

## Reviving the Role of Regulators in Bangladesh Capital Market

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**Abstract:** The capital market is visualised as a tool for economic development through mobilisation of scattered resources and their allocation to appropriate areas. The liquidity, solvency and efficiency of the economic system of a country can be better accomplished by capital market, when the banks and financial institutions of the country are reluctant to provide long-term and medium term resources for industrialisation and privatisation. Banks have been traditionally major sources of all types of credits particularly industrial credits. Not only the banks these days are restricted to finance long-term credits due to short-term nature of the deposit- base of these banks, but also are struggling to overcome their liquidity problems. On the other hand, the development of financial institutions, the traditional suppliers of the long-term funds for private industry, is lying dormant due to the problems of profitability, liquidity and solvency of these institutions. Under this circumstances, the capital market beckons as the only major source of finance for industrialisation and privatisation. But the existing state of the capital market is hardly in a position to play as the mobiliser of resources for economic development. Therefore, the country's capital market needs structural change as well as proper regulation which are likely to improve the confidence of investors-both local and foreign and to boost the functions of capital market as well. The major regulators in Bangladesh capital market are Securities and Exchange Commission (SEC), Stock Exchanges, Registrar of Joint Stock Companies (RJSC) and ICB. In addition, the government has recently given permission to set up merchant banks to provide their support towards the growth, development and consolidation of capital market.

**Key words:** Role of regulators, Capital market, Bangladesh

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### Introduction

Capital market is recognised as a vehicle for rapid economic development through mobilisation of available resources in a country. But it was only since 1992, the capital market of Bangladesh started to be recognised as a source of finance for industry and business. With the success of big public issues in 1994 and 1995, investors took the capital market seriously as an alternative to money market as a source of financing. It is estimated that an aggregate amount of Tk. 20 billion has been raised against public issues, right issues and private placement of shares, debentures and other securities during 1992 through 1996 (The Financial Express, 1999). After that, the unprecedented market crash in 1996 has shaken the confidence of the investors and its impact is still lingering. Investors are the prime-movers of the capital market. Our main task is now to win back investors greater participation in the capital market as well as their confidence. Unfortunately, the lost confidence of the investors is yet to be restored. Some major developments, particularly the introduction of on line computer trading in country's two bourses, and also some organisational (internal) changes or-reforms have taken place since then. But these have not been sufficient enough to restore their confidence, until institutions like SEC, Stock Exchanges, market/ financial intermediaries, which are concerned with the development of the market revive their significant roles for the benefit of the investors. Keeping in view, the roles of regulators, the objective of this study is to provide some recommendation for improving the functions of regulatory bodies to bring back discipline as well as investors' confidence in Bangladesh capital market. In this context, the study is organised as follows. In the first part we have highlighted the roles of the regulatory bodies and in the second part, we have offered some recommendations for the improvement of the functions of regulatory bodies of Bangladesh capital market.

### Materials and Methods

This study is based on library research. No mathematical and analytical approaches are used here. The information on the report was collected from available relevant articles, journals, Bangladesh Economic Survey 2002 and daily newsstudys.

**Roles of the Regulatory institutions in the Capital Market of Bangladesh:** In order to stimulate rapid economic growth of a country particularly through industrialisation and mobilisation of domestic savings, appropriate institutions in the capital market are essential. The capital market in Bangladesh is governed by the following institutions.

**The Securities and Exchange Commission:** The Securities and Exchange Commission (SEC) was formed to supervise the securities market of Bangladesh in June 09, 1993. SEC is a dynamic body regulating the activities of capital market on the basis of introducing regulatory measures from time to time. SEC has been set up not only to control the capital market but also to give protection to investors (Tanber Ahmad Chawdhery, 1998). Capital market is regulated by the Securities and Exchange Ordinance 1969, the Securities and Exchange Commission Act 1993 and the Companies Act 1994 (Mansur Alam, 2002)and rules and regulations made there

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under.

**The Major Functions and Responsibilities of the SEC are:** (Ibid)Regulating the business of stock market  
Determination and regulation of the business of brokers, sub-brokers, share transfer agents, managers/ brokers to the issues, underwriters, portfolio managers, investment consultants and other middlemen related to security dealings.

Registration, control and management of mutual funds of joint fund schemes.

Development monitoring and control of self regulated bodies related to security dealings.

