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BANGLADESH CAPITAL MARKETS: AN OVERVIEW

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Executive Summary

Bangladesh's capital market, with a market capitalization of about USD 65 billion dollars as of April 2024, is a frontier capital market that is primarily an equities market. The Dhaka Stock Exchange (DSE) and the Chittagong Stock Exchange (CSE) are the only two exchanges in the country with mostly identical securities that can be traded between them. However, DSE stands out as the leading exchange due to its bigger trading volume and greater number of securities. The country's capital market does have a fairly large market for debt instruments—accounting for about 42% of the total market capitalization—but nearly all of it is government-issued Treasury instruments that are only accessible to banks, which are considered member dealers. Individual and other non-member investors could buy Treasury instruments through these member dealers, but that is reportedly an inconvenient experience. Such inaccessibility to regular investors and a dearth of corporate bonds leaves the secondary market mostly devoid of trading debt instruments.

Despite what might seem like a sizeable capital market, it is in fact quite small compared to its Asian peers and represents only about 18% of Bangladesh's impressive GDP. This small scale of the market is characterized by a lack of depth on both the issuing and demand sides. Several factors involving capital protection concerns, regulatory interventions, a narrow investment basket, low financial literacy, and technological backwardness make for an inconvenient experience that discourages and pushes back both potential IPO prospects as well as investors. The ultimate long-term remedy for this inhibiting situation is implementing and ensuring sound policies. With that being said, mutual funds and state-of-the-art trading platforms could be utilized to bring in more institutional and retail capital in the immediate future. The simplified investing process through both mutual funds and easy-to-use apps allows for more capital to be directed to the capital market. Moreover, mutual funds go beyond only attracting more capital, as their expert portfolio management enables them to deploy capital with a long-term focus. Therefore, regulators making mutual funds more incentivizing to investors and developing advanced trading platforms could pave the way for much-needed market expansion.

Regardless of the challenges that most developed markets faced to some extent during their frontier periods, Bangladesh's capital market's gradual growth following the expansion of her economy paints a picture of growth. The current low Price-to-Earnings (P/E) ratios further highlight the growth opportunities still available. But most of the macroeconomic tailwinds resulting from Bangladesh's demographic dividend aren't here to stay, and thus long-term robust policymaking should be prioritized to make the country's capital market globally integrated. Bangladesh should learn from how countries with the world's leading financial markets were able to drive their markets to their peak long after their demographic dividend had expired.

1. Capital Market of Bangladesh

Bangladesh's capital market is composed of the Dhaka Stock Exchange (DSE), the Chittagong Stock Exchange (CSE), the Bangladesh Securities and Exchange Commission (BSEC), the Central Depository Bangladesh Limited (CDBL), and other necessary organizations, all working together to keep the entire market functional. The two exchanges—the DSE, founded in 1954 in then-East Pakistan and reestablished in 1986 after independence, and the relatively new CSE, established in 1995—are ultimately where all investments and trading take place, with the DSE accounting for the majority of all trading.¹

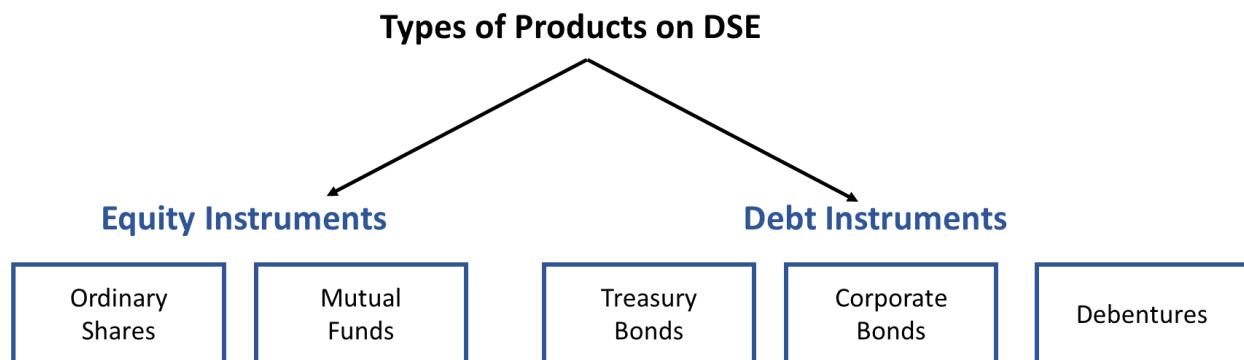
Brief Timeline of Bangladesh's Capital Market

