RECENT TRENDS IN CAPITAL MARKET OF BANGLADESH: CRITICAL EVALUATION OF REGULATION

by

Syed Golam Shahjarul Alam

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Examination Committee:	Dr. Sundar Venkatesh (Chairperson)
	Dr. Winai Wongsurawat
	Dr. Yuosre Badir

Nationality:	Bangladeshi
Previous Degree:	Master of Business Administration
	University of Dhaka
	Dhaka, Bangladesh
Scholarship Donor:	Bangladesh Bank
	(Central Bank of Bangladesh)

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School of Management
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ABSTRACT

The Capital Market of Bangladesh is passing tough times since December 2010 as high volatility is eroding the capital of Thousands of Investors that might turn into social instability. This fall is caused by many factors that I tried to identify and tried to link up between causal factors of market crash and regulatory failure. Primary issue related problems was faulty listing methods and IPO overpricing, few numbers of new listings, revaluating assets before company listing, high premium in issuance of right share/Repeat IPO etc. while secondary market related problems was stock splits and stock price manipulations through block trading, circular trading and insider trading. Investor's greed and irrational behavior played a big rule to make the stock prices sky rocking as they were crazy to buy shares without judging the company fundamentals. Shares of the companies with closed operations and big accumulated losses were rising constantly due to investors high risk appetite that caused them to loss everything. Government had already taken many steps (including SEC reforms) to stabilize the market but failed as investors confidence is in the bottom level. Government and regulators should work together to identify the main speculators and should brought under proper trial to bring investors back to the market. Regulator should make reforms on Listing procedures and other faulty regulatory frameworks to ensure transparency and efficiency in the capital market and also should bring clear guidelines regarding Private Placements, Asset Revaluation, Insider Trading, Dealing with Omnibus Accounts etc.

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LIST OF ABBREVIATIONS

AIT	Asian Institute of Technology
BB	Bangladesh Bank
DSE	Dhaka Stock Exchange
SEC	Securities and Exchange Commission
CSE	Chittagong Stock Exchange
Report	Ibrahim Khalid Share Probe Report
FI	Financial Institution
ADB	Asian Development Bank
EII	Eligible Institutional Investors
IPO	Initial Public Offerings
PER	Price Earnings Ratio
DGEN	DSE General Index

CHAPTER 1
INTRODUCTION

1.1 Background/Rationale for the thesis

Sound Capital Market is an indispensible part of an Economy. Without sound and efficient capital market, rapid economic development could be hampered as capital market provides long term funds to entrepreneurs. Capital Market of Bangladesh is still highly speculative and lacks transparency due to poor regulatory framework. In Bangladesh, Financial sector was historically driven by banks and capital market had fewer rules to play as people had mixed perception about the risk pattern in capital market that discouraged them mostly to invest there. But in the mid of ninetieths of last century capital market started to show vibrant behavior that make people interested about the stock exchanges. As the index was rising sharply and everyone was making money, many people started to invest their money to the heated market that made a bigger bubble and finally the bubble bursts. Benchmark index came down to 700 point in November 1997 from its highest 3600 point in November 1996. Thousands of investors lost their money that made them reluctant to invest in the capital market again. It took one decade for them to forget the history of collapse.

After that, regulators had taken many steps to stabilize the market. Hundreds of new issues came to the market. Central depository, circuit breaker, online trading, etc. were introduced in the market to attract investors. As a result, the market started to grow again. Investors started to forget the history of 1996 and started to invest again. This time most investors were new and young with little knowledge about stocks and did not care about market risk. They invested their money and finally lost everything when the bubble started to burst in December, 2010 that had started to grow from the year 2009. This time Benchmark index came down to 3616 points in early February 2012 from its highest point 8918 in December 2010. Millions of investors lost their money and came down to the street. This is the small picture of stock market crashes in Bangladesh. In both cases regulators had failed to take proactive measures to not grow the bubble and caused losses for millions of investors when the bubbles burst. When analysts were anxious about the bubbles, regulators were ignoring them and even defended the bubbles.

The recent volatility of the capital market of Bangladesh is an abnormal phenomenon and such volatility tends to economic instability. I believe it will be interested enough to look into the causes of the problem. As such volatility affects mass people (many investors), it is essential to try to minimize such volatility by identifying the causes (esp., Regulatory failure) and solving the problems. In my study, I will try to identify the reasons of this volatility and also to recommend some suggestions to minimize such volatility in future.

1.2 Statement of the Problems

- As recent volatility raises many questions about the regulatory capability of the SEC, I would like to study whether regulator had any rule to worsen the problem or does it had anything to do at all?
- In my study, I will try to identify the reasons of recent unexpected events of the capital market of Bangladesh and will also try so suggests some ways to avoid same incidences in the future. Another reason to choose this topic is my present job field. I work for the central Bank of Bangladesh that plays a vital rule for economic development as a regulator. So the learning from this study will help me to identify

future risks associated with both money and capital market and also will make me able to make proactive decisions to prevent the economy from such disasters. As no research is made in this important issue, I believe that my research will be very useful for users.

- I also believe that regulators (e.g., SEC, DSE, CSE, Bangladesh Bank) might use my study to strengthen the financial system (esp., capital market) of Bangladesh.
- It is unknown whether the recent stock market fluctuation is due to regulatory failure or due to irrational behaviors of investors.
- Irrational behavior of investors might be an important reason for recent stock market bubble. Patterns of investor's behavior might be covered by the study.
- In many cases, data availability might hinder to reach on my objectives. Data related to stock manipulations and insider trading are not available and that's why I have to rely on secondary sources (if there is any) to conduct my study.

1.3 Objectives of the Research

1.3.1 Overall objective

The study will try to identify the rule of regulators behind the recent capital market crash and focus on developing a road map for promoting Sustainable capital market regulatory framework in Bangladesh.

1.3.2 Specific objectives

The specific objectives of the study will be:

- To analyze and identify the reasons (Esp., regulatory rules.) for recent stock market crash in Bangladesh.
- To review the existing listing and trading rules in Stock indices in Bangladesh.
- To recommend some guidelines for better regulations to strengthen the capital market of Bangladesh.

1.4 Scope

This study is focused on the recent trend of the capital market of Bangladesh. The study will explain the regulatory aspects of capital market of Bangladesh on the basis of disclosed regulations and will try to judge the quality of the regulations in terms of its achievement of the goals. This study is basically descriptive in nature. Data is collected from both Primary (Stock Exchange, SEC) and secondary sources like different publications of DSE, Bangladesh Bank, ADB, WB and IMF. Some other research papers in this line will also be used.

The areas that will be concentrated are:

- Various aspects of capital market regulations of Bangladesh
- Recent trends of Capital Market
- Bubble creation and Bubble Burst and reasons behind this market collapse

CHAPTER 2
LITERATURE REVIEW

2.1 Terminology

To establish the conceptual framework for the research, it is important to provide definitions of key terminologies that are given below:

2.1.1 Capital Market

A capital market is a market for both debt and equity securities, where business enterprises and governments can raise long-term funds. It is defined as a market in which money is provided for periods longer than a year (Sullivan et. al., 2003)

2.1.2 Money Market

Money market is a segment of the financial market in which financial instruments with high liquidity and short maturities (one year or shorter) are traded. Trading in the money markets involves Treasury bills, bankers' acceptances, certificates of deposit, commercial paper, federal funds, and short-lived mortgage- and asset-backed securities. It provides liquidity support to the global financial system (Frank J. Fabozzi et. al., 2002).
Money market of Bangladesh consists Bangladesh Bank (BB) as the central bank, 4 State Owned Commercial Banks (SCB), 5 government owned specialized banks, 30 domestic private banks, 9 foreign banks and 29 non-bank financial institutions. Moreover, Micro-Credit Regulatory Authority (MRA) has given license to more than 300 Micro-credit Organizations.

2.1.3 Stock Exchange

A stock exchange is a body that provides services to stock brokers and traders to trade stocks, bonds, and other securities. Stock exchanges also provide facilities for issuance and redemption of securities and other financial instruments, capital events including the payment of income and dividends. Securities traded on a stock exchange include shares issued by companies, Mutual funds, unit trusts, derivatives and bonds. The initial public offering (IPO) of securities (stocks and bonds) is done in the primary market and subsequent trading of it is done in the secondary market. A stock exchange is often the most important component of a stock market.

The major functions of Stock Exchanges are:
1. Listing of Companies (As per Listing Regulations).
2. Providing the screen based automated trading of listed Securities.
3. Settlement of trading (As per Settlement of Transaction Regulations).
4. Gifting of share / granting approval to the transaction/transfer of share outside the trading system of the exchange (As per Listing Regulations 42).
5. Market Administration & Control.
6. Market Surveillance.
7. Publication of Monthly Review.
8. Monitoring the activities of listed companies (As per Listing Regulations).
9. Investor’s grievance Cell (Disposal of complaint by laws 1997).
10. Investors Protection Fund (As per investor protection fund Regulations 1999).

11. Announcement of Price sensitive or other information about listed companies through online.

2.1.6 Demutualization

Demutualization of a stock exchange is the process of transforming a non-profit member-owned mutual organization into a profit seeking shareholder Corporation. Exchanges all over the world have been demutualizing due to increasing international competition and technological challenges to traditional modes of securities trading. The change of a stock exchange from a member-owned organization to a for-profit shareholder corporation triggers a number of questions about regulatory oversight.

In Bangladesh, Stock indices are directed by the elected body of stock brokers where conflict of interest happens. There is very poor corporate governance in the Stock Indices that is an important reason of recent debacle (Investigation Report by the Committee). In chapter 2 I discussed about benefits of demutualization that are applicable for the capital market of Bangladesh. As stock dealers and brokers are familiar as institutional investors and play a big rule in the capital market mechanism, they should be regulated properly. In Bangladesh, DSE conduct inspection on brokerage houses and DSE is also run by a selected committee of brokerage house, so one cannot expect proper judgment from the DSE.

