

Capital Market Debacle in Bangladesh: In-Depth Inspection

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Abstract

Recent turmoil in capital market after an era has reached its devastating pinnacle. Unpredictable market index and its dubious nature have demotivated thousands of small investors. Consequently, violent protest of the investors against the capitalist elites and the delinquency of market authority has been focused seemingly as criminal activities, once whoever was considered as accelerator of economic development. The current scenario resembles that of 1996, and the futile efforts of the market authority alongside with the government proved the failure of the economic system that promotes this bubble market. Once the bubble bust, the tricksters try to bring back the trust of the small investors in the name of adopting different regulations that again save the swindlers. Because of nosedive and abrupt upheaval in stock market, small investors are entrapped again and again; the fruits of the scam are favored to the elites. Different analysis was undergone finding the causes of this collapse and remedies were suggested but the charlatans could not treat the ailing market. Actually that's the capitalism-on the threshold of its decline, on international financial recession context masquerade the real panorama behind the crisis. In this article the real causes of the turbulence in the stock market will be revealed and the solution to overcome this trick-trap will be suggested.

1. Introduction

Capital market is the vital part of financial market and lifeblood of business and industry. It functions as the main source for raising capital. It provides long-term fund for industries and creates investment scope for the mass. Capital market plays a vital role in industrial, and thus overall economic, development of a country. Though our capital market was established long ago it gained momentum in the late '80s and early '90s. Overcoming the debacle of 1996, the capital market started functioning smoothly again, but has started behaving irrationally in the recent years. From last few years more and more common people were attracted to the capital market expecting quite a justifiable return over the last decade. In 1996 there were only three lakh BO (Beneficiary owner) account holders whereas today the number stands at an astonishing 35 lakh holders. Ninety percent of the present investors are small investors, and not only do a large number of investors, but also their families rely heavily for their living on the ups and downs of the market.

In the last two years, the market index increased from 2,795 points in December 2008 to 8,290 points at the end of 2010. On January 9, the index fell 600 points, and 600 points again the next day. The index increased by almost 1,000 points on the following day. Such ups and downs are totally unusual,

abnormal and unexpected. This turmoil in the stock market creates anarchy in the society as the small investors are highly affected by the unpredictable market fluctuation. The small investors' outburst and street vandalism creates panic among the prospective investors. Probe committee formed and report was published but the market fails to bring back the trust of the investors. So the deep inspection on the market and noteworthy solution to the investors are required.

2. Methodology

The Report on the capital market debacle in Bangladesh is a study that has been designed employing several methods. It integrates three components in assessing the current scenario of capital market in Bangladesh. These are: (i) Desk research and media survey, (ii) Dialogues and seminars; (iii) Focused Group Discussion and key Informant Interviews.

Much of the information in the report that follows was taken from open sources, including periodicals and academic journal articles, internet-based documents and media accounts. To ensure accuracy in the collection of data, we adopted standards and methods to form criteria for accepting data from open sources. In order to improve accuracy and reduce bias, we attempted to corroborate every piece of data collected from one secondary source with data from another source that was independent of the original source — that is, the second source did not quote the first source. The study surveyed 10 newspapers from July 2009 to June 2011 – namely, *Prothom Alo*, *The Daily Star*, *Independent*, *The Financial express*, *New Age*, *The Independent*, *Janakhantha*, *Jugantor*, *Sangbad* and *New Nation*. When using media sources, we checked subsequent reporting by the same publication to find out whether the subject was described in the same way as before. All the data and examples used by the media have been verified, and our findings have been validated through the rigorous application of survey and case study methods.

The study incorporated outcomes of 10 dialogues and seminars held from January 2009 to July 2011 in Bangladesh. Three focused group discussions (FGDs) and a number of Key Informant Interviews (KII) were conducted with investors, market experts, academics and media personnel to verify data culled from secondary sources, obtain information relevant to this report, and to refine the recommendations made on the basis of the research.

3. History of Capital Market in Bangladesh

Dhaka Stock Exchange was incorporated on 28th April, 1954 as the East Pakistan Stock Exchange Association Limited (EPSEAL) which started formal trading in 1965 at Narayangonj. Subsequently, in 1962 it was renamed as Dhaka Stock Exchange Ltd. after the shiftiness of Dhaka in 1958. Dhaka Stock Exchange Ltd. (DSE) suspended its trading and all administrative activities in 1971. After independence of the country its trading was resumed in 1976 with the changes in government policies with nine listed companies. Gradually the securities market in Bangladesh has been developing and another securities market in Chittagong, the commercial city of Bangladesh, started operation in 1995. Now both the markets are automatically operated.

