

# Capital market: structural problems & solution

MAROOF MOHSIN

The recent performance of the capital markets in Bangladesh, notably from December 2010 till February of 2011, has been very poor compared with its performance over the last five years. The index fell from a high of around 8,900 points to 5,200 points, a drop of almost 42 percent in just three months. Bangladesh capital markets have been in the top three best performing markets in the world over the last three years. However, its recent performance has cast a big doubt about its future performance. It is a case of "too much money chasing too few stocks".

This correction in the market has been long overdue because there was too much money in the stockmarket in too few stocks. This inflationary pressure was finally controlled by the central bank by raising its cash reserve ratio (CRR) and statutory liquidity ratio (SLR) thus resulting in limiting the liquidity flow into the capital market. The interbank call money rate (DIBOR Dhaka Interbank Offer Rate) went up by 189 percent. One of the main reasons for this was that the domestic banks had too much of their money invested in the stockmarket, for quick and easy profit taking and as a result caused the stockmarket to rise even higher. So, to control the excess money in the capital market the central bank took these drastic measures, as it is within their right to do so, to control inflation.

The problems of the capital markets in Bangladesh are structural, and, actually quite far-reaching than what meets the eye. As we all know, the capital markets here, notably the Dhaka Stock Exchange (DSE), is way overvalued due to, firstly, the DSE index calculations being incorrect. Secondly, there are big syndicates acting together to artificially influence the prices resulting in huge profits for them at the expense of the average investors who put in their hard earned lifetime savings. And last, but definitely not least, is the Securities and Exchange Commission (SEC) whose total policy and regulations favours the syndicates which primarily consists of high net worth people and the stock exchange members resulting in an "artificial demand driven market". Until and unless these fundamental issues are addressed the capital markets here will fail to see the light of the day.

So, if we look at the issues individually like the DSE Index, the syndicates, comprising of stock exchange members and the SEC we can find the common link, which is the stock exchanges and the SEC.



The recent debacle on the stockmarket has outraged small investors and fuelled street agitation.

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So the question arises, what do we do about them? The answer, my dear readers, rests with the question, which is to solve the problems at the two exchanges and the SEC and you will get a vibrant, dynamic and progressive capital market whereby all players involved starting from the stock exchange members and employees, firms wanting to raise capital. The SEC and most importantly the investors will enjoy the economic benefits because the markets will multiply enormously resulting in big profits for all trickling down to higher salaries, higher returns, dividends, more employment and capital market growth which in turn will attract more capital for our markets which in turn creates a virtuous cycle of wealth creation!

The solution is actually twofold. Firstly, there needs to be structural changes in the capital markets and secondly, there needs to be more supply of good companies getting listed.

Let's look at the structural changes first. What I mean by structural changes is, in essence, changes required at the DSE, CSE and the SEC. Let's look at the structural

changes at the stock exchanges first which can be brought about through demutualisation. Demutualisation is the process of transformation from members associations into for-profit corporations. Stock exchanges across the globe have rethought their business strategy and model due to the simultaneous convergence of a number of powerful developments in order to find ways of how best to survive. And, in the process the exchanges have evolved towards new corporate, legal and business models to strengthen governance and face competition through the process of demutualisation. Currently, the DSE and the CSE operate under a mutualised structure. Under demutualisation the mutual ownership structure will change to a share ownership structure. The process entails first converting memberships into shares, which may or may not be followed by a public issue. Ownership and trading privileges are effectively separated. Stockbrokers are no longer owners but customers of the exchange. Directors are elected by shareholders and answerable to them.

The reasons for demutualisation

are many but here are a few.

First and most importantly, in the case of Bangladesh, it is of rationalised governance. The corporate model of the exchange under demutualised structure will enable management to take actions that are in the best interests of customers and the exchange itself. With the separation of ownership and trading privileges, an exchange will achieve greater independence from its members with respect to its regulatory functions. There will be the requisite degree of transparency. Demutualised exchanges will be forced to account to their shareholders regarding the bottom line as well as corporate governance.

Secondly, there will be more investor participation. The new corporation will be more profit orientated due to shareholder accountability. Unlike a mutual structure where often only broker-dealers maybe members, a demutualised exchange affords both institutional and retail investors the opportunity to become shareholders. A demutualised exchange will have greater flexibility to accommodate the needs of institutional investors as customers, and potentially, as

owners.

Thirdly, it is the resources for capital investment. A competitive stock exchange must be able to respond quickly to global competitive forces and technological advances. With the capital raised from initial public offerings or private investment and a heightened awareness of accountability to stakeholders, a stock exchange should have both the incentive and the resources to invest in the competitiveness of its information systems. So to be competitive, products and services must not only be timely and cost effective, but also reliable.

The second part of the structural changes needs to be at the SEC of Bangladesh. The fundamental issue here is: what is the regulator doing to help minimise risk for the investors? The absolute minimum the SEC can ensure is to have risk minimising tools. As a first step they can introduce scrip netting facility, like financial netting currently allowed, which could be in the form of settlement of trades being T+0: T is for time and currently trades have a settlement period of T+3 which means that investors buying any stock will have

to wait three days before he can sell out his position. Next, they can introduce short selling whereby the investors has the facility to short sell if he thinks the price of stocks would fall and then buyback. By introducing these facilities it will allow investors to minimise risk as and increase liquidity as well. The SEC should also have a good surveillance system in place to ensure fair play. The introduction of equity derivatives should also most definitely be taken into serious consideration to minimise risk, as there are no instruments to do so.

