A pan-GCC stock market is a must, not a mere necessity

Karim A. Souaid, Founder and Managing Partner of Growthgate Equity Partner looks at the possibilities of a broader stock market in the region

Capital formation in developed and emerging markets alike relies primarily on the possibility of entrepreneurs and business owners to tap into private savings. Such savings are either held in the form of deposits and thus translate into loans to businesses, or in the form of equity investments that get channeled principally into listed and traded stocks.

The GCC countries—Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates—account for less than 15 per cent of the total population of the Arabic-speaking countries but

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with oil production they account for some 70 per cent of the area's GDP and around 90 per cent of the region's stock market capitalisation. The relative wealth of the GCC region is in large part due to its vast energy resources. However, it would be unfair to label these economies as solely oil-dependent due to the significant diversification and economic development that have occurred in the past 15 years outside the petroleum sector. Some GCC countries are making clear attempts to develop niche markets or exploit relative advantages in the real economy from food processing to transport and from communications to financial services.

The development and strength of the financial sector in the GCC will depend both on further economic diversification and the ability to serve the growing needs of the regional markets. The existence of a stock market, whether local or regional, is of course not sufficient to ensure economic growth. But it is hard to think of competitive economies such as the GCC that do not also exhibit a measure of financial market development. Wealthier countries are more capable of generating savings destined for capital market investments, and have the means to build the supporting financial infrastructure. If one safely assumes that the GCC exhibits political stability, a rising GDP, and relatively strong economics, the challenge for building efficient stock markets seems to be a structural one.

To put things into perspective, one should note that as of mid-September 2014 the total market capitalisation of the GCC markets stood at circa $1.179 trillion, whereas at same period the aggregate capitalisation of the shares of Apple, Exxon-Mobil and Coca-Cola was circa $1.2 trillion.

Consolidating the regional exchanges into a pan-GCC online market–just as Euronext-with multiple locations, would go a long way in adding liquidity, depth and volume to all stocks issued and traded in the region. This would also assist regional businesses–of all types and sizes-to raise growth capital through IPOs without the worries of filing complexities or of post-IPO issues such as lack of marketability or a phenomena better known as 'listed but not frequently traded shares'.

The introduction of free trade and travel within the GCC, and the use of a fixed exchange rate pegged to the US Dollar, has encouraged investors to engage in more cross-border transactions in search of profit-making opportunities. Yet despite the appeal of cross-border trading, most stock exchanges in the GCC remain national institutions that in some instances trade only local, country-specific stocks.

Stock exchange consolidations produce economies of scale both in operations and in trading volumes. Operational economies of scale can arise from the establishment of compatible or shared trading platforms while economies of scale can be realised from heightened market liquidity. The compatibility of trading platforms across the GCC could reduce the cost of cross-border transactions, attracting new investors to the equity markets and generating higher trading volumes. High trading volumes are important to an exchange because of the increased liquidity associated with them.

However, despite the potential benefits offered by the establishment of a pan-GCC exchange, several factors are often cited against such calls for consolidation. These include inter alia, the existence of cross-country legal and regulatory differences, and home-country bias.

Cross-country legal and regulatory differences are a serious hindrance to consolidation. At present, several authorities in each country regulate the securities markets, with each having its own set of rules. But regulators' concerns are the same: protecting investors from unfair dealings and curbing market excesses. Such common goals can surely be encapsulated into a GCC Securities Regulations Act. Just as all air controllers in each of the GCC countries are equally concerned about the safety and security of airlines and passengers, same principle could apply on securities regulators reading from the same book of rules. Also, a common GCC prospectus that requires same substance and level of disclosures by issuers would go a long way in bridging the gap between different sets of filings and reporting rules.

Another less convincing factor is mentioned against consolidation pertaining to 'home-country bias, meaning a distinct preference for holding assets in one's own country—despite the advantages of cross-regional portfolio diversification. It is reported that some investors tend to focus more on their home markets and the companies that do business within these markets because they are familiar with them. However, this argument is moot in the case of the GCC with cross-regional investors historically participating at large volumes in local IPOs, and in some instances companies from a specific market (Saudi) having listed their shares on another (Dubai).

As the GCC's financial markets gain in importance as a means to raise capital for investments, a consolidation of exchanges would become a must, not a mere necessity. Going forward, GCC governments can play an important role in the transformation of the countries' stock exchanges. If they do, this would encourage the reinvestment of private savings into regional economies, as well as the emergence of large listed-companies that create employment opportunities, and operate in various economic segments thus, further diversifying from the energy sector.

Overall, it is too early to predict the exact structure or timing of any pan-GCC stock market, but its advent is incontrovertible. FME

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