



# **Securities Commission, Malaysia**

## **Securities Market and the New Economy**

**Mr Andrew Sheng  
Chairman**

**Securities and Futures Commission**

***28 August 2000***

# The Economics of Securities Markets

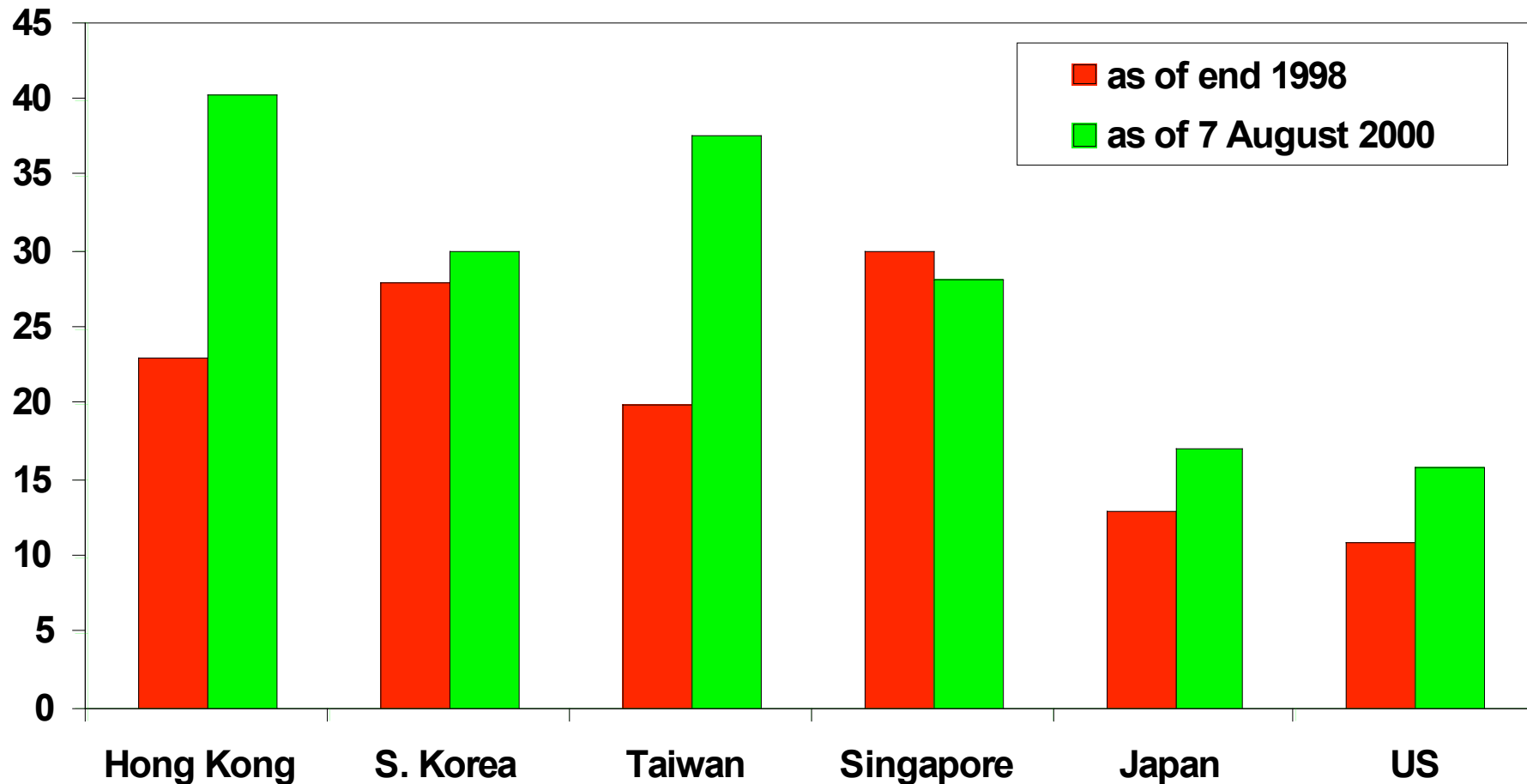
- ◆ **Demand side -**
  - Aging population saving in equities
  - Growth of middle class desiring participation in New Economy
  - Deregulation widens investor choice
- ◆ **Supply side -**
  - Merit-based regulation on issuers limit supply of companies assessing equity market
  - High costs of IPOs - 7% commission on issuing in NASDAQ & NYSE; 10% costs not uncommon
- ◆ **Geographical & Market Constraints -**
  - Local exchanges list local companies - not global market

# The New Economy - challenging the Old through Technology

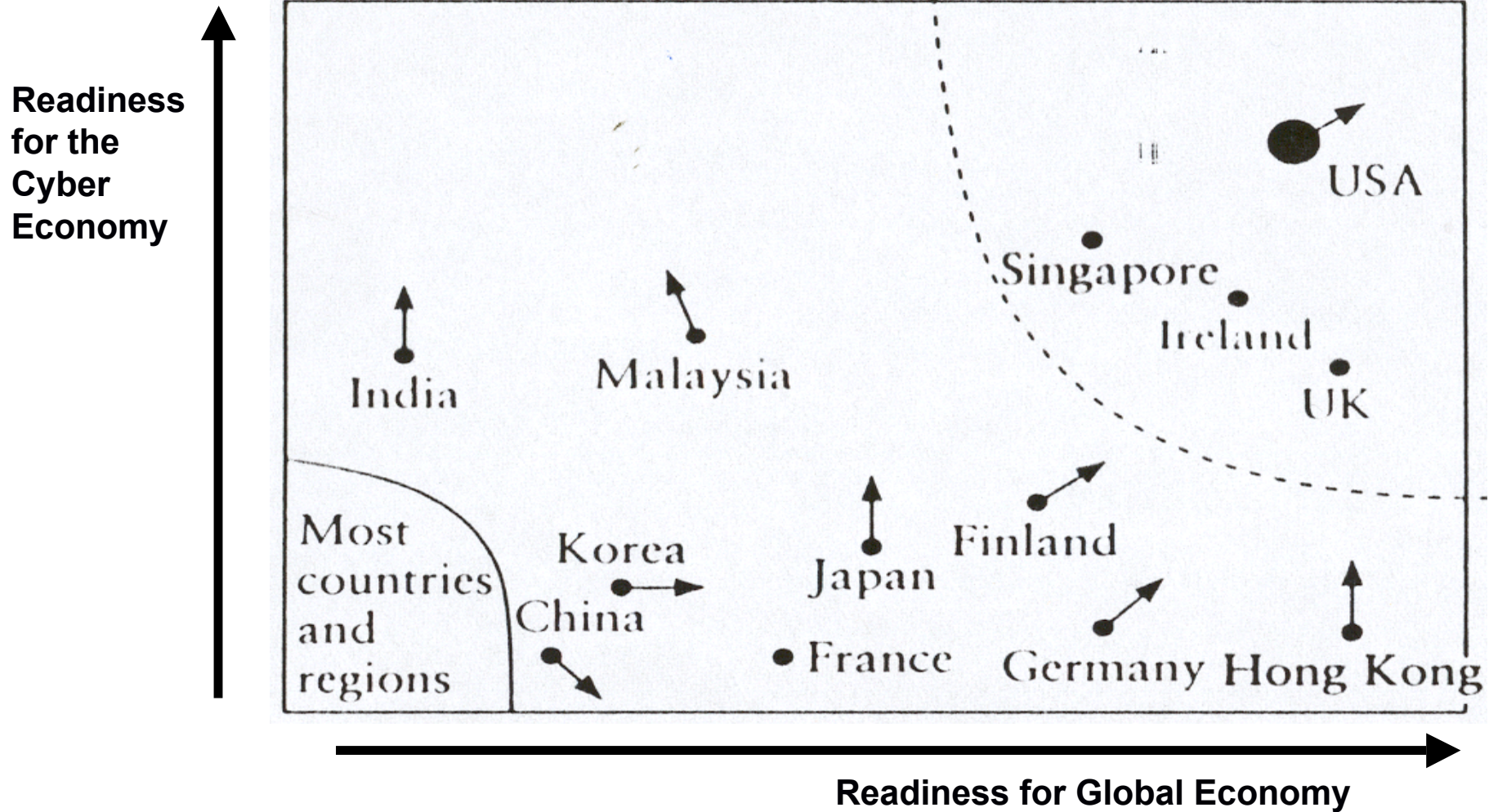
- ◆ **Financial Markets are networks**
- ◆ **Metcalfe's Law** - “The value of a network goes up as the square of the number of users”
- ◆ **Technology creates 7 x 24 Global markets** - Internet cuts through traditional intermediation, threatens old franchises and creates new value
- ◆ **Reality** - we have global markets, but national laws

