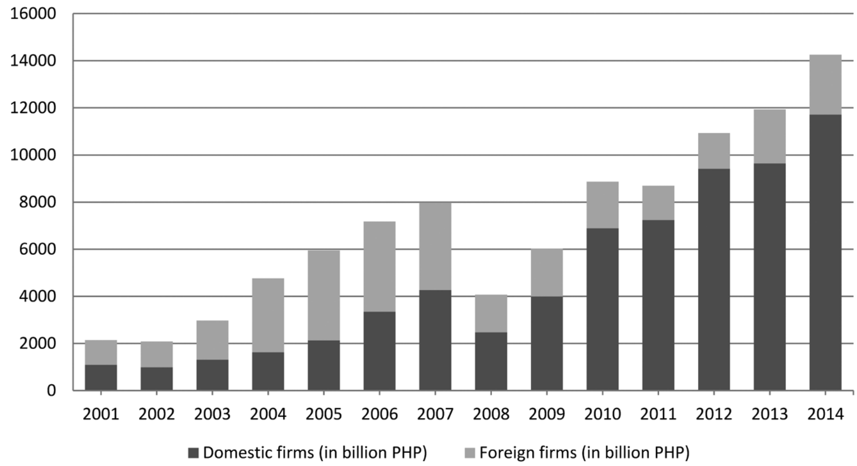

Source: WFE (2015)

Figure 4. Domestic market capitalization by sector, 2014



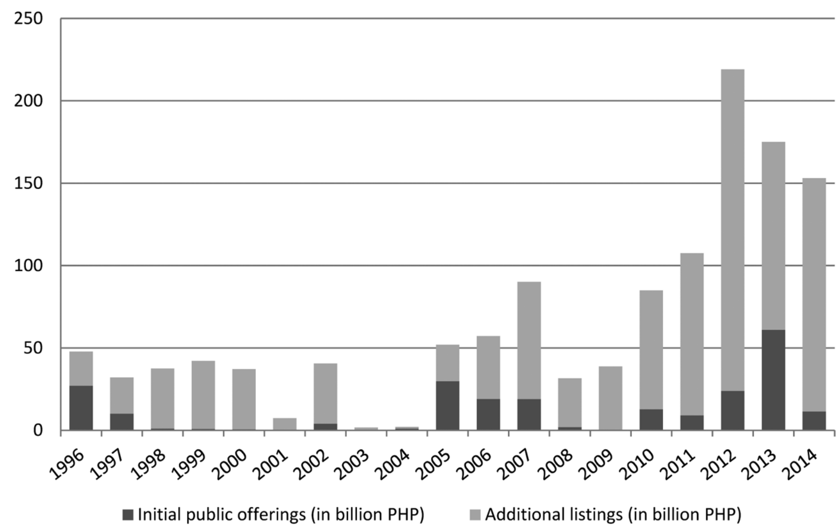

Source: PSE (2014)

Figure 5. Breakdown of the market capitalization of domestic and foreign listed companies, 2001–2014




Sources: *PSE Annual Reports*, various issues

Figure 6. Capital raised by different categories, 1996–2014

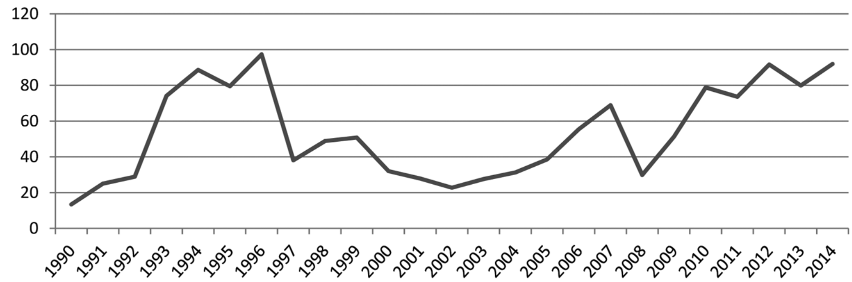



Sources: *PSE Annual Reports*, various issues

was a trend of increasing number of listed companies undertaking additional listings. This indicated that the firms saw value in continuously utilizing the stock market to raise funds for their projects, instead of the typical "one-and-done" listing behavior (Visda et al. 2013). Figure 6 shows the capital raised by different categories during 1996–2014.

