

Larson, Erik

Article

Creating markets, leaving legacies: The origins and operations of stock exchanges in Fiji, Ghana, and Iceland

economic sociology_the european electronic newsletter

Provided in Cooperation with:

Max Planck Institute for the Study of Societies (MPIfG), Cologne

Suggested Citation: Larson, Erik (2006) : Creating markets, leaving legacies: The origins and operations of stock exchanges in Fiji, Ghana, and Iceland, economic sociology_the european electronic newsletter, ISSN 1871-3351, Max Planck Institute for the Study of Societies (MPIfG), Cologne, Vol. 8, Iss. 1, pp. 23-27

This Version is available at:

<https://hdl.handle.net/10419/155877>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

Creating markets, leaving legacies: The origins and operations of stock exchanges in Fiji, Ghana, and Iceland

Erik Larson
Macalester College
larsons@macalester.edu

During the last two decades of the twentieth century, the number of countries with stock exchanges essentially doubled. While some of these new exchanges were founded in large countries in transition from state socialism, many of these exchanges were set up in more peripheral locations in the world economy. This empirical fact seemed to challenge accounts of globalization positing the development of a single world market and pose questions about how to understand the emergence of these new exchanges. Additionally, the development of these new stock exchanges provided the opportunity to examine processes of market formation and operation in comparative perspective.

To provide evidence relevant to the questions about the diffusion of stock markets and the nature of these markets' operations, I undertook a comparative study of three of these newer, somewhat peripheral exchanges. I used four criteria to select exchanges for study. First, I screened for exchanges that were established at a similar time during the 1980s or 1990s. Second, since regional processes may influence developments and since my theoretical questions also concerned global processes, I decided to include exchanges from diverse geographic regions. Third, I selected exchanges for diversity in International Finance Corporation classification. Since these classifications may represent differences in countries' relations to the global economy, selecting for classification diversity followed a logic analogous to geographic diversity. Finally, as much as practical given the other criteria, I looked for exchanges that were relatively comparable in size. With these criteria and information from the International Finance Corporation about stock exchanges throughout the world, I selected the exchanges in Fiji, Ghana, and Iceland for my research.

I completed intensive field research in each of the three countries. In each case, I spent four months conducting participant observation, in-depth interviews, and archival research. In each country, I began my research at the stock exchange itself, moving from the exchange to stock broking firms (which I selected for more in-depth study based on firm characteristics that I learned in my initial research period) and to regulatory agencies and other participants, such as institutional investors. Analytically, I used my data to understand how the exchanges were established and how the markets work.

I found that different concerns motivated the establishment of these three stock exchanges, but that there were common experiences in setting up these markets. In each case, international legitimacy associated with establishing a stock exchange brought with it international assistance – in the forms of financial aid and technical expertise – to help plan for and launch the exchanges. This international legitimacy, however, was fungible, as the “solution” of establishing a stock exchange was attached to a variety of problems.

Reasons for Creating Stock Exchanges

In Fiji, the stock exchange was seen as a means to establish a more dynamic and neutral capital market. Rather than the exchange fulfilling demand of investors or companies for such a market, the stock exchange was seen as a means to stimulate such demand. The greatest push for the exchange came from the national provident fund. Given its size relative to the economy and the large proportion of national investment assets that it held, the provident fund had been criticized for having too great an influence on asset prices and also faced a limited supply of securities in which to invest. Establishing a stock exchange provided a means to address both issues. With a market institution establishing prices, the provident fund would be insulated from political criticism, while at the same time be able to take advantage of an increased supply of potential

investments, as the stock exchange encouraged more companies to go public.

