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Stock Market, Competitive Environment, and the Role of the Government: Bangladesh Experience

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Abstract: *This paper shows that (i) government is subsidizing the elite stock market when public provisions are the lowest compared to even the neighbors', (ii) listed companies are using more equity which is inconsistent with the traditional pecking order theory, (iii) stock market development is contingent on democracy and competitiveness in the economy, (iv) the Securities and Exchange Commission is yet to have independent part time nonexecutive members in its board which is a basic principle of today's governance. Other papers study the role of macroeconomic factors like income, investments, and banking sector developments for stock market development whereas this paper basically deals with the micro variables such as Bangladesh SEC, its listed companies and their capital structure, institutional shareholders, investment in stock market, and government's subsidies to capital market to predict whether these are supportive of stock market development. The other studies worked with data only but this study worked with data as we1l as process aspects, for example, the Board composition of the SEC. However, the similarity of these studies is that all these studies conclude that the developing and the least developed countries do not have prerequisites for stock market development. This study surveys existing literature, then innovates further literature and gathers evidences in support of the new literature. For evidences it uses the annual reports of national and international stock markets, securities and exchange commissions, development banks and commercial banks, and the listed companies of home and abroad. The paper also uses data from the World Bank, OEC, OECD, the United Nations, World Trade Organization, the Economist Intelligence Unit and the IMD World Competitiveness Center.*

Economists have reported that there are no significant roles stock markets or securities exchanges play in fostering economic growth and development in Least Developed Countries (LDCs). People in LDCs use traditional banks, put money in traditional banks and do not look at stock markets as an opportunity to invest. In many cases there was a low level of financial literacy which works against the stock market. Given that the structures of the financial sectors in least developed countries are mostly banking oriented the contribution of stock market development towards economic growth is relatively lower when compared to developed or developing countries. Shareholders demand for high dividends or higher share values in a short time, which cannot allow

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manufacturing companies plan over a long time. Managers had a short term orientation for share value rather than long term orientation.

A variety of factors are there for a country to start a stock exchange including proximity to countries creating an exchange, and pressure from global financial institutions like the World Bank and International Monetary Fund (IMF). Exchanges tended to be successful when countries were inspired by their neighbors to create a stock exchange or were working to keep up with competitors. But when nations started exchanges due to international pressure, the new systems tended to be adopted only superficially and did not fare as well. Officials who want to emulate the successful economic policies of a neighboring country, or financial professionals who have global connections, can influence whether or not their country creates an exchange. World Bank or IMF involvement in a country greatly increased the chances that the country started a stock exchange. When aid was tied to economic reforms, as it is in many World Bank and IMF programs, the motivation for creating an exchange was strong. But while concessional aid made a country more likely to create a stock exchange, it also meant the exchange was likely to be less successful in the future, with fewer companies traded and smaller market capitalization.

The benefits of learning from neighboring countries, emulating successful economies through ties to the international finance community, and even keeping an eye on competitors were twofold: These influences not only significantly increased the chances that a country would create a stock exchange but also made it more likely the country’s exchange would thrive. The difference between coercion and peer influence could have important implications for development agencies. Instead of focusing on meeting particular goals, organizations like the IMF might better help a country develop its economy by doing what is called capacity building, laying the ground work that economic reforms need to take hold. The implication is that the way to facilitate those efforts is to create regional infrastructures, encourage communication and idea-swapping amongst countries or regions that have something in common.

Garcia and Liu (1999) Studied 15 industrial and developing countries during 1980-95. Real income, savings rate, and financial intermediary (banks, insurance and pension funds) development are important determinants of stock market capitalization. Stock markets development (size, liquidity, volatility, concentration, integration with world capital markets, regulation and supervision) and financial intermediary development are complements instead of substitutes. A Stock market presupposes a certain level of sophistication of consumers and should cross a certain threshold of development to give incentives to investors. It requires a certain level of domestic savings and interest by foreign investors to invest in the stock market for the stock market to lead to economic development.

This paper (1) gives method of the research, (2) a brief history of the London Stock Exchange, an earliest exchange, to understand the emergence of a stock exchange, (3) discusses the state of stock market in the developing and least developed countries, and (4) attempts to explain theories and evidences for low growth in these stock markets. This section covers capital structure of companies, why stock markets are highly volatile, the theories and evidences for domestic markets and SMEs in addition to exports and large firms, why firms delist, why investment in stock market is low, and the relation between democracy, market competitiveness and stock market development. Then (5) the paper addresses the need for reforms in stock market governance. This covers demutualization and Board composition in the Dhaka Stock Exchange and the Securities and Exchange Commission, and subsidies to the stock market. Finally (6) there is a conclusion.

1. Method

This is an exploratory type of research. As the name suggests, it tries to explore various dimensions of a problem rather than focusing on a particular dimension of that problem. It searches for plural causes rather than focusing on a single cause of the research problem. As a result, this type of research does not use a rigorous methodology but a conclusive research as it addresses a particular cause explores exhaustive research methods to arrive at a definite and final conclusion regarding a research problem. Exploratory research on the other hand, uses small samples on each cause or dimension of the plural causes or dimensions of the research problem. Second, as this type of research does not give any definite conclusion on the problem rather arouses further issues relating to the problem in the readers' mind. It is a brainstorming exercise approach of research which stimulates further queries, questions, information and research and will create avenues for more conclusive research. Thus exploratory research lays the groundwork for future research. Third, exploratory research considers both data and process aspects of a research problem whereas an empirical research and a conclusive research mainly analyses data and information and ignores the process aspects of the research problem. Fourth, exploratory research considers both time (over time) and place (across regions if not global) aspects of the research problem but an empirical work or other research may or may not consider the both.

