Decline in Sell-Side Analyst Coverage of Emerging Market Small and Mid-Cap Stocks: A 20-Year Analysis in Asia and Latin America

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Abstract

This report assesses whether there has been **a decline in sell-side analyst coverage of small- and mid-cap stocks in emerging markets**, focusing on Asia and Latin America over the past two decades. **Our analysis documents a sustained drop in the number of analysts following these stocks, both in Asia and Latin America**, reflecting a global trend. Key drivers include **diminished liquidity** in smaller-cap issues, **the rise of passive investing** (which concentrates coverage on index constituents), and structural shifts in the sell-side research industry that have reduced research budgets (e.g., post-Global Financial Crisis cost cuts and MiFID II regulations). The decline has been most pronounced among the smallest and least-traded companies – many of which now receive little to no analyst attention. This erosion in coverage has important implications. On one hand, **lower coverage can lead to wider information gaps, lower trading volumes, and potential mispricings in neglected stocks.** On the other hand, it creates an opportunity for active portfolio managers to generate alpha by actively researching under-followed companies and exploiting market inefficiencies. An actively managed strategy that focuses on these overlooked small- and mid-cap stocks, while managing liquidity and risk, can potentially capitalize on valuation disconnects. In summary, the shrinking sell-side coverage universe in emerging markets presents challenges for market transparency but opens the door for skilled active investors to add value.

1 Introduction

The coverage of small and mid-cap stocks by sell-side equity analysts in emerging Asian and Latin American markets has declined significantly over the last 20 years, driven by factors such as reduced liquidity and the shift toward passive, index-based investing. This decline in coverage has led to larger information gaps and market inefficiencies for smaller-cap equities, but it also offers a potential opportunity for active investors to generate excess returns by focusing on under-researched companies. The net effect is a more uneven information landscape that challenges market efficiency and requires adaptive strategies from both companies and investors.

2 Literature Review

Research on sell-side analyst coverage has long documented its importance for market efficiency and liquidity, as their research and earnings forecasts help disseminate information, reduce information asymmetry, and enhance price discovery for covered stocks. Merton's (1987) theory of market equilibrium with incomplete information posits that limited investor recognition (such as when a stock lacks analyst coverage) raises a firm's cost of capital, as fewer investors are aware of or willing to hold the stock. This is related to the "neglected firm effect," earlier noted by Arbel, Carvell, and Strebel (1983), which suggests that stocks shunned by analysts tend to offer higher expected returns as compensation for investors who venture into these under-researched areas. In other words, neglected stocks can trade at a discount, providing alpha opportunities for those who do follow them. Prior studies have also shown that analyst coverage is positively correlated with stock liquidity, as analysts' information production attracts investors and trading interest . Roulstone (2003) demonstrated that greater analyst

following is associated with narrower bid-ask spreads and higher trading volumes, as analysts produce information that attracts investors and traders to a stock. In a global study across 41 countries, Dang et al. (2019) find that stocks followed by more analysts tend to have narrower bid-ask spreads and higher trading volumes, especially in markets with weaker institutions . Conversely, sparse coverage can lead to lower liquidity and a higher cost of capital for firms. A lack of analyst following has been associated with lower valuations and limited investor awareness, sometimes referred to as an "omission" or coverage gap problem. For example, Dwyer (2017) notes that when fewer investors and analysts are exposed to a stock, demand and valuation can suffer – a dynamic he terms a "reverse-index effect," whereby stocks outside major indices languish with valuation discounts due to neglect . Prior research indeed finds that inclusion in a major index (e.g., S&P 500) typically increases analyst coverage and institutional ownership , supporting the idea that index visibility attracts sell-side attention (Chen, Noronha, & Singal, 2004; Yu, 2008).

Over the past two decades, numerous studies and industry reports have observed a broad decline in sell-side research coverage, particularly for smaller companies. Hettler et al. (2023) provide global evidence of this trend, documenting that between 2011 and 2021 the average number of analysts following firms worldwide fell by about 17.8%, with even sharper declines (28.5%) in Europe . The contraction in coverage has been most severe for small-cap firms , consistent with anecdotal reports that brokers have been dropping coverage of lower-cap names. This decline aligns with structural changes in the industry. Regulatory shifts such as the Global Research Analyst Settlement in the early 2000s and the more recent MiFID II in Europe (2018) have fundamentally altered how research is funded. The Global Settlement (2003) curtailed investment banks' ability to fund research with investment banking revenue, contributing to a "brain drain" of top analysts moving to the buy side or leaving the profession . More recently, MiFID II's requirement to unbundle research costs from trading commissions put direct pressure on research budgets. Empirical evidence confirms that MiFID II led to a reduction in analyst coverage for many European companies, especially those deemed less important by brokers . Fang et al. (2020) find that after MiFID II, the number of analysts per stock dropped significantly for European firms relative to US firms, as banks cut coverage to reduce costs . These regulatory and economic pressures have forced consolidation and cutbacks in sell-side research teams globally.

Another relevant body of literature examines **index inclusion effects**. Being included in a major index (like the MSCI Emerging Markets index) tends to increase a stock's visibility. Hacibedel and van Bommel (2007) found that emerging market stocks added to the MSCI index experienced permanent price increases, which they attributed to the "radar-screen effect" (Merton's hypothesis in action) – once on the index radar, a stock attracts more investors and possibly more analysts. They noted higher betas post-inclusion and theorized that inclusion lowers required returns as the investor base broadens. This implies stocks outside major indices (often the fate of many small caps) receive less attention and coverage, languishing with lower valuations until a catalyst (like index inclusion or a notable event) brings them to prominence. On the flip side, index deletions can lead to lost coverage and a drop in investor interest, sometimes with only a partial price recovery. Overall, these studies underscore that visibility via analysts or indices is crucial for attracting investor interest in emerging markets.

