

# Stockmarket conundrum

AF NESARUDDIN

After the Bangladesh stockmarket debacle in 1996, the market recovered gradually and had been growing steadily until 2008. In view lower rates of interest on bank deposits, tax-free income benefit, overseas remittance, fair rate of return on investments and lack of sufficient avenues for investment by individuals, investors were encouraged recently to invest more in the stockmarket. The market became reasonably stable until 2008. In 2010, the share price index started rising and it became abnormally high in late 2010 creating an alarming situation and a concern among the experts. From the first week of December, there was repeated falls in the stock prices and in the process, many investors incurred huge losses and market is yet to be stable. Ultimately, highest level of the government had to intervene to turn the situation to a tolerable level from the disaster. Among other issues, the government also formed an investigation committee to detect the market manipulation, if any.

Now the questions are why it happened, how it happened, who are responsible and how to bring the manipulators, if any, into books and protect such untoward happening in future for steady growth of the capital market. As already indicated, the government has already formed an investigation committee with specific terms of reference and we are looking forward to the findings of the committee. So, I will refrain myself from commenting in this regard.

Among other issues, it was observed that in recent times, initial public offerings (IPOs) were priced at a very higher level specially under book building method. With the high price of any IPO, investors try to come to a conclusion that price of existing shares in the same sector is undervalued and this perception may mislead them to buy at higher price. That is how market price of shares increased apart from manipulations, if any. In other words, when the price of an IPO is approved by the Securities and Exchange Commission (SEC), then a clear message is going to the market that the SEC has accorded approval after the required due diligence and scrutiny. So people specially the small investors can rely upon such valuation and judicious decision. For any reason, if the price is fixed at a higher side, among other things, it has apparently two direct impacts: a) investors are exposed to high risks of losing capital as well as insignificant rate of return on their investment, and b) price of shares in the same sector attracts higher price for no apparent reasons.

It is a common knowledge that both quantitative and qualitative fundamentals are considered for buying shares in the stockmarket. Future potentials are of course very important for valuing business and shares but this should not be the major criterion in valuing shares on IPO ignoring other fundamentals. Besides, in an uncertain market scenario like ours, this kind of approach



Investors are seen through a broken window during clashes in the commercial heart of Dhaka on February 14. Security personnel cracked down on investors after they pelted police with bricks, set fire to an office building and smashed scores of vehicles to protest a steep fall in share prices.

should not be considered as major criteria. Further, in our country, it is unfortunate that many of the sponsors of listed companies could not discharge their obligations properly towards small investors and in few cases, investors have been cheated and SEC's actions were not enough to change this culture to a remarkable level. In such a situation, pricing of IPO obviously deserve special attention of the SEC for a stable, growth oriented and healthy capital market.

Revaluation of fixed assets and restating net assets value (NAV) has become a common phenomenon in recent time to attract the high price for IPOs. In the absence of realisation of gain, in no way, it helps to increase and growth of business. This is merely a satisfaction of the owners to satisfy themselves as to the tangible value of the business and to impress upon the new comers (investors) indicating the NAV.

It has been noticed that before going for IPO, the auditors are changed. Change of auditors is not unusual and not always bad. The intention behind the change is important. If the change is aimed at ensuring quality, it is fine. Otherwise, the reason for change of auditors should strictly be reviewed including pre-change period financial performance of the company and qualifications

(observations) made by previous auditors.

Book building method is apparently a sophisticated and widely used concept but unfortunately, this method is being misused with some motive. It needs adequate efforts by regulatory agencies to customise it for implementation in Bangladesh context.

It must be taken into consideration that demand-supply gap is already in existence and there is huge demand of good shares in the capital market in Bangladesh. There are a number of companies outside the capital market having strong fundamentals and very good track records. Care should be taken to ensure entry of these good and potential shares into the market. At the same time, restrictions should be imposed and risky shares should be less privileged for IPO so that small shareholders do not lose money eventually. The SEC seating on the driver's chair should ensure this before they place it to general public for subscription. Experts also feel that there are rules and regulations but the question is whether these are applied and enforced properly and judiciously.

We appreciate that price of shares in the secondary market is difficult to control as it depends on demand and supply, rumours and unusual expectations of the investors. But SEC as the regu-

latory agency for capital market has a greater role to play in taking active regulatory steps and preventing manipulation of inflated IPO share price before it goes to public.

