Some reflections on Bangladesh capital market

DR. MIRZA AZIZUL ISLAM

Capital market in Bangladesh is yet to play its potential role as a vehicle for financing long term investment. However, the hangover of an unpalatable historical past which saw a dramatic upsurge in the second half of 1996 only to be followed by a drastic and prolonged downswing has been successfully overcome. Discernible signs of renewed vitality have emerged. A number of actions are in the offing to add depth to the market, increase the variety of instruments that can meet diverse investors' preferences, further promote orderly trading, enhance professional competence of market intermediaries and facilitate expeditious issuance of securities at reduced cost.

THE capital market of Bangladesh owes its origin to East Pakistan Stock Exchange Association Limited set up in 1954. The association was later converted into Dhaka Stock Exchange in which formal trading was started in 1956. The exchange was renamed as East Pakistan Stock Exchange in 1962 and underwent another name change in 1964 when it was renamed again as Dhaka Stock Exchange (DSE). Trading on the stock exchange was suspended during the liberation war. There was no trading in the immediate post liberation years as the economic policies of the country during those years had a strong orientation towards central planning. Trading was resumed in 1976 with the shift of development strategy in favour of a greater role of the private sector. DSE has remained in continuous operation since then. Chittagong Stock Exchange (CSE) was set up in 1995.

Both Dhaka and Chittagong stock exchanges experienced a meteoric rise between July and November 1996. Average daily turnover increased by over 1000 per cent. The share price index of DSE jumped from 957 on 2 July 1996 to a record high of 3649 on 5 November in 1996. In CSE also the index rose dramatically from 411 on 2 July 1996 to 1417 on 2 November 1996. Then, started a process of catastrophic crash, particularly in DSE, with the index falling to 3065 in DSE by 30 November 1996. The index continued a downhill march thereafter with the lowest level recorded at 463 on 3 May 1999.

Since then the capital market in Bangladesh had been in a state of doldrum. However, the market has been showing unmistakable signs of resurgence from early 2004.

A bird's eye view of the recent past and the present

As already noted, the potential contribution of capital market in financing development is yet to be realized in Bangladesh. This is evidenced by the fact that market capitalization as a proportion of gross domestic product (GDP) is of the order of six per cent of GDP. In contrast, the relevant orders of magnitude in India, Pakistan and Sri Lanka are respectively 47 per cent, 20 per cent and 15 per cent. Given the size of population of Bangladesh and steady growth of its GDP exceeding five per cent over the past one decade, considerable unrealized opportunities exist for utilizing the capital market as a vehicle for raising long term investment finance. The recent developments clearly suggest strongly positive developments in this regard.

Relevant data in support of positive developments are presented in table 1. Data for DSE only are used in this paper because it is a march larger exchange than CSE and the developments in the latter closely parallel those in the former. It will, be noted that the number of listed companies declined as of June 2005 relative to the previous year because a number of non performing companies were delisted. Since then, the Securities and Exchange Commission (SEC) has given consent to initial public offering (IPO) for nine companies. A few more are in the pipe line. By June 2006, the number of companies listed on the stock exchanges will definitely exceed that of the pervious year. The general index and market capitalization have both increased substantially over the past two years. Perhaps, even more remarkable is the rise in turnover which indicates resurgence of vitality of the capital market. Bangladesh has outperformed most other stock markets of the region in terms of change in index as of 17 August 05 relative to 31 December 04 (table 2). Furthermore, this notable gain has been achieved while maintaining a significant degree of stability. To illustrate this point, it can be noted that during the past six months, day to variation in the DSE's general share price index was less than one per cent on overwhelming number of trading days

There are also strong signs of confidence in the primary market. All IPO issues for which subscription closed between November 2003 and August 2005 numbering 18 were substantially oversubscribed. These positive developments have been induced by a number of measures taken by SEC in concert with other market actors to revive investors' confidence in the capital market and to ensure orderly and transparent trading on the exchanges. Some of these are presented below:

(i) The process of dialogue and communication between SEC and the exchanges has been institutionalized by constituting a consultative committee of which a senior SEC official is the convener and the Chief Executive Officer of the two exchanges are members. The committee invites representatives of other market actors, as needed to review market developments and recommend regulatory changes or administrative orders for appropriate action by SEC and / or the exchanges.

(ii) A regular system of inspection of brokerage houses by SEC and the exchanges has been put in place.