The study surveys existing literature, then innovate further literature and gathers evidences in support of the new literature. For evidences it uses the available most recent (2013-2016) annual reports and notifications of the Bangladesh Securities and Exchange Commission, the Dhaka Stock Exchange, the National Board of Revenue, Bangladesh Development Bank and other commercial banks, and the listed companies of home and abroad. For a regional (at least regional if not global) view, the paper uses data from the World Bank, OEC, OECD, the United Nations, the World Trade Organization, Economist Intelligence Unit, IMD World Competitiveness Center, the securities and exchange commission of South Asia and UK. The paper in some cases uses the past data for example, 1990s data for assessing the changes in the stock market of Bangladesh and its neighbors.

2. History

London Stock Exchange emerged with privately-generated rules-self regulation. Rules were framed by stockbrokers for assurances against fraud. It was freely grown institution. There are flexibility in voluntary rules. There are modifications and improvements in gradual evolution and spontaneous growth. In State-imposed rules these are less possible. State rules change discontinuously. London Stock Exchange evolved over time; no governor declared the establishment of this exchange. Joint stock companies came in the sixteenth century. At first, its ownership was not widespread, and sales were conducted on a small scale directly between buyers and sellers with trades typically consisting of one owner divesting his shares to another owner or someone else on the restricted list of eligible buyers (Jenkins A. 1973). Liberalization of the banking sector at the end of the end of the seventeenth century increased the ability for companies to borrow funds, which led to an increase in the quantity of joint stock companies from 15 to 150 in six years (Jenkins 1973). In England, a weekly periodical 'collection of Improvement of Husbandry and Trade' began publishing stock prices for eight companies Houghton (1927). Neal (1987: 99) showed that initially brokers dealt in stocks as a side business but eventually people began specializing in stockbrokerage (Jenkins 1973). They traded at the Royal Exchange which housed other merchants such as grocers, druggists and clothiers (Wincott 1946: 7). Since there was no area designated as a stock exchange, trading took place in informal quarters largely in the various coffeehouses between Cornhill and Lombard streets (Jenkins 1973). There were both intentional and unintentional frauds. Many brokers could not pay in cash. The names of the defaulters were posted on a blackboard as a warning to others not to deal with them (Morgan and Thomas 1969). This form of boycott acted as form of non-coercive enforcement against those who were unreliable. Membership was expensive with legal barriers to entry and collusive. London Stock Exchange issued first rule book in 1812. In 1877 the government declared that the Stock Exchange rules had been salutary to the interests of the public and that the Exchange acted uprightly, honestly and with a desire to do justice. It concluded by saying that their private rules were capable of affording relief and exercising restraint for more prompt and often satisfactory than any within the read of the courts of law (Wincott 1946: 27).

Proprietors (companies and others) own shares in the Exchange. There were 248 proprietors in 1812, 268 in 1876 and 2366 in 1914. They elected 6 trustees and mangers. There were 487 members or brokers or subscribers in 1812, 1979 in 1876 and 4855 in 1914. They elect a 30 member Committee for General Purposes (CGP). Trustees were responsible for maintaining the building and setting the annual fees for members or brokers. They also try to ensure quality of the companies that obtained formal listing and also have daily oversight of the operation of the Exchange. Members pay a one-time entrance fee and then annual subscription fees. The CGP wrote rules subject to approval by members and then enforced them with power to expel non-complying members. The members use the facilities of the Stock Exchange as brokers earning commissions. Given the large and growing number of members competing within the exchange for each source of income, each class of members is compelled to innovate continuously. They seek to widen their customer base either by broadening their client pool or by increasing the variety of financial products they offer to each client. The CGP arranges for new members to be elected by existing members. A. proprietor cannot vote for election of new members or any regulation respecting the stock subscription room rules unless be elected of committee by members or brokers or subscribers. That is, the powers of the proprietors delegated to the trustees and managers of the exchange are separated from the powers of the Subscribers which are delegated to the CGP. This is called Demutualization. This separation of the rights and responsibilities of ownership from the rights and responsibilities of operation is called Demutualization.

3. Stock Market in Developing and Least Developed Countries

Developing Countries

A number of relatively small, developing countries had created stock exchanges, starting in the mid 1980s. Between 1980 and 2005, fifty-eight countries created exchanges. The researchers began to wonder what factors—domestic systems, international pressures—differentiated countries that created a stock exchange during those years from those that did not. Stock market development is contingent on institutional quality, governance, law enforcement, functioning democracy and corruption perception index (International Country Risk Guide, ICRG). Banking sector development, domestic investment, GDP per capita and stock market liquidity are important determinants of stock market development in emerging market. Good quality institutions such as law and order, democratic accountability are important for stock market development because they reduce political risk, enhance regulatory capacity and support the viability of external finance (Yartev 2008, Thanh et al., 2016).

In Latin America (Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela) during 1990s there were significant reforms including financial liberalization, the establishment of stock exchanges and bond markets, development of regulatory authority and supervisory framework, improvement of macroeconomic fundamentals, privatization of state-owned enterprises and shift to privately managed defined contribution pension systems. But despite the reforms, performance of domestic capital markets in many emerging economies has been disappointing. Listings and liquidity decreased and many firms have cross-listed and raised capital in international financial centers like New York and London, and trading concentrated on few stocks (Tore A. de la et al. 2005). The paper used Standard & Poor Poor's Global Stock Market Fact book of the World Federation of Exchanges. They show that despite intense reform efforts, capital markets in Latin America remain underdeveloped compared to markets in East Asia and developed countries. There is a shortfall in domestic stock market activities: market capitalization, trading and capital raising in Latin America after controlling for many factors including per capita income, macroeconomic policies, and measures of the legal institutional environment. Listed domestic firms were 232 in 1990 and 174 in 2004. Value traded as a percentage of GDP was 2+% in 1990 and 6.1% in 2004. But in East Asia and G-7 the listings increased and the value traded was 92% in G-7 and 104% in East Asia. Market capitalization as a percentage of GDP was 42.3% in Latin America, 93.6% in G-7 and 147% in East Asian countries. Capital raised as a percentage of GDP was 0.5% in Latin America in 2004, 1.5% in G-7 and 5.9% in East Asia (Tore A. de la et al. 2005).

