Background on the Australian Listed Equity Market

Submission to the House of Representatives Standing Committee on Economics Inquiry into Common Ownership and Capital Concentration in Australia

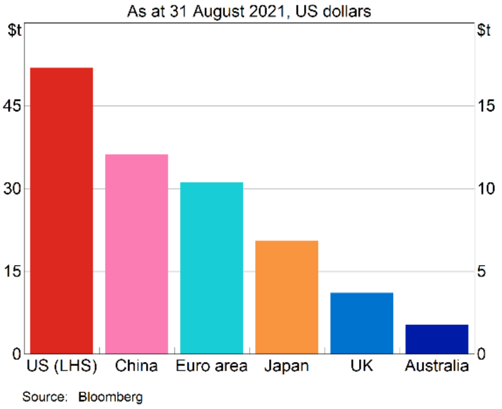
September 2021

As of August 2021, the capitalisation of the listed Australian equity market was about $2.5 trillion (US$1.8 trillion), which is smaller than that of the largest markets overseas (Graph 1). However, as a ratio to GDP, stock market capitalisation stands at around 140 per cent, which puts Australia around the middle of this group, comparable to Japan and the United Kingdom (Graph 2).

Graph 1

Global Equity Market Capitalisation

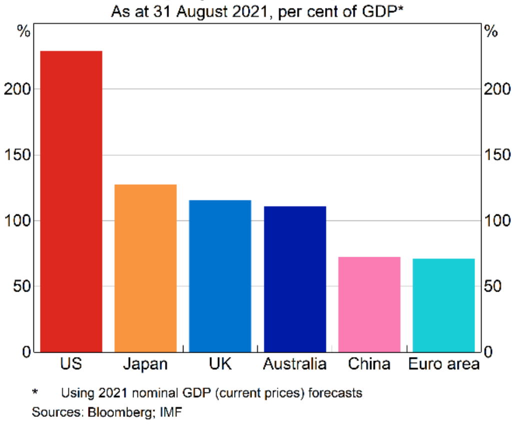
As at 31 August 2021, US dollars



Graph 2

Global Equity Market Capitalisation

As at 31 August 2021, per cent of GDP*

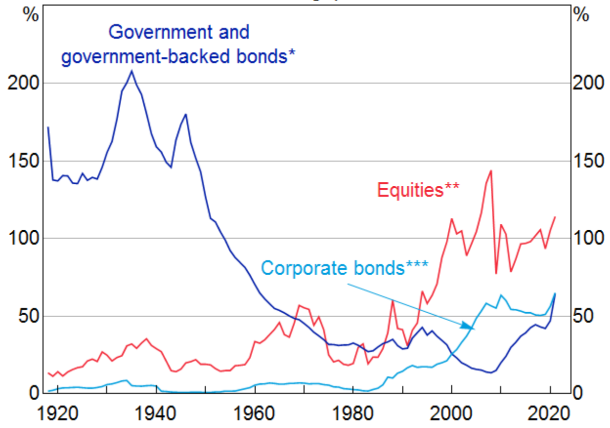


The equity market is the largest securities market in Australia (Graph 3, updated from Mathews (2019)). This has not always been the case – the market for government and government-backed bonds has been much larger in the past and, as measured by securities outstanding, was at around the same level as the market for equity in 1990. The equity market expanded rapidly through the 1990s, supported by the privatisations of the Commonwealth Bank and Telstra, demutualisation of several financial institutions and an increased supply of capital to the share market because of compulsory superannuation (Lowe and Gizycki 2000).

Graph 3

Australian Financial Markets

Securities outstanding, per cent of GDP



* Includes central and state government bonds, as well as those issued by government-owned corporations

** Includes only companies listed on the Sydney Stock Exchange prior to 1964, so may understate the size of the market for this period

*** Includes all bonds issued by non-financial corporates, financial corporates and asset backed securities; data on bonds issued offshore are not available prior to 1983

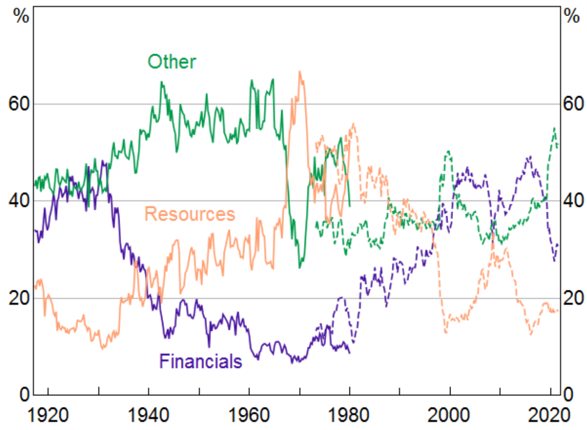
Sources: ABS; ASX Limited ABN 98 008 624 691 (ASX); Black et al (2012); Foster (1996); Mathews (2019)

By sector, financial corporation and resource stocks are the largest categories of the Australian Stock Exchange (ASX), currently accounting for around 30 per cent and 20 per cent of market capitalisation, respectively (Graph 4). Within other industries, the largest categories are healthcare (11 per cent of the index) and consumer discretionary (8 per cent). The relative size of these industry sectors has changed over time.