(iii) Automated trading system has been introduced by both exchanges. CSE has opened internet trading facility.

(iv) The central depository system (CDS) for electronic trading was operationalized in January 2005. All new primary shares can be issued only in electronic form. The existing paper securities are being gradually dematerialized. As of now, shares of companies accounting for well over 70 per cent of market capitalization have been demated.

(v) The settlement cycle has been reduced with effect from 01 March 2005.

(vi) There have been considerable improvements in the regulatory framework since 1996. These relate to, inter alia, disclosure requirements for IPOs; right issues; qualifications of auditors, their retention by listed companies and standards of audit; insider trading; and eligibility criteria and codes of conduct of merchant bankers, stock dealers / brokers and their authorized representatives as well sponsors, trustees, asset managers and custodians of mutual funds.

(vii) SEC has strengthened its monitoring and enforcement role with the result that there has been a considerable decline in the number complaints against market intermediaries as well as issuers. A particularly heartening fact is the fall in the incidence of issuers' default with respect to holding annual general meetings and submission of half yearly / annual financial statements.

(viii) SEC is undertaking a more rigorous screening of the proposals for initial public offering. In consequence, the secondary market is pricing then well. The shares of nine companies for which public subscriptions closed between 15 November 2003 and 18 May 2005 are now being traded in the secondary market. The market price of all of them is well above the initial offer price excepting in two cases. In one case, the market price as of 31 July 2005 was Tk 99.75 and in the other case, it was Tk 90.75 against the initial offer price of Taka 100 in both cases. In contrast, out of 10 immediately prior issues, the shares of as many as four companies fetched market price well below the initial offer price (ranging from under 10 per cent to 60 per cent of the offer price).

Some ruminations about the future

SEC, in collaboration with other relevant agencies, is in the process of initiating several steps with a view to enhancing the confidence of the investors, increasing the quantity and variety of instruments, and improving the functioning of the market. Some of the forthcoming measures to accomplish these objectives are briefly mentioned below.

(i) As of now, enforcement powers of SEC are, after due enquiry and giving an opportunity to the violators to be heard, limited to cancellation or suspension of registration of market intermediaries, and imposition of penal measures which may involve levying of fines on or filing of cases in competent courts against issuers / market intermediaries. These is no legal provision for SEC to award compensation to shareholders or to file cases on behalf of shareholders. SEC is in the process of drafting amendments to the relevant laws so as to be able to better protect the interests of the shareholders.

(ii) The need for strengthening compliance by all market intermediaries is greatly felt. As present, the regulatory requirement for appointment of a compliance offer extends only to stock broker / dealer. SEC intends to extend the requirement to other market intermediaries laying down the qualifications of the concerned officials and specifying the issues to be addressed in implementing internal compliance procedures.

(iii) A sound capital market requires depth with a wide range of products and instruments to cater to varying risk return liquidity preferences of investors and also to ensure that the adverse effects arising from disturbance in some part do not assume systemic proportions. In this regard, SEC, in collaboration with Bangladesh Bank had made long term government bonds tradable on stock exchanges. But, not much of trading has been actually taking place. SEC and Bangladesh Bank have formed a joint committee to suggest measures to activate trading in government bonds. Recently introduced asset backed securities which are now being issued only on private placement basis need to be brought into the mainstream secondary market.

(iv) At the initial stages of capital market development, privatization of state owned enterprises can make a signification contribution. In Malaysia, for example, the Privatization Master Plan resulted in many government linked firms being listed with Kuala Lumpur stock exchange. Seven largest firms listed with the exchange belong to this category. Government linked firms account for 34 per cent of total market capitalization. In Bangladesh also efforts are being made to progressively offload government shares through the stock exchanges. Hon'ble Finance Minister recently chaired an inter Ministerial meeting at the request of SEC. The meeting took a number of decisions regarding off loading of government shares and issuance of bonds by government agencies through the capital market. The implementation of these decisions will make a notable contribution to the depth of the capital market.