East Pakistan Stock Exchange Association Ltd Founded	1954
Trading Resumes	1976
Reestablished as Dhaka Stock Exchange (DSE)	1986
Bangladesh Securities & Exchange Commission Established	1993
Chittagong Stock Exchange (CSE) Established	1995
First Capital Market Crash	1996
Electronic Trading Introduced	1998
Central Depository Bangladesh Ltd. (CDBL) Established	2000
DSE 2 nd Highest Performing Exchange Globally	2010
Second Capital Market Crash	2011
3 New DSE Indexes Launched: DSE Broad Index (DSEX), DSE 30 Index (DS30), and DSEX Shariah Index (DSES)	2013
A Consortium of the Shenzhen Stock Exchange and Shanghai Stock Exchange becomes Strategic Partner of DSE, with 25% Shareholding	2018

ULAB CES Visual based on data from the report titled "The Emerging Asia-Pacific Capital Markets"

¹ As per total trade value and trade volume reported by Dhaka Stock Exchange and Chittagong Stock Exchange.

As for market stage, Morgan Stanley Capital International (MSCI) classifies Bangladesh’s capital market as a frontier market—a term for less advanced markets in their early stages.² The early-stage nature of the country’s capital market is evidenced by the fact that most of its secondary market is equities with the absence of more sophisticated instruments such as derivatives, where institutional investors represent a small minority of the investor base, and the debt market is almost entirely exclusive to its primary market, where private debt instruments are almost non-existent.



ULAB CES Visual based on Dhaka Stock Exchange’s Product List

² MSCI Market Classification, <https://www.msci.com/our-solutions/indexes/market-classification>

1.1 Equity Market

The Dhaka Stock Exchange and the Chittagong Stock Exchange, with roughly similar market capitalizations, collectively currently represent around USD 131 billion³, although a more realistic figure for the country's entire stock market is USD 64–67 billion because all the listed companies are mostly common between the two exchanges where inter-trading is possible. However, the DSE is much more active, has more securities, and thereby is the premier bourse, as indicated by its latest trade volume of around 179 million compared to the CSE's much smaller latest trade volume of around 6 million as of April 24, 2024.

FY2023	DSE	CSE
No. of Listed Securities	653	615
Issued Equity and Debt (in USD bn)	38.0	37.9
Market Capitalization (in USD bn)	70.2	68.9
Trade Value (in USD bn)	17.4	0.6
Trade Volume (in bn)	34.8	1.6
Broad Index Annual Change	-0.5%	-0.1%

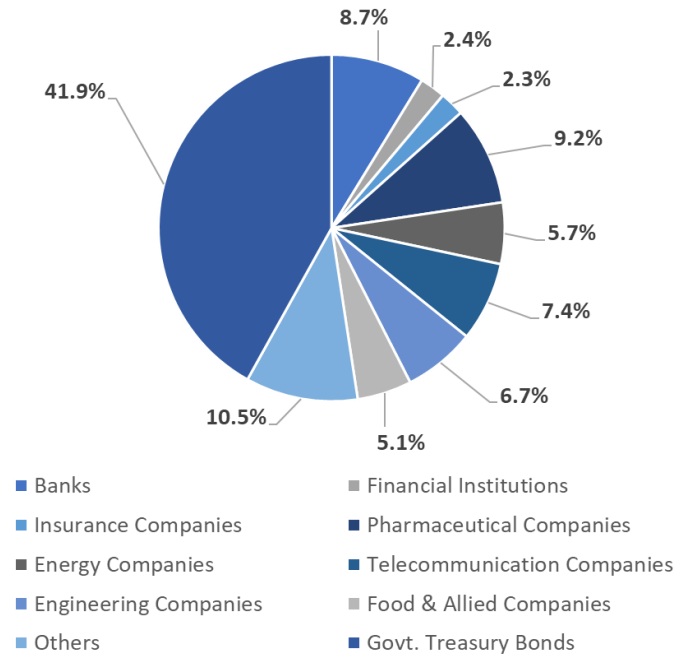
*ULAB CES Visual based on data from Bangladesh Bank's FY2023 Annual Report
N.B. All BDT figures have been converted to US Dollar figures at FY2023's average exchange rate of 110*

Equity instruments account for approximately 58%³ (excluding mutual funds) of the DSE's market capitalization. When mutual funds are included, the share is considerably larger because the majority of them are equity-focused funds. Sector-wise, banks and financial institutions, pharmaceutical companies, telecommunication companies, food consumer companies, energy companies, and engineering companies constitute the majority of the overall stock market in terms of market capitalization.⁴