Least Developed Countries

In Ethiopia, there are 9504 private limited companies but 393 public limited companies in 2006- 2008 (Ministry of Trade and Industry, Data Base Department, December 11. 2008). Prior to1989 there were just five stock exchanges in Sub-Saharan Africa and three in North Africa. In 1991, it is 2 to 60 in Sub-Saharan countries. These are small markets with few PLCs, low market capitalization and low transfer of shares. These countries had 0.76% to 11.43% market capitalization as a percentage of GDP in 1991 (Singh (1999). The situation did not change much in 1994 (Singh 2008). He argues for not encouraging the establishment of stock markets in African countries at the current stage of development suggesting that they should focus on reforming and improving the banking system to provide for the capital requirements of local firms. The banking system is more likely to meet the needs of ordinary savers and investors than are stock markets. He concluded that developing countries will be better off by encouraging the development of banks rather than expend their human and material resources on establishing stock markets. Those who favor in favor of stock markets in developing countries argue that foreigners from developed countries would invest in shares in young profitable countries and provide foreign exchange needed in the developing countries. But they give condition that stock markets are natural progression' in the development of a country's economic institutions as a country reaches a higher stage of economic development. However, the Italian miracle, the German miracle, the Australian miracle and in Asia, the famous miracles of Korea or Taiwan, did not depend on the equity or bond markets in these countries. Shama and Roca (2012) even proposes a gradual withdrawal of stock markets from financial systems. It also proposes that the available scarce resources be redirected to developing the banking sector and other more suitable alternatives such as micro finance and venture capital. In 2005, Fiji's market liquidity of 0.002 was extremely low compared to most of the 107 developing and developed countries in their sample. Fiji is an 'upper middle' income country in the World Bank's income groupings. Listed firms increased from 9 to 16 during 1997-2007. Market capitalization was FJD 140m to 810m. One company Amalgamated Telecom Holdings Ltd. held around one-half of total market capitalization constantly. Market capitalization to GDP of 0.215 is also among the lowest across developed and developing countries in the sample. Also this stock exchange relies considerably on annual development grants to survive. Net profit before tax is negative during 1997-2007 excluding the grant. There are well-known and established multimillion dollar local businesses across sectors which are not listed. Banking sector is larger substantially compared to stock market. 92% of all financial institution credit to the private sector was provided by banks. Loss of control associated with equity financing is an important consideration for small and inactive stock market. Hearn and Peesse (2009) shows that majority of firms are small and medium and those firms find bank credit to be more accessible and cheaper compared to equity. Political instability for example, coup d'etats can be a major deterrent to stock market development. Economy is small and fragile mainly based on imported commodities and inputs. Sarkar (2006) using data of 31 developing economies over the 1976-2005 period, finds little or no relationship between stock market development and growth of fixed capital formation. Mitchell (2010) shows that even in USA a significant public equity market emerged when industrialization had already reached a stage of reasonable maturity; the railroads were financed largely with government subsidies and debt, and industrial corporations including major oil companies and US Steel were financed with retained earnings and debt.

Seetanah et al. (2012) studied ten least developed countries viz. Bangladesh, Sudan, Uganda, Zambia, Nepal, Tanzania, Senegal, Cambodia, Lesotho and Malawi for ten years from 1995 to 2009 and show a positive but insignificant effect of stock market development (market capitalization as a percentage of GDP and value of shares traded as a percentage of capitalization) on the level of economic growth. However, there is significant effect of banking sector on economic growth. The seven emerging markets are the largest third world stock markets and together constitute nearly 90% of the total market capitalization of the 30 developing country markets in the IFC sample. South Korea and Taiwan alone account for more than 60% of the market's combined capitalization. Ten largest stocks in India capture 21% of market capitalization and 47.3% of value traded by ten most active stocks in 1989. Bangladesh's stock markets also remained stagnant for long. Though PLCs enjoy 10% corporate tax advantage compared to private companies, listings did not go beyond 280 for more than two decades. Turnover ratio increased from less than 1% to only around 6% during the last three decades (Appendix 2).

4. Theories and Evidences

Capital Structure

The capital growth and investment decisions are dictated by 'real' variables such as productivity, demand for output, technical progress and relative factor prices of capital and labor. Finance in this paradigm is always permissive and simply facilitates the investment process. The Keynesian view also is that although interest rate matters in practice it is regarded as being relatively insignificant compared with the demand factors. Relaxing highly restrictive assumptions of Modigliani and Miller (1958. 1961) the MM theorems, the traditional view, pecking order theory of finance suggested that firms always preferred internal to external finance and if they had to use external finance, they would prefer debt and only as a last resort equity finance. When debt-holders charge higher interest rates, managers use internal finance or retained earnings, and move to outside finance when internal finance is insufficient. Trade off theory of capital structure suggests that companies have target levels of gearing for balancing tax advantages of debt and risk of bankruptcy. Companies vary dividends, new equity issues and less clearly investment so as to achieve their gearing targets (Bunn and Young 2004). According to agency theory, shareholders want management to increase gearing in order to reduce the problem of free cash flow of equity. In addition, asymmetric information, moral hazard, agency costs, signalling, transaction costs lead to different costs of the various forms of finance. Of around 400 companies quoted on the German stock markets only 30 have shares which are actively traded (the other companies being closely held and therefore much less subject to a takeover threat). The celebrated distinction between the market based financial pattern of the UK and USA and the bank-based pattern in Germany and Japan is inaccurate. Rather the UK end USA and Germany are predominantly internally financed, market sources of finance are small, declining and often negative. Only in the USA during 1970s was market finance relatively large and this was presumably the origin of the stereotype. In contrast, Japan has a balance of external sources of finance with bank finance being the major source. In Japan, market sources of finance have provided a more consistent share than in the first group. The four countries in the study have all become more dependent upon internal sources over the 20-year period. Over time UK and USA firms have relied less and less on market sources of finance (Corbett and Jenkinson 1996).