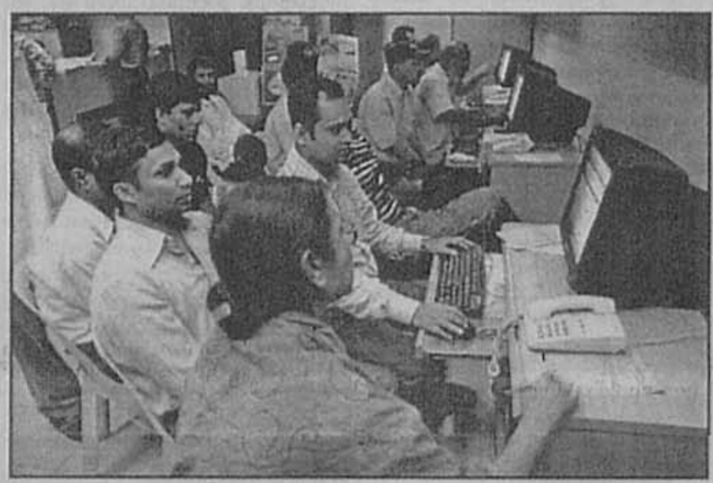
(v) A healthy capital market requires engagement of competent professionals by a wide range of market actors. Among the positions which require the services of people with adequate knowledge of the principles of corporate governance as well as security laws and regulations are the members of company boards, company secretaries, officials of the share departments of companies, authorized representatives of brokers, compliance officers of market intermediaries etc. Academic institutions or the professional bodies in the country do not produce enough people to fill up such positions. SEC has constituted a Steering Committee for preparing suggestions to set up a capital market training institute to bridge the gap. Asian Development Bank is expected to assist in this endeavour. SEC's investors' education programme has been intensified to enable investors to make informed decisions concerning their portfolio.

(vi) SEC is revisiting IPO and rights issue rules and drafting direct listing rules. The objectives are to reduce issue cost, simplify procedural requirements and shorten the time gap between submission of an application to and consent by SEC.

Concluding observations

Capital market in Bangladesh is yet to play its potential role as a vehicle for financing long term investment. However, the hangover of an unpalatable historical past which saw a dramatic upsurge in the second half of 1996 only to be followed by a drastic and prolonged downswing has been successfully overcome. Discernible signs of renewed vitality have emerged. A number of actions are in the offing to add depth to the market, increase the variety of instruments that can meet diverse investors' preferences, further promote orderly trading, enhance professional competence of market intermediaries and facilitate expeditious issuance of securities at reduced cost. In sum, Bangladesh capital market is now prepared to be harnessed in the service of the country's economic development. It is hoped that policy makers, issuers of securities, market intermediaries and investors will all join hands in fuller realization of its potential.

The author is the Chairman of the Securities and Exchange Commission of Bangladesh. The opinions expressed in this article are not necessarily those of the Commission.



FILE PHOTO: STAR

Dhaka Stock Exchange--the hangover of an unpalatable past has been successfully overcome.

Role of regulators in improving corporate governance

DR. TARIQ HASSAN

Good corporate governance is now widely recognized as essential for establishing an attractive investment climate characterized by competitive companies and efficient financial markets. It is imperative that economies in the South Asian region develop necessary framework of corporate governance and achieve implementation through active participation of key stakeholders, in order to provide impetus to economic growth.

MORE than two hundred years ago, Adam Smith, in his classic essay 'Wealth of Nations', wrote the following:

"The directors of such (joint-stock) companies, however, being the managers of other people's money rather than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private company frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company."

(Adam Smith, *The Wealth of Nations*)

It is evident from the passage quoted above, that corporate governance is neither a buzz word nor a new area of interest. The conduct of companies and its impact on stakeholders has been an area of active research and interest since a very long time. However, alongside the advances in communication, increases in volume of international trade and the phenomenon of globalization, the world has also experienced a spate of corporate scandals and economic crises like those in Asia in the 1990s. The combination of these factors has brought corporate governance into the lime light and it is now a leading policy agenda in the developed and developing world alike.

Adherence to the principles of good corporate governance serves to foster investor confidence and attract domestic as well as foreign investors. It is empirically tested that the extent to which a company is perceived to operate within the principles of good corporate governance largely affects its ability to attract investment. The need for corporate governance in South Asia is vastly recognized. The countries in the region have made a slow but positive response to corporate governance challenges. South Asian regulatory bodies have played a very active role in introducing corporate governance practices, and sustaining these efforts is now the key to developing the good governance paradigm.

Regulatory responsibilities for improving corporate governance

The regulator has a key role in implementing corporate governance requirements. Creation of a strong legal and regulatory framework that is adequately enforced serves to protect stakeholders' interests and engender investor confidence, as a first step. The second step is taking an iterative approach, and continuously improvising on the existent framework.

