Escalating Economic Activities through Long-term Finance from Capital Market

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Introduction

The prime objective of capital market is to provide long-term finance to industry so that economy can move toward progress that will ensure productivity, employment and as a whole the growth of the economy. Primary market deals with providing long-term finance to business and industry. On the other hand, in order to accelerate long-term finance, secondary market comes into existence. Secondary market supports primary market to facilitate liquidity and transferability. Without liquidity of the capital, it will not get the momentum. As a result, secondary market was established to facilitate the liquidity of long-term finance. We, however, often witness that secondary market are getting more highlights comparing to primary market because of its high sensitivity and high-voltage media coverage on secondary market. Secondary market, in real scenario, is the tip of the iceberg of capital market. Though primary market remains back of the scenario, it is the market through which long-term finance are channeled to industry to accelerate economic activities. Secondary market has also its importance

but at the same time it is highly important to contain manipulation and other malpractice to have an ideal capital market. All over the world, there are ups and downs in the capital market and it is natural characteristic of the capital market. However, the market where manipulation and malpractice are well handled, managed and contained, we term it ideal capital market. In reality, we hardly find any ideal capital market in the world.

Primary Market

To shed light on primary market, very little has been discussed on primary market. Now we would like elaborate in details about the primary market. Primary market facilitates different types of financing such as equity, bond, derivatives. When there are more instruments in the primary market as to financing to business and industry, the capital market will be more vibrant, less volatile and market will have more depth. Consequently, it will minimize the manipulation and malpractice. We need to take some bold efforts to introduce more instruments into the capital market. While introducing a new instrument into the market, there is likely to have some loopholes in the regulatory framework about the instrument. However, considering everything it should be prompted earlier. In world capital market, we have found many instruments trading on the exchanges such as equity, bond, preference share, derivatives. In our country, because of solely depending on equity-based market, we have found huge ups and downs in the capital market for which so far we witnessed two debacles in 1996 and 2010.

Price discovery for Issue Prices

At present, we are using two systems, i.e. Fixed Price (At Par) and Book-building system when raising equity. Book-building system had a few irregularities in recent past in our capital market that weakened the confidence of the general investors. However, book-building system is well-accepted and well-recognized system around the world. We have also fixed price system which is not widely used around the world because despite having fixed price system, share also can be issued in discount as practiced in developed capital market but discount is not allowed in our capital market due to having no legal framework. Considering the reality, we feel, book-building system should be used in a such fashion where qualified and eligible investors will behave rationally and discover the share price through their valuation and Issuer Company will get justified price in consequence. In our country, there is questionable behavior of many Institutional investors, not all institutional investors, regarding book-building system for which our main regulator, Bangladesh Securities and Exchanges Commission, took many steps to update the book-building system. However, all the concerned parties of the capital market could not achieve the spirit of an effective book-building system. In book-building system, eligible investors discover the price where regulator has no role in deciding the share price.

For price discovery, in book-building system, there are two renowned methods: English auction and Dutch auction. For valuation, our regulator has also provided five ways such as based on NAV, EPS, Average Market Price of Similar Stock, Price to Book Value Multiple of Similar Stock and Price to Earnings Multiple of Similar Stock.

We know that worldwide IPO can be processed in two methods: merit-basis or disclosure-basis. Here, we used disclosure-basis method in which all information are available to the investors so that investors can analyze all the numeric and non-numeric information to fix the price and regulator has hardly play any role in it. However, it's wrong practice as regulator help to fix the share price in book-building system. Regulator should not fix the prices rather regulator should facilitate the process so that eligible investors can fix the price in justified way. We use fixed price system when Net Asset Value (NAV) and General Reserves are comparatively low of a company or for a new company which is going to start production, i.e. Greenfield Company. Greenfield Company is allowed to be listed around the world and in our country there is no bar as well for Greenfield Company. But in reality we hardly found Greenfield companies being listed.

Bond Market

Worldwide we find that bond have been using for long-term finance. Around the world and even in our neighboring countries such as India, Pakistan also has bond market. There are many types of bond used as vehicle for long-term finance.

Bank Finance and Market Cap to GDP

In our country it is solely bank-based finance system to finance to business and industry which

is not suitable for long-term finance because banks are supposed to provide short-term finance. Banks are taking short-time deposit against which long-term finance is not feasible. In 2017, Bank loan had been provided to industry 167,300 crore whereas finance from capital market was 1442 crore, which accounted for less than 1% of total bank finance to industry. Because of this dismal scenario our Market Cap to GDP ratio has been declined over the years. (Source: Business Hour 24.com). Market Cap to GDP ratio has been suffered immensely in 2011 because of debacle in 2010.

Year	Market Cap to GDP (%)
2010	50.70
2011	33.20
2012	26.30
2013	25.50
2014	24.10
2015	20.60
2016	19.70
2017	21.62
2018	17.21

(Source: Business Hour 24.com)

On the other hand, if we look at Market Cap to GDP ratio to other countries, we find that market cap to GDP ratio is close to 100% or more than 200%. In order to improve the situation, we need more and more IPO in line with our GDP growth.

