Demutualization of stock exchanges and its social consequences

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Abstract. As part of the demutualization process, stock exchanges are transformed from traditional membership structure (mutual) for entrepreneurial structure focused on maximizing value for owners. Stock exchanges as part of their activities provide a special kind of services: issue, secondary market trade, dissemination of information about quotations and others.

The activity of stock exchanges is seen partly as a public good. But increase efficiency of exchange's activity as a company does not necessarily translate into an increase quality of its functions to society. Hence the important role of the state, so in the framework of forming exchanges structures, there is a system of public supervision, reducing conflicts interest of particular groups of stakeholders.

Keywords: demutualization, stock exchange, company, society

JEL classification: G10, L2, L3

1. Introduction

Traditionally, stock exchanges were natural monopolies, which were focused on the supply and demand for certain financial instruments [Di Noia, 1999]. A single exchange in the region (country) naturally attracted all transactions related to securities. Exchange can therefore be defined as an entity that provides centralization of securities trading [Macey, Kanda, 1990]. It also determines flow of information, disseminating and triggering competition among the participants in stock market. In terms of microeconomic, the stock market tends to ensure satisfaction of current and potential market participants by minimizing transaction costs, establishment prices in the market that accurately reflect the price equilibrium formation and reduce the risk of investment. Through the execution of functions, the stock exchange fulfills macroeconomic or social functions.

Historically, exchanges were seen as non-profit institutions, organized in public interest activities. This view has changed with the phenomena of change organizational-legal form, e.g. demutualization. Currently, most of the exchanges operate as commercial enterprises. In view of the described phenomena, there is a problem of the social consequences of changes legal and organizational structure of exchanges.

2. Characteristics of demutualization as a process of change legal form of stock exchanges

Demutualization is the process of leaving of the traditional membership structure (mutual) stock exchanges [Steil, 2002]. The basis of demutualization is the separation of ownership and membership. In this process, the owners are third parties, not members of the stock exchange.

The traditional organization of stock exchange is cooperative structure created by members of the stock exchange. This form of exchange has followed that the stock market, where had take place efficient securities trading, it had to be in a specific place, at fixed times, according to the established rules ask and bid prices of contracts and with guarantee of settlement transactions (delivery of cash and securities). In order to meet the conditions and prevent overflow on the floor, it had to select brokers who represent the interests of all concerned trade. Rationing access to the stock exchange takes place through the sale of "places", that is membership fees - high initial and lower annual [Steil, 2002]. However non-members wishing to use the possibilities offered by the concentration of capital in one place, they paid fees to members of stock exchanges for representing their interests. In this way, members of the stock exchange became the intermediaries (brokers) for transactions made by investors.

Members of the stock exchanges, through appropriate regulations saw that other intermediaries were not admitted to the floor, which the example was established (high) fixed commissions for stockbrokers for a place on the floor, which were on stock exchanges in New York, London, Paris. Permanent commissions in the United States were abolished in 1975, in London in 1986 and in Paris until 1989, which was associated with transition to an electronic trading system [Gorham, 2011]. Members also prevented so the other players do not take competitive business. Hence, they introduced the ban of competition between intermediaries related to the commission in order to counteract reduced commission rates and a ban on trading by the brokers of the stock exchange for other exchanges. This ban was introduced in 1970 by members of the NYSE under art. 394, that limited trade by members of the NYSE outside the NYSE [Stoll, 2008]. In addition, so that other markets did not attempt to offer lower commissions, dominant stock exchanges refused access to information regarding quotations and prices of securities on their floors. In this way, they benefited from the uncertainty of investors not participating in the exchange, which in this case were made to invest in large, highly liquid markets, where prices are more predictable.

In view of the conditions, members of stock exchanges jealously guarded access to trade on the floors. They were not willing to give this role to automated systems and also change the organizational structure [Gorham, 2011]. However, the transformation of the environment, mainly in the financial markets forced the transformation of existing business structures, that expression were demutualization processes [Gorczyńska, 2012].

Demutualization processes started in the nineties of the twentieth century. Table 1.2 presents the stock exchanges, which first changed their organizational and legal form. These are the European stock exchanges that have made the conversion to electronic trading. In contrast, demutualization on the large world stock exchange-the London Stock Exchange (LSE) took place just in 2000.

Table 1.2. The first stock exchange, which made demutualization

The stock exchange	**Year**	**The stock exchange**	**Year**
Stockholm Stock Exchange	1993	SIMEX	1999
Tradepoint / virt-x	1995	LIFFE	1999
Helsinki Stock Exchange	1995	Toronto Stock Exchange	2000
Copenhagen Stock Exchange	1996	Sydney Futures Exchange	2000
Amsterdam Exchanges	1997	New York Mercantile Exchange	2000
Borsa Italiana	1997	Hong Kong Stock Exchange	2000
Australian Stock Exchange	1998	London Stock Exchange	2000
Iceland Stock Exchange	1999	Deutsche Börse	2001
Athens Stock Exchange	1999	Oslo Exchanges	2001
Stock Exchange of Singapore	1999	Euronext	2001

Sources: B. Steil, Why do exchanges demutualize?, 25/06/2002

It lists two reasons of demutualization. The basic reason is to limit the control of the members of the stock exchange as strategic owners (especially local, national). Stock exchanges operate in a competitive financial market, and in order to be competitive, they must reduce costs for issuers of securities and increase investment portfolios for investors. However members of stock exchanges, seeking to maximize their own profits from brokering, do not always take care about improving the competitiveness of exchanges. The main justification is the belief that private structure makes more quickly to respond to new challenge of environment [Steil, 2002].

