

THIRD EYE

Demutualisation of stock exchanges



MAMUN RASHID

WE are witnessing a correction in our capital market. Although we can see street demonstrations and too much hue and cry about protecting small investors' interest, this is perhaps a good time even for the political regime to swallow the bitter pill than just before the election. However, how far this correction will help to remove manipulation or maneuvering in the "junk shares" or terribly overvalued ones without fundamentals, I am not quite sure. This is more related to bringing in overall corporate governance and accountability into the process including in the regulatory agencies, who also earned bad names in recent times including individual integrity issues.

The laundry list seems to be quite long, with demutualisation or segregation between brokers and management of the exchanges being at the top. I was particularly happy to note that both of our exchanges have in principle agreed to follow the demutualisation route, though timing has not been firmed up yet.

In 1993, the Stockholm Stock Exchange became the first exchange to demutualise. Since then, 21 exchanges in the developed markets have demutualised -- representing almost 40% of the membership of the World Federation of Exchanges. More are joining the bandwagon in the emerging markets.

Demutualisation can be defined as a process by which a mutually owned stock exchange is converted into a company owned one by shareholders through transforming its existing legal structure into a business corporation. In contrast, a mutual stock exchange is a non-profit, mutual organisation with monopoly power, owned by its members. Here, the owners are at the same time its clients who are

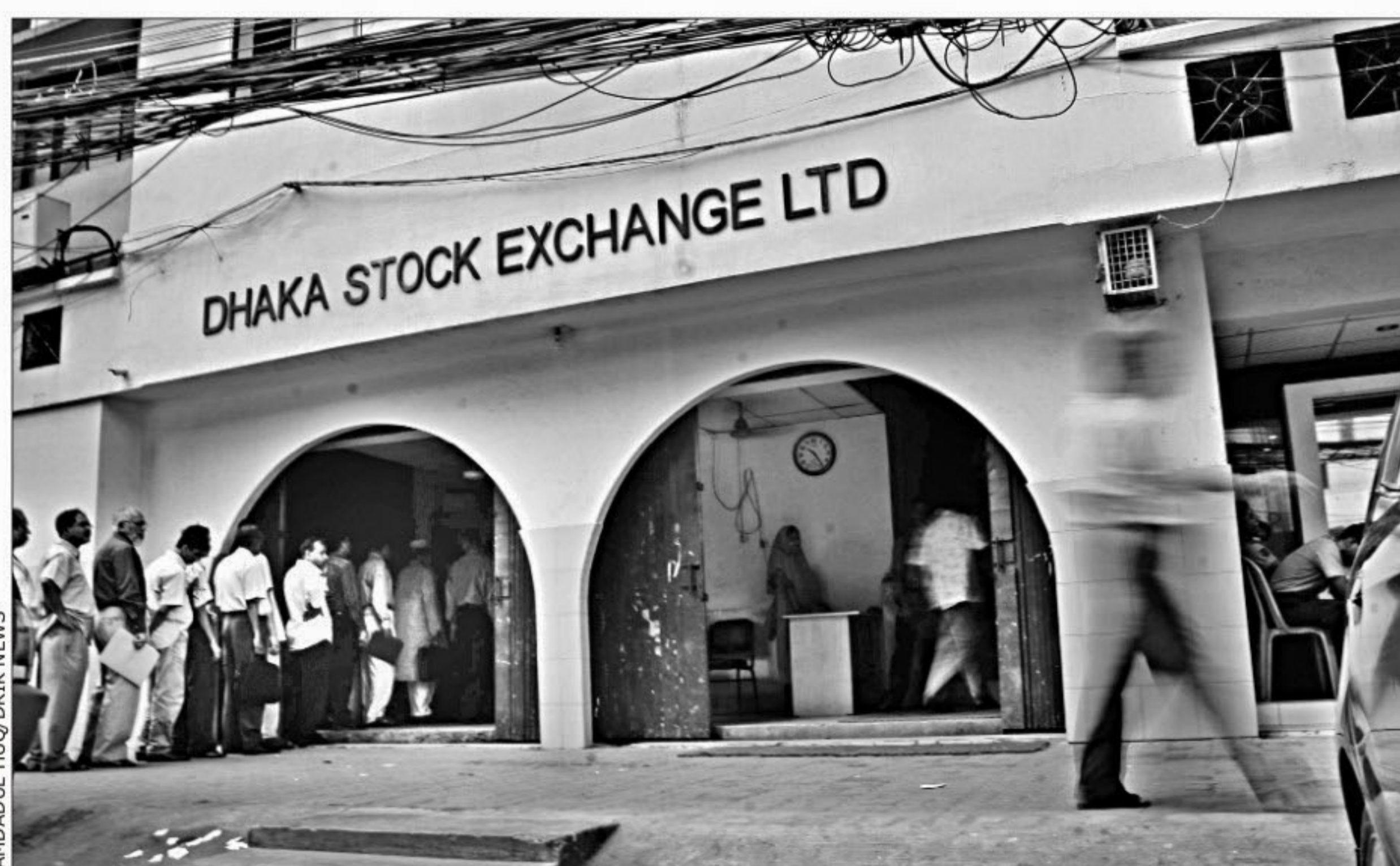
the end users of its trading services. They share the profits of the company, based on their stakes.

