Fordham International Law Journal

Volume 21, *Issue* 2 1997 *Article* 7

Globalization of Capital Markets

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Abstract

Speech given at Session 1: The Global Capital Market: What's Next. Richard Grasso spoke about the exciting changes that are transforming the global capital markets, particularly as seen from the perspective of 11 Wall Street. He also gave a brief review of some statistics, from markets past and present to show how dramatic these changes have been.

GLOBALIZATION OF CAPITAL MARKETS

*Richard A. Grasso**

I am delighted to participate in the Fiftieth Anniversary celebration of the International Bar Association and would like to thank Professor Katsoris, not just for the invitation to participate in this event, but also for all of the great work he has done at the New York Stock Exchange with our Arbitration Forums. I believe we are a better mechanism to serve investors because of the outstanding contributions of Professor Katsoris.

I would like to focus my remarks on the exciting changes that are transforming the global capital markets, particularly as seen from the perspective of 11 Wall Street. A brief review of some statistics, from markets past and present, shows how dramatic these changes have been.

If we look back fifty years, to the period when the IBA was established, the NYSE's market looked quite different from the one we proudly display to the world in 1997. In the year of Marshal Plan, which set Europe on the path to economic recovery, the NYSE had a total market capitalization of less than US$100 billion. To put that figure in context, the NYSE entered the 1990s with a market capitalization of US$3 trillion, and we find ourselves today in 1997 with a market capitalization, in the domestic segment of our business alone, that is well above US$8 trillion. If we include our non-U.S. listed companies, the NYSE is the worlds only US$10 trillion market.

The extraordinary growth in the NYSE's trading volume also provides a good indication, I believe, of the changes we can anticipate in the next twenty-five or fifty years. When the IBA was founded in 1947, the NYSE had an average daily volume of less than a million shares and a total years volume of 253 million shares. The total years volume for 1947 would be roughly half of the average daily volume of the NYSE in 1997.

If we try to grasp how dramatically different the capital markets are going to be, we can look at other statistics, of a much more recent vintage, which should show how our horizons have changed. Where once our market was overwhelmingly national, it is becoming increasingly global. At the NYSE, we entered the

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1990s with eighty-seven non-U.S. issuers traded on our board. Today, the NYSE has 314 non-U.S. issuers and, to emphasize the significance of this change, almost ten percent of the roughly 500 million shares we trade each day represents non-U.S. securities.

Another way to consider how dramatically different the capital markets of the world will become is to examine the composition of the NYSE's listed companies. Just seven years ago, the NYSE did not trade a single Chilean company. Today, Chile trails only Canada, the United Kingdom, and Mexico in contributing non-U.S. products to our market. Eighteen Chilean companies are part of our family of listed companies.

To bring home the scope of change at the NYSE, consider that in 1994 and 1995, the most actively traded stock was not an American company, but Telefonos de Mexico. In attaining the most active spot in 1995, for the second consecutive year, Telefonos de Mexico traded more than one billion shares. Very few individuals at 11 Wall Street, and certainly fewer in the broader community of constituents whom we are proud to serve, would have imagined this feat as recently as five years ago.

It is my view that the change has only begun to occur. For example, think about the huge impact of privatizations in the past five years, when almost a half-trillion dollars in assets have been returned to investor hands. This trend goes beyond the well-known companies that have tapped the American capital market and list on the NYSE, for example the Deutsche Telekom's, the Daimler Benz's, and the Cadbury Schweppes's of the world. Many other companies, which until recently did not garner much publicity in the United States, have come here to raise capital. For example, the Telephone Company of Peru raised almost US$900 million in the American marketplace last year.

When these changes are considered in terms of their cumulative impact, they have clearly transformed the nature of our franchise. To an ever-increasing extent, we are operating a global franchise that has its greatest market potential beyond our national borders. To underscore this situation, consider the fact that if we listed every U.S. company that is traded on other markets in the United States and meets our qualifications to trade on the NYSE, a 100% market capture, we would add roughly 730 companies, with a market capitalization of approximately US$760 billion. This is not an insignificant number, and one that includes some of the great technology companies of the Silicon Valley that we have repeatedly approached about moving to our marketplace. But even if we were 100% successful in listing all of these companies, we would increase our business by less than 10% from a valuation perspective.

