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THE INTEGRATION OF EUROPEAN AND ASIAN STOCK EXCHANGES: FEDERATION OF EURO-ASIAN STOCK EXCHANGES

Abstract: The integration of capital markets has a significant meaning for economy development. When capital markets are associated, they are better managed and the capital flow is wider. Because of well developed capital market the level of savings in economy grows, and it gives opportunity to allocate them in productive investments – and this is the source of economical growth, which is very important in the times of financial crisis. The advantages of capital markets cooperation and integration are available for European and Asian stock exchanges because of the existence of Federation of Euro-Asian Stock Exchanges (FEAS). This organization promotes the development of emerging stock markets in Europe and Asia by supporting each other and exchanging experiences.

Key words: financial integration, capital markets cooperation, capital flow, capital markets managing.

1. Introduction

Modern economy is a system of connected subjects, corporations, institutions and countries. By the process of globalization the good impulses can be sent between them to improve the development process, but there is also a threat of exchanging disturbances. In the time of global financial crisis there are symptoms of integration of institutions, as a solution for many problems, which cannot be solved in individual way. The biggest breakdown in world's economy 2009 was the situation on the financial markets, especially on the capital markets. This is the reason why the cooperation between them is so important, to overcome the difficult effects.

The effects of the crisis are connected not only with the obvious investor's fear of making investments. They also show the situation of corporations on capital markets, which have problems with surviving, or companies which had plans to start up with stock exchange debut, and now are waiting for better circumstances.

Increasing globalization of the world economy has an impact on the behaviour of national capital markets (a segment of financial markets, where the long-time instruments are issued and traded). It makes stock exchanges (where the trading activity can be done) to cooperate in order to make economic growth. Recently the

international economy started changing to a single market, using the liberalization of trade and investments, which allowed better and more efficient allocation of resources. Globalization is also closely connected with regionalization – this is the reason why associations of stock markets are often set in regions. Also most of exchanges investors become from surrounding regions.

2. Capital markets integration and cooperation

The integration of the world capital markets is one of the impacts of globalization. We can say that the integration of international stock markets can be seen as the most significant change in the global capital market. On the whole global market, foreign exchange and bond markets become more integrated. All issues connected with domestic markets become well-known by the whole economy, also the law of one stock market begins to apply throughout the world – this is the way to propagate good solutions. With the equity markets integration capital becomes more mobile. The next result of capital market integration, and also an impact for its development and companies efforts, is removing stock exchanges restrictions and listing of stocks on more than one exchange (we can observe increases in share of the present foreign firms and in share of the non-residents stock investors). There is also another result for markets integration – increasing linkages are transfer from developed stock markets to emerging stock markets. There is need for stock exchanges to change their structure and governance to be more cost efficient and transparent. Stock exchanges started changing their structures and now the process of integration and consolidation is crossing borders. The real way of the integration is to link stock exchanges electronically so that their members can execute orders on them. It makes stock exchanges more effective and achieves increase in its depth and liquidity. The other, but in completion, way to integrate the capital markets is to associate them in transnational organizations, such as: Federation of European Securities Exchanges, World Federation of Exchanges, African Securities Exchanges Association, America's Central Securities Depositories Association, Asian and Oceania Stock Exchanges Federation, etc.

The integration in financial sector is an effect accompanied by the process of globalization. The integration can be defined as “opening the national capital markets for free flow of the capital between countries, which contribute in global financial market”.¹ The causes of financial integration are the following:²

- aspiration to enlarge profits because of efficiency gains,
- risk reduction,

¹ W. Dębski, I. Bujnowicz, *Integracja i rozwój rynków kapitałowych a wzrost gospodarczy. Przegląd Polski*, [in:] W. Małecki (ed.), *Globalizacja rynków finansowych – implikacje dla Polski*, Vizja Press&IT, Warszawa 2007, p. 46.

² *Ibidem*, pp. 39-40.

- development in discipline of informatics technology,
- broadening of scale of products and financial services offered, also for foreign investors,
- deregulation and liberalization of financial markets,
- globalization (it also supports the increase of investment in economy, when country resources are not sufficient),
- pressure of stock holders on the improvement of firm earning power.