# The New Economy is Changing global markets

The market cap of the top 10 TMT stocks as % of total market cap



# National Readiness to Move into the New Economy



# Internet Market Continues to Grow

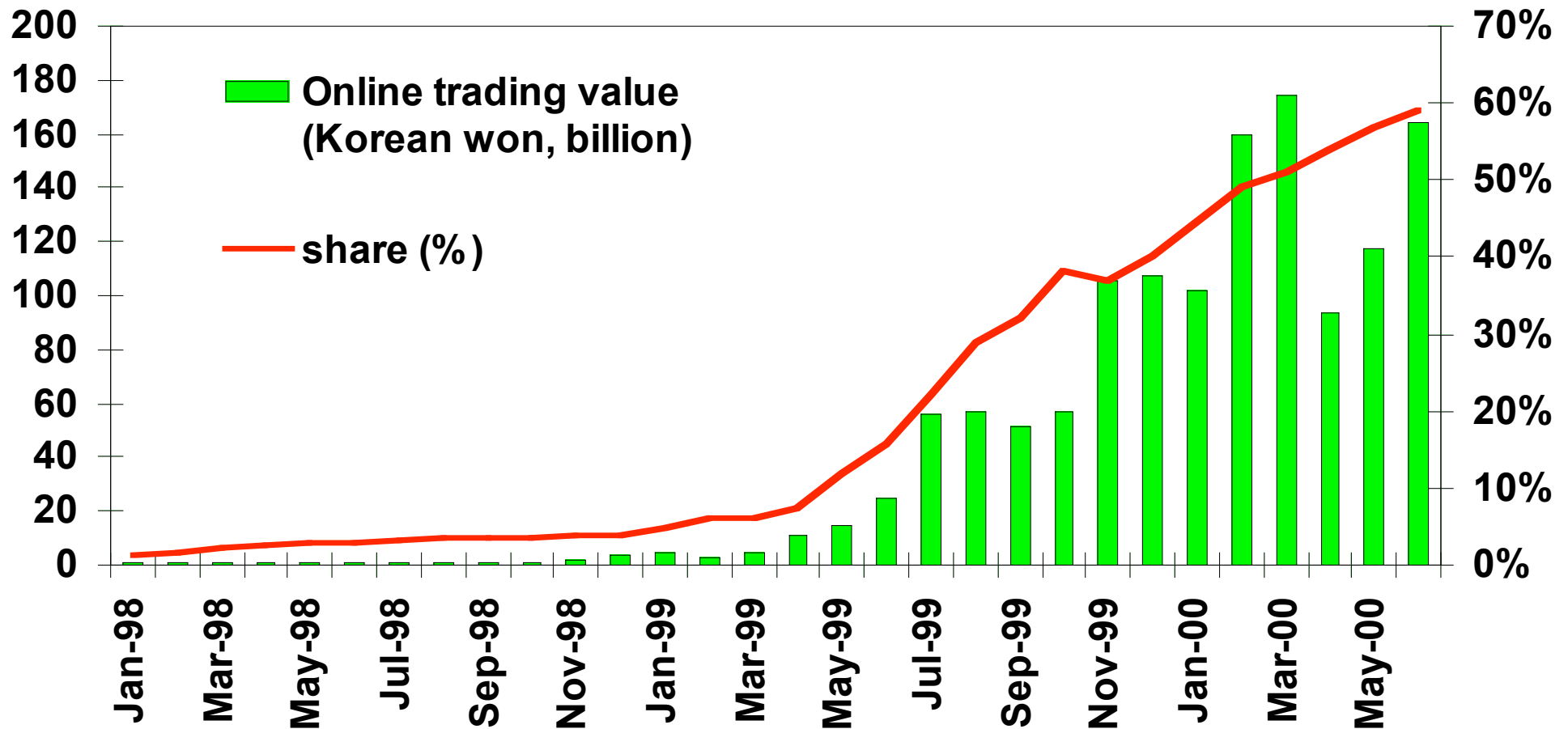
- ◆ Number of Internet brokers in Hong Kong rose from 8 in Oct 99 to 32 in Jul 2000
- ◆ Another 238 will move online in the next 12 months

	Internet Users (million)	Internet Penetration (%)	Internet Brokers	Commission Rates
<b>Hong Kong</b>	<b>2.0</b>	<b>29.1</b>	<b>8</b>	<b>Deregulating</b>
<b>Singapore</b>	<b>1.1</b>	<b>28.4</b>	<b>6</b>	<b>Partial</b>
<b>S. Korea</b>	<b>6.7</b>	<b>14.3</b>	<b>21</b>	<b>Deregulated</b>
<b>Thailand</b>	<b>0.8</b>	<b>1.2</b>	<b>n.a.</b>	<b>Fixed</b>
<b>Malaysia</b>	<b>0.8</b>	<b>3.7</b>	<b>n.a.</b>	<b>Fixed</b>
<b>Philippines</b>	<b>0.6</b>	<b>0.8</b>	<b>n.a.</b>	<b>Deregulated</b>
<b>Japan</b>	<b>14.0</b>	<b>11.0</b>	<b>33</b>	<b>Deregulated</b>
<b>US</b>	<b>58.0</b>	<b>21.0</b>	<b>100</b>	<b>Deregulated</b>

Source: Lehman Brothers, October 1999.