Table 2.1 DSE Top five BO Accountholders in 2010

Sl.	Name	Total Annual Turnover (Tk. Billion)
1.	Prime Bank Investment Ltd.	676.73
2.	IDLC Finance Ltd.	555.58
3.	LankaBangla Securities Ltd.	525.33
4.	Trust Bank Ltd.	523.25
5.	AB Investments Ltd.	497.33

From the table, we find that all the top investors are brokerage houses who are mainly monitored by DSE that creates many conflicts of interests. So, if brokerage houses make any big irregularity, DSE is supposed to hide it as it a member of DSE. In 2010, many positive factors along with regulatory supports (SEC, DSE) inflated the market and finally caused big losses for general investors. In case of irregularities (serial Trading, price manipulation) by brokerage houses/members, DSE had failed to make any proper investigation and also failed to inform it to SEC for regulatory actions and favored members. In case of price bidding under book-building method, some members (associated to underwriter of the company) quoted very high and irrational price and DSE listed the securities of these companies without asking any question that rises about the transparency of the listing methods. Without stock exchange demutualization such conflict of interests could not be avoided.

2.1.7 Stock market Bubble

A stock market bubble is one kind of economic bubble that takes place in stock markets when market participants drive stock prices above their value in relation to some system of stock valuation. (Smith et.al. 1988)

Impact of Bubble: There is debate about the impact of economic bubbles among different schools of economic thoughts. Many of the mainstream economists believe that bubbles cannot be recognized in advance, cannot be prevented from forming and attempts to "prick" the bubble cause financial crises. Instead of pricking the bubble, authorities should wait for bubbles to burst by their own ways, dealing with the consequences via monetary and fiscal policies (Robert E. Wright, 2010).

Other economists believe that bubble have negative impact on the economy as it tends to cause misallocation of resources into non-optimal uses.

Robert E. Wright, a political economist argues that bubbles can be identified ex ante with high confidence. In addition, the crash that is caused by an economic bubble can demolish a large amount of wealth and might cause continuing economic depression; this view is particularly linked to the debt-deflation theory of Irving Fisher and elaborated within Post-Keynesian economics.

An important aspect of economic bubbles is its impact on spending habits. Market participants with overvalued assets tend to spend more because they "feel" richer (the wealth effect). Many observers quote the housing market of New Zealand, Spain, United Kingdom, Australia and United States in recent times as an example of this effect.

Possible causes of Bubble: Low interest rate policies by the Federal Reserve system are believed to have exacerbated housing and commodities bubbles. The housing bubble popped as subprime mortgages began to default at much higher rates than expected, which also coincided with the rising of the fed funds rate.

It has also been variously suggested that bubbles may be intrinsic, rational and contagious. To date, there is no widely accepted theory to explain their occurrence. Recent computer-generated agency models suggest that excessive leverage could be a key factor in causing financial bubbles.

Some of the causes of economic bubble are given below:

Liquidity: One of the possible causes of bubbles is the presence of excessive liquidity in the financial system that induces aggressive lending banks that make asset markets vulnerable. Economic bubbles often occur when too much money is chasing too few assets, causing both good and bad assets to appreciate excessively beyond their intrinsic value to an unacceptable level.

Greater fool theory: Greater fool theory says that bubbles are driven by the behavior of highly optimistic market participants (the fools) who buy overpriced assets in anticipation of selling it to other speculators (the greater fools) at a higher price. According to this unsupported explanation, the bubbles continue as long as the fools can find greater fools to pay up for the overpriced assets. The bubbles will be ended only when the greater fool becomes the greatest fool who pays the highest price for the overpriced asset and no longer finds another buyer to pay for it at a higher price (Levine et.al. 2007)

Extrapolation: Extrapolation is the process of projecting historical data into the future on the same basis. If price of an asset have increased at a certain rate in the past, they are supposed to continue to rise at that rate perpetually. It says that investors tend to extrapolate past abnormal returns on investment of certain assets into the future, causing them to overbid those risky assets in order to attempt to capture the same rates of return again. Overbidding on certain assets will at a point of time results uneconomic rates of return for investors and then the asset price starts to shrink (Buchanan and Mark, 2008).

Herding: Investors tend to buy or sell an asset in the direction of the market trend. This is sometimes supported by technical analysis that tries to identify those trends and follow them that creates a self-fulfilling prophecy. Investment managers are compensated and retained in part due to their performance relative to their industry peers. Taking a conservative or contrarian position as a bubble builds results in performance unfavorable to peers that might cause customers to go to competitors and might affect the investment manager's employment and compensation.

Moral hazard: Moral hazard is the prospect that a party insulated from risk may behave differently from the way it would behave if it were fully exposed to the risk. A person's belief that they are responsible for the consequences of their own actions is an important aspect of rational behavior. An investor must balance the possibility of making a return on their investment with the risk of making a loss - the risk-return relationship. A moral hazard can occur when this relationship is interfered with, often via government policy. A recent example is the Troubled Asset Relief Program (TARP), signed into law by U.S. President George W. Bush on October 3, 2008 to provide a Government bailout for many financial and non-financial institutions who speculated in high-risk financial instruments during the housing boom condemned by a 2005 story in The Economist titled "The worldwide rise in house prices is the biggest bubble in history".

Manipulation: Manipulation could be a very important reason of economic bubble. Especially, stock market bubble could be created through stock manipulations. In many developed and developing countries, big investors (Both individuals and Institutional) might manipulate the stock price and could create a bubble. Recent stock market bubble in Bangladesh is mostly caused by manipulations (Ibrahim Khalid stock market probe Report, 2011)

Insider Trading: Insider trading also might be a cause of economic bubble, esp., in the capital market. Insiders can use the hidden information to take advantage of the undisclosed news from the market and can make the stock price higher than its intrinsic value (Ronald R et. al. 1993)

Other possible causes of Economic Bubble: Some regard bubbles as related to inflation and thus believe that the causes of inflation are also the causes of bubbles. Others think that bubbles represent an increase over that “fundamental value” of an asset, which finally return to that fundamental value. Finally, others regard bubbles as necessary consequences of illogically valuing assets solely based upon their returns in the recent past without resorting to a rigorous analysis based on their underlying "fundamentals".

2.1.8 Omnibus Account

Omnibus account is a type of account between two futures merchants (brokers). Transaction of individual accounts is combined in this type of account that allows easier management of portfolio by the futures merchant. But this type of account could be used to manipulate stock as many individual transactions are kept hidden over there.

In a recent investigation, it was found that many speculative deals were made through Omnibus accounts of Merchant Banks. Report showed that each Omnibus account consists of 3000-10000 individual accounts and big market players/manipulators used Omnibus Accounts to make speculate stock prices. Even high SEC and Government Officials used the help of Omnibus account to buy and sell share though its prohibited for them to involve invest in the stock market. (Ibrahim Khalid Committee Report)

In this case Merchant Bank did not comply with SEC and Bangladesh Bank rules. As per central Bank law, shares of Banks cannot be bought in unidentified accounts but Merchant banks did so in many cases. But SEC never raised any question about such accounts and never made any investigations to dig out irregularities that indicate poor regulations.

2.1.9 Stock market crash

A stock market crash is a sudden dramatic fall of stock prices across a significant cross-section of a stock market, resulting in a significant loss of paper assets. Crashes are driven by panic as much as by underlying economic factors. They often follow speculative stock market bubbles. Stock market crashes are social phenomena where external economic events combine with crowd behavior and psychology in a positive feedback loop where selling by some market participants drives more market participants to sell. Generally speaking, crashes usually occur under the following conditions, a prolonged period of rising stock prices and excessive economic optimism, a market where P/E ratios exceed long-term averages, and extensive use of margin debt and leverage by market participants (Galbraith, The Great Crash 1929, 1988).

There is no numerically specific definition of a stock market crash but the term commonly applies to steep double-digit percentage losses in a stock market index over a period of several days. Crashes are often distinguished from bear markets by panic selling and abrupt, dramatic price declines. Bear markets are periods of declining stock market prices that are measured in months or years. While crashes are often associated with bear markets, they do not necessarily go hand in hand. The crash of 1987, for example, did not lead to a bear market. Likewise, the Japanese Nikkei bear market of the 1990s occurred over several years without any notable crashes.

2.2 Comparison of recent stock market volatility of DSE with other markets

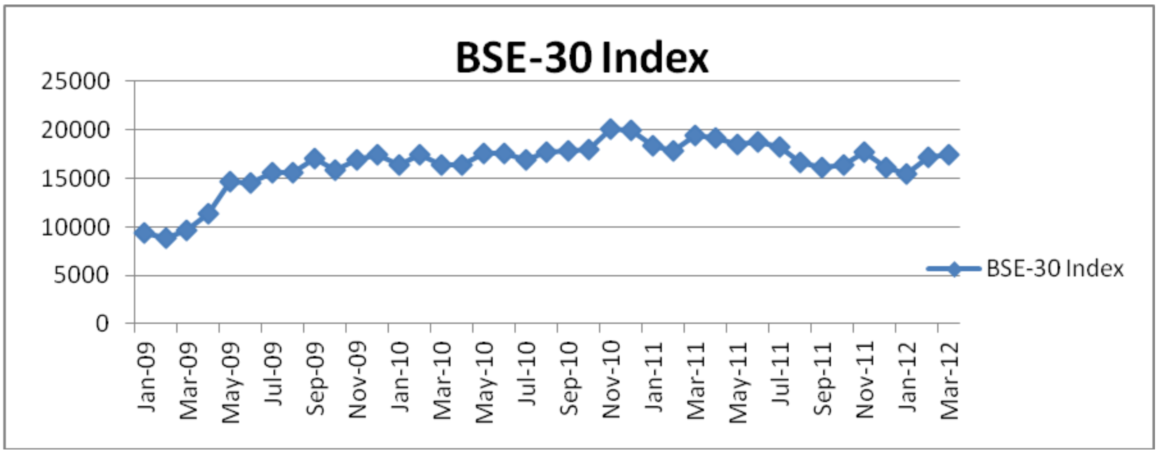
As any sudden dramatic and persistent stock price fall is treated as stock market crash, I believe the recent price fall of Dhaka stock exchange should be called a crash. Recent price fall in DSE was sudden and persistent that caused significant loss of paper wealth and was abnormal in nature compared to other stock markets. If I compare the price trends of Dhaka Stock exchange with other stock exchange I find the price movement of DSE is absolutely different from other stock markets.

