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Strategic Priorities for EU Accession Country Securities Exchanges

Silvio John Camilleri

Banking and Finance Department, FEMA, University of Malta
Email: silvio.j.camilleri@um.edu.mt

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This is a summary of the author's presentation at the first of three seminars held at the Malta Stock Exchange and entitled "The Instruments to Finance Business Growth".

The presentation outlined the strategic priorities for securities exchanges in EU accession countries, with a special reference to the Malta Stock Exchange (MSE). Most of the EU accession country exchanges were set up only recently in conjunction with government privatisation programmes. These exchanges are typically small and witness modest levels of liquidity. On the other hand these exchanges typically use modern electronic trading systems which give them a competitive edge over other institutions. MSE is one of the smallest exchanges in EU accession countries and turnover is heavily dependent on three major equity issues. EU accession country exchanges have to address five inter-related strategic priorities as outlined below.

1 Internationalization

The internationalisation process resulting from deregulation and technological improvements has lead companies to market their securities to foreign investors, commonly by issuing Depository Receipts. The main concern for accession country exchanges is that business may be diverted away

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to larger exchanges. One salient issue is that the larger and more liquid securities are more likely to be successful in trading overseas, since these can generate higher interest on part of international investors. One policy which exchanges have adopted to tackle internationalization was to create alliances with other exchanges. Yet, concluding such agreements can be complex when issues relating to the politics and financing of proposed projects have to be considered.

The impact of the internationalization on MSE in terms of migration of trading activity, took place in Maltacom plc. Yet most of the trading activity of this particular GDR issue has flowed back to the home markets. Such occurrences have also been witnessed on other EU accession country exchanges. Significant depository receipts activity may be difficult for Maltese companies given that an issue has to be of a comprehensive size to attract sufficient trading. This limits the population of Maltese companies which may successfully cross-list given their limited capitalization. In addition primary equity issues listed on MSE are usually oversubscribed, and therefore the benefits of obtaining additional finance through cross-listing do not seem to apply.

2 Increasing Business

Enhancing listing and trading activity is a two sided effort, in the sense that both the demand and supply of securities have to be encouraged. Encouraging investors to approach the market entails having an adequate legal setup in line with international standards which safeguards shareholders' rights and guarantees efficient services of dispute resolutions. In enhancing the supply of securities, first-time listing companies may be targeted and EU accession country exchanges have set up several programmes with this specific aim. Exchanges may also consider generating higher revenues by diversifying in related services such as settlement systems and derivatives products, although the latter activity usually requires well-developed underlying markets.

The potential for MSE to attract new listings from local companies is hindered, not only by the small population of firms but also in view of the small size of firms. Given this, MSE should be looking at ways of generating new business which are not confined to the listing of home companies in order to supplement the revenue generated by this activity. MSE's current involvement in the BorzaMed project may potentially address the issue of developing alternative revenue sources. Another potential source of business might be in seeking to attract cross-listings from North African countries. Yet, such objectives may not be easy to accomplish due to cultural differences.

3 Enhancing Liquidity

Liquidity may be defined as the ease through which a trader may transact assets at reasonable cost. Enhancing liquidity is one of the major objectives of the trading protocols adopted by exchanges. Increasingly, modern markets are relying on automated systems such as electronic order-matching facilities. In the absence of large amounts of market activity, exchanges may consider emphasising a "human element" such as market making to foster liquidity. Yet, liquidity does not necessarily increase by a change in the trading protocol. This may be particularly so in case of MSE where a change in the investors' habits to trade upon their expectations more frequently might be required.

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4 Technology and Infrastructure

In the interest of profitability and competitiveness, exchanges should aim to process transactions at a low cost. Cost savings may be realised by using the software and/or hardware of other exchanges. The shared costs may make it easier for the exchanges to reap the benefits of economies of scale related to investing in a new trading system. Despite this, conflicting ideas may still arise when evaluating subsequent system upgrading and maintenance activities.