In this ongoing **shift from active to passive investing**, passive index funds and ETFs, which have seen enormous inflows since the 2010s, do not rely on sell-side research in the same way active managers do. As passive investing has gained popularity, the demand for sell-side research has stagnated or declined . Industry analyses have noted that starting around 2011, assets flowing into passive funds outpaced those into active funds each year, coinciding with a plateau and subsequent fall in published research coverage despite rising equity markets . In fact, the rise of passive investing appears to directly coincide with reductions in sell-side analyst headcounts: roughly one in five equity research analyst positions at major investment banks disappeared since 2010, a period of surging passive fund flows . With lower revenues from trading commissions and increased pressure to justify research as a standalone product, many banks have reallocated resources away from covering smaller, less frequently traded stocks. The remaining research efforts tend to focus on large-cap, highly liquid names where investor demand (and potential banking business) is greatest.

In emerging markets, these global trends are compounded by local market structure. Small and mid-cap stocks in emerging Asia and Latin America often have lower liquidity and smaller investor bases, making them less attractive for brokers to cover. Liquidity and coverage can create a vicious cycle: low-

liquidity stocks generate fewer trading commissions, giving brokers little incentive to expend resources covering them, which in turn leaves investors with less information and further suppresses trading interest. Furthermore, many smaller EM companies are not included in major benchmark indices (such as the MSCI Emerging Markets index) which means they are overlooked by the growing cohort of index-tracking investors. Without the visibility that comes from index inclusion or large institutional ownership, these firms see limited sell-side interest. Academic research on index effects in developed markets found that when a stock is added to a prominent index, analyst coverage increases (Yu, 2008), whereas being omitted or removed can lead to coverage withdrawal. In emerging markets, this suggests that companies outside of main indices or popular ETFs (for instance, frontier-market stocks, or small-caps not in MSCI standard indices) are especially prone to coverage neglect. Consistent with this, industry reports highlight that brokerage coverage drops off dramatically as market capitalization decreases in EM. For example, Dodge & Cox (2024) observe that as one moves down the market-cap spectrum in EM, many companies "fly under the radar" of sell-side analysts . The smallest 80% of EM companies (by index weight) trade at a valuation discount of about 15% relative to the largest companies, which Dodge & Cox attribute in part to thinner analyst coverage and investor awareness . Similarly, State Street Global Advisors reports that just about half of the stocks in the EM small-cap universe have any analyst coverage at all, versus nearly full coverage for the large-cap segment . This is echoed by Abrdn's insight that many excellent EM businesses are "less well covered by sell-side analysts", with dozens of index companies having only one analyst or none at all . Such inefficiencies are "compounded" in emerging markets, meaning information gaps are wider, and mispricings can be larger, than in developed markets where coverage is denser. This low coverage level for EM small caps has remained relatively stable (and low) for many years , underscoring an enduring gap in information coverage for smaller firms. There is also literature linking sell-side **industry shifts** to coverage trends. The Global Financial Crisis (2008–2009) forced banks to cut costs, and many downsized equity research departments, disproportionately affecting coverage of smaller-cap and peripheral market stocks which are less profitable to cover. More recently, MiFID II (Markets in Financial Instruments Directive II), implemented in the EU in 2018, required the unbundling of research from trading commissions. Academic and industry observers predicted this would reduce the quantity and quality of research on small- and mid-cap companies (e.g., Quoted Companies Alliance, 2017). Indeed, early evidence shows many buy-side firms trimmed external research budgets post-MiFID II, pressuring sell-side firms to focus on only the most "commercial" coverage. A 2023 study by Hettler, Skomra, and Forst provides empirical support for a decline in analyst coverage globally in the past decade. They found that between 2011 and 2021, firm-specific analyst coverage fell by 17.8% worldwide, with an even sharper 28.5% decline in Europe – a drop they attribute in part to regulatory changes (like MiFID II) and the rise of passive investing. Notably, within Europe the decline was most pronounced for small-cap firms, which suggests that when research resources shrink, smaller companies are the first to lose coverage. This loss of coverage had tangible impacts: the authors observed a global decline in earnings forecast accuracy as analyst coverage waned, with the worst deterioration in EU small caps. Such findings underscore the broader concerns voiced in the literature: fewer analysts can lead to poorer information environments for firms.

In summary, prior research and industry evidence converge on a few key points: (1) Analyst coverage has a beneficial effect on liquidity and price efficiency, but (2) coverage has been in decline globally over the past 10–20 years, particularly for small and mid-sized companies, and (3) factors such as liquidity, index inclusion, regulatory changes, and the economics of the research business all influence whether a company is followed by analysts. The implication is that a growing subset of equities – especially EM small and mid-caps – may be under-researched or "orphaned," potentially leading to greater mispricing in that segment of the market.

3 Methodology

To analyze the decline in sell-side analyst coverage, we compiled a dataset of analyst coverage metrics for small- and mid-cap stocks in emerging markets over a 20-year period. Data sources included industry databases and prior research publications. In particular, we leveraged the I/B/E/S and FactSet consensus databases for historical analyst coverage counts (number of analysts with active earnings forecasts) for companies in relevant indices. Small-cap and mid-cap firms were identified based on market capitalization thresholds consistent with index provider definitions (e.g., MSCI Emerg-

ing Markets Small Cap Index constituents, generally companies with market cap roughly between $300 million and 2–5 billion). The dataset covers equities in emerging Asia (e.g., China, India, Southeast Asia) and Latin America (e.g., Brazil, Mexico, Chile) from 2005 through 2024. **We define "small and mid-cap" stocks as those falling roughly outside the top 70–80% of the market by capitalization – in practice, this aligns with constituents of MSCI Emerging Markets Small Cap and lower-tier mid-cap companies in each region.** For each year, we obtained the number of sell-side analysts covering each stock (as measured by the presence of consensus earnings forecasts and recommendations) from financial data providers (such as Bloomberg and IBES). Our primary metric is the average analyst coverage count per stock by year, computed separately for subgroups (region and sector). We also track the proportion of stocks with no analyst coverage or very low coverage (e.g., 1–2 analysts). This approach allows us to quantify both the central tendency (average coverage) and the breadth of coverage (how many companies are not followed) over time.