Graph 4

Market Capitalisation by Sector

Share of total index



Notes: Solid lines show series calculated from RBA dataset, dashed lines show Datastream series; dates correspond to start of calendar year

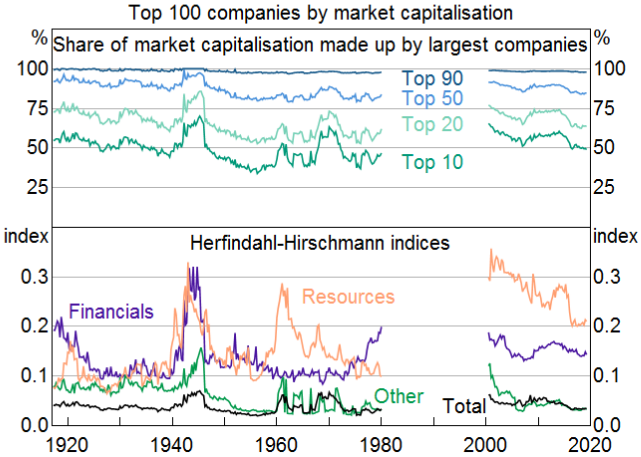
Sources: ASX; Mathews (2019); Refinitiv

The 10 largest listed companies have accounted for around half the market capitalisation of the top 100 stocks on average from 1917 until 2018 (Graph 5). The share of market capitalisation of the 10 largest companies peaked during periods of high commodity prices such as the 1960s and 1970s. This is also evident in alternative measures of concentration, such as Herfindahl-Hirschmann indices, which are higher when concentration is higher. The resources and financial sectors were, and continue to be, notably more concentrated than the rest of the market. Measures of concentration have declined slightly over the past 20 years or so. Internationally, among similar-sized stock exchanges, the level of concentration seen in Australia is not unusual (Kohler 2018).

Graph 5

Equity Market Concentration*

Top 100 companies by market capitalisation



* Individual company data from Mathews (2019) is only avaible to 1979; modern data are only readily available after 2000

Sources: ASX; Bloomberg; Mathews (2019); Refinitiv

The make-up of the top 10 companies has been little changed over time: of the top 10 companies in 1917, five were still in the top 10 at the end of August 2021 (Table 1). In contrast, only one of the top 10 US companies in 1917 was still in the top 10 100 years later (Kauflin 2017). Consistent with this, Australia's listed corporations are relatively older than those in other major equity markets: weighted by market capitalisation, the average listed company in Australia is around 105 years old, compared with 77 years in Japan, 82 in the US and 95 in the UK (Graph 6).

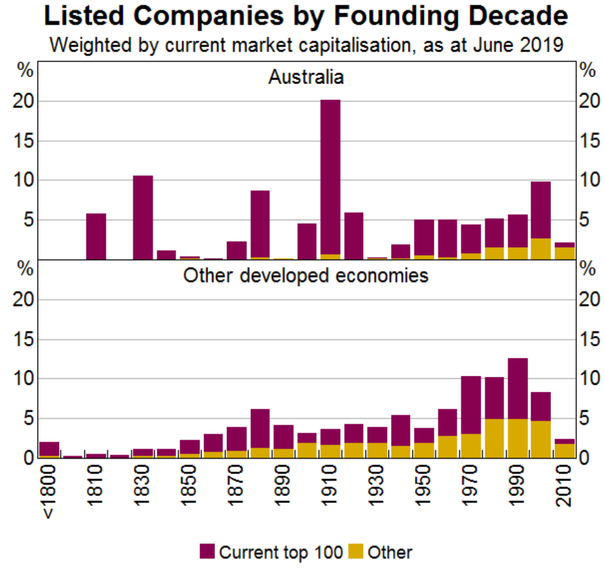
Table 1: Largest 10 Listed Companies by Market Capitalisation in 1917

