CHAPTER IV
CONCLUSION

4.1 Conclusions

The move towards consolidating stock exchanges across regions appears quite likely. Each exchange will face increased competitive pressure as the liberalization of capital in their country and across the region addresses the needs of international trade and investments. Regions that already have many exchanges in close proximity to each other are most likely to consolidate, such as the case in Europe and Central America – Caribbean regions. Each exchange must decide upon what their role and business model will be, as either a niche market player or part of a greater regional market.

The efforts of this paper were to determine if there were benefits for the consumers who use these exchanges, and there does not appear to be any boost to liquidity or growth in market capitalization. This testing did not consider the impact consolidation would have upon the profitability of exchanges in the region nor their ability to reduce costs while simultaneously improving profit margins. In the eyes of business operators, these concerns are far more important over the long term if competition is increasing regionally. The exchanges that operate in small nations face many of the same operating costs as exchanges in bigger nations, however it is assumed that they have more difficulties passing on those costs.

The four multinational exchange groups examined had three different routes to becoming a multinational exchange, reflecting the differences in development in their respective regions. The group of nations that joined up with Cote d'Ivoire in Africa did so as a convenient way to participate in the established success of that exchange. The nations that cooperated in the East Caribbean stock exchange considered this an extension of their financial integration and a way for all members to benefit from the introduction of a securities market for their region. Europe, and their two separate multinational exchanges, is the only example of initially independent and profitable exchanges coming together in an effort to improve efficiency while facing a perceived increase in competition. Fundamental to the success of each of these examples to gain

efficiency has been the creation of a single clearing and settlements depository and seamless integration of information technology.

In the ten years since the first group of eight nations decided to consolidate all their security trading activities under the operations of one business, some of the promised success of consolidation has remained elusive. The initial results from the models used in this paper indicate that their performance has been in-line with other exchanges from nations of similar size. Future testing with this model might produce better results, if the effects of consolidation take several years to materialize. The model does, however, place more emphasis upon the effects of citizens' wealth, money supply, taxation, and the historical results of the exchanges' performance. This leaves very little impact that is likely to occur from consolidation; much like the other factors had a limited impact upon the success of increasing liquidity and the overall captalization of an exchange relative to GDP.

It is likely that the reason that merging exchanges did not have a significant impact upon liquidity and market capitalization relative to their peers is that network externalities effects are generally small and it takes time for the operator of the exchanges to make the changes required before they can offer more benefits to consumers. Other factors, such as improved communication technology and regulatory changes, could produce similar improvements of growth in liquidity and development and were not captured in the models. Finally, it is possible that the various strategies employed in creating a multinational exchange bear greater influences to different market forces. Multinational exchanges in Africa appear to struggle with consumer awareness while those in Europe struggle more with regional competition for investors' capital and corporations willing to list on their exchange. A more regional comparison taking into account the specific market forces with the greatest influence upon their success could better isolate the effects of consolidation.

4.2 Implications of Results

With the testing not finding benefits for consumers in the form of increased liquidity or a larger stock exchange capitalization relative to the size of the economy, exchange owners need to carefully consider why they are merging with another

exchange. What benefits are they hoping to achieve? There are as many valid reasons for an exchange to remain independent as there are for a merger. There does not appear to be a valid reason for merging simply on the assumption that it will increase the attractiveness for trading or listing upon the exchange.

The network externalities that were expected however may still be there. In all testing the market capitalization size was a significant variable positively influencing both liquidity and development. Also the longer an exchange successfully stays in business there was evidence that it improves liquidity. For small, unprofitable exchanges mergers may be the most suitable solution if it can lower the cost of operations to a point of reaching critical mass allowing it to slowly and profitably grow over time. The benefits of network externalities are likely small and slowly accrue over the years for many small nations as indicated by the variables mentioned above.

4.3 Limitations of the Models

This model had several challenges to overcome which addressed one-time historical shocks. The collapse of the former Soviet Union and the insolvency of the many state owned enterprises created a model of stock exchange development for the government to sell off their assets. This created an unusual bias in the initial years with the number of listed companies being unusually high then falling for many of the years that followed. While Europe was not the only region that saw the employment of this strategy, it did create many small exchanges with distorted data. A common practice of such exchanges was to only list the market capitalization of companies whose stocks were traded that year, thus distorting the true nature of their size and vibrancy. The limitations of obtaining highly accurate data have always been a problem with economic research and this case is no exception. Extensive efforts were employed to clean up the outliers, however it would likely be far more accurate if this model was performed many years from now after these companies have a significant track record of publishing respectable data. There was also the challenge faced with each nation's differing definition towards many standard economic statistics. As such,

this model should be considered simply for the best efforts being made at this time and future results may prove more accurate.

Also, this model examined exchanges on a global scale, however it is expected that consolidation and competition is found only on a regional level. Consideration of running it on a regional level, to examine factors that more accurately depict influences in that specific region, could reveal more informative results about the impact mergers have specifically with the competition there. There still might be some undiscovered benefits to consumers, however above average growth in liquidity and market capitalization growth were not found based upon the testing at a global level. The model also assumed that most nations were relatively similar in needs and structure. A more focused approach could make adjustments for varying levels of financial and regulatory infrastructure within the specific region.

Finally, it is quite feasible that the length of time required to restructure member exchanges, improve cost efficiencies, and pass on the final benefits to consumers exceeds the few years actually tested. Consumer based benefits, such as lower trading costs, lower listing and maintenance fees, and increased information availability may materialize after profit margins improve. These benefits would likely be the stimulus required to give the merged exchanges the liquidity and development boost these models are searching for. The length of time required to pass on these benefits may be influenced by the regions that the exchanges reside in as varying levels of consumer support for stock exchanges appear in the testing.