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CAPITAL MARKET IN BANGLADESH: SOME RECENT TRENDS

Courtesy by: AIMS of Bangladesh Ltd

The capital market

Bangladesh capital market is quite small compared to both other regional markets and to the size of its economy. Though generally a capital market has two prongs, the stock market and the debt market, Bangladesh market has only stock market in active operation, as a debt market is still in its incipient stage. However, the stock market is also considerably small thanks to a conducive regulatory regime, lack of incentives and local business ethos. Since going public appears to be losing control over their creation by most of the entrepreneurs, who prefer running proprietary concern to corporatized public company, and as government fiscal measures act as a disincentive, few companies become interested to move to the capital market for raising capital. A proprietary concern may be taxed at individual rate, a private company at its double rate.

Among over 40,000 small and medium companies only 291 have become listed till April 30, 2007, of which 33 have been delisted in the past 15 years. Though the governments tried their best to attract the growing private companies to turn their enterprises into public limited and get listed to reap benefits and avail incentives offered time to time, on average only 10 companies have joined the market each year, and a large section of which is under regulatory compulsion.

Though industrialization has picked pace in Bangladesh almost three decades back, capital market has failed to attract the entrepreneurs as the key source of capital, which has usually been occupied by the banking system since beginning. That is why Bangladesh capital market has the lowest market capital as percentage of GDP in the region as well as other similar sized economies, as the following table shows, while its neighboring country India, sharing almost the same industrial history, has the highest:

Sl	Country	GDP Size	Market Capital of the listed stocks	Market Capital as Percentage of GDP
01.	South Korea	$886.00b	$824.00b	93.0%
02.	India	$750.00b	$810.00	108.0%
03.	Indonesia	$353.00b	$134.00b	38.0%
04.	Iran	$182.00b	$38.30b	21.0%
05.	Pakistan	$127.00b	$48.00b	41.0%
06.	Philippines	$117.00b	$73.70b	63.0%
07.	Bangladesh	$62.02b	$4.47b	7.5%
08.	Vietnam	$61.00b	$14.00b	23.0%

Stock Exchange Trends

The country's stock market, after the excruciating debacle in 1996, has been in a consistent trauma till mid 2004. As the DSE general index performance shows in the following table, the market peaked in December 2004 and came down but settled at well over 1,700 at present.

Period	2002	2003	2004	2005	2006	2007
January	749.11	807.60	961.18	1,843.95	1,643.34	1,805.12
February	768.04	806.92	953.81	1,835.62	1,531.44	1,791.54
March	795.05	750.84	973.88	1,919.25	1,491.77	1,760.88
April	763.70	787.94	1,112.19	1,537.87	1,361.27	1,743.33
May	752.91	791.70	1,185.83	1,648.28	1,355.04	
June	792.56	830.46	1,305.21	1,713.17	1,339.52	
July	874.57	799.98	1,289.14	1,510.11	1,406.81	

August	870.46	793.12	1,513.29	1,613.17	1,587.08	
September	874.22	788.89	1,633.02	1,649.05	1,562.53	
October	842.36	801.27	1,710.45	1,679.28	1,541.65	
November	845.08	920.61	1,882.63	1,694.42	1,527.30	
December	848.41	967.88	1,971.31	1,677.35	1,609.51	

The Stocks

At present there are some 320 listed securities of which 258 are equity, 14 mutual funds, 8 debentures and 40 treasury bonds listed with the country's prime bourse, the Dhaka Stock Exchange (DSE). The market is evidently predominated by the equity shares that constitute over 98% of the stock market. The following table shows the relative strength and share of the stocks in the market:

Type of securities	Number of stocks	Issued capital	Market capital	Net asset value
Equity stocks	92.14%	98.76%	98.86%	98.55%
Mutual funds	4.64%	1.07%	1.01%	1.39%
Debentures	2.86%	0.18%	0.13%	0.06%

Though in most countries mutual funds have a much larger share in the capital market, they could not do so in Bangladesh due to some inherent problems with the mutual fund industry. Despite there has been a mutual fund regulations since 1997 (later substituted by a rules in 2001), but since the state-owned agencies operate in an uneven playing field and are not within the domain of the said rules, none but a single private asset management company came forward. Besides, stringency of the mutual fund rules and lack of policy support from the regulatory body regarding quota in the primary shares also contributed to the cool response from the private sector. However, with the recent introduction of the 10% quota in IPOs for mutual funds would sure encourage more private AMCs to emerge.

The debentures market seems to have a different future, as failure to comply with the rules and lack of sincerity in commitment by some of the issuing companies have already ruined the confidence level of the investors in the market. These companies defaulted the payment of coupons, and sometimes failed to repay in time after redemption. There might not be an immediate recovery of the sector unless a new host of issuing companies comes forward with new products with guaranteed repayment.

Sectoral Dominance

The securities have been categorized in 16 different sectors. By number the largest sector is textiles under which so far some 44 companies have been categorized. Of these, some 5 companies have already been delisted. Banks and financial institutions come second with 39 companies, followed by food and allied industries with 36 companies and insurance companies with 32. However, banks and financial institutions together is the largest sector in terms of issued and market capital, net asset value, and almost all other market performance indicators.

