



## **'REFLECTIONS ON AUSTRALIA'S CAPITAL MARKETS'**

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Good afternoon ladies and gentlemen. Thanks for your kind introduction and thanks for your invitation to speak here today.

This is the last opportunity that I will have to address you as I will be retiring from what has been arguably the most interesting of the many interesting jobs I have held. Managing the Australian Stock Exchange has not only been a challenge, but a very satisfying task as our capital markets have grown in sophistication and size and Australia has made its mark as a financial market of distinction, not only regionally, but at a global level. All being well, our Board has indicated that it will announce my successor before the end of this month.

Today I want to focus on what I see as some major challenges ahead and offer some observations on how we might deal with these and continue the successful growth of our markets. Along the way I want to traverse a little history, which can provide some useful pointers to the future.

First, however I want to touch briefly on News Corporation's recent proposal to reincorporate in Delaware in the United States – in essence, their proposal to consummate a long running affair with that nation. It has understandably been a topic of healthy debate within our markets and amongst the financial media.

What we *do know* is that in 2003 the company earned 81% of its operating income from the US and just 7% from within Australasia. That, along with Rupert Murdoch's much-publicised US citizenship is in itself somewhat explanatory to their motives. The company's website reports that at 31 December 2003 Newscorp held assets of US\$52 billion and had recorded annual revenues around US\$19 billion. Again, a fairly clear indication of the company's operating base and focus.

The company has more than 30,000 employees in many countries around the world. And yet throughout the growth of this company it has been the Australian Stock Exchange, and its predecessor state exchanges, that have supported international investor access and facilitated the liquidity and growth in turnover in Newscorp's shares.

We can be absolutely certain that this is a tremendous achievement for a national stock market in a nation that has just reached 20 million people. Our capital markets have supported the global expansion of an icon Australian company during the past 25 years from a small publisher of an Adelaide afternoon daily newspaper to the most international and diversified media company the world has ever seen.

There are however, many things that we do not know. What, if anything, will happen to the liquidity and trading of NewsCorp shares in Australia? How and when will Standard and Poors consider NewsCorp for inclusion in the S&P500 or exclusion from their Australian indices?

The answers to these questions, as they emerge, will no doubt be accompanied with much analysis and comment by our media.

However, what I can discuss is the resilience of Australia's capital markets. In the 9 months to 31 March 2004 there was \$31 billion in new capital raised – through more than 130 new floats and other subsequent placements and capital raisings – in the Australian market. Indeed across the past decade there has been more than \$250 billion in capital raised by companies from domestic and international investors in our market. To put NewsCorp in that context of our overall market health, rather than the other way around, NewsCorp ordinary shares have about \$25 billion in market cap, with approximately \$16 billion of 'free float' included in the Australian market index once you exclude Murdoch's family interests. Likewise the NewsCorp preferred shares have capitalisation of \$44 billion of which \$32 billion is considered as part of the index.

I can also tell you about the liquidity of NewsCorp's shares in the Australian market. In the past twelve months the company's ordinary shares have experienced liquidity levels of 108% – that is, the company's entire capital base has more than turned over in the past year. Excluding Murdoch family holdings the liquidity is 154% of the free float shares on issue. We would expect to make up any of that liquidity that may disappear through natural growth and the ongoing injection of new capital.

Australia's market is, and will remain, both deep and liquid.

Back in 1999/2000 there was much criticism leveled at the Australian market for being old economy and lagging the technology boom experienced particularly in the NASDAQ market in the US. The threat was that many Australian companies seeking access to deeper pools of capital, or the deeper pockets of investors, would migrate offshore. The argument went something like this:

- Company would be more 'fully valued' (i.e. have a higher PE multiple) amongst a larger group of peer companies;
- The company's share price would of course soar;
- The company's new 'currency' (i.e. their stock) would give them cheaper capital to continue to grow, using their stock for everything from salaries for key personnel to payment for acquisitions.

The mere mention of a company contemplating a 'future, possible move' to Nasdaq would create activity and hype in what shortly afterwards became a substantive tech wreck.

During the boom, ASX commissioned a Stanford University Finance Professor, George Foster, to examine the relationships between a company's chosen place of listing, the company's fundamental financial performance, and the earnings multiples given to those companies by the market. His findings clearly identified a relationship between fundamentals and PE multiples. There was no evidence to suggest that moving the place of listing from Australia to the US, or from NZ to Australia for that matter would, of itself, lead to a higher price multiple.