The formula for calculating DSE all share price index was changed according to IFC in 1 November 1993. The automated trading was initiated in 10 August 1998. In 1 January 2001 was started. Central Depository System was initiated in 24 January 2004. As of November 16, 2009, the benchmark index of the Dhaka Stock Exchange (DSE) crossed 4000 points for the first time, setting another new high at 4148 points. The following table shows market is growing abnormally from 2006 to upward.

	2006	2007	2008	2009
Number of Listed Companies	310	350	412	443
Domestic Market Capitalization (in \$ million)	4673	10822	15400	19020
Value of Shares Traded (in \$ million)	NA	NA	NA	NA
Average Daily Turnover (in \$ million)	NA	NA	NA	NA
Average Value of Trades (in \$ thousand)	NA	NA	NA	NA
New Capital Raised from Initial Public Offerings (in \$ million)	24.2	67.6	44.2	4.9
New Capital Raised from Secondary Public Offerings (in \$ million)	NA	NA	NA	NA
Number of Trading Days	NA	NA	NA	NA
Turnover of Listed Securities (in \$ million)	1099.3	4707.9	9708.8	8186.6

Source: Market information-DSE website (up to June 2009)

4. Is Capital Market Investment Real?

Capitalist economy formed with two economies, or two types of markets: the first represents the real economy where the production, marketing and real services take place, and the second is the financial economy, which some refer to as the parasite economy, where the contriving, buying and selling of various financial papers takes place. Capital market is a market where long term financial instruments are traded. It is part of financial market alongside money market.

Financial instruments or papers are considered as binding contracts, or cheques or securities, representing a transferable right by one party that can be bought and sold, whether in a company property, its debts, government bonds or real estate or in many other (rights) certified by financial papers that are transferable, and considered as a temporary option to buy or sell another specific right at a price that differs from the current market price (e.g. options contracts).

All this has no direct connection whatsoever with the real economy. This parasite financial economy has grown to the point where the value of its transactions have exceeded those transactions undertaken in the real economy by manifolds.

5. Tricks of Stock Market

It is noteworthy that the stock market has turned into a big casino. Speculation dominates the stock markets with sharp and repeated fluctuations becoming a feature of the market. Banking system is considered as the chief calamity of the Capitalist economy. The banks managed to collect people's money under the name of deposits and to dispose of their money, as if they were the money of the banks and not the money of the depositors. They also managed to legitimize what they had collected in terms of funds from depositors by lending these funds to capitalists and businessmen, including traders in the stock markets, and also by lending money to the depositors themselves in some cases, then charging a guaranteed rate of interest for each loan.

However, this legitimizing process is only partial. This is so because the banks' owners, most of whom happen to be capitalists and their companies, are given priority in acquiring loans, and these loans are at a reduced rate of interest. Other capitalists and businessmen are second on the list under the pretext that the default risks are minimal. Finally come the small businessmen and consumers from among the common people. This bias is clearly reflected in the disparity of the interest rates applied

to each. In Bangladesh lending rate on consumer credit is 19.5%-20% and lending rate to capitalist is 10%-13%.

The capitalist elites, collaboration with their institutional investors and speculators control the market. They can make the market boom or they can create demand of a specific share. The speculators purchase at higher rate of a specific share and create demand of that share in the market. The small investors for getting capital gain rush to purchase that very share. When the demand of that share is high in the market, the speculators sell that shares at a high rate and amass capital from the market.

As huge numbers of that share available in the market, according to supply theory, the price falls alarmingly. The capitalist speculators exit the market with multiple times capital gain. The small investors are ultimate losers. This is the tricks of capital market like casino and gambling.

6. Apparent Causes of debacle in DSE

The double standards played by the watchdog of capital market. According to SEC's own rules, an investor cannot get loans from merchant banks, if he or she buys shares with price-earning ratio (something that reflect whether a share is overpriced or not -- the higher the ratio, the more overpriced the share is) of more than 40. But the recent IPOs that SEC approved through book building, belies its own wisdom.

