Available online at www.sciencedirect.com
ScienceDirect
Journal of Banking & Finance 32 (2008) 512–525
Journal of BANKING & FINANCE
www.elsevier.com/locate/jbf

Stock exchange demutualization, self-listing and performance: The case of the Australian Stock Exchange

Isaac Otchere [a,*], Khaled Abou-Zied [b]

[a] *Sprott School of Business, Carleton University Ottawa, ON, Canada K1S 5B6*
[b] *ABN AMRO Delta Asset Management, 13 Geziret Street, Giza, Egypt*

Received 25 November 2005; accepted 27 July 2007
Available online 7 October 2007

Abstract

This paper examines the effects of the recent spate of financial exchange mutual-to-stock conversion phenomenon on the performance of listed exchanges and the quality of the stock market using the Australian Stock Exchange (ASX) as a case study. We find that the ASX stock significantly outperformed the stock index and the control group on a market-adjusted return basis. The stock market performance is driven by strong operating performance. The profitability ratios of the ASX have significantly improved in the five years following the demutualization and self-listing. The performance improvements remain significant even after controlling for growth in the Australian economy. From a market quality perspective, we document evidence of increased trading activity by foreign investors after ASX's demutualization and self-listing. Interestingly, we also find that bid-ask spreads of the stock market have narrowed in the post-conversion period. In particular, small-cap firms have become more liquid. The results show that stock exchange conversion from mutual to publicly traded exchange is not only value enhancing for the exchange and its shareholders, but it is also beneficial for the stock market as a whole.
© 2007 Elsevier B.V. All rights reserved.

JEL classification: G15; G32; L2

Keywords: Stock exchange; Governance structure; Performance; Self-listing; Market quality

1. Introduction

Stock exchanges have traditionally been run as mutual organizations with monopoly power, but in recent years they have experienced new challenges that have short and long term ramifications on their operations. Changes in the competitive environment and technology have had strong impact on their operations. For example, improvements in technology have created both opportunities and threats for the exchange industry. On one hand, technological advancement has fundamentally altered the landscape, enabling exchanges to overcome national boundaries and reducing the intermediary role of exchange members (Galper, 1999). It has also reduced trading costs (Macey and O'Hara, 1999), as well as facilitated the trading of shares on several stock exchanges. Investors do not necessarily have to execute their trades on the local stock exchange. They can place orders wherever and whenever they wish to do so without being limited to specific trading times and location. Thus, technology has expanded trading opportunities.

On the other hand, the migration of order flow to other markets has affected the local franchise that the exchanges had in their respective countries. What was once a captive market is no more the sole jurisdiction of the local exchange. Also, the competitive environment is entirely changing. Hitherto, stock exchanges used to enjoy monopoly status in their domestic markets. The increasing internationalization of financial markets has reduced barriers

* Corresponding author. Tel.: +1 613 520 2600x2731; fax: +1 613 520 4427.
E-mail addresses: iotchere@sprott.carleton.ca (I. Otchere), khaledabouzied@abnamro-delta.com (K. Abou-Zied).

0378-4266/$ - see front matter © 2007 Elsevier B.V. All rights reserved.
doi:10.1016/j.jbankfin.2007.07.011

to access and has set national exchanges in direct competition with each other and with electronic communications networks (ECNs). Exchange members are facing difficulties in protecting their intermediation franchise due to the different trading and listing alternatives that are available to investors and companies (Steil, 2002). Competition and technology have also affected the sources of revenues. The major sources of income for exchanges have hitherto been membership fees, listing fees, trading revenue, and sale of company data. Lee (2002) and Otchere (2006) show that the importance of these revenue sources is changing. For instance, listing fees have significantly reduced, as the marginal cost for adding new members goes towards zero. In fact, reducing listing fees could be a deliberate policy that can give the exchange a competitive advantage as it can attract more domestic and foreign listings. As a result of the pressure on traditional sources of revenue, exchanges have to explore other sources of revenue, but their ability to do so could be stymied by the members if the undertaken jeopardizes the members' own business interests.