The ideal situation for the integration and cooperation of capital markets is when the same financial instruments are valued the same on different markets. The real integration is when “investors can in one country buy and sell without restriction equities that are issued in another country and as a result identical securities are issued and traded at the same price across markets after adjustment for foreign exchange rates”.³

A regional stock market is defined as “having no specific location but is a consortium of stock exchanges within geographic proximate nations. A company located within a region should be free to issue and redeem capital via any exchange that is a member of a regional stock market”.⁴ Regionalization is a process of integration of capital market products and infrastructure in a region. Members and investors are taking advantages from liquidity and optimum turnover. Being involved in a regional stock market association makes it possible to later join larger global exchanges.

The development of stock markets is one of the conditions of economic growth of a country. The reasons of authenticity of that conclusion prove that liquidity and risk diversification make investors more active. The corporate governance regulations improve the flow of information about activities of companies, so they must become more effective. What is very important – the stock market gives also opportunity for direct capital flows to the most productive aims. It also expands capital accumulation and technological innovation. The relationship is also opposite – the level of economy development provides impacts for capital market growth because of the resources of savings, which can be changed into investment.

The technological advance is one of the most important factors of capital markets integration. The surge of information exchanging and detecting of telecommunication networks technology is helping to overcome the obstacles of foreign trading by making it fast and reliable. It also gives an impact for capital markets to open their borders. It helps international investors to attract new capital.

³ P. Pieper, R. Vogel, *The Stock Market Integration in Latin America*, CAER II, Discussion Paper No. 21, Harvard Institute for International Development, Cambridge 1997, p. 35.

⁴ V. Hooper, *Integration of Stock Exchanges in Regions*, [in:] *G-15 Conference on Capital Markets: Challenges and Opportunities in the New World*, Cairo University, Egypt, Cairo 2001, p. 4.

3. Advantages and disadvantages of capital markets integration and cooperation

The integration of capital markets gives an impact to economic development, in the way of financial development, the capital accumulation and an increase of productivity growth. Stock markets can also affect economic activity through the creation of liquidity. Liquid equity markets make investment less risky and more attractive, because of the possibility to sell stocks quickly and cheaply. Also companies can have permanent access to capital, even if it is placed in equity issues. All those factors make stock market liquidity an impact for more investment in the most effective enterprises, and it is one of the most important impacts for economic growth. The financial development facilitates economic growth because of the reduction of cost of external financing of companies, so it is significant impact of the rise of new firms. It can enhance innovation and promote growth in indirect ways.

The integration of a region's capital markets should give following benefits: lower prices of financial services (growth of competition), a chance for regional firms to develop economies of scale, more efficient markets, innovation in financial products and services, easier financing for companies, reduction of the transaction costs, more efficient allocation of capital, higher returns on investments, improvement of macroeconomic performance of the region's economy. A regional stock market creates bigger and more efficient markets. It also gives companies an opportunity to compete for capital on emerging markets and present those corporations to large local institutional investors. The regulation of corporate governance can be exchanged between countries, which helps in their development and better management of the companies (they can fulfil internationally acceptable standards). Also the brokerage firms have to improve their standards and services to be equal on the integrated market. Those benefits are reliable reasons for governments to support the process of capital markets integration.

The support is required because of the obstacles accompanied by regional integration of the capital markets. At first the currency must be convertible, to enable the cross-borders capital activity. Second condition is to overcome barriers of monopolistic practices (which is connected with higher costs). Also the differences in legal regulations, regimes, taxation system, and accounting, and protection of national industries can complicate the development of integration. It is very important to engage politics in making a connection between capital markets, at first to remove the lack of information. Differences in culture and history can also complicate the integration, so particularly the investor protection should be even on all markets.

