



# ROLE OF STOCK EXCHANGE IN THE ECONOMIC DEVELOPMENT OF PAKISTAN

## The role of stock exchange in the economic development

**T**he role of the stock market is to raise long-term funds for corporations (primary market) while providing a platform for the trading of securities (secondary market). Stock exchanges encourage investment through pooling of resources, enabling corporations to obtain funds to expand their businesses. In Pakistan where the saving rate has remained sticky at under 15%, the importance of the stock exchange in aggregating savings and then channelizing them to

gration with the global economy. A functioning stock market makes it easier for firms to find sources of capital in both domestic and international capital markets. Case in point is the growing number of GDRs that allow foreigners to participate in local offerings without taking currency risk. In the last eight years, several blue-chip Pakistani companies such as Oil & Gas Development Company (OGDC), MCB Bank Ltd (MCB), Pakistan Telecommunication Company (PTC), Hub Power

**A**lam has over 20 years of experience in the financial sector. His current assignment as CEO AKD Securities is to head a talented young team of professionals to rise to the occasion in prevailing tough conditions. The company has the honor of winning the prestigious CFA Association of Pakistan award for Best Brokerage House for two consecutive years 2005-06 and 2006-2007. The Investment Banking Division of AKD Securities is considered to be one of the most active and innovative in the financial sector. Mr. Alam also oversees AKD Group financials in consort with CEOs of the respective group companies.

Before joining AKD Securities in 2007, Mr. Alam was working first as the Head of Mutual Funds Division and then as the Head of Treasury at Pakistan Industrial Credit and Investment Corporation (PICIC). Under his dynamic leadership, the Net Asset Value (NAV) of the funds grew at a very healthy pace, beating the

### Muhammad Farid Alam, FCA Chief Executive Officer - AKD Securities Limited

KSE-100 Index and other parameters set by the management. Mr. Alam gauged the appetite of the market and raised over Rs. 3.4 billion during 2003-04 through right issues by first convincing the board of directors and then the investors; the successful mobilization of resources set a new trend in closed end funds.

Mr. Alam also reorganized ICP SEMF under NBFC Rules 2003 and managed flotation of two new funds.

Mr. Alam acted as the Domestic Consultant for Asian Development Bank on Financial Sector Intermediation Loan (FSIL), during 2004. The assignment included review and reporting on various policies and procedures agreed by the Government of Pakistan with ADB. These related mainly to monetary policy, foreign exchanges, money and capital markets.

Before joining PICIC, he was the Head

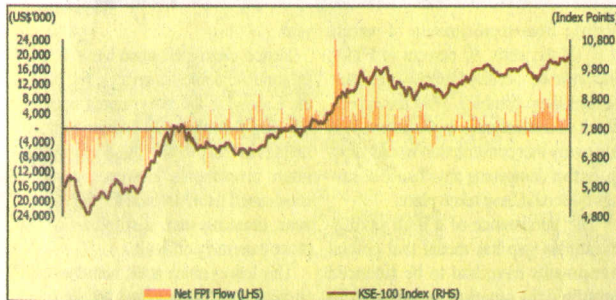
of Finance and Secretary to the Executive Committee and Board of Directors at Corporate & Industrial Restructuring Corporation (CIRC), Government of Pakistan where he was actively involved in remedial banking. He was responsible for managing billions of Pak rupee funds of the organization, which could not be placed with private sector banks under the law. He paved the way for Government institutions to place their funds with private sector banks meeting certain criteria which not only enhanced the income of the Corporation but also cleared the hurdle for other organizations once and for all. He also invested in Government securities which yielded handsomely.

Mr. Alam has extensive investment banking experience which he started gaining during his stay at Crescent Investment Bank Limited-the first investment bank in Pakistan, where he served in various

capacities including Treasurer, Equity Strategist, Chief Financial Officer, Chief Internal Auditor and Manager Corporate Finance. He also managed discretionary clients' portfolio of over PKR 3 billion.

Mr. Alam is a fellow of Chartered Accountants (FCA) and serves on various Committees of the Institute of Chartered Accountants including a high powered Economic Advisory Committee. He has the honor of representing Pakistan at various international forums in London, Frankfurt, Malaysia, India, Singapore and Hong Kong. Mr. Alam also frequently contributes to various news paper articles on Capital markets & Economy which have been published in Khaleej Times, Business Recorder, Financial Daily etc & professional bodies' journals. He is also often invited as an expert and appears on various channels to speak on topics like Money Markets, Capital Markets & Economy.

To find out more about Mr. Alam, his articles etc you can visit his website [www.mfaridalam.com](http://www.mfaridalam.com)





meet the burgeoning investment requirements of the country cannot be overemphasized. Therefore, as an alternative to debt financing, the stock exchange as a whole facilitates productivity levels and hence economic growth, particularly in the present tough economic conditions, where asset pricing is under pressure and bankers have gone too cautious in lending.

It is felt that there is a general ignorance regarding the essential role that Pakistan's stock exchanges are playing in achieving equitable, broad-based and sustainable economic development of the country. From a broader perspective the role of a stock exchange is vitally important for countries moving toward greater inte-

Company (HUBC) and Lucky Cement (LUCK) have benefitted from GDRs. Besides companies, this has been beneficial for the entire economy in many different ways.