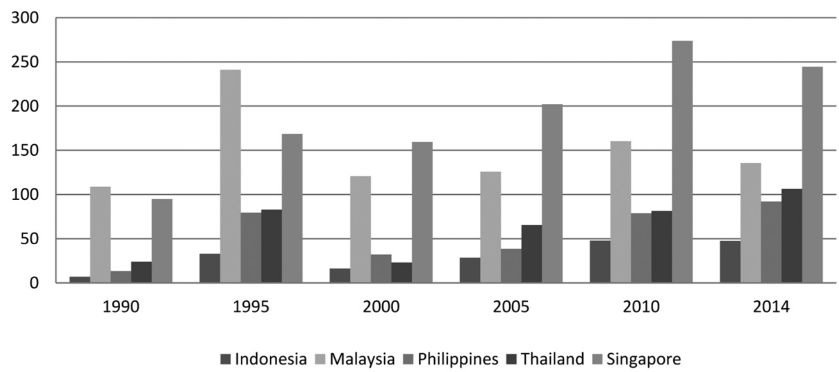
The market size can also be measured in relative terms using the market capitalization ratio, which is the market capitalization as a percentage of the GDP. In the Philippines, the market

Figure 7. Market capitalization ratio of the PSE, 1990–2014




Source: World Bank (2015)

Figure 8. Market capitalization ratios of the ASEAN-5 stock exchanges, 1990–2014




Source: World Bank (2015)

capitalization ratio showed an increasing trend, with volatile movements from 1990 to 2014. The ratio increased significantly from 13 percent in 1990 to 92 percent in 2014, with an average of 8 percent annual growth. Figure 7 shows the market capitalization ratio of the PSE during 1990–2014.

When compared with the other ASEAN-5 stock exchanges, Malaysia and Singapore enjoyed the largest size of stock market in terms of market capitalization ratio during the past two decades. The PSE was ranked the second lowest among them. Despite its low ranking among the ASEAN-5 countries, the PSE experienced a phenomenal rise in global ranking as measured by the market capitalization ratio. According to the World Development Indicators (WDI), the ranking of the PSE rose from 55$^{th}$ in 2005 to 44$^{th}$ in 2009 (World Bank 2015). Later on, there was a substantial improvement in ranking from 44$^{th}$ in 2009 to 29$^{th}$ in 2010. In 2014, the PSE was ranked the 12$^{th}$ largest in the world (World Bank 2015). Figure 8 shows the market capitalization ratios of the ASEAN-5 stock exchanges during 1990–2014.

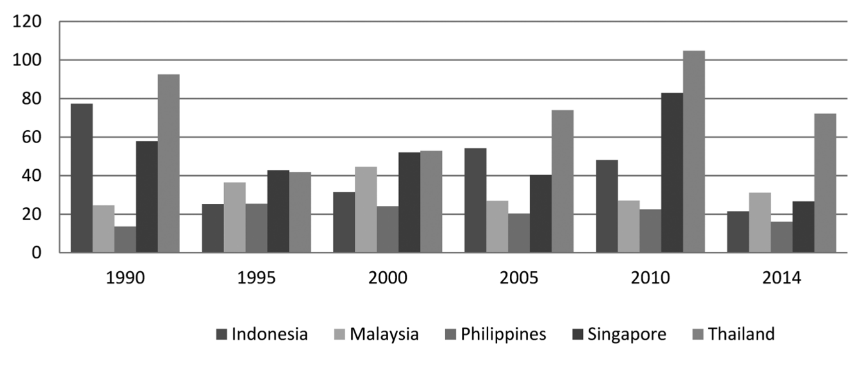
*Liquidity of the Philippine stock market*

The growth of stock market can also be measured by its liquidity, which refers to the ease with which agents can buy and sell assets in a financial market at posted prices (Levine and Zervos 1996).

Two indicators are used to measure the liquidity of the stock market. The first indicator equals the ratio of the total value of traded shares in the stock exchange divided by market capitalization. This is also known as the turnover ratio. The second indicator is the ratio of the total value of the shares traded in the stock exchange divided by the GDP, which measures the degree of trading relative to the size of the economy (Levine and Zervos 1996, 1998). According to the WDI (World Bank 2015), the Philippine stock market experienced low liquidity during the past two decades. In regional comparison with the ASEAN-5 countries, the Philippines had the least liquid stock market in terms of turnover ratio during the past two decades. Among these countries, Thailand had the most liquid stock market despite its relatively small market size. Figure 9 shows the turnover ratios of the ASEAN-5 stock exchanges during 1990–2014.