Market Cap to GDP Ratio of Main Stock Exchange of Different Countries (June 2017)

Country	Market Cap (Billion in Dollar)	GDP Size (Billion in Dollar)	Market Cap to GDP (%)
Bangladesh (DSE)	47.16	242.69	19.43
India (BSE)	1948.14	2250.99	86.55
Pakistan (Karachi)	91.04	271.05	33.59
Malaysia (Bursa Malaysia)	415.38	302.75	137.2
Singapore	773.99	296.64	248.78

(Source: Business Hour 24.Com)

Securitization

We are used to witnessing infrastructure financing by the government in collaboration with big lending agency such as World Bank, ADB, IMF and so on. It is interesting that such huge and long term financing can be made through capital market by securitization. Securitization is a financial technology that helps to accumulate various types of debts for the purpose of pooling and selling them to investors in the form of securities. These are Asset-backed securities, i.e. bonds backed by infrastructure loans. These loans are sold to investors directly through the capital markets. Infrastructure loans are pooled together and the issued securities are arranged in tranches. The most noteworthy about securitization is its ability to transform a pool of illiquid infrastructure loans into tradable securities.

Our IPOs: Dividend and Issue Prices

Dhaka Stock Exchange was established in 1954. Since then we have 300 plus companies in 64 years. In 2018, we got only 13 companies being listed through IPO. Financing through capital market is given in tabular form. Comparing to bank finance, it is very minimal amount.

In 2018 (January to December)

Category	No. of Companies	Raised Financing (In Crore)
Fixed Price (At Par)	11	266
Book-building	2	280
Right Offer	2	208
Total		754

Source: Bangladesh Securities and Exchange Commission

There is a misconception that listed companies are not paying good dividend and mostly are below to the Issue Prices. We have analyzed 87 companies being listed in the capital market from 2011 to 2018. It means on an average yearly 11 companies have been listed in the capital market in last 8-year, which is very poor number being listed. We found that this 87-Company paid on an average around 15% dividend (cash and stock), which is quite good.

As to the Face Value, 6 companies out of 87 companies are below to their face value, which accounted for around 7% of total listed companies in last 8-year. Regarding issue prices (issued with premium or more than face value), 23 companies out of 87 companies are below their initial issue prices accounting for 26% of total listed companies in last 8-year.

Barrier of IPOs

Since 1954 we have got around 300 plus companies being listed whereas there are many good companies who could be listed in the capital market. There are many reasons for not being listed.

Firstly, if a company gets listed, it has to be transparent. We know that there is lack of transparency among

the companies, not all the companies, who are unwilling to be listed. If listed, transparency has to be made, resulting in more revenue for the government in the form of Tax and VAT. Hence, Government should come forward to encourage companies to be listed in the capital market.

Secondly, IPO-approving is time-consuming process, taking around 2/3 years, for which it fails to attract to the promising entrepreneurs to raise financing through IPO. Because, business model, market scenario are changing in quick time and required machineries as well. Hence, it is very difficult for the promising entrepreneurs to be patient for such long time. Eventually, these promising entrepreneurs are inclined to bank financing.

Thirdly, many are afraid of complying with compliance of the Securities and Exchange Commission. Though initially, for compliance, company bears additional cost and facing the hurdles in operating the company, compliance helps a company in the long run to be sustainable and for better growth.

Fourthly, tax benefit is not significant for the listed companies against non-listed companies and it varies for 2.5% for bank, insurance and financial institution between listed and non-listed, 5% for mobile companies between listed and non-listed and 10% for other companies between listed and non-listed. On the other hand, there is no benefit regarding VAT between listed and non-listed companies. Listed companies should be given VAT benefit as well to woo them in the capital market. Because, listed companies are transparent and pay more VAT than that of non-listed companies.

Remedies against the barrier

We cannot list a company with force and it cannot be desired. For fundamentally strong companies who are efficient in operating high capital-based company, it is important to remove the barriers of lengthiness of IPO. If necessary, legal barriers should be conducive or relaxed for that company and other companies such as Multi-national, Government-owned companies. A differentiated rate regarding Tax and VAT should be implemented for listed companies against non-listed companies. At the same time, corporate governance compliance can be relaxed for such potential companies so that these companies are interested to be listed in the capital market.

Conclusion

As discussed above, we know that capital market contributed less than 1% to the total financing of the economy. Bank provides more than 99% of total financing which should not be practiced because capital market is tested system in the world through which long-term finance should be provided. If bank provides long-term finance, there is risk of loan default which is highly prevailing in our country. If banking system collapses, it will affect whole economy and hamper our economic growth. If Bank has surplus money, they should invest it through capital market.

For price discovery, in book-building system, there are two renowned methods: English auction and Dutch auction. For valuation, our regulator has also provided five ways such as based on NAV, EPS, Average Market Price of Similar Stock, Price to Book Value Multiple of Similar Stock and Price to Earnings Multiple of Similar Stock.