I interpret his findings to mean that in practice a company gets less attention, not more, in a bigger pool of capital. Investors have finite time and resources in evaluating markets, sectors and companies, particularly new ones operating outside their core home market. Unless fundamental revenues, earnings and cash flow are apparent it won't matter where you are.

Because of its fundamentals, NewsCorp is quite a different proposition - not least because for all intents and purposes they are operating in the US and they are large enough that any potential admission to the S&P 500 will make them accessible to many US fund managers. Whatever happens, it will be a fascinating process and interaction between the company, investors and other market participants. It certainly does not follow that other Australian companies, which do not have News Corp's size nor operating presence in the US, will successfully migrate to that market.

Returning to my core purpose today, that is to provide you with some insights into my time in Australia's capital markets:

Before the stock exchange, my career was in public policy-making, most of it as a senior officer of departments in Canberra or as head of the state public service and Premier's Department in New South Wales. I was Auditor-General in Victoria and also served as President of the Commonwealth Remuneration Tribunal, not to forget various task forces and committees I worked on along the way.

All well and good; so, why the history? It only struck me when I commenced at ASX, that throughout that whole period at the forefront of some fairly significant public policy matters, there had never been much heed paid to Australia's capital markets, which I believe to be one of the critical factors driving the very heartbeat of the nation's economy and lifeblood of its future.

There was nothing unique about my relative lack of awareness, and I would venture that even now - in these days of shareholder democracy, massive privatisations, market growth and corporate governance concerns - many public policy makers' perceptions while vastly improved, would retain something of a blind spot on the importance of capital markets and their role and their significance to the economic well being of the nation.

Why is this a concern? Because it would be very hard to find a successful and sustainable economy that lacks a vibrant capital market. I cannot think of any off the top of my head and I suspect the reason is because it is self-fulfilling. Capital markets exist for the efficient raising of capital at the lowest possible cost and where that is done well it will enhance economic activity and create jobs - feeding back into capital market growth and innovation.

The greater the depth, the liquidity and the integrity of our capital market, then the greater the efficiency with which Australian companies, large and small, can raise capital. The more efficiently that capital can be raised, the cheaper it is, the greater the amount of economic

activity that can be generated. That means jobs, first and foremost, and the willingness of people who can create employment to back their ambitions with reality.

As many here will know, Australia's capital markets today are strong and respected. According to the Morgan Stanley Capital International index, the MSCI, Australia's global rating is 2.22%. Doesn't sound like much, does it, until you reflect that this puts us eighth on the world scale, ahead of economies like Italy and only one percent behind industrial powerhouses France and Germany with nearly three times our population. In Asia-Pacific ex-Japan, we comprise about 40% on the index, well ahead of markets such as Hong Kong and Singapore. This matters because it is indices such as the MSCI that determine exactly where the world's capital looks for a home. Fund managers will often use that index or others as a weighting guide and invest or benchmark accordingly.

However, while Australia has an effective deep and liquid market, which punches well above its weight, we need to keep a weather eye open and remain alert. We might be traveling well for now, but it was not always the case and there are never any guarantees for the future.

Even those with little familiarity or interest in the markets will be aware of the turmoil during the late 1960s and early-70s, a time when many ordinary investors' savings were burnt. The Australian market of that time was *not* one in which any investor could have complete confidence in the markets.

What drove the transformation of our capital markets? How did we get from that disarray to the present in what seems a remarkably short period of time? I believe there were seven key factors that were crucial to success.

First, the regulatory and structural reforms which led to (among others) adoption by the Government of the Rae report recommendations bringing in corporate and trade practices reform, reform of Corporations Law, and ultimately, the creation of a consolidated national corporations legislation.

These developments paved the way for the formation of a single national stock exchange in place of the six state based exchanges that had operated separately since the late 19<sup>th</sup> century. This second significant initiative consolidated Australia's fragmented markets to create a single pool of capitalization and liquidity, accessible to all domestic and indeed international investors.

Looking back, this achievement seems so obvious – of course it is better to have a national securities legislation and a single national pool of liquidity rather than to operate in six competing state-sized fragments. Obvious it may be, but it is something that many other markets, not least of all the United States, have not yet achieved.

Complementing this unification was the introduction of electronic trading and equally important electronic clearing and settlement. We were among the first in the world to fully automate and have tended to remain at the forefront in the use of technology and the regulatory frameworks that govern our market activity. Not all major exchanges have yet made that transition to automate and to their cost.

A third factor was the focus on the governance structure of the exchange itself - leading to ASX's eventual demutualisation and listing. Again, we were among the first and for several years, the only, listed exchange. This initiative, apart from unlocking the true value of the exchange for shareholders, has empowered the organization's drive for efficiency,

effectiveness and responsiveness to customers' needs, while still maintaining our reputation for integrity, so necessary to market confidence and growth.

