

# Bangladesh Economic Update

## *Capital Market*

March 2012



উন্নয়ন অন্বেষণ  
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The Innovators

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## 1. INTRODUCTION

The capital market of Bangladesh is the third largest in the South Asia and one of the smallest in Asia. There are two full-fledged automated stock exchanges: Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE). After many years of operations of the exchanges, the Bangladesh Securities and Exchange Commission (BSEC) was established in 1993 to regulate the businesses of the exchanges, ensure proper issuance of securities and compliance with laws and protect the interests of securities investors.

*In FY 2011-12, the turnover in DSE dropped to Tk. 117145.07 crore from Tk. 325879.77 crore of the previous FY of 2010-11, a rate of decrease by 65.05 percent.*

The current issue of the *Bangladesh Economic Update* makes an attempt to understand the reasons for the continuous fall in capital market. The main reasons for failing to revive confidence amongst investors are due to non-implementation of commitments made to resuscitate the market, failure in taking actions against the individuals involved in the crash, lack of zero-tolerance in regulatory oversights. These have manifested in inadequate supply of liquidity in the market. After the crush in the capital market in 2011, a continuous fall in turnover is observed, indicating over the time short in supply of liquidity in the capital market. In FY 2011-12, the turnover in DSE dropped to Tk. 117145.07 crore from Tk. 325879.77 crore of the previous FY of 2010-11, a rate of decrease by 65.05 percent.

The Unnayan Onneshan in its issue of Volume 2, No. 9, October 2011 of *Bangladesh Economic Update*<sup>1</sup> has discussed the reasons for crash of the market. The major findings of this issue were that individuals manipulated the crash in the market, as the mounting growth in the size of the market did not reflect the ground realities of the economy. For example, GDP and the market capitalization have not witnessed any significant correlation, indicating that the growth of the capital market has not matched the growth in the real economy. The market capitalisation exceeded the total investment of the economy. In FY 2009-10 and FY 2010-11, the market capitalisation and investment ratio were 134.29 percent and 116.13

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<sup>1</sup> [http://www.unnayan.org/reports/meu/oct\\_11/meu\\_Oct\\_2011.pdf](http://www.unnayan.org/reports/meu/oct_11/meu_Oct_2011.pdf)



percent respectively while the market capitalisation and investment ratio remained between 10 percent and 35 percent during the period of FY 1995-96 - FY 2006-07.

The present issue has focused three areas. The first section deals with recent development in the market by focusing on trends in market capitalization, investment capitalization ratio, turnover, volatility and the risk associated with capital market. The second investigates into two big crashes of the capital market and tries to identify the processes through which the so-called “game planners” materialized such crashes. The final section tries to find out the reasons for the failure in recovery.

## **2. RECENT DEVELOPMENTS IN CAPITAL MARKET**

The present most important problems of the capital market are lack of confidence of investors and lack liquidity of the capital market. After the crush of the capital market in 2011, a continuous fall in turnover has been observed, revealing the crisis of liquidity in the capital market since the collapse. In FY 2011-12, the turnover sunk to Tk. 117145.07 crore from Tk. 325879.77 crore in FY 2010-11, a reduction of Tk. 208734.7 crore, meaning a fall of 64 percentage. The prevailing contractionary monetary policy through high rate of interest along with government’s greater than before dependency on loans from the banking sector for financing public deficit have also weakened supply of liquidity into the capital market.

*In January 2013 total market capitalisation of DSE was Tk. 184545.2 crore, a less of 4.5 percent than that of previous fiscal year of 2011-12.*

In January 2013 total market capitalisation of DSE was Tk. 184545.2 crore, a less of 4.5 percent than that of previous fiscal year of 2011-12. In FY 2010-11, the market capitalisation was Tk. 232701.6 crore. In FY 2009-10, the turning year, saw the market capitalisation increased by 127.31 percent from the previous year and reached from Tk. 100143.3 crore in FY 2008-09 to Tk. 227640.8 crore in FY 2009-10. The increasing trend of market capitalization till FY 2011-12 states that the volume of value of capital stock has followed a positive trend, but after the crush the market capitalization starts to fall. There is no significant correlation is there between GDP and market capitalization. That means, the size of market capitalisation did not show any influence on GDP yet.

*In FY 2012-13, the market capitalisation and investment ratio witnessed a downward trend, reaching at 83.01 percent.*

In FY 2012-13, the market capitalisation and investment ratio witnessed a downward trend, reaching at 83.01 percent. This indicates the descent in ratio between capitalisation and investments, revealing a continuous fall in the capital market.

Sector wise performance of the market capitalization process has a clear implication of the growth process of capital market over the time. During FY 1995-96 the sectors which have directly influential role of real sector contributed the major market capitalization but in FY 2000-01 the scenario has turned to changed and financial sectors have started to contribute the major market capitalization and finally in FY 2010-11 the major sector wise contribution of market capitalization was banking sector. In this year, the banks, insurance including mutual funds jointly contributed 53 percent of the market capitalisation whereas pharmaceuticals and chemicals, textile industries, food and allied products and engineering contributed 21 percent jointly of total market capitalisation.

*The sector wise contribution of financial institutions fell down from 12 percent to 8 percent from FY 2010-11 to January, 2013.*

After the crush of the capital market in FY 2010-11, the components of financial sectors fell down significantly. The sector wise contribution of financial institutions fell down from 12 percent to 8 percent from FY 2010-11 to January, 2013. Moreover, continuous fall down in the contribution of banking sector is observable. From this time horizon, the falling rate of contribution in banking sector in market capitalisation is 2 percent which came down from 29 percent to 27 percent from FY 2010-11 to January 2013.

By analyzing different indicators of the capital market in 1996s it is clear that a single game planner played this game and in which there are less contribution of financial sectors in the process of market capitalization.

The trend of general index of DSE during capital market crash of 1996 showed that the price of general index share grew at a smooth rate from January 1995 to June 1996. In January 1995, the general index was 834.08 which became 959 in June, 1996. After this month, the game plan started and creating false demand probably, the price of index started to grow significantly.

On the other hand by analyzing different indicators of the capital market in 2011s it is clear that a group of game planner played this game and in which there are significant contribution of financial sectors in the process of market capitalization.

The percentage change of general index of DSE made an exceptional result in 2011 than that of the capital market crashes in 1996. This exceptional result occurred due to long time market volatility. In November 2009, the general index of DSE increased about 30.22 percent than the previous month.

After this consecutive twelve months, the general index rose on average 1 to 12 percent monthly. This long time growth of the capital market index made a greater confidence among general investors of the capital market. Consequently, in this period, no greater market price volatility of general index was observable. As a result, a continuous trend of a greater profit induced general investors to reinvest their profits along with additional capital. In this time, however, the long term game planners again won the game. They collected the liquid money from the capital market by selling the shares and therefore, the supply of shares increased and made the general index fall.

The government took many steps to address the continuous declining trend of the capital market like tax rebate of capital market investors, exemption of credit for marginal level investors as well as influence banks to generate more investment in capital market. But every steps have proven to be inefficient due lack of policy adjustments due to lack of confidence of investors, liquidity problem, regulatory problems and structural problems.

One of the major causes of the lack of confidence might be overvalued of the share price which has prevailed during before the crash of capital market. It was found that many of the new issues were overvalued and lost value in fast few month that are contrary to traditional ideas regarding IPO. As a result after crashing the market the value of these kinds of shares devalued significantly which is responsible for loss the confidence of the investors.