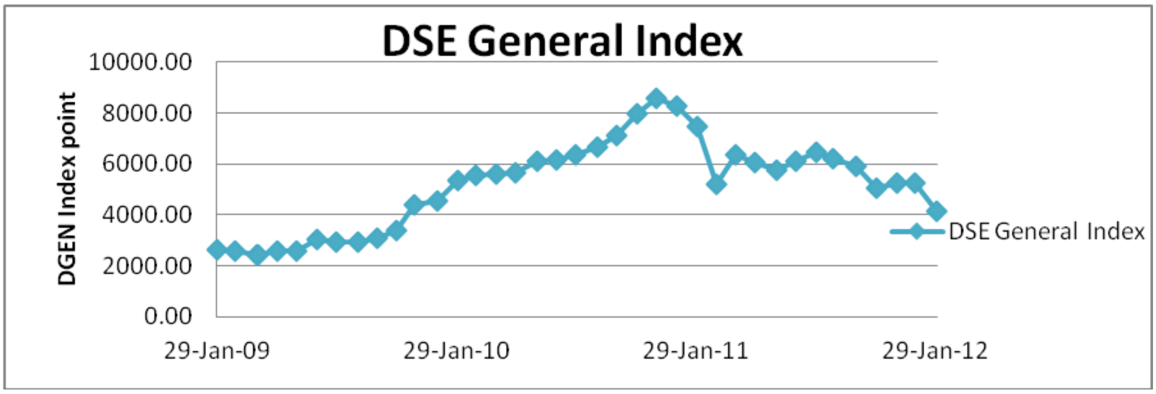
Table-22: Comparison of DSE volatility with other market

Name of the Index	Index Return (Dec'10-Jan'12)	Std. Dev of index return (Dec'10-Jan'12)
DSE	(50%)	11%
BSE-30	(14%)	7.8%
SET	55.62%	5.84%

From the table 2.2, we find that during December 2011 to January 2012 Bombay Stock Exchange selected index (BSE-30) felled by 14% while SET index of Thailand increased by 55.62% during the period while Dhaka Stock Exchange general Index (DGEN) felled by more than 50% during that period, i.e., DGEN lose its value by 50% during the period that says that this is not simple volatility and it can be defined as a collapse.
On the other hand, Standard deviation of index return (a measure of volatility) for BSE-30 and SET index was respective 7.8% and 5.84%. But for DSE, the standard deviation of index return was 11% that was much higher than other two indices.
DSE index felled sharply during the period from 8200 point (approx.) to 4000 point (approx.) and the fall was persisted over a long period.

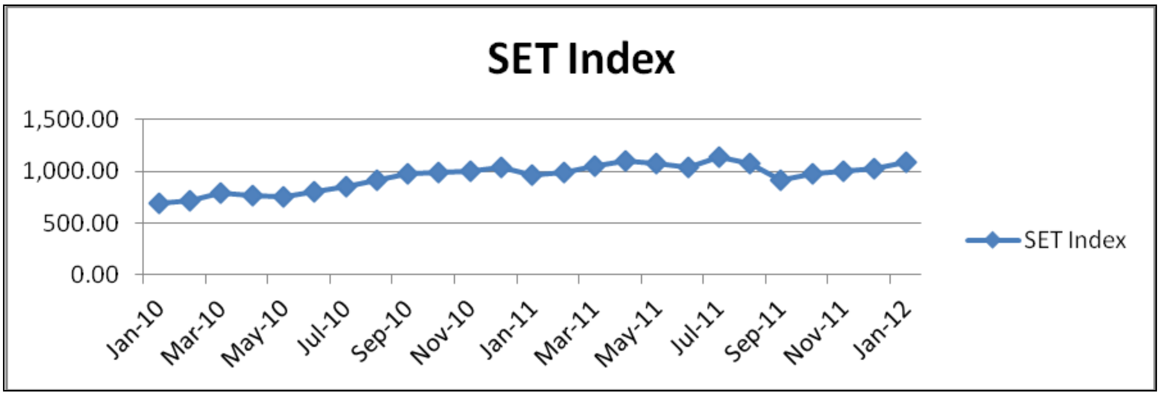
Graph 2.1 Trend of Bombay Stock Exchange-30 (BSE-30) index





Graph 2.2 Trend of DSE General (DGEN) index

Graph 2.3 Trend of SET Index



From the graph 2.1 we find that BSE-30 index fluctuating over the period in the range of 10000 to 20000 points and showing an increasing trend now. As a result the standard deviation of the index return was 7.8%. But the BSE-30 index fluctuation is much lower than the DSE general index (Graph-2.2).

Graph 2.3 gives the trend of SET Index of Thailand that is growing fast and crossed 1000 points from 600 points during the period. Standard deviation of SET index was 5.84% that is much lower than that of DSE general index (11%).

Graph 2.2 gives the highly volatile and sharply falling index trend of DSE general Index that started to increase from 2600 points in January 2009 and crossed its zenith price of 8600 in December 2010. After climbing the highest point it started to fall sharply and came down below 4000 in January 2012 less than half of the highest point.

From the above analysis we can conclude that DSE index movement was not normal and the fall was so abrupt that it caused huge loss for investors. Especially investors who invested with margin loan lost everything as the index loss was more than 50%. Both BSE-30 and SET are facing regular rise and fall while DSE is facing regular and sharp that indicates that the fall was like a stock market collapse and in the later part of the study I will identify this as a stock market collapse.

2.3 Previous research on this topic

Many studies are done around the world to find the reasons of stock market crash and linked with regulatory issues. Recent economic crunch and stock market crash in US motivated economists to conduct in-depth research on it. In Bangladesh many analysts expressed their view regarding the capital market crash but no comprehensive research work is still done on it. Government had formed an enquiry team headed by Mr. Ibrahim Khalid, former deputy Governor of the Central Bank to make a probe into the recent activity and to identify the culprits that submitted their report to the government. I am going to discuss the causes of recent Credit Crisis of 2007-2009 and “Ibrahim Khalid stock probe report” regarding the stock market of Bangladesh in this chapter.

2.3.1 Research on Capital Market crash in Bangladesh

After the recent catastrophe of capital market of Bangladesh, Government of Peoples republic of Bangladesh had formed a high-powered committee in 2011 to investigate the issue and to give a report to the government within two months. The committee was headed by the ex-deputy governor of Bangladesh Bank, Mr. Khondoker Ibrahim

Khaled and the committee was named *"Ibrahim Khaled share market probe Committee"*. The committee published a report that was initially kept undisclosed to the general people but later on it was disclosed as investors groups and civil society was creating pressure over the government for disclosing it. I will try to summarize the findings of the report in this chapter.

Reasons behind the Market Failure: Committee identify following broad factors that caused the capital market disaster recently:

a) Primary Issue related Problems:
- Direct listing in Primary issue
- Abuse of Book Building Method of IPO
- High premium for stock listing
- Illegal Private placement market
- Asset Revaluation of Companies before listing to charge higher premium.

b) Secondary market related problems:
- Circular trading in Secondary market
- Block trading
- Stock Price Manipulation through Omnibus Accounts
- Most of the market players are identified in the report

c) Irregularities in issuance of Right Share/Preference Share/Repeat IPO etc.

d) Recommendation of Stock Dividend by companies against unrealized Profits

e) Regulatory Failure
- Inconsistency in regulatory activities
- Supporting and legalization of unethical activities of Big Investors
- Irresponsible Behavior/Weakness in many areas
- Formulating policies to support market Players (Manipulators)
- Lack of Due Diligence
- Lack of Co-ordination between SEC and Stock exchanges
- Allowing Financial Institutions to invest in capital market aggressively
- SEC Failed to take measure against manipulation of Financial statements

Report says that the burden of this failure should be carried by Securities and Exchange Commission (SEC).

Recommendations by the Committee

The Committee has recommended some suggestions to the Government to recover the Capital Market from the depression. Major points of their recommendations are given below:

a) Restructuring of SEC
- Termination of SEC chief and some other corrupt members
- Comprehensive inspection of their corruption and necessary legal actions
- Recruiting qualified accountants/financial analysts/experts/Talents for SEC
- Increase the remuneration of SEC staff to attract talents
- Ensuring integrity of SEC personnel

b) Stock Exchange Demutualization:
- Form Committee within DSE to give report regarding demutualization process within 3 months

- If DSE fails to give report on time, Government should take steps after 3 months
- Government can take advisory supports from World Bank or any other international organization
- Government can employ an "Administrator" to DSE to implement the demutualization process.

c) Co-ordination between SEC and stock exchanges for better regulation
d) Capital Market financing by Financial Institutions (FI's)
   - Formulate policy for capital market investment by FI's in the line of such policies in India and Pakistan
   - Take measures against FI's who are involved with the recent stock market manipulation
   - Central Bank should monitor FI's aggressive stock investment very strictly

e) Formulate clear policy for Pre-IPO placement
f) Ensure transparency in dealing with Omnibus Accounts
g) Prohibit share trading by some Government Officials (e.g., SEC, DSE, CSE, Bangladesh bank , Commercial bank officials)
h) Asset Revaluation by companies should be reviewed by SEC
i) Review the Book-Building Method of IPO
j) Make uniform face-value of all companies
k) Take legal actions against market players/manipulators
l) Government should be more aware about the capital market and they should be free from influence of top market players (Salman F. Rahman, Rakibur Rahman etc.)
m) SEC should Open Investors advisory support services to avoid rumor-based trading

Conclusion: Committee has made a study on the capital market issues. They specially focused on individual manipulations and regulatory system failure and provided some clear-cut recommendations for the government. I will conduct empirical study on some of the factors to test whether the volatility was due regulatory failure or not.

CHAPTER 3
METHODOLOGY

3.1 Data Source

This study is basically descriptive in nature. Data is collected from both Primary (Stock Exchange, SEC) and secondary sources like different publications of DSE, Bangladesh Bank, ADB, WB and IMF. Some other research papers in this line will also be used.

3.2 Analysis Technique/method

3.2.1 Qualitative analysis: As my study will try to examine the regulatory aspect in the capital market of Bangladesh, I will focus more qualitative analysis techniques.

3.2.2 Quantitative Analysis: In my study, I will also use quantitative techniques to analyze data. Software's like SPSS, Excel might be helpful for me.