A demutualised stock exchange will provide most of the same services as a mutual stock exchange but a bit differently. A mutual stock exchange is owned by the members and most of the time it tends to favour the interest of the members only. This tendency at times does not recognise the rights of other stakeholders of the capital market. In a demutualised stock exchange, ownership is divided between members and outsiders. This is to some extent a balanced approach to remove conflicts of interest and advancing accountability.

A mutual stock exchange is unable to respond quickly and decisively (this point is clear when we take the recent decision-making process of our stock exchanges into cognisance). It acts well when the interests of all the stakeholders are more or less homogeneous. However, with diverse stakeholders' interests and dynamic business conditions, the consensus decision making of a mutual governance model becomes slow and cumbersome.

A demutualised stock exchange with a profit-oriented corporate model will enable management to take actions that are in the best interest of customers and the exchange itself. Above all, with the separation of ownership from its trading activities, there will be greater independence from its members regarding its regulatory functions.

Investor participation is a key advantage of a demutualised stock exchange. In a mutual structure stock exchange, only brokers/dealers may be the members; therefore, power shifting may not occur. A stock exchange has many stakeholders -- participating organisations, listed companies, institutional and retail/individual investors. A need to shift the power from



ANDADUL HUQ/DRIK NEWS

Demutualisation itself cannot solve all problems. We need to educate investors, owners, management and as such all stakeholders to adjust to the changed scenario and make best out of this.

one group of stakeholder to another within the stock exchange may arise.

Separating trading rights from ownership will make this shift occur easily and in a way which is more feasible economically and politically. Most importantly, attracting institutional investors and retaining them by accommodating their needs will be much easier as shifting of powers will occur automatically in a more flexible demutualised stock exchange. We must not forget that in a demutualised stock exchange, institutional investors are not only customers but can be potential investors too.

Demutualisation will also provide resources for investment. Researchers have already identified

the need for investment in our stock exchange infrastructure. An efficient capital market is defined as a market in which stock prices reflect all the information available to the market about future economic condition of the country and future profitability of the listed companies. To make this happen, an infrastructure of sound information system is essential, which requires a large amount of capital investment. Capital raised from an initial public offering (IPO) or a private placement of a stock exchange can provide an opportunity to invest in its information system and make it more market efficient.

Demutualisation in the developed market is mainly market-led. The objective is to be competitive and the initiative is led by the

exchange itself. By contrast, demutualisation in the emerging markets is largely policy-led and initiatives are mainly taken by the government.

Stock exchanges usually act as a self-regulator and their regulatory functions cover the areas of trading, market manipulation and members' activities. As after the demutualisation, stock exchange will become a profit-making organisation; there remains the possibility that regulatory functions may be compromised for the goal of maximising profit. After demutualisation there will be no members, there will either be customers or owners or both.

