CAPITAL SUPPLY

The stock market route

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CAPITAL is regarded as short and long term business investment. It normally comes from two sources; equity and borrowing. But the permanent part must come from equity; temporary part comes from debt instrument sale, or direct borrowing from financial intermediaries against collateral. There is no hard and fast rule as to the ratio of equity capital and debt capital, big businesses go for higher debt capital than the smaller ones. However, highly leveraged businesses undergo more risk than the others, in the sense that after fixed interest payments the highly indebted businesses remain low on surplus availability. Economic history says, business with high debt went bankrupt more frequently than the rivals with more equity capital, one beauty of equity capital is that against it businesses do not need to pay any pre-committed financial pay-out, the equity suppliers are always the end receivers of profit, left after deductions of all expenses and fixed payment obligations. In other words, businesses done with equity capital can go without paying anything to its real owners-the equity holders. Sometimes, businesses can go without distributing the profit by retaining it for future use. The undistributed profit or what is called retained earning in business science together with paid up capital or equity capital supplied initially in the way of share subscription form the shareholders' equity which is also popularly known as businesses' reserves. In many businesses share holders equity outweighs the debt capital they initially borrowed from the financial institutions. This type of businesses will be always in a better position than the rivals with lower equity and reserve base as far as the mitigation of cost of business is cornered. Many businesses, of course, dispense with the profit by giving out good cash dividend to the shareholders, normally the businesses which see no further scope for business expansion do so. The basic argument here is that when businesses can not use the money more gainfully, then the owners should have the money, and let the owners of business use their own money whatever way they like. When businesses see further prospects they can go raising more equity capital, either in the form of right share issue or bonus share issue.

By retaining the profit and by using repeated calls for additional capital businesses can go big. A big business can reap many benefits, such as economies of scale, developing brands, going outside its own territory, spending more money for everything related to business. At one time, the big business drives the small ones out of the market and then big businesses collude among themselves, and then reap almost a monopoly profit for the owners. Borrowed capital can not meet the needs of the capital when capital needs are to be permanent.

In the past, equity portion or permanent part of the capital was used to be supplied by one person who owned the business or by the members of his family. But big business needed big capital which one person or family members were unable to supply. There arose the need for market for capital. The market was there, but only for borrowed capital. Then came the concept of business with limited liability for those owners who preferred to remain inactive. The advent of public limited company type business offered the potential investors that option. Nowadays, thousands of members of the public supply the equity capital but they remain immune from liability. If businesses go bust the shareholders bear no liability. That gave rise to the way of putting together the big capital for big business. Now market for capital has become another important market in a market economy alongside other markets. A part or unit of business' permanent capital has become known as 'share' with the ordinary people. Out of many options people choose the option of investing in share with more expectation. To ordinary investors, shares and stocks are the same thing, though there is a difference based on text books' definition. Shares of a particular company together become known as its stock. That is why; the phrase stock market has come to be in use today. Today, stock market closely approximates the capital market. Stock market is that part of the financial market which is not only more exciting but also the most important part of it. Stock market is not to be the first market in a market economy; rather it follows the other markets. But once it comes into being and starts operating it leads the other markets, even the whole economy.

Today, all countries of the world have their own stock markets, by far the biggest and one of the oldest ones is the wall street's New York stock market, the other notables are London and Tokyo stock markets. All the former Soviet republics and all the former socialist countries have now stock markets. All Arab countries too have stock markets. For long, the Arab countries waited pondering over whether Islam approved stock market or not. Many Muslims thought stock market business is related to speculation and gambling which are prohibited in Islam. Finally, all the Muslim countries decided to have their stock markets. And now Arab stock markets are those belonging to the best performing ones in the world. With the rise of capital market everywhere the world suddenly experienced that there was no dearth of capital any more. Capital can flow from one country to another via stock markets so easily that a country with less capital can supplement its own capital with outside capital. In the recent years a revolution in financial engineering has taken place. New products have been made available to the investors. And also new tactics and new strategies are being chalked out everyday by the stock market players in order to beat their rivals in the market place. Regulatory framework has been strengthened, but stock market players devise new tactics to defeat the best of the regulations.