CHAPTER 4
Recent Trends of Capital Market

Over the last few years, the capital market of Bangladesh has witnessed a super-normal growth which is not in line of development of real sector of the country. Progress in capital market development has been made possible by, among other things, the central depository system and the automated trading system, a substantial increase in the minimum capital requirement of banks and nonbank financial institutions, lower interest rates on long-term government savings instruments, and an increase in overseas workers' remittances (Bangladesh Bank, 2011). Increased investors' participation and demand for stocks are fueling price hikes in the market. Other indicators of the capital market also recorded significant growth. Market capitalization of DSE remarkably increased during last three years as reflected in the ratios of market capitalization to the country's GDP at current market price. Market capitalization stood at Taka 2700.7 billion at the end of FY10 increased by 190.1 percent from Taka 931.0 billion of end FY08. The ratio of market capitalization of DSE to GDP rose to 39.1 percent in end FY10 from 5.2 percent in FY06 and from 2.3 percent of FY00. Except for the 13.1 percent bubble in 1996, the ratio was almost flat at below 3 percent up to FY04. After the 1996's bubble and bust, the market returned to sunny days in the beginning of last quarter FY04 by crossing the index 1100 marked point.

After ten years of a flat capital market, the DSE General Index (DGEN) crossed 3000 marked point in December 2007 for the second time. Since the third quarter of FY09, the DGEN gained sharply and it jumped to 8918.51 in December 2010 increased by 5908.51 points or 197 percent from the index of end June 2009(3010 points).

When the recent past global recession adversely affected the world capital market, sustained rise of price index and daily average turnover of Bangladesh capital market could be seen as a positive sign for the Bangladesh economy. Investment by foreigners in DSE increased during last three years. In FY10, the foreign trade turnover was Taka 18.7 billion (0.7 percent of total turnover in DSE) which was 57.9 percent higher than previous year. Foreign trade was Taka 9.9 billion (6.0 percent of total turnover) in FY07 and was Taka 3.4 billion (9.7 percent of total turnover) in FY97 (Bangladesh Bank, 2011)

Nonetheless, long-term prospects for capital market development are mixed. Although, the Securities and Exchange Commission (SEC) of Bangladesh has tried to correct the abnormal behavior observed in the market, very often it is argued that lack of proper and firm decisions from the regulator's side has contributed to make the market more unstable rather than stabilizing it. At the beginning of recent Bull Run, Bangladesh capital market was fairly underpriced in terms of Price Earnings Ratio. The market weighted PER of DSE was 11 to 18 during FY04-FY07. PER became to bigger from beginning of FY09 as the acceleration of price index. The PER reached to its peak level at 30.6 in February 2010 from 18.4 of end June 2009. The high PER indicates that the market is highly overpriced and overheated. The strong demand from the retail investors, not matched by a corresponding increase in supply of stocks, has caused the PER to rise beyond rational levels. In terms of any measure, Bangladesh capital market is overheated during last couple of years as supply shocks (Bangladesh bank, 2011).

The capital market developments and its sustainability depend on market fundamentals at least in the medium term, and the fundamental strength of the market essentially comes from financial strength of the listed companies. Also, strong regulatory environment created and maintained by the regulatory bodies and participation of institutional investors and professional market analysts help orderly market operations. The market witnessed that last few years many fundamental companies with strong financial strength have been listed in the market. The main regulatory body SEC and the Government of Bangladesh and others related regulatory authorities have continued their all efforts to develop the Bangladesh capital market that reflected in the market trends. But growth of market demand for stock was much then that of supply that inflated the market in recent years and made the market most volatile one in the region. The recent vibrant nature of the capital market also might be due to the increased interest in the market by a large number of individual investors which has been influenced by the government's decision to reduce the bank interest rates for its different types of savings instrument. Some basic information regarding Dhaka stock Exchange is given below:

Table 4.1 Dhaka Stock Exchange (DSE) activities

	FY08	FY09	FY10	FY11
No. of listed securities	378	443	450	459
Issued equity and debt (billion Taka)	284.4	457.9	607.3	618.51
Market capitalization (billion Taka)	1044.80	1903	3508.00	2616
Turnover in value (million Taka)	4309.46	9327.153	17831.37	5598.52
DSE General Index*	2795.00	4535.30	8290.50	5257.50

- Year-end close Price, Source-Dhaka Stock exchange

Table 4.2 DSE Highest Records

	Values	Date
Total Number of Trades	389310	05-12-2010
Total Trade Volume	242856735	21-07-2011
Total Traded Value in Taka(mn)	32495.756	05-12-2010
Total Market Capital in Taka(mn)	3680714.195	05-12-2010
DSI Index	7383.93657	05-12-2010
	8918.51346	05-12-2010

From Table 4.1, we find that DSE general index, Daily trade value and market capitalization of DSE increased substantially during last 4 years. But number of listed securities remained almost the same during the period that implies that supply side response was less relative to demand side response and market capitalization and index increased due to increased demand for securities and scarcity of good securities.

Nature of Investors: At the end of 2010, total number Beneficiary Owner (BO) Account stood at 3.3 Million (DSE Data). Out of that a big number of investors did not have sufficient knowledge about securities trading and most of them were relying on rumors spread by big investors. Information of BO accounts of last 3 years are given below:

Table 4.3 Change in total Number of BO Accounts in two Years

Date	Total No. of BO A/C	Change (+/-)
01.01.2009	14,68,500	--
30.06.2009	14,19,019	(49481)
31.12.2009	19,20,602	5,01,583

30.06.2010	25,70,654	6,50,052
31.01.2011	33,79,719	8,09,065

From the table we find that most of the BO accounts were opened during June ’2009 to January ’2011 that indicated that more than half of the investors could be treated as new investors. During 2009, stock exchanges, Institutional investors and SEC make many campaigns within and outside the country to attract new investor that seems to be successful as the BO accountholders was doubled in last two years that might be treated as a potential for market development. But due to scarcity of new securities market price increased substantially. This demand-supply mismatch along with inadequate investor’s knowledge made the stock prices in a new height and finally turned into a big depression that is still going on.

Recently listed Companies with financial information: Twenty three companies (including three direct listing companies) raised new equity of Taka 18.2 billion in the capital market in FY10, higher than the Taka 5.9 billion raised by the sixteen companies in FY09. Of the new equity issued, Taka 5.3 billion raised through private placements and Taka 12.9 billion raised through public placements against Taka 0.9 billion raised through private placements and Taka 5.0 billion through initial public offerings (IPO) in FY09.The volume of public offerings in FY10 was oversubscribed more than nine times indicating the high demand of new securities in the primary market. Bonus shares valued at Taka 27.6 billion were issued in FY10 by one hundred and twenty one companies against retained profits, higher than the Taka 16.2 billion issued in FY09 by ninety one companies. Currently 493 securities (Debt and Equity securities) are being traded in Dhaka stock exchange. Few numbers of companies are making fresh issue every year. 13, 18 and 10 companies listed their securities respectively in 2009, 2010 and 2011(up to July). Traditionally DSE used fixed price method for flotation of new companies. But fixed price method does not attract good companies always. So, to attract new companies, SEC decided to introduce Book building method that is a globally acceptable method for IPO. But in Bangladesh, Book Building method is handled very roughly that caused loss for millions of investors. Detail information of securities floated in the market for last 3 years are given in table 4.4.

Table 4.4 Detail information of fresh Issues in the DSE during 2009-11

year	Issue Name	Book Value	Issue Price	Opening Price	1st day return	1st Month close Price	1st Month return	1st year close price	Yearly return
2011	M. I. Cement	10	111.6	134	20.07	140	25.45	70	-37.28*
2011	MJL BD Ltd.	10	127	145	14.17	190	49.61	71.9	-43.39*
2011	Reliance MF	10	10	12.7	27.00	10.5	5.00	8.3	-17*
2011	EBL NRB MF	10	10	10	0.00	9.2	-8.00	8.6	-14*
2011	SEBL 1st MF	10	10	10.2	2.00	8.5	-15.00	8.7	-13*
2011	Barkatullah Electrodes	10	60	73	21.67	65	8.33	35.1	-41.5*
2011	Salvo chemicals	10	10	68	580.00	48	380.00	23.5	135*
2011	MBL MF	10	10	10.8	8.00	9.5	-5.00	7.7	-23
2011	AIBL MF	10	10	9.5	-5.00	9.8	-2.00	9.5	-5
2011	Deshbandhu polymer	10	10	74	640.00	61	510.00	29.3	193
2010	PHP MF	10	10	9.6	-4.00	9.5	-5.00	5.4	-46
2010	Active Fine Chemicals	10	10	136	1260.00	130	1200.00	77	670
2010	IFIL MF	10	10	9.3	-7.00	10.2	2.00	7.2	-28
2010	Popular MF	10	10	10.9	9.00	10	0.00	7.4	-26
2010	Janata MF	10	10	12.6	26.00	11.4	14.00	8.1	-19
2010	Green delta MF	10	10	11.4	14.00	10.5	5.00	7.4	-26
2010	Beacon Pharma	10	10	89.2	792.00	85.2	752.00	41	310
2010	Malek Spinning	10	25	89	256.00	85	240.00	70	180
2010	United Air	100	100	235	135.00	620	520.00	510	410
2010	ICB 3rd MF	10	10	12.7	27.00	12.4	24.00	8.7	-13
2010	Phoenix MF	10	10	12.9	29.00	12.7	27.00	9.4	-6
2010	IFIC MF	10	10	16.5	65.00	16	60.00	14	40
2010	RAK Ceramic	10	48	208	333.33	170	254.17	103	114.58
2009	Dhaka Insurance	100	120	799	565.83	740	516.67	2646	2105
2009	R. N. Spinning	100	100	514	414.00	506	406.00	1197	1097
2009	DBH 1st MF	10	10	28.6	186.00	24.2	142.00	16.1	61
2009	Prime Bank 1st Icb MF	10	10	23.5	135.00	20.6	106.00	17.5	75
2009	Trust Bank MF	10	10	27	170.00	20	100.00	17	70
2009	Provati Insurance	100	100	559	459.00	619	519.00	800	700
2009	ICB employees MF	10	10	25	150.00	27	170.00	17	70
2009	Goldenson (RPO)	10	20	57	185.00	60	200.00	102	410
2009	Grameen Phone Ltd.	10	70	177	152.86	171	144.29	245	250
2009	Islami Insurance	100	100	462	362.00	511	411.00	604	504
2009	ICB AMCL MF	100	100	261	161.00	180	80.00	156	56
2009	Dacca Dying	10	10	63.1	531.00	59	490.00	73.1	631
2009	MARICO BD Ltd.	10	90	325	261.11	451	401.11	672	646.67
2009	EBL 1st MF	10	10	35.5	255.00	31.5	215.00	17.5	75
2009	Rupali Life insurance	100	100	1955	1855.00	1667	1567.00	2497	2397
2009	Asia Insurace	100	100	405	305.00	470	370.00	838.5	738.5
2009	Bay Leasing	100	250	784	213.60	762	204.80	1721	588.4
2009	Prime Finance 1st MF	10	10	71.6	616.00	46.9	369.00	29.8	198

From the table 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. 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. Actually this is an example of overpricing of IPOs in Bangladesh that caused bubble in the market.