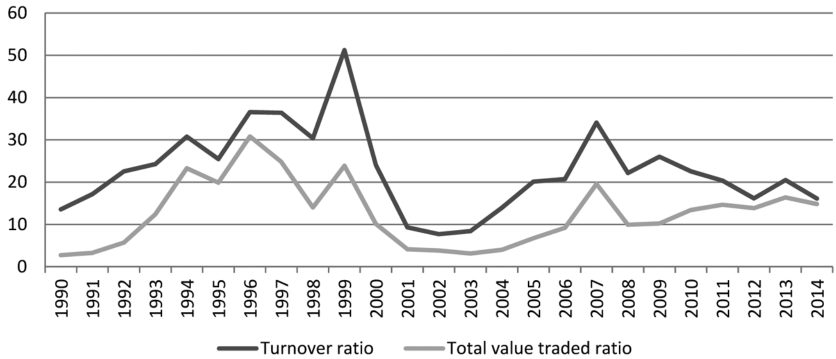
If the turnover ratio is considered, it can be observed that it fluctuated in the range of 14–30 percent from 1990 to 1998. It reached its peak of 51 percent in 1999, and immediately slumped to a low level of 9 percent in 2001. It started to improve in 2004 and reached another peak of 34 percent in 2007. The ratio gradually declined to 16 percent in 2014 (World Bank 2015). It is worth noting that the total value traded ratio exhibited a similar growth pattern to the turnover ratio. The low liquidity in the stock market could be attributed to the following factors. One factor was the high transaction costs involved in the trading activities. A market with high transaction costs would tend to have less trading, hence, affecting the liquidity of the market. A study involving 12 stock exchanges showed that the Philippine stock market suffered from high transaction costs of equity securities trade that included trading fee, clearing fee, broker's commission, and stock transaction tax (SEC 2015b). In terms of friction costs, the Philippines ranked the 5$^{th}$ highest among these 12 stock exchanges, with 77 basis points per side of the transaction. Another factor was the limited size and diversity of the investor base. It has been argued that a diversity of investors with different risk appetites leads to a more divergence of view, which fosters trading activities (Ghosh and Revilla 2007). In the Philippines, despite the growing investor base, the overall base of 525,850 investor accounts represented only a half percent of the estimated 100 million population in 2012. This could indicate that the stock market investment has been confined to the privileged few with high level of annual income and educational background (PSE 2015b). Figure 10 shows the turnover ratio and the total value traded ratio of the PSE during 1990–2014.

Figure 9. Turnover ratios of the ASEAN-5 stock exchanges, 1990–2014




Source: World Bank (2015)

Figure 10. Turnover ratio and total value traded ratio of the PSE, 1990–2014




Source: World Bank (2015)

## CHALLENGES IN THE STOCK MARKET DEVELOPMENT IN THE PHILIPPINES

Despite the improvement in various stock market indicators mentioned in the previous section, some challenges continued to hinder the further development of the stock market. The first challenge was the shallow and less diversified investor base when compared with its Asian counterparts (SEC 2015b). Historical data indicate that while the stock market has been growing, it has not expanded at a pace to match its Asian counterparts. According to the Stock Market Investor Profile conducted by the PSE, there were only 525,850 investor accounts in 2012 out of a total of 100 million Filipinos. The overall investor base of a half percent of the estimated total population indicated that there was no widespread participation in the local market. Out of the total accounts, 96.4 percent were classified as retail accounts while the remaining were considered as institutional accounts. Local players dominated the PSE with 98.5 percent of the total accounts, while foreign investors only covered 1.5 percent of the total accounts (PSE 2015b). To foster a larger and more diversified investor base, the PSE partnered with various institutions and individuals to promote the expansion of the country's investor base by providing financial market education for Filipinos. Among the initiatives implemented to achieve this were financial literacy road shows, the launch of the PSE stock market 101 webinar, stock market 101 seminars, programs for young investors, certified securities specialist course, provincial run of the PSE advanced stock market course, financial literacy competitions, and industry exposition (PSE 2014).

