

Some important notes from the lecture delivered by Dr. Ayub Mehar

The lecture was based on 'Efficient Market Hypothesis', Capital Assets Pricing Model, Arbitrage Pricing Theory, Markov Chain Process, Miller and Modigliani famous theorem of irrelevancy of financial and dividend policies, Gordon's model and other such leading theories in financial economics, which were supported by 'wealth maximization hypothesis'. He was of the opinion that on practical front, this concept favored the capital account convertibility, cross boarder listing of securities, cross boarder investment, free trade policies, globalization, merger & acquisition activities, introducing common currencies, expansion of contemporary forms of money including e-money and establishing the integrated and common stock exchanges etc.



Dr. Ayub Mehar, Director General R&D, FPCCI delivering lecture to the participants on "Common Stock Market in South Asia: Prerequisite and Consequences"

He described Capital Market as a sub-set of financial markets, which provides a linkage between the users and suppliers of the funds for long-term investment. It plays a crucial role in the process of capital formulation by bringing together those who have surplus funds and other who want to use those funds, and thus play vital role in enhancing economic activity. Globalization introduced the mobilization of those funds from one country to other for enhancement overall economic activities globally. The integration of stock exchanges is one of the advancements in this direction.

He focused on efficient capital market model as a useful tool for investors to

determine their required rate of return on the basis of risk free rate of return, risk associated with the company, and the price of risk taking in term of the difference between the returns on risk free and risky assets. He opined that corporate earnings and dividend policies and the macroeconomic fundamentals including prime rate of interest, taxes on dividend and capital gains, and the taxes on corporate income and its products play the important role in determination of the equilibrium in stock markets.

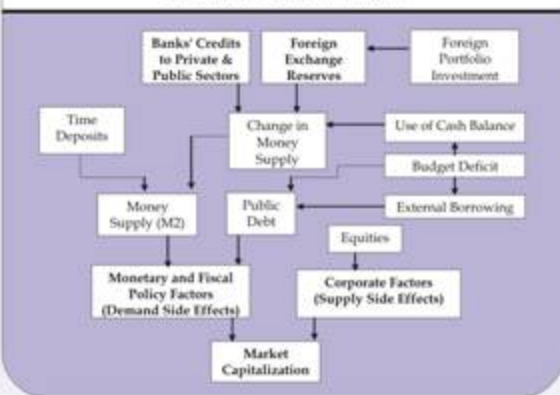
The lecture was based on the hypothesis that market capitalization depends on the total funds invested in the listed companies' and the market liquidity in the long-term. Low volatility in trading volume and stability in stock prices are the natural consequences of a common stock market.

Linking the hypothesis with the assumption of creation of Common Stock Market in South Asia, he said that a common stock market may force the participating countries to create harmony in their monetary and fiscal policies. The variations in prime interest rates, exchange rates, taxes on corporate earnings, dividend incomes and capital gain may leads the change in the direction of investment inflows and outflows.

While discussing the theoretical development of the topic Dr. Mehar elaborated the concept of wealth maximization and market efficiency. He mentioned the linkages of financial market with the monetary and fiscal policies and compared the fiscal and monetary policy parameters of the SAARC countries. He also compared the financial markets of the South Asian countries. The gravity and magnitude of the economic relations among the South Asian countries show a disappointing picture of the outcomes of several strategies and efforts to promote the mutual economic relations among the countries in South Asia. It was corroborated in the various studies that trade relations cannot be promoted without strong politico-cultural relations among the nations. The politico-cultural relations among the nations can be strengthened by the exchange of services including health, education, energy, communications, transportations and financial services.

For sustainable economic and financial infrastructure development, South Asian countries have to mobilize and utilize their resources endogenously. It will improve the efficient utilization of financial resources. It is possible through cross boarders investment among the South Asian countries. However, to make it practicable the policy makers and planners have to make their financial system transparent, frictionless and efficient. The lecture supported the idea of creating Common Stock exchange in South Asia as a favourable mechanism to improve the efficiency and investment activities in the region. This step is an advanced stage of the cross boarder investment and listing which can create arbitrage opportunities if markets are fundamentally different in their macroeconomic police and informational efficiency.