CHAPTER 5

Empirical examination of three problems identified by Ibrahim Khalid committee

In recent years, Bangladesh capital market witnessed both bullish and bearish trends caused by irregular fluctuation in the indices due to various reasons. In this chapter, I will try to identify some reasons/factor that caused such irregular cycles or stock market crash in Bangladesh.

5.1 Changes in Face Value (Stock Split) of Securities: There are several theories that explain the reasons of stock split by companies. The most common reasons are to achieve an optimal price range for liquidity, to achieve an optimal tick size and to signal the confidence of managements' in the future stock price. Various studies on stock split and market behavior shows that there are stock price might lead increase in stock price and trade volume in the short term (Aduda and Caroline. 2010).

Copeland (1979) noted that a stock split changes stock prices to a more optimal price, which in turn increased demand for the stock. Their hypothesis of the optimal price range stated that there was a price range within which trading was most liquid for stocks of a company. Baker and Powell (1993) noted that the main motivation for the executives to split stock was toward improved liquidity. High-priced stocks found to be illiquid due to the psychological reasons and transaction costs. Therefore, when the prices climbs up to a certain level, the executive splits the stock to lower prices which facilitates trading and enhance liquidity. Benartzi et al. (2005) argued that management splits their stocks only if it considers the current level of stock price and earnings to be persistent.

In Bangladesh, price of small face value (Tk.10) securities are relatively higher then big face value (Tk. 100) securities where other things remain the same. By May 2010, SEC instructed all companies to convert the face value of securities to Tk.10 from various per values that increased price level of Tk. 10 share substantially that inflated both the individual stock price and indices. During the period of 2009-2010, 62 companies had changed their face value. Some of the examples are given below with pairs:

Table 5.1 Price comparison of companies with same fundamentals but different per value

Items	1. Union Capital (Par value-10)	2. BIFC (Par value-100)	Differences(1-2)
EPS-2009 (Tk.)	3.90(39.00)	34.35	-4.65
NAV-2009 (Tk.)	15.60(156)	153	+3
(floating share (%))	417.5 Million (21%)	359.0 Million (22%)	+58.50
Dividend-2009	30%B	10%C, 12%B	+8%
Price-30/12/09	116.50(1165)	323.00	TK. 842
Price-30/12/10	246.80(2468)	1117.00	TK. 1351
Market Return (31/12/09-31/12/10)			82%

Table 5.2 Price comparison of Mutual Funds with different per value

Items	1. AIMS MF (Par value-1)	2.GrameenMF(Par value-10)	Differences (1-2)
EPS-2009 (Tk.)	0.19(1.9)	3.45	-1.55
NAV-2009 (Tk.)	1.91(19.1)	34.65	-15.55
Paid Up capital	168.0 Million	170.0 Million	-2

Dividend-2009	No dividend was declared that year due to pending case with the court.		
Price-30/12/09(TK)	13.83(138.30)	78.48	+59.52(176%)
Price-30/12/10 (TK)	11.85(118.50)	104.17	+14.33(114%)

From the both table given above that with similar financial condition or weaker financial conditions lower face value companies were overvalued relative to higher face value companies in same industries. This situation was persisting for many years and regulator failed to identify the face value of all listed companies that created some overvalued securities in the market. Investors were eager to buy the securities of these companies that were going to change face and before split price of these were jumping. As an example, National Bank Ltd (NBL) spits its share from Tk. 100 par value to Tk. 10 at 22/09/2010. At that day, the price of those securities was Tk. 823.00(82.30) only. But after just two months, price of the securities stood at Tk. 140 (22/11/2011) without any significant change in the company fundamentals. Another example is Prime finance and Investment Companies Ltd. that split the stock in 25 July 2010 when the stock price was Tk. 331. But just after two month (26 July 2010) stock price rose to Tk. 472 and the increase during this two month is almost 43%. So, we might say that change in face value (stock Split) inflated the market and caused an unanticipated bubble in the market. List of some stock split companies and their market capitalization are given below:

Table 5.3 List of some stock split companies and their Market Capitalization(Tk.)

Name of the Company	Market Capitalization (as on 02.07.2009)	Market Capitalization (as on 05.12.2010)	Change (%)	Market Adjusted Return (%)
NBL	17093.45	77256.42	351.96	2.5
Pubali Bank	16979.24	57735.13	240.03	(30)
UCBL	9544.65	765099.54	7916.0	Not traded in 2009
Uttara Bank	20777.12	43391.15	108.84	(150)
ICB Islamic Bank Ltd	7946.52	13958.75	75.65	(147)
Eastern Bank	2475.00	39460.16	1494.3	4
Uttara Finance	2475.00	21859.2	783.2	240
Al-Arafah Islami Bank	6687.61	32413.54	384.68	101
Prime Bank	15747.27	57186.03	263.14	(30)
Southeast Bank	10584.51	45708.89	331.84	(77)
Dhaka Bank	7324.53	21250.18	190.12	(55)
NCCBL	7511.61	37404.66	397.95	(54)
Social Islami Bank	6762.96	16044.57	137.24	(76)
MIDAS Finance	1560.80	12483.34	699.80	228
Standard Bank	6953.95	22424.52	222.47	(23.8)
EXIM Bank	12498.38	42838.33	242.75	(153)
People’s Leasing	10172.48	33180.05	226.17	612
Prime Finance	10172.48	43690.10	329.49	263
Jamuna Bank	5100.82	17602.83	245.09	(103)
Shahjalal Islami Bank	7583.21	309117.03	3976.3	45
Premier Bank Ltd.	6889.42	20200.744	193.21	(62)
BD Finance	2039.68	20200.75	890.38	273
Phoenix Finance	1059.30	12199.52	1051.6	225
First Security Bank	2768.4	12963.72	368.27	(65)
Aftab Automobile	2768.41	24360.48	779.94	70

From the table we find that market capitalization of stock split companies increased substantially during that period. Market adjusted returns of these companies were mixed as dividends, Right share issues are not considered here.

Stock denomination fixation and Regulatory rules: From the table 4.5 we find how stock split companies' shares increased substantially. But such behavior is considered as normal in terms of other markets and cannot be treated as market failure and regulator cannot stop stock split in a stock market.

5.2 Asset Revaluation: Chainirun and Narktabtee (2008) argued that firms revalue their assets to signal the firms' growth prospect and liquidity improvement in order to decrease information asymmetry. Sharpe and Walker (2007) revealed that announcements of asset revaluation were associated with substantial upward movement in stock price and these shift in stock price generally sustains in later months.

In Bangladesh, companies revalued their assets (Land and other Fixed Assets) that increased their asset value substantially as price of land and all other assets increased sharply that caused increased stock prices in the market. Many factors influenced companies to revalue their fixed assets. Some of these factors are to increase Stock price, to get more credit under NAV-based margin rules, to get higher ratings, to strengthen financial statement and to attain investors confident etc. sample of the companies of top value gainers are listed below:

Table 5.4 Top 10 NAV-gainer companies after asset revaluations

Name of the Company	NAV per Share(Tk.)		NAV Change (%)	Stock Price Change during Jan'2009-Dec'2010 (%)	DGEN Change Jan'2009-Dec'2010(%)	Market Adjusted return (%)
	Before Asset Revaluation	After Asset Revaluation				
Libra Infusions Ltd.	438	15,667	3472	355	212%	143
Sonali Ansh Ltd.	297	2,157	626	767		555
Rahim Textile Ltd.	127	785	518	641		429
BD Thai Aluminum	142	566	298	185		(27)
Orion Infusions Ltd.	20	101	413	357		145
Ocean Containers	13	50	296	Not Applicable*		----
Shinepukur	12	26	120	21		(191)
Prime Textile	300	633	110	572		360
Eastern Insurance	151	309	104	162		(50)
BD welding	20	39	95	1001		789

*As the company was listed in 2010.

From the Table 5.4 given above, we find that some company gained up-to 1000% after asset revaluations during the period of 2009-10. As there is a clear and direct relationship between asset revaluation gain and stock price growth, I can say that revaluation might help the market to grow up faster and also caused much volatility. Many of the company directors sold their shares when the price went to the peak in 2010. But such phenomenon is supported by study and cannot be treated as regulatory failure.

5.3 Issuance of Right/Preference Shares:

Companies offer right shares to increase capital base or to meet regulatory capitals. In 2010, 22 companies proposed right shares to existing shareholders valuing 24720 million Taka that almost 17 times than that of 2009 figure which was only 1450 Million taka. Most of the right proposals of 2010 were with a premium price that differed on a range of 10% to 600%.

Table 5.5 Top Companies offered Right shares with high premium

Company Name	**Premium Value (Tk.)**	**Stock Price on 01/01/2009 (Tk.)**
Confidence Cement Co. Ltd.	600	323.00
Bay Leasing & Finance	250	784.75*
Eastern Insurance Co. Ltd.	200	562.25
The City Bank Ltd.	100	432.50
Phoenix Finance	100	440.50
Asia Insurance	100	404.30*

*Close Price of 1st Trading day

From table 5.5 we find that in January 2009, price of confidence cement co. ltd. was only Tk. 323 but just after one year its right offer price was Tk. 700 (including Tk. 600 Premium) that was approved by the SEC which is a classic example of regulatory silence toward manipulation.

