

The Pakistani Equity Market in 50 Years: A Review

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The equity market plays an important role in the economic development of a country. However, in Pakistan the equity market has not played its due role because of interventionist economic policies and over reliance on debt financing. It was not until the middle of 1980s that the importance of the equity market was recognised and steps were taken to activate the market. However, the market actually became active in the beginning of 1991 when it was opened to foreign investors, besides other liberalisation measures. Since then the market has made considerable progress and improved in size and depth.

This paper reviews the performance of the Pakistani equity market in the background of Pakistan's Golden Jubilee programme. The information was collected from the Corporate Law Authority (the regulatory body), the State Bank of Pakistan (the central bank), and International Finance Corporation (a branch of the World Bank). The paper shows that the Pakistani equity market gained momentum in the 1960s and made significant progress in listings and market capitalisation. However, the market lost its momentum in the 1970s due to political turmoil in the country and the nationalisation policies adopted by the then government. Though the policy of greater reliance on private enterprise restored the market sentiments in the 1980s, the market actually regained its momentum in early 1990s when it was opened to international investors. In terms of its performance, the market was ranked third in 1991 among the emerging markets. Unfortunately, the market could not maintain its performance in later years because of economic and political instability. A series of political changes in the country, ethnic violence in Karachi, increasing inflation and unemployment rates, widening budget deficits, etc., proved to be detrimental to business activities.

I. INTRODUCTION

The equity market plays an important role in the economic development of a country. It helps in the mobilisation of financial resources, both domestic and foreign, for investment in various sectors of the economy. Moreover, it serves as an effective medium for exchanging business information among shareholders, business community, and prospective investors. It is often considered a barometer that reflects the general investment climate of a country.

In Pakistan, like other developing economies, the equity market has not played its due role because of interventionist economic policies and overreliance on debt financing. It was not until the mid of 1980s when the importance of an effective equity market was recognised and steps were taken to activate the market. However, the market actually became active in the beginning of 1991 when it was opened to

international investors. Since then the market has made considerable progress and improved in size and depth.

The purpose of this paper is to review the performance of the Pakistani equity market in the background of Pakistan's golden jubilee programme. At present there are three equity markets operating in Pakistan. However, the Karachi Stock Exchange (KSE) is the main exchange and bulk of trading takes place on its floor. Hence, this paper focuses on the performance of the KSE.

The paper is organised as follows. The next section describes the evolution of the equity markets in Pakistan. Section III evaluates the performance of the KSE in recent years. The final section contains the summary and conclusions.

II. HISTORICAL DEVELOPMENT

Pakistan has a fairly long history in equity markets. Soon after its independence in August 1947, the Karachi Stock Exchange came into existence in September 1947, and was incorporated as a company limited by guarantee in March 1949. At that time it had 90 members and 5 listed companies with paid-up capital of Rs 37 million.

Despite problems of political instability, a rudimentary infrastructure, an almost nonexistent industrial base, and a small entrepreneurial class, Pakistan's economy made steady progress in the 1950s largely due to a healthy mix of private initiative and Government support. Consequently, the stock market also made progress and listings rose to 81 companies by 1960 with paid-up capital of above Rs 1.0 billion, while the market capitalisation was about Rs 1.9 billion.

The country experienced continued economic progress in the 1960s, particularly in the first half of the decade the economy underwent remarkable growth. The second Five Year Plan (1960–1965) was the most successful plan in Pakistan's history. However, a war with India in 1965 and the socio-political unrest in the late 1960s affected the economy adversely. Nevertheless, the stock market continued to expand and by 1970, listings rose to 219 while market capitalisation increased to Rs 5.66 billion.

Although the 1970s started with the formation of another exchange, Lahore Stock Exchange, the which began functioning in May 1971, the decade remained dismal for the stock market due to adverse economic and political conditions. A separatist movement in the Eastern wing of Pakistan caused another war with India in 1971 that resulted in the separation of the Eastern wing and the establishment of Bangladesh. Subsequently, a government with socialist manifesto came into power that started nationalising large segments of industry, insurance, and banks. By 1974, it was estimated that almost 70 percent of the country's economy was under state control, while the 30 percent private sector was dominated by the fully nationalised financial sector. This nationalisation policy highly discouraged private business activities and with it the stock market. A political movement against that Government in the late 1970s resulted in its removal and imposition of Martial Law. These political fluctuations in the country paralysed the investment atmosphere and proved fatal for the stock market. Overall, by 1980, the number of listed companies was 314 while the market capitalisation increased to Rs 9.37 billion.