IMPACT OF MONETARY AND FISCAL POLICIES ON STOCK MARKET: SIMULTANEITY IN THE MODEL



Speakers (L to R) Mr. Iqbal Tabish Secretary General SAARC CCI, Prof Iqbal Ismail, former Director, KSE, Mr. M.A Lodhi, Secretary General, FPCCI, Mr. Aftab Ahmad Chaudhry, Secretary General, SAFE & Managing Director, ISE, Dr. Ayub Mehar, Director General, R&D FPCCI.



SAARC CCI Lecture Series "Creation of Common Stock Market in South Asia Prerequisite and Consequences"

Organized by
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In view of the importance of stock market and the present worldwide inclination of cross boarder investment activities, it was suggested that policy dialogue and academic work should be highlighted by the SAARC Chamber of Commerce & Industry (SAARC CCI). In this context, on the theme of 'Common Stock Market in South Asia: Prerequisites and Consequences'. The 5th Lecture of the Lecture series was organized by SAARC CCI in collaboration of FPCCI supported by Fur Die Freiheit (FNF), regional office, India.

The lecture was delivered by Dr. Ayub Mehar, Director General (R&D)-FPCCI while Mr. Aftab Chaudhry, Secretary General, South Asian Federation of Exchanges and MD, Islamabad Stock Exchange (SAFE) and Professor Iqbal Ismail, a former Director, Karachi Stock Exchange responded to the lecture.

Inaugural Session

While welcoming the speakers and participants, Mr. Iqbal Tabish, SG, SAARC CCI, gave introductory remarks and described the importance of 'Lecture Series Program'. He highlighted the utility of lecture series and mentioned that by such series SAARC CCI is serving as think tank, which develop harmonization and consensus in the policy parameters and promotes the dialogue on key economic issues in the region.

Mr. Sultan Ahmed Chawla, President FPCCI in his welcome address appreciated the idea of creating common Stock Market in South and hoped that it would help not only developing social contacts but also add value to the cooperation in Services Sector under SAFTA. He said that until today, despite the cooperation in various areas of the economy among the SAARC member states, there have not been any serious attempts to bring together the stock exchanges. Therefore, SAARC member states should forge regional alliances and cooperation in view of the effects of globalization on financial markets. He emphasized that Stock exchanges are instruments aiming to mobilize financial resources to facilitate their optimal utilization in profitable investment projects. Hence through the creation of Common Stock Market in SAARC member countries, the existing stock exchanges could coordinate and standardize their policies, rules, regulations, market techniques and procedures.



Mr. Sultan Ahmed Chawla, President FPCCI addressing the participants of SAARC CCI Lecture Series, "Common Stock Market in South Asia: Prerequisite and Consequences"

Mr. Tariq Sayeed, President SAARC CCI, during his keynote address indicated the importance and implications of integration of services sectors in SAARC countries. He described the role of the Stock market in the development of the trade and investment in the region.

According to Mr. Tariq Sayeed, after the inclusion of services in SAFTA, the gravity and magnitude of the economic relations among the South Asian countries has increased. Some studies on quantification of cooperation in Service in South Asia have estimated potential of around \$ 20 billion per annum. He was of the opinion that trade relations cannot be promoted without establishing strong politico-cultural associations among the nations, and politico-cultural relations can be strengthened by the exchange of services including health, education, energy, communications, transportations and financial services. The exchange of financial services provides the cross boarder investment opportunities, which leads the ultimate development of the trade among the nations. The formation of a common stock market in South Asia is the core idea of the exchange of financial services. The theme of the "Common Stock Market in South Asia", is a great concern not only for the financial sector of the region, but it is also important from the overall socioeconomic development and relations among the countries.



Mr. Tariq Sayeed, President SAARC CCI, addressing the participants of SAARC CCI Lecture series, "Common Stock Market in South Asia: Prerequisite and Consequences"

Key findings/outcome of the lecture

- Monetary and fiscal policies in the context of Pakistan are classified as the significant determinants of the market capitalization. In the context of Pakistan, it was observed that foreign investment and private sector credit have positive correlation with the KSE100 index. It was concluded in a study (Government of Pakistan: 2005) that market capitalization depends on the investment in equities and market liquidity. However, the valuation ratio will be independent from the magnitude of equities if equity-elasticity is equal to one.
- The harmonization and uniformity in the monetary and fiscal policies require some basic regulatory works. Harmonization between the rules and regulations among the countries are required to determine the balanced strategies regarding the reinvestment of corporate profits (retained earnings) for modernization and expansion, dividend payments, treatment of the sick units and placing of the companies on default counters at the stock exchanges.
- Strong and effective physical infrastructure to revive the social and economic relations among the South Asian countries is urgently required to promote the financial linkages between the countries. This strategy requires some basic work: We have to promote tourism industry, we need harmonization between the rules and regulations to determine the balanced strategies for development of financial sector, and we need cooperation in policies for allocation of invest-able funds on their comparative advantage bases.