Table 5.6 Top Companies offered preference Shares

Company Name	Value of Preference Share (Tk. Million)	Private Placement
Beximco Pharma	4100	63%
Sumit Power	3000	69%
Aftab Automobile	1800	82%
Peoples Leasing	1200	58%
BD Thai Aluminum	750	77%

In case of preference share, most of them are distributed through private placement where there was no transparency of allocation. Another interesting thing is that, stock price of most of the companies mentioned above increased substantially just after the offerings that increased the greed of investors to make profit through buying right/preference shares of these companies.

5.4 Faulty listing methods: In the year 2010, regulator introduced Book building method to attract new companies to the market. Some companies abused this opportunity to exploit maximum benefits from listing that inflated the market. SEC allows companies to float securities through IPO (Fixed Price and Book Building method), Direct Listing and Repeat IPO where Book building method is used mostly in the year 2010. In Bangladesh, following companies used book building method for listing in the capital market:

Table 5.7 Companies floated shares through Book Building Method

Name of Company	Premium value	Offer price	Collected capital (Million Tk.)	Market Price (02/02/12)
MJL Bangladesh Ltd.	142.40	152.40	5690	68.10
MI cement Ltd.	101.60	111.60	3050	65.20
Khulna power company Ltd.	184.25	194.25	9600	43.20
Ocean containers Ltd.(OCL)	135	145	1600	46.20
RAK Ceramics Ltd.	38	48	1310	54.07

From the Table 5.7 we find that first four companies charged very high premium for its share where and withdrawn huge amount of capital from market. When these companies asked for very high price, shares of other companies of same industry tends to rise on an expectation that it is highly undervalued that increases the general price index. As per the local expert, local media and committee report, Book building method is the most important factor behind the recent stock market volatility in Bangladesh. So we need to study this factor deeply to reach on a conclusion.
I would like to describe the implication of price discovery method followed to discover the price of KPCL and OCL here.

Khulna Power Company Ltd: Khulna Power Company Ltd. is a power generation company under private ownership that sells supply electricity to consumers through national distribution system. Its security was first traded in 18April, 2010 and price of the securities is being discovered by eligible institutional investors through Book Building system. The company was registered in 15 October, 1997. Its NAV was 17.09 and 18.53 respectively for the year 2008 and 2009 while EPS was 0.97 and 2.79 respectively for the year 2008 and 2009.

Other listing related information regarding the company is given below:

Table 5.8 Basic Listing Information of Khulna Power Company Ltd.

	Khulna Power Company Ltd.	
	Name of the Item	**Taka**
Sl.	Face Value	Tk.10
1.	Indicative price	Tk. 162
2.	Offer Price	TK. 194
3.	NAV (As of 2009)	Tk. 18.53
4.	EPS(As of 2009)	Tk. 2.97
5.	Salable Shares	5,21,48,250
6.	Paid Up capital(As of 2009)	TK. 208,593,0000
7.	First day Trade Price(18/04/2010)	Tk. 273.60
8.	Trade price after 7 days	TK. 270
9.	Trade price after 30 days	TK.207
10.	Trade Price After 1 year	Tk. 90.60
11.	Lowest trade price	TK. 55.00
12.	Highest Trade Price(18/04/2010)	Tk. 341

Net Asset Value of KPCL was TK. 18.53 and indicative price was Tk. 162 that is Ten times higher than the asset value of the company. EPS of the company was TK. 2.79 and before the listing P/E of the security stood at almost 60 that is unusual in respect of other company.

Ocean Containers Limited: It is the pioneer for Inland Container Depot (ICD) and Container Freight Stations (CFS) and is the largest privately owned land container port (Off-dock) in Bangladesh. It is located at Patenga Industrial Area of Chittagong on the International Airport road, which is only 6 km from the country's largest seaport, Chittagong Port. It was listed with DSE in 2010 through book building method.

Other listing related information regarding the company is given below:

Table 5.9 Basic Listing Information of Ocean Containers Limited.

	Ocean Containers Limited.	
Sl.	**Name of the Item**	**Taka**
1.	Face Value	Tk.10
2.	Offer price	Tk. 145
3.	NAV (As of 2009)	Tk. 55
4.	EPS(As of 2009)	Tk. 3.73
5.	First day Trade Price (04/03/2910)	Tk. 297
6.	Trade price after 7 days	TK. 279
7.	Trade price after 30 days	TK.258
8.	Trade Price After 1 year	Tk. 96.60
9.	Lowest trade price	TK. 62
10.	Highest Trade Price (04/03/2910)	Tk. 2254

From these figures, we find that the maximum price of the stock was Tk. 2254 and minimum price was Tk. 69 only against face value of Tk. 10. The lowest price of the securities was half of the offer price of the securities that indicates that many shareholders caused huge losses out of this security.
In both cases discussed above most benefit goes to the owners of the company and both the company are owned by same people. Few institutional investors benefited directly from these two securities.

Book Building method for price discovery gives various massages to the market. Some of these are follows:

1. Investors will feel that market is undervalued and they will select instruments that are already in the peak but relatively undervalued if compared to KPCL/OCL.
2. Companies of same industry of which KPCL is operating should go up. Most of the companies of power sector seemed undervalued relative to KPCL as it was overvalued and investors had expectations that price of each company will go to that level that fueled the speculative trend of the market.
3. General Investors had a perception that Eligible institutional investors are technically sound to discover the justified price for a specific stock and their valuation method should be reliable. So, general investors had a perception that market is still undervalued and it has huge potential to go up. So they started to invest their money in this heated market and made it heater that ultimately caused a disaster in the market.

Comment: In case of Book building method, EIIs are the authorized body to discover the price and regulator's intervention might deter companies from IPO process. So, though there were some negligence in the regulations but it could not be treated as regulatory failure.

5.5 Stock price Manipulation: Stock price manipulation was very common in last few years as some company's stock price grew by more than 4000% in one year without any significant change in company fundamentals. Stock price was inflated with the help of serial trading by few numbers of big investors that was one of the reasons of recent collapse of stock market in Bangladesh. Investigation Committee found many proof of Serial Trading to increase individual stock price that caused bubble in the market. Top twenty gainers in Dhaka stock exchange in the year 2010 are as follows:

Table 5.10 Top 20 Gainers in 2010

No.	Company name-Category	Price (01/01/10)	Price (30/12/10)	Change (%)	Market Adjusted Return (%)
1.	Ctg. Vegetables-Z	119.75	5099.50	4158.46	4076.99
2.	Safco Spinning-Z	84.50	753.75	792.01	710.54
3.	Tallu Spinning-Z	156.00	848.75	444.17	362.7
4.	Rahima Food-B	165.25	693.75	319.82	238.35
5.	BD welding-A	66.80	266.50	298.95	217.48
6.	Prime Insurance-A	444.00	1584.25	256.81	175.34
7.	Monno Staffler-A	987.25	3360.50	244.13	162.66
8.	Sonargoan Textile-A	380.00	1288.00	238.95	157.48
9.	Dhaka Insurance-A	812.25	2646.50	225.82	144.35
10.	City Gen Insurance-A	474.25	1503.75	217.08	135.61
11.	HR Textile-A	271.00	842.25	210.79	129.32
12.	Mithun Knitting-A	534.75	1503.75	217.08	135.61
13.	Mercantile Insurance-A	488.50	1454.25	197.70	116.23
14.	Libra Infusion-A	1782.00	4994.75	177.48	96.01
15.	Delta Life Insurance-Z	14,450.25	38899.25	169.19	87.72
16.	One Bank-A	451.75	1153.75	155.40	73.93
17.	Continental Insurance-A	434.50	1105.00	154.32	72.85
18.	Aramit Cement-A	628.00	1592.00	153.34	71.87
19.	Singer BD-A	2873.25	7169.50	149.50	68.03
20.	Monno Ceramic-A	462.00	1138.25	146.37	64.9

From the table, we find that the highest gainer of the table gained more than 4000 percentage points in one year and last gainer of the table gained 146 percentage points in one year without any significant change in company fundamentals. By searching company websites, AGM reports and Stock exchange disclosers, no specific reasons behind the stock price boom was found for most of the companies.

Company Profile: Chittagong Vegetable Oil Industries Ltd.

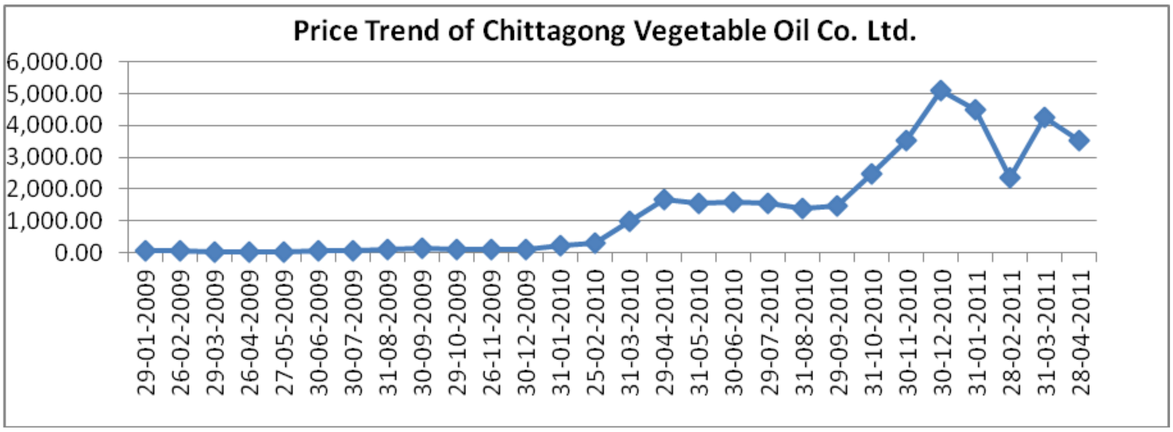
Chittagong Vegetable Oil Industries Ltd. was established as a Private Limited Company in 1984 and later converted into a Public Limited Company in 1990. It is basically a family owned company. The company started commercial operation by producing and marketing Phulcopy brand Soyabean Oil which was very popular among the edible oil consumers.