Finally, the government of Bangladesh, who oversees the SEC, needs to ensure that the SEC as an organisation is run by more professional and credible people who has sound knowledge of the capital markets and its mechanisms. If that means hiring professionals from local or abroad and paying them attractive salaries then be it.

The second part of the solution is to have more companies being listed. This also applies to the government taking a dynamic approach in their privatisation manifesto and deregulating the economy so more of the state owned enterprises can be brought to the market which in turn would benefit the exchequer from more revenues. Investors would then have a wider selection of stocks to choose from thus making the former state-owned enterprises accountable to shareholder pressure and making them perform better.

Henceforth, we can see that, until and unless there are structural changes brought about in the capital market it will not grow. Artificially creating demand by pumping in more money in the capital market will only inflate the market temporarily before falling again. This will never solve the underlying fundamental problems. Whereas, when you open up the capital market by addressing its structural problems and bring in new products and regulations the market will grow, become more dynamic as capital flow will increase thereby increasing profitability for all. Good examples of demutualised and highly profitable exchanges can be seen all over the world like the LSE, NASDAQ, NYSE, EURONEXT to name just a few. These exchanges have evolved to such an extent that now the exchange business and the financial markets are in trillions of dollars! So Bangladesh needs to wake up, as the benefits are enormous!

The writer is the senior business development manager at Alliance Capital Asset Management Ltd.

# The greenest car you've likely never heard of

AFP, Greensburg

The greenest car you've likely never heard of will soon be hitting Honda showrooms across the United States as the Japanese automaker expands sales of its compressed natural gas powered Civic.

Honda has been quietly winning green car awards for more than a decade as it cautiously introduced the Civic GX first to government and business fleet owners and then retail customers in a handful of test markets.

The nationwide retail launch set for this fall comes as US President Barack Obama pushes for wider adoption of fuel-efficient vehicles -- including mandating that all federal cars will need to run on alternative, hybrid or electric power by 2015.

Potential customers could also be lured by substantial cost savings as oil prices climb amid tensions in the Middle East and natural gas prices fall in the wake of major new discoveries in the United States.

But the Civic GX enters a crowded field where new plug-in hybrid and fully electric cars -- the Chevy Volt and Nissan Leaf -- are grabbing headlines and zippy new compact cars offer competitive fuel economy.

Honda's goals are relatively modest -- doubling sales to around 4,000 vehicles in the first year of national sales while Nissan is hoping to hit annual US sales of 20,000 Leafs -- but it still thinks the GX can compete.

"We're asking the GX purchaser to make far fewer sacrifices than any other alternative fuel vehicle," Eric Rosenberg, who heads Honda's alternative fuel program in the United States.

"When you compare it to the Volt or Leaf, it's the most affordable, it has the best range and it



The decal of Honda's compress natural gas Civic GX is seen on a recently assembled car as it awaits final testing at the Japanese automaker's Greensburg, Indiana plant. The greenest car most people have likely never heard of will soon be hitting showrooms across the United States as Honda expands Civic GX sales beyond a handful of test markets.

AFP

has the quickest refill."

The GX can drive up to 250 miles (403 kilometers) on a single tank and only takes a few minutes to fill at public or home fueling station.

The Leaf has a range of 62 to 138 miles (100 to 222 kilometers) depending on road conditions and takes 30 minutes to partially charge at a quick-charge station and seven to 20 hours using

a standard 220 or 110 volt outlet.

GM's Volt can drive 25 to 50 miles (40 to 80 kilometers) on its battery before switching over to a gasoline-powered engine and takes four to ten hours to charge.

Honda's GX is also the cleanest car on the US market, according to the American Council for an Energy-Efficient Economy which looks at a vehi-

cle's total environmental impact.

That's because natural gas is a clean-burning fuel. It consists primarily of methane and emits about 30 percent less carbon dioxide and 70-90 percent less smog-forming particulates than gasoline.

Electric cars may emit nothing from the tailpipe, but they have a significant carbon footprint because 45 percent of US electricity is generated by coal. Their batteries also carry a heavy environmental toll.

Realtor and property manager Irma Vargas bought her first Civic GX in 2006 to save on fuel costs and get access to carpool lanes -- a perk that can cut a 90-minute commute in half in congested Los Angeles.

"Me and my business partner bought it and were going to take turns with it because it was a new idea," Vargas said in a telephone interview.

"We found that we were fighting over it, so he ended up getting the next year's model."

Vargas sold the GX to an employee so she could upgrade to a new model in 2008 and has convinced four of her friends and customers to buy one as well.

She figures she's saved thousands of dollars on fuel costs -- she can fill her GX at home for about a dollar a gallon while it costs nearly four dollars a gallon to fill her Lexus hybrid, which she saves for long trips and big shopping excursions.

But it will be years before the GX or electric cars are sold in sufficient numbers to make a significant dent in greenhouse gas emissions, cautioned Lonnie Miller, an analyst at auto research firm R. L. Polk.

"If you look at the traditional batch of gas-electric hybrids, it's 2.6 percent of all US new vehicle registrations," he told AFP.

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