# Online Trading - The Korean Experience

- ◆ Online trading - 60% of total trade
- ◆ jumped 338 times since Jan 1998 value



# Tremendous Growth in Online Trading

	Sep 99	Apr 00	Growth
Number of online brokers	10	32*	220%
Online trading value in HK securities (HK\$bn)	0.523	2.407	360%
Total online trading value (HK\$bn)	2.863	8.735	205%
Number of accounts	8,876	37,382	321%

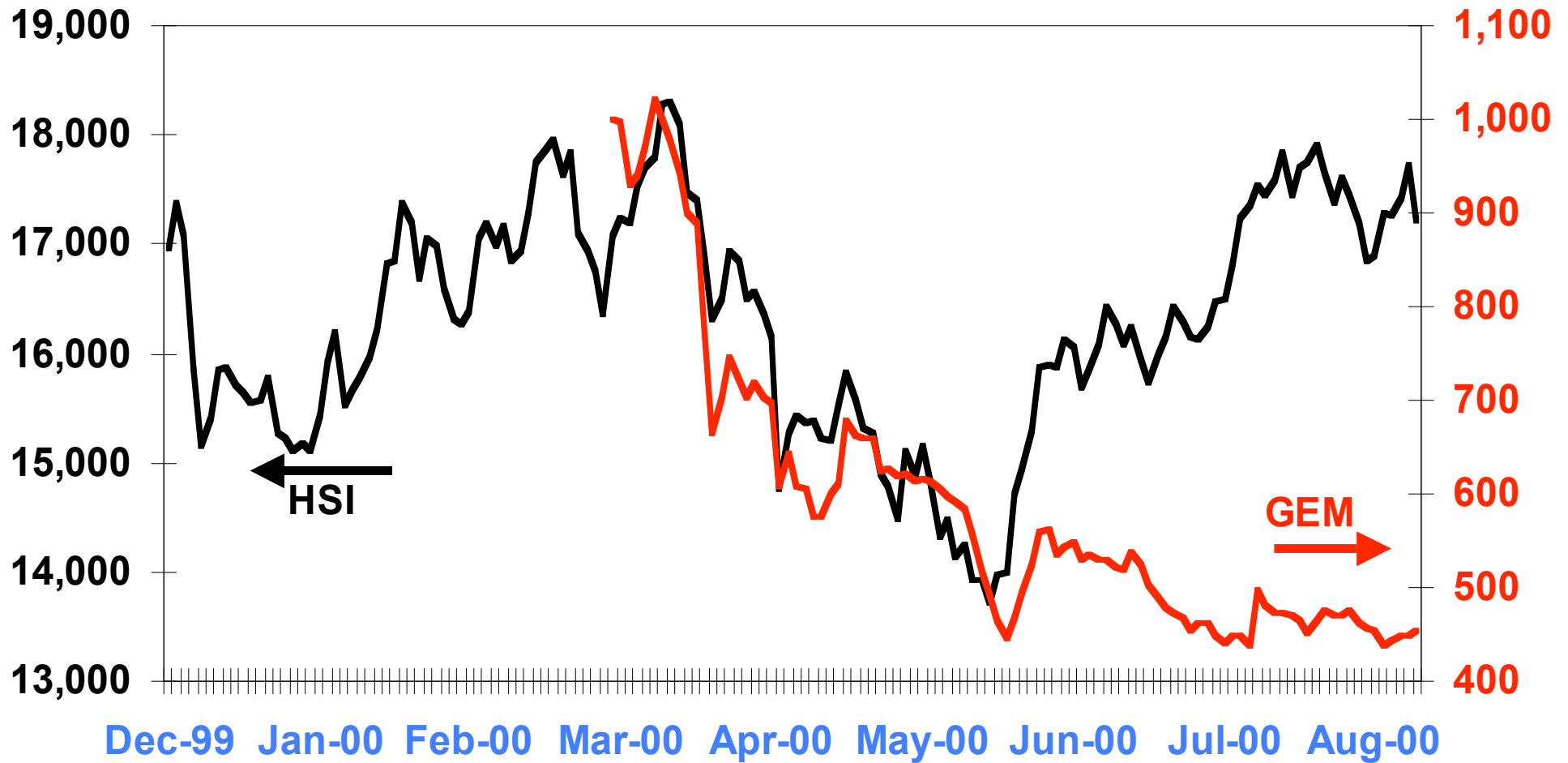
\* 2000 July figure

# Meeting the Online Challenge

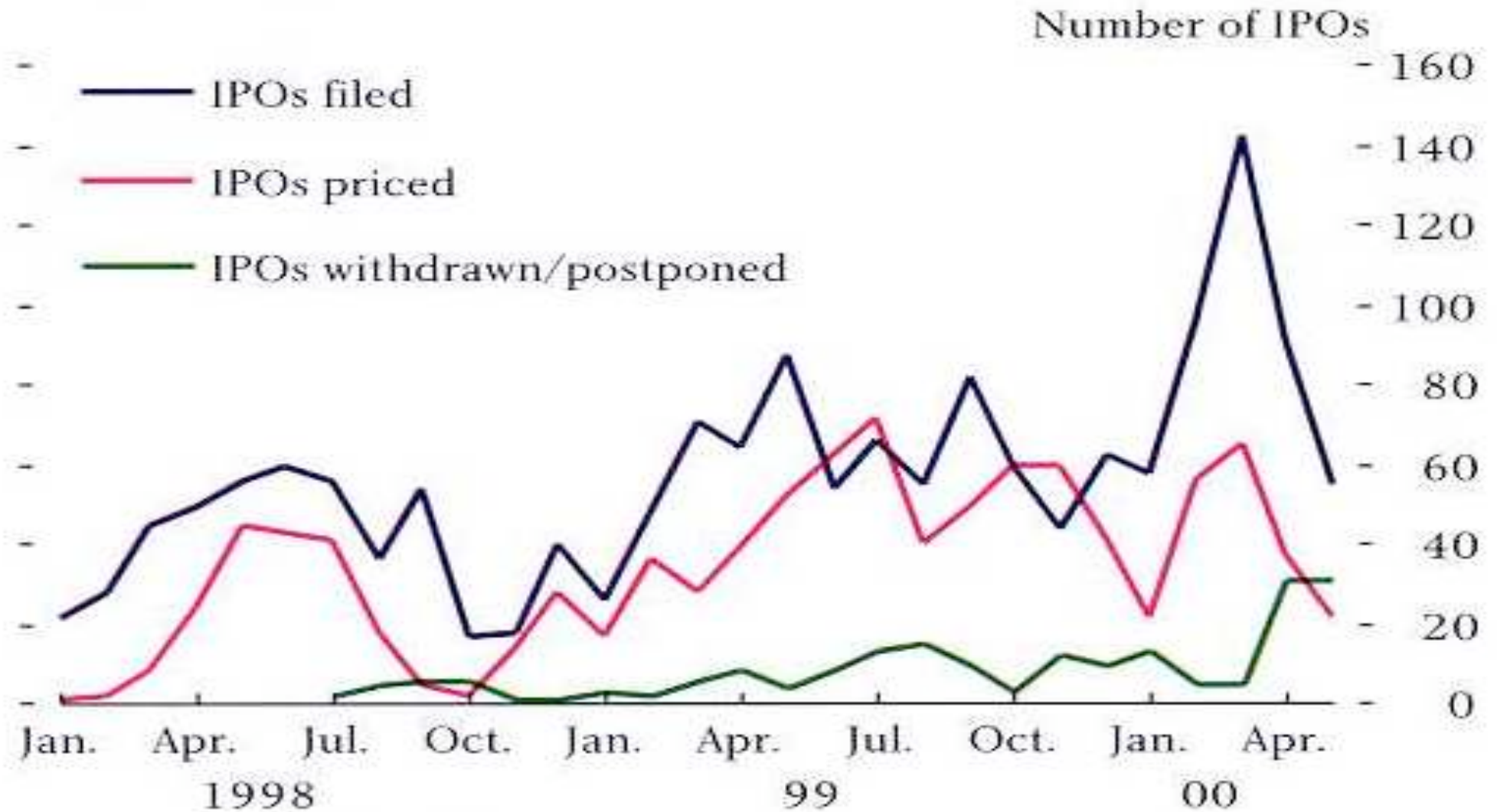
- ◆ **Infrastructure** - **HKATS** launched and **AMS3** to be launched, enabling online trading
- ◆ **Regulatory framework**
  - **Guidance Note on Internet Regulation** was issued (Mar 99)
  - **Circular Licensing Requirements** for provision of financial information on the Internet (Jun 00)
  - **Guidelines on eIPO** (Jul 00)
- ◆ **Investor education** - “**to be an informed investor**”, the electronic Investor Resources Centre (eIRC) has been launched, <http://www.HKeIRC.org>
- ◆ **Regional cooperation** - regular dialogue with other regulatory authorities