Side by Side the Sponsors of the company had been running their original Petrol and Lubricants business through a Petrol Pump set up long before 50 years with Tank Lorries. After running the edible oil factory for continuous 6(six) years with satisfactory profit result and giving dividends to the shareholders a setback appeared in the edible oil producing and marketing business due to increase of raw material price i.e. crude oil in the international market and also sporadic growth of other edible oil factories whereby the company had to undergo continuous loss (Chittagong Vegetable Oil Industries Ltd)
Since the Sponsors gained wide experience in Fuel and Lubricant business through their running of Filling Station (Petrol Pump) for more than 50 years Mr Shamsul Alam Shamim who became Chairman after the demise of previous Chairman Alhaj Md Yunus conceived an idea of diversifying the edible oil production to the Petrochemical production by converting the existing vegetable oil Plant to Petrochemical Refinery Plant for the greater interest of the shareholders. Thereafter the Management thought it viable to convert the factory into oil refining Plant with existing machinery in addition to some other machinery and equipment of oil refinery.

To this end in view Chittagong Vegetable Oil Industries Ltd. has been converted into CVO Petrochemical Refinery Ltd. as per Special Resolution passed in EGM of the general shareholders on 6-5-2010 and also approved by the Registrar of Joint Stock Companies & Firms vide certificate No. 937 dt. 29-07-2010.Accordingly a Pilot Plant was set up side by side carrying on the work of converting the existing edible oil Plant to a composite Refinery plant and sold through their family distribution channel.

The trial operation of the Pilot Plant started from April 2010 and during the last quarter from April to June 2010 the trial operation yielded a Net profit of Tk. 2, 16,89,911/- as disclosed in the Annual Report for 2009-2010. In the subsequent years, the company made substantial profit from trial production. The company through earning of profit in trial operation of this diversified industry declared 20% Stock Dividend to the shareholders in 2009-2010 and it expect to go into commercial operation after completing all the government formalities of its conversion program (Chittagong Vegetable Oil Industries Ltd).

Table 5.2 Price Trend of Chittagong Vegetable Oil Ind. Ltd.



Price trends given above raise questions about any fundamental changes in the business. We need to analyze all the disclosed information and financial performance of the company to find out the reasons behind the price change.

Table 5.11 Financial Performance of Chittagong Vegetable Oil Industries Ltd.

Year	Basic EPS	Net Asset Value Per Share	Net Profit After Tax (mn)	Dividend history
2000	-10.40	230.40	-10.40	0
2001	-3.17	227.23	-3.17	0
2002	-15.24	211.99	-15.24	0
2003	-41.13	165.86	-41.13	0
2004	-1.70	26.66	-1.70	0
2005	-4.09	154.07	-4.09	6.00
2006	-6.40	147.67	-6.40	0
2007	-3.21	144.46	-3.21	0
2008	-4.62	139.83	-4.62	0
2009	-24.38	115.45	-24.38	n/a
2010	21.69	114.29	21.69	20%B

From the above table, we find that, the company is with very poor financial performance. In the last decade, the company paid dividend only twice, in the year 2005 it paid 6% cash dividend and paid 20% stock dividend in 2010. Its dividend history does not match with its highly inflated price.

Table 5.12 Price trends of the stocks of Chittagong vegetable oil Industries Ltd

Month	Monthly price of stock	Month end Index	stock Return	Index Return	Monthly excess stock return, α_1
30/12/2008	3.13	2,795.34			--
31/1/2009	4.13	2,649.49	32%	-5%	37%
1/28/2009	4.20	2,570.96	2%	-3%	5%
26/2/2009	3.40	2,446.92	-19%	-5%	-14%
30/4/2009	3.50	2,554.36	3%	4%	-1%
29/5/2009	3.85	2,572.18	10%	1%	9%
6/30/2009	5.93	3,010.26	54%	17%	37%
30/7/2009	5.80	2,914.53	-2%	-3%	1%
31/8/2009	8.53	2,941.28	47%	1%	46%
30/9/2009	13.50	3,083.89	58%	5%	54%
29/10/2009	10.75	3,364.26	-20%	9%	-29%
26/11/2009	10.53	4,380.95	-2%	30%	-32%
12/30/2009	11.08	4,535.53	5%	4%	2%
31/1/2010	21.40	5,367.11	93%	18%	75%
28/2/2010	29.98	5,560.56	40%	4%	36%
31/3/2010	99.43	5,582.33	232%	0%	231%
29/4/2010	169.00	5,654.88	70%	1%	69%
31/5/2010	153.55	6,107.81	-9%	8%	-17%
30/6/2010	159.00	6,153.68	4%	1%	3%
29/7/2010	156.95	6,342.76	-1%	3%	-4%
31/8/2010	140.00	6,657.97	-11%	5%	-16%
30/9/2010	148.88	7,097.38	6%	7%	0%
31/10/2010	249.03	7,957.12	67%	12%	55%
30/11/2010	353.95	8,602.44	42%	8%	34%
30/12/2010	509.95	8,290.41	44%	-4%	48%

Hypothesis Testing

Statistical test should be made to test whether the monthly stock return is higher than the market return or not. To test this, paired sample test is done by using SPSS. Let us assume the hypothesis.

Null hypothesis, H_0: $\alpha_1 = 0$,
Alternative Hypothesis, H_1: $\alpha_1 \neq 0$,

I expect the value of α_1 *is* positive, i.e., there is excess stock return in the market. So my objective is to prove that there is excess stock return in the market. However, I will now try to prove the alternative hypotheses that $\alpha_1 \neq 0$.

Table 5.13 - Paired Samples Test

		Paired Differences					t-statistic	Degrees of freedom	p-value (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	Lower	Upper			
Pair	Stock Return – index Ret urn	.24996	.52665	.026	.03257	.46735	2.373	24	.026

Table 5.14 - One-Sample Test

	Test Value = 0					
	t	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
					Lower	Upper
MAR	2.373	24	.026	.24996	.0326	.4673

As the t-statistic is 2.73 and the p-value is 0.026 that is below 0.05, so the null hypothesis is rejected and there is excess market monthly return for the stock price of Chittagong vegetable industries Ltd.

As there is significant excess return for the stock, we can analyze the disclosed news of the company to judge the return. Following table shows all the mentionable news disclosed with the bourse.

Table 5.15 Disclosed Price sensitive information of Chittagong vegetable oil Industries Ltd

Date	News Title	Disclosed Price sensitive information
2008-10-30	Dividend Declaration	The Board of Directors did not recommend any dividend for the year 2007-2008.
2008-11-02	EPS	As per audited accounts as on 30.06.08, the Company has reported net loss of Tk. (4.62) m with EPS of Tk. (4.62) as against Tk. (3.21) m and Tk. (3.21) respectively as on 30.06.07. Further**, as per audited accounts for the year ended on 30.06.08 the company is not in operation.**
2009-10-29	Dividend Declaration	The Board of Directors did not recommend any dividend for the year 2008-2009.
2010-02-02	EPS	As per un-audited half yearly accounts as on 31.12.09, the Company has reported net loss of Tk. (23.60) m. with EPS of Tk. (23.60) as against last year's half yearly of Tk. (2.34) m. and Tk. (2.34) respectively.
2010-03-25	Business Change	Board of directors of the company has resolved to change the name of the company to 'CVO Petrochemical Refinery Ltd.'
2010-05-02	Business Change	In response to SEC's Letter dated 22.04.2010, the company has informed that Soyabean Oil Plant of the company was not formally closed but the production and Marketing of Soybean Oil in the factory was stopped due to high prices of raw materials in the international market resulting continuous loss in running the factory. Such a situation compelled the company to go into diversification by converting the Soyabean Oil plant into a Petrochemical Refinery Plant in the same factory with certain modification and alteration. It was also assured that the refinery plant will give high yearly return to give satisfactory dividend to the shareholders. In this respect the present name of the company will have to be changed from Chittagong Vegetable Oil Industries Ltd. to CVO Petrochemical Refinery Ltd. The Board unanimously agreed to undertake the new business and the Managing Director is hereby authorized to take all necessary steps in this regard. In this connection it was also agreed that the additional capital to be required for the new project will be provided by the Directors as loan from their own sources."
2010-10-31	Dividend Declaration	The Board of Directors has recommended stock dividend @ 20% for the year ended on June 30, 2010.
2011-01-26	Category Change	The Company will be placed in "A" category from existing "Z" category with effect from 27.01.2011 as the company reported disbursement of stock dividend @ 20% for the year ended on June 30, 2010.
2011-04-13	EPS	Announced 3rd quarter EPS of Tk. 26.38 against previous year same quarter loss of Tk. .

If we analyze all the news, we find that most price sensitive news was about change of business nature. The company was producing edible oil and shifted it business into crude oil refinement and also renamed the company into CVO petrochemical company Ltd. They said that they can run an oil refinery with existing machinery with some modernization that involves minor costs. They also said that the company has started test production without regulatory permission.

Securities exchange commission (SEC) has taken some initiatives to protect investors from any potential loss. Some of the steps are mentioned below:

1. **Query to the Company:** SEC many query to the company for several times to explain the reason behind the price boom of the company stock. In each time, the company answered that there is no undisclosed price sensitive information of the Company for recent unusual price hike.

2. **Investigation of factory and accounts:** SEC/DSE sent their investigation team to the factory and looked into physical and financial resources to discover the reason of price boom and disclosed the found matters to investors through stock exchanges.

3. **Investors awareness messages:** SEC disclosed many messages to made investors aware from not to buy the security of the company to protect them from any potential loss. SEC says "Honorable Investors please make your investment decision based on company fundamentals, technical analysis, price level, disclosed information; and avoid rumor based speculations."

4. **Repeat of company Fundamentals to DSE Screen:** SEC repeatedly disclosed the company fundamentals to the screen to make investors aware about the company.

5. **Legal actions against company Directors**: SEC sued against five directors for recent price hike of the company stock and the case still running with the court.

Table 5.16 Regulatory Actions displayed in DSE screen

Date	Steps
2010-02-11	In response to a DSE query dated 10.02.10; the company has informed that there is no undisclosed price sensitive information of the company for recent unusual price hike.
2010-03-24	In response to DSE query dated 21.03.2010; the company has informed that there is no undisclosed price sensitive information of the company for recent unusual price hike.
2010-03-25	An inspection team of DSE has inspected the factory and revealed that the production of Chittagong Vegetable Oil Industries Ltd. has been closed since 2008 and the machineries of the factory are almost out of order. The team did not find any worker or other office staff in the factory rather one factory in-charge and one security guard. It seems to the team that the production is not possible by the existing machineries due to out of order of the machineries.
2010-03-20	In response to a DSE query, the company has informed that there is no undisclosed price sensitive information of the company for recent unusual price hike.
2010-04-18	SEC has formed an enquiry committee to investigate in to certain unusual price movement in shares of Chittagong Vegetable Oil Industries Ltd. in the stock exchanges.
2011-07-06	SEC has formed an enquiry committee to conduct further enquiry regarding steep rise of Chittagong Vegetable Oil Industries Ltd.'s share price in 2010.