FINANCIAL STRENGTH

Country	Market Capitalization (Million US \$)	Value of shares Traded % of market capitalization	Number of Listed Companies	No. of Stock Exchanges
Bangladesh	6793	95.5	276	2
India	5491101	90.8	4897	22
Pakistan	70242	167.3	454	3
Sri Lanka	7923	12.3	235	1
Italy	2120440	149.7	284	1
France	2428572	119.6	717	1
U.K.	3794310	123.6	2913	1
United States	19425955	182.8	5133	7

Source: World Bank / IFC, Washington

Response to the lecture

Mr. Aftab Chaudhry, Secretary General, SAFE stated that no example in the world financial market is available for the existence of a common stock market. A common stock market can be existed only in the presence of a common currency, which is not possible in case of South Asia. He mentioned that, a common market is characterized by the free movement of capital, labor, goods, and services between the countries of a region, which is often also referred to as the economic integration. No single region in the world has a Common Stock Exchange, even the European Union which is the prime example of a region having maximum economic and political union.



A view of the participants of the lecture.

In the context of stock markets, instead of creating a common stock exchange the consolidation of the business of different markets has taken place on commercial considerations and not on regional considerations. The creation of Euro-next in 2000 could be called as the first attempt to create a Pan European regional stock market in order to take advantage of the harmonization of the European Union Financial Markets. Euro-next was formed following a merger of the Amsterdam Stock Exchange, Brussels Stock Exchange, and Paris Bourse, in 2002; the group merged with the Portuguese stock exchange and renamed itself as Euro-next Lisbon. Euro-next has cross-membership and cross-access agreements. In year 2006, New York Stock Exchange acquired Euro-next, and became the "first global stock exchange". Unlike the global trend, no domestic or regional integration of stock exchanges has taken place in South Asia. Countries like India, Pakistan and Bangladesh have history of

having multiple exchanges -India at one point had 28 domestic exchanges, which are consolidating now, Pakistan has three and Bangladesh has two stock Exchanges. SAFE was established in year 2000 on the initiative of regional exchanges to promote the development of regional capital markets. However, due to lack of political support, capital control restrictions, and differences in securities laws/regulations, the consolidation of the market remains a distant. Professor Iqbal Ismail, Former Director, KSE, stated that financial models including CAPM are not valid incase of Pakistan. He mentioned the financial theories are not applicable in South Asia. He states that the low trading volume in Bangladesh is because of the cash requirement for the sale and purchase of share in Bangladesh.

Mr. M. A. Lodhi, Former Managing Director, KSE & Secretary General, FPCCI concluded the session with remarks of appreciation for SAARC Chamber for arranging deliberation on such an important issue. He termed the session as a successful step to highlight the associated problems with the idea of Creation of Common Stock Market in South Asia.

STOCK MARKET DEVELOPMENT INDEX

	Rank (out of 52)		Score (1-7 scale)	
	India	Pakistan	India	Pakistan
Financial development index 2008	31	54	3.8	5.5
Capital account liberalization	46	46	3	3
Domestic financial sector liberalization	36	49	3.8	3.1
Equity markets development	25	34	5	4.6
Regulation of security exchanges	27	48	5.3	4
Corporate tax rate (%)	39	51	3.5	3.7
Equity market turnover	17	1	6.6	5.3
Stock market capitalization to GDP	26	37	5.6	3.6
Stock market value traded to GDP	39	36	5.1	5.2
Rate of access to local equity market	37	36	5.7	4.9

Source: World Economic forum Geneva

Pre-requisite steps prior to creation of common Stock

Integration should be an evolutionary process. Starting from the development of common understanding through information sharing and cooperation between the governments, regulators, market players, and professional service providers, strong and effective physical infrastructure will be required to revive the social and economic relations among the South Asian countries. To achieve such objectives, it was urgently required to promote the financial linkages between the countries. This strategy requires some basic work: We have to promote tourism industry, we need harmonization between the rules and regulations to determine the balanced strategies for development of financial sector, and we need cooperation in policies for allocation of invest-able funds on their comparative advantage bases.