- Book building is a way of asserting the price of a share. A small number of select investors bid for a portion of a company's shares and buy. That price then becomes the face value of the share. The companies which have come to the market or are waiting to be listed have indicative prices (the price that they got from book building process) which reflect price-earning ratios well above 40. This means they are all overpriced in SEC's eyes.
- Book building was also manipulated. A cartel with links to the company in question, deliberately bid at a higher price so that the share hits the market at a higher face value. Many of these shares later lost their value considerably to the loss of investors. And many of them rose even higher to the benefit of the manipulators.
- "Direct listing" was another trick that the companies played to hoodwink investors, and about which SEC played a dubious role. This system was first introduced for government companies that went public, but then SEC allowed private companies to raise money the same way. Under this, a share had a bottom price fixed and the upper price left unlimited. So manipulators had their own cartel start quoting the shares at astronomically high prices to lure unsuspecting investors. Strangely, the same SEC that allowed direct listing, stopped it for private companies after a while, as prices went mad. Then again it allowed two companies to go for direct listing, for reasons unknown.
- Issuance of preferential shares is another trick. A company would issue certificates for a certain period to an investor with the promise that after that timeframe, the investor would get a certain interest rate on the money paid for the certificate. He or she could then convert a part of the certificate into primary shares at the average market price prevailing in the last three months or so. The trick here was that the company would artificially keep its share price high through its syndicate and then sell the preferential shares at a higher price.
- Share Split played on the "psychological weakness" of retail investors and encouraged them to buy lower denominated shares that had a huge impact on the stock market. Split of shares affected the circuit breaker on share price movement.
- The apathetic attitude of the SEC to the market. The SEC's quick changes in decisions showed the regulator's weakness, which the manipulators used to their advantage.
- On right share, the report said issuance of such shares is legal either to fulfil regulatory requirements or raise capital for business expansion. On issuance of right shares, a

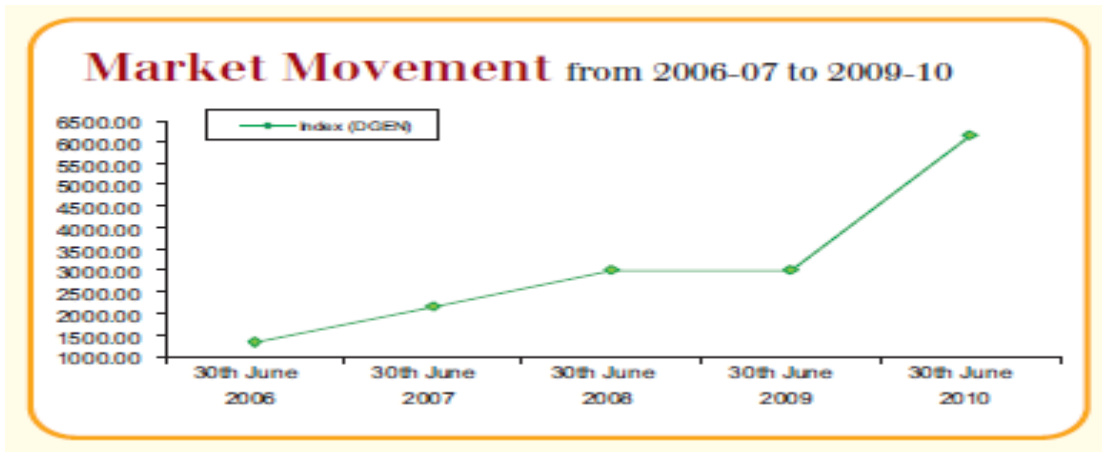
company's earnings per share are diluted as the number of shares gets increased. Although share prices are supposed to come down after that, the opposite happens on Bangladesh's capital market. The prices go up after issuance of right shares.

7. Apparent Solutions

- The home affairs ministry, in a move to maintain order in the stock market, asked the Dhaka Stock Exchange to strengthen its security system and introduce identity cards for investors.
- It also suggested installation of closed-circuit TV cameras in the areas near the Dhaka Stock Exchange leading up to Shapla Square in Motijheel to help the law enforcement agencies to maintain law and order. It also suggests increasing the number of security personnel inside the DSE.
- Create a “capital market crisis control centre”. A centre comprising a small, select group with implementation and monitoring powers should be formed immediately to work as the central co-ordination body. It should be entrusted with the responsibility to monitor SEC, DSE and CSE. It should also maintain secrecy and confidentiality.
- Create a centralized market stabilization fund. The size of the fund should at least be Tk2,000 crore. Pooled from government funds that are already allocated but remain unused (EEF, BIFF), and from institutions and individuals that profited in the last three years, the fund can provide quick and dynamic support to the market when needed. It will buy from the 'buy list' and selectively from outside (IPOs and fixed income) if necessary. It will also provide buying support to a list of shares under a certain price floor (for example, prevent GP shares from falling below Tk 175).
- Impose a uni-directional 'automatic' circuit breaker. It will prevent downward spiral in the market, and give regulators time to come up with and implement additional measures and help calm investors. But it should not be arbitrary, in which case, it may amplify panic.

8. Real Causes of the Debacle

- Stock market is a casino market. It is alike gambling. In gambling some will be winner and the others will be loser what is actually happening in the market. Where there is gambling, there is lose. Gambling market is always fluctuating in nature compare to other market, based on real production. The graph below explains the market fluctuation in recent years. After 2010, market nosedive clarify the gambling nature of the market to its investors.