What else Regulators could do?

In developing countries, Stock manipulations and insider trading are very common phenomenon and regulatory steps might not be successful due to irrational market behavior. In this case, SEC used all the steps to protect investors. But irrational market behavior, investor's greed and confidence might motivate investors to invest there after precautionary messages from regulator.

5.6 Excessive liquidity in the capital market: Excessive liquidity in the stock market caused sharp increase in stock price as supply of stock was meager relative to increased demand. Financial Institutes could invest more than 10% of their demand and time liabilities to the stock market and greater involvement of financial institutes increased the liquidity in the market that created a bubble in the stock market. From table 2.1, it was found that financial institutions are the biggest investors in the market and there aggressive involvement increased market liquidity manifold in recent years.

Table 5.17 Increase of Market Capitalization and Total Turnover

	30/12/08	30/12/09	30/12/10	30/12/11
No. of listed securities	378	443	450	459
GDP Growth rate (%)	6.19	5.74	6.07	6.66
Market capitalization (Million Taka)	1043799.02	1903228.05	3508005.80	2616730.54
Growth in Mkt. Capitalization (%)	***40.64***	***82.33***	***84.31***	***-25.40***
Turnover in value (Million Taka)	4309.46	9327.153	17831.37	5598.52
Growth in turnover (%)	226.91	116.43	91.18	-68.60
DSE General Index	2795.3	4535.5	8290.4	5257.6
Money Supply (M2)	2719789	3281922	3992790	4645219
Growth in Money Supply (%)	*20.40*	*20.67*	*21.66*	*16.34*

The Table shows that market capitalization and turnover of Dhaka stock exchange, prime bourse of Bangladesh increased substantially in consecutive three years that might be considered as a good factor for capital market development. But as the supply side response was poor, stock price might go up due to excess liquidity. SEC had nothing to do with this as they had no direct tool to control money supply and also they cannot force companies to come to the market.

CHAPTER 6
RECOMMENDATIONS AND CONCLUSION

As per my analysis and other investigations it was found that the stock market boom and fall during 2009 and 2010 was due to following reasons:

a) Direct Listing and Book Building in IPO, Asset Revaluation, high indicative price for IPO, Misuse of Book Building method of IPO, and pre-IPO Private placement activity.
b) Circular trading, Block Trading and unusual trading of securities where few numbers of investors/institutions are involved.
c) Issuance of Right Share, Preference share, Repeat IPO at excessive price
d) Excessive Greed of Investors and Institutions
e)

But in most cases, market behavior was consistent with that of other markets and empirical studies also support the market behavior. The Study did not find concrete base to conclude that the volatility was due to regulatory failure. I contrary with the conclusion of Ibrahim Khalid committee and recommend for further study in line with the existing literature to conclude whether the volatility in DSE is due to regulatory failure or not.
I suggest following recommendations for stronger capital market in Bangladesh in line of my analysis.

6.1 Demutualization of Stock Exchanges

Stock Exchanges of Bangladesh are controlled by its members under the supervision of SEC. But such control creates conflicts of interests in the market. In India, Bombay Stock Exchange was demutualised under the pressure of Government. Bangladesh should follow the same. Peoples heading the DSE are highly debated for his rule in market manipulation (Ibrahim Khalid Report). According to the report “conflict of Interest” made the body almost inactive on its rule. Government should force Exchanges to be demutualised. In this regard, government can take the help of any donor agency (World Bank or Asian Development Bank) to develop necessary infrastructure.

6.2 Strengthening the Market Surveillance Systems

To strengthen the SEC’s operations and governance, (i) a real-time market surveillance system should be installed, and (ii) capacity building will be provided to improve monitoring, supervision, and enforcement capacity of the SEC. The SEC surveillance system should complement the stock exchanges’ own market surveillance activities and ensure that the exchanges are performing their regulatory functions well. The stock exchanges should establish a regulatory review committee to support the implementation of surveillance systems and to prevent vested interests of the exchanges’ members from encroaching on the exchanges’ regulatory functions. The committee will be composed of representatives from the legal and accounting professions, who will be independent of members of the exchanges, and an SEC representative who will participate as an observer. The committee will be responsible for establishing policy and direction in applying the regulations of the exchanges; reviewing existing regulations, regulatory practices, and procedures of the exchanges; and providing views on new regulations and recommending appropriate regulations. The two stock exchanges can form an inter-market surveillance unit, to share and discuss matters of mutual concern and to share information.

6.3 Ensuring Integrity and Efficiency of SEC Members and Staffs

Staff of SEC, CSE, and DSE will be trained in modern market surveillance and enforcement techniques to enable them to be more effective at detecting trading irregularities and market abuses. The training will include examination of evidence and analysis of trading accounts of brokerage firms. In addition, staff will be trained not to contaminate evidence obtained from the surveillance system that could later be used in prosecuting a matter in the courts.

6.4 Co-ordination between SEC and Stock Exchanges

From the analysis and Investigation report we found lack of coordination and inconsistencies between the functions of SEC and Stock Exchanges. Esp. in case of Company listing and surveillance, Coordination is highly important. To combat future debacle both SEC and stock exchanges should work closely.

6.5 Bank Finance in Capital Market

Commercial Banks relies heavily on capital market by investing directly and indirectly (Margin Loans) that creates high risk on depositor's money. So Regulators should impose restriction on investment on Capital market by Banks. In India, Banks can invest a certain portion of their owner's equity/capital (not deposit) to capital market but in Bangladesh Banks can invest 10% of their total liability that is not rational at all. Such huge investment by banks pushes only the demand side and creates bubble to the market as supply side response is very low in Bangladesh. SO, regulators should set new limit on the basis of Shareholders equity and should monitor this very strictly.

6.6 Introduction of Asset Revaluations Policy

In my analysis, I showed how companies revalued their fixed assets to manipulate stock price that caused distortion in the market and ultimately caused huge sufferings for Investors. In Bangladesh there is no certified surveyors in Bangladesh and also don't have any Chartered surveyor Institute. So, their jobs could not be reliable and that's why regulators should establish clear guideline for Asset revaluation. Chartered Accountant (CA) firms can play a rule to revalue asset until Chartered surveyor Institute. But CA firm that conduct asset revaluation should not audit the company account. Also companies should take SEC nod before disclosing the asset revaluation result and SEC should check the result with due diligence.

6.7 Consistency in Regulation

From the analysis made in this report, I found various inconsistencies in the SEC regulations. SEC notification came only when the market rises continuously for many days that do not reflect good regulation. The Bangladeshi stock market needs to move towards a market based system of regulation for capital market activities and SEC should act proactively instead of its reactive response. SEC does not measure the costs and benefits of its rapidly changing guidelines/regulations. SEC and GOB should have long term visions regarding market and should make cost-benefit analysis before making any rule/law as it affect investor's return. Regulatory parity and consistency between all institutions and participants conducting related capital market activities has to be ensured at all times.

6.8 Supply of adequate securities

Supply side response during last two years was very poor relative to sky rocking demand of securities that helped to inflate the price of almost every share traded in Dhaka and Chittagong stock exchanges. Government initiated to offload more securities of government owned enterprises several times to meet unanticipated demands of the market but finally it has failed to offload these securities. Government should take measures to bring good companies (both local and MNCs) by allowing easy access and good IPO price to promote the market. Other regulators like (Bangladesh Bank, Bangladesh Telecom Regulatory Authority, Registrar of Joint Stock companies and Ministries) can also take measures to enlist new companies to the market to enhance the depth of it.

6.9 Transparency in listing procedure

As listing methods (Book Building methods and direct listing) played a vicious rule to damage the stability of the market; major change should be brought to make it acceptable and transparent. In this regard, SEC should promote only Fixed Price method as it lack less opportunity to manipulate the offer price. SEC can also use due diligence to fix the offer price under this method.

For Book Building Method, price bidder Eligible Institutional Investors (EIIs) should deposit at least 10% of the value of the securities that they are interested to buy. Such deposit will make them more careful and help them to make better analysis to quote any price. Lock-in period should be fixed to at least 180 days at short lock-in (21 days) help them to speculate them more to get higher returns. Institutes and persons behind the book building scam should be under trial and steps should be taken to the confiscate their ill-gotten wealth. Peoples of Regulatory bodies who allowed such offences also should be brought under proper trial. Direct listing method should not be allowed as it is very to manipulate under this method.

6.10 Serial Trading and Manipulation

As there are many evidences that some investors and institutions were involved in the serial trading and insider trading to manipulate the price of individual stocks under regulatory supports. Manipulative trading under Omnibus accounts should be fully investigated and peoples and institutions under the hidden accounts should be identified and also should bring under trial if any irregularity is found.

Steps already taken by the Government: Government already took some steps to stabilize the market. Securities and Exchange Commission is restructured and all the all management people are replaced by new peoples. Uniform per value of shares are started from December 2011 that ensured the uniformity in terms of par value in the market. Government sued against some manipulators and the court is running the cases. Government has also introduced some big funds to provide liquidity supports to the market and also planning to compensate small investors who lost everything due to use of margin loan by redeeming the interest of the loan.

Conclusion

The study shows that the major reasons behind the stock market crash are irrational market behavior, inconsistency in regulations, excess liquidity in the market, stock split by companies, faulty listing system, issuance of right shares and preference shares by companies at high price, stock manipulations by insider trading, serial trading etc and excessive greed of investors. In most cases, investor's behavior was natural and consistent to the standard behavior. But the study did not find regulatory failure as the root-cause of the volatility and disagree with the Ibrahim Khalid Committee report and suggest for further study to implement the recommendations of the committee.

Due to many constraints (data availability and access, time etc.), I have failed to conduct more comprehensive study on the crash but I hope my study might give some guideline for researchers who want to conduct further study on it. Further study in this field is required as many of the issues are not covered in my report.

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