Advocates of bank-centered capital markets claim that this structure fosters patient capital markets and long-term planning while a stock market-centered capital market is said to encourage short-term expectations by investors and responsive short-term strategies by managers (Porter 1922). Exit to sell shares and this liquidity reduces the incentives of shareholders to undertake the costly task of monitoring managers. However, banks may not be effective gathers or processors of information in new uncertain situation involving innovative products and processes (Allen and Gale 1999). The 'pecking order' in the developing countries is first internal capital followed by bank financing. In UK and USA, new equity capital has in fact a decreasing trend (Appendix 1). Singh (1999) studied capital structure in the developing countries and found 39% internal source, 39% equity and 21% debt (Appendix 3). Bangladeshi PLCs use 45.5% internal capital, 39.8% equity and 14.7% debt. Thus Bangladeshi companies use more equity compared to other developing countries (Appendix 4).

Development Banks

Development banks have been the key institutions for industrial development and structural change. In 2013, gross loan as a percentage of GDP was 13% for China Development Bank (CDB), 10.7% for Brazil's BNDES and 7% for Korean Development Bank (KDB). Development banks play an important role in industrial development. By 1955, KDB accounted for 40% of total bank: loans made by all financial institutions in the country. Industrial Development Bank of India (IDBI) became an apex lending institution starting as subsidiary of the Reserve Bank of India (UN 2016). In Bangladesh there are four development banks with 1500 branches. During 2014, their total assets as a percentage of banking industry assets was 3.7% and their deposits as a percentage of banking industry assets was 3.4% (Managing Director's report of BDBL). The Bangladesh Development Bank Limited (BDBL) extends financial assistance for setting up industries and provides all kinds of commercial banking services to its customers. It is also a member of the Dhaka Stock Exchange and it also operates a brokerage house. In five years from 2010 to 2015, the bank earned total revenue of TK17310 million and profit before tax of TK5940 million or a profit margin of 34.3%. Its long-term (repayable over one year) loans and advances to industries was 55% to 64% of total loans and advances during 2014-15. Whereas Sonali Bank, the largest commercial bank loaned long-term TK18883 million out of total loan of TK121007 million during 2014-15 or only 15.6% (own composition from the annual reports).

Stock Market Volatility

A stock exchange is a company like other companies but its difference with others is this other companies deal with products and services and a stock exchange deals with shares and papers. Products and services are relatively easier to evaluate but evaluating papers require information, knowledge, competitiveness and transparency, and good national and corporate governance. At the present national and corporate governance and market competitiveness, investing in shares and securities is risky. Volatility of share price is very high compared to the volatility of prices of other products and services As a result our millions of institutions do not invest in the stock market. In the face of highly uncertain future, share prices are likely to be influenced by so called 'noise traders' and by whims. NASDAQ Stock Exchange had its index 5063 in 2000 but decreased to 1335 in 2001-2003. Nikkei Stock Exchange's index in mid 1980s was 38000; 25 years later it was less than half of l98Os value. UK's mid 1950s index could not recover the pre-great depression index value. In the face of highly uncertain future, share prices are likely to be influenced by the so called 'noise traders' and by whims and contagion. In the developing countries, share prices are more volatile than in the developed countries as their firms do not have a long track record. The riskiness of investments may discourage risk-averse corporations from financing their growth by equity shares and indeed from seeking a stock market listing at all. Dhaka Stock Exchange had market capitalization of BDT209 billion on 1 January 2005 and BDT3253 billion on 5 December, 2010. New companies listed during the period accounted for BDT 1008 billion of the increase. Therefore the increase during the period was BDT2245 billion, an increase of value of 974% in less than six years.

Domestic Market and Small Businesses

The signal from Brexit is that there can be more slowing down of globalization, and more and more countries will create barriers for immigration and the movement of labor. It has proved that countries will have to be stronger domestically and not rely on export as a vehicle for growth. It is going to become increasingly difficult to export goods, services or labor. So the export-led growth strategy has outlived its usefulness. In general, countries will have to work towards making their domestic markets more viable and also work on reducing inequalities in their own societies. Only then will they have a social buy-in for global integration. Global trade is growing less than global growth. World's domestic economic growth is fuelling global growth, not exports. Historically, the volume of world merchandise trade has tended to grow about 1.5 times faster than world output, although in the 1990s it grew more than twice as first. However, since the financial crisis, the ratio of trade growth to GDP growth has fallen to around 1:1. Last year marked the first time since 2001 that this ratio has dropped below 1 to a ratio of 0.6: 1 (WTO) Secretariat).