# Where are we?

The tech bubble has deflated somewhat during Q2

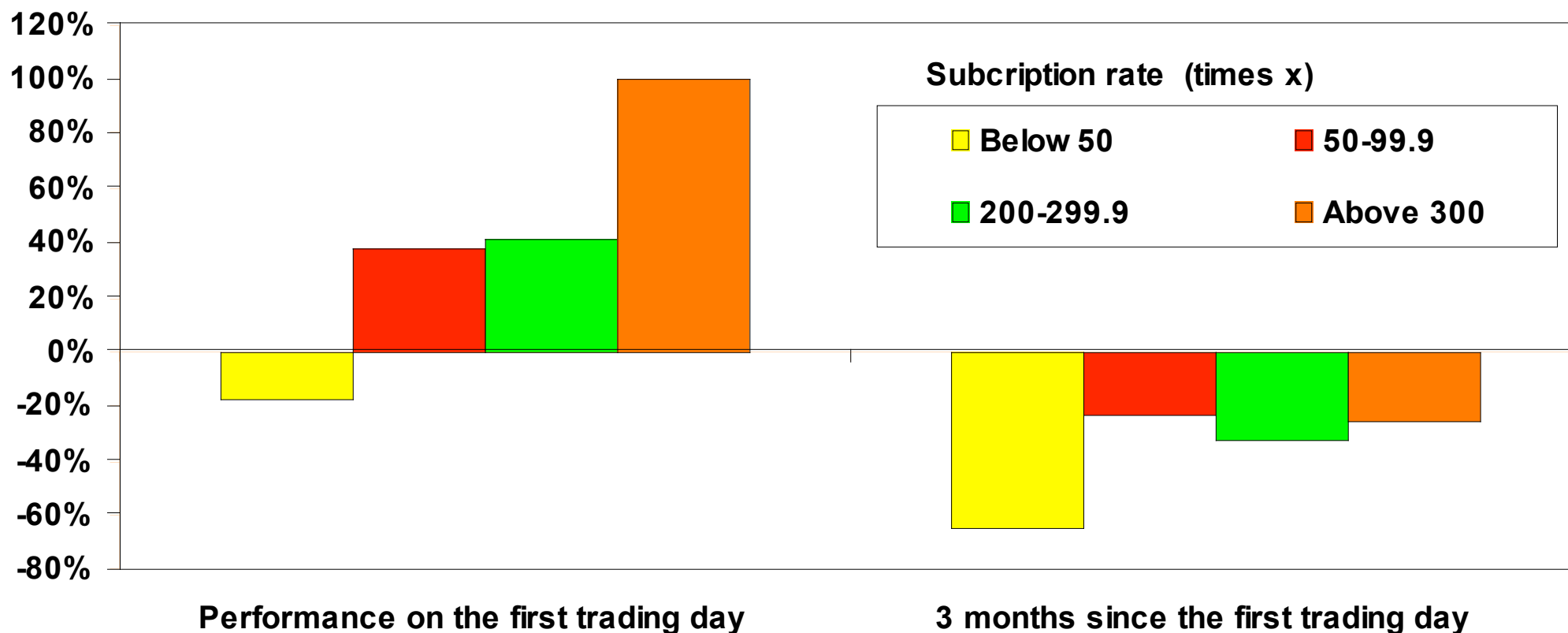


# US IPOs - also correcting

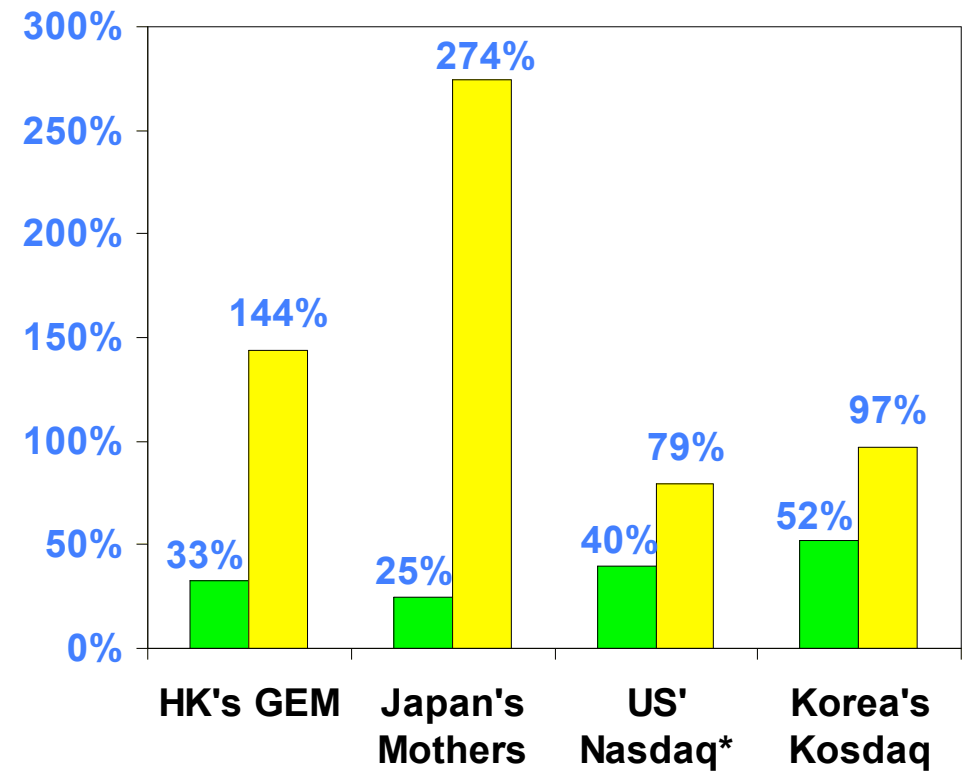
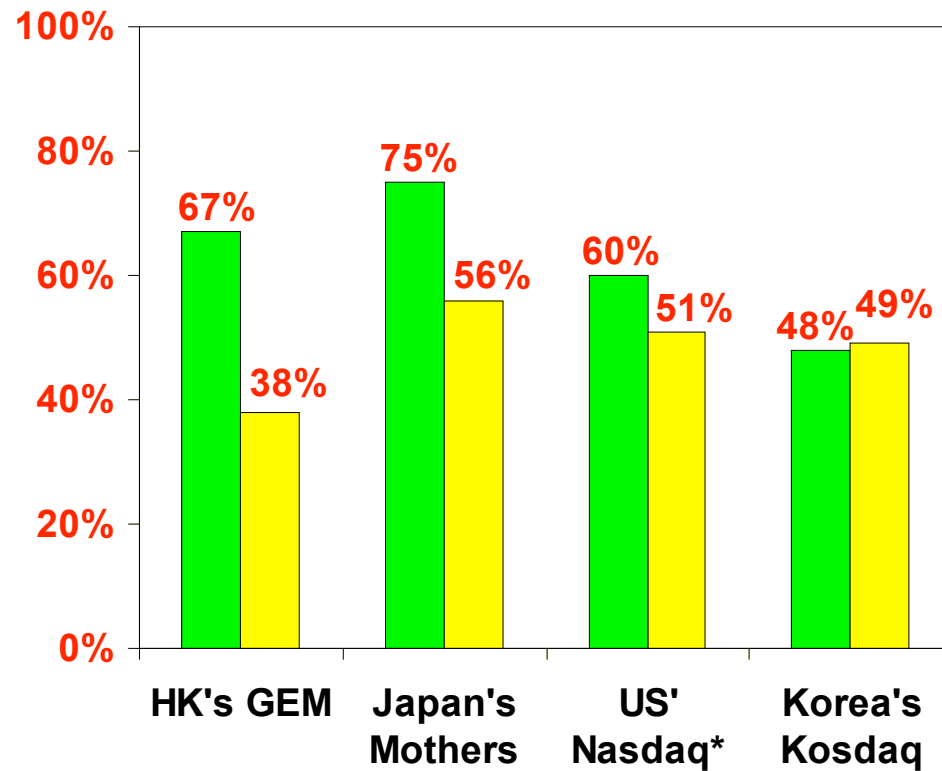


# Performance of GEM Stocks

- ◆ First trading day - performance improved with subscription rate
- ◆ 3 months later - all negative returns
- ◆ Out of 40 issues, 13 (33%) were above IPO price