³ ULAB CES Calculation based on figures reported by Dhaka Stock Exchange and Chittagong Stock Exchange

⁴ Capital Market Development in Bangladesh (October 2023), Monthly Reports, Bangladesh Bank

Sector-Wise Shares of Market Capitalization of DSE (End of October 2023)



ULAB CES Visual based on data from Capital Market Development in Bangladesh, Bangladesh Bank, October 2023

The equity market—being a frontier stock market—features a limited catalog of products devoid of sophisticated instruments like derivatives and Exchange Traded Funds (ETFs), offering only ordinary stocks and mutual funds. However, authorities are planning to introduce convertibles, ETFs, and other advanced products.⁵

1.2 Debt Market

The debt market within the Dhaka Stock Exchange represents approximately 42%⁶ (excluding mutual funds) of the total market capitalization; the figure is likely somewhat less when the market capitalization of mutual funds is considered.

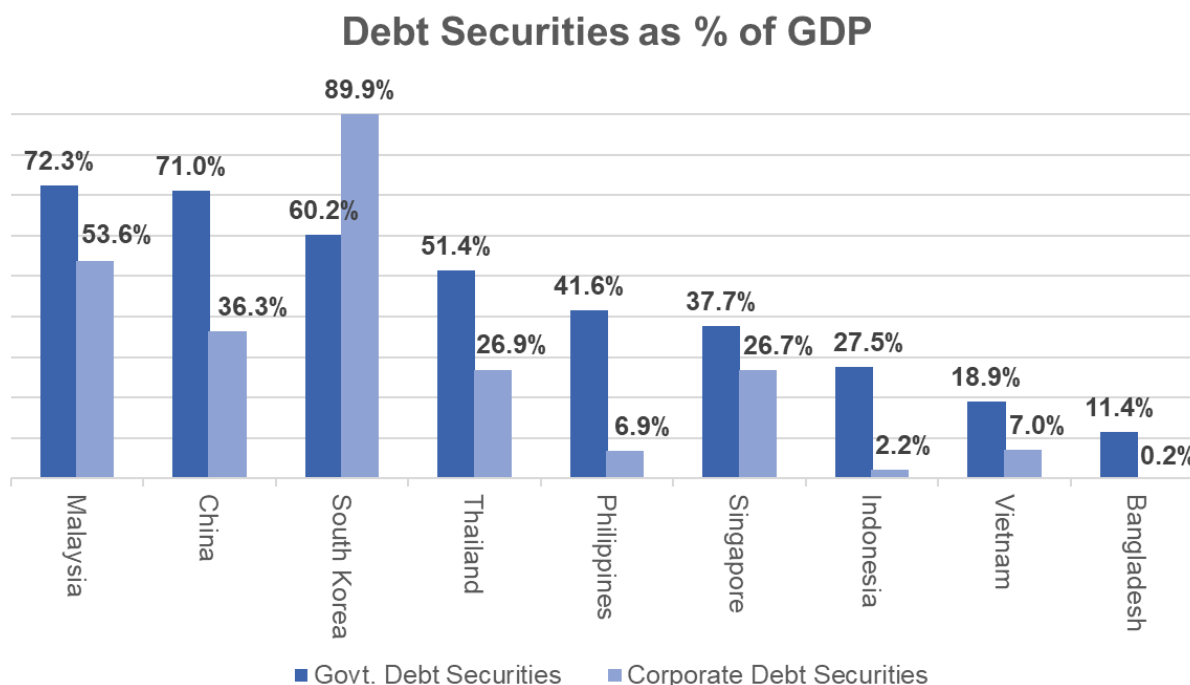
Although the debt market’s size of around USD 27⁷ billion may give the impression that Bangladesh’s capital market boasts a significant debt market, nearly all of it is inaccessible for retail investors in the secondary market and constitutes government-issued debt instruments issued in the primary market that are mostly accessible to banks. Moreover, even with the overwhelming share of the entire debt market, the government

⁵ Future Products, Dhaka Stock Exchange, https://dsebd.org/products_of_dse.php

⁶ ULAB CES Calculation based on figures reported by Dhaka Stock Exchange and Chittagong Stock Exchange

⁷ Reported figure in BDT converted to USD at the exchange rate of 110

debt market represents only 11.4% of Bangladesh’s GDP. On the private market side, debt issuances are rare, representing an even meager share of 0.19% of the GDP.⁸



ULAB CES Visual based on data from “Bangladesh’s bond market one of the smallest in Asia. What will strengthen it?,” The Business Standard

2. Challenges

A combination of issues in the areas of market depth, regulations, and investor base make for an investor base formed of speculative retail traders and institutions with a predominantly ultra-conservative risk appetite harboring low confidence in the public market.