The mutual form of exchange in which ownership rights and the right to consume the exchange's services are coupled, can indeed hinder the exchange's ability to adapt to changing circumstances. As the conduits to the trading system, exchange members derive significant profits from intermediating end-customer (non-member) transactions.[1] Domowitz and Steil (1999) argue that members may resist innovations that reduce demand for their intermediation services even if such innovations would enhance the value of the exchange. Hart and Moore (1996) and Cybo-Ottone et al. (2000) narrate cases where reforms in a number of exchanges in the US, Europe and other countries have been hindered by the exchanges' inability to secure consensus among their members. The mutual ownership structure can thus be an impediment to the exchange's efforts to remain competitive and profitable. All these developments taking place in the exchange industry and the rigid nature of the mutual structure pose significant threats to the financial health of stock exchanges.

In the mid-90s, the Australian Stock Exchange (ASX) realized that the mutual structure was inadequate in enabling it to respond to the challenges and threats that it faces. Consequently, in 1996, the exchange members voted to demutualize. The demutualization process culminated in the exchange going public in October 1998, listing its shares on its own exchange. The ASX is not an isolated case; since its conversion and subsequent self-listing, the number of exchanges that have converted from mutual, not-for-profit organization to for-profit structure has increased. According to the World Federation of Exchange (WFE, 2004), in the mid-1990s approximately 90% of the exchanges that make up the Federation were run as mutual companies. By 2002, 63% of them had changed their mutual structure. In April 2005, the New York Stock Exchange (NYSE) announced what is perhaps the biggest shake-up in its history by merging with Archipelago Exchange, a publicly traded electronic trading firm and thus becoming a publicly traded exchange and as recently as November 2006, the New York Mercantile Exchange (NYMEX) also joined the NYSE, London Stock Exchange, and the Australian Stock Exchange, among others, as self-listed exchanges. Appendix A lists the names of the exchanges that have demutualized and self listed. Self-listed exchanges are geographically dispersed but most of them are located in North America. Self –listing appears to be a necessary response to the shocks that the industry has experienced in recent years. Of the top 10 stock exchanges in the world by market capitalization in 2005, 80% have demutualized (the exception is the Swiss and Spanish Exchanges), and 7 out of the 10 largest stock exchanges have self listed. A major exchange that is not currently publicly traded is the Tokyo Stock Exchange. However, it has taken the first major step to achieving a public status as it has demutualized. That all the major exchanges have demutualized and become public companies shows the necessity to have a structure that allows the exchange to respond to the challenges in the industry.[2]

Given the circumstances that have prompted the change in the governance of exchanges, it is reasonable to surmise that the conversion from mutual structure to publicly traded self-listed exchange structure will be value-enhancing for the exchange itself, and also has the potential to improve the quality of the stock market. The improvement in performance could occur because self-listing provides managers of the exchange the free

[1] Traditionally, stock exchanges have not dealt directly with end-customers. Brokers, who are members and direct customers of stock exchanges, have acted as intermediaries by providing share trading and other services to investors. However, increased competition and pressure on traditional revenue sources and the need to maximize profits have created competition between exchanges and their members. Domowitz and Steil (1999) show that some exchanges with automated order driven trading systems are providing trading services directly to end-customers.

[2] These developments, which are likely to continue in the future, raise questions about the future strategies of exchanges. With improvement in technology the cost of running an exchange is likely to reduce, listing fees and trading fees can reduce significantly. In fact evidence exist that some exchanges have reduced listing fees in order to attract more firms to list on their exchanges. Future strategies are likely to involve forming alliances (such as the one between NYSE and the Tokyo exchange), derivative trading (most exchanges including the ASX and TSX have entered this lucrative area), joint ventures (like the one recently announced by NYSE and NSE of India), consolidation (e.g., NYSE and Euronext, CME-CBOT, Deutsche Bourse-ISE). These are indications of what the future holds for the publicly listed exchanges. It is also possible that as the marginal cost of trading on most automated trading system and for listing firms goes to zero, and competition increases, listing fees can be eliminated completely and trading fees can fall significantly. In fact, Lee (2002) suggests that these costs can be negative in the sense that exchanges could be paying for the privilege of executing orders on their trading platforms and argues that some exchanges are already doing this through subsidies provided to market makers.

Download English Version:

https://daneshyari.com/en/article/5090994

Download Persian Version:

https://daneshyari.com/article/5090994

Daneshyari.com