This problem of regulation exists even in a mutual stock exchange, though it may not be as severe as

that in a demutualised stock exchange, which is driven by profit maximisation. Creation of a separate regulatory entity can be a solution to this problem given demutualisation is policy-led and a financial council can be formed under the ministry of finance. Another solution which may be costly but will bring greater transparency is to outsource regulation to an independent third-party regulatory body.

Financial stability is another big challenge which needs to be covered. Revenues earned by the stock exchanges are mainly from membership subscription fees, transaction fees, service fees etc., and if a mutual stock exchange has deficits, it enjoys financial coverage from its government and other donor agencies.

As in emerging economies like Bangladesh, a mutual stock exchange is seen as an institution, serving national interest. The financial stability of a profit-making demutualised stock exchange is not granted by the structure itself. To avoid instability, liquidity and other financial ratios need to be closely monitored regularly to ensure a good financial health of the demutualised stock exchange. To be more secure and risk averse, a reserve fund can be created, which will act as a buffer against any financial shocks.

However, demutualisation itself cannot solve all problems. We need to educate investors, owners, management and as such all stakeholders to adjust to the changed scenario and make best out of this. We need to keep in mind specific issues pertaining to the overall economic and political environment in Bangladesh when implementing demutualisation and give it time to transition and settle into the system.

The writer is a banker and economic analyst. E-mail: mamun1960@gmail.com

Unfolding war

AKMAL HUSSAIN

THE cold blooded assassination of Minister Shahbaz Bhatti, following that of Governor Salmaan Taseer, has made apparent the modus operandi of the Taliban-Al Qaeda, in this, the latest phase of their war strategy: Target a prominent politician who explicitly opposes their extremist ideology on humanitarian grounds, pass a fatwa and then execute with telling efficiency.

The objective is to demonstrate

It is clear from their declarations as much as their systematic actions that the Taliban-Al Qaeda seek to capture the Pakistani state, or as large a part of it as they can.

that it is the Taliban-Al Qaeda ideology rather than the Constitution of Pakistan which defines what is acceptable. Equally, it is they who determine the guilt of an errant individual and the punishment to be given, rather than Pakistan's judiciary.

Conversely, through these assassinations the extremists are attempting to de-legitimise the government by showing that it has failed to protect the lives of its leaders, let alone ordinary citizens. What makes this failure endemic to the existing institutional structure is

that organs of the state itself, which are supposed to provide security to citizens, are undermining it.

This is illustrated by the statement of the Advocate General of Balochistan, General Salahuddin Mengal, in his reported statement before the Supreme Court recently: "We are recovering dead bodies, day in and day out, as the Frontier Constabulary and police are lifting people in broad day light at will, but we are helpless."

It is not surprising therefore that the Supreme Court in a recent court order observed, ".....the law and order situation is required to be tackled in accordance with the Constitution and it is the duty of the state including the Federal as well as Provincial governments to protect the lives and properties of the citizens in terms of Article 9 (Security of Person) without any discrimination."

The relationship between the state and citizens in the context of security is fraught because of another factor: The widespread perception that Pakistan's premier intelligence service, Inter-Services Intelligence (ISI), treats with kid gloves some of the deadliest extremist groups who were earlier nurtured as "strategic assets."

What then is the war strategy of the Taliban-Al Qaeda? It is clear from their declarations as much as their systematic actions that the Taliban-Al Qaeda seek to capture the Pakistani state, or as large a part of it as they can. Their strategy is informed by the classic principle of guerilla warfare: Undermine the will to fight of Pakistan's military, the government and their civilian support base.

They have attempted to achieve these goals in three phases: First, was to capture significant swathes of Pakistan's territory, initially in FATA and then the settled areas of Pakhtunkhwa province. In this

phase the extremists were driven back by the Pakistan military by what is regarded as one of the quickest and most efficient combat operations in the history of modern counter insurgency.

The second phase of Taliban-Al Qaeda strategy was to spread out to the major urban centres and establish sleeper cells there. At the same time, gun and suicide bomber attacks were mounted against key military, intelligence and police installations to undermine morale.