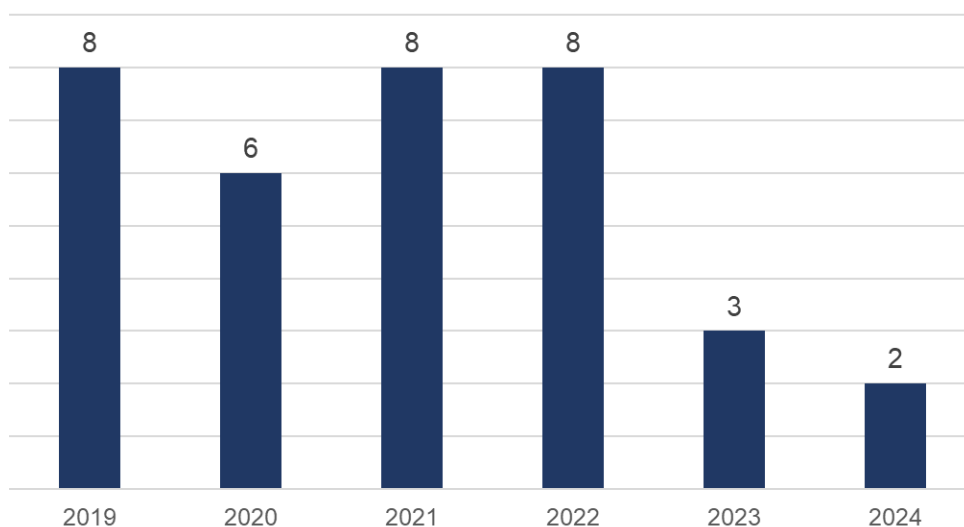
2.1 Small Pool of Quality Companies

One of the core issues in Bangladesh’s capital market is the small pool of investment-grade stocks. This is to blame for several factors, the chief of which are a dry and slow IPO pipeline, the absence of incentives for private companies to consider going public, and a difficult business environment.

⁸ “Bangladesh’s bond market one of the smallest in Asia. What will strengthen it?,” The Business Standard, 25 January 2024

Out of approximately 282,538⁹ registered companies in the country, only 653 companies are public companies. This implies that while there may be potentially investable companies, the stock market’s IPO process isn’t a smooth experience for companies that might undertake it. This is evident in the fact that in the last five years, only about six companies, on average, could get listed per year.¹⁰ The supply side (of companies) is exacerbated by the difficulty of doing business in the country, as it discourages capable people from starting businesses in the country.

IPOs on DSE Per Year (2019 – March ‘2024)



ULAB CES Visual based on data from IPO Archives, Dhaka Stock Exchange

2.2 Small Institutional Investor Presence

Another core issue is the small institutional investor presence in the capital market, a key hurdle to deepening the capital market. While a lack of quality blue-chip companies turns back institutions that might invest, other confidence and convenience factors such as time-to-time allegations of manipulations, market forces inhibiting actions, and underdeveloped trading systems push further away whatever interest that could be kindled. Generally, institutional investors have a conservative risk appetite, and the aforementioned factors and events like the controversial 2011 stock market crash that wiped out over USD 600¹¹ million of ordinary people’s hard-earned savings make them even more risk-averse.

However, globally as well as in our neighborhood, as seen in the US and India, pension, provident funds, and similar retirement funds paint a contrasting picture of being major

