



## Do not pass go: time to tackle a monopoly that delivers outrageous profits *Canberra should encourage competition by allowing rival share trading systems*



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“WE’RE not against competition, but . . .” That’s the universal second-string defence pushed by monopolists enjoying government-enforced entry barriers whenever competitive threats emerge. They always follow the “but” with predictions that the poor old public will suffer unless governments adopt their recommendations. And, by pure coincidence, those recommendations just happen to be in the monopolists’ interest.

Last Tuesday’s *Australian Financial Review* article by Australian Securities Exchange CEO Robert Elstone, titled “Competition opens up securities risk”, argued that “allowing ASX-listed securities to trade on a number of venues is fraught with peril”. Of course, he slipped in a line to comfort us: “despite claims to the contrary, ASX is not opposed to competition”. If so, it’s a strange monopolist. If it’s maximising shareholder value, it should be anti-competition.

The ASX is not just a monopolist. It holds multiple monopolies. No European or North American stock exchange is so sheltered. As a result, the ASX charges high prices and generates outrageous profits — at the expense of investors, companies and the Australian economy. Exposing the ASX to competition would best serve the public interest.

Incumbents’ traditional first-line defence has been that competition is bad. If governments didn’t fall for that, they plucked the second string. Electricity, gas and telecommunications monopolists all pulled both strings. In each case, subsequent easing of entry barriers produced enormous public benefits. As these experiences have weakened the first-line defence, modern-day monopolists often go straight to No 2.

Elstone’s public appeal was a desperate act, after the ASX’s attempts to turn the regulator — the Australian Securities and Investments Commission — against recommending two licence applications apparently failed. The preceding Friday, ASIC provided its advice to Senator Nick Sherry, the minister responsible within Wayne Swan’s Treasury super-portfolio.

The ASX’s monopolies — including listing services, trade execution and trade-related services such as clearance, settle-

ment, trade reporting and market data supply — are goldmines.

While a couple of tiny stock exchanges target small-fry companies, ASX is the only exchange on which companies seeking serious access to Australian capital can list. ASX has a monopoly over trade execution in ASX-listed shares and holds the only Australian clearance and settlement licences. A rule requiring brokers to report all trade details to the ASX gives it a monopoly over ASX-listed share trade reporting and market data.

In 2006/07, the ASX made a \$398.2 million profit on “exchange-traded activities” on revenues of \$520.3 million — an outrageous 76.5 per cent profit margin. In 2006, London Investment Banking Association chairman Alan Yarrow complained that European equity exchange margins of 50 per cent were “higher than Gucci and Hermes”.

Unfortunately, as the AWB saga showed, government-granted monopolies give grantees incentives to waste huge resources defending them. Monopoly rents get capitalised into share prices. The ASX, capitalised at \$5.8 billion, has spent a packet. At its October AGM, Elstone described its enormous profit as “pleasing, particularly when regard is had to the human resources diverted to the preparation of a submission into the ASIC consultation process”.

Monopolists weave great tales. At the AGM, ASX chairman Maurice Newman noted some ASX-listed shares were owned by international institutions and some Australian investors owned overseas-listed shares, and claimed this “refuted claims that ASX is a protected monopoly”. Nonsense. The ASX holds absolute monopolies on services covering ASX-listed shares.

If Sherry approves their licences, the two applicants (AXE and Liquidnet) will initially target only some ASX goldmines (trade execution, reporting and market data) and trade types.

Last month, a much bigger threat hit the ASX’s radar, when Nomura-owned Chi-X announced its intention to seek a licence. As it employs a transparent quote-displaying system, ASIC is even less likely to reject it. Last April, Chi-X became the first European



alternative trading system (ATS). It offers trading, clearing and settlement for selected Dutch, French, German, Swiss and British stocks. On some days, it trades over 20 per cent of key stocks like Philips and Shell. Last week, it traded almost 10 per cent of British shares.

At the AGM, Newman said the ASX's trading fees on a \$1 million transaction were "only" 0.16 basis points (they'd be considerably more on an average \$27,000 trade). Chi-X Europe's average is 0.05bp — less than one-third ASX's — despite its smaller \$23,600 average trade. Elstone bragged that total trading, clearance and settlement fees on ASX share trades averaged 1.18 basis points. Chi-X Europe's average less than 0.62 bp — 47.5 per cent lower.

Elstone's claim that the ASX's fees have fallen is irrelevant. Even profit-maximising monopolists cut prices when marginal costs fall. Telecom made the same claim about long-distance prices before competition slashed its 90 per cent margins.

Chi-X also threatens ASX's trade reporting and market data goldmines. In Europe, it charges very low trade reporting fees and provides market data gratis.

Deregulation drove Chi-X's European entry. "Concentration rules" — which required all trades in shares listed on some exchanges to go through those exchanges — were abolished and traders were given the right to nominate clearing and settlement providers. Incumbents have responded with dramatic price cuts. Last April, the London Stock Exchange slashed fees on the types of trades that AXE will target by 87.5 per cent. Standard clearance fees on

LSE shares fell 30 per cent last year and by 75 per cent in 18 months for large customers.

Longer-term, ATS competitors like Chi-X may even threaten ASX's listings business. American ATS BATS Trading, launched in January 2006, is already the third-largest US share-trading market after NYSE and Nasdaq. Last Friday, it traded 10.4 per cent of all US-listed shares. It recently applied for an exchange licence.

While the ASX faces no trading competition on ASX-listed shares, US exchanges compete with more than 40 ATSs. NYSE and Nasdaq trade fewer than half the shares listed on their exchanges.

Monopolists' third-line defence is to stall. Every day competition is delayed means more profits. The AXE and Liquidnet licence decisions have already taken far too long. Unbelievably, they first approached ASIC almost two years ago. Following its initial June 2006 approach, AXE lodged a draft licence application in January 2007 (Liquidnet had done so in September 2006) and revised it in March 2007. It had planned to launch by mid-2007. It is still waiting.

Yet ASIC didn't even issue a consultation paper until July 23. ASIC said then that it would provide advice to the minister in September. It did so only 11 days ago.

Sherry should put a rocket under ASIC. It should stop mollicoddling the monopolist and assess further applications — including Chi-X's — much more quickly.

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