Prohibition of insider's fraudulent deals related to securities of security markets.

Prohibition of unauthorised trading.

Takeovers and management of companies and shares or stocks.

Spreading investment education.

Calling information from and inspection, investigation or audit of security issues, stock exchanges and related parties.

Carrying out research into and publication of information on security related matters.

### Stock Exchanges

**Dhaka Stock Exchange (DSE):** Dhaka stock exchange (DES), the first bourse of the country was established in 1954. It is regulated by its own regulations and run by its own Board comprising of nine elected councillors and three councillors nominated by the government.

**The Major Functions of DSE:** Provide listing rules to give assurance that the issuance of a company's securities has conformed to legal requirements.

Provide disclosure rules (The Financial Express, 1999).

Publication of monthly journal, showing performance of the market as well as listed companies.

Provide floor for transaction(Capital Market Development, 1994).

Ensure adequate volume of trade leading to liquidity.

Provide reasonable level of fairness in deal making and trading.

Registering, monitoring security prices.

Provide adequate instruments and technical aids for prompt and smooth trading (A. K. M. Tafzal Haque, 1996).

**Chittagong Stock Exchange (CSE):** Bangladesh government approved Chittagong Stock Exchange as a second bourse of the country on February 12, 1995, in order to accelerate industrial growth for overall benefit of the economy. Chittagong Stock Exchange was incorporated as public limited company on April 1, 1995. Since then, it has accomplished some innovative functions.

On June 30, 1997, CSE started automated trading system on Wide Area Network.

On June 02, 1998, it started screen based trading replacing the floor based cry out system.

On January 16, 2000 CSE established South Asian Federation of Exchanges.

Chittagong stock exchange is a self regulatory organisation. It has board of directors comprised of 24 members for policy formulation. Of 24 members, 12 are elected and 12 are nominated by SEC. In addition, it has independent secretariat for policy implementation.

**The Roles of Chittagong Stock Exchange:**The major role of Chittagong stock exchange is to create an effective, efficient and transparent market of international standard to save and invest in Bangladesh in order to facilitate the competent entrepreneurs to raise capital.

**Other Roles Are:** Seek explanation from the listed company(s) on any reasonable ground.

Delist any company for some specific reasons.

Extend time schedule for AGM/ EGM.

Observe AGM/ EGM time schedule.

It can take any legal action against the listed companies for violation of listing regulations or for not fulfilling the continuous listing requirements.

**The Registrar of Joint Stock Companies (RJSC):** This office, under the ministry of commerce, administers the registration of companies as specified in the companies Act. A Company files its memorandum and articles of association with the Registrar, who after assuring himself that all requirements have been met, issues a certificate of in-corporation. Every company with issued share capital must keep a list, update at least annually, showing its members and the number of shares held. Presumably the Registrar inspects the information filed with him (Ibid).

**The Investment Corporation of Bangladesh:** One of the dominant players of the financial market in Bangladesh is Investment Corporation of Bangladesh. The establishment of Investment Corporation of Bangladesh (ICB) on October 1, 1976, was a major step in a series of measures undertaken by the government to accelerate the pace of

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industrialisation and develop a well organised and vibrant capital market. (The Financial Express, 1999).

**The Major Activities of ICB are to:** Act as a catalytic agent to encourage and broaden the base of investors.

Develop the capital market through mobilising savings.

Provide financial assistance in the form of underwriting, issue of securities, IPO placement, trustee to debenture issue of IPO facilities over industrial projects/ companies.

ICB provides investment counsel to issuers and investors.

Participate in government dis-investment programme

Finance joint venture project.

Provide credit facilities to invest in IPO and in listed securities.

Manage eight close –end mutual funds and an open-end (unit fund) to mop savings and to support the stock market (Ibid).

CB is also playing a leading role in the stock exchanges. Since inception, ICB has been playing a dominant role to ensure a healthy and well organised secondary market.

**Lack of Market Intermediaries and the Role of Merchant Bank:** Market and market intermediaries play an important role in the development of the capital market. The goals of market intermediaries can be classified into two broad categories:

To facilitate capital formation, that is to channelise more funds.

To facilitate market transactions.