There are several reasons for this. First, among the securities all banks are large in size and obliged to go public within three years after commencement of operations as per the existing laws. As the government policy was to maintain a minimum paid up capital for banks at Tk1.0 billion, which of late has been raised to Tk2.0 billion, and for nonbank financial institutions at Tk250 million, the 39-odd companies have together raised substantial capital in the market. While in comparison the average textile companies are usually relatively small in size from the very beginning, and also remained nearly unchanged. Thus we see that though price-earning ratio of the financial sector is larger (14.72%) than that of the textiles (12.57%), earning per share of the former (35.17%) outpaces the latter (12.81%) by large difference. The table below shows the comparative performance of the major sectors as on March 29, 2007:

Sector	Price earning ratio	Earning per share
Banks and financial institutions	14.72	35.70
Investment	8.09	38.28
Engineering	22.14	19.41
Food & allied	19.41	21.46
Fuel & power	21.66	28.20
Textiles	12.57	10.88

Pharmaceuticals & chemicals	12.04	78.89
Paper & printing	5.44	15.65
Service	9.83	5.51
Insurance	12.76	36.85
Miscellaneous	9.29	33.06
Dhaka Stock Exchange	14.48	32.20

In terms of earning per share, the pharmaceuticals and chemicals sector is the most attractive (78.89), as their price earning ratio (12.04) is also relatively smaller. Investments, the mutual funds, secure a second position in the same consideration with a sizeable earning per ratio of 38.28, as the recently introduced 10% quota in the IPO contributed to their earnings significantly during the past half year. Especially the private sector mutual funds have secured a telling earning per share of over 60% in less than a year, which pushed the entire sector up. As a result, a newly launched mutual fund by a state-owned agency fetched price over Tk360 against its face value of Tk100 with a lesser net asset value (NAV).

Though the banking sector is now most attractive to both the institutional and individual investors, its other precursor, the insurance sector, also fares quite well. With an earning per share of 36.85% and a price earning ratio of 12.76% the sector has so far 32 companies listed and more companies are in the queue to join soon under regulatory compulsion. Apart from a handful ones, most general and almost all life insurance companies usually pay good dividends, which keep the sector vibrant and attractive to the investors.

Apart from the above three leading sectors, pharmaceutical and chemicals, cement, engineering and textiles sector securities also offer good promise to the investors. However, some 40 blue chips in all these sectors, picked from both the Category-A (with good dividends and complying all regulations) and Category-N (new issues with good corporate history) shares, now make the mainstay of many of the portfolio managers' choices.

NRB Direct Investment

The nonresident Bangladeshis (NRBs) have increasingly been interested in the country's capital market, who over the past few years expressed more demand for fresh stocks. With introduction of a 10% quota for the NRBs in the initial public offerings (IPO), the demand has bee satiated to some extent. But is now quite evidently shown increasing. As per the available data the following amounts have been invested in the listed companies by the NRBs in the past 5 years:

Year	Amount in BDT	Amount in US$
2002	Tk 14.06m	$0.25m
2003	Tk135.18m	$2.33m
2004	Tk 47.39m	$0.80m
2005	Tk130.32m	$2.15m
2006	Tk279.06m	$4.21m
2007*	Tk244.08m	$3.54m

*Till April 30

Increasingly Crowded Primary Market

IPOs have never been so coveted as these are now, since most IPOs fetch lucrative market price during the first flush of trades. Though the number of IPOs is not consistent throughout the past decade due to various reasons, which ranged from 3 to 18, but the response was. Investors always craved for new shares, which they hoped to be good, even during the first few trades. That is why they oversubscribed almost all shares irrespective of their nature of business and the past performance. The fact can be substantiated from the ratio of oversubscription during the IPO, as appended below:

Year	No of IPOs	IPO Amount	Subscription Received	Oversubscription Ratio
2002	9	Tk 198.00m	Tk 938.19m	373.8%
2003	14	Tk1,376.17m	Tk26,305.70m	1,811.5%
2004	3	Tk 568.04m	Tk 6,233.40m	997.4%
2005	18	Tk3,207.00m	Tk15,917.36m	396.3%

2006	7	Tk1,980.86m	Tk14,534.17m	633.7%
2007*	4	Tk1,940.80m	Tk10,238.44m	527.5%

*Till April 30

The initial response in the market also shows that the pricing method is not yet mature enough to meet the demand of the day. However, recently there are debates that the shares should be offered at a fair market price instead of a universal face value of Tk10 or Tk100. Thus a book-building pricing strategy is now being under deep consideration by the market regulators to tap both the wholesale and retail investors, through which a more practical and a fair market price would be fixed during the initial offer before it comes to the market for general trading. A new rule is likely to be enacted on the system, whereby the merchant bankers and underwriters might be selected as the primary book runner to book the offer prices.