In Ghana, the stock exchange was established as part of the Economic Recovery Programme (ERP), a structural adjustment program that aspired to increase the productive potential of the economy through liberalization. The goals of ERP included doubling domestic savings to 10% of GDP and increasing foreign investment from 5% to 7% of GDP. To meet these goals, the ERP called for expansion of the financial sector, and establishing a stock exchange represented one of the means of this expansion. Serving as means to privatize state-owned enterprises as well as an institution for businesses to raise capital, the stock exchange represented a part of an entirely new financial system, which would help create incentives for Ghanaians to save and invest. It would also encourage international investors to supply capital to the country, which became particularly important in light of declining foreign aid from developed countries. Hence, there is a similarity in Ghana and Fiji in the envisioned effects of creating a stock exchange: the institutional innovation would stimulate the demand for such an institution by creating investors to supply capital and supporting companies, which wanted to raise capital. Nevertheless, there is an important difference that illustrates the fungible nature of stock exchanges. In Ghana, the stock exchange was viewed as providing new incentives for people to save and invest, increasing the supply of capital. In Fiji where sufficient capital already existed, the stock exchange would solve the problem of a limited supply of investment opportunities and address the concern about the influence of large investors.

Similar to the exchange in Ghana, the stock exchange in Iceland traces its origins to policies of government liberalization. Rather than international financial institution-led structural adjustment, however, the liberalization in Iceland was a component of a policy program that was part of the process of European integration. The policy of liberalization encouraged both increased independence of the banking sector and increased share ownership. To facilitate increased independence within the banking sector, the Central Bank established an exchange to trade its debt instruments. At about the same time, the government provided a tax incentive to subsidize individual purchases of company shares. The new exchange, however, did not trade these shares. Despite a very large increase in trading in company shares on over-the-counter markets, trading in company shares on the stock exchange happened only after the government made the exchange independent

from the Central Bank. In its new position as an independent institution, the stock exchange was given oversight duties and also named the competent authority for certain European Economic Area functions.

Legacies of Institutional Locations

The institutional locations of the exchanges – the position of the exchange in relation to existing social actors – and the motivating purposes in establishing the exchanges created legacy effects on the operations of the exchanges. The institutional locations of these exchanges are defined by their relation to extant financial sector actors and to the state.

These institutional locations influenced the formation of stock brokerage firms. In Fiji, establishing the exchange as a counterweight to the national provident fund placed the exchange largely outside of the commercial banking sector, which was dominated by overseas banks, and in relative isolation from the state. Brokerage firms in Fiji were largely new creations. While the initial brokerage firms were subsidiaries of the exchange itself and the provident fund, these firms were spun-off and wound-up, respectively, when new brokerage firms were established. In Ghana, the exchange served as an instrument of structural reform and privatization. Given that the large commercial banks were state-owned enterprises, locating the exchange within these banks would have given too much continuing authority to the state. Brokerage firms, however, were supposed to serve to mobilize capital from foreign and domestic investors. In this light, brokerage firms were established by secondary financial institutions (which had contacts with domestic investors) and as new entities by “returning” expatriate Ghanaians who had contact with international investors. In contrast to Fiji and Ghana, the exchange in Iceland was established with greater involvement by the commercial banking sector and located more within the state. The commercial banks’ early involvement in the exchange – and their prominent role in trading government debt securities – led these entities to establish brokerage firms and to these firms becoming dominant in the brokerage market.

These variations in the institutional locations of the exchanges and brokerage firms are associated with differences in the trading practices and rules for each of the markets. In Fiji, trading rules require that all orders are priced by individual clients with a maximum buying or

minimum selling price. These orders are to be placed with the market during the first session after receipt of the order and orders are matched in strict price and time priority order. In Ghana, the exchange started by using a "call-over" auction. Under this system, brokers first placed orders to sell. Each broker was allowed to place one order, aggregating any number of clients' orders into this one order. Brokers who placed their orders earlier than other brokers were allowed to adjust their prices downward to match the lower-priced offers to sell. After all these orders were collected, brokers could place orders to buy (again, restricted to a single order per broker but allowing for price adjustment). After all the buying orders were placed, orders were matched from the highest-price order to buy and lowest price order to sell, with trades happening at the buyers' price. This system of processing provided brokers with a great deal of discretion in pricing clients' orders, which has persisted even with the shift to a continuous auction trading system. Brokers used this discretion to handle pre-arranged block trades – often involving foreign investors – at prices at a discount or premium to the prevailing market price. After these trades, brokers would "restore the price" by trading a single 100 share lot at the previous market price. In Iceland, the stock exchange has used an electronic trading system since its founding, switching to the SAXESS system when the exchange joined NOREX, the alliance of Nordic exchanges. The system is programmed to match orders on price-time priority, but also allows brokers to enter manual trades that are in the range of the best buying and selling prices or that are of sufficient size. In practice, much of the trading that occurs involves proprietary trading by the commercial banks. These traders may have open orders in the trading system, may arrange for trades with other brokers, or may take advantage of open orders in the trading system.