It is expected that market intermediary forces will play a pivotal role in strengthening the market under the present context of the capital market, battered by lack of investor's confidence. But the depressed situation in the capital market is still present, due to lack of or low quality of market intermediaries. Whenever any capital market face such a depression, the growth and development of the market is vitally dependent on supportive financial institutions. Merchant Banks are one of such institutions. Such Banks are the indispensable adjuncts of capital market. After the capital market debacle in 1996, it was strongly suggested to establish merchant banks to facilitate proper development of the capital market.

**Merchant Bank:** Merchant banking as a concept is relatively new in Bangladesh. In the Gazette Notification by the Securities and Exchange Commission (SEC) dated May 26, 1995, a merchant bank has been defined as the person who buys and sells securities and /or does portfolio management on behalf of its client, who carries on business of securities underwriting as an underwriter, who remain involved with securities as a manager or as an advisor in the business office management.

**Role of Merchant Banks :** Bearing in mind the functions of merchant banks, the government has given permission to 22 merchant banks to operate until now. They usually provide expert services which are not normally expected from the traditional banks- such as conducting market studies for clients about the prospect of initial public offering (IPO) of shares, preparing prospectuses and under writing shares (SEC, 1998).

**Other roles of the Merchant Banks are as Follows:** The merchant banks by being dominant financial intermediaries may induce savings and at the same time encourage investment.

Since the merchant banks are allowed to undertake a variety of functions, they tend to be more innovative by bringing into market new financial intermediaries to cater to the needs of investors with different risk and return perceptions. The merchant banks are much equipped due to their expertise, experience and financial positions, to handle the sophisticated needs arising out of globalization of capital market.

With regard to fund/asset management, the merchant banks are perhaps the most efficient due to their global positioning. These banks have the ability to constantly monitor the risk adjusted return offered by the securities market around the world.

For economic development merchant banks are especially important because these banks help a country to gain access to international capital market.

The merchant banks which manage huge investment funds (for example pension funds, mutual funds etc.) can play important roles in controlling stock market volatility.

The merchant banks, as corporate advisors, help companies in making their corporate and financial management policies to take advantage of market sentiments and demand.

## **Recommendations for the Improvement of Regulatory Bodies of Bangladesh Capital Market**

**Securities and Exchange Commission (SEC):** The Securities and exchange commission can play a vital role in the development of capital market by ensuring proper regulation and punish those transgressors who do not properly publish their financial statements and hold AGM in time. For this, the Securities and Exchange Commission Ordinance, 1969 and the Securities and Exchange Commission Act 1993 need amendments to strengthen the SEC.

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Listed companies accounts in many cases are poorly presented and not entirely reliable. International Accounting and auditing standards should be observed in the preparation of financial statement and in their audit.

To bring back investors confidence, the Securities and Exchange Commission must create an environment by ensuring proper disclosure in audited financial statements.

The commission must employ more resourceful, competent and qualified people.

Regulation should apply to all sales of securities, both public and private.

Although both the bourses of the country went on online trading from 1998, of them CSE began it in June while DSE in August, the heart of this automation system, the central depository system is still missing in our share trading system. It is necessary to set up this facility immediately to give investors a fuller sense of security. In the absence of such modern device, our market has failed to invite foreign investors.

SEC must stop abusive practices like false and misleading documents insider trading, commingling etc.

**Dhaka Stock Exchange (DSE):** DSE's listing rules are outdated and lack objectivity. Detailed provisions for listing and administration of listed stocks are needed to facilitate surveillance, and to enforce compliance of rules and regulations.

Activate DSE members by forming joint venture with foreign broke rage houses to improve capital base and technical know how.

**Enforcing regular holding of AGM:** Holding of AGMs (Annual General Meetings) by the companies in time must be made mandatory with no scope given to them under whatever pretext for delaying the same.

Enforcing regular declaration of dividend.

The minimum capital requirement of the stock-brokers/dealers should be raised from Tk. 1,00,000 to a reasonable amount in order to enable them to carry out stock-trading and market-related activities.

**Chittagong Stock Exchange (CSE):** Chittagong stock exchange is yet to prove itself to be a competent player of Bangladesh capital market. To make it more effective, the following recommendations can be put forward:

Attempt to cover more profitable companies under listing regulations.

Development of corporate governance to bring back investors confidence in capital market.

Tax exemption to investors, if they invested in publicly traded company.