1917 company name	2019 name[(a)]	1917 Sydney Stock Exchange rank	2021 (25 August) ASX rank[(a)]	Notes
Bank of New South Wales	Westpac	1	5	*Merged with Commercial Bank of Australia in 1982 to form Westpac*
British Tobacco	British American Tobacco	2	--	*Delisted from ASX in 2001 following acquisition; BAT currently listed in the UK*
Bank of Australasia	ANZ	3	7	*Merged with Union of Australia Bank in 1951 to become ANZ*
Union of Australia Bank	ANZ	4	7	*See above*
Colonial Sugar Refining Co.	CSR	5	145	*Sold its sugar refining operations in 2010, now produces building products*
Commercial Bank of Sydney	NAB	6	6	*Merged with National Bank of Australasia to become NAB in 1982*
Broken Hill Proprietary	BHP Billiton	7	2	*Became BHP Billiton in 2001 following merger*
Union Steam Ship Company of New Zealand	--	8	--	*Acquired by P&O and later closed*
Howard Smith	Wesfarmers	9	8	*Acquired by Wesfarmers in 2001*
Mount Lyell Mining Co.	Iluka Resources	10	114	*Several rounds of acquisition and mergers in the interim*

Sources ASX; Bloomberg; delisted.com.au; RBA; NLA; Sydney Stock Exchange

Note: (a) As at April 2019. If the company has been acquired or merged, this is the name/rank of the acquirer or new entity; see notes

Graph 6



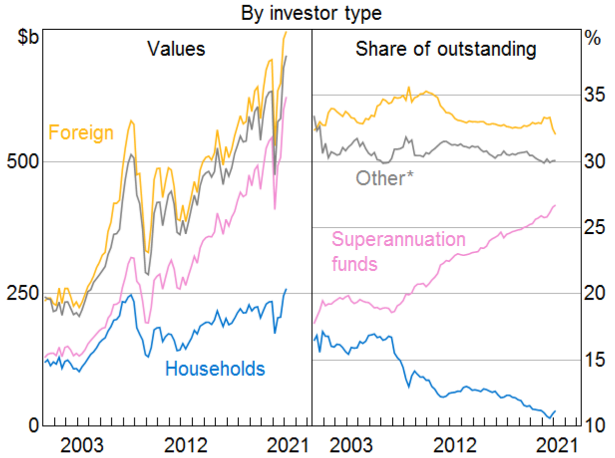
Source: Mathews (2019)

Of the roughly 2,000 listed companies on the Australian Stock Exchange, around 150 are foreign headquartered.[1] About 50 of those companies have primary listings on other exchanges, such as News Corporation and Unibail-Rodamco-Westfield. The two largest mining companies listed on the Australian Stock Exchange, Rio Tinto and BHP, are dual-listed, meaning there are two separate companies, one listed in Australia and one listed in the another country (the United Kingdom in the case of these companies) with an equalisation agreement in place. The equalisation agreement ensures that a share in each respective company entitles the owner to receive the same dividend payments and voting rights. BHP has recently proposed to unwind its dual-listed structure, moving to a primary listing in Australia.

Foreign investors account for about one-third of the value of holdings of Australian listed equity (Graph 7). Over the past 15 years, the share accounted for by superannuation funds has increased strongly, while the share accounted for by direct household ownership has fallen.

1 Data from the July 2021 ASX Foreign Entity Report found at https://www2.asx.com.au/listings/how-to-list/listing-requirements/foreign-entity-data

Graph 7
Ownership of Equity
By investor type

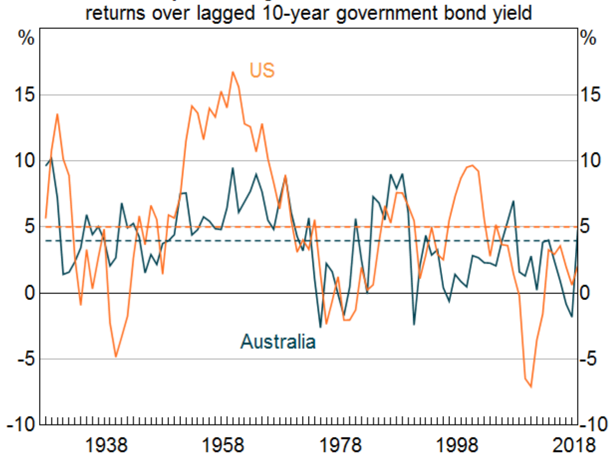


* Includes investments of fund managers, which may be investing on behalf of other investor types, including pension funds

Sources: ABS; RBA

Equity markets generally offer a higher average return than safe assets, such as bonds, because investors need to be compensated for the additional risk that is associated with equities. On average, in Australia the realised equity premium – the return on equity relative to the return on a 10-year government bond over a 10-year period – has been broadly comparable to that in the United States (Graph 8).