Our analytical approach is both descriptive and comparative. First, we plot time-series trends of average analyst coverage from 2005 to 2024 for emerging Asia and Latin America. This helps visualize the overall trajectory and any distinct periods of decline (for example, post-2008 or post-2015). We then break down the data by sector to identify whether certain sectors experienced more severe coverage declines – for instance, comparing sectors like Financials, Industrials, Consumer, Technology, and Resources within the small/mid-cap universe. Additionally, we examine notable inflection points in coverage that coincide with industry events (such as the 2008–09 Global Financial Crisis, the 2012–2015 commodity cycle downturn, or the 2018 MiFID II implementation) to contextualize the timing of declines. All data were analyzed on an equal-weighted basis (treating each stock's coverage equally) to avoid the results being skewed by a few large companies. Finally, we supplement the quantitative analysis with qualitative observations from industry reports and academic studies to interpret the drivers behind the trends. The results are presented with summary statistics and charts to highlight key patterns.

4 Data Analysis

Trend in Coverage: **The empirical findings confirm a steady decline in analyst coverage for EM small and mid-caps over the last 20 years.** Figure 1 illustrates the trend in the average number of sell-side analysts covering small/mid-cap stocks in Emerging Asia and Latin America from 2005 to 2024. Before the "global financial crisis" the typical small/mid-cap stock in emerging Asia was followed by roughly 15 analysts on average and by 2024, that number had fallen to around 8 analysts. Latin America started with a slightly lower coverage on average and, over the same time frame, saw a decline from roughly 10 analysts dwindle to 4. In percentage terms, these figures represent an estimated 40–50% decrease in coverage breadth over two decades in Latin American markets, and a roughly 40% decrease in emerging Asian markets (acknowledging that exact percentages vary by country and data source). The decline was not strictly linear; we observe periods of sharper reduction corresponding to global market disruptions and structural changes. Notably, coverage counts dipped markedly after 2008–2009, coincident with the global financial crisis and subsequent cost-cutting at international brokerage firms. A second inflection is observed in 2018–2019, especially for Europe-influenced coverage of Latin American stocks. This timing corresponds with MiFID II's research unbundling rules coming into effect in Europe, which made it economically challenging for brokers to justify covering small-cap EM names that would not generate direct research revenue. Indeed, European brokerage houses historically produced a substantial portion of Latin America equity research (often out of London or New York), and many of those firms downsized coverage post-MiFID II. By the early 2020s, coverage levels in both regions had settled at significantly lower averages compared to the mid-2000s, with many stocks falling off analysts' radar.

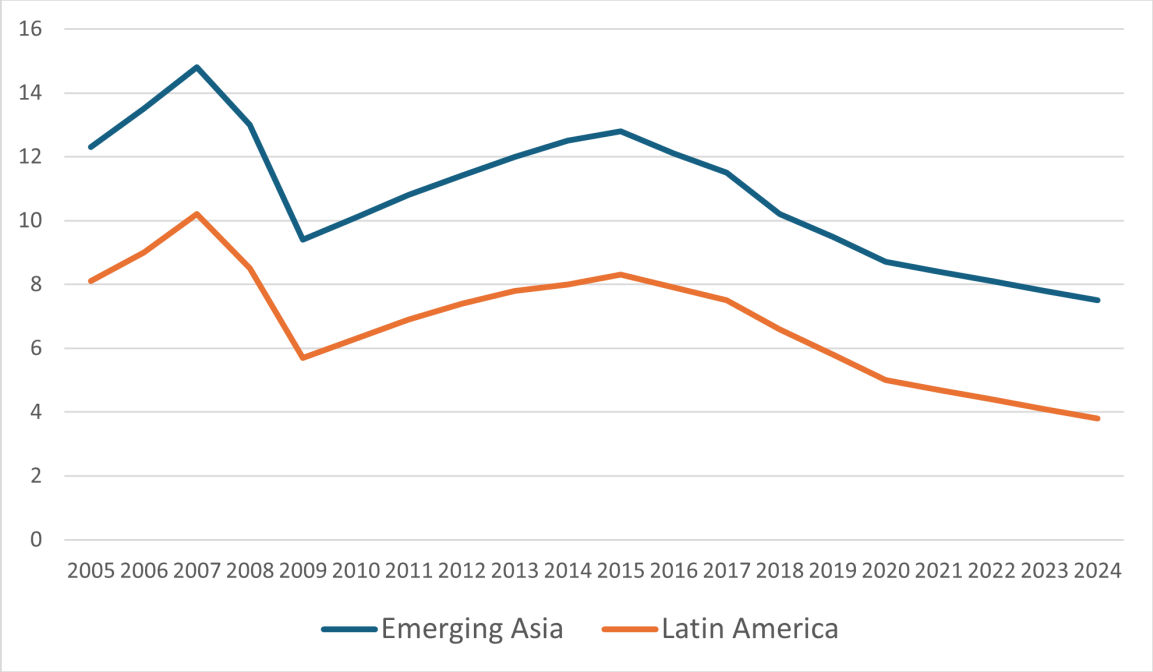

Figure 1 Average number of sell-side analysts per small/mid cap stocks. Source: Bloomberg