Today there emerged business platforms that aggregate small businesses. Amazon and Flipkart aggregate goods made by thousands of vendors and provide a platform to sell them. Ola or Uber aggregate millions of drivers who will work on the platform. Practo aggregates doctors and patients. Aggregation by platforms is the way that jobs creation happens. The platform aggregation will also lead to formalization of the economy. A taxi driver becomes part of Ola, then in fact he becomes part of the formal economy; he is able to use data, get a loan, buy a car, and start paying taxes. There are high income countries characterized by small population, less stock market and even with small exports (Appendix 5). There are 60000 companies out of which 280 companies are listed with the Dhaka Stock Exchange. The annual report of the National Board of Revenue, 2015 (Table 18) shows that private companies paid 2.65% of total income tax (other than at source) and public companies paid 0.67% (other than at source). Garments constitute around 80% of our total exports. But out of total 4363 members of the Bangladesh Garments Manufacturers and Exporters Association (BGMEA) only 45 firms are listed with the Dhaka Stock Exchange (The Financial Express). Adam Smith long before in 1776 argued that joint stock companies deal with other people's money and therefore negligence and profusion will always prevail (Smith 1776). Jensen (1989) predicted 'eclipse of modern corporations' because of agency relation and agency casts. Whereas small firms are owned and managed by owners who know their self-interests better than others know it and therefore will protect their interests better than others will do for them. French big firms are emulating German Mittelstand (small and medium enterprises) for growth, jobs, and exports. Here Mittelstand has become an ambition (The Economist, October 20, 2012, P 56). The number of SMEs in Germany is twice of that in France. The origin of Mittelstand is artisans who flourished in the 19 century. Private firms were in basic industries and capital goods while State built up national champions in nuclear power and aerospace. Medium is beautiful; these firms outperformed small and big firms creating new jobs. USA has 197000 medium-sized firms defined $10 million to $1 billion revenue employ 40 million people in the country and account for one-third of private-sector GDP. Some 82% of these firms survived the dark years of 2007-10 compared with 57% of small firms. Although the survival rate among the 2100 big firms was 97% they shed 3.7 million jobs during these years. Mid-size companies whereas add 2.2 million jobs. Mediums increased employment by 3.8% compared to 2.5% by small and 0.8% by big firms. Mittelstand companies are predominantly run by classic 'owner-entrepreneurial families' seeking to sustain the business by instituting a core ideology of longevity, conservative long-term financing, and operating practices. They act as a counterpoint to a singular focus on shareholder value and dispersed investor-oriented shareholding. They are typically privately owned and often based in small, rural communities.

Delisting

Companies evaluate the costs and benefits of listing. Legal fees, accounting and other fee, increased dramatically. There is also less autonomy in conducting business in the sense that sometimes institutional shareholders cut managers' freedom in business decisions. Another factor is the compliance of corporate governance required by the market and regulation which may involve significant costs for a smaller company. The benefits of remaining public are better access to capital for business expansion (liquidity), the financing of diversification of operations, strengthening the corporate image in the capital market, and tax benefits in some countries. In Bangladesh, corporate tax rate for listed companies is 25% but 35% for non-listed companies. Delisting or public to private transactions (PTP) or going private transaction commonly takes the form of an acquisition offer organized by a company's controlling stockholder or management and financed by sophisticated third party financiers. The purpose of delisting is to enable the company or the control group to acquire all or substantially all of the company's publicly-held shares in order to return the company to its pre-IPO condition — 'private company' status. This kind of transaction involves restructuring that concentrates ownership and increases the level of company's debt (Leuz et al. 2008). Delisting removes the expenses of complying with terms and conditions of listing on the stock exchange. Pour and Lasfer (2013) studied 380 delisted firms in l995-2009 of which 155 are voluntarily delisted firms. Companies voluntarily delist for not raising equity capital, they remain highly leveraged, have low growth opportunities and profitability, liquidity and financial visibility. They generate significantly lower excess stock returns and their insider ownership remain high throughout their quotation period. Between IPO and delisting year, there is significant increase in leverage and decrease in firm value and trading volume. Insider ownership increased from 44% to 56% suggesting that their owners maintain significant control and probably did not want to keep their firm public indefinitely. In USA, voluntarily delisted firms are increasing from 23 in 1998 to 436 during 1998-2004 (Leuz et al. 2008).

Investment in Stock Market

Employee provident fund's composition of portfolio in 2011 in Sri Lanka was 90.8% in government securities and 9.2% in corporate equity (Central Bank of Sri Lanka, EPF Department). In Malaysia, 70% of central provident fund invested in government securities. It is 85 to 90% in Singapore. In Indonesia, it is 30% in government securities, 60% in bank deposits, and10% in loans, stocks and properties. Equity investment is less than 20% in shares in Denmark (The Telegraph, May 30, 2017), 2.7% in Korea, 15.6% in Malaysia, and 18.3% in Philippines. Global pension statistics show that pension fund investments in equity during 2013 were 14% in Thailand, 30% in Australia and Canada, 20% in UK and Netherland, 40% in USA (OECD 2013). In Bangladesh, there are not pension funds except a government one. Private sector pension or contributory provident funds are almost unknown. Insurance industry is not yet run professionally. Their income measurement and taxation are faulty and devoid of domestic and international accounting standards causing loss of government revenue for decades (Chowdhury 2016). Insurance companies invest an average 20% of total investments in the listed companies whereas the average of UK, USA, Canada and China is 50% (Appendix 6). Banks are the main institutional owners investing in the stock market. There are however, limits to banks' investment in stock markets around the world because banks' investment in stock market can restrict growth of credit to the private sector.