After crushing the capital market in 2011, a continuous fall in turnover indicates the crisis of liquidity of capital market over the time. In prevailing of contractionary monetary policy of the central bank, the interest rate increased and the liquidity crisis deepened in the banking sector. As the liquidity crisis further deepened in the financial sector, the ability of the investors to borrow and invest in shares rapidly declined and remained constrained. In times of a contractionary monetary policy, the rising price level always contributes to a liquidity crisis in the financial sector. Behind this, the government debt in banking sector has risen significantly from banking sector which created crowding out of private investment from capital market. Jointly, these reasons decline the confidence of the small investors as well.

Both the SEC and the stock exchanges failed to monitor the issue of IPO and rights shares. Overpricing through overstating EPS (earning per share) and NAV (net asset value) is still a problem. Non-compliance of the listed companies with the mandatory disclosure requirements is persistent. Audit opinions are not often

reliable. The SEC did not allow merchant banks to make forced-selling when share prices started falling. As a result the outcome is that both the merchant banks and the investors are now holding investments with heavy losses. The analysis shows that there was cartel in controlling the index of the capital market. Several research along with Ibrahim Khaled reported the specific persons as the ruling actors of the capital market crash but the scenario of the ‘game planners’ of this capital market, however, remained unspecified.

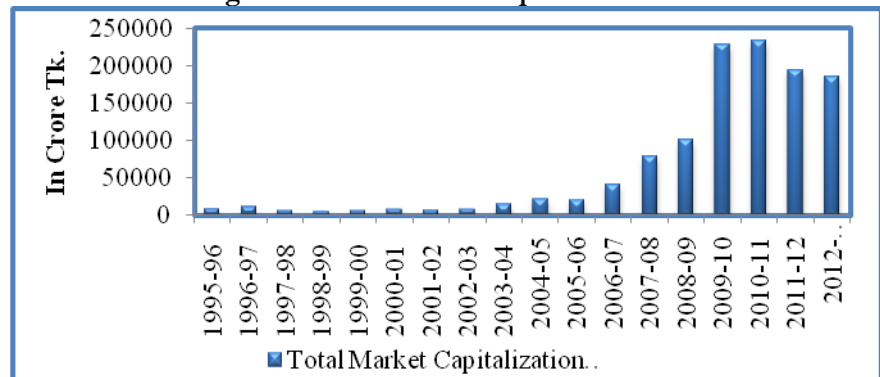
## 2.1 Market Capitalisation

The market capitalisation refers to the sum that derived from the current stock price per share times with the total number of shares outstanding. Although the market capitalisation of a company indicates the value of that company, it is only a temporary metric based on the current stock market. In terms of economic significance, the assumption behind market capitalisation is that market size is positively correlated with the ability to mobilize capital and diversify risk on an economy in a wide basis (Agarwal 2001).

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**Figure 1: Total Market Capitalization**



Source: Dhaka Stock Exchange (DSE)

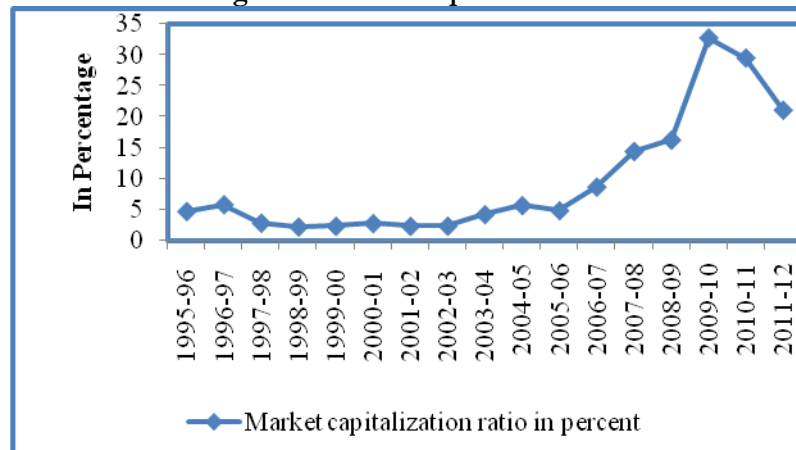
In FY 2010-11, the market capitalisation was Tk. 232701.6 crore. In FY 2009-10, the turning year, saw the market capitalisation increased by 127.31 percent from the previous year and reached from Tk. 100143.3 crore in FY 2008-09 to Tk. 227640.8 crore in FY 2009-10. The increasing trend of market capitalization till FY 2011-12 states that the volume of value of capital stock has followed a positive trend, but after the crush the market capitalization starts to fall.

## 2.2 Market Capitalisation Ratio

*In FY 2011-12, the market capitalisation ratio was 21.12 percent, which sharply declined from 29.55 percent of the previous FY 2010-11.*

Market capitalisation ratio equals the value of listed shares divided by gross domestic product (GDP). This ratio is often used as a measure of size of the stock market. In FY 2011-12, the market capitalisation ratio was 21.12 percent, which sharply declined from 29.55 percent of the previous FY 2010-11. Between FY 1995-96 and FY 2008-09, market capitalisation remained within four to 20 percent. In FY 1995-96, the rate of market capitalisation was 4.77 percent, which reached at 5.72 percent in FY 2004-05. After this period, the rate of market capitalisation increased and in FY 2008-09 the market capitalisation ratio reached at 16.29 percent. In FY 2009-10, however, market capitalisation ratio doubled than that of the previous year and reached at 32.79 percent.

**Figure 2: Market capitalisation ratio**



Source: Dhaka Stock Exchange (DSE)

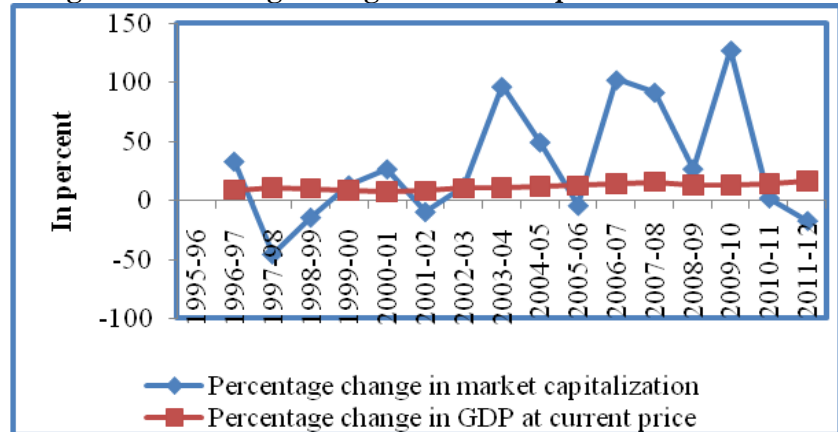
## 2.3 Relationship Between Capitalisation and Gross Domestic Product (GDP)

The market capitalisation to GDP ratio can be used as an indicator of market development. No significant correlation exists between GDP and market capitalization. That means the size of market capitalisation does not bear any significant relations with the growth of the economy.

The percentage change in GDP at current price illustrates a smooth shape whereas the percentage change in market capitalisation demonstrates an erratic trend of ups and downs. In FY 1996-97, the rate of growth in market capitalization was 33.26 percent whereas the rate of growth in GDP at current price was 8.64 percent.