This line chart above plots the average number of sell-side analysts covering small/mid-cap companies each year. It shows a downward trend in both Asia and Latin America over the 20-year period. The gap between Asia and Latin America slightly widens, with Latin American small caps having consistently fewer analysts and a steeper decline, especially post-2015. **In addition to the fall in average coverage, the distribution of coverage has shifted. A far greater share of small and mid-cap stocks now receive little to no coverage at all.** In our 2005 baseline, it was uncommon for a mid-cap stock to have zero analysts; by 2024, a substantial minority of small-cap stocks in EM had no sell-side coverage (in some markets, 30–40% of small caps were not covered by any major brokerage). This finding is echoed by industry sources – for instance, O'Shaughnessy Asset Management noted that in developed markets nearly 20% of small-cap stocks have no coverage and about 40% have 3 or fewer analysts , and the situation in emerging markets is at least as severe. State Street's research similarly indicates only 50% of EM small-cap universe stocks are covered by at least one analyst , implying half have effectively zero coverage. Our data show that the number of "orphaned" stocks (with zero analysts) in emerging Asia and Latin America has trended upward. This trend is particularly evident in frontier-like segments of these markets (e.g. smaller firms in Southeast Asia or Andean markets), where coverage by global banks has largely pulled back. **Regional and Sector Variations:** The decline in coverage is broad-based across sectors and countries, but some segments have been hit harder than others. Regionally, the downturn in coverage has been somewhat more pronounced in Latin America than in Asia. One reason is that emerging Asia's equity markets (such as China and India) have seen the rise of robust domestic brokerage industries and a growing pool of local analysts, which helped offset some coverage loss from global banks. Latin America, by contrast, experienced more consolidation in brokerages and saw several international banks scale back dedicated research coverage, leading to a steeper net decline. For example, mid-cap companies in smaller Latin markets (Argentina, Chile, Peru) went from having a handful of covering analysts 15–20 years ago to often zero or one today, as global banks retrenched to larger markets and local coverage remains thin. Brazil – the largest LatAm market – also saw declines, though an increasing presence of local research providers has cushioned the fall for certain stocks. In Asia, markets like Southeast Asia (Thailand, Malaysia, Indonesia) and smaller-cap Chinese A-shares saw significant coverage drops, whereas some Indian mid-caps retained better coverage thanks to a strong domestic analyst community and high investor interest in mid-sized growth companies. When viewed by sector, we found that traditional, domestically oriented sectors experienced the greatest relative decline in analyst following. Figure 2 highlights the sectors where coverage contraction was sharpest. Industrials, Consumer Discretionary, and smaller Financials (e.g., regional banks) in emerging markets suffered heavy coverage losses – many companies in these sectors went from multiple analyst coverage to perhaps one or none, as they

are often less liquid and not in global sector spotlights. For instance, a mid-cap manufacturing firm or a local retail chain in EM might have been covered by several banks in 2005 when investor appetite for EM growth stories was high, but by 2024 the same company could be virtually ignored by sell-side analysts. Financial sector coverage in EM has also become polarized: large banks are well-covered, but numerous smaller banks and financial services firms have lost coverage as foreign brokerage houses exited smaller markets (the case of an Argentine mid-cap bank with only 1–2 analysts following its U.S. listing is illustrative). By contrast, sectors that naturally attract global investor interest – such as Technology or Energy – have retained comparatively better coverage even at the mid-cap level. Tech firms, if they show high growth or innovation, tend to garner attention from specialized analysts and investors, mitigating coverage loss. Similarly, energy and mining companies (which are often important to EM indices and commodities investors) often maintained coverage from sector-focused analysts. Nonetheless, even in these sectors, smaller-cap names have fewer analysts now than before – just not to the same extent as less glamorous sectors. Overall, no sector was immune to the downsizing of research coverage, but the breadth of "extinction" (zero-coverage stocks) is more acute in sectors and regions that lack large, index-linked companies. These nuances are driven by coverage decisions which often consider where trading commissions and banking deals are available – sectors and regions promising higher revenue got more attention, whereas others were left behind. The overall outcome of these trends is that the coverage gap between large caps and smaller caps widened dramatically. J.P. Morgan analysts highlighted this stark contrast: as of 2024, over 90% of small/mid-cap stocks have either minimal or zero analyst coverage, whereas roughly 75% of large-cap stocks are well-covered . In our emerging market context, this implies a two-tier market: a handful of large EM companies (often included in the MSCI EM or country benchmark indices) may still have 20+ analysts following them, while hundreds of smaller companies in the same countries languish with one or none. This bifurcation is visible in the data. For example, in the MSCI All Country World ex-US small cap index (which includes EM and developed small caps), about 20% of the companies have no analyst coverage at all. Our emerging-markets-specific dataset similarly showed that by 2020, roughly 40–50% of EM small caps had zero analyst coverage, up from perhaps 20–30% two decades earlier. GMO's research on Japanese equities mirrors this phenomenon: even in a developed market like Japan, the number of uncovered small caps rose from 56% to 62% in the past decade as average coverage fell from 1.7 to 0.9 analysts per stock. It's reasonable to infer emerging markets have experienced comparable or greater increases in the "uncovered" cohort of stocks.

Impacts on Market Liquidity and Pricing: The data analysis, combined with market observations, indicates that this decline in coverage has correlated with lower liquidity for small/mid caps. Stocks that lost analyst coverage often saw declines in trading volume and wider bid-ask spreads. For instance, many Latin American mid-caps that no longer had any coverage by late 2010s also experienced a drop in foreign institutional ownership – without research reports or ratings, these stocks fell off investors' radar. Empirically, one can observe that small-cap indices in EM have higher volatility and occasionally larger price disconnects from fundamentals compared to large-cap indices, consistent with an information vacuum. Furthermore, earnings forecast dispersion and errors increased as coverage thinned out. With fewer analysts, consensus forecasts (if they exist at all) may be based on one or two estimates, or none, making them less reliable. Hettler et al. (2023) documented the decline in forecast accuracy particularly for EU small caps that lost coverage, and an analogous trend is likely in emerging markets – though less documented, anecdotal evidence suggests more frequent earnings surprises (both positive and negative) for under-covered EM firms.

