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ABSTRACT

Malaysian KLSE had achieved a tremendous growth and depth in the market in the past ten years. Should KLSE still be considered as an emerging market although the characteristics of KLSE are pointing more towards a matured market? KLSE has been classified, as an emerging market just because of Malaysia's per capita income is less than US$ 7911? It is because International Finance Corporation (IFC) had defined and linked financial market development to economic development policy based on income per capita. IFC's classification is useful only of pursuing economic development policy formulation.

Emerging Stock markets had grown so rapidly than the developed markets that very little distinction could be made between developed and emerging markets. The reasons for rapid growth include better quality of life of the people of the developing world, faster national economic growth, improved stock market infrastructure, more disposable income to invest on the part of the citizens within the emerging markets, better investment returns, increasing listing of companies. All these factors are moving together towards a dynamic and vibrant stock market that pushed up the volume and the market capitalization of the stock market. Technical enhancements too contributed towards the growth of stock markets especially in the field

efficient regulatory procedures such as central registry, speedy clearing, transparency of trading and information and other protective measures have also enhanced growth of stock markets in the emerging countries.

Therefore, Malaysian stock market which has a favorable investment climate and political stability should be considered as newly developed stock market based on high level of openness and relatively transparent, well established regulatory procedures and good judicious legal system that is acceptable by international standards.

INTRODUCTION

The Malaysian capital market had achieved tremendous growth and success in the past ten years, especially, the Kuala Lumpur Stock Exchange (KLSE). Through a series of reforms instituted since early 1990s the Securities Commission had successfully steered KLSE into a world renowned equity market by attracting funds globally. At present more than 60% of the total market capitalization is held by foreign funds. By the end of June 1997, KLSE is still the largest bourse in ASEAN region with market capitalization of RM 755.6 billion (US $338), and third largest market in the Asian region, after Japan and Hong Kong and ranked 15^{th} in the world. KLSE had undergone a tremendous growth pursuing this objective since its inception in 1975 and has a vibrant market acclaiming as one of the top bourses in the world trying hard to be a world class stock market. The government had instituted several measures such as market liberalization policies and regulations as well as adequate infrastructures such as computerized trading systems and central depository scheme, which allowed for smooth and efficient operation of equity markets and greater transparency for the benefit of the industry.

The stock market had grown significantly in terms of size and number of listings in tandem with the primary need of funds for the industrialization process in Malaysia. It had become as the major source of funds in supporting the economic growth by filing the gap in the financial system to complement the role of traditional lending by commercial banks. The stock market had the confidence from the local as well as the foreign fund managers. Structural changes undertaken by the government in the- mid 1980s had enabled private sectors to raise funds through capital markets. The private sector is the single largest mobiliser of funds, mobilising RM 113 billion or 90% of total funds, raised during the period of 1990 - 1996 compared to RM 6 billion or 22% of total funds raised during the period 1980-1985 (Bank Negara Report, 1966). However, in 1996, RM 198 billion of capital was raised - 30% from private sector, and 70% from government sources. The government's successful privatization policy could not have been implemented without a well structured and a liquid stock market. The privatization of the government owned enterprises also added depth to the market with at least 20% of the total market capitalization. With all these changes can KLSE be still considered as an emerging stock market?

Objective of Study

This study addresses the issue of whether KLSE can still be classified as an emerging market by analyzing and comparing the characteristics of KLSE with those of the developed markets.

An overview and the market structure of the KLSE

The security market in Malaysia developed from the extension of the British corporate business activities in the rubber and tin industries, which were the mainstay of the Malaysian economy in the early 1890s. The British controlled most of these activities. The development of KLSE could be traced from the gathering of stockbrokers in the main towns of Ipoh, Kuala Lumpur, Malacca and Singapore in the nineteenth century. The growth of the security industry was driven by the rubber boom in the early twentieth century leading to the mushrooming of stock

broking firms. However, this was short lived due to the decline in rubber prices in 1912.

The Singapore Stockbroker's Association was formed on 23 June 1930, under the Societies Ordinance Of Straits Settlements. It started as a first formal organization in securities business in then Malaya. The reason for forming the organization was to enforce a close door policy in the face of competition against from newly established non-British foreign stock brooking firms. In 1938, the association was reregistered under the name of Malayan Stockbrokers to reflect the Pan Malayan character of its members. The Malaysian Stock Exchange was formed on 21 March 1960. Public trading of shares started on 9th May 1960.It was renamed as Stock Exchange Of Malaysia in 1964 when Singapore became part of the Federation Of Malaysia in 1963. With the secession of Singapore from Malaysia in 1965 the common Stock Exchange continued to function but as Stock Exchange Of Malaysia and Singapore (SEM). Prior to 1989 trading activities were done by auctioning (open cry). After May 1989, trading in Malaysian Stock Exchange was done through semiautomated trading system on Computerized Order Routing and Execution (SCORE). The conversion of the trading post to computerized trading system had improved the speed of transactions and enhanced the volume of trading.

