What does the future hold for global stock exchanges after COVID?

*The COVID pandemic is altering the face of stock exchanges worldwide and threatens the continued hegemony of the American NASDAQ and the New York Stock Exchange (NYSE). Tensions between the US and China and Brexit contribute to the crisis. **Alissa Kole** writes that developed market stock exchanges, remade as technology companies, will face an uphill battle in light of unfolding political and financial dynamics.*

Among its other unintended consequences, the pandemic is continuing to alter the face of stock exchanges worldwide. For the past two decades, the trajectory of stock exchanges has been quite linear and hence predictable: they have demutualised or privatised and subsequently consolidated, until recently in horizontal industry mergers that have continued unabated even last year (i.e. Euronext acquired Borsa Italiana from the London Stock Exchange).

Yet, this linear trajectory of development of the exchange industry is now being disturbed by a number of unique trends with long-term consequences for the sector and for the future of global capital markets. The established hegemony of the American NASDAQ and the New York Stock Exchange (NYSE) — historically in fierce competition with the London Stock Exchange, as well as with a few other large exchange groups — is facing an increasingly uncertain future in the post-pandemic environment.

The pandemic is not the only culprit: other trends, notably Brexit, have cast shadows on the future of the LSE as a leading listing and investment destination. The exchange had reacted swiftly, proposing to alter its listing rules first to court the potential listing of Saudi Aramco, the Saudi oil giant, and more recently with a new proposal to allow companies with dual class shares to be listed in its Premium segment, which met an investor outcry.

On the other side of the Atlantic, the Sino-American tensions during the Trump Presidency have spilled into the capital market space, with the result that three large Chinese issuers were forced to delist from NYSE. A second, rather controversial, decree obliges dual-listed companies to allow the American Public Company Accounting Oversight Board (PCAOB) to access their audit files, a measure battled by the Chinese government for years. If applied, many more de-listings of Chinese firms from the US markets could ensue in the coming three years.

If these various trends are extrapolated into the future, the hegemony of New York and London-based exchanges appears far from certain in the long-term. Many stock exchange groups, not least NASDAQ and Euronext, have long ago recognised the limits of their historical model as listing/trading venues and have essentially transformed into technology companies, providing services not only to their issuers but also to other smaller markets.

The recent acquisition of Institutional Shareholder Services (ISS), a governance and integrity rankings and solutions provider, by Deutsche Borse (DB) highlights that exchanges now recognise that to remain relevant in the environment of depressed listing activity and financial innovation in the form of SPACs, horizontal mergers and acquisitions will no longer suffice to ensure their sustainability. Perhaps for that reason, no regulatory concerns have been raised despite an evident conflict of interest whereby ISS still rates DB-listed companies.

Yet, even vertical acquisitions such as the DB purchase of ISS or NASDAQ's acquisition of Puro.Earth, a carbon removal marketplace, may not be enough to keep established stock exchange groups' competitive position intact. With political developments in Hong Kong coming closer into China's sphere of influence, the Hong Kong Stock Exchange may become a more palatable alternative for secondary listings by Chinese issuers wishing to tap into sources of foreign institutional capital (especially if US listings will be subject to closer PCAOB oversight). Chinese issuers will be able to tap into global institutional capital through Hong Kong on the condition that political meddling with the stock exchange (as for the example its recent announcement to obscure board director identity) remains minimal.

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Indeed, the Hong Kong market is poised to be one of several beneficiaries of shifts in the capital market landscape, and by extension, of the stock exchange industry. It not the only one. In a bid to deepen local capital markets, Dubai has moved earlier this year to require all locally domiciled public joint stock companies and even others operating in the UAE that meet specific revenue conditions to mandatorily list their shares locally.

Until now, while many regulators have provided incentives to list to small cap or family-owned companies (i.e., the JOBS Act in the United States), none have formally required a domestic listing, even if in some markets the pressure to list domestically exists, sometimes trumping corporate interests. Dubai Ports (DP World), for example, delisted its shares from the LSE in 2015, reverting to NASDAQ Dubai listing, before delisting entirely and returning to state-ownership in 2020.

Yet, return to state ownership is far from the norm. The opposite trend can be expected in most emerging markets where sovereigns are overloaded with debt as a consequence of COVID and – if market valuations are favourable – might list minority stakes in domestic state-owned enterprises (SOEs). Saudi Arabia, which listed its national oil giant in 2019 on the local stock exchange Tadawul – elevating it from an unknown frontier market a decade ago to now the largest in the region – has just unveiled a $55 billion privatisation programme.

Not only that, but in a little noticed announcement, Atlantic Healthcare, a British healthcare company, announced earlier this month its intent to follow an LSE debut with a Tadawul listing, which has itself weeks ago announced that it will privatise and self-list. While the regulatory regime governing listings in Saudi Arabia has for many years allowed dual listings with the hope of attracting companies from Arab countries with lower domestic trading volumes, this has so far not materialised. If it goes ahead, Atlantic Healthcare will be the first foreign company to list in Saudi Arabia.

The significance of this announcement is that it holds the potential to alter the status quo whereby advanced country stock exchanges welcome listings from countries with less established markets. As developed market companies fundraise in cash-rich emerging markets such as Saudi Arabia and are subsequently encouraged to list locally, the direction of foreign listings may well change to the benefit of emerging market exchanges.

A similar logic has played out in the world of sovereign wealth funds, where implicit industry rules have encouraged foreign asset managers to be domiciled in local domestic financial centres to get mandates. As emerging markets such as China and Saudi Arabia rethink mechanisms to deepen their capital markets, they may develop more explicit mechanisms to require domestic companies to list locally and encourage foreign issuers raising private capital within their borders to do the same.

While it is premature to proclaim a fundamental shift in the stock exchange landscape, signs of fierce competition abound. Unlike big tech, which asserted its dominance through acquisitions, solidifying its role throughout the pandemic, developed market stock exchanges that have in recent years emerged as predominantly technology companies will face an uphill battle in light of unfolding political and financial dynamics.

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Notes:

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