In the case of Pakistan, with per-capita incomes sticky at the US\$1,000 mark, the stock exchange helps to create investment opportunities for small investors. They can own shares of the companies just like large investors, and enjoy similar rates of return. In this context, stock exchanges help in redistribution of wealth through stock price increases and dividends with investors getting the chance to share in the wealth of profitable businesses. A healthy trend in this regard is Online Trading which leads to greater awareness for

retail participation and also enhances the benefits for a larger number of people. Simply put, any investor can access the stock market via the internet and without even calling up a broker become part owner of a business conglomerate and enjoy the proportionate benefits.

The stock exchange also serves as an economic barometer and can give important signals to economic policy makers regarding how their decisions related to interest rates, taxes and currency volatility impacts different sectors of the economy. Historically, the KSE has been a leading indicator to changes in the real side of the economy and an effective predictor of growth. Indeed, the meltdown in CY08 did not come as a major surprise given the then-prevalent macro-economic difficulties and the recent resurgence in the KSE certainly parallels rapid improvement in the economy. The stock exchange thereby helps both policy makers to adjust their actions and for regulators to effectively monitor.

The stock exchange can also help the government as well as private sector to raise money through privatizations and GDR offerings. Government divestments in the last couple of years have indeed added color to the local stock exchanges and given them much needed float, depth and breadth. Since the initiation of

economic & financial reforms in the early 90's the GoP has raised a total amount of PkR475bn through the successful privatization of government enterprises especially those in the Financial and Oil & Gas sectors. This not only helped the Government raise much needed funds for priority spending on infrastructure development but also improved the financial performance and service quality of these companies by promoting greater level of competition.

#### Major Privatizations Deals

In the current backdrop where the fiscal authorities are facing increasing stress due to anemic growth in tax generation and higher defense related expenditures, the stock exchange can provide an avenue for the government to fund long-term projects through revival of the privatization program. This will help against the serious crowding out of private sector credit while allowing the Central Bank to continue on the path of monetary easing. At the same time, the stock markets are contributing directly to the government kitty through the tax collected on Capital Value Tax (CVT) and withholding tax on share transactions. With the Government planning to introduce Capital Gain Tax (CGT) on local equities, the contribution of the stock market in solidifying fiscal consolidation will increase. However, this will depend

largely on how interaction with tax authorities particularly of individuals is facilitated. We feel that technology and the level of advancement (e.g. UIN) already attained may help achieve the objective without unnecessary interaction with tax authorities and hiring of income tax practitioners at year end. Deduction of tax as advance tax automatically from an investor account based on UIN, each time he sells a stock is a suggested approach. This will not only smoothen up the mechanism but will also ensure receipt of much needed revenue by the FBR throughout the year.

The stock exchange also allows domestic companies to tap foreign savings through foreign flows. This is especially important in the case of Pakistan where there is sizable saving - investment gap of around 5% of GDP. Hence to maintain an optimal level of capital accumulation necessary to support 4%+ level of real GDP growth, continued inflow of Foreign Portfolio gains significant importance. In the last five years, Pakistan has received cumulative FPI of US\$7.2bn which has not only helped to sustain economic growth momentum but also eased pressure on the balance of payments & the PkR exchange rate by partially financing the enlarging trade gap. In

FY10, economic consolidation especially currency stability & lowering of Credit Default Swap spread on the country's external commercial has resulted in Karachi Stock Exchange to attract FPI of US\$435mn FYTD. Returning confidence in the outlook of domestic equities by both domestic and foreign institutional investors, can potentially lay the ground work required to attract long term foreign direct investment into the country. A key component in this regard has been the role of CDC (transparent electronic transfer) and technology innovations that have reposed investor (both local & foreign) faith in the stock market. It is interesting to note that foreign investors used to be a dream a few years ago but are now taken for granted! Higher FPI flows, despite serious security conditions, have led the market capitalization of the KSE to increase to its current value US\$35.2bn as compared to US\$27bn in the previous year. At the same time, improved risk perception of Pakistan has helped raise the average daily turnover at the KSE to 169mn shares from 119mn shares at the end of CY09.

Lastly, by diversifying ownership, companies generally tend to improve on their management and efficiency in order to satisfy the demands of these shareholders and the more

Name	Amount realized (US\$mn)	Transfer During
26% (1.326 billion) B class of shares of PTCL	2,618	Jul 2005
OGDCL 9.5% GDR (408,588,000 Shares)	771	Dec 2006
UBL 25% GDR (202,343,752 shares)	650	Jun 2007
PTCL (10%)	898	Sep 1994
Habib Bank (51%)	378	Dec 2003
NRL (51% GOP shares)	276	May 2005
Pak American Fertilizers (100%)	265	July 2006
KESC (73% GOP shares)	265	Nov 2005
Pak Arab Fertilizers (Pvt) Ltd. (94.8%)	237	May 2005
United Bank Ltd. (51%)	200	Oct 2002
Total	6,558	

stringent International Financial Reporting Standards (IFRS) and GAAP in case of GDRs. This form of corporate governance weans out the weak corporations through acquisitions/takeovers etc.

In conclusion, the local stock markets have been playing a positive role in the Pakistan Economy where its contribution stands to magnify in the coming times particularly with the planned introduction of more products (particularly Derivatives) and the proposed Demutualization of stock exchanges. This should further augment an increase in investor base leading to a larger pool of funds

available for capital formation in the country. Already, technological advancements such as CDC (electronic settlement), UIN, online trading are facilitating this progress. To conclude, equities as an asset class remain largely untapped in Pakistan and once the aforementioned developments take place, it is felt that the general public would gradually diversify itself away from fixed income investments (Banks, NSS) towards equity investments. As such, it is perceived that the role of the stock exchanges in Pakistan's economy should only augment going forward.