In implementing, promoting and improving good corporate governance framework, the regulatory role varies from consultative to administrative. Foremost, the introduction of a code of corporate governance requires the involvement of regulatory authorities and corporate sector representatives to ensure that it fulfills the fundamentals of transparency and accountability. Only a consultative process can ensure that such a framework objectively addresses the needs of diversified stakeholders.

Once the corporate governance code has been developed, it requires legal backing to allow a certain level of enforceability. The manner in which the framework is to be implemented varies according to the needs and circumstances of every jurisdiction. This can take the form of necessary amendments in corporate laws or incorporation in listing regulations of stock exchanges or encouraging voluntary adaptation through issuance as guidelines. Whatever may be the manner of introduction of a code of good governance, its effective implementation requires vigilant oversight by the regulatory body concerned.

It is also essential that the regulator maintains a regular dialogue with various stakeholders to allow them to understand and discharge their responsibilities in the corporate governance framework. This requires that compliance with good governance practices is understood by companies to be in their own interest of enhancing business value. It also requires directors and managers to set strategic goals, establish financial and other policies, and run the affairs of the company while being accountable to shareholders for the performance and activities of the company and ensuring conformance with laws, rules and regulations. Furthermore, shareholders particularly institutional shareholders should play an active role in assessing the performance of management and exercising their rights. The regulator may need to create an enabling environment for improving participation of these various groups of stakeholders in implementing good corporate governance.

Improvement in corporate governance practices comes with the regulators' ability to reward those companies that display committed compliance with good corporate governance as well as take action against erring companies and their directors or managers.

Our experience in promoting corporate governance in Pakistan

Pakistan's frontline corporate regulator, Securities and Exchange Commission of Pakistan (SEC), has been proactively pursuing its agenda of instilling good corporate governance practices since 2002. Making a steady start to adopt and implement good governance practices, SEC issued the Code of Corporate Governance in March 2003. The Code was incorporated into the listing regulations of the stock exchanges. It is mandatory upon listed companies to comply with the Code and the stock exchanges ensure compliance therewith.

The Code of Corporate Governance seeks to establish a system whereby a company is directed and controlled by its directors in compliance with the best practices so as to safeguard the interests of diversified stakeholders. It proposes to restructure the composition of board of directors in order to introduce representation by minority shareholders and broad-based representation by executive and non-executive directors. It also emphasizes openness and transparency in corporate affairs and decision-making process and requires directors to discharge their fiduciary responsibilities in the larger interest of all stakeholders in a transparent, informed, diligent, and timely manner. Furthermore, it seeks to achieve the objectives of good corporate governance by recommending strengthening of corporate working, internal control system and external audit requirements.

Subsequent to the introduction of the Code, a number of measures are being taken to ensure that there is adequate awareness in the corporate sector of the need for and benefits of good governance. In this regard, a number of seminars and training workshops of directors and management of listed companies have been held under the auspices of the SEC as well as a number of private sector organizations.

Earlier this year, in partnership with notable private sector representatives, SEC established the Pakistan Institute of Corporate Governance to serve as the focal point for training and research on corporate governance in the country. It is expected that establishment of the Institute would provide an enabling environment for effective implementation of the Code of Corporate Governance.

Also, compliance with the Code of Corporate Governance has been incorporated into the criteria of awards announced by professional and industry associations. This has served to give due recognition to companies that follow better corporate governance practices.

Conclusion

Good corporate governance is now widely recognized as essential for establishing an attractive investment climate characterized by competitive companies and efficient financial markets. It is imperative that economies in the South Asian region develop necessary framework of corporate governance and achieve implementation through active participation of key stakeholders, in order to provide impetus to economic growth.

Good corporate governance is not about conformance in letter but in spirit as well. It cannot be measured by a box ticking exercise and companies therefore must be enabled to develop a corporate culture in which transparency and accountability are predominant features. Providing an enabling environment with a conducive regulatory framework is the foremost responsibility of the frontline regulators of every country. Once this job is well done, the rest falls into place more easily!

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RECENT TRENDS IN GLOBAL CAPITAL MARKETS

Role of Singapore Exchange in the regional economy

SWEE TIAN ANG

SGX recognises the positive effects of exchange networks and by leveraging on its strengths in Asia, we are pro-actively forging alliances with like-minded institutions.

THE development of capital markets is an important aspect of any modern economy. The direct correlation observed in economic development and the state of capital markets in many countries across the globe is telling that they progress in tandem. As the world becomes more integrated, capital markets play a critical role not just in providing liquidity and investment instruments, but also in maintaining global financial stability.