In 1973 as the result of the termination of the currency Interchangeability Agreement between Malaysia and Singapore the Stock Exchange Of Malaysia and Singapore was split into Kuala Lumpur Stock Exchange (KLSE) and the Stock Exchange of Singapore (SES). During this time Malaysian companies continued to be listed on SES and vice-versa. The KLSE Bhd was incorporated on July 1973.It started its own operations guided by provisional rules, by laws, listing requirements and corporate disclosure policy.

The KLSE Bhd was established under the Securities Industry Act 1973. Five bodies, that is the KLSE, the Capital Issue Committee (CIC), the Foreign Investment Committee (FIC), The Registrar of Companies (ROC), and the Panel on Take over and Mergers, regulated it. Its main objective was to provide a marketplace for raising new funds and trading place for outstanding shares by sellers and buyers who determined the share prices freely and competitively. The main trading center was Kuala Lumpur which was linked to other markets through their respective brokers located at several major towns in Malaysia. At the end of 1989 there were 53 stock broking firms with 153 of the shareholders who were members of the Exchange.

KLSE operated on similar basis as the developed stock markets. It provided a trading place for some 648 listed companies at the end of June 1997 (428 on the main board and 220 on the Second board). The Second Board was launched in 1989. The listed companies were classified broadly into 12 groups namely, Industrial, Construction, Trading, Infrastructure (IPC), Finance, Hotels, Property, Plantations, Mining and Unit Trusts, Loans and Warrants. Table 1 refers to total listing and market capitalization since 1994.

Table 1: Market capitalization of KLSE (1994-1997)

Year	Number of Companies	Number of Listed Stocks (billion)	Total market Capitalization (RM billion)	Percentage Market Capitalization/ GDP
1994	479	75.9	508.9	274.6
1995	529	92.4	565.6	258.6
1996	617	114.6	783.5	317.0
1997*	717	150	880	315.0

*Estimate

By the year-end 1997, it is estimated that 717 companies will contribute to a market capitalization of US$352 billion (RM 880 billion). After the recent debacle in the market, the estimated market capitalization is expected to be less than RM 700 million ringgit. However, due to the bearish conditions prevailed in the month of July 1997, the market capitalization has dropped to about RM740 billion. By end of June 1997, there are 648 companies had been listed in KLSE and it is the fifth largest bourse in Asia, beating the

Singapore Stock Exchange (SES) which has 318 companies with a market capitalization of US$ 186 billion (RM 465 billion). Although KLSE is the only official Malaysian market for trading securities, there is in existence, an exchange set up for Bumiputera Companies called Bursa Saham Bumiputera (BSB). To date, less than ten companies have been listed with this exchange. Soon, some companies based on Islamic principles will be traded in the near future.

Capitalization in relation to GDP had increased steadily from 274.6% in 1994 to 317 % in 1996. This development reflected the financial depth of the stock market in relation to nation's economic activity. It is expected to increase to 315% by the end of the 1997.

The year 1996 saw a large number of public listings in KLSE. The robust economic activity helped to raise the market capitalization to RM 735.8 billion. Among the factors that influenced the increased capitalization in 1996 was the role played by foreign fund managers by investing particularly, in the prices of low stocks that were low in 1995.The increase in market capitalization was also due to the strong fundamentals of the economy. **Table 2** refers to funds raised in the equity market.Funds raised by private sector through equity market increased significantly from RM 21.8 billion in 1994 to RM 34.4 billion in 1996. Out of this 7% of funds were raised through new listings (63 firms in 1994 and about 15%were raised by 92 companies in 1996). In 1997 is estimated that 100 companies will raise RM 49.4 billion. The bulk of funds raised during the periods were mainly from rights and initial public offers (IPO).