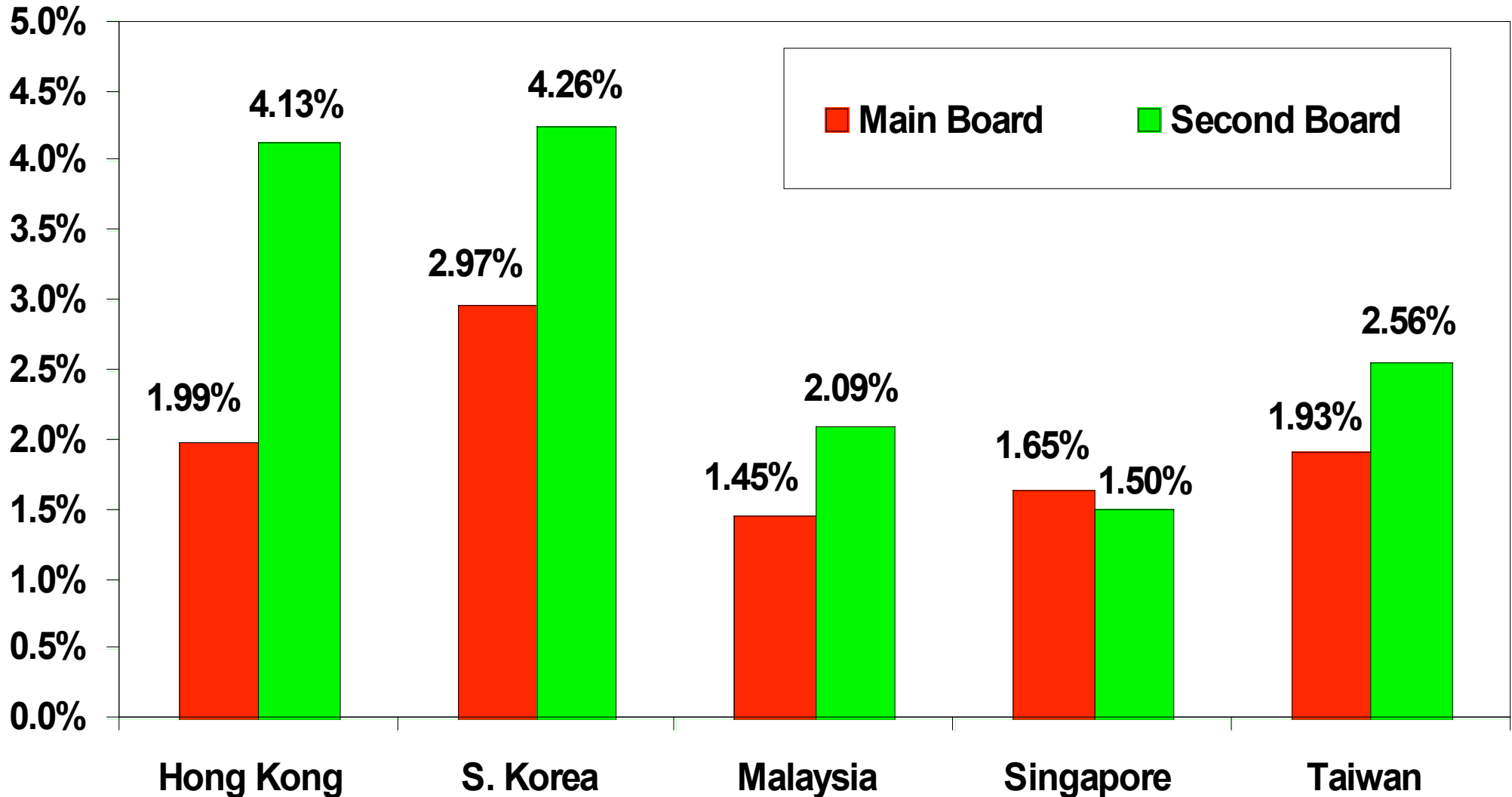
# New IPOs Performance - Similar to GEM



Source: \* MSDW

# Higher Volatility in the Second Board

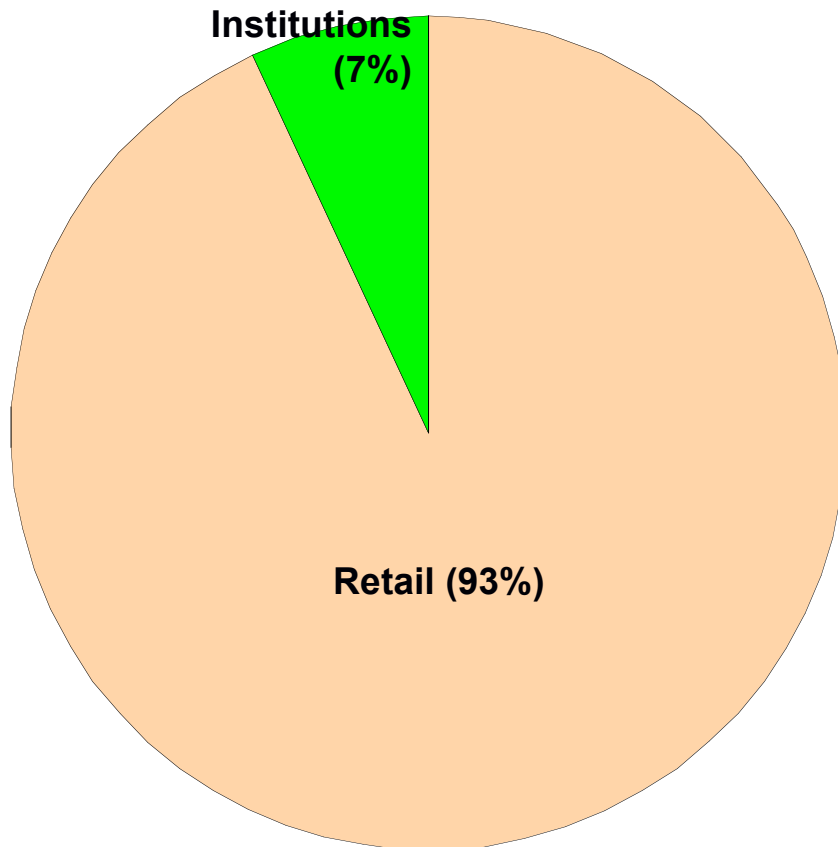
(20 Mar - 8 Aug, standard deviation of daily return, %)



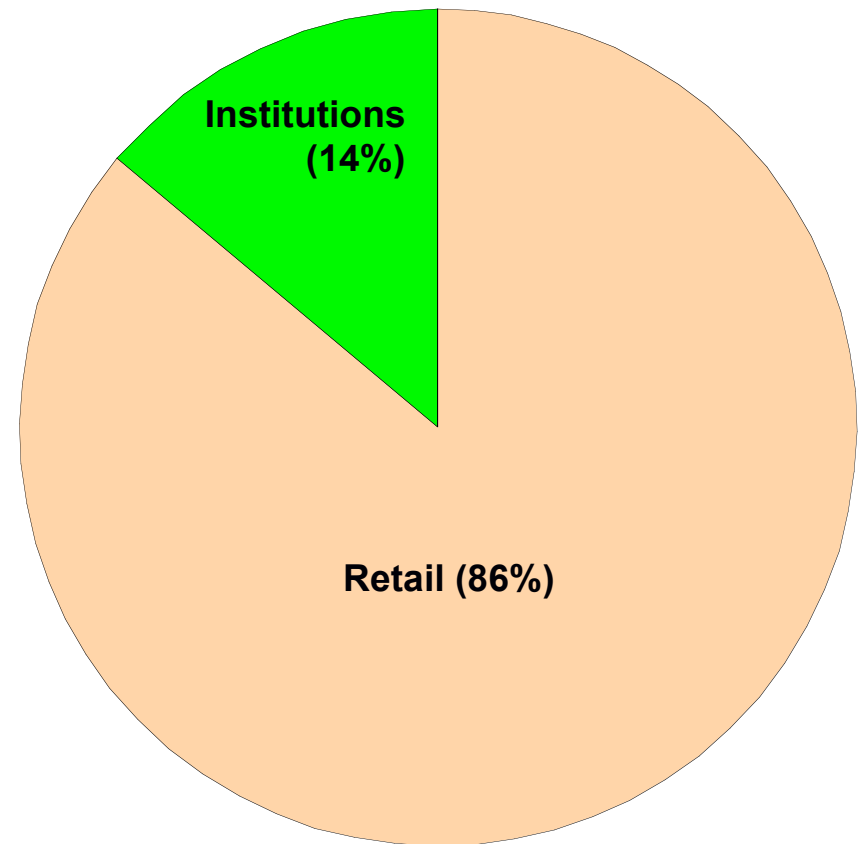
# Second Board Dominated by Retail

## Turnover by Investor Type

### KOSDAQ



### ROSE



## Recent lessons from tech bubble

- ◆ The New Economy has clearly changed our way of living and trading, but not all New Economy companies are successful
- ◆ E.g. recent loss of market cap of the top 10 TMT stocks in Japan was US\$496 bn; some tech stock prices fell 98%
- ◆ In Hong Kong, the GEM index reached new low in July, 57% lower than the peak
- ◆ But there was no crisis
- ◆ **Invest with your eyes open**