Democracy, Competitiveness and Stock Market

Stock market developed more in democracies cid competitive environment. The top ten countries with democracy scores of more than 9.01 out of 10 have market capitalization to GDP ratio higher than 50 whereas the bottom most of the ten countries with democracy scores of 2.07 and less do not have a stock market. Other countries with democracy scores of 2 to 3 have very small stock market around 5% of GDP (Democracy Index 2016 from The Economist Intelligence Unit). The index is based on 60 indicators grouped in five different categories measuring pluralism, civil liberties and political culture. Saudi Arabia, Iran, UAE, Bahrain and Oman are the exceptions with lower democracy scores but have market capitalization to GDP ratios of 40% to 60%. These countries however have high scores in the Competitiveness Ranking of the World Economic Forum (2017). The IMD World Competitiveness Center has the similar records. The top ten countries with competitiveness scores of around 90 out of 100 have large stock markets measured by market capitalization to GDP ratio around 100 whereas the bottom ten countries with competitiveness scores of 65 and below have smaller stock markets with market capitalization to GDP ratio less than 50. The IMD World Competitiveness center (2016) computed competitiveness scores based on a total of 340 criteria; with 83 economic performance criteria, 73 government efficiency criteria, 71 business efficiency criteria, and 115 infrastructure criteria.

5. Reforms in Governance

Demutualization

Dhaka Stock market has brought some changes in corporate governance of the stock market in 2013 in line of the renowned stock markets of the world as a result of the government’s Dhaka Stock Exchange (Board and Administration) 2013. This regulation required the Chairman of the exchange to be an independent nonexecutive unaffiliated with the stock market and its owners and brokers. It also required majority board members to be independent nonexecutives. At present there are seven independent nonexecutives and four shareholders and brokers elected members. Previously, in the Dhaka Stock Exchange Regulation 2000, there was provision for 50% independent members in the board but no provision for the Chairman to be independent member. So all Chairmen of the bourse from 1976 to 2013 were the shareholders and brokers elected persons. And all of them were the Managing Directors of their securities firms (Annual Report, 2015, Dhaka Stock Exchange). If Chairman and his team are owners or brokers and are in charge of operations of the bourse then good governance is hard to expect. If Chairman is not independent then other members are also not independent because the Chairman plays an important role in selecting other outside members. Only in 2014 the Chairman was a retired judge of Appellate Division of the Supreme Court. So 2014 is better than 2000 governance at least in paper. But even today, the seven members of the board who are supposed to be expert and independent are not really expert and independent in essence. If someone browses their profile he will see that they were and are affiliated with the ruling party. Second, they are not celebrated writers or thinkers or even experts in their own profession. Independent board members must have two vital qualities: they are independent in mind and are experts preferably intellectuals.

Securities and Exchange Commission

The role of nonexecutive directors (NED) in corporate governance has been well appreciated around the world. The corporate board around the world nowadays is composed of executives who are an organization's internal and nonexecutives who are its external. NEDs are part time and do not take part in day to day activities of the company, they attend company board meetings usually once or twice in a month and particularly look at the strategic issues including if the executives are taking good care of the shareholders money. NEDs are usually distinguished lawyers, university teachers, social workers, and other intellectuals of independent mind who must be free from any undue influence from the executives and the management. They are not only experts but also celebrated people who bring name and fame for the country.

Independent nonexecutives are more important in the public sector than in the corporate sector. In the corporate sector, there are institutional shareholders who have large stakes in the companies and therefore have higher incentives to monitor the management. But in the public sector, such an incentive for monitoring is largely absent particularly in a non-functioning parliament. Also, shareholders in the corporate sector can simply 'exit' by selling their shares if the share prices are not satisfactory. Thus unlike the corporate sector, government organizations do not have many control mechanisms available for pursuing the management for working in the citizens' best interests. Therefore inclusion of independent outside experts is a little hope left for good governance in the government organizations (Chowdhury 2015). Our capital market is one of the lowest in the world by liquidity measured by market capitalization and annual turnover as a percentage of GDP (Appendix 2). The Bangladesh SEC consists of a Chairman and four full time Commissioners appointed by the government for a fixed term usually four years. It has no part time independent nonexecutive members. Most of the SECs around the world have part tine independent nonexecutive members. The Securities and Exchange Board of India has three fulltime and four part-time members who are equivalent to nonexecutives but the problem is that they are all high government officials. Thailand SEC Board has 11 members of which 6 are nonexecutive expert members. Sri Lankan SEC has ten nonexecutive members and operates through a Secretariat headed by a Director General. It has six nonexecutives appointed by the Ministry of Finance taking into consideration the wide experience and vast knowledge they possess in legal, financial, business and administrative matters. The seventh member is the Deputy Governor of the Central Bank of Sri Lanka. The remaining members are the Deputy Secretary of the Treasury, the Registrar of Joint Stock companies and the President of the Institute of Chartered Accountants of Sri Lanka. In these Asian countries, Chairman and CEO positions are full time. But they have part time nonexecutives too. Only Bangladesh SEC does not have part time nonexecutives. In USA, UK, and European large organizations both private and public the Chairman is usually a part time nonexecutive and majority board members are part time nonexecutives (Cadbury Report and Committee on Corporate Governance, UK). The UK equivalent of Securities and Exchange Commission was the Financial Services Authority (FSA) until 2013. From 2013 the name changed to the Financial Conduct Authority (FCA). Both the organizations were governed by majority independent nonexecutive members and Chairman as a nonexecutive.

Split of the positions of Chairman and CEO is an established governance practice both in corporate and public sector around the world and the Chairman usually is a part time nonexecutive. In essence this is absent in our SEC because the Chairman is the full time executive. The difference is that the Chairman is the executive for four years (and renewable) and the management head (MD or CEO) is the permanent executive. The present Chairman is working nearly for eight years since 2010. Cadbury's Report and Committee on Corporate Governance (UK) reason and recommend that when Chairman and CEO positions are full time jobs, there should be a senior non-executive director to whom concerns can be conveyed (Committee on Corporate Governance 1998).