The integration and cooperation of regional capital markets is a difficult process, especially because of the national authorities approach. They often do not want to relinquish control over financial markets and are afraid of losing parts of existing capital markets which can be absorbed by larger ones. The differences between

legal regulations, financial or social systems are also an obstacle, especially when there is no trust between participants of integrated market. The costs of integration can also be high. Some companies can lose on integrated market because of the lack of competitiveness and governments have to give up with supporting chosen companies. The time of the regulations adaptation can be long and also bring costs (regulatory costs). It is important to consider pros and cons of integration of capital markets process, but it is irrefutable fact that in the time of crisis stock markets at once are stronger than individually.

4. The integration and cooperation of Asian and European capital markets – Federation of Euro-Asian Stock Exchanges (FEAS)

The integration of Asia and Europe has been created for many years. The proof of close connections between them are especially projects connected with education and technological improvement (for example, the agreement between European Union and India on scientific cooperation). Because of advantages, mentioned above, also the cooperation between stock exchanges can be profitable for both sides and particular members from two regions. The stability of euro currency and the region can be attractive for Asian investors and Europe is an example of good regional cooperation and institutionalization. Europe can learn from Asian experiences from the financial crisis 1997, because there are reasons to compare the rotations on Asian markets to nowadays European crisis, because there are similarities of the situations and regions (for example, close connections between the countries, the influence of globalization and liberalization processes).⁵ The crisis is prone to diffuse, so it is clear that the cooperation should be tightened to find solutions together and support each other. This is also an advantage for companies from both regions, because of wider perspectives of stock placing and the growth of trust between business partners from cooperating countries. Global centres of capital flows and markets are settled, but with some effort and development the process of integration can create new promising business centres.

One of the examples of stock exchanges integration is the Federation of Euro-Asian Stock Exchanges (FEAS). It is a non-profit international organization. It was established in 1995 with 12 founding members, to initiate cooperation between exchanges in the region and with governments in other parts of the world. The founding members consist of exchanges from countries in Europe, outside the European Union and EFTA, Central and South Asia and the Middle-East. Any subsequent membership will be open to exchanges or an association

⁵ Nasza część Europy nie powinna zapaść na azjatycką grype, *Gazeta Giełdy „Parkiet”*, 14.03.2009.

of exchanges located in Europe and Asia.⁶ Now it has a total number of 32 stock exchange (SE) members from 29 different countries (and 11 affiliate members). Members of FEAS are the following (Figure 1):⁷ Belarusian SE, Ukrainian SE, Moldovan SE, Zagreb SE, Belgrade SE, Bucharest SE, Sarajevo SE, Banja Luka SE, Tirana SE, Montenegro SE, Bulgarian SE, Macedonian SE, Istanbul SE, Takasbank, Georgian SE, Iraq SE, Amman SE, SDC Jordan, Palestine Securities Exchange, Baku SE, Baku Interbank Currency Exchange, Tehran SE, CSD Iran, Bahrain SE, Abu Dhabi Securities Market, Muscat Securities Market, State Commodity and Raw Materials Exchange of Turkmenistan, Toshkent Republican SE, Kazakhstan SE, Kyrgyz SE, Mongolian SE, Lahore SE, Karachi SE, Association of Capital Market Intermediary Institutions (TSPAKB), Association of Certified Market Professionals (ACCOMP), Central Registry Agency, Egyptian Exchange, Istanbul Gold Exchange, MISR for Central Clearing, Depository and Registry, MSM Brokers Association, Nasdaq OMX Armenia, National Depository Center of Azerbaijan, Securities and Exchange Brokers Association (SEBA), Tehran Securities Exchange Technology Management Company (TSETMC).