The 1980s began with a policy of greater reliance on private enterprise. However, no serious measure was taken until the middle of the decade. In the budget for the year 1985-86, significant measures were taken including, (1) total exemption of dividend income from income tax; (2) regularisation of monetary system through the issue of special bonds; (3) issue of foreign exchange bearer certificates to encourage remittances through regular banking channels; (4) issue of bearer government bonds to the general public; (5) a programme to gradually permit the entry of the private sector in the financial system through investment banks, leasing etc.; and (6) a disinvestment programme of government held shares.

These measures improved the investment climate and restored the business confidence that had a favourable impact on stock market activity. As a result, by 1990, listings rose to 487 compared with 314 in 1980 while market capitalisation went up to Rs 60.8 billion. The annual turnover also rose nearly ten times to 252.9 million shares representing a traded value of Rs 5 billion.

The 1990s started with privatisation moves and measures taken to liberalise the economy. In the beginning of 1991, significant measures were taken including, (1) the opening of the market to international investors; (2) removal of constraints to repatriation of investment proceeds, gains, and dividends; (3) privatisation of public sector industries; (4) deregulation of economy and allowing commercial banks in the private sector; and (5) liberalisation of foreign exchange restrictions and allowing Pakistanis to have foreign currency accounts.

The stock market responded positively to these measures and unprecedented bullish trends were observed in the first year of the opening of the market, i.e., 1991. The new listings, market capitalisation, and trading volume increased significantly. These developments were accompanied by the inflow of foreign capital through the Commonwealth Equity Fund, the Pakistan Fund, and the Credit Lyonnais Pakistan Growth Fund. Another important development was the creation of the third stock exchange in the country, the Islamabad Stock Exchange, that started operating on August 1992.

Unfortunately, the market could not maintain its performance in later years because of economic and political instability. The country has undergone a series of political changes that had an adverse impact on investment climate. Particularly, the city of Karachi, the financial centre, had been the subject of continued ethnic violence that proved to be detrimental for business activities and with it the stock market. In addition, the increasing inflation and unemployment rates and widening budget deficit affected the market sentiments.

However, despite the unfavourable economic and political events the market made considerable progress in the 90s largely due to privatisation moves and liberalisation measures. By the end of 1997, the listings rose to 781, more than 60 percent increase compared to 1990. Similarly the market capitalisation increased by more than eight times to Rs 465 billion. Table 1 shows the performance of the Karachi Stock Exchange over the decades.

Table 1
Growth of the Karachi Stock Exchange Over the Decades

| Years | Listed Companies (No.) | Listed Capital (in Mill Rs) | Market Capitalisation (in Mill Rs) |
|-------|---------------------------|--------------------------------|---------------------------------------|
| 1949 | 5 | 37.0 | NA |
| 1950 | 15 | 117.3 | NA |
| 1960 | 81 | 1,007.7 | 1,871.4 |
| 1970 | 291 | 3,864.6 | 9,658.1 |
| 1980 | 314 | 7,630.2 | 9,767.3 |
| 1990 | 487 | 27,737.3 | 53,709.2 |
| 1997 | 781 | 208,807.0 | 465,005.9 |

Source: Karachi Stock Exchange.

III. RECENT DEVELOPMENTS

Although the Karachi Stock Exchange has been in operation for almost fifty years, it really became active in 1991 when liberalisation measures, particularly the opening of the market to international investors, were announced. Hence, it would be appropriate to have a closer look at the market for recent years. Table 2 provides market indicators on annual basis whereas Figures 1–4 shows the trends of these indicators on monthly basis.

The table as well as the figures indicate that there was not much movement in the market before its opening in early 1991. The opening of the market along with other liberalisation measures was announced on February 7, 1991. However, the market actually responded in June and became bullish as reflected by the sharp rise in SBP monthly index, shown in Figure 1. The bullish trend continued till the end of that year. As a result, new records were set as can be seen from Table 2 showing that by the end of 1991 listings rose significantly to 542, turnover of shares increased by about 2.5 times to 617 millions, and market capitalisation went up by more than three times to Rs 183 million. Further, the national index SBP increased by 133 percent while the increase in international index IFC was 172 percent. In terms of its performance the market was ranked third, after Argentina and Columbia, among the emerging markets monitored by the International Finance Corporation (IFC).

It appears, however, that the market overreacted in the first year of opening because it was followed by the period that may be called the correction phase. In 1992, the market generally had a downward trend with both the SBP general index and IFC return index fell by 7 percent and 18 percent respectively. However, the market deepened in terms of listings and 86 new companies were listed during the year that helped in increasing the turnover of shares and market capitalisation.