In addition to the shallow investor base, another challenge was that the PSE was still less competitive when compared with its regional counterparts. For instance, the Philippines had the smallest number of listed companies during the past two decades when compared with the other ASEAN-5 countries (World Bank 2015; WFE 2015). In terms of market capitalization ratio, the PSE was ranked as the second lowest among the other ASEAN-5 countries during the past two decades (World Bank 2015). In terms of turnover ratio, the Philippines had the least liquid stock market among the other ASEAN-5 countries during the past two decades (World Bank 2015). To address this challenge, the PSE laid down plans to develop new products to enable issuers to easily raise funds using various methods (SEC 2015b). Toward this goal, the three-year strategic plan of 2013–2015 was implemented. Under this plan, the PSE introduced a wider range of products and services to the market. For example, in November 2013, the co-branded SGX-PSE MSCI Philippines Index Futures was listed in the Singapore Stock Exchange. Later, in December 2013, a first exchange traded fund, the First Metro Philippine Equity Exchange Traded Fund, was listed in the PSE. During the same month, an initiative to expand the PSE into Islamic Finance was undertaken, whereby Shariah-compliant securities were listed (PSE 2015a). However, there was concern over the SEC's overly conservative attitude toward approving or disapproving various products and services that have already been presented in its regional counterparts. This continued to be a major policy constraint in the development of the Philippine capital market.

The lack of competitive nature of the PSE is also revealed by the high transaction costs associated with trading in the PSE (SEC 2015b). A study involving 12 stock exchanges showed that the Philippines suffered from high friction costs of equity trading. The country was ranked the 5$^{th}$ highest in terms of friction costs among the 12 countries (SEC 2015b). Table 3 shows the total friction costs on secondary trading of equity securities per jurisdiction. To address this challenge, a study was conducted to rationalize nontax friction costs relating to equity securities transaction in the primary and secondary markets, which include underwriting, registration, listing, clearing, depository, and transfer agent fees and brokers' commission. In addition, the Financial Sector Tax Neutrality Act was proposed to abolish the IPO tax and lower the stock transaction tax to 0.25 basis points of the gross selling price or gross values in money of the shares of stock sold (SEC 2015b).

Aside from the above challenges, corporate governance of the PSE was weak. Corporate governance is a significant determinant of stock market efficiency. The lack of transparency prevents stock markets from working effectively (Guinigundo 2005). Holistically, the Philippine financial system urgently needed improved coordination, effective regulation, and supervision. A rapidly changing market condition gave rise to a new business structure and "hybrid" products that no longer fit with the traditional regulatory authorities. This created a significant space for regulatory arbitrage, which encourages the development of conglomerated financial organizations (Guinigundo 2005). Indeed, conglomerates were an important feature in the country. According to the IMF (2010), about 60 percent of bank assets and 75 percent of effective market capitalization belong to conglomerates. In addition, the county was governed under a regime of multiple regulators that the authorities had to ensure consistency and comparability across their respective governance structure. To achieve this, it required either legislative intervention or a workable relationship between regulators and regulated entities (PDP 2011). The PSE recognized the significant role of corporate governance in the overall growth of the stock market. Thus, a corporate governance committee was established in the PSE to align the exchange's corporate governance practices with internationally accepted standards by assisting on issues related to the performance of the exchange, the performance of the President and his management team, compensation package, succession planning, the overall governance of the exchange, and market governance (PSE 2014). In addition, the PSE Corporate Governance Office was created to assist the corporate governance committee to carry out the fundamental functions of corporate governance. The office also provided support to the PSE in uplifting corporate governance in the Philippine stock market through various market initiatives, and partnership with regulators, corporate governance advocates, and other stakeholders (PSE 2014). These corporate governance initiatives were no different from the ones implemented by the other ASEAN countries. For instance, the ASEAN Corporate Scorecard was jointly developed by the Asian Development Bank and the ASEAN Capital Market Forum. It provided a rigorous methodology benchmarked against international best practice to assess the corporate governance performance of the listed companies of participating countries, including the Philippines (SEC 2015c).