Outside the United States, however, the opportunities for growth are of another, far greater, dimension. At the end of May 1997, we estimated that if we added only the top one-third of 2,400 eligible companies, we would double the market value of the NYSE, even before the privatization effect.

Let me cite just one example of the scale of our international opportunities. In the fourth quarter of 1996, when Deutsche Telekom effected the largest global IPO in history, Deutsche Telekom's contribution to the NYSE was equivalent to a full six percent of our total domestic opportunity.

From my perspective, we are only at the dawn of a period of enormous growth in our markets here in the United States and around the world. This period will be viewed by historians who look back from 2047, the centennial of IBA, as a formative one, in which certain seminal developments served as the catalysts of profound change. When historians focus on the leaders who shaped these developments, they will emphasize the contributions of two people, Lady Thatcher and Ronald Reagan, who gave an enormous boost to the health of free markets everywhere.

When Margaret Thatcher and Ronald Reagan won their respective electoral victories in 1979 and 1980, few could have foreseen how the balance of world forces would shift so decisively in favor of free markets in little more thana decade. A remarkable convergence of events helped produce this change:

- Margaret Thatcher's unwavering commitment to returning state-owned entities to the disciplines of the free market. Prior to that point of origin, as I will term it, capital markets outside the United States had been historically debt-driven economies, for the most part managed without the disciplines of the free marketplace. After Margaret Thatcher's government had demonstrated that Britain could achieve a new level of prosperity through privatization, deregulation and lower taxation, we found ourselves, I believe, in a very different world.

- The widening gap between the prosperity and innovation of the free-market countries, on the one hand, and the austerity and stagnation of the Soviet-led Eastern bloc on the other. Lacking the economic basis to compete with the West, the Soviets spent themselves into oblivion trying to match President Reagan's build-up of America's defense forces. If America had a secret weapon in the final phase of the Cold War, it was not so much the Strategic Defense Initiative as the astounding technological innovation and entrepreneurship that increasingly defined American strength.

Worldwide improvements in communications helped make people behind the Iron Curtain increasingly aware of the chasm between the standard of living provided by their own command economies and the extraordinary opportunities, political, social, and economic, available in the West. The chasm, of course, led directly to the fall of the Berlin Wall.

In the United States itself, longer-term demographic trends have provided greater opportunities for private savings and investment to more and more people. As the pool of private savings has expanded, a smaller percentage of our population has come to rely solely on the traditional safety net provided by government-sponsored programs. Indeed, people are looking increasingly to their private investment, whether through direct stock ownership, fund participation, or other sources, to make possible a comfortable retirement or to finance a child's education. This trend will only become more pronounced as people live longer and have more leisure time at their disposal. It is not surprising, therefore, that people have become more receptive to a long-term approach toward investment while broadening their participation in the capital markets.

Although the changes I have described are momentous, they are actually only beginning to gather strength when we consider the world as a whole. If you overlay the fact that governments of many countries are getting out of the business of running entities and turning them over to the disciplines of the free market, and if you consider that the U.S. capital market, the broadest and deepest in the world, is still basically a marketplace whose consumers have weighted their portfolios disproportionately toward domestic stocks relative to the world's economy, you quickly understand why it is my belief that the globalization of capital markets has just begun.

I believe technology will be a key element in driving the structure and influencing the speed at which capital will flow around the world. I also believe that Commissioner Wallman is to be congratulated for his unwavering commitment to trying to bring change in the pricing tables of the U.S. markets, which I believe will help the NYSE in its global effort to bring more product and certainty into the cross-border listing of securities.

In the final analysis, the relevant questions markets will face, whether they are markets here in the Unites States, Europe, Asia/Pacific, or Latin America, will involve a redefinition of franchise. If there is any one question I am asked by people visiting the institution that I am privileged to be a part of, it is, "why the trading floor?"