The harmonization and uniformity in the macroeconomic variables including GDP, external trade, FDI, private investment, interest rate, inflation; business environment - including investment protection regulation, cost of doing business, labor laws and productivity, procedural requirements and invisible costs; regulatory requirements including labor laws, taxation policies and mechanism, courts, crime, law and order, policy uncertainty, financing and investment regulation and magnitudes, corruption, provision of utilities, physical infrastructure; financial access, efficiency and stability including legal rights of investors and lenders, interest rate spread, risk premium, banking adequacy ratio and prudential regulations, Stock market efficiency including market capitalization, reliability and growth of market indexes, market liquidity, trading volume, number of listed securities, number of brokerage houses and security firms, stock turnover, flow of capital including FDI, FPI, tariff and taxation policies, Regulations for transfer of dividend income, flow of capital, corporate regulations including take over activities, corporate governance dividend policies, financial policies etc are required for the desired integration and the development of the common stock market in South Asia. A common or integrated stock market cannot perform its due role without harmonization in the monetary and fiscal policies of the countries in the region. The role of monetary and fiscal policies cannot be ignored in determination of the performance of a stock market.



President SAARC CCI, Mr. Tariq Sayeed presenting official crest to Dr. Ayub Mehar, DG, R&D, FPCCI. Others (L to R) include Mr. Zakria Usman, VP FPCCI, Prof. Iqbal Ismail, KSE, Mr. Aftab Ahmed Chaudhry, Secretary General, SAFE & Managing Director, ISE, Mr. M A Lodhi SG FPCCI, Mr. Mansha Chura, VP, FPCCI.



President SAARC CCI Mr. Tariq Sayeed presenting official crest to Mr. Aftab Ahmed Chaudhry, Secretary General, SAFE & Managing Director, ISE. (L to R) Prof Iqbal Ismail former Director, KSE, Mr. Zakria Usman, VP FPCCI, Mr. M.A Lodhi, SG, FPCCI, Mr. Mansha Chura, VP FPCCI and Dr. Ayub Maher, Director General & DFPCCI.

CORPORATE GOVERNANCE

	Rank (out of 52)		Score (1-7 scale)	
	India	Pakistan	India	Pakistan
Corporate governance (overall)	20	35	5.2	4.5
Extent of incentive-based compensation	32	52	4.5	3.6
Efficacy of corporate boards	25	52	5	3.6
Reliance on professional management	21	50	5.4	3.9
Willingness to delegate	23	44	4.5	3.7
Strength of auditing and accounting standards	21	34	5.7	4.9
Shareholder rights index	1	1	5	5
Ethical behavior of firms	34	32	4.2	4.3
Protection of minority shareholders' interests	21	26	5.3	5

Source: World Economic forum Geneva

Conclusion

After a detailed analysis, comment and question answer sessions, it was jointly recommended that at first stage the South Asian countries should develop an integration of their stock exchanges for cross boarder trading and listing of the companies.

Suggestions and Policy Recommendations

- There is an earnest need for taking Pre-requisite measures so that integration should be through an evolutionary process. Starting with the development of common understanding through information sharing and cooperation amongst the governments, regulators, market players, and professional service providers, strong and effective physical infrastructure to revive the social and economic relations among the South Asian countries is urgently required to promote the financial linkages between the countries.
- The regulatory bodies and planning authorities need to take initiative to make a harmonized and uniform investment and financial environment. There must be uniformity on the Future trading and Hedging issues. The availability of required physical infrastructure; financial access, efficiency and stability including legal rights of investors and lenders, interest rate spread, risk premium, banking adequacy ratio and prudential regulations will have to be ensured.
- To make Stock market an efficient vehicle for cooperation, there is also need compatible measures like market capitalization, reliability and growth of market indexes, market liquidity, trading volume, number of listed securities, number of brokerage houses and security firms, stock turnover; Flow of capital including Foreign Direct Investment, Foreign Private Investment, tariff and taxation policies.
- Regulations for transfer of dividend income, flow of capital, corporate regulations and corporate governance dividend policies are required for the development of the common stock market in South Asia. He requested the respective Governments of South Asia to harmonize its monetary and fiscal policy measures because a common or integrated stock market cannot perform its due role without harmonization in the monetary and fiscal policies of the countries in the region.