# Our Regulatory Framework on GEM

- ◆ **In line with IOSCO Regulatory Principles:**
  - **Information Disclosure - complete, timely and accurate**
  - **Investor - fair and equitable treatment**
  - **Accounting and Auditing - international standards**
- ◆ **Our Basic Regulatory Principles:**
  - **Sufficient protection of investors**
  - **Complete and timely disclosure of material information**
  - **Strict corporate governance standards**
  - **Sponsor scheme to improve quality**
  - **Co-operation with CSRC on Mainland-owned enterprises seeking listing**

# The Risk of New Start-ups

- ◆ You have to kiss many frogs to find a prince
- ◆ “For 10 start-ups, 3 eventually fail and another 6 at best break even. **Only 1 makes money.**” *Anderson Consulting, Outlook 2000, Number 2.*
- ◆ “75% of the Internet companies will disappear within 3-5 years. For B2C companies, **only 1.7% is making money.** This will rise to 7-8% in 3 years.” *Merrill Lynch.*
- ◆ **Risks are high, but there are winners in the New Economy**

# Valuation of .com - the Old Way

- ◆ **Traditional tool - discounted cash flow analysis:**
  - **bias for capital intensive projects where risks are manageable and predictable, and the nature of the projects do not change**
  - **for high risk eCommerce ventures, a much higher discount rate is used → lower value projections**
  - **resulting in an all-or-nothing decision**
  
- ◆ **Old valuation tools not that helpful**

# Using Real Options Theory to value .coms

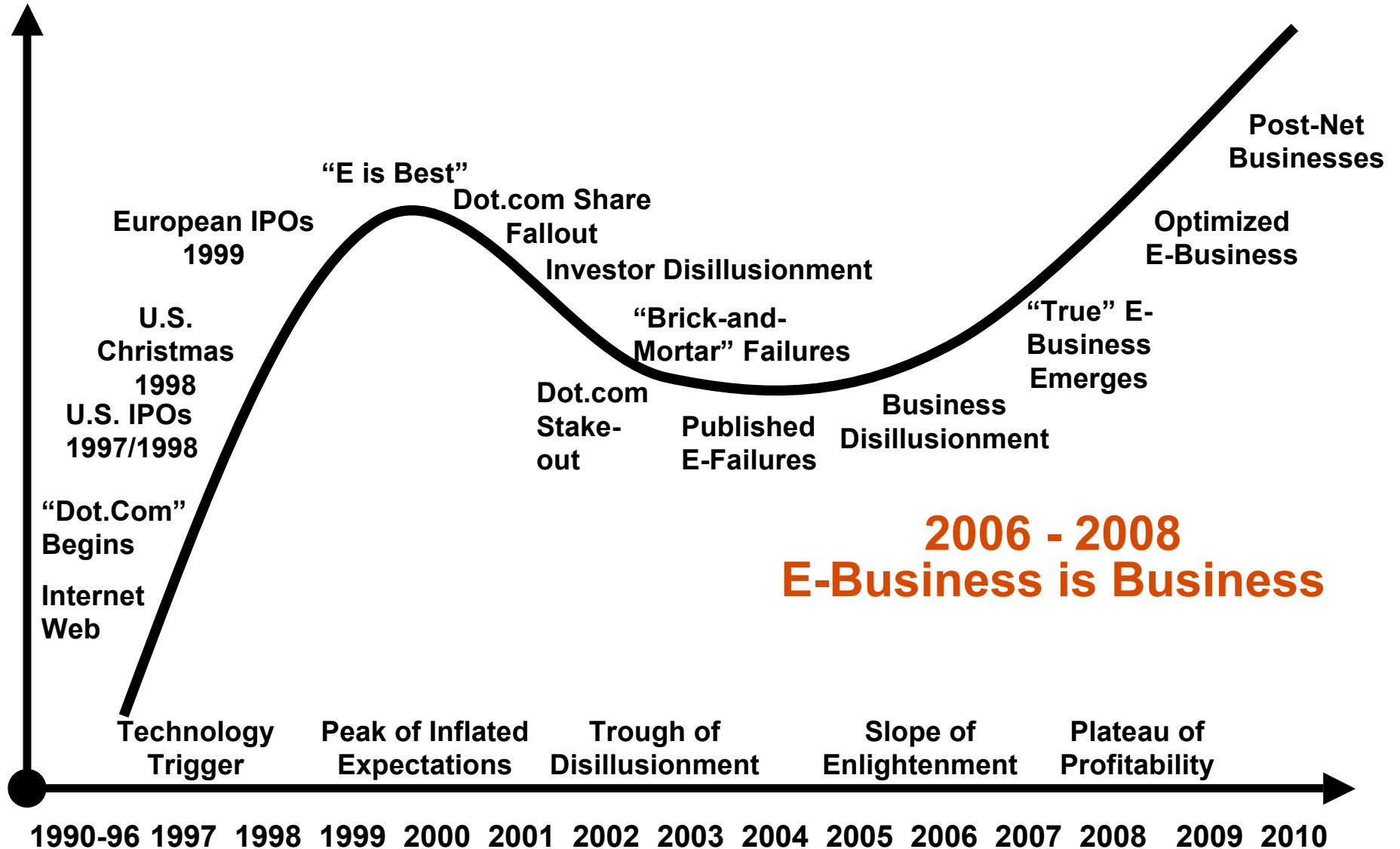
## ◆ Real Options Theory:

- an equity stake in a venture can be treated like a call option on the assets of that company
  - the holder has the right, but not the obligation, to purchase the assets of the new venture
- 
- ◆ You know **one out of 10 may win**, but not which one, so you buy options on each
  - ◆ E.g. Australian mining company - you don't know whether you can find gold, but you raise capital to explore - **exploration cost cash flow = burn rate**

# The Internet Industry Itself is Changing

- ◆ **Transition into a more mature phase** from hyper-growth (>100%) to sustainable long term growth (<100%)
- ◆ **Transition + Increased competition = consolidation**
- ◆ **Investment Life Cycle: New Economy** ⇒ Opportunities ⇒ High returns ⇒ Investments ⇒ Competition ⇒ Low returns ⇒ Less investments ⇒ Industry matures
- ◆ **Old Economy firms** fight back through technology and acquisition

