

# Bursa strives to stay relevant

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It will adopt FTSE global index standard to enhance the quality of the market

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**I**N these turbulent times, all financial markets are slogging to be more appealing, with the hope of taking full advantage once investor confidence returns and serious dough pours in. Hence, to continue being defensive and to play catch up with regional peers is a losing strategy.

How can the Malaysian market remain relevant in the global scheme of things if the issues of liquidity and free float are not sorted out?

Bursa Malaysia Bhd certainly realises this. This was the motivation behind the decision to have the benchmark index, the KL Composite Index (KLCI), adopt the FTSE global index standard and thus be known as the FTSE Bursa Malaysia KLCI from July 6.

The FTSE Bursa Malaysia KLCI will comprise the 30 largest main board companies based on investable market capitalisation. It will be free-float-adjusted and liquidity-



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screened to give investors a highly investable and tradable index which remains characteristic of the underlying market.

The index will be calculated by FTSE according to transparent, publicly available rules and overseen by a committee of independent market practitioners who will review the index in June and December every year.

The improved index will closely track the pulse of the Malaysian market as it will adopt a higher speed of calculation of every 15 seconds compared with 60 seconds now.

"What is more important during this downtime is to prepare. The purpose of having a benchmark index is to enhance the quality of the market," says Bursa Malaysia Bhd CEO Datuk Yusli Mohamed Yusoff. "The market needs to attract customers. We need to learn from the experiences of other markets."

## Not just about size

It is important to note that size alone does not determine inclusion in the FTSE Bursa Malaysia KLCI's top 30 stocks. Liquidity and free float are two of the more important factors in picking the index constituents.

For starters, they need to have at least 10% of their free-float shares traded per year, and a 15% free float available in the market. Yusli sees this as a fairly low hurdle, and adds that over time, the rules will be made more stringent, in line with Bursa's effort to stay relevant and attractive in today's economy.

He dismisses the worry that the 70 other stocks that make up the KLCI now would be sold down.

"Since our announcement, there has been no major movements in these stocks. In fact, some of the stocks have actually gone up. Even before this, the top 30 companies represented nearly 60% to 70% of the entire market's trading," he says.

Yusli acknowledges that the criteria for the current KLCI can be enhanced. For example, it uses the full market capitalisation of a stock as a qualifying factor for a component.

However, a huge market capitalisation alone cannot attract people. For big investors, it is important that they are able to easily get in and out of a stock. When a stock is illiquid, it becomes expensive and time-consuming to buy a share.

However, if a stock is liquid, there will be more investments and capital activity, and eventually the share price will better reflect the value of the company. When two stocks are equally attractive, the one with more share liquidity will win over the investors.

Says Yusli: "For too long, the issues of liquidity and free float have been a problem. People like shares that are freely available. Secondly, are the shares actively traded? If I want to buy 10 million shares, and I want to buy quickly and with minimal impact, can I do it?"

Bursa Malaysia measures liquidity through velocity, which is the total value of the shares traded divided by the market capitalisation. The local bourse currently has a velocity of about 30%, and Yusli hopes to increase this to 60% over the next two to three years.

"In Malaysia, we have many interesting companies but it is frustrating because trading is so thin. It is critical for everyone to appreciate the importance of liquidity in the marketplace. For a market to be relevant, it needs to be liquid," he says.

## Emerging opportunity

Yusli says that as a marketplace, Bursa needs to be conducive for all sorts of players – big and small investors, those looking to make arbitrage profits and even speculators. Therefore, liquidity is of intrinsic

## KLCI vs. FBM KLCI

	KLCI	FBM KLCI
Number of constituents	100	30
Market cap representation to main board	74%	64%
Correlation to FTSE Bursa Malaysia EMAS (5 years)	99.4%	99.1%
Volatility (3 years)	16.5%	17.0%
Volatility (5 years)	14.2%	15.0%

Note: Data at Dec 31, 2008

Source: Bursa Malaysia

importance.

"How many times have we heard company owners say 'My shares are undervalued.' If a company is attractive, people will want to trade the shares. The company must realise the importance of promoting itself and telling people just that," he adds.

"It needs to carry out investor relations activities and tell people about its philosophies and goals."

FTSE Group Asia Pacific managing director Paul Hoff says the emerging markets in Asia have been dominated by Taiwan and South Korea.

"With South Korea moving to a developed status in September, there is an opportunity for Malaysia and other smaller emerging markets to receive a higher level of attention from specialist funds focusing on the Asian emerging markets," he says.

He adds that China remains a market with limited access due to certain capital controls.

"If the Malaysian market maintains an open forex and foreign ownership regulatory structure, it will be well-placed to attract more international institutional emerging market investments," says Hoff.

Nevertheless, Yusli does not want liquidity from unsustainable means.

"As you know, the Malaysian market used to have syndicates which were responsible for a lot of the liquidity in our market. They're now not in the market, and that's clear from the present volume.

"While the syndicates provided liquidity, there was also share price

manipulation and shares getting cornered.

"We don't want that. We want a better class of investors. We want a quality market that is sustainable," he says.

## Selling down stakes

To increase liquidity and free float, Yusli says, it is important for the Government to reduce its stakes in some of the government-linked companies (GLCs). In some cases, the Government holds more than 50% of a GLC's equity.

For example, Khazanah Nasional Bhd owns 69.33% of Malaysia Airlines, 44.5% of Axiata Group Bhd, 37.8% of Tenaga Nasional Bhd and 42.74% of Proton Holdings Bhd.

"If the leadership feels that it is important for our market to be performing in a certain manner, then they must look at what is important to make this market better," Yusli points out, adding that the largest shareholders of big foreign companies don't own the majority of its shares.

For him, happiness is when every company on Bursa has a 50% to 60% free float.

"This is the quickest way to increase Malaysia's relevance. In certain international indices, the market capitalisation is calculated based on the free float of the company, and not its entire outstanding paid-up capital," he says.

Hence, companies with smaller free floats stand to lose out as they

have a lower weightage in the indices.

Hoff says that within Asia Pacific, Malaysia's weighting in the indices is relatively small compared with its total market cap due to the smaller free float factor.

"The investable market cap of FTSE Global Equity Index Series' Malaysia Index is only US\$69bil. This is smaller than just Toyota, and about the size of Canon and Honda's investable market cap combined," he says.

## Market improving?

Of course, no interview with the head of a stock exchange is complete without getting his take on the market.

"We seem to be seeing people wanting to come back to the market. Company results will continue to be challenged. People need to be realistic. The next one to two years will be volatile but it will have to get better eventually," says Yusli.

"If investors find a company with strong potential, then maybe this is a good time to invest in it. Of course, they have to do their homework first."

Yusli adds that transparency is another extremely important factor. "The big companies are supposed to lead by example. The last thing we need is another Transmile. We simply cannot afford that," he says.

On regulated short-selling, Yusli says the exchange is looking at increasing its efficiency. Currently, in Malaysia, investors tend to only get excited when the market goes up, as short-selling is highly regulated and investors do not really get a chance to profit from a falling market.

"We are working on allowing the borrower and lender of the stock to negotiate directly with each other. This will probably happen by year-end," he says.