Market integrity, the fourth factor, was an important early initiative in our markets with the chief initiative being the introduction of continuous disclosure as a means of informing the market. Ten years ago, it gained statutory backing under the Corporations Act. It remains the primary force of market integrity on our exchange, and the most effective model, not only for Australia, but we would contend, world-wide.

This supervisory regime has enabled the development of an effective partnership with the Australian Securities and Investments Commission, ably led by Jeff Lucy, with the ASX conducting supervision in real time, but backed by ASIC with the statutory authority to regulate markets and prosecute offenders. This co-regulatory arrangement is a matter of great interest to international stock exchanges who clearly see it as a superior model which enables flexible responses to the myriad issues which arise in effective supervision of markets. We have been fortunate that both the government and the opposition have been publicly supportive of this approach as it clearly offers the most effective and cost efficient approach.

The fifth factor was the number and scale of the privatizations and demutualisations that drove growth and diversity of market capitalisation from the early 1990s and carried through to this decade. The structure of the market has also shifted dramatically away from domination by resources to the financial services, media, transport and telecommunications sectors in particular. Since the early nineties we have seen the aggregate market capitalisation of all of our listed companies grow from the low 200 billions to a staggering three quarters of a trillion dollars, above the level of Australia's total GDP.

Together with effective supervision, which contributes that essential component of confidence, it is no wonder that our markets now are ranked and regarded so highly and are able to sustain overall market liquidity in excess of 80% up from 30% just ten years ago.

Sixth, a parallel achievement has been the proliferation of listed investment products. The Australian market was one of the first to diversify the listed product, offering beyond pure equities, with the creation in 1976 of an options market. Australia was the first exchange outside the US to set-up such a market, in fact the third anywhere in the world, and it has gone on to be one of the success stories of ASX's business. More recently the growth of warrants, interest rate securities, listed property and other investment trusts and futures, have all added to the diversity of listed product available to all investors.

The seventh and final factor which caps all of the preceding ones is the growth in superannuation monies through compulsory and voluntary contributions complemented by the extraordinary level of participation by the private investor. Active participation by the private investor is with us still, according to our latest share ownership study, and now a significant share of trading activity on our markets. This engagement, which had its genesis in the privatization of government enterprises and demutualisations, has matured through positive encouragement by both major political parties. Together with effective education Australia now has over half of the adult population, from all walks of life and across the nation, holding an average investment of some \$40,000. This is over and above compulsory superannuation contributions. Further, the average portfolio size, that is the number of stocks held by the Australian investor, has risen to seven from three just five years ago.

All these factors have built on themselves – the creation of a single national exchange from the six state stock exchanges was only possible through the application of sophisticated

communications technology, which allowed instant and real time access by all market participants across Australia, thereby ensuring not only transparency in trading, but fair and equal access.

But overall, the really important factors in Australia's market success to date have been the creation of a significant pool of money through contributions to superannuation funds and the active engagement by the Australian community in the capital markets.

However, there will be many challenges awaiting our future market operators and market participants and recent market capital trends over the past decade provide some guide as to what we can expect in coming years.

Australia's capital markets have also been extremely accessible to international capital flows, partly because of the efficiency of our systems and also the stability of the regulatory structure. Foreign investors hold over 40% of the equities listed on ASX. Australia has become an exporter of capital with a rising proportion of funds under management being invested offshore.

Looking forward I think that one of the great hurdles facing Australia as an economy, and as a community, is the need to renew much of our ageing infrastructure and to expand our base to meet the needs of a growing and greying population. Undoubtedly the pressure on existing infrastructure has intensified in recent years.

Obviously there has been major infrastructure spending during the past decade, including the construction of new motorways in most of the major population centres helping relieve traffic congestion. And of course, after decades of discussion, we now have the Alice Springs to Darwin rail link.

But it is equally obvious that there remains a need for much greater additional spending on roads, on rail links, on water management, and on electricity infrastructure in parts of Australia. I could go on. Anyone who has wanted to catch a train recently in Sydney or set the sprinkler going on their lawn or had power rationed, will know what I mean. But these issues are not confined to our urban and suburban areas. Significantly impaired or inadequate transport, communication and other facilities infrastructure reduces our economic capacity as a nation and as individuals.

I should make it clear that in talking about infrastructure, I am *not* just referring to what you might call the concrete and steel within which we lead our lives. I would also class investment in social capital including education, as an example of building our economic infrastructure.