The 1993 experienced a series of political changes. The year started with Mr Sharif's cabinet which was dismissed in April and a caretaker government was formed.

Table 2
Growth of the Karachi Stock Exchange Over the Years

| Year | Listed Companies (No.) | Trading Days (No.) | Shares Traded (in Mill) | Market Capitalisation (in Mill) | SBP Index 80-81=100 | Change (%) | IFC Index Dec 84 = 100 | Change (%) |
|------|------------------------|--------------------|-------------------------|---------------------------------|---------------------|------------|------------------------|------------|
| 1986 | 361 | 235 | 114,088 | 29,491.1 | 199.87 | NA | 142.9 | NA |
| 1987 | 379 | 241 | 157,297 | 34,251.5 | 228.89 | 14.3 | 152.4 | 6.6 |
| 1988 | 404 | 240 | 169,261 | 40,014.0 | 262.67 | 15.0 | 173.4 | 13.8 |
| 1989 | 440 | 238 | 214,572 | 46,494.5 | 277.28 | 5.6 | 184.5 | 6.4 |
| 1990 | 487 | 229 | 255,397 | 53,709.2 | 308.52 | 11.3 | 205.0 | 11.1 |
| 1991 | 542 | 232 | 616,892 | 182,622.1 | 718.17 | 132.8 | 557.8 | 172.1 |
| 1992 | 628 | 241 | 799,336 | 203,501.7 | 665.16 | -7.4 | 455.1 | -18.4 |
| 1993 | 653 | 232 | 1,276,393 | 348,642.3 | 947.18 | 42.4 | 710.8 | 56.2 |
| 1994 | 724 | 324 | 1,816,075 | 377,332.5 | 940.34 | -0.7 | 650.3 | -8.5 |
| 1995 | 764 | 218 | 3,051,086 | 317,455.2 | 675.16 | -28.2 | 447.8 | -31.1 |
| 1996 | 782 | 229 | 6,732,645 | 426,400.0 | 552.34 | -18.2 | 360.4 | -19.5 |
| 1997 | 781 | 237 | 13,357,301 | 465,005.9 | 557.52 | 0.9 | NA | NA |

Sources: Karachi Stock Exchange, State Bank of Pakistan, and International Finance Corporation.

However Mr Sharif's cabinet was reinstated in May but again had to leave in July causing the formation of a new caretaker government. The general elections were held in October that marked the end to this crises and Ms Bhutto's government came into power. These political changes affected the market sentiments which remained depressed throughout the period. The investors, however, became optimistic after the elections and once again the market became bullish in the last quarter as can be seen from Figure 1. Overall, the year ended with 42 percent gain in local index and 56 percent gain in international index.

The bullish trend continued in the first quarter of 1994 and the market reached its peak in March. However, the market lost its momentum in the second quarter and remained bearish, in general, throughout the year. This was due to the significant reduction in the annual production of cotton, Pakistan's major export, and political tensions between Ms Bhutto's government and opposition parties, particularly the Mohajir Quami Movement (MQM), a Karachi based political party. The market finished the year with a loss of 0.7 percent and 8.5 percent in SBP and IFC indexes respectively. However, despite the bearish sentiments 72 new companies were listed during the year. Particularly, the listing of Pakistan Telecommunications Company (PTC) and Hubco played a significant role in increasing the market capitalisation and turnover of shares.

The 1995 proved to be a disaster year for the equity market mainly due to the political unrest in Karachi. The repeated strikes called by the MQM together with continued violence and increasing casualties completely paralysed the business activities. The situation was further aggravated by the Mexican financial crises that discouraged the foreign investors in investing in emerging markets. As a result, the market collapsed by 28 percent in local index and 31 percent in international index. The market capitalisation went down to Rs 317 billion. A significant increase in turnover of shares was largely due to the trading in PTC and Hubco.

The depression continued in 1996 with no signs of improvement on economic and political front causing the stock market to remain sluggish throughout the year. The dismissal of Ms Bhutto's government in November, which was supposed to eliminate the political unrest in Karachi, as well as the caretaker's capital market package to boost the market could not gain investor's confidence. By the end of the year the SBP index fell by 18 percent and IFC index by 19.5 percent. The heavy trading in PTCL and Hubco, however increased the turnover of shares more than twice to 6.7 billions.