**Figure 3: Percentage change in market capitalisation and GDP**



Source: Dhaka Stock Exchange (DSE)

*In FY 2012-13, the percentage change in GDP at current price was 16.16 percent whereas, the percentage changes in market capitalization faced a negative growth, reaching at 16.95 percent.*

Again in FY 2001-02, the market capitalisation witnessed a negative growth by 9.82 percent whereas the percentage change of GDP at current price was 7.75 percent. In FY 2010-11, the percentage change of market capitalization was 2.22 percent whereas the percentage change in GDP at current price was 13.42 percent. Finally in FY 2012-13, the percentage change in GDP at current price was 16.16 percent whereas, the percentage changes in market capitalization faced a negative growth, reaching at 16.95 percent.

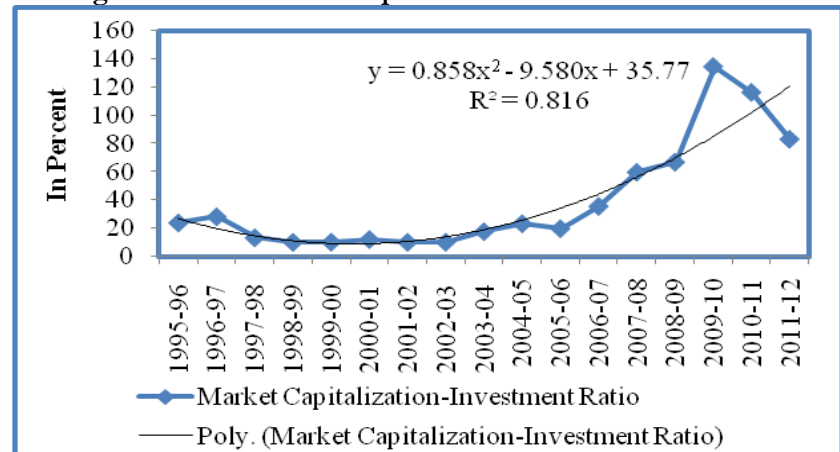
## 2.4 Market Capitalisation and Investment Ratio

*In FY 2011-12, the market capitalisation and investment ratio witnessed a downward trend, reaching at 83.01 percent.*

In FY 2011-12, the market capitalisation and investment ratio witnessed a downward trend, reaching at 83.01 percent. This indicates the descent in ratio between capitalisation and investments, revealing a continuous fall in the capital market. During FY 1995-96 to FY 2006-07, the market capitalisation and investment ratio persisted between 10 percent and 35 percent. Following that fiscal year in FY 2007-08, the scenario changed significantly and the ratio of the market capitalisation and investment increased with a high growth and reached 59.69 percent, indicating huge concentration in capital market than other forms of investment.

In FY 1995-96, the market capitalisation and investment ratio was 23.86 percent, which increased with an average rate of increasing growth of 1.12 percent in the following year and reached at 35 percent in FY 2006-07. In FY 2007-08, the market capitalisation and investment ratio increased to 59.69 percent, a 70.54 percent higher than that of the previous fiscal year. This increasing rate prevailed during FY 2009-10 and FY 2010-11 and the market capitalisation and investment ratio were 134.29 percent and 116.13 percent respectively.

**Figure 4: DSE Market Capitalisation and Investment Ratio**



*In FY 2012-13, market capitalisation and investment ratio became 83.01 percent, representing a plunge in the market.*

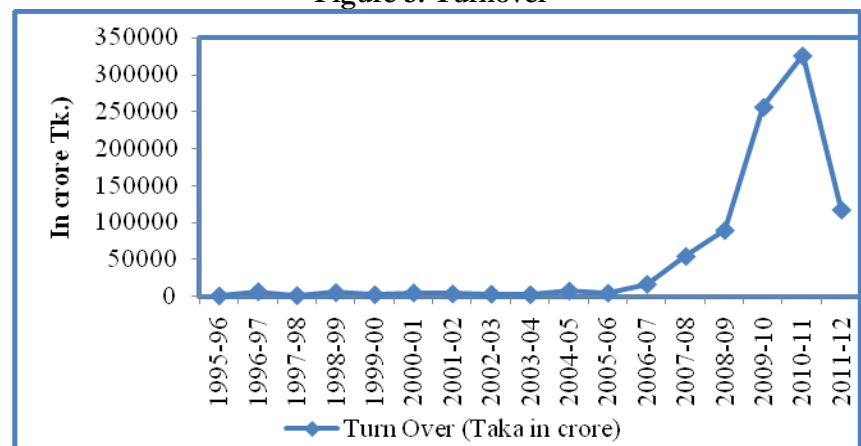
Source: Authors' calculation based on Dhaka Stock Exchange and Bangladesh Bank

During these years the market capitalisation exceeded the total investment of the economy. In FY 2012-13, market capitalisation and investment ratio became 83.01 percent, representing a plunge in the market.

## 2.5 Turnover

Turnover equals the value of total shares which is divided by the market capitalisation. High turnover is often used as an indicator of high level of liquidity. Turnover can also be used as the complements of total value traded ratio. (Mollik and Bepari) Whereas total value traded and GDP ratio captures trading compared with the size of the economy, turnover measures trading related to the size of the stock market. Therefore, a small, liquid market may have a high turnover ratio within a small total value traded and GDP ratio.

**Figure 5: Turnover**



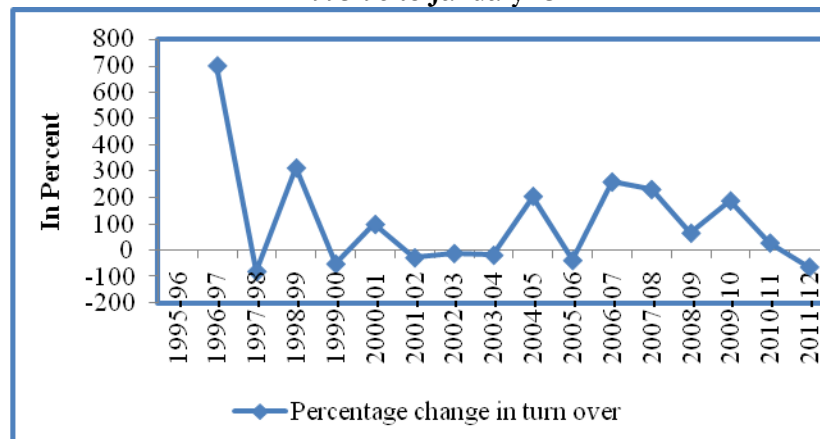
Source: Dhaka Stock Exchange (DSE)

*In FY 2011-12, the turnover sunk to Tk. 117145.07 crore from Tk. 325879.77 crore in FY 2010-11, a reduction of Tk. 208734.7 crore, meaning a fall of 64 percentage.*

After the crush of the capital market in 2011, a continuous fall in turnover has been observed, revealing the crisis of liquidity in the capital market since the collapse. In FY 2011-12, the turnover sunk to Tk. 117145.07 crore from Tk. 325879.77 crore in FY 2010-11, a reduction of Tk. 208734.7 crore, meaning a fall of 64 percentage. The prevailing contractionary monetary policy through high rate of interest along with government’s greater than before dependency on loans from the banking sector for financing public deficit have also weakened supply of liquidity into the capital market.

The extent of ups and downs in turnover of the capital market mainly depends on economic environment and others factors such as short term increase in profit than those of other economic activities. In calendar year 1996, the sudden increase in general index tempted the people, inducing them to invest more in the capital market. Therefore, in FY 1996-97, the turnover increased by 697.81 percent than the previous fiscal year. The ‘game planner’ associated with the artificial increase in the general price index achieved their goal by alluring general public to invest in the market.