The third phase consisted of assassinating some of Pakistan's key political leaders, first Mohtarma Benazir Bhutto, then Governor Salmaan Taseer and now Minister Shahbaz Bhatti. This was combined with organising a propaganda apparatus with a national outreach, for capturing the ideological space. This was done by winning allies amongst elements in the media, madrassas, selected sectarian groups and some of the mainstream religious parties.

The danger to the state and society of Pakistan lies in three eventualities: (a) Continued violence reaches a point where governance is seen to collapse. This would create the possibility of a military managed formation of a "national government" dominated by right wing parties, with a representation for the Taliban, (b) Widespread mayhem through simultaneous terrorist attacks in key cities, as a prelude to an extremist counter revolution, and (c) A Mumbai-style attack against an Indian city which could trigger a devastating war between Pakistan and India.

The writing is on the wall. It is time for the democratic government and the security apparatus to get their act together to defend Pakistan and its people.

The writer is Distinguished Professor of Economics, Beaconhouse National University.

Day of the long knives

NEYAMAL BASHIR

MADAM Prime Minister, let us first talk about what the government's vendetta against Dr. Yunus is not about.

It is not about corruption. If it were, why have known corrupt individuals been left untouched in the last three years? Why are known bank defaulters so close to the government (and the media organisations reporting on the allegations)? Why is the Anti Corruption Commission (ACC) crippled to the point of neutering? Why has the government passed a parliamentary bill making government employees and sitting justices immune from ACC prosecution?

It is not about microfinance either. A significant part of the government's own poverty alleviation programmes are microfinance based. A majority of the registered NGOs' main job is micro-lending. We have not seen any reversal of microfinance policy of the government or NGO sector. Only Yunus is a "blood sucker" and all others are saints.

It is not about running Grameen Bank more efficiently either. Look at the crippled history of organisations run by the government of Bangladesh. Biman Bangladesh Airlines, Milk Vita, Bangladesh Railway, Sonali Bank, Bangladesh Jute Mills Corporation... oh, the list is so long, it breaks my heart

This is only about revenge. About breaking Yunus' back and wiping out his legacy, as payback

for his *ashpardha* in daring to enter politics in 2007. Teaching a lesson, and sending a clear signal, to all Bangladesh. No one goes against our two political parties, AL and BNP, and survives.

This is only about revenge. About breaking Yunus' back and wiping out his legacy, as payback for his "ashpardha" in daring to enter politics in 2007. Teaching a lesson, and sending a clear signal, to all Bangladesh. No one goes against our two political parties, AL and BNP, and survives.

There are reports you also feel slighted about not receiving a Nobel Prize for the 1997 CHT Peace Accord. I won't mention that if this had come to pass, the current non-implementation of the fourteen year old accord, and expanded Bengali settler programme and violence in CHT, would have been a bigger "Nobel scandal" than whether a loan came of use in Jobra or not. Encouraging you in this ven-

detta, at every step of the way, are the sycophants who always surround power, but who will also run away as soon as power is lost. A chorus of voices repeating honeyed words, and rushing to implement bad ideas and terrible plots. A flood of bad, crooked advice. Madam, Yunus is nothing, no one will remember him. Madam, he has no support. Madam, Nobel Prize winner, so what? Madam, we must finish him now.

Madam Prime Minister, your father Bangabandhu Sheikh Mujibur Rahman the Father of the Nation, led this country to independence. Our Bangladesh passport, the fluttering green and red flag, all came due your father. You don't need to rename China-Bangla Maitree Centre, create a new airport, insert his name into the Constitution, or pass any laws to remember and honour his unique role.

But your father had yes-men around him as well, and he also listened to them too much. He people who whispered similar type of advice, and ran to implement them. JSD has to be wiped out. Rakkhi Bahini has to be alternative to the army. Bhashani has to be marginalised. Tajuddin is becoming competition.

History shows that those sycophants guided your father into a disastrous direction, and on the day that he needed them the most, they were nowhere in sight.

The writer is a freelance writer and development researcher.