The 1997 started with the uncertainties of general elections. Though the index went up after the election results it dropped back quickly. In order to rescue the capital market that remained sluggish for the last three years, the government took

Fig - 1 SBP Monthly Index

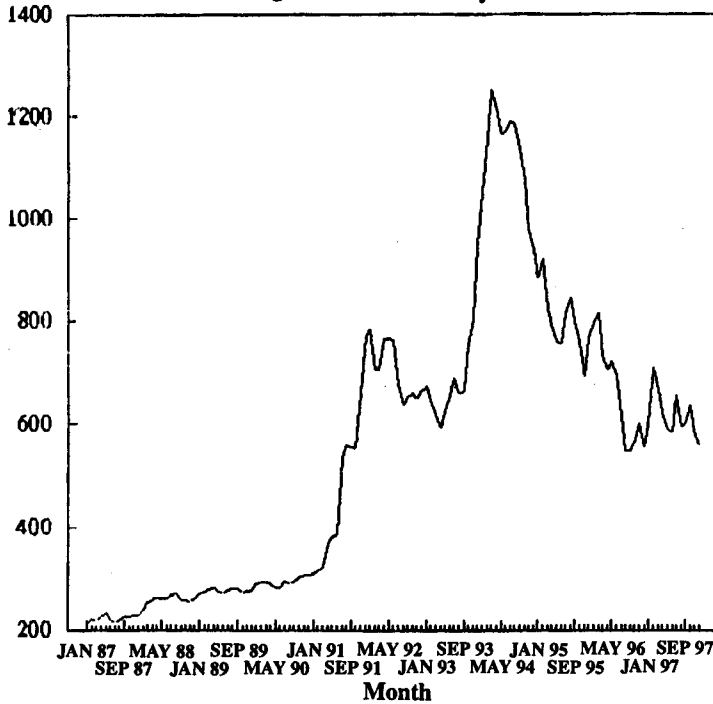


Fig - 2 SBP Monthly Returns

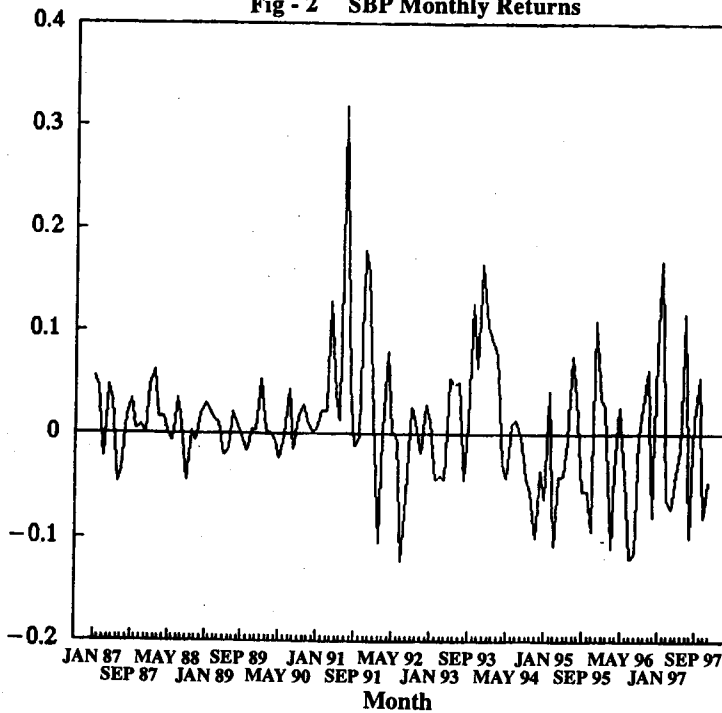
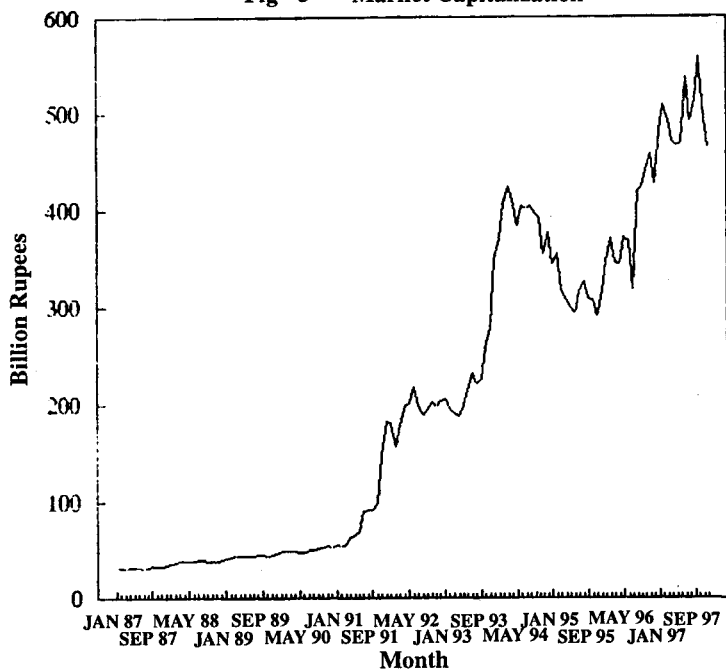
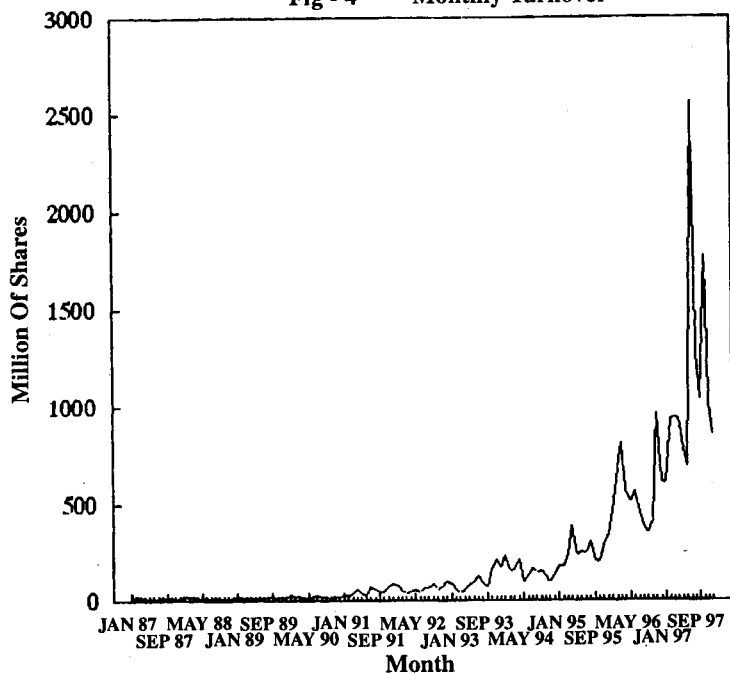