**Figure 6: The percentage change of turnover of DSE during FY 1995-96 to January 13**



Source: Dhaka Stock Exchange (DSE)

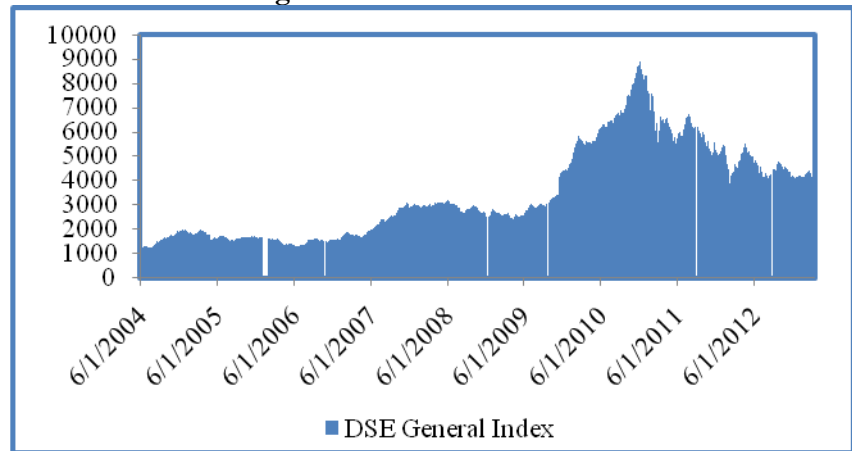
There has been a significant level of squeezes in liquidity in the capital market during this period. In FY 1995-96, the turnover of DSE was Tk. 819.91 crore whereas in FY 1996-97, this turnover reached at Tk. 6541.35 crore. ‘Fake’ demand augmentation mechanism during this period has led the general price index to move vertically and hence, increased the liquidity of capital market. The following year in FY 1997-98, the turnover reduced by a significant rate of 80.71 percent and reached at Tk.1261.6 crore. Again, in FY 2009-10, the turnover increased dramatically and reached at Tk. 256353.55 crore and it continued at Tk. 325879.77 in

FY 2010-11 and dropped to Tk. 117145.07 crore in FY 2011-12 by 64.05 percent.

## 2.6 Capital Market Volatility

Volatility is a measurement of the degree of price movements of a stock. It shows how active a stock price typically is over a certain period of time. In general, the volatility of stock is determined by the fluctuations in stock index. Fluctuation in the stock index also depends on the demand and supply of securities traded in a stock exchange. The market estimate of volatility can be used as the barometer of the vulnerability of the stock market. Stock return volatility represents the variability of day-to-day stock price changes over a period of time, which is taken as a measure of risk by the relevant agents. High volatility, unaccompanied by any change in the real situation, may lead to a general erosion on the confidence of investors in the market and redirect the flow of capital away from the stock market. The excessive level of volatility also reduces the usefulness of stock price as a reflector of the real worth of the firm.

**Figure 7: DSE General Index**



Source: Dhaka Stock Exchange (DSE)

The volatility in stock return in DSE seems to follow clustering at particular points; there are periods of high volatility followed by periods of low volatility. Many events and random shocks are responsible for the index price fluctuations. For example, declaration of lucrative incentives in the national budget of FY 2003-04, floatation of shares of some profitable companies through Initial Public Offer (IPO) along with several important reform measures initiated by the Securities and Exchange Commission (SEC) helped allure the investors back to the capital market.



*In FY 2012-13, the volatility followed a declining trend.*

The downward drive of capital market in 1996 had been created by fake demand mechanism resulting to short term price volatility in the capital market. In FY 2010-11, the ‘game plan’ was different from 1996 and the index volatility has a similar shape for a sudden time (about one year) before the downturn of the market. In FY 2012-13, however, the volatility followed a declining trend. From the above analysis it is clear that DSE index movement was not normal and the fall was so abrupt that it caused huge loss for investors.

## 2.7 Capital Market Size

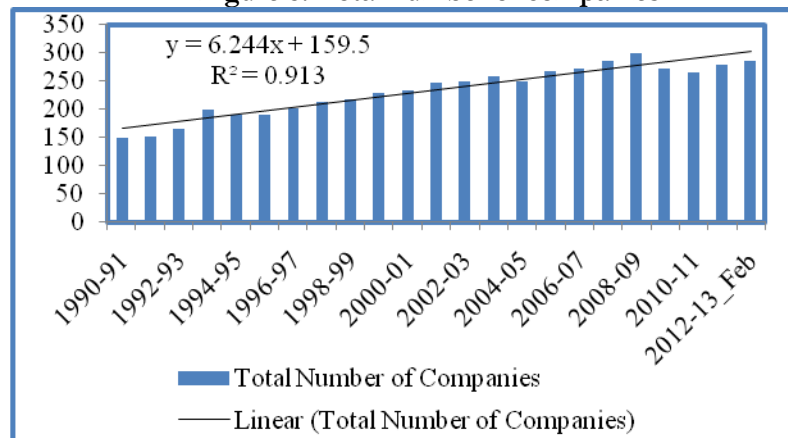
One of the important indicators of capital market is the number of its listed companies. The rationale of including this measure is that as the number of listed company increases, available securities and trading volume rises as well. Based on the properties of the companies, the companies are divided into five groups; A, B, G, N and Z. The properties of these companies are shown here (Table-1).

**Table1: Capital market company category and characteristics**

| Company  | Properties  |
|----------|---|
| <b>A</b> | Holding Annual Meetings (AGM) and have declared dividend at the rate 10 percent or more in a calendar year      |
| <b>B</b> | Holding Annual Meetings (AGM) and have declared dividend less at the rate 10 percent or more in a calendar year |
| <b>G</b> | Greenfield companies.   |
| <b>N</b> | All new listed companies except Greenfield companies.   |
| <b>Z</b> | Have failed to hold the AGM or fail to declare any dividend or which are not in operation continuously.         |

Source: Dhaka Stock Exchange (DSE)

**Figure 8: Total number of companies**



Source: Dhaka Stock Exchange (DSE)

*The number of the listed company grew from 149 in FY 1990-91 to 286 in February, FY 2012-13 with an average annual rate of growth of 3.01.*

In February, FY 2012-13, the number of DSE listed company was 286. The number of the listed company grew from 149 in FY 1990-91 to 286 in February, FY 2012-13 with an average annual rate of growth of 3.01 and a standard deviation of 44.32. In FY 1990-91, the number of listed companies of DSE was 149 whereas in FY 2001-02, the number of listed companies increased to 248. The rationale of including this measure is that as the number of listed company increases that reveals available securities and trading volume also increases.

The descriptive statistics of the total listed companies in DSE showed that the minimum and maximum numbers of listed companies of DSE were 149 and 300 respectively. The average mean value of listed companies was 234 based on the last twenty three year's information. The standard deviation of the number of listed companies was 44.32 (Table 2). The high level of standard deviation means there is significant level of volatility exists in case of listed companies in DSE.