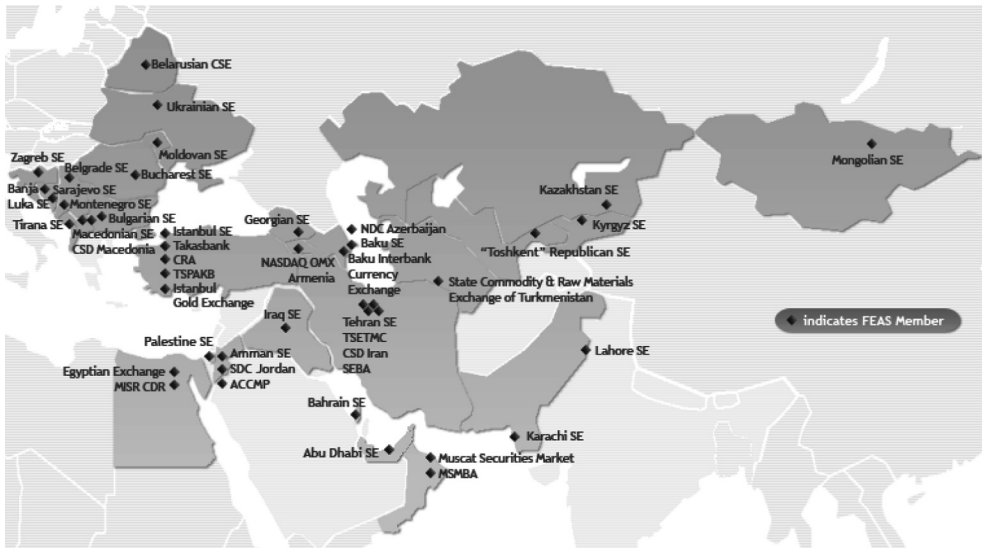


Figure 1. FEAS Members – geographical reveal

Source: *FEAS Members*.

⁶ *Charter and Mission*, <http://www.feas.org/Content.cfm?Get=Charter&Top>About> (accessed 15.03.2010).

⁷ *FEAS Members*, <http://www.feas.org/MemberIndex.cfm?Top=Members> (accessed 30.03.2010).

The region of Europe and Asia, in spite or because of the crisis, has a desire to continue growth tendency in world economy and on capital markets (together and individually). To help countries and their stock exchanges and whole financial markets, FEAS was established. The goal of its existence is to help members to achieve individual goals in development. The organization advantage is openness for new members – emerging stock exchanges from Europe and Asia. The mission of existing FEAS is: “to help create fair, efficient and transparent market environments among FEAS members and their operating regions. FEAS aims to minimize barriers to trade through the adoption of best practices for listing trading and settlement and by promoting linkages among members for cross-border trading”.⁸ The long-term mission of the Federation is realized by detailed objectives:⁹

1. To promote good “corporate governance” for exchanges, brokerage companies and listed companies. Facilitate timely disclosure of material events to achieve transparency through effective dissemination of information.

2. To encourage convergence among FEAS Members in their: listing requirements, trading rules technical infrastructure and settlement cycle.

3. To promote mechanisms for reliable, transparent and uninterrupted securities trading and settlement.

4. To create greater recognition and visibility for the region’s securities and investment opportunities both locally and internationally.

5. To encourage the listing of “investment grade” securities in the respective Home markets of the Region.

6. To encourage foreign investor participation in Member Markets.

7. To promote linkages among the Region’s: intermediaries, data vendors, settlement and custody institutions, exchanges; and also encourage cooperation among Region’s Regulators.

8. To promote and encourage research activities and training for FEAS Members and their personnel.

9. To assist Members of FEAS to increase financial literacy through public awareness.

For making the cooperation more efficient, there are lots of new activities started in the organization. At first, for the exchange of data and experiences, the FEAS Data Center was established (to standardize and promote cross-market statistics and the initiation of the FEAS Index)¹⁰. The destination of this project is to upgrade the visibility, transparency and cross-border trading between investors from member countries. The other way to bring closer together the cooperation was undertaking: “Bilateral Visits, establishing the FEAS Training Center; the joint ISE/FEAS

⁸ *Charter and Mission.*

⁹ *Ibidem.*

¹⁰ *President’s Message*, <http://www.feas.org/Content.cfm?Get=Welcme&Top>About> (accessed 16.03.2010).

projects with international associations and organizations such as the World Bank, World Federation of Exchanges (WFE), UNPRI and the Organization for Economic Cooperation and Development (OECD)".¹¹