Fig - 3 Market Capitalization**Fig - 4 Monthly Turnover**

significant measures in May 1997. These include (1) extension of capital gains tax exemption for another three years to 2001; (2) exemption of bonus shares from tax; (3) removal of tax on dividend payout for all mutual funds; (4) exemption of tax for foreigners from investing in fixed income securities of the government and corporations; (5) increase in the limit of investment in shares by provident and pension funds from 10 percent to 20 percent; and (6) increase in the ceiling of investment in one company from 1 percent to 5 percent.

The response to these measures did not show up by the end of the year. However, after three years the market was able to register a marginal gain of 0.9 percent in SBP index. The trading volume increased significantly to over 13 billions. Overall, the market remained depressed largely due to political and economic instability of the country.

IV. SUMMARY AND CONCLUSIONS

The purpose of this paper was to review the performance of the Pakistani equity market over the years. Although at present there are three stock exchanges operating in Pakistan, the Karachi Stock Exchange is the only truly active stock exchange and bulk of trading takes place on its floor. Hence, this paper has focused on the performance of the KSE.

The analysis shows that the Pakistani equity market gained momentum in the 1960s and made significant progress in listings and capitalisation. However, the market lost its momentum in the 1970s due to the political turmoil in the country and the nationalisation policies adopted by the then government. Though the policy of greater reliance on private enterprise restored the market sentiments in the 1980s, the market actually regained its momentum in early 1990s when it was opened to international investors.

The opening of the market put a new life in the market and unprecedented bullish trends were observed. The size and depth of the market were also improved significantly. In terms of its performance the market was ranked third among the emerging markets. Unfortunately, the market could not maintain its performance in later years because of economic and political instability.

Measures have been taken to rescue the market. However, these measures may not be sufficient in the presence of unfavourable economic indicators. The increasing inflation and unemployment rates and widening budget deficits need to be controlled. Moreover, the Pakistani equity market is dominated by groups of investors. They may be the institutional or foreign investors who set the tone for the market. Often their actions are followed by the small and individual investors who in the event of adverse market conditions become the victims of market fluctuations. This practice should be prevented to protect small investors. In this context, the authority and capability of

Corporate Law Authority, the regulatory body, should be strengthened. In addition, effective measures should be taken to ensure political stability. Political unrest is detrimental to investment climate and discourages business activities. The maintenance of general law and order situation is the prerequisite for economic growth and should be given top priority.

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