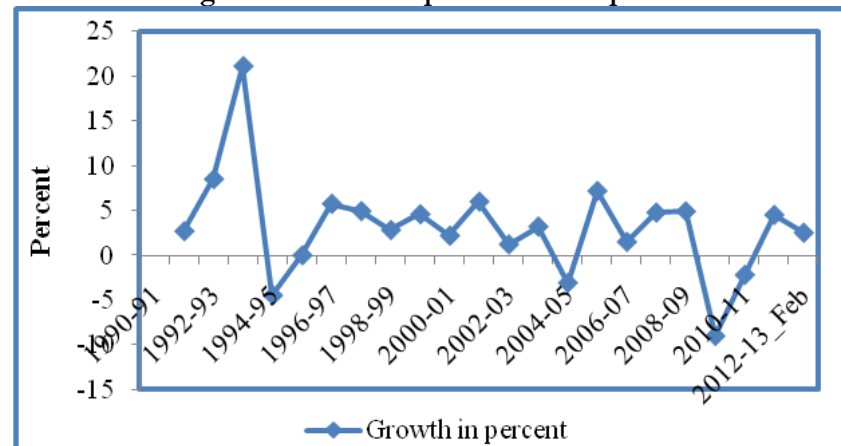
**Table2: Descriptive statistics of listed companies of DSE**

|                     | N  | Minimum | Maximum | Mean   | Std. Deviation |
|---------------------|----|---------|---------|--------|----------------|
| Listed Companies    | 23 | 149     | 300     | 234.48 | 44.322         |
| Valid N (List wise) | 23 |         |         |        |                |

Source: Author's calculation based on data of DSE

In FY 1991-92, the number of listed companies increased to 2.68 percent whereas in FY 1994-95; the number of listed companies decreased to 4.47 percent. In FY 2009-10, the number of listed companies of DSE decreased from 300 to 273, about 9 percent less than the previous year.

**Figure 9: Growth in percent of companies**



Source: Author's calculation based on data of DSE

## 2.8 Sector Wise Performance

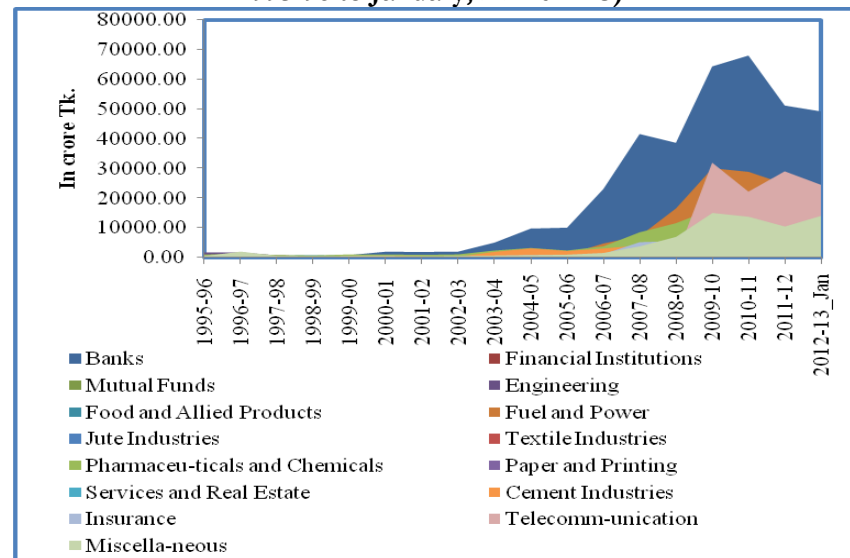
Sector wise performance of the market capitalization process has a clear implication of the growth process of capital market over time. Till FY 1995-96 the sectors, which were directly related to real economy, contributed the major market capitalization but the scenario has changed since FY 2000-01, with the financial sectors contributing the major market capitalization. Since FY 2010-11 the banking sector emerged as the major sector in terms of contribution of market capitalization.

*In January 2013, a declined trend of market capitalisation was witnessed for the banking sector, reaching at Tk. 49251.80 crore, a sharp drop Tk. 1986.9 crore than in FY 2011-12 in which year the banking sector contributed a total amount of Tk. 51238.60 crore. On the basis of market capitalisation in ordinary shares of companies listed with DSE, total market capitalization of banking sector in FY 2010-11 was Tk. 68061.9 crore which was 5.67 percent higher than that of previous fiscal year.*

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In this FY 2010-11, total market capitalisation of mutual fund was Tk. 3595.5 crore which was Tk. 3588.10 crore in FY 2011-12. Generally, the investment in mutual fund is assumed to be safe investment due to volatility in capital market but the market capitalisation of mutual fund was comparatively lower than the other sector. In FY 2010-11, the market capitalisation of fuel and power sector was Tk. 28931.4 crore which was 4 percent lower than that of previous fiscal year.

**Figure 10: Sector-wise contribution in market capitalisation (FY 1995-96 to January, FY 2012-13)**

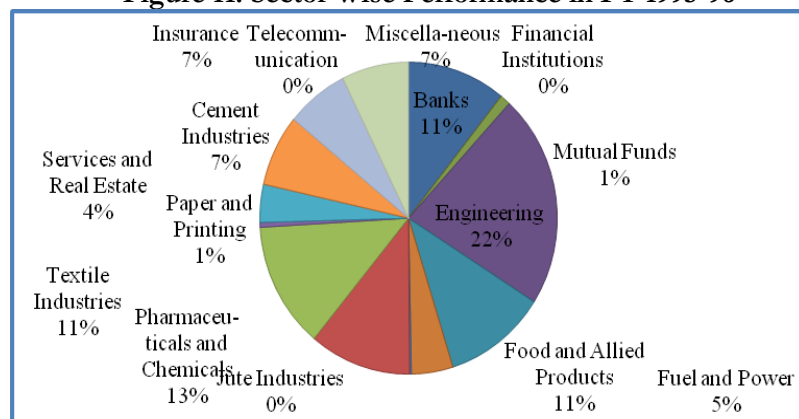


Source: Dhaka Stock Exchange (DSE)

Although the real sector components of economy such as jute industry gained a positive growth in market capitalisation in FY 2010-11 than previous FY 2009-10 but the total market capitalisation was lower which was only Tk. 79 crore. But in FY 2011-12 there observed again negative growth of this sector and total market capitalization of this sector turned in to Tk. 49.80 crore. Telecommunication sector started its activities in capital market in FY 2009-10 with a total market capitalisation of Tk. 31826.6 crore. In the following fiscal year, the market capitalisation of this sector dropped down by 30.46 percent and stood at Tk. 22131.4 crore.

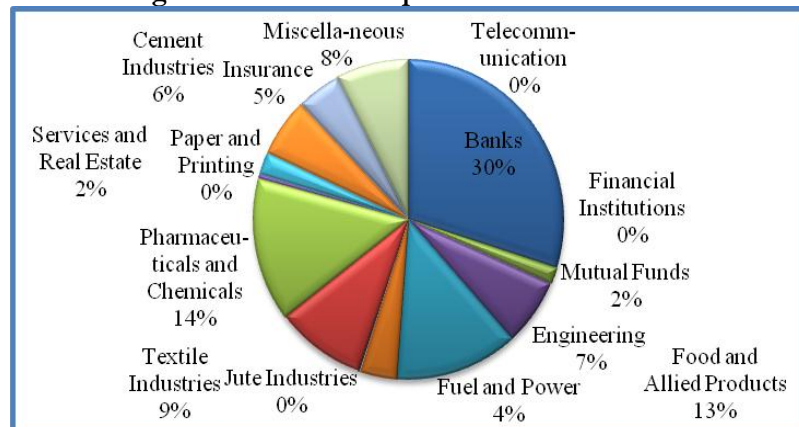
Sector wise composition of the financial sector including banks, investment and insurance continues to hold the majority share in total market capitalisation. In FY 1995- 96, the major contributions of market capitalisation were engineering (22 percent), pharmaceuticals (13 percent), food and allied products (11 percent), banks (11 percent) and insurance (7 percent).