The management of the organization is transparent and simple: the governing body is General Assembly, comprised of all 32 members, which meets once annually, in a member country.¹² The responsibility for development and undertaken policies (strategies are made for 5-years periods), and administrative decisions, is in hands of Executive Committee (12 members). There is also the Working Committee, whose acidity must be approved by the Executive Committee. Every office was settled in 1995: Tuncay Artun, representing Istanbul SE as its Chairman and CEO, was elected President (now: Huseyin Erkan); Walid Asfour from the Amman SE for the Vice President of FEAS and the position of Secretary General is held by Aril Seren. The administration headquarters and the Secretary General are in Istanbul, Turkey.¹³

The impact of connections and growing cooperation between European and Asian stock exchanges can be observed on global capital markets. The global indexes provider, Dow Jones Indexes, has established three Dow Jones FEAS Benchmark Indexes (5th June 2009). Those are first indexes created to measure the performance of companies across the region of Europe and Asia (one of them is a composite index and two are sub-indexes). Funds and structure products can be created on the basis of those indexes. Dow Jones FEAS Composite Index includes (for now) component stocks of 10 of the 32 member exchanges of FEAS: Abu Dhabi (UAE), Amman (Jordan), Bahrain (Kingdom of Bahrain), Belgrade (Serbia), Bulgaria, Istanbul (Turkey), Karachi (Pakistan), Macedonia, Muscat (Oman) and Zagreb (Croatia).¹⁴ It will be rebalanced, when new members will be added to composite index. They are, as it was mentioned, divided into two sub-indexes:¹⁵

- The Dow Jones FEAS Middle East/Caucasus Index: Abu Dhabi, Amman, Bahrain and Muscat,
- The Dow Jones FEAS South East Europe Index: Bulgaria, Zagreb, Macedonia, Belgrade and Istanbul.

The indexes are calculated and pass over in euro and United States dollar.

The meaning of that across-regional index can be seen on Figure 2. The middle graph is still under the rate of emerging market (it is connected with the situation of countries which are involved in FEAS – some of them are just at the beginning of rapid development), but over the average of global index – it can be an indication for capital market integration.

¹¹ *Ibidem.*

¹² *History of FEAS*, <http://www.feas.org/Content.cfm?Get=History&Top=About> (accessed 20.03.2010).

¹³ *Ibidem.*

¹⁴ *FEAS members.*

¹⁵ *Dow Jones Indexes*, <http://www.djindexes.com/literature/index.cfm> (accessed 31.03.2010).

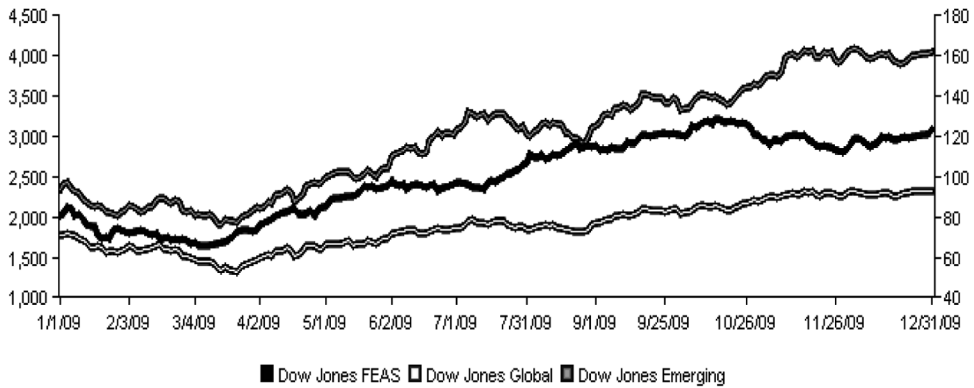


Figure 2. Dow Jones FEAS Benchmark Composite Index performance in 2009 (in United States dollar)

Source: *Dow Jones*, <http://www.feas.org/DowJones.cfm> (accessed 31.03.2010).