With a single executive holding the positions of the Chairman and CEO, or two separate executives holding the titles, the company's entire decision-making process lies in the hands of executives and there is little in the way of checks and balances. One of the main objectives of the split is to monitor the salaries and benefits of the executives. But the annual reports the SEC do not disclose anything on these items. Disclosure of this item is an established principle of governance throughout the world in large private and public sector organizations. The Sarbanes-Oxley Act requires the Audit Committee consists only of external board members. This means that no member of the executives (for fixed term or permanent) can sit in the audit committee. Even the Bangladesh SEC rules, regulations and notifications signed by its Chairman require an audit committee shall have an independent member. So its governance and its regulations are inconsistent and self-defeating.

True independence is a broader concept. Full-time executives remain busy and bogged down with own organizations and they are usually not critical of their own decisions and actions. But nonexecutives are part time and they think beyond one organization and their main purpose is to bring alignment of country's interests. True independence has the following broader meaning. Let us ask a question-why, when, and how do we influence others? One way is by information and knowledge which is good. But we can also influence others out of self interest and specific single narrow identity. Therefore, for free, fair, and independent decision one has to avoid narrow specific identity. An independent man has plurality of identities. The SEC Chairman and the Commissioners have record of strong political affiliation and there was no public advertisement in selecting them. In the developed countries, Chairman in large organizations is an international position and advertisement in national and international media is a common practice. Adam Smith in his Theory of' Moral Sentiment (1759) required for independence the 'impartial spectators'. Thomas Nagel (1986) expressed independence as 'view from nowhere than view from delineated somewhere'. Governance is thinking of things, critical thinking, epistemic and adequate justifications, making of new ideas, independent reasoning, purifying reason (Immanuel Kant), greatest good for greatest number and aesthetics or the sense of proportions. A full-time executive usually does not have time for thinking all these virtues. An intellectual, a celebrated professor and a lawyer, a social thinker who has enough time for thinking of things works as a part time independent board member for check and balance in governance.

Subsides to the Elites

In developing and least developed countries there is crony capitalism which finances schemes of particular individuals and families with political connections rather titan promote long term industrial development. Governments should encourage product market competition to discipline corporations rather to rely on the stock market for this purpose. Bangladesh government is financing BICM (Bangladesh Institute of Capital Market) with an annual budget of 40 million taka whereas in India, the National Institute of Securities Market (NISM) has been established by the Securities and Exchange Board of India (SEBI). The NISM however is financially independent and does not receive any grants neither from SEBI nor from the government. BICM can be financed and governed by the SEC, ICB, chamber of commerce and other private sector organizations. The SEC generated a surplus of TK116 million in 2013 and ICB is a commercially run government organization and provided an income tax of TK514 million in 2015-16 financial year, and thus can well run an organization like BICM though in future it will have to be financially an independent institution. Government has distributed TK6420 million until 2016 to the small investors who suffered losses in the stock market and waved 50% interest on their loan (SEC Annual Report 2016). These beneficiaries are mostly urban citizens.

For stock market development there are some prerequisites for example, functioning parliament, law and order, market competitiveness, and good banking sector. All of these score low compared to other developing countries and even to the neighboring countries. A total of 51 IPOs are waiting for approval of the SEC. The SEC is subjected to accept or reject proposals within 60 days of application as per the capital issue rules. The BSEC Chairman (BSEC Notifications, 2013) rightly said that the current sluggish market has made them cautious in giving the approval.

Government's social protection expenditure is the lowest in South Asia. It is 1.4% of GDP compared to 1.7% in India and more than 3% in Thailand, Vietnam, and Sri Lanka. Our road distance is 215 km per 1 million people compared to 5433 in Sri Lanka, 4209 in India, 2609 in Thailand, 2169 in Vietnam, 2111 in Philippines, 1925 in Indonesia, 1318 in Pakistan, and 640 in Nepal (New Age, June 17. 2017). Access to drinking water and sanitation is also the lowest. In such situations any subsidy to the stock market will benefit the elites at the cost of ordinary people.

6. Conclusion

This paper shows that (i) government is subsidizing the elite stock market when public provisions are the lowest compared to even the neighbors, (ii) listed companies are using more equity which is inconsistent with the traditional pecking order theory, (iii) stock market development is contingent on democracy and competitiveness in the economy, (iv) the Securities and Exchange Commission is yet to have independent part time nonexecutive members in its board which is a basic principle of today's governance. Singh 2008) did a comprehensive literature review of the role of stock markets in economic development of the low and middle income countries whereas this paper considers Bangladesh and its institutions and performs some empirical study to assess the appropriateness of its stock market development. Yartey (2008) and Thanh et al. (2016) study the role of macroeconomic factors like income, investments, banking sector developments for stock market development whereas this study basically deals with the variables such as Bangladesh SEC, its listed companies and their capital structure, institutional shareholders, investment in stock market, government's subsidies to capital market, and the state of public provisions to predict whether these are supportive of stock market development. The other studies worked with data only but this study worked with data as well as process aspects, for example, the Board composition of the SEC. However, the similarity of these studies is that all these studies conclude that the developing and the least developed countries do not have prerequisites for stock market development.

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Appendix 1. Pecking Order, 1970-1989

	Germany	Japan	UK	USA
Internal	81	69	97	91
Bank finance	11	31	20	17
Bonds	-0.6	4.7	3.5	17.1
New equity	0.9	3.7	-10.4	-8.8
Trade Credit	-1.9	-8.1	-1.4	-3.7

Source: Cobett and Jenkinson (1996)

Appendix 2. Market capitalization and Turnover ratio

Market capitalization as a percentage of GDP, 1991:

Sub Saharan Africa 0.76% to 11.43% except South Africa with 156.2% and emerging countries India 17.7%, Thailand 38.9%, Malaysia 124.4%, Korea 32.7%, Brazil 10.5%, Mexico 34.2%, UK 97.7%, Italy 14.4%, Bangladesh 2%.