**Figure 11: Sector Wise Performance in FY 1995-96**



Source: Dhaka Stock Exchange (DSE)

**Figure 12: Sector wise performance in FY 2001-02**



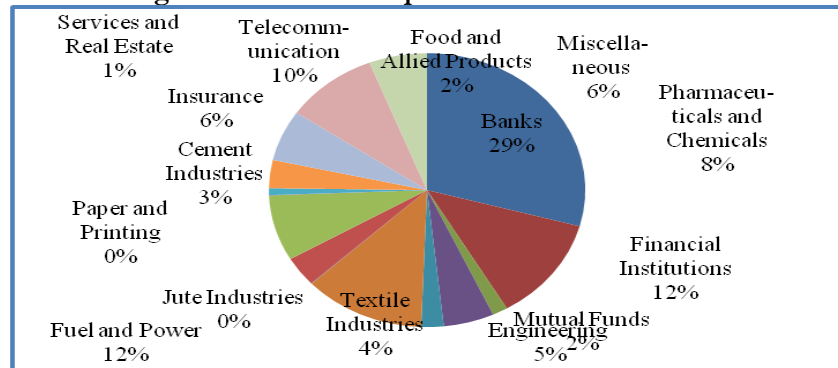
Source: Dhaka Stock Exchange (DSE)



In FY 2001-02, the major sector wise contribution of market capitalization has significantly differed from the previous period. In this fiscal year the major contribution in terms of market capitalization was banking sector. About 30 percent market capitalization has contributed by banking sector. All the other sectors like engineering, food and allied products, pharmaceuticals and fuel and power have less contribution in market capitalization. The sectors, which can directly influence the real economy, have contributed less than that of previous time and the growth in share of financial sector in market capitalization has increased significantly.

The financial sector contribution in capital market in terms of market capitalisation increased significantly in FY 2010-11. In this year, the banks, insurance including mutual funds jointly contributed 53 percent of the market capitalisation whereas pharmaceuticals and chemicals, textile industries, food and allied products and engineering contributed 21 percent jointly of total market capitalisation. The short term profit of financial sector induced the investors to make a larger investment in financial sector than those of the real sectors. Therefore, in the short run, the profit has been maximized but in the long run, a disturbing effect on the economy could be seen which has already been observed through the downward trend in capital market.

**Figure 13: Sector wise performance in FY 2010-11**

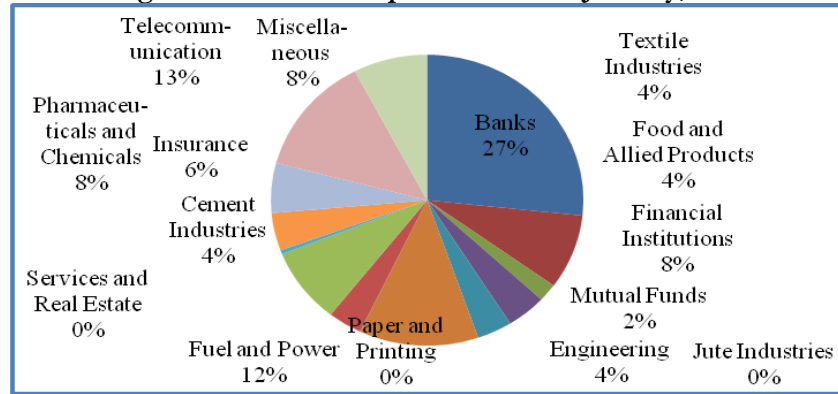


Source: Dhaka Stock Exchange (DSE)

*From FY 2010-11 to January 2013 falling rate of contribution in banking sector in market capitalisation was 2 percent which came down from 29 percent in FY 2010-11 to 27 percent in January, 2013.*

After the crush of the capital market in FY 2010-11, the components of financial sectors fell down significantly. The sector wise contribution of financial institutions fell down from 12 percent to 8 percent from FY 2010-11 to January, 2013. Moreover, continuous fall in the contribution of banking sector is observable. From FY 2010-11 to January 2013 falling rate of contribution in banking sector in market capitalisation was 2 percent which came down from 29 percent in FY 2010-11 to 27 percent in January, 2013.

**Figure 14: Sector wise performance in January, 2013**



Source: Dhaka Stock Exchange (DSE)

### 3. COMPARATIVE ASSESSMENT OF COLLAPSE OF CAPITAL MARKET

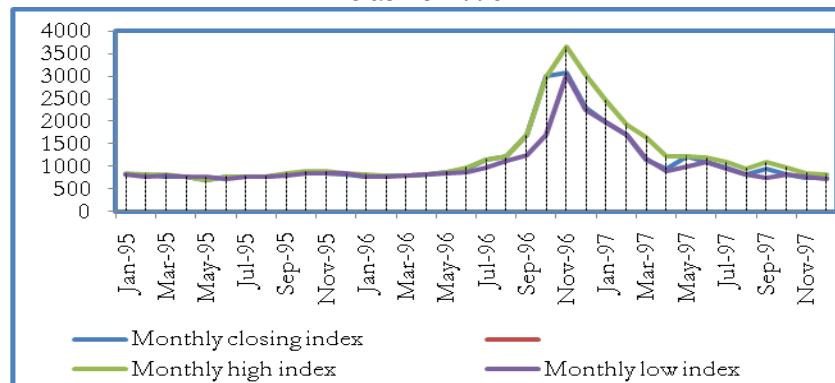
There are mainly two big crashes of the capital market in the history of the Bangladesh - one has occurred during 1996 and another happened recently in 2011.

#### 3.1 Collapse of Capital Market In 1996

*There was a large surge in the stock market in the summer and fall of 1996 evidenced by a large increase in the market capitalisation.*

There was a large surge in the stock market in the summer and fall of 1996 evidenced by a large increase in the market capitalisation. The monthly closing index was 775.65 in January, 1996 which increased to 3064 in November, 1996. After an increase in the general index of DSE for a brief period, the index started to fall dramatically. In December 1996 the index fall down to 2300.15. The short time quick profit generation persuaded the investors to invest more in the capital market. The confidence of the investors, however, damaged significantly because of excessive speculations, allegedly aggravated by widespread irregular activities.

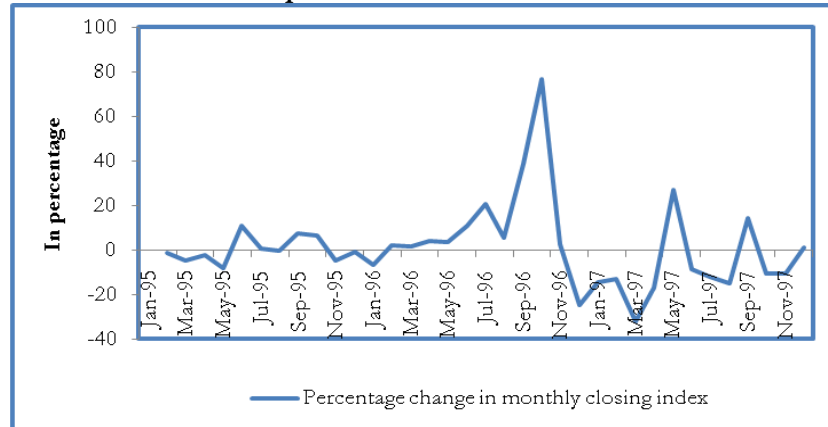
**Figure 15: Trend of general index of DSE during capital market clash of 1996**



Source: Dhaka Stock Exchange (DSE)

The trend of general index of DSE during capital market crash of 1996 showed that the price of general index grew at an increasing rate during the period of January 1995 to June 1996. In January 1995, the general index was 834.08, which became 959 in June, 1996. After this month, the manipulators created false demand, the index started to grow significantly. In November 1996, the index reached at the peak of 3064.99. The index started to fall dramatically to reach at 749.85 in November, 1997.