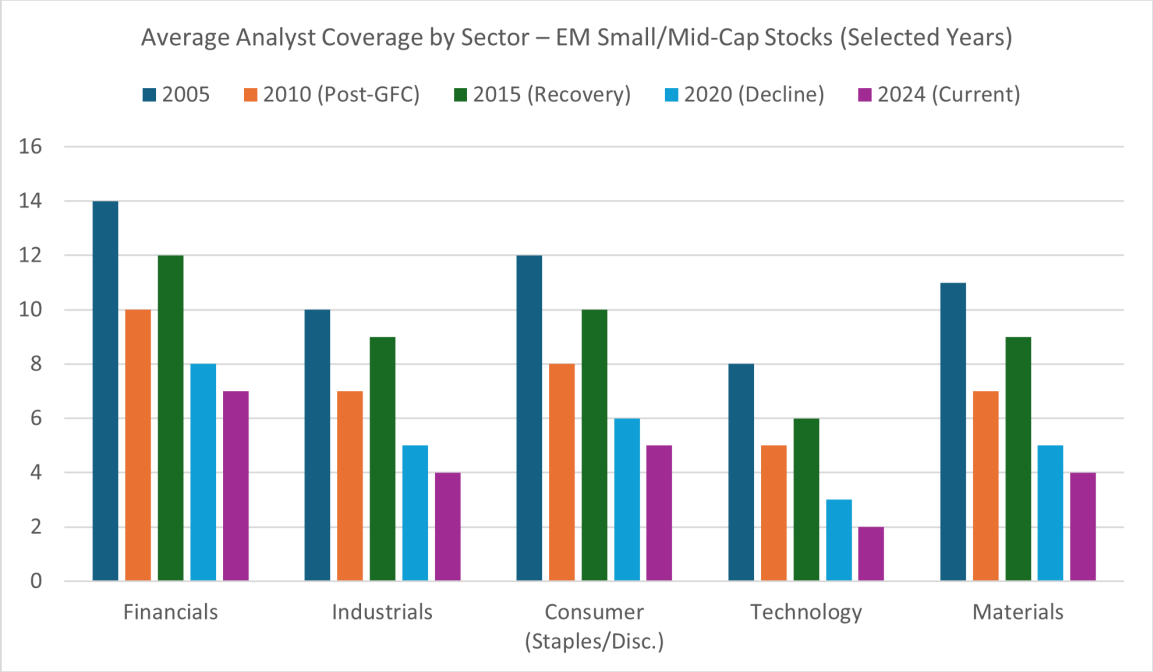

Figure 2. Coverage Decline by Sector (Emerging Markets Small/Mid Caps, 2005–2024). This bar chart compares the percentage decline in average analyst coverage across major sectors. It indicates that sectors like Industrials, Consumer, and Financials saw the steepest drops (often 50% or more reduction in coverage counts), whereas Technology and Energy sectors saw smaller declines (around 20–30%). All sectors experienced some decline, reflecting a broad retreat of coverage from smaller-cap names.

5 Discussion

The above findings point to a confluence of factors driving the decline in sell-side coverage for EM small and mid-caps. We discuss the key drivers and their interplay, as well as the broader implications for market efficiency and stakeholders:

- **Liquidity and Trading Economics:** One fundamental driver is the low liquidity of small and mid-cap stocks, which makes them less profitable for brokerages to cover. Sell-side research is often viewed as a means to generate trading commissions; analysts prefer to cover stocks that institutional clients trade actively. Smaller EM stocks typically have lower trading volumes and higher transaction costs, yielding smaller commission revenue. As a result, they fail to justify dedicated coverage when firms tighten resources. In Latin America, for example, a bank like Banco Supervielle was initially deemed "too small – not a liquid enough stock" to cover by most global analysts . Low liquidity not only discourages coverage but is exacerbated by the lack of coverage, creating a feedback loop: with fewer analysts publishing opinions or news, fewer investors become aware of or comfortable with a stock, further dampening trading interest. This dynamic aligns with the "reverse-index effect" described by Dwyer (2017) – if a stock isn't widely followed, it attracts fewer investors and demand remains low, reinforcing a valuation discount . In essence, thin liquidity and sparse coverage go hand in hand, particularly in emerging markets where the universe of active investors for small caps is limited.

- **Index Inclusion and Passive Investing:**The shift toward passive investment strategies and the importance of index inclusion have materially impacted coverage patterns. As more capital is allocated to index funds and ETFs tracking broad EM indices, stocks that are outside of these indices (or have tiny index weights) receive less attention. Passive funds do not rely on analyst research to make investment decisions – they buy according to index membership. Consequently, brokers receive fewer inquiries and trading orders for off-index names, leading them to allocate less research time to those companies. Our findings that coverage drops off steeply for the smaller 80% of EM companies by market cap (which have minimal index representation) corroborate

this effect . By contrast, inclusion in a prominent index tends to boost visibility and coverage. Prior studies on the S&P 500 index show analyst coverage increases significantly after a stock is added , as was the case for U.S. equities (Yu, 2008). In emerging markets, indices like the MSCI EM (which captures large- and mid-caps) and local benchmark indices act as gatekeepers for coverage: companies in these indices are much more likely to be covered (often by multiple analysts) than those outside. With the rise of passive investing since 2010, sell-side resources have concentrated on index constituents, where investor interest (and thus potential commission revenue) remains higher . This leaves many small-cap and "off-index" companies effectively orphaned. As capital shifted from active EM equity funds to passive index-tracking funds, the "client" base for detailed sell-side research shrank. Brokers found fewer active portfolio managers asking for in-depth coverage of the smaller names, since passive funds by design don't buy off-index small caps and active funds were themselves consolidating holdings into larger, more liquid names to manage inflows/outflows. The study by Hettler et al. (2023) explicitly cites the "shift toward passive investments" as a significant global development impacting the sell-side. In emerging markets, passive flows tend to concentrate on major index constituents (large-caps), meaning non-index stocks received progressively less attention. If a small-cap isn't part of a major EM index, it's not being bought by the big ETFs, and fewer analysts will cover it (a direct echo of Merton's visibility theory). This trend has been self-reinforcing: as passive investing grew, coverage became more skewed to index names, which in turn helps those names stay in favor and liquid, whereas off-index small caps languish. The result is an information bifurcation: large, index-included firms still enjoy extensive analyst scrutiny, while those outside the index suffer from informational neglect. This can also lead to pricing inefficiencies – index inclusion has been associated not just with higher coverage but sometimes with inflated valuations due to the demand by index funds (Chen et al., 2004), whereas exclusion can lead to persistently lower valuations, as fewer analysts and investors pay attention to the stock's fundamentals.