As FEAS is a non-profit organization, it has to use the support of outside sponsors which currently are: Is Investment (investment banking service), The NASDAQ OMX Group (the world's largest exchange company), Finans Portfoy (portfolio management company, Turkey), Tayburn Kurumsal (Turkish joint venture with the Tayburn Group, Scotland's biggest corporate communication companies), Muskat Securities Market, Amman SE, Gama Holding (international company), Seker Securities (Turkish capital market company) and Deutsche Bank.¹⁶ FEAS is also cooperating and learns from experiences of such supporting organizations as: World Federation of Exchanges, International Accounting Standards Committee, International Securities Services Association (ISSA), OECD and South Asian Federation of Exchanges.¹⁷

The goal of FEAS existing organization is to promote the development of emerging stock markets in Europe and Asia by reinforcing each other efforts. The main pressure it takes is to: "support a transparent market environment between FEAS members to advance trading in these markets. The introduction of the Dow Jones FEAS Indexes will support this mission as the index provides market participants with easy access to a unique combination of emerging and frontier market stocks", as said Michael A. Petronella, president of Dow Jones Indexes.¹⁸ The Dow Jones FEAS Indexes can contribute in promoting growing spirit of enterprise in the Euro-

¹⁶ *Sponsors*, <http://www.feas.org/Contributors.cfm> (accessed 10.03.2010).

¹⁷ *Supporting Organizations*, <http://www.feas.org/Content.cfm?Get=Supporters&Top=Members> (accessed 26.03.2010).

¹⁸ *Dow Jones Indexes and the Federation of Euro-Asian Stock Exchanges to Design Regional Indexes*, <http://press.djindexes.com/index.php/dow-jones-indexes-and-the-federation-of-euro-asian-stock-exchanges-to-design-regional-indexes/> (accessed 15.03.2010).

Asian region, creating value of visibility and transparency, compatibly with the main headword of the federation: FEAS is your gateway of the markets of tomorrow.

FEAS creates publications and annual reports about situation of organization and individual members or INTERFEAS Magazine. The most important initiative is the Bilateral Exchange Program. Every member can propose the other a meeting or working together, but all members have a knowledge about it. The examples of bilateral cooperation are: “The Macedonian SE visit to the Bucharest SE about: 1. Data Distribution Policy 2. Experience in Creation of a Data Distribution Policy 3. Technology used for Data Feed implementation process or: The Kazakhstan SE will visit the Muscat SM. The training program includes: 1. Islamic banking 2. Clearing and settlement system 3. Risk-management, market indicators, new financial instruments”.¹⁹

There are many conditions on which integration of capital markets can work. FEAS is trying to synchronize the regulations on the markets, to make real transactions on them and to estimate their value correct. Nowadays, investors create their portfolio by diversification of risk on the multinational market. This is why the integration of European and Asian stock markets is so important – to support each other development and to create well-established system of investors rights protection on emerging markets.

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¹⁹ *Bilateral Exchange*, <http://www.feas.org/bilateral.cfm> (accessed 29.03.2010).

INTEGRACJA GIEŁD PAPIERÓW WARTOŚCIOWYCH EUROPY I AZJI NA PRZYKŁADZIE ORGANIZACJI FEDERATION OF EURO-ASIAN STOCK EXCHANGES

Streszczenie: Proces integracji rynków kapitałowych ma duże znaczenie dla rozwoju gospodarki. Powstawanie stowarzyszeń rynków kapitałowych prowadzi do poprawy sposobu zarządzania nimi oraz do wzrostu przepływów kapitałowych między nimi. Dobrze rozwinięte rynki kapitałowe powodują wzrost poziomu oszczędności w gospodarce, co z kolei może być wykorzystane jako źródło nowych inwestycji – a to jest bardzo istotne w dobie kryzysu finansowego. Korzyści wynikające z kooperacji i integracji mogą stać się udziałem giełd papierów wartościowych z Europy i Azji, dzięki powstaniu Federation of Euro-Asian Stock Exchanges (FEAS). Organizacja ta zajmuje się promowaniem rozwoju giełd z regionu Azji i Europy poprzez wzajemne wsparcie i wymianę doświadczeń.