**Figure 16: Percentage change in monthly closing index DSE during capital market crash of 1996**

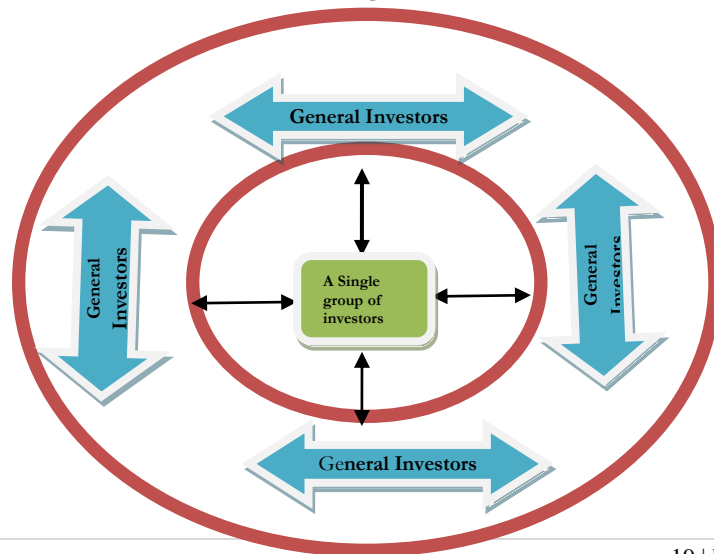


Source: Dhaka Stock Exchange (DSE)

The percentage change in monthly closing index of DSE during capital market crash of 1996 showed that the price volatility occurred due to short time game plan. This volatility of increasing the index only took three months to reach the peak. The short run game plan probably indicated that a single group of investors were engaged in this game.

**Figure 17: Probable game plan during the crash of capital market during 1996**

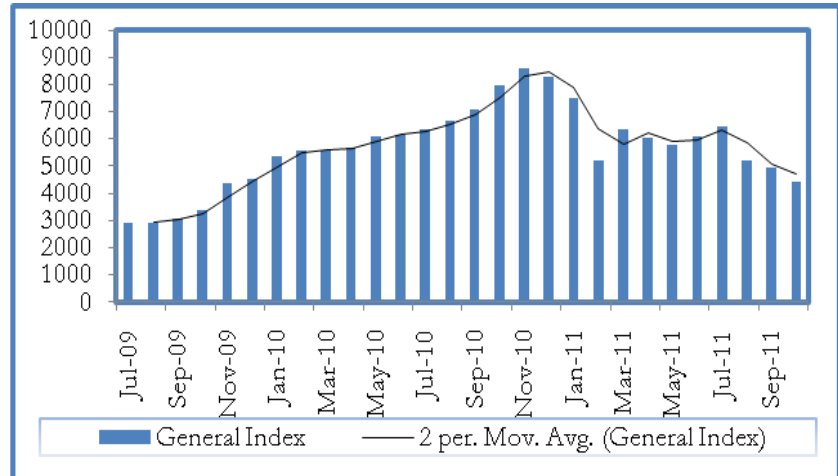
*The short run game plan probably indicated that a single group of investors were engaged in this game.*



### 3.2. Collapse of Capital Market In 2011

In July 2009, the general index of DSE was 2914.53 which increased and reached at 5654.88 in April 2010. Finally, in November 2010, the general index reached at the peak and became 8602.44, which was the peak of the capital market before the crash. After that, the general index started to fall.

**Figure 18: The trend of general index of DSE during capital market crash of 2011**



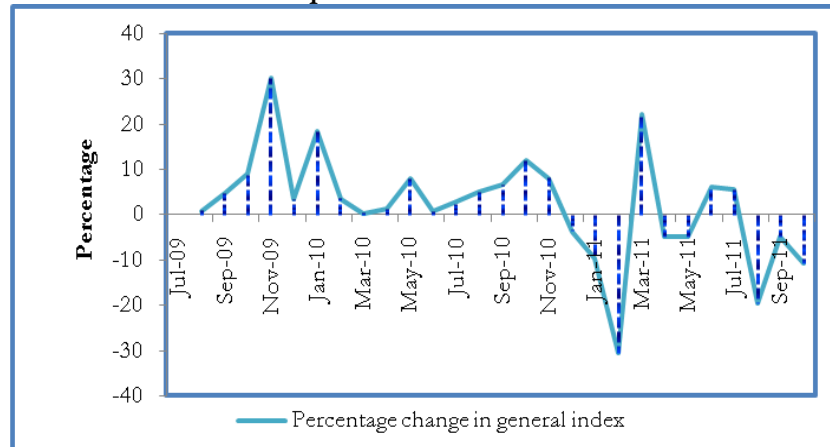
Source: Dhaka Stock Exchange (DSE)

*Long time growth continuum of the capital market index made a greater confidence among general investors.*

In November 2009, the general index of DSE increased about 30.22 percent than the previous month. During the consecutive twelve months, the general index rose on an average of 1 to 12 percent per month. This long time growth continuum of the capital market index made a greater confidence among general investors. Consequently, in this period, no greater market price volatility of general index was observed. As a result, a continuous trend of a larger profit-seeking behaviour induced general investors to reinvest their profits along with additional capital. During this time, the game planners collected the liquid money from the capital market by selling the shares. Therefore, the supply of shares increased and made the general index to fall. In December 2010, the general index first started to fall by 3.62 percent than that of the previous month. In February 2011, the general index decreased by 30.5 percent and reached at 5203.08. This falling trend of general index of DSE had been continuing and finally, fall to 4410.14 in October 19, 2011.



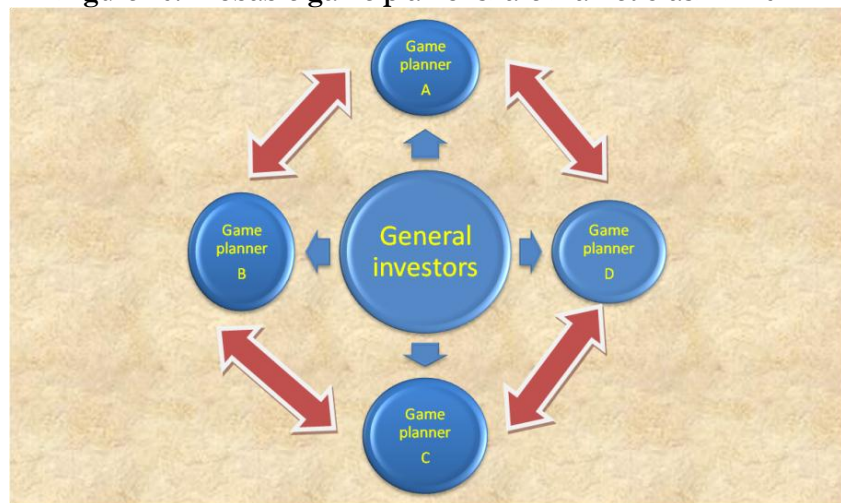
**Figure 19: The percentage change in general index of DSE during the capital market crash of 2011**



Source: Author's calculation based on data of Dhaka Stock Exchange (DSE)

A fake demand and sustainability for a long time made a strong confidence in investors. The long term game planner probably would be a group of investors who did it by making internal interactions. The long-term continuation of increasing the general index gave a strong proof behind this argument.