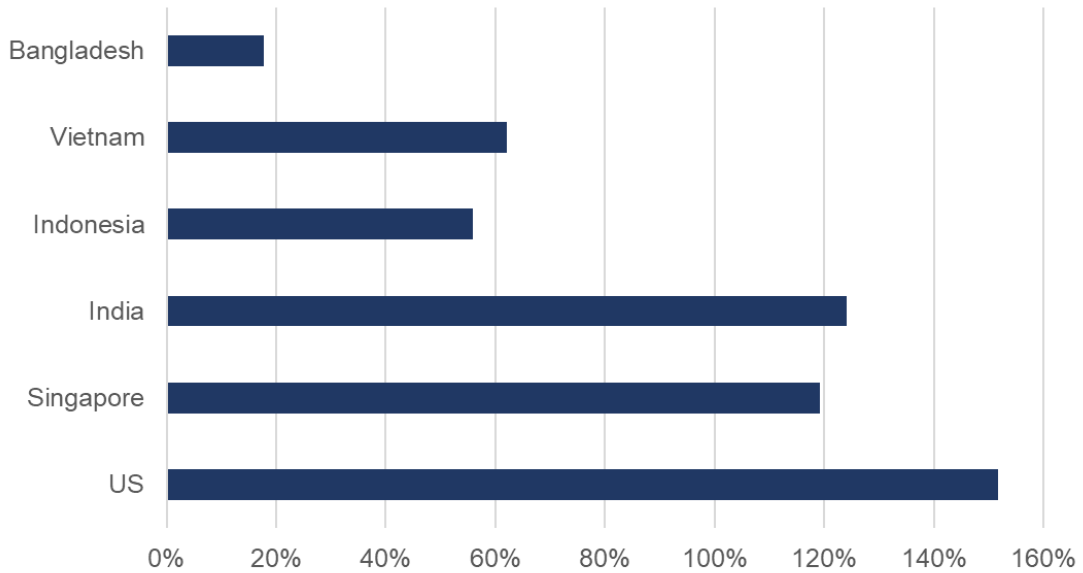
⁹ “81pc corporate taxpayers fail to submit returns”, New Age, 23 June 2023

¹⁰ ULAB CES Calculation based on data from IPO Archives of Dhaka Stock Exchange

¹¹ 2011 Bangladesh Share Market Scam, Wikipedia,
https://en.wikipedia.org/wiki/2011_Bangladesh_share_market_scam/

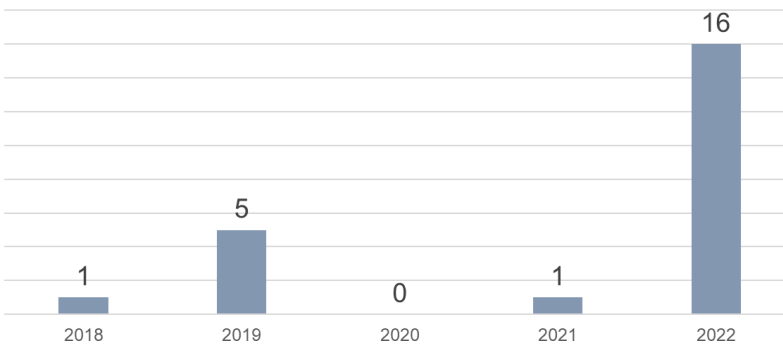
investors in the capital markets. In Bangladesh, unfortunately, such funds are yet to look beyond fixed deposit schemes and government certificates.

Stock Market Capitalization as % of GDP (2023)



ULAB CES Visual based on data from Bangladesh Bank, CEIC, and YCharts

Confirmed Number of Firms Involved in Manipulation in the Stock Market



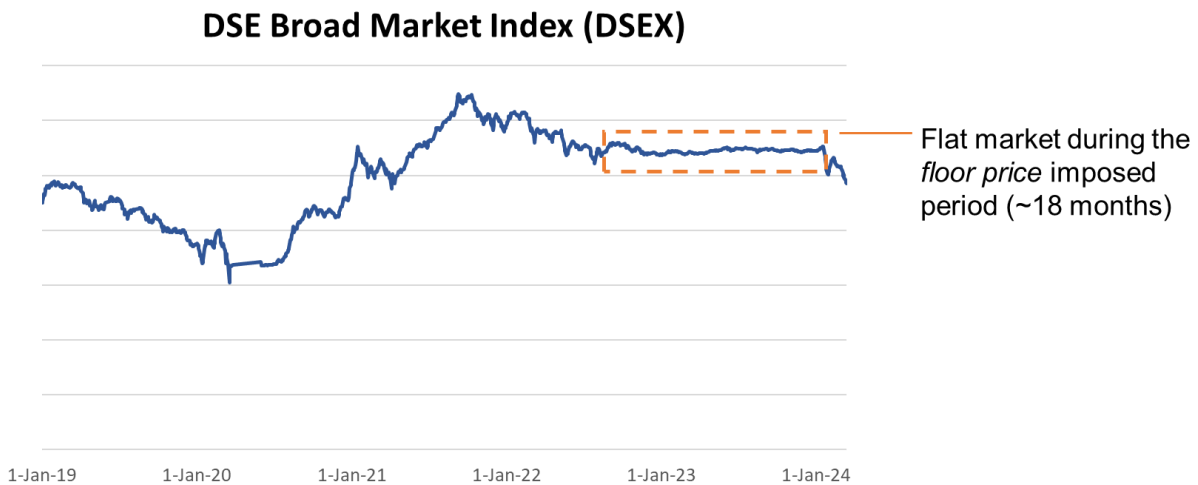
64%

of respondents to the Bangladesh Capital Market Sentiment Survey 2024 believe that the market is manipulated