5 Subsidiary Issues

Exchanges may only prosper if the development of the underlying securities market is fostered. For instance, higher investor protection should make it more attractive to hold traded securities. Similarly, it might be difficult to attract institutional investors in the absence of an efficient legal setup, including facilities for the settlement of legal disputes within an acceptable time frame. Further desirable policies include tax stability. In addition, the legal and regulatory setup should not cause inefficiencies for listed companies. Whilst industry standards in terms of disclosure and related items should not be compromised, listing requirements should not translate into an unnecessary burden.

Final Note

The above challenges imply that survival for the stock exchanges in EU accession countries can be difficult. Yet, smaller exchanges should serve as a means through which smaller companies can tap funds. Such companies may be well known within their region however they may find the marketing campaigns and fees involved in listing on a major exchange to be prohibitive.

Overall, the above strategic priorities emphasize the importance that exchanges should be equipped with the appropriate human resources and technological systems in order to enable them to address future challenges. In addition, the possible courses of action to be adopted by exchanges, do not depend entirely on the latter institutions but also on policy makers, regulators, institutional investors and the companies seeking finance. This implies that the exchanges' human resources who get involved in external contacts and relations are one key element for these institutions.

The discussion largely assumed that companies shall continue to demand the services of securities exchanges, at least at the regional level. This is a reasonable assumption in the short to medium term. Yet, exchanges should also consider the possibility that in the longer term securities activity might accrue to a select number of large exchanges and computerised alternative trading systems. If this occurs, the survival of various exchanges – including those in EU accession countries – might be compromised.

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The presentation outlined the strategic priorities for securities exchanges in EU accession countries, with a special reference to the Malta Stock Exchange (MSE). Most of the EU accession country exchanges were set up only recently in conjunction with government privatisation programmes. These exchanges are typically small and witness modest levels of liquidity. On the other hand these exchanges typically use modern electronic trading systems which give them a competitive edge over other institutions. MSE is one of the smallest exchanges in EU accession countries and turnover is heavily dependent on three major equity issues. EU accession country exchanges have to address five inter-related strategic priorities as outlined below.

1 Internationalisation

The internationalisation process resulting from deregulation and technological improvements has lead companies to market their securities to foreign investors, commonly by issuing Depository Receipts. The main concern for accession country exchanges is that business may be diverted away to larger exchanges. One salient issue is that the larger and more liquid securities are more likely to be successful in trading overseas, since these can generate higher interest on part of international investors. One policy which exchanges have adopted to tackle internationalization was to create alliances with other exchanges. Yet, concluding such agreements can be complex when issues relating to the politics and financing of proposed projects have to be considered.

The impact of the internationalisation on MSE in terms of migration of trading activity, took place in Maltacom plc. Yet most of the trading activity of this particular GDR issue has flowed back to the home markets. Such occurrences have also been witnessed on other EU accession country exchanges. Significant depository receipts activity may be difficult for Maltese companies given that an issue has to be of a comprehensive size to attract sufficient trading. This limits the population of Maltese companies which may successfully cross-list given their limited capitalization. In addition primary equity issues listed on MSE are usually oversubscribed, and therefore the benefits of obtaining additional finance through cross-listing do not seem to apply.

2 Increasing Business

Enhancing listing and trading activity is a two sided effort, in the sense that both the demand and supply of securities have to be encouraged. Encouraging investors to approach the market entails having an adequate legal setup in line with international standards which safeguards shareholders' rights and guarantees efficient services of dispute resolutions. In enhancing the supply of securities, first-time listing companies may be targeted and EU accession country exchanges have set up several programmes with this specific aim. Exchanges may also consider generating higher revenues by diversifying in related services such as settlement systems and derivatives products, although the latter activity usually requires well-developed underlying markets.

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Exchanges may only prosper if the development of the underlying securities market is fostered. For instance, higher investor protection should make it more attractive to hold traded securities. Similarly, it might be difficult to attract institutional investors in the absence of an efficient legal setup, including facilities for the settlement of legal disputes within an acceptable time frame. Further desirable policies include tax stability. In addition, the legal and regulatory setup should not cause inefficiencies for listed companies. Whilst industry standards in terms of disclosure and related items should not be compromised, listing requirements should not translate into an unnecessary burden.

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