**Figure 20: Probable game plan of share market crash in 2011**



*The long term game planner probably would be a group of investors who did it by making internal interactions.*

#### 4. CONTINUATION OF FALL

The capital market has not revived after the crash and in certain circumstances the fall has continued, despite an enquiry to the crash by the government and announcement of certain measures. The announced measures, amongst others, are the likes of tax rebate, exemption of credit for marginal level investors.

### ***Overvaluation***

One of the major causes of the lack of confidence might be overvaluation of the share price, which has prevailed during and before the crash of capital market. It was found that many of the new issues were overvalued and lost value in fast few months after the offerings, despite conventional wisdom of maintenance of value of the initial public offerings (IPO). Most of such losing stocks were listed through “book building method” where it was assumed that premium value for new stock was much higher than the intrinsic value and after listing in the market these stocks reached on their fundamental value. Many shares were then overvalued. Most of the IPOs and rights issues in the pre-crisis period were also overvalued several times over their fundamental value. So after crash of the market, the value of these kinds of shares devalued significantly which is responsible for loss the confidence amongst the investors.

### ***Liquidity problems***

The steps taken by the government to recover the capital market have yet to be proved efficient, as they could not generate the required liquidity for the capital market. After the crush of the capital market in 2011, a continuous fall over the time in turnover indicates the crisis of liquidity of capital market. In FY 2011-12, the turnover was Tk.117145.07 crore which was Tk.325879.77 crore in the previous FY 2010-11. A significant level of liquidity of capital market squeezes in this time. The steps taken by the government, however, could not increase the liquidity in the capital market. In FY 2011-12, the turnover declined by 64 percent than that of FY 2010-11. On the other hand, in case of sector wise performance, the components of financial sectors fell down significantly. The sector wise contribution of financial institutions fell down from 12 percent to 8 percent from FY 2010-11 to January, 2013. Moreover, continuous fall in the contribution of banking sector is observable. The rate of contribution by banking sector in market capitalisation came down from 29 percent to 27 percent from FY 2010-11 to January 2013. So, the declining trend of the turnover of the capital market indicated a sharp level of capital out of the market.

### ***Contractionary Monetary Policy***

Because of contractionary monetary policy of the central bank, the interest rate increased and the liquidity crisis deepened in the banking sector. As the liquidity crisis further deepened in the financial sector, the ability of the investors to borrow and invest in shares rapidly declined and remained constrained. In times of a contractionary monetary policy, the rising price level always contributes to a liquidity crisis in the financial sector. Besides, the

government debt in banking sector has risen significantly which created crowding out of private investment from capital market.

### ***Regulatory Problems***

A major objective of the new SEC was to raise investor confidence and increase the turnover in the market. That did not happen as intended. It is mainly because the SEC could not identify and investigate many irregularities that happened in the process of the stock market bubble.

To make restructuring of the Securities and Exchange Commission (SEC) with skilled human capital is one of the major constraints. Both the SEC and the stock exchanges failed to monitor the issue of IPO and rights shares. Overpricing through overstating EPS (earning per share) and NAV (net asset value) is still a problem. Non-compliance of the listed companies with the mandatory disclosure requirements is persistent. Audit opinions are not often reliable. The SEC did not allow merchant banks to make forced-selling when share prices started falling. As a result both the merchant banks and the investors are now holding investments with heavy losses.

Committee of Ibrahim Khaled has made a study on the capital market issues. They specially focused on individual manipulations and failure of regulatory system and provided some clear-cut recommendations for the government. But these have not been implemented.

### ***Structural problems***

The two big crashes of capital market occurred during 1996 and 2011. The analysis shows that there were cartels that control the capital market. Several researches along with Ibrahim Khaled Committee reported the wrong doings of specific persons. Nevertheless, no action to date has been taken against these cartels of the capital market. This culture of impunity enjoyed by such cartels has resulted in reduction in confidence in investors.

## **5. CONCLUSIONS**

The continuous fall in the capital market exhibits lack of confidence by the investors. The absence of confidence has persisted as the government has failed to bring the perpetrators of two crashes to book and the regulatory regime is yet to enforce zero-tolerance on the activities of the cartels. The regulatory regime is fraught with faulty mechanisms that allow, amongst others, activities such as over-valuations of stocks, non-compliance

of the listed companies with the mandatory disclosure requirements, faulty audit opinions. The contractionary monetary policy and other policy measures have also kept the liquidity crisis unaddressed and in some cases have exacerbated the supply of liquidity. Moreover, the non-implementation of certain measures announced by the government has retarded the recovery. The revival of lost confidence in investors requires multi-pronged approach including actions against the cartels, signal of zero-tolerance by the regulatory regime on corporate governance, increased supply of liquidity to the general investors and full implementation of measures announced by the government.



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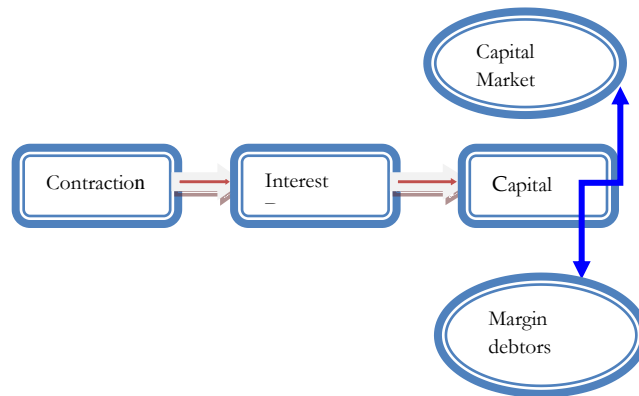
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## ANNEX- A: DIFFERENT TYPES OF RISK IN CAPITAL

### 13.1 Risk in Interest Rate

The capital market securities will be affected by changes in the general level of interest rates. The net asset value of the fund is expected to increase from a fall in interest rates whereas it would be adversely affected by an increase in the level of interest rates.

**Figure 20: Risk in Interest Rate**



### 13.2 External Risk Factor

Performance of the fund is substantially dependent on the macroeconomic situation and the capital market of Bangladesh. Political and social instability may create an adverse effect on the value of the assets of fund. Adverse natural climatic condition may influence the performance of the fund.

### 13.3 Volatility Risk:

The capital market of Bangladesh is highly volatile and mutual fund prices as well as prices of securities can fluctuate significantly. The fund may lose its value or incur a sizable loss on its investments due to such market volatility. Stock market trends indicate that prices of majority of all the listed securities move in an unpredictable direction which may affect the value of the fund.

### 13.4 Concentration Risk

Due to a limited number of listed securities in both the DSE and CSE, to invest the assets of fund in a widely diversified portfolio may be difficult as and when it is required to do so. Moreover, due to a very thin secondary debt market in Bangladesh, to swap between asset classes would be difficult for the Fund Manager, if and when it is required. Limited options in the money market instruments will contract the opportunity of short term or temporary investments of the fund which may adversely affect the returns.

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