In addition, SEC has no doubt a great role to analyse the nature of recent IPOs -- how it was priced, how valuation of shares was done, whether the management has been able to achieve the business results as projected and whether the issuers have been using the money raised for the intended purposes as declared. Similarly, pending applications for IPOs also deserve such scrutiny so that it cannot be approved at higher price without the solid grounds and fundamentals. Finally, without leaving it to the market, considering the peculiarities of Bangladesh capital market and level of knowledge of new and small investors, SEC may also like to formulate a policy guideline and take regulatory steps for introducing a "blended price" of IPO at the bidding stage under book building method considering current business performance and earnings per share, realistic business forecast and also NAV focusing less on future forecast.

The writer is a chartered accountant and a partner of Hoda Vasi Chowdhury & Co.

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## BUTTONWOOD'S NOTEBOOK

# Contagion effect

THE ECONOMIST

The news from the Middle East suggests that 2011 will prove to be a year like 1989, when a number of regimes in one region are swept away. There seems to be a contagion effect, with news of unrest in one country inspiring protesters in another.

Equity and bond markets are also marked by these contagion effects with risky assets tending to move together, notably in 1987, 1998, 2002 and 2008. The benefits of diversification disappear in such circumstances as correlations move to 1.

Globalisation is often used as a catch-all term to describe these trends but I think that's a bit lazy; there was less globalisation (in terms of world trade) around in 1987 than in 2008. But there are some obvious factors that might make investors react simultaneously. The US has been such a dominant economy that any evidence that it is faltering is bound to affect other countries significantly; it might thus be rational for investors to treat a sharp fall on Wall Street (as on October 19, 1987) as signalling bad news elsewhere. Similarly, many countries tie their currencies to the dollar or see the dollar rate as a signal; thus a change in Fed interest rate policy that might alter the value of the dollar would also have international effects.

The post-1971 world has also seen the abandonment of many controls on capital and, as a consequence, the development of global banks and fund managers; as their attitudes to risk change, the effects will spill across borders.



Egyptians hold a picture of a man killed during the uprising that ousted president Hosni Mubarak at Cairo's Tahrir Square on February 18 during celebrations marking one week after Mubarak was forced out of office.

How might all this tie in to political turmoil? Some might point to the 24-hour news cycle, which translates news instantly round the globe, or to modern media like Facebook or Twitter. The problem in using the latter to explain cross-border politics is that this is not a new phenomenon. Back in 1848, regimes across Europe were swept aside in a wave of unrest; France lost a

King (only to gain an emperor as a result); Austria lost its political genius, Metternich; Germany almost achieved unity; Italy attempted to turf out the Hapsburgs. The nearest equivalent to tweeting, back then, was to send a message by carrier pigeon.

If there were economic causes of that revolt, they probably had a long gestation. This was an era of industrial-

isation, when the growth of factories was creating both an organised working class and a politically-conscious middle-class; Marx published the Communist manifesto in 1848.

Since the regimes of the day were aristocratic and monarchical, they had been in office a long time. There was no outlet to channel the discontent; no chance for opposing parties to take

power. So revolution was the only option. The same was true in 1989; it was clear communism was not delivering the promised living standards; and the ruling regimes were, by definition, responsible, since they brooked no opposition. Market setbacks also seem to follow a moment when one world view (the internet will boost stock valuations in perpetuity, house prices can never go down) seems to hold sway. This view pushed valuations to extremes; a change in view would inevitably have a substantial effect on prices, a revolution in market terms.

I would add a further factor. It is in the nature of dictatorial regimes to devote a lot of resources to oppression; this is economically inefficient. It also relies on drawing young men into the police and army; men drawn from the same class that is most likely to be discontented. When push comes to shove, rulers can find (as the Shah did in 1979, and Mubarak has just discovered) that their weapons of oppression don't work.

The Middle East regimes resemble those aristocratic regimes of 1848 and the communist regimes of 1989 in that they have been in power for a long time and that they seem to have been left behind in history. The turmoil spreads because so many countries have so much in common.

Let us hope things in the Middle East resemble 1989 more than 1848, when many of the revolutions fizzled out. Indeed, the world might have been a lot better place in the 20th century had Germany been united by 1848's liberals instead of by war and Bismarck in 1871.

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