**Investment Corporation of Bangladesh (ICB):** ICB's present program of bridge financing has to be improved. Because high yield (average 16%) both from bank and Government sponsored securities induced the institutional investors to purchase particular securities like defense saving certificate, national investment bonds and other approved securities.

ICB, which is holding large chunk of the securities of listed public companies including multinational should participate more actively in the stock market to increase trading in the securities market.

The corporation should operate as a buffer to stabilise the stock market so that the investors confidence in the stock market grows from strength to strength and their interests are protected.

Quotas/ concession offered to ICB need to be reviewed.

ICB should be made more private sector friendly.

There should be more open end mutual fund through which the small and medium savers get opportunity to invest their saving at any time of the year.

**Market Intermediaries and Merchant Bank:**The market intermediaries are not providing proper functions in the market. As a watch dog of capital market, the Securities and Exchange Commission should start making regulation regarding these intermediaries.

The newly established merchant banks have hardly made any impact on driving resources to the capital market. The Securities and Exchange Commission is entrusted with the responsibility of regulating the activities of merchant banks, therefore, the SEC should take the following initiatives:

If merchant banks do not perform their due roles, their registration should be cancelled. And new banks can be permitted to accomplish the job.

Organise a special cell in its office to look into the affairs of merchant banks with a view to aiding them as much as possible under the present condition.

Improvement of market situation, so that foreigners come forward to invest in Bangladeshi Stocks.

The merchant banks, on their part, are required to make special efforts for activating themselves in the market by properly manning their organisations with hands having experience and competence to handle their affairs with confidence.

## **Conclusion**

A strong capital market acts as a vehicle for growth of the economy. Therefore, it should be the joint responsibility of the regulators, the exchanges, Securities and Exchange Commission and the government to properly discharge their

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due roles. At the same time, there must also be adequate, update and relevant information flow from the listed companies to the investors at the joint initiatives of the stock exchanges and the SEC after checking and rechecking them properly. Concerned agencies should also educate the investors. In addition, investment facilities and law and order situation of the country need improvement. Although, the government has sophisticated plan but it has not been that effective for the revival of foreign investment.

Last but not the least, the market intermediaries including the financial intermediaries must discharged their responsibilities to boost the capital market. In addition, they are to build their image as a necessary alternative by maintaining a smooth relationship with their customers.

Keeping in view the objectives of capital market, the regulators need to be more cautious. Specific recommendation for improving the roles of regulators as provided in this study will go a long way in activating capital market and ensuring public confidence.

#### Appendix 1: Trading Performance of Dhaka Stock Exchange Securities

Year	Total Number of Securities (including Mutual Fund and Debentures)	Paid up capital and Debenture (In crore Tk.)	Market capitalization (In crore Tk.)	Total turnover (in crore Tk.) (year/month)	Share price Index
1994	170	1167.38	4177.87	429.00	846
1995	210	1983.98	5651.81	638.00	835
1996	205	2305.24	16810.62	3013.30	2300.15
1997	222	2820.78	7130.16	1740.34	756.78
1998	228	2862.57	5025.40	3436.84	540.22
1999	232	2877.46	4478.12	3896.44	487.77
2000	241	3119.20	6292.40	4036.48	642.68
2001	249	3345.43	6522.28	3986.93	817.79
2002 (Jan)	252	3407.18	6058.03	297.36	817.86
2002 (Feb)	252	3406.86	6218.97	190.02	818.28

Source: Bangladesh Economic Survey, 2002.

#### Appendix 2: Trading Performance of Chittagong Stock Exchange Securities

Year	Total Number of Securities (including Mutual Fund and Debentures)	Paid up capital and Debenture (in crore Tk.)	Market capitalization (In crore Tk.)	Total turnover (in crore Tk.) year/month)	Share price Index
1995	61	1036.80	2413.90	1.97	409.43
1996	117	1872.60	14704.30	608.90	1157.90
1997	141	2276.14	5583.23	854.51	332.98
1998	150	2418.03	4138.25	1403.60	232.80
1999	159	2508.09	3654.24	1153.79	197.83
2000	165	2726.60	5776.55	1293.38	1412.25
2001	177	2965.27	5636.35	1479.62	1836.87
2002 (Jan)	179	3010.46	5287.37	103	1836.64
2002 (Feb)	179	3008.32	5381.40	87	1837.29

Source: Bangladesh Economic Survey, 2002.

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