If you were standing on the floor with me recently with Ralph and Vicki Lauren, you would understand why a trading floor and technology are not mutually exclusive, but indeed complementary. Both make us the logical place for yet another great American company "going public," in this case, a company now worth more than US$1 billion but twenty-six years ago still an idea. When that first stroke of ten shares traded followed by 6.5 million shares, you would understand why the NYSE has spent more then US$1.25 billion over the last 100 years on technological infrastructure, yet still offers the unique advantage of point-of-price discovery for buy and sell orders of all sizes. You would understand why the markets in the United States, the deepest, most liquid and most transparent, have always dedicated themselves, and certainly 11 Wall Street's franchise has grown from the premise, of serving the least-sophisticated user of the market. If we can do a good job for that customer, all who use our markets will be well served.

What we've done is to combine the advantages of price discovery and technology, not to displace one with the other. Technology speeds the trading process and increases our ability to handle higher and higher levels of trading volume, but it is essentially a means to the end of ensuring that buyer and seller get the best possible prices on the trading floor. The direct interaction of buyer and seller, through the agency-auction process, is crucial to optimal price discovery.

Let me give you a typical example of how the process works. Assume that you call a broker you do business with and place and order to buy, let us say, RL, Ralph Lauren. The broker enters that order right at his or her desk, hits a send key, and our network, called Super Dot, which is the largest ECN network in the world, takes the order form wherever it is originating, delivers it to the floor of the NYSE, introduces it for execution and has it back on the terminal of that broker in a total elapsed round-term time of twenty-two seconds. On a typical day in 1997, what I have just described produces 84% of the NYSE's transactions and 42% of or trading volume. In effect, we have wrapped or price-discovery model in a package of state-of-the-art technology.

To return to my theme of how the world has changed, when I described this process to my ten-year-old he replied, "Twenty-two seconds. Why so long?" After I reminded him of my role in feeding as well as funding his appetite for technology, I then took him through what makes technology and price discovery unique at 11 Wall Street, and that is not simply the speed at which we bring an order to the floor, execute it and confirm it but the uniqueness of introducing the smallest order and the largest on an equal footing and making certain that the least-sophisticated user, the smallest lot in trading, has the same chance of price improvement.

The reality is that technology is not a substitute for people or markets; it is a tool that, when used effectively, can become a powerful engine of strategic and competitive advantage. I would not be human if I did not worry, as do so many people, about where technology is taking us. Yet at the same time I am assure you that we have gladly embraced technology and made it a great asset. In basically the same square footage where a volume of ten million shares per day once represented the limits of what was feasible, we are now routinely handling 500 million shares on what we define as a quiet day. Technology is a great enabler.

Another question I am often asked is "why come to the United States?" I will round off my remarks by answering that question. It is estimated by some of the largest international broker-dealers in the United States that the retail customer here in the American marketplace, where today that customer has perhaps no greater than seven percent of his or her portfolio on the equity side dedicated to non-U.S. securities, and on the institutional side no greater than ten percent, that those levels of contribution will double within five years. That doubling will create three-quarters of a trillion dollars worth of demand for non-U.S. securities.

We estimate that shortly after the turn of the new millennium, where our non-U.S. list today numbers 314, very proudly, it will stand at perhaps 600-700 companies with a daily contribution to our volume of perhaps as much as 17%-18%. When you run those numbers, you find what we are suggesting is that perhaps as many as 75-100 million shares of volume each day at 11 Wall Street will be from the international community. This is a challenge we welcome with great anticipation.

It is a time when governments and companies around the globe understand that there is an enormous appetite in the U.S. market. The threshold for entry, the depth of disclosure, transparency, comparability of accounting format, to the credit of the Securities & Exchange Commission, has constantly reflected changes in the environment. Yet it has never wavered from the fact that the American customer must have the ability to understand and compare a dollar's worth of earnings of a bank in the United States with a dollar's worth of earnings of a bank somewhere else in the world.

In the initiatives on internationalization that come from the NYSE, NASDAQ, and the other U.S. markets, I believe there is a sense of commonality. We in this country are privileged to have some 60 million direct participants and perhaps another 110 to 120 million indirect participants in our markets. They depend on the quality of disclosure, the immediacy and transparency of the price discovery process, and they expect whether a company is domiciled here in the United States, in the U.K., or in Asia, that the quality of disclosure, the frequency of disclosure, and the comparability of one's accounting will be discernible to the least sophisticated user of this market.

It is an unprecedented time for us, a time of enormous opportunity, and one which we at the NYSE in our little corner of the franchise welcome with enthusiasm.