Table 3. Total friction costs on secondary trading of equity securities per jurisdiction, selected countries

| Exchange | Stamp Duty | Stock Transaction Tax | Commission | Clearing Fee | Trading Fee | Total per side (in BP) | Total per Side excluding Commission (in BP) |
|---|---|---|---|---|---|---|---|
| Bursa Malaysia | 10 BP or fractional part of value of securities | None | Fully negotiable | 3 BP of transaction value | 70 BP | 83.00 | 83.00 |
| Ho Chi Minh Stock Exchange | None | 10 BP | Maximum of 45 BP | No data | No data | 55.00 | 10.00 |
| Hong Kong Exchange | 10 BP on the value of the transaction | 0.3 BP per transaction | Fully negotiable | None | 0.5 BP | 10.80 | 10.80 |
| Indonesia Stock Exchange | None | 1.8 BP of the value per transaction | Maximum of 130 BP | 0.9 BP of the value | 3 BP | 135.70 | 5.70 |
| Korea Exchange | None | 30 BP | Fully negotiable | 0.04446 BP of trade value | 0.22763 BP of trade value | 30.27 | 30.27 |
| National Stock Exchange India | None | 10 BP per transaction | Maximum of 250 BP | USD0.03310 | Estimated at 0.33 BP | 260.33 | 10.33 |
| Philippine Stock Exchange | None | 50 BP | 25 BP to 150 BP | 1 BP | 1 BP | 77.00 | 52.00 |
| Shanghai Stock Exchange | 10 BP of the traded value | None | No data | No data | No data | 10.00 | 10.00 |
| Shenzhen Stock Exchange | 100 BP of the traded value for seller | 6.96 BP of the traded value per transaction | Maximum of 30 BP | No data | No data | 136.96 | 106.96 |
| Singapore Exchange | None | None | Fully negotiable | 4 BP on the value of the contract | 0.75 BP on the value of the contract | 4.75 | 4.75 |
| Stock Exchange of Thailand | None | None | 20 BP or 25 BP | 0.1 BP | 0.5 BP | 20.60 | 0.60 |

BP = basis point
Source: SEC (2015b)

The final challenge faced by the Philippines was its unsound legal framework for financial sector development. Critical financial sector reforms can only be implemented by the financial regulators if they have legislative support to provide for the necessary legal and regulatory environment for the reforms. The policy and structural issues were known to most of the stakeholders. The challenge was to develop a holistic framework that links them into a common strategic plan. It also required an orderly execution and commitment among stakeholders to adhere to the plan (PDP 2011). In light of this challenge, the Capital Market Development Plan (2011–2016) was implemented to improve the institutional capacity of regulators. The strategies designed toward attaining this aim were the following. First, the SEC pursued an organizational review and formulated an overall reorganizational plan for the agency. Second, activities and strategies to increase the SEC's manpower capacity and performance were undertaken. Third, the SEC head office was transferred to enable the agency to accommodate bigger clientele and provide adequate space for its expanding workforce. Finally, the SEC sought to secure congressional grant of fiscal autonomy (SEC 2015b).

## CONCLUSION

This paper explored the stock market development in the Philippines by focusing on the past and recent developments. Specifically, it looked at the structural and regulatory developments in the Philippines' stock exchange and the growth of the Philippine stock market in terms of size, liquidity, and other key market indicators. An exploratory analysis showed that the first formal stock exchange in the Philippines was established early in 1927. However, stock market activities in the country were generally regarded as insignificant and speculative in nature during the 1930s up to the 1970s. This paper also points out that the Philippine stock market has undergone a number of major structural and regulatory reforms and development since the 1990s. These included the unification of the two stock exchanges, the demutualization of the PSE, and the enactment of the Securities Regulation Code. As a result, the Philippine stock market has experienced phenomenal growth over the years as measured by various stock market indicators. For instance, the PSE was cited as one of the best performing stock markets in the world in 2012 by the WFE. In the same year, the PSEi outperformed other markets and was reported by the WFE as among the top three best performing benchmark indices in the world. Also, the PSE was one of the only two out of the 64 member-exchanges of the WFE that experienced growth in stock market indices for six consecutive years from 2009 to 2014. According to the WDI (World Bank 2015), the ranking of PSE improved from 55th in 2005 to 44th in 2009, and then substantially to 29th in 2010. In 2014, the PSE was ranked the 12$^{th}$ largest stock exchange in the world. In 2013, it was recognized as the best stock exchange in Southeast Asia by the financial magazine *Alpha Southeast Asia*. Although the Philippine stock market has developed substantially over the years, it still faces a wide range of challenges, including a less diversified investor base, lack of competition vis-à-vis the PSE's regional counterparts, weak corporate governance, and weak legal framework for financial sector development. Based on this paper's findings, further research on stock market development in the Philippines may be conducted in the future.

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