# The New Economic Model

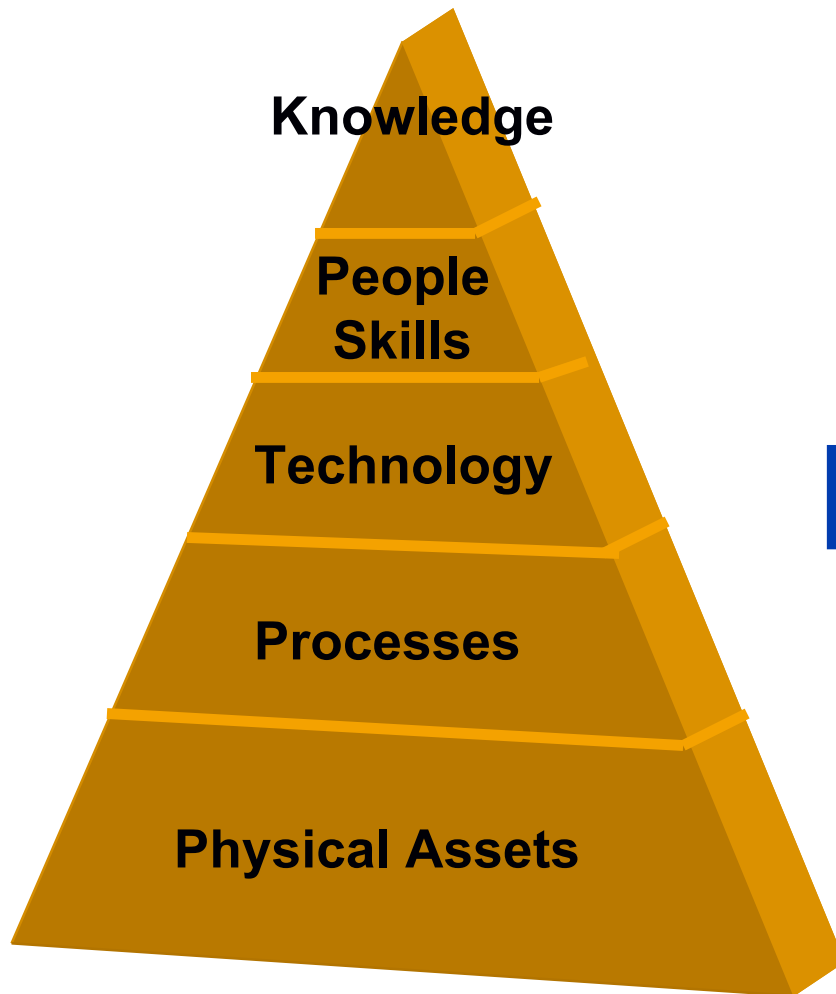


## Lessons for Asia

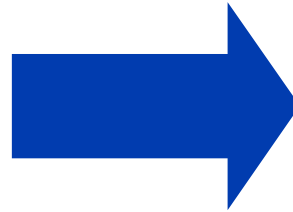
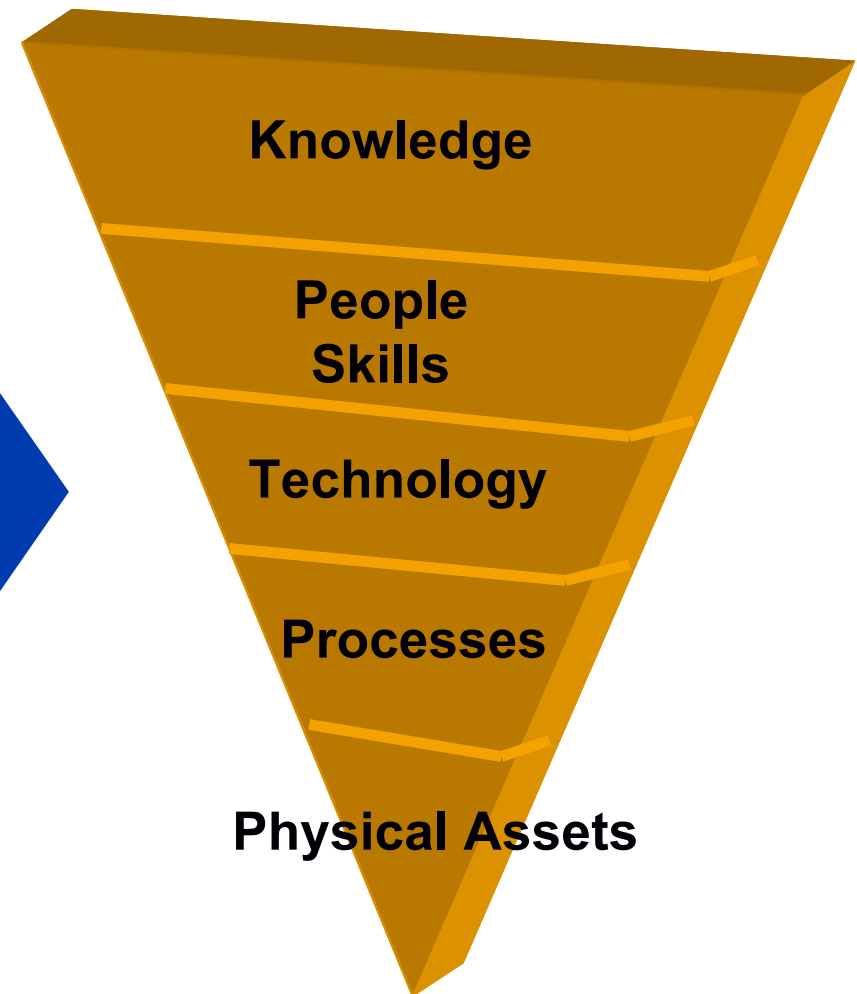
- ◆ **New Economy has benefited Asia in terms of exports, but not all Asian economies prepared for service sector competition**
- ◆ **New Economy driving structural changes in financial markets - growing concentration in banking/fund management power**
- ◆ **New Economy has clear winners & losers. First movers win and last movers lose, difference is policy framework**
- ◆ **Asian economies need to compete in different environment - service and knowledge counts**
- ◆ **Time is of the essence - paranoia or paralysis**

# New Economy = Knowledge-based Economy

## Assets Today



## Assets Tomorrow



# Getting Ready for the New Economy

## Issuers:

- ◆ Need to understand that tapping public capital has obligations to public - honesty, transparency and disclosure

## Service Providers - HKEx and Intermediaries:

- ◆ Need to get the software, hardware and delivery channels right

## Regulators - FSB, SFC, HKEx:

- ◆ Need to get the regulatory framework right
- ◆ Need to have greater investor education

## Investors:

- ◆ Need to understand the risks and rewards
- ◆ Need to know the rules of the game

**Please visit our  
Investor Education  
website**

**<http://www.HKeIRC.org>**



**Thank you very much**