These differences in trading practices create the foundation for different relations with individual investors, exemplified by variation in meetings of brokers with individual clients across the three markets. In Fiji, brokers typically explained to clients how the market operated and gave an overview of particular shares, their current prices, and the prices of open orders on the exchange, expecting clients to use this information to place orders with specific prices. Often these meetings would also involve some education about how the market worked and the trends in particular shares over time. In Ghana, brokers seldom explained the processes of trading to clients and, when they did, the explanation served to tell the clients why the transaction would have to take some time. Meetings with clients in

Ghana focused more on selection of particular companies in which to invest, with brokers distinguishing between companies that paid a higher dividend and those that might offer longer-term prospects of capital gains. While brokers in Fiji would describe the different listed companies and the various components of an investor's return (dividends and capital gains), they did not provide the interpretative framework to distinguish types of companies as in Ghana. In Iceland, meetings with individual clients frequently were conducted by representatives who specialized in customer service, with representatives sending instructions to brokers. In comparison to Ghana and Fiji, client meetings in Iceland were oriented much more toward a financial services model, concerning more than investment decisions. Additionally, a much larger proportion of individuals in Iceland invested through managed funds, so that the selection of particular companies was made by a fund manager. In such cases, the individual was left to determine – with the assistance of a representative – which investment strategy should be pursued, while the specific decisions to achieve the strategy were made by investment professionals.

Variability in Stock Market Operation

The organization of brokerage shapes the ways in which investors' participation is fed into the stock market. As a result, brokerage organization also shapes the manners in which the markets operate, influencing characteristics such as price, volatility, trading volume, and liquidity.

In Fiji, given that all orders were traded under the same system of price-time priority and that investors placed orders with brokers at specific prices, one might anticipate that investors' assessment of shares would have a large influence on the prices of trades and the volatility of the prices. Yet, investors' understanding of how prices should be set and how the market operates were moulded through the information provided by brokers. For example, many brokers would emphasize recent price trends. Explaining to clients that a particular share was experiencing a gradual increase in price encouraged sellers to use the last traded price as a baseline to which one should add a small amount. When clients give such orders to brokers, particularly once they are placed with the stock exchange, they become what is "on the market," developing an objective quality, thereby reconfirming the price trend. Certainly some of the price trends on the stock exchange during my research reflected the supply-and-demand situa-

tion: with only a small number of listed companies, relatively small total market capitalization, and incentives for share investment, one would expect that prices might increase. As the precise supply-and-demand situation changes, the investors' understanding may shift, changing the orders that are put onto the market. In the end, though, investors' understandings, as shaped by brokers, would continue to impact pricing and volatility.

The connection between investors' perceptions and market realities was also found in Iceland; however, the actors whose perceptions matter differed. In contrast to Fiji, proprietary traders drove the market. Traders' understanding of an appropriate investment – one that is volatile with sufficient liquidity – led the set of traders to similar securities. Particularly in the case of securities in which trading rules or other arrangements call for a certain mass of participation (such as market maker arrangements) the volatility was as much the consequence of trader action as the cause of trader action. Even in the case of shares that tended to be less liquid, less volatile, and that did not have any market maker agreement, proprietary traders would take positions, attempting to move the market. For example, in response to a query from the stock exchange about the share price movement of a small company, a trader explained that his firm kept buying shares to "find out what the real price was" – a "real price" representing one at which a larger volume of shares would transact. While the Iceland Stock Exchange publishes an official price of shares each day, this trader – and, for that matter, most of the other brokers – considered that "real" prices differed from the official prices and that they were marked by a higher volume and participation level. To this end, these traders and brokers for large investment funds would often attempt to "find" the real prices by placing large orders to buy or sell shares. These orders could create volatility, bringing in traders and brokers, whose daily work consisted of watching the market.