Graph 8
Realised Equity Risk Premium*
10-year trailing cumulative annualised returns over lagged 10-year government bond yield

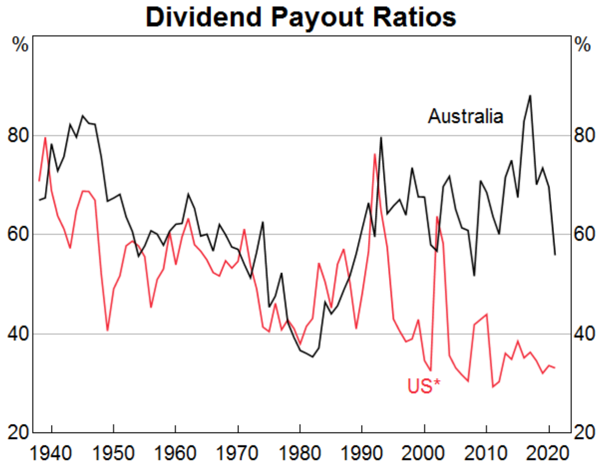


* Dotted line is the average

Source: Modified from the sources of Mathews (2019)

The dividend payout ratio for equities is the proportion of profits paid out as dividends. On average around 65 per cent of listed company earnings were paid to investors in the form of dividends from 1917 until the present, although this has varied over time (Graph 9). The introduction of franking credits in the 1980s in Australia contributed, at least in part, to the relatively high dividend payout ratios since the early 1990s (Bergmann 2016).

Graph 9

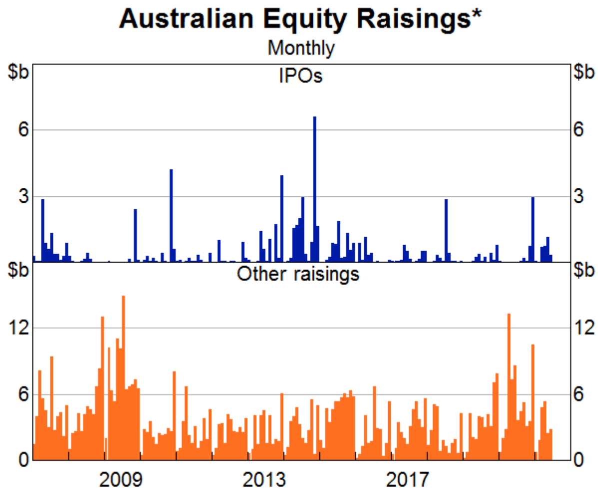


* Excluding 2008

Sources: ASX; Mathews (2019); Refinitiv

Initial Public Offerings (IPOs) are a source of finance for companies' first listing. However, in Australia the dominant form of capital raising is by companies that are already listed raising further funding (Graph 10). Since 2008, an average of $5 billion per year has been raised through IPOs, while other raisings accounted for an average of almost $43 billion. The amount raised fluctuates over time, with increased issuance seen in the immediate aftermath of the global financial crisis and as the COVID-19 pandemic worsened in 2020.

Graph 10



* All listed companies

Sources: ASX; RBA

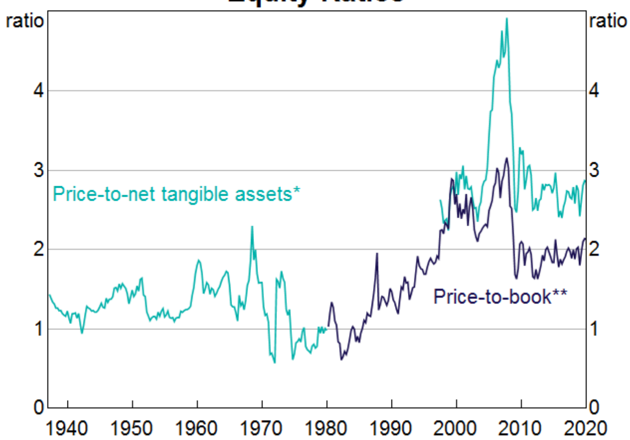
The price-to-book ratio is a valuation metric reflecting the premium the market is willing to pay for a company's assets over their accounting cost. In a highly simplified economic model, this ratio should not deviate much from one. If it were to do so, a company could invest capital in some business, float it on the stock exchange and make a capital gain. If that occurred on a large enough scale, there would be forces that would push the ratio towards one. The supply of new equity on the market could bring equity prices down, and the extra supply in the product market would reduce profits, and thereby reduce valuations.

However, there are reasons for the price-to-book ratio to deviate from one. For example, it can be higher because companies might have market power in their product markets. If new companies cannot be established to compete because there are some barriers to entry, then high valuations can persist. But there are other reasons price-to-book ratios might be high. For example, unrealised capital gains on assets can increase the price-to-book ratio.

In Australia, measures of price-to book valuations have increased since 1980, reflecting an increase between 1980 and 2000 (Graph 11).

Graph 11

Equity Ratios



* RBA dataset to 1979, S&P/ASX 200 from 1999–2020, no data available in the interim

** Includes intangible assets

Sources: ASX; Bloomberg; Mathews (2019); Refinitiv

Reserve Bank of Australia
13 September 2021

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