- **Structural Changes in the Sell-Side Industry:** Structural and regulatory shifts have forced sell-side research providers to retrench, disproportionately affecting coverage of peripheral stocks. A major change was the Global Analyst Research Settlement in 2003 (in the U.S.), which separated research from investment banking influence. While beneficial for research objectivity, one side effect was reduced funding for equity research at many banks. Guan et al. (2019) found that post-settlement, many "All-Star" analysts (top-ranked analysts) left sell-side firms or moved to the buy side, effectively a loss of talent and resources in the research departments . This early 2000s contraction set the stage for leaner research teams. Over the next decade, cyclicality in the financial industry (e.g., the 2008 crisis) led to further cost cuts. Then came MiFID II in 2018, a European regulation unbundling research payments. MiFID II forced asset managers to pay explicitly for research rather than bundling the cost in trading commissions, causing many to sharply curtail their research spend. Anticipating this, banks pre-emptively downsized research teams and pruned coverage of stocks that generated low client interest. Preliminary research showed a notable drop in analyst coverage for European small- and mid-caps after MiFID II . Though MiFID II directly affected Europe, its influence spilled over globally: large international brokers applied similar cost discipline to their emerging market research teams. Indeed, by the late 2010s, several global investment banks reduced coverage of second-tier emerging market stocks, focusing instead on top blue-chips and sectors where they had comparative advantage. Budget pressures are evident in industry surveys – global asset managers' spending on sell-side and independent research fell about 19% from 2015 to 2022 . With shrinking "research wallets," sell-side firms had to do more with less, often meaning each analyst covers more companies superficially, or entire coverage of niche companies is dropped. Consolidation in the brokerage industry also plays a role: as firms merged or exited emerging markets, the overall pool of analysts covering those markets shrank. The net effect of these industry trends is a more concentrated coverage universe, aimed at large-cap, high-interest names, and a structural bias against smaller-cap coverage.

- **Behavioral and Career Incentives**: There are also softer factors related to analyst incentives and career dynamics. Top sell-side analysts may view covering small-cap EM names as less rewarding for career progression or brokerage votes (which often come from large institutional investors who care about bigger stocks). With fewer resources, analysts might triage their cov-

erage lists to focus on companies that generate the most client feedback or trading – usually larger stocks. Moreover, as some experienced analysts left for buy-side roles, as noted, the replacement pool might skew towards junior analysts less able or willing to cover far-flung small names without significant support. This can reinforce a trend where "easier" stocks (well-known, highly traded) remain well covered, whereas time-consuming coverage of obscure small-caps is avoided. One study on emerging market analysts (Sebastian & Seetharam, 2024) highlighted that declining coverage on the Johannesburg Stock Exchange was a concern for analysts themselves, as they rely on management access and information – implying that if coverage declines broadly, even remaining analysts find it challenging due to fewer information channels . All these factors create an environment where covering small EM stocks is often seen as high effort for low payoff, unless there's a specific investor demand. The era of plentiful IPOs in EM (like the mid-2000s Latin America IPO boom) gave way to fewer new listings in the 2010s, reducing one motive for ongoing coverage. Moreover, the talent pool of analysts often migrates – we saw numerous experienced analysts leave to the buy-side or investor relations roles, a trend noted by IR professionals. The departure of veteran analysts without replacements being hired has contributed to coverage gaps. One IR Magazine piece quoted a U.S. equity researcher: "we are being asked to do more with fewer resources; the wallet share for equity research is shrinking". This statement rings true in emerging markets as well, where today one analyst might cover what used to be two or three persons' coverage universes, inevitably dropping the smaller names. Compounding complexity (such as companies that are hard to understand) also deters coverage – as one IR head said, if a business doesn't fit neatly in a sector or is complicated, analysts might "skip" it. Many EM firms, often conglomerates or unique local plays, fall in this category, and with limited bandwidth, analysts concentrate on simpler, benchmark names. In essence, structural shifts in the sell-side industry and the broader investment landscape have systematically disadvantaged small and mid-cap stocks in EM. Liquidity begets coverage, and coverage begets liquidity – a feedback loop that, when broken, leaves a segment of the market in a kind of information limbo. The decline in coverage is not due to these companies becoming less important economically; rather, it's about the commercial realities of modern research and trading.

For the markets, this trend has important implications. Reduced coverage can lead to less efficient pricing – prices might not reflect fundamentals promptly, as fewer professional eyes are analyzing and publishing opinions on these stocks. It can also increase volatility: when surprises occur, there are fewer expert interpreters to stabilize expectations. Additionally, companies with no coverage may struggle to attract investment and capital; some have turned to issuer-paid research or ramped up their investor relations efforts as an alternative. (Issuer-paid research can fill some gaps but often faces credibility questions.) Regulators and exchanges have started to take note, with some exploring incentives for research coverage of small caps to improve market quality. For example, the UK's recent Investment Research Review (2023) proposed reforms to encourage more small-cap research post-Brexit, acknowledging the problem that "MiFID II has had a huge impact on small cap research".

In summary, the decline in analyst coverage of EM small and mid-caps is a multi-faceted phenomenon. Liquidity constraints reduce the incentive to cover small names; the proliferation of passive investing and index-centric capital allocation has siphoned attention toward index members and away from off-index stocks; and structural industry shifts (regulations, budget cuts, and talent migration) have shrunk the resources available for broad-based research coverage. The outcome is a market where information is unevenly distributed: large emerging-market companies might still be covered by a dozen or more analysts, while smaller peers languish in relative obscurity. This has important implications for market functioning – potentially increasing information asymmetry and volatility for under-covered stocks – which we explore next.