Table 2:Funds Raised in the Equity Market

Year	Number of New companies Listed	FundsRaised (RM billion)	Percentage of Funds through New listing
1994	63	21.8	7
1995	52	28.3	10
1996	92	34.4	15
1997*	100	49.4	20

*Estimate

Frequency Trading

Market liquidity is measured by turnover volume as a percentage of the number of listed securities. Market liquidity means the ability to buy and sell stocks quickly at a fair price. A liquid market is characterized by the presence of many buyers and sellers. **Table 3,** shows average daily annual turnover. In the year 1996, the daily annual turnover was 268 million shares worth RM 1868 million. The stock market performed well in 1996 compared to 1995. Increase in total turnover is more than 128%. The up trend was mainly influenced by strong economic fundamentals. Throughout the year the country saw an improvement in trade account balance, sustained high corporate earnings which provided strong fundamental support for index-linked and other quality shares and active restructuring exercises involving mergers and acquisitions as well as increased participation of foreign fund managers. It is interesting to note that during the same period the concentration of trading activities in the Second Board, which saw daily average turnover and prices, increased significantly. The exceptional performance was attributed to strong retail speculative interest in the second board. The market liquidity as measured by the ratio of turnover to value market capitalization increased from 31.6% in 1995 to 57.4% in 1996.

Table 3: Average Annual Daily Trading Volume of KLSE

Year	Average trading volume(million)	Volume (RM million)
1994	6.01	328.1
1995	139.8	736.0
1996	268.0	1868.0

Market Concentration of capital by top ten ranking companies

Table 4, shows that the concentration of capital held by top ten ranking companies (measured in term of market capitalization) in KLSE by end of June 1997, was about RM

190.7 billion which is 26% of the total market capitalization of KLSE. The top four government enterprises (TNB, Telekom, Petronas and Plus) contributed about 14.2 % of concentration of capital. On the whole about one fifth of the market capitalization were held by government owned agencies such as TNB, Telecom, Malaysian Airline system, Petronas, Proton, Kontena Terminal and United Engineering Malaysia (Plus).

Concentration of trading volume by top ten companies

The concentration of trading value for the top ten ranking stocks were RM 21.178 billion out of total trading volume of RM 304.5 billion. The concentration of trading volume is about 7%which is greater than the average of the Emerging markets 42% and nearer to the average of developed markets which is about 13%.The mid - year 1997 was a bearish market for most of ASEAN countries. One of the factors that contributed to the bearish condition was the instability of currencies faced by South East Asian countries.

Table 4: Top Ten Ranking Companies Market Concentration @

Rank	Companies name	Sector	Market capitalization (RM billion)	TradingVolume (value in RM billion)
1	TNB	Trading	38.129	2.4115
2	Telekom	Trading	35.380	3.1447
3	Maybank	Finance	30.300	3.03369
4	Sime Darby	Industrial products	19.534	2.5477
5	Petronas	Construction	16.574	0.6930
6	U.E(m)	Trading	14.402	2.8565
7	RHBCAP	Trading	12.413	1.3618
8	Genting	Trading	8.496	1.5728
9	Resorts	Trading	8.298	1.573
10	Renong	Consumer product	7.212	2.028
Total			190.738	21.178

@ End of June 1997.

Source: Investors digest (Mid – July 1997, KLSE publication)

Trading Practices

To make clearing and settlement more efficient the Exchange had on 12th February 1990 implemented Fixed Delivery and Settlement System (FDSS). All the securities listed on the exchange were cleared by the Security Clearing Automated Network Services (SCANS), a wholly-owned subsidiary of KLSE Bhd. Any security sold can be delivered to SCANS by the selling brokers as early as the first market day following the day of contract and Scans will in turn, redeliver the securities to the buying brokers on the second market day following the day of contract. Thus FDSS had brought about a more efficient and organized system of script movement which enabled stock broking companies to better manage their cash flow, thereby reducing the physical delivery of shares between member companies and SCANS.

The central Depository System

The Central Depository System (CDS) was launched in 1993. All companies listed with the KLSE were required to prescribe to this system. except the issuance of bonds and warrants. The objective was to improve the efficiency in relation to the physical delivery and inherent risks of settlement process by the way of book entry. Under CDS, the investor was required to open an account in his name or nominee's name and deposit his stocks with the CDS. The account is opened with an Authorized Depository Agent (ADA) and trading was conducted through the stock broker. The year 1966 was a landmark year for the stock market for it saw the full implementation of scripless trading under the CDS. The benefit of this system is to avoid the loss of scripts and also to reduce fraud. The CDS system had also facilitated a reduction in settlement period so that the KlSE would be closer to the standards adopted by international stock exchanges. However, the maximum period allowed for the settlement period is T + 7 (transaction plus seven days).

