



A 10-point plan for capital market development



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Bangladesh's capital market has long been entrapped in a vicious cycle of underdevelopment. The fact that the annual stock market turnover is less than 5 percent of GDP is a glaring indicator of this. The problems include prohibitive illiquidity of the market, the absence of bond and derivative markets, inefficient regulatory oversight, lack of corporate transparency and good governance, a fragile financial sector burdened with mounting non-performing assets, a worsening balance of payments (BOP) crisis and exchange rate volatility, and an environment of weak protection for investors.

While some problems are macroeconomic and more related to the central bank, others are relevant to the capital market regulator and are believed to be at the core of capital market underdevelopment in Bangladesh. In this short note, I will briefly explain a 10-point plan for capital market development in Bangladesh.

1) The Bangladesh Securities and Exchange Commission (BSEC), as the primary capital market regulator, must commit to ensuring free market arbitrage. This means that the regulator shall never impose price controls (neither floors nor caps), thereby restricting free and fair trading in securities in any organised stock exchange.

Free market arbitrage is a precondition for an efficient capital market. We observed that the regulator, in the face of market volatility, imposed artificial price control measures, directly impeding free arbitrage in securities. Every time such price controls were implemented, they caused long-term market illiquidity and harmed the interests of investors and capital market intermediaries. Such anti-market measures were often politically motivated and instigated by various misguided government agencies.

2) The BSEC must rewrite the public

issue rules, particularly ensuring a prudential framework for the public issue of equities, debt securities, quasi-debt securities, and financial derivatives. The public issue rules should require no fixed pricing of securities at face values, no opaque private placements without the exchange of fair considerations, and a minimum of 25 percent float. Any issue of debt securities should also undergo the standard process of public subscription, fair pricing, active trading on stock exchanges, and mandatory redemption at the end of tenors.

The approval process must be based on a few verifiable and highly relevant financial metrics. These include turnover, earnings before interest, taxes, depreciation, and amortisation (EBITDA), earnings before interest and taxes (EBIT), net profit after taxes (NPAT), cash flow from operations,

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- » The Bangladesh Securities and Exchange Commission must rewrite the public issue rules, particularly ensuring a prudential framework for the public issue of equities, debt securities, quasi-debt securities, and financial derivatives.
- » A prudential regulatory framework is imperative so that mergers and acquisitions (M&A) of companies can be implemented based on market pricing or fair valuation, supported by verifiable inputs.
- » It is imperative that the board of directors of stock exchanges comprise independent people with relevant skills and competencies.
- » A tax policy revision is necessary so that corporate tax rates for listed companies are always 10 percentage points lower than those for unlisted companies.

free cash flows, and a history of capital structure prior to the IPO application. No securities should be allowed to be listed unless the issuer company is complying with basic corporate governance regulations concerning the independence and integrity of corporate boards and board committees.

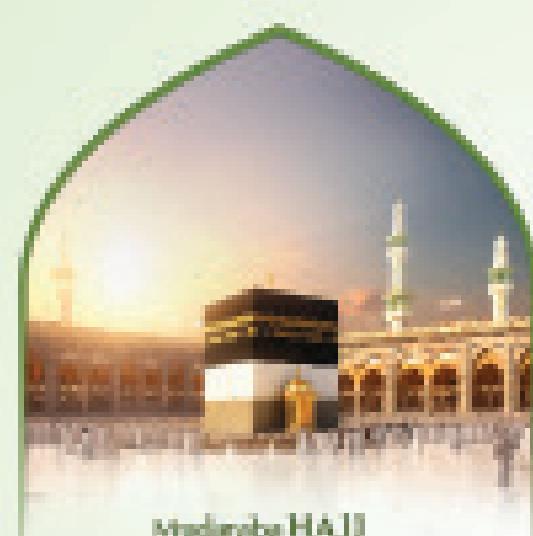
The functioning of the audit committee and the nomination and remuneration committee (NRC) is weak and unregulated. The extent of family control must be reduced in the board of directors of any company listed with stock exchanges. The accounting and reporting of related party