Therefore, building a thriving and healthy capital markets characterised by a robust regulatory and institutional framework, as well as efficient infrastructure for public information and trading/settlement remains a key priority globally. In particular, much emphasis has been placed on improving integrity of the marketplace through enhancing corporate governance standards.

SGX has helped create growth in recent years

Along with the rest of the financial sectors, the global capital markets suffered tumultuous times during the Asian financial crisis in 1997, the burst of the dotcom bubble in 2000, and the aftermath of the terrorist attacks on the US in 2001. Recovery in the major global economies set the industry on a rally in 2002, which continued into 2003 where debt and equity underwriting experienced solid activity. Capital market's activity was further strengthened as international equity markets put on a generally healthy showing during 2004.

It was estimated by Mckinsey & Company that the total value of the global capital markets including bank deposits, government and private debt securities, and equities stood at US$119 trillion at the end of 2004. While this value is projected to grow beyond US$200 trillion by 2010, guarded optimism shapes environment for 2005 since potential disruptions such as the stubbornly high oil prices loom in the background.

In terms of market segmentation, the leading sector within the capital markets is bonds outstanding, which accounts for about 43% of the global value. Bank deposits and equity securities account for the remaining 30% and 27% respectively. Geographically, the US continues to dominate the market value, taking a share of about 37%. Europe is the second largest region with 31%, and is gaining strength through integration. Asia is a region made up of markets of vastly different sizes, with Japan dominating two thirds of the region's capital markets, and China and India driving growth.

Global IPO jumped sharply in 2004, roughly doubling over 2003 in transaction numbers and even more than that in dollars raised. In total, 1516 deals were concluded, raising US$124 billion. While North America and Europe reasserted themselves in the IPO scene, the centre of gravity continues to shift towards emerging economies such as China, India, Russia and Israel. The thirst for capital in these emerging markets has attracted increasing competition from many international stock exchanges, and has thus given rise to the number of cross-border listings.

SGX as the Asian Gateway attracts foreign listings

Singapore is located at the heart of the exciting growth story of Asia, where there are tremendous investment needs. Companies within Asia are also fast expanding overseas, and capital is often a critical success factor. Against such a backdrop, SGX has been able to contribute by providing a platform for capital raising, and at the same benefit from it. Last year alone, 48 foreign companies were listed on SGX. For the first time last year, the number of foreign companies surpasses that of the local companies. On the whole, out of the 665 companies currently listed on SGX, 28% are foreign, making up 40% of the market capitalisation. Such receptivity to foreign companies is a unique feature of Singapore market which foreign companies find comfort in when choosing to list on SGX.

In 2004, the Singapore bond markets saw the largest number of foreign issuers at 34, raising a total of S$3.5 billion. This included not only corporates and financial institutions such as General Electric and Citigroup, but also supranationals such as the Asian Development Bank (ADB) and U.S. Agencies like Fannie Mae.

Beyond raising capital, both Multi-National Corporations (MNCs) and smaller companies alike have found Singapore conducive for conducting business operations in areas like manufacturing, research & development, and distribution & logistics. Out of the 7000 MNCs located in Singapore, many have established their regional Headquarters here. This powerful MNC network, coupled with Singapore's extensive network of Free Trade Agreements (FTAs) and Double Tax Avoidance Agreements (DTAAs) must have helped attract the 1100 Chinese companies and 1500 Indian companies that currently have operations here.

SGE strives to build capital markets through partnerships

SGX recognises the positive effects of exchange networks and by leveraging on its strengths in Asia, we are proactively forging alliances with like-minded institutions. On the securities front, SGX is currently in active discussion with Bursa Malaysia to establish a co-trading linkage similar to the one it had forged with Australian Stock Exchange a few years ago.

We have also participated in a joint collaboration with four other ASEAN stock exchanges - Indonesia, Malaysia, Philippines and Thailand - to create an index of ASEAN stocks, which will be launched soon. It will be a tradable index that comprises many top names, and will facilitate the creation of exchange-traded products such as funds and futures targeted at investors who recognise the economic and investment prospects of ASEAN.

Through all these, we hope to pave the way for stronger growth in financial services activities between Singapore and our partners, to promote better market access and to enhance cross border flows of capital.

Swee Tian ANG is President, Singapore Exchange Ltd.