Bangladesh has also a stock market, but though started much earlier, remains a junior member of the world stock markets in term of size, depth and turn-over. Nobody counts Bangladesh stock market seriously, not even by the policy makers at home. It remained small in every respect. The main reasons were, for long the businesses in Bangladesh preferred to remain family oriented, the businessmen understood by capital as the borrowed money from the banks. Bangladesh market was kept protected from outside competition and small and family-owned businesses made a good profit. Whatever small foreign investment Bangladesh received over the years also made good profit taking advantage of the protection. So small a capital was needed for the business that the entrepreneur never bothered to raise equity capital through the stock market route. Things got started to change since the middle of eighties of the last century, some local and foreign businesses got listed with the stock exchange. But the market itself remained under the total grip of the Dhaka Stock Exchange members, who were also known as brokers. The brokers were the manager to the issue, underwriters, the placement takers and everything. They needed even no licence for doing these businesses from any regulatory body. The trading was under the cry-out system, at noon brokers used to assemble on the designated floor of the stock-exchange, auctioned the stocks and within few hours used to vanish into crowd.

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There were so many complaints against the brokers but there was none to hear. Controller of capital issue was the regulator in name only, it only permitted the issuance of capital but nothing else it did. After repeated demands from stakeholders, especially from small investors, government of Bangladesh finally set up a powerful regulatory body under the title "Securities and Exchange Commission" in 1993. But its initial performance was dismal. Under its very nose the worst scandal in the Bangladesh stock market history took place in 1996. The prices were pushed up sky rocketing through market manipulation. Market crushed suddenly, the un-informed and ill-informed small investors lost almost all their money overnight. In a very short period, 2/3rd of the value of the stocks they held simply evaporated. Blame game started but that could not compensate the loss of small investors. The famous British financial weekly the Economist wrote," The Slaughter of Innocents". The same weekly just a month earlier wrote, to make money someone should go to Dhaka. The members of the public faulted Securities and Exchange Commission for not protecting them. Everyone forgot everything as the time passed. However one good thing happened, after 1996 government of Bangladesh took reforms program at hand with the financial help from the Asian Development Bank. By 2000, many reforms were put in place -- the trading side of the bourses was separated from management side, brokers were required to take licence from the regulator, separate merchant banks licences were issued and so on. Now trading of stocks is done through a computerised automatic trading system, stocks are dematerialized through a central depository, markets have been spread all over Bangladesh. But after all these changes Bangladesh stock market is still smalls, only 263 companies raised their equity capital through this market. The total value of all stocks is slightly more than 8 billion dollars, which is only 9 percent of Bangladesh GDP. Of the 14 lac recorded investors, 3 to 4 lac investors are active, the rest are active only in the IPO (Initial Public Offering) market or what is known as the Primary market. Over the last few years the markets saw very few IPO coming, excepting few from banking and other financial sectors. The largest private sector company-The Grameenphone is still outside the market. Government needed money, but did not know how to sell shares from its state-owned enterprises through stock market. Bureaucracy in this case was always a discouraging factor. Private entrepreneurs are not interested to list their businesses with the stock exchanges, because they don't want to expose their businesses to public scrutiny. If their businesses remain private, they can hide many things, including the real profit.

No amount of incentives for listing with the stock exchange proved to be sufficient with entrepreneurs in this case.

Banks and other financial companies' stocks made up the most of the market value of the listed companies. The reason was: under the regulatory prescription financial companies, including the banks, must raise at least 50 percent of their equity capital from the market. For other types of companies there was no such compulsion.

Roughly one-third of the companies listed with stock exchanges are non- performers and they are placed under 'Z' category by the regulator, many entrepreneurs prefer to keep their companies under "Z" category simply to avoid paying dividends to the small shareholders as well as tax to the National Board of Revenues. Poor auditing standard is another vexing problem for the investors. Some auditing firms simply sign the audit reports and balance sheets of the companies as they are asked for by the promoting entrepreneurs. Most of the middle class people of Bangladesh with surplus incomes still prefer to invest in the fixed interest paying government owned saving certificates. Their other better option is to put the money in the banks' fixed accounts.

However, our stock market holds a tremendous potentiality. We are convinced, as the economy grows stock market will also grow and at one stage our stock market will outperform all other sectors of the economy.

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