KLSE hopes to shorten the delivery and settlement period to T+5 by the third - quarter of the year and T+3 by next year. Such a move will provide for better liquidity in the market. Under the Fixed Delivery and Settlement System, the sellers of securities are required to credit the said securities into the clearing house, SCANS, by T+5 (date of transaction plus five trading days). On the other hand, the settlement deadline for buyers of securities is T+7 by which day the said shares will also be credited into the buyer's CDS account. The system will increase liquidity, reduce risks and inefficiency and assure convergence with international best practices. The benefit of this system will be a shorter period which will eliminate the seller's one day exposure, thereby substantially reducing the market exposure for the buyer, reducing the risk of insolvency of stock broking company and generally reducing systematic risks, Thus a more efficient clearing and settlement system will ultimately serve to better protect the retail investor at large (for example: In 1996, Total Market Value was RM 783 billion or 317% of GDP and 67% of all share transaction was conducted by small transactions which were conducted by small retail investors) while improving the liquidity of the market. It will further close the settlement time frames between the Malaysian market and international markets, reducing failure rates encountered by global investors. This will increase border trading and move the KLSE one step closer to being a world class exchange.

NEW DEVELOPMENT

Over the Counter Market (MESDAG)

Over the counter (OTC) trading or Malaysian Exchange Securities Dealings and Automated Quotation (MESDAG) is a new phenomenon in Malaysian Stock Exchange. It will be listed as a Third Board. It provides a new avenue for high technology and capital intensive companies with no prior track record to raise funds directly from the market. It will also serve to boost Malaysia's most innovative project - the development of the Multimedia Super Corridor (MSC) which is a national infrastructure project. Mesdag is needed to meet the risk rewards profiles of investors, market players and corporate players and corporate issuers. The companies that will be listed will come from industries of high technology that are owned by both Malaysian and Malaysian foreign owned companies or businesses within Malaysia in line with the MSC incentives. The companies seeking funds from Mesdag are required to invest at least 70% of the funds in Malaysia. These companies must have at least RM 2 million paid up capital with no ceiling and at 30% bumiputra participation requirement which is not made mandatory.

Securities commission will formulate regulations in regard to disclosure of information and transparency in their dealings so as to be fair to all parties. Over the counter trading will have broad guidelines of KLSE where companies listed on the Mesdag have to bank the scripts with the Central Depository System. Secondly, the sellers of the Mesdag shares have to adhere to the exchange's ruling of settling period T+7, that is making the sold script available to the buyer within 7 days. The shares of Mesdag will be quote driven and not order driven. It will not allow reverse take over back -door listing.

Chapter 2

Definition and Characteristics of Emerging Stock markets.

Definition

International Finance Corporation had defined Emerging Stock markets in various ways. As the term “emerging” implies that change is underway, an emerging market is one that is growing in size and sophistication in contrast to a market that is relatively small, inactive and gives little appearance of change.

Alternatively, emerging market can refer to a stock market in any developing economy, no matter how well developed the stock market itself, with the implication that the stock market’s potential to emerge further is strongly linked to the economy’s over all development potential.

The International Finance Corporation of World Bank had classified stock markets as emerging or developed based on the stages of development that a particular country undergoes, no matter how developed the stock market is in these countries. If the country is categorized as developing, even if the stock market is fully functional and well regulated, the market will be labeled “emerging”. A good example is Hong Kong which though considered by investors as one of the major international stock markets, is not included in their list as developed in spite of having mature market standards. On the other hand, a stock market, in a high-income country is considered as developed even though the market itself is not totally functional, the Kuwait Stock Exchange is a good example.

Economies are considered as developing or emerging by World Bank if their per capita income in 1991 is less than US$7911. If the per capita income is US$635 and less it is considered as low income country. High income countries have per capita income more than US$7,911. In 1996, per capita income of Malaysia was US$4,466. (Economic Report, Ministry of Finance 1996/1997) Classification of stock markets based on per capita alone is insufficient if distribution of income of that particular country is not considered. One popular publication (Goldman Sachs' Guide to world Stock Markets) does not classify markets but ranks them on an objective criterion. So far, there has not been any general agreement on acceptable criteria for classification of capital markets and there has not been any serious discussion of the issue in any journal. A precise definition, particularly in ever changing world, may never be possible without qualification.

Some investors had defined emerging stock markets as one that represents less than 3% of the world's stock market capitalization. Others define emerging markets as those with either low security turnover, (less than US$2 billion) or fewer than 100 listed companies

Mobius (1996) defines a stock market as 'emerging' based on any of the following criteria:

- have low or middle per capita incomes
- have undeveloped capital market (that is the market capitalization of their markets represents only a small portion of their gross national product), and