transactions is an area requiring enhanced oversight. The regulator should commit to discovering the fair value of securities to be listed with the stock exchanges. Unless and until entrepreneurs are guaranteed a fair valuation of their corporations, no well-governed business enterprise will voluntarily choose to be listed with the stock exchanges and be subject to enhanced compliance costs. The role of stock exchanges should be primary in the process of listing securities. And the role of the regulator should be solely regulatory, not operational.

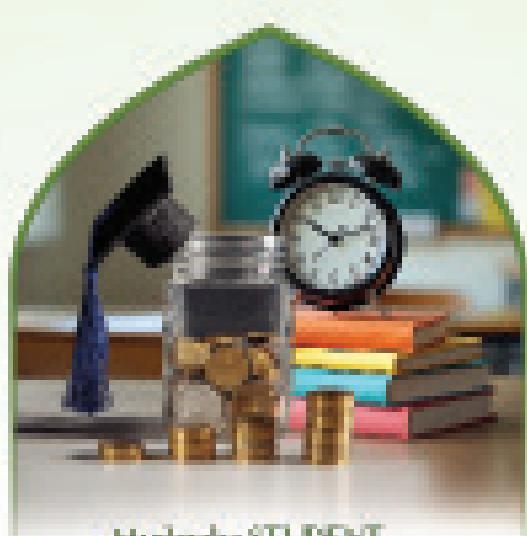
3) The capital market in Bangladesh is incomplete and underdeveloped. It is mostly an equity-based market with no secondary market for trading in corporate bonds and financial derivatives. An amendment to securities laws is required to allow for on-market share buybacks and executive compensation schemes in stocks and warrants, subject to prudential regulation and real-time disclosure. On-market share buyback regulation will act as an automatic stabiliser for the capital market.

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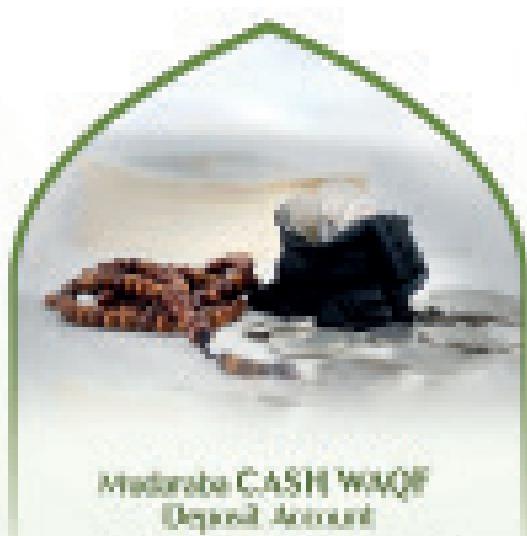
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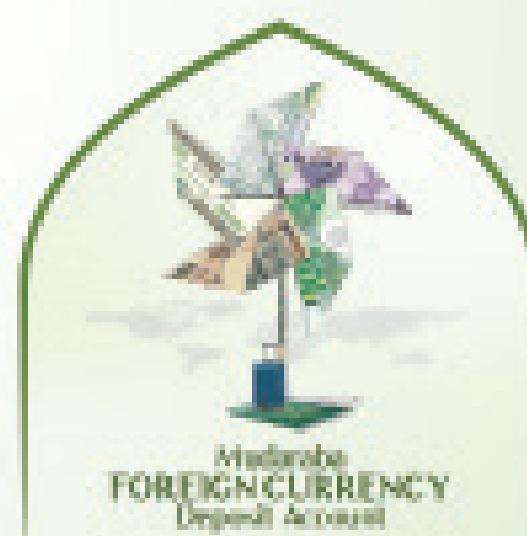
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