The lucrative primary market draws huge investors who now number over 750,000, as reflected by the staggering number of beneficiary owner's (BO) account. Besides, a large number of fake BO accounts had earlier been unearthed and cancelled time to time, which reflect the enthusiasm of the investors in the primary stocks.

Private Sector Spearheads the Mutual Funds

The mutual funds were first introduced by the state-owned investment agency Investment Corporation of Bangladesh (ICB) in 1980. It launched some 8 close-end and one unit fund till 2002, when it had to create 3 subsidiaries under an Asian Development Bank prescription, including the asset management company, which was entrusted with the responsibility to launch mutual funds under the SEC rules. This company has launched 3 close-end and 2 open-end mutual funds since 2003. Meanwhile, another state-owned lending agency, Bangladesh Shilpa Rin Sangstha (BSRS) launched its solitary mutual fund in 1997, which is run under its own statute.

Though mutual funds have emerged in Bangladesh three decades back, it was the couple of close-ended mutual funds launched by AIMS of Bangladesh Ltd that have elevated the sector to a new height. Established as the country's first asset management company (AMC) in 1999 by a group of expatriate Bangladeshi professionals, the company in 2000 mustered efforts to bring some 8 financial institutions to act as the sponsors of the first private sector mutual fund in the country.

The first fund, AIMS First Guaranteed Mutual Fund, with a size of Tk70 million carries a feature of capital guarantee. After the initial tenure of 5 years, the Fund for the first time in the country's capital market history, has its size doubled to Tk140 million and tenor enhanced by another 10 years with a reduced capital guarantee through an unanimous resolution by its unitholders.

The dour market situation and the restrictions worked to prevent a second private sector AMC to come forward with mutual funds. However, AIMS continued its efforts to bring a second mutual fund to the market. And in September 2005, it launched Grameen Mutual Fund One, another close-end fund with a size of Tk170 million, with Grameen Bank of the Nobel laureate Dr Muhammad Yunus as sponsors. The fund received an overwhelming 9.7 times oversubscription. It started in a relatively buoyed market, but soon precipitated lower due to dismal political developments at the national level. However, later the introduction of a quota in the IPO for mutual funds provided a new lease of life to the mutual funds.

As the only fund governed by the SEC mutual fund rules, the private sector- and the ICB subsidiary-managed funds had to operate under a number of restrictions and SEC guidance. First, the funds had to maintain the investment restrictions specified in the rules, in which it could not invest more than 10% of its assets in any single security, own more than 15% of paid-up capital of any company, invest more than 20% of shares, debentures or other securities of a single company, or invest more than 25% of its assets in any single industry. These prevented the fund to reap benefits for its investors by always investing in more lucrative companies in a single industry (for example, bank, cement, etc). Second, as per law these funds could not borrow, while all other older mutual funds could, during the high times of purchasing, which also deprived their investors of many investment opportunities. Third, there were no opportunities to invest in IPOs in substantial quantity until the end of 2006, for which the funds had to rely solely on the secondary market, which was volatile for a prolonged period. This also affected the optimum performance of these funds.

AIMS had long been trying to pursue the market regulators for a quota in IPO for the mutual funds for the interests of both the investors and the market as a whole. After years of persuasion, the SEC was finally considerate to promulgate the Public Issue Rules in 2006 that provided a 10% quota in IPOs for the registered mutual funds, which opened a new vista for small investors in Bangladesh. Though this unbundled investment opportunities for mutual funds, the quota was soon found loose to prolification by the state-owned investment agencies. The quota was offered only to the 'registered (with the SEC)' mutual funds, but the 9 mutual funds operated by the ICB and one by Bangladesh Shilpa Rin Sangstha (BSRS), which are run on their respective statutes with borrowed fund and not registered with the SEC, began to participate in the IPO quota, which marginalized the two private sector funds by AIMS and five by the ICB subsidiary.

The quota has allowed the mutual funds acquire a good number of shares in IPOs. But the situation may not remain the same in near future if more banks and NBFIs come in the market at a time. The reality with the present market capital composition in the DSE does not match with the restrictions imposed by the rules, as it tilts heavily on some particular industries, such as banks, insurance companies, etc. AIMS would have to redesign its strategic possession of these shares, which are usually promising if held for longer time, unless the SEC ponders deeply on revising the restrictions upward.

The older state-owned investment agencies are still out of purview of the SEC mutual fund rules, which allow them play in an uneven field, plunging the 'registered' mutual funds in disadvantage. First, their mutual funds have unlimited borrowing power, which marginalize the registered funds in competing the IPO quotas and acquisition of other shares in the primary market, as well as in the secondary one. This in turn damages the managerial capacity of these agencies, and gives a misleading performance scenario of the funds. The funds are also not bound by any quantitative restrictions on single company or industry. Second, they are not required to publish any NAV on regular basis, and have disbursed dividend while having negative NAV. Third, by allowing themselves sitting in the Board of public limited companies whose shares they acquire in substantial number, they have access to the privileged insider information, which not only distort their performance, but also the market as well. This further damages the already uneven playing field, and lead to deterioration in the mutual fund development in the country. Therefore, mutual fund industry may only flourish in an even playing field.