Source: DSE Annual report 2009-10

- Economic freedom of the capitalist is the main reason of this crisis. The capitalists maximize their wealth by any means. They control the economy and investment of any country. Without investing in real production based economy they invest in this bubble economy to boost up their wealth in short time. Ultimately they rip off money from the market.
- Political system controlled by bourgeois is another cause of the crisis. The bourgeois are using their political power in financial market. They are malpractising in the capital market by working as syndicate and exploit the small investors.
- Apathetic attitude of the government to financial market. Government tries their best to solve the problems but responsible people involved with this system manipulate it. The government decision does not function properly.

9. Capitalism in Crisis Globally

Though capital market in Bangladesh in crisis now, over the globe from May 2009 to this time last year, the global financial crisis was in full swing. The US economy, where the crisis started, due to the sub-prime mortgage market collapse, was in freefall and close to its second quarter in recession.

The world's premier economies were all in recession and attempting to contain the fall out through the numerous stimulus plans, bailouts packages and nationalisations. The crisis that is now known as the 'great recession' was described as the worse financial crisis since the great depression of the 1930's and for this reason many began writing the obituary of the global free market system.

For long free market ideologues have argued financial crisis are cyclical - this means they are a naturally occurring phenomena. They claim historically due to time and nature all economies go through seasons where wealth is created leading to a boom with much wealth being generated. They considered it an inevitable matter that not all would benefit from a boom in an equal manner and once profits reached a particular level there would inherently be a slowdown in economic activity, which was considered necessary by some economists as this would lead to the redistribution of wealth.

So from this perspective a crash was necessary when during the ascent of the cycle wealth would not be distributed in equal manner. Thus after every crash, downturn, slump and recession free market ideologues blame nature for creating the business cycle. Due to this opinion gaining legitimacy the

financial crisis was separated from the 'market' and hence the systems legitimacy was never brought into question. As STRATFOR confirmed *"Financial panics are an integral part of Capitalism. So are economic recessions. The system generates them and it becomes stronger because of them. Like forest fires, they are painful when they occur, yet without them, the forest could not survive. They impose discipline, punishing the reckless and rewarding the cautious."*

10. Recommendations

- Banking system should be revitalized. The role of the banks in the stock markets is more dangerous than their role in the real economy. This is so because they lend the dealers of shares loans which exceed what they have in cash by manifolds. For instance, a share whose price in the stock market is \$100.00 can be bought with \$5.00 from the buyer's own cash and \$95.00 with money borrowed from the bank, or borrowed from brokerage houses who in turn borrow it from the bank. This means that this person who deals in the stock market can buy a number of shares whose price is twenty times more than his cash can buy. However, the bank does not lend this sort of money to anyone except the very wealthy capitalists, this means that only those persons would be able to multiply their purchasing power in the market, thanks to the banks, and consequently increase their influence over these markets and increase their wealth at the expense of the common people from among the depositors or the traders.
- Distribution of the wealth should be ensured. In public limited company' system, it is set up in the first instance to enable businessmen and their businesses to protect their huge capital against the creditors and others who have interests in the business, in the event that some of these business ventures fail. It also enables them to control the ordinary shareholders who invest in these businesses. The distinguishing characteristic of the public company is that it has limited liability; hence if its business fails and losses are incurred, those who have rights upon the company would not be able to claim anything back from the investors, regardless of the amount of their capital (shareholding). They would only be able to claim back what is left in the company in terms of its capital. In this system the capitalists maximize their wealth and the wealth is circulated among them.
- Values and Morality of the society should be improved. Only making profit even by manipulating others are the moral values of business in our society. Father of the capitalist economy Adam Smith told that the greed is the moral and this morality controls the economy. This is the existing values in our society which creates problem.
- Ethics in business should be maintained properly. Practically there is no ethics in business in Bangladesh. The business man can cheat, manipulate the consumers for their business gain. The syndicates increase price of necessary goods alike the capitalist who increase the price of share by tricks.
- Government should be more careful to the welfare of the people. Government is more concern with power rather than welfare of the people. If the government does not play responsible role to general people for economic growth and sustainability, this problem will occur repeatedly.
- Direct foreign investment should be filtered. From where the fund is infiltrating in our economy, where to invest, whether the tax is not paid regularly or not, it should be scrutinized.

11. Conclusion

The reason why such crises occur is due to the aims Capitalism attempts to achieve with the economy. A closer analysis shows that the foundations of Capitalism were never brought into question as all the debates that took place deflected such an issue. The global financial crisis was dealt with as a financial crisis in the banking sector which needed to be tackled; as a result the problem was seen to be with one economic sector rather than the system. So as in case of stock market-the foundation of the market is not questioned. As a result no discussion took place in the midst of the global financial crisis questioning the legitimacy of free market capitalism when it quite clearly had malfunctioned. So it is the capitalism –its economic system and financial market is the main causes of this market debacle and crisis.

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