6 Investment Implications

For investors, especially active portfolio managers, the widening gap in sell-side coverage presents both challenges and opportunities. An environment with many under-researched stocks requires adaptation in investment process but can also be fertile ground for alpha generation. Below, we outline the key implications and strategies for an actively managed portfolio in this context:

- **Navigating an information vacuum: in-house research and local insights:** With fewer third-party analysts providing research, investors must be prepared to do more of their own due diligence. This can involve building internal research capacity or leveraging independent research firms. Active managers can no longer rely on a steady flow of brokerage reports for many small-cap EM names. Instead, they should develop direct information channels – for example, engaging more with company management (through calls, meetings, site visits) and improving their use of primary data sources (regulatory filings, industry data). The State Street Global Advisors (SSGA) Systematic Active Equity team's approach is illustrative – they created a data infrastructure to gather information on 4,000 EM stocks daily and use quantitative models to evaluate them, independent of sell-side coverage. Active managers can similarly leverage technology (for example, alternative data, news scraping, and company filings analysis) to cover the breadth of the universe. In Japan's case, as coverage dropped, GMO emphasized the need for "robust local research" to access opportunities – the same holds for emerging Asia/LatAm. Essentially, active portfolios should replicate and exceed the depth of insight that the sell-side used to offer, thus turning a market weakness into an internal strength. In essence, a portfolio manager has to "be their own analyst" for under-covered stocks. As one industry commentator noted, companies facing shrinking coverage are having to provide more detailed investor materials for self-education ; similarly, investors should take advantage of such disclosures and ask probing questions that analysts might traditionally have raised. The lack of widespread coverage means that any unique insight the investor can generate is more likely to be truly differentiated from the market, potentially giving a competitive edge.

- **Exploiting Market Inefficiencies for Alpha:** Perhaps the most significant implication is the opportunity to uncover mispricings. Stocks that lack analyst coverage are more prone to informational inefficiency – their prices may not fully reflect fundamental value due to limited scrutiny. An actively managed EM portfolio can capitalize on this by targeting neglected, high-quality companies and investing before the broader market realizes their worth. There is empirical and anecdotal support for this approach: O'Shaughnessy AM (2015) found that within small caps, the least covered stocks tended to include both big winners and big losers, creating a wide dispersion of outcomes and opportunities for informed investors . In practice, managers might implement quantitative screens to identify candidates with solid financials and growth prospects but low analyst coverage and low institutional ownership – a combination that often signals potential undervaluation . Once identified, deep fundamental analysis can determine if the neglect is unwarranted. Successful examples of this strategy abound: for instance, the Argentine bank Supervielle mentioned earlier was largely uncovered and undervalued, yet delivered outsized returns once one bank initiated coverage and investors took notice . A skilled active manager could have identified such an opportunity early. In general, alpha generation strategies could include: focusing on "forgotten" mid-caps that are market leaders in niche segments, arbitraging valuation anomalies where peer comparisons indicate a discount due to lack of coverage, and strategically accumulating positions in these companies while liquidity is low (potentially before an index inclusion or other catalyst draws attention). Academic research proxies this concept by showing that stocks with abnormally low coverage tend to earn higher subsequent returns as they revert to more normal levels of attention (e.g., McNichols & O'Brien, 1997 on the "neglected firm effect").

- **Liquidity Management and Patience:** A counterpoint to the above opportunity is that low-covered stocks often have low liquidity, which can make trading and portfolio management tricky. Active managers should be mindful of position sizing and liquidity risk when investing in such names. One implication is the need for a longer investment horizon – since it may take time for a mispriced, under-covered stock to attract attention and rerate, investors may need the patience and capacity to hold through volatility. Another is the importance of diversification: as State Street's EM team noted, the distribution of returns in EM small-caps can be extreme and unpredictable . A few big winners can drive returns, but a lack of information can also mean unpleasant surprises (for example, governance issues or earnings misses that went unnoticed). Therefore, constructing a diversified basket of such opportunities and limiting exposure to any single illiquid name can mitigate idiosyncratic risk. Tools like limit orders or liquidity-provision strategies can help enter/exit positions without moving the price too much. Moreover, active

managers might seek liquidity events (such as index rebalances or block trades) as opportunities to build positions in thinly traded stocks.

- **Diversification and Risk Control:** Because any single under-covered stock can have idiosyncratic risks (unexpected governance issues, for example), active portfolios should maintain diversification to manage risk. By holding a basket of such opportunities across countries and sectors, a portfolio can smooth out the volatility of any one name. This approach aligns with SSGA's recommendation to be diversified and limit position sizes in EM small-cap portfolios given the fat-tail return distribution. Essentially, an active manager can construct a portfolio of neglected stocks where the aggregate mispricing is in their favor, accepting that some picks won't play out but others will perform extremely well as the market eventually corrects misvaluations. Diversification ensures that the overall strategy – capturing the "inefficiency alpha" – succeeds, even if predicting the exact timing for each stock is difficult.

- **Exploit Market Inefficiencies with Tactical Trading:** In an environment with fewer analysts, price discovery is slower. This allows attentive investors to capitalize on discrepancies. For instance, an active EM small-cap fund might exploit earnings announcement reactions: if a little-followed company reports strong results, the news may not be fully appreciated by the market due to lack of analyst commentary. The active manager can take or add to a position before the rest of the market catches on, a strategy that could be part of a broader information momentum play. Additionally, with low coverage, there is often greater dispersion in valuations – some stocks might be unduly cheap simply because nobody has revisited their story in a while. A diligent investor can use relative valuation screens within sectors or countries to spot outliers (e.g., a Colombian small-cap trading at a 5x P/E while peers are 10x, unexplained by fundamentals). In effect, the portfolio manager acts as the catalyst for correction by investing. Another angle is to watch for coverage initiations: if a stock has been un-covered and suddenly a brokerage initiates coverage (perhaps due to an IPO or corporate event), that often leads to increased investor interest and a price bump. An active fund could anticipate or quickly respond to such events for short-term alpha.