Another reason of demutualization is raising of capital necessary for expansion and investment in technology (through the sale of shares). Researches show that raising of capital is secondary goal of demutualization or may not be at all [Steil, 2002]. Most of the exchanges that have made demutualization had not pressing need to raise new capital. Moreover, in case of lack of capital, raising of capital may by form payments of fees membership without including the external owners.

Therefore demutualization involves leaving the traditional membership structure of stock exchanges. At the same time the stock exchanges acquire new owners: non-members of the stock exchange. Due to the different contribution of external owners, the stock exchanges may be different. They can be the stock exchanges, which are defined as after demutualization, but still 90% owners are members of stock exchange- the example was in 2000 Borsa Italiana. At the other extreme there are the markets that have very diverse base of owners (shareholders) and are listed on a stock exchange (eg. Warsaw Stock Exchange).

3. Entrepreneurial organizational structure of the stock exchange as a result of demutualization processes

Change the organization of stock exchanges make that stock exchanges become an example rather entrepreneurial than membership a structure of management. Assuming the formula of companies, the goal of their activities becomes maximization profits.

Demutualization processes imply further action of stock exchanges - public issue of their shares. The stock exchanges, which changed its legal form to a joint stock company and they meet the requirements for admission and listing of securities on the stock market, may issue shares. It is often the case that some stock exchanges issue shares in their own market. Thank to issue of shares, they raise capital for further development.

Thus, the stock exchanges, which until were characterized by a membership management structure, now their functioning form has approached the companies. After the demutualization process, a group of stakeholders who are interested in the financial results of stock exchange are no longer members, but new owners- most common stockholders. The stock exchange takes the form of commercial business entities engaged in service activities. Listing of shares and trade of securities were traditional areas of activity, but many stock exchanges have developed new business areas, eg. technology outsourcing. Generally, there are four types of services provided by the stock exchanges. These are:

- share issue- admission, listing and trading of securities of issuers,
- trade of securities on the secondary market, both the underlying assets (cash market) and derivatives,
- distribution of information about trading,
- other services (eg. clearing and settlement, sales software for analysis of trade, training) [Gorczyńska, 2010].

Business entities using services of stock exchanges are customers. According to the classification of services, customers of stock exchange are: issuers of financial instruments, investors (institutional- banks, investment funds, pension and so on., and individuals), as well as entities that are professional distributors information about trade (eg . agencies, investment firms, Internet portals, IT companies) [Di Noia, 1999].

Group of stakeholders of stock exchange is wider than presented group. It include: the owners (members of the stock exchange, shareholders), customers (investors, issuers), management and employees, the media, business partners, government and society.

4. Demutualization processes from the perspective of society

A look at the stock market as a company focused on the field of production-supplied services. Focusing on this area, it should be remembered that the stock exchange produces a specific "good". According to the traditional approach, these services are public goods, even if the exchange is private [Pagano, Roell, 1990]. They are supplied by the stock exchange, and meet the common needs- society. However, it should be noted, that with the development of the stock exchanges, it has emerged services to a specific group of customers, eg. outsourcing technology.

In the framework of the services for society are implemented macroeconomic functions of stock exchange. They are .:

- Function of allocation- at the stock exchange takes place free transfer of financial resources from entities with their surplus to entities that do not have them enough. On the one hand, the stock market give the opportunity to choose the form of investment even small investors, and due to a destination of financial resources, and another hand- enable issuers wide access to free financial resources,

- Function of evaluation – in the framework of optimal price equilibrium of listed shares is current and relevant valuation of capital in the economy,

- Function of control - associated with guaranteeing investors (the shareholders) an effective and efficient control of companies that are their (co) owned [Kulpaka, 2007].

In order to properly execute the above social functions of the stock exchange, there must be the correct realization of all services as a business. Inefficiency one sphere of the supplied services may cause negative effects, which will affect investors, but also other groups of stakeholders, including society (the so-called. negative external effect). Thus, for example, poor quality of information given by issuers, resulting from the competition of stock exchanges and alternative turnover markets, can result in poor assessment of companies by investors. This in turn determines the formation of "bad" prices, which results in poor allocation of resources. In turn, inefficient clearing systems and procedures for settlement may cause delays in payment, wrong settlement between business entities, which could threaten the stability of the entire financial system. Uncontrolled transfer functions of investment to quick computers may cause more frequent collapse as a result of market failure or error committed when dealing with orders. These collapses can create a risk of crisis.

Thus, it is not always a direct relationship between the quality of the supplied services and realization of the macroeconomic functions by stock exchanges, so between a increase competitiveness of stock exchange and a "social" role of the stock market. Hence, the "social" utility supplied services can't be measured only on the basis of profits of stock exchange as a company.

Contemporary stock exchanges are characterized by strong competition. It is obvious that in the long run ineffective exchanges will lose market share to others [Ramos, 2003]. Therefore stock exchange after demutualization takes care about increase efficiency. At the same time they must take care of the interests of all stakeholders. Therefore, social problems are usually solved by a system of public supervision of the stock market [Switzer 2013]. In such cases, the organizational structure of the stock exchange allows state to control in order to reduce conflict of interest.

5. Conclusions

The end of the twentieth century was a period of dynamic processes of change organizational and legal forms of the stock exchanges. In the framework of the demutualization, stock exchanges leave traditional membership structure (mutual) and take an entrepreneurial form that is aims at maximizing value for the owners. As part of their activities, supply a special kind of services: issue, secondary market trade, dissemination of information about quotations and others.

It should be noted, that the activities of stock exchanges is seen partly as a public good, even if they are privately managed. But increase the efficiency of the stock exchanges do not necessarily translate into an increase in the quality of their functions for society. Hence, the important role of the state, so in forming structures of stock exchanges, there is a system of public supervision, reducing conflicts interests of particular groups of stakeholders.

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