Efficient and effective investment infrastructure in all its forms will lead to real returns in terms of improved productivity and efficiency - lower congestion costs being an obvious example, and enhanced lifestyle. Improvements in productivity in turn, will help to sustain the rate of economic growth.

How new infrastructure work is financed is always a big question. In the 1960s Sydney built an opera house on the back of a lottery. It worked then but I don't recommend it as the best solution now.

Governments are notoriously constrained in their ability to spend money on major new projects such as freeways, ring roads and harbour tunnels - hence the rise of the user-pays toll roads. Again, a satisfactory solution, but not a complete solution for the current challenges.

It is my view that the challenge of infrastructure renewal also represents one of the major opportunities for Australian capital markets in coming decades. Capital is available if we have the will to utilise it effectively to enhance Australia's economic activity and wealth.

Over this period there will be what I call a "wall of money" amassing in our superannuation funds as Australians build their superannuation savings, much of it compulsory, to pay for their years in retirement.

Now I want to make one point absolutely clear. Capital, whether locally raised or sourced internationally, will properly seek maximum return commensurate with risk. If the most attractive opportunities are here or overseas, then Australian capital will follow accordingly. Government should *not* seek to mandate or in any way direct where superannuation savings are invested. The investment of superannuation savings is quite properly a role for the private sector to determine. My point is simply that we have the capacity to utilise capital in Australia or invest it overseas, and increasingly we are a nation exporting capital.

Among the key tasks for policy makers, and increasingly for those of us in capital markets, the challenge will be to identify economically justifiable investment opportunities and ensure that funds are efficiently mobilised towards these infrastructure projects.

It is well known that continued growth in private sector participation in the provision of infrastructure can bring with it significant advantages:

- Infrastructure projects can be funded earlier than would otherwise be possible because of limitations on the supply and allocation of public funds. You may have seen our own state government's recent advertising about funding shortfalls for its investment needs.
- Private sector involvement in infrastructure projects will also ensure an efficient prioritising and pricing of infrastructure. Projects will only attract private investment if they are justified on the grounds of economic return.
- Ultimately the investment in infrastructure will have a pay-off in the form of stronger productivity performance.

Capital markets and, in particular, ASX have a key role to play in enabling savings from whatever source, to move into infrastructure projects in the most efficient way possible - which is via traded securities, either in the form of units in trusts or some other form of infrastructure linked security.

And here I should remind you of a couple of what should be rather obvious points:

- The enhanced liquidity afforded by traded securities in a deep capital market is of real and significant benefit. It does enhance the market value of the asset because of its accessibility.
- The liquidity and machinations of capital markets also ensure that capital is supplied to projects at an efficient and transparent market-determined price.

- There is enhanced scope for community participation in the investments when they are listed. Australians are willing and able to invest in these sorts of projects and there is a significant benefit to the community in their being able to do so.
- The added transparency of listed assets makes them attractive from a community and policy perspective, particularly with respect to providers of essential infrastructure. Listing on ASX brings an endorsement of the standard of governance and disclosure expected of companies.

I would be misleading you if I did not also say that Australian capital markets, and ASX, themselves stand to benefit from the listing of more infrastructure type assets. Listing of additional assets on Australian securities markets will attract further investment to the market. We have found that a virtuous cycle comes into action. As more investment is attracted to our securities markets, the market becomes more liquid, which in turn attracts additional investors to the market. The end result is that capital market activity overall will grow and, importantly, this will bring broader benefits to the Australian economy.

It is clear that Australia is already well advanced down the path towards increasing private sector involvement in the provision of infrastructure and Australia's capital markets are playing an important role in this. Already it is possible to invest in tollways, airports, energy companies and other infrastructure services through securities listed on ASX. How the capital market has changed over the past decade! - And so too the society which it supports.

Still, the coincidence of a large requirement for funding of infrastructure spending, and the accumulation of savings through the superannuation system will, in all likelihood, see us take further steps in this direction. To facilitate the flow of funds into infrastructure projects it is vital that the financial sector plays its role in developing opportunities for investment.

Governments need to remain open to, and encourage, this private sector involvement, including through providing an appropriate framework, and means such as public sector-private sector partnerships. And despite it being a federal election year, it is appropriate that all parties acknowledge the important role that capital markets can continue to play in the efficient financing of infrastructure provision.

As far as I am concerned, the importance of creating employment through continued economic growth is not a partisan issue, and nor can it be treated as a specialist one. It is in all our interests to know, understand, appreciate and facilitate the continuation of a true Australian success story.

Thank you.