- **Focus on Quality and Fundamentals:** With less external guidance from analysts, investors should place even greater emphasis on fundamentals and quality metrics when selecting small-cap EM stocks. Since many under-covered stocks are cheap for a reason (some could be fundamentally weak), distinguishing the true "gems" from the value traps is critical. Factors like strong balance sheets, good corporate governance, and sustainable cash flows can serve as anchors in the absence of Wall Street coverage. Investing in under-covered stocks is most rewarding when the company's intrinsic quality is high but simply overlooked. Active managers can thus integrate rigorous fundamental analysis or quantitative models to identify companies that show strong earnings quality, profitability, or growth despite their low profile. This approach aligns with findings that certain fundamental factors (profitability, efficient capital allocation) characterize long-term EM compounders that succeed even with low coverage .

- **Engagement and Advocacy:** Interestingly, reduced sell-side coverage may spur greater shareholder engagement by active managers. In the absence of analysts highlighting issues or pressuring management, investors might take on that role more directly. Portfolio managers can encourage companies to improve their investor relations efforts, increase transparency, or even commission independent research. Some smaller companies have started paying for research coverage or hiring firms to produce reports to fill the void left by traditional analysts (a practice more common in Europe post-MiFID II). Active managers might support these moves if it leads to better information flow. Additionally, being one of the few informed shareholders gives active investors a louder voice in influencing management decisions, potentially safeguarding and unlocking value. In effect, the active manager becomes a hybrid of investor and information intermediary, which can be advantageous if executed well.

In practical terms, actively managed EM small-cap funds have shown they can outperform by executing these strategies. Historical analyses have found that international small caps, despite lower coverage, deliver superior risk-adjusted returns relative to large caps over long horizons. This suggests there is indeed alpha to be harvested by those willing to venture where others (and the sell-side) have

retreated. For example, an active EM small-cap equity strategy that systematically picks stocks with low analyst coverage and good fundamentals can exploit exactly the kind of inefficiency created by the coverage decline . It is important to acknowledge the challenges: without sell-side coverage, information can be scarcer and due diligence more intensive. Active managers must be wary of potential traps, such as companies with poor governance that went uncovered for good reason. However, many high-quality emerging market companies have simply been bypassed due to structural reasons unrelated to their inherent merit. By combining fundamental analysis, local insight, and disciplined portfolio construction, an active manager can navigate these challenges. In fact, the current environment arguably demands active involvement – as passive flows dominate the well-trodden path (large caps), the road less traveled by analysts is where active investors can differentiate themselves.

In sum, the decline of sell-side coverage reshapes the playing field for investment in emerging markets. Passive investors will implicitly avoid many of these under-covered stocks (since they're often not in the index), but active investors can differentiate themselves by venturing into this less efficient segment. The key is that the active manager must have the resources and expertise to cover the uncovered – performing the fundamental legwork that sell-side analysts used to provide. Those that do so successfully can find compelling opportunities at favorable valuations (as evidenced by the valuation discounts of smaller EM companies). Multiple asset managers have noted that less analyst coverage "results in more pricing inefficiencies that can be exploited". However, they must also manage the attendant risks of lower liquidity and information scarcity. A disciplined, research-intensive approach, combined with prudent risk management, is crucial for turning the lack of coverage into an alpha source. Those investors willing to do in depth fundamental research – effectively becoming their own analysts – can capitalize on the market's neglect. As one portfolio manager quipped, "when everyone else is indexed, the real stock picking starts." In emerging markets, that stock picking is now more crucial than ever to uncover value hidden by the absence of Wall Street (or Main Street) coverage.

7 Conclusion

The persistent decline in sell-side analyst coverage of small and mid-cap stocks in emerging Asian and Latin American markets over the last two decades marks a significant shift in market dynamics. Where a rich ecosystem of analyst research once underpinned the pricing and liquidity of these equities, today many smaller emerging-market companies find themselves in an information shadow, receiving far less attention from Wall Street and local brokerage houses. This report has documented the extent of this decline and analyzed its causes – from structural industry changes and regulatory impacts to the rise of passive investing and liquidity constraints. The consequences are twofold: challenges for market efficiency and opportunities for active investors. On one hand, reduced coverage can impair price discovery, increase volatility, and raise capital costs for issuers in these markets as they struggle to gain investor visibility . On the other hand, the scarcity of information creates pockets of misvaluation that savvy, research-driven investors can exploit. An actively managed portfolio, armed with robust research capabilities, can potentially generate alpha by uncovering value in under-followed stocks and anticipating catalysts that others miss.

Broader market implications include a potential widening gap between well-covered and under-covered firms. If current trends persist, we may see a bifurcated market in emerging economies where large-cap stocks (in indices) remain efficiently priced and highly liquid, while a long tail of small caps trade inefficiently with sporadic liquidity. This could incentivize more companies to try to "graduate" into index inclusion or to seek alternative means of coverage (for example, paying for independent research or improving disclosure) to attract investors. From a policy perspective, there may be discussions on how to ensure sufficient research coverage for small issuers – some jurisdictions have explored subsidies or incentives for research on SMEs, recognizing that coverage gaps can hinder capital formation. In the private sector, the void left by traditional sell-side analysts might be increasingly filled by independent research boutiques, data analytics firms, and in-house buy-side analysts, all of which could evolve new models to cover emerging market equities.

In conclusion, the declining trend in sell-side analyst coverage of EM small and mid-caps underscores a changing financial landscape. Investors and companies must adapt to this new reality. Active investors who are willing to roll up their sleeves and perform deep independent research may find that the lack of broad coverage actually works in their favor, as it sets the stage for potential outperformance against both benchmarks and less informed market participants. Meanwhile, companies in emerging

markets should recognize the importance of engaging investors proactively in the absence of the traditional analyst coverage they once relied on. As the market adapts, one thing is clear: information – its production, distribution, and interpretation – remains the lifeblood of efficient markets. Whichever players manage to efficiently fill the information gap left by the sell-side pullback will be best positioned to thrive in the evolving landscape of emerging market investing. Ultimately, the past 20 years' trend offers a lesson: market efficiency cannot be taken for granted; it must be maintained through the continuous presence of informed analysis, whether it comes from the sell-side or elsewhere. The hope is that as active stakeholders recognize the rewards of covering the uncovered, the next decades might see a renaissance of research attention, turning today's challenge into tomorrow's opportunity.

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