Brokers in Ghana perceived a professional responsibility to "protect the market," perhaps attending to their greater discretion in pricing clients' orders. Since most retail client orders were at a best effort basis and since these orders (as opposed to block trades) were taken to indicate the correct market price, brokers exerted a good deal of influence on prices. As in Iceland, there was concern about a correct or real market price; however, in Ghana, brokers shared an understanding of what a correct market price for a share was, decreasing the volatility in share prices when compared to Iceland. This perception was expressed in a meet-

ing held by the stock exchange's Continuous Auction Trading implementation committee. Exchange officials and brokers expressed the belief that price changes on the market should be for a reason and the direction of price changes should reflect the most current information about a company. An exchange between two brokers illustrated an understanding that there was a professional responsibility to not "spoil the market" by following client orders to sell "at any price", if there simply wasn't demand for a company with "good results." Perhaps more striking was the conversation inspired by a consultant's comment that "volatility is good" (a statement that could very well have been uttered by one of the proprietary traders in Iceland). The reaction of the stock exchange officials showed that volatility was generally not considered good in Ghana (unless the volatility related to actual market developments, such as news releases of a company's profits). Excess volatility – volatility beyond what news about the market justifies – was held to be inappropriate, because it would spoil the public image of the stock exchange. Brokers had internalized this message and managed volatility by sacrificing liquidity. Rather than finding some buyer for a client's shares today, they avoided "spoiling the market." The notion that supply and demand were not the determinants of price movement was expressed by a broker who told me that the price of the shares of a company that he was selling "had gone up far enough." The broker expressed the view that supply and demand imbalances are temporary and that he shouldn't exploit the imbalance. In this case, the broker was selling shares owned by his brokerage firm, not a client. Thus, the broker's objective interest would appear to be to sell the share as highly as possible. Similarly, brokers would seem to have an objective interest to have high volatility and high trading volume (to maximize commissions) at all times. Yet, this broker – along with other brokers in Ghana – held to a belief that they had a higher obligation to limited price volatility for the exchange.

While brokers in Ghana limit volatility by managing liquidity, one would expect that brokers in Iceland, with some level of preference for volatility, did not manage liquidity. Yet, brokers expressed concern about acting to maintain liquidity. One broker explained that big trades for clients were negotiated off-market and reported manually, because "if you put it all on the market, the other brokers would take away their buying orders." Many of these manual trades were achieved by swaps – the seller exchanging shares in one company for shares in another company, rather than receiving cash. One asset manager

explained "If somebody needs cash, it is a difficult situation. To sell something off, you take a hit. The cash price can be 5 – 10% lower." While the lack of cash during this period for many investors likely reflected the wider economic circumstances – fairly rapid depreciation of the krona against both the dollar and the Euro accompanied with high levels of foreign-currency denominated debt – the response in the situation to manage liquidity was telling. Brokers in Iceland acted to manage liquidity, realizing that attempting to use the liquidity of the orders already on the market would result in a drying up of the market. In contrast to the liquidity management in Ghana, liquidity management in Iceland was price mediated (cash settled transactions were at higher prices than bartered transactions), rather than reliant on the shared orientations of brokers to protecting the market.

Conclusion

The results of my research on stock exchanges in Fiji, Ghana and Iceland suggest that the development of these

new stock exchanges should be understood as the consequence of using a globally legitimate mode of action in response to particular national concerns. These new markets were created in a manner that positioned the innovation in particular relation with existing actors. This positioning of the stock exchanges influenced which market participants were most influential on market outcomes. Overall, the comparative analysis of market operation demonstrates that price dynamics in markets are mediated by patterns of participation.

Erik Larson is an assistant professor of sociology at Macalester College in St. Paul, Minnesota. His research focuses on the emergence and transformation of legal, economic, and political institutions in relation to the global and national developments. In addition to his study of new stock exchanges, he is also examining political contention concerning economic affirmative action targeted on the basis of indigenous status; the preparation, presentation, and interpretation of evidence for international treaty reporting and monitoring bodies; and the nexus between the global indigenous rights movement and national and regional indigenous rights movements.