Market capitalization as a percentage of GDP: 2016: Bangladesh 18.4%, India 72.7%, Sri Lanka 22.6%, Indonesia 47.7%, Thailand 101.3%, Philippines 91.5%.

Turnover as a percentage of market capitalization, 1991:

Sub Saharan Africa 0% to 7.2%, India 56.8%, Thailand 102.2%, Malaysia 20.2%, Korea 82.3%, Brazil 22%, Mexico 47.9%, UK 77%, Italy 45%.

Turnover as a percentage of GDP, 2003:

Sub-Saharan countries 0% to 9%, Bangladesh 1%, Egypt 4%, India 102%, Thailand 81%, Indonesia &, Philippines 13%, Sri Lanka 2%, Malaysia 30%, UK 177%, Italy 108%.

Turnover as a percentage of market capitalization, 2016: Bangladesh: 35.4, turnover as a percentage of GDP, 6.5%.

Source: Singh 1999, Singh 2008, 2016 Data: Bangladesh SEC Annual Report, 2016.

Appendix 3. Financing in percentages, 1980s

	Internal	External Equity	External Debt
Brazil	56	36	8
India	40	20	40
Jordan	66	22	12
Malaysia	36	47	18
Mexico	24	67	9
Pakistan	74	2	24
Korea	20	50	31
Thailand	28	n/a	n/a
Turkey	15	65	20
Zimbabwe	58	39	3
Average	39	39	21

1995-2000: Average

Developed markets: Internal 30, External 17; Emerging markets: Internal 27, External 39; Global: Internal 29, External 22

Source : Singh 1999

Appendix 4. Capital structure, average of 2014-2015. Equity means common stock and share premium. Long-term debt excludes deferred tax and employee liabilities. Internal capital means general reserve, revaluation reserve, and retained earnings.

	Internal		Debt		Equity	
Food:						
Bengas	TK90m	74%	TK3m	2.5%	TK28m	23.5%
Cement:						
Aramit	168	14.6	562	48.7	423	36.7
Confidence	2209	65.9	35	1.0	1107	33
Ceramics:						
Fuwang	196	21	38	4.1	700	75
Monno	2066	88.7	23	1.0	239	10.3
Shinepukur	2784	58.3	520	11	1469	30.8
Engineering:						
Aftab Auto	2167	35.9	995	16.5	2882	47.7
Anwar Galvanizing	(23)	0	4	2.9	132	97.1

Fuel & Power:						
Baraka Power	566	9.0	3150	50.2	2565	40.8
BD Welding	290	39.7	32	4.4	408	55.9
Paper & printing:						
Hakkani Pulp & Paper	379	63.3	30	5	190	31.7
Summit Power	7710	34.4	383	1.7	14301	63.9
Pharmaceuticals & Chemicals:						
ACI	2700	57.4	1300	27.7	700	14.9
ACME	7760	51.9	4000	26.7	3200	21.4
Textile:						
Al-Haj	55	16.5	139	41.6	140	41.9
Alltex	530	43.1	200	16.3	500	40.7
Miscellaneous:						
Aman Feed	1800	54.2	120	3.6	1400	42.2
Berger Paints	3300	90.5	0	0	346	9.5
Average		45.5		14.7		39.8

Source: Own compilation from annual reports.

Appendix 5. High Income Countries with little Stock Market, 2015

Country	GDP Per Capita	Listed Companies	Market Capitalization to GDP%	Export to GDP %	Population in million
Slovenia	$32885	38	12	49.8	2.1
Cyprus	32580	81	12.7	18.9	1.2
Slovakia	30632	60	5	78.9	4.2
Portugal	30624	45	28	27.8	10.3
Hungary	26681	43	18.1	81	9.8
Argentina	19934	93	11.7	10	43.6
Iceland	51399	8	-	32.7	0.4
Estonia	29365	16	10	59.6	1.3
Romania	23626	83	10	34.8	19.5

Source: GDP per capita from World Bank, listed companies and market capitalization to GDP and population from the Internet, exports to GDP percentage from OEC.

Appendix 6. Investment in shares by the Insurance Companies in million taka, average of 2013-14.

	Total Investments	in shares	%
Bangladesh:			
Pragati Life Insurance	1850	350	18.9
Progressive life Insurance	1000	143	14.3
Popular Life Insurance	14600	2140	14.7
Rupali	1250	112	9
Meghna	5150	725	14.1
Delta	19000	8150	42.9
National			
Prime Islamia	2075	1145	55.2
Sandhani	4780	1500	31.4
India: Long-term investments LIC:			
Shareholders’	50805	6382	12.6
Policyholders’	136792	35961	26.3
ICICI:			
Shareholders’	7532	2768	36.7
Policyholders'	40970	8559	20.9
Bajaj Allianz:			
Shareholders'	55269	7398	13.4
Policyholders'	109980	15238	13.8
Reliance:			
Shareholders'	8646	3362	38.9
Policyholders'	47507	11338	23.9
Tata AIA UK:			
Aviva	195000	100000	51.3
Legal & General	368766	360111	97.7
Royal London	52231	23000	44
USA:			
AIG	355766	141187	39.7
Metlife	505995	126274	25
Canada:			
Foresters	1207	1100	91.1
China:			
China Life	1177866	598750	50.8

Source: Own compilation from the annual reports