ULAB CES Visual based on data from the report titled "Stock manipulation" in the Daily Star and the report titled "Survey: 64% believe capital market is manipulated" in the Dhaka Tribune

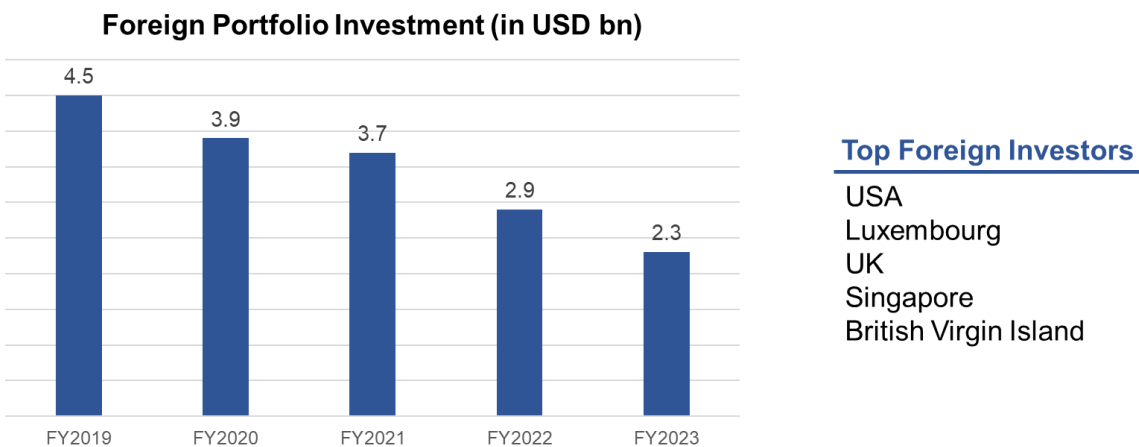
2.3 Uncertain Regulatory Environment

Unfortunately, Bangladesh's public market has been marred by unfavorable interventions that prevent market forces from keeping the stock market dynamic, the most recent of which is the stock market's current floor price, which has been in place for about 18 months since July 28, 2022¹², resulting in low liquidity and, as a result, investor funds trapped in an almost stagnant market.



ULAB CES Visual based on data from EDGE Research & Consulting Ltd

Only the most absurd or risky circumstances allow for an intervention like this one. Such interventions pose policy risks for both domestic and foreign investors, eroding investor confidence. To make matters worse, the problem does not end with investors losing trust; it turns out that regaining investor confidence after it has been eroded is far more expensive and difficult.



ULAB CES Visual based on data from Bangladesh Bank

¹² "Floor price restriction withdrawn for all but 35 stocks", The Business Standard, 18 January 2024

2.4 Low Financial Literacy

Another factor, closely aiding distrust in hindering capital market development, is the fact that the majority of the investor base in the country's capital market is financially illiterate. The average individual's preference for negative real return (after adjusting for inflation) savings accounts over quality stocks alone serves as evidence of low financial illiteracy in Bangladesh.

Participation from financially illiterate investors results in a volatile market dominated by speculative traders, which not only leads to an unreliable price discovery process but also provides a fertile ground for manipulation.

3. Potential Opportunities

Being a frontier capital market, Bangladesh obviously has a lot to do to establish itself as a model for global markets. However, beginning with the low-hanging fruit, such as enlarging the pool of IPO prospects, making IPOs desirable, and taking advantage of existing pooled vehicles like mutual funds to increase participation, can set the stage for further development.

3.1 Increasing Post-IPO Tax Incentives and Streamlining IPO Process

Although the government made the right decision to make tax cuts for both listed and non-listed companies in the FY2022-23 budget, the tax rate difference between these two categories of companies isn't adequate. Currently, the difference stands at 7.5% (20% for listed companies versus 27.5% for non-listed companies)¹³. However, some argue that it should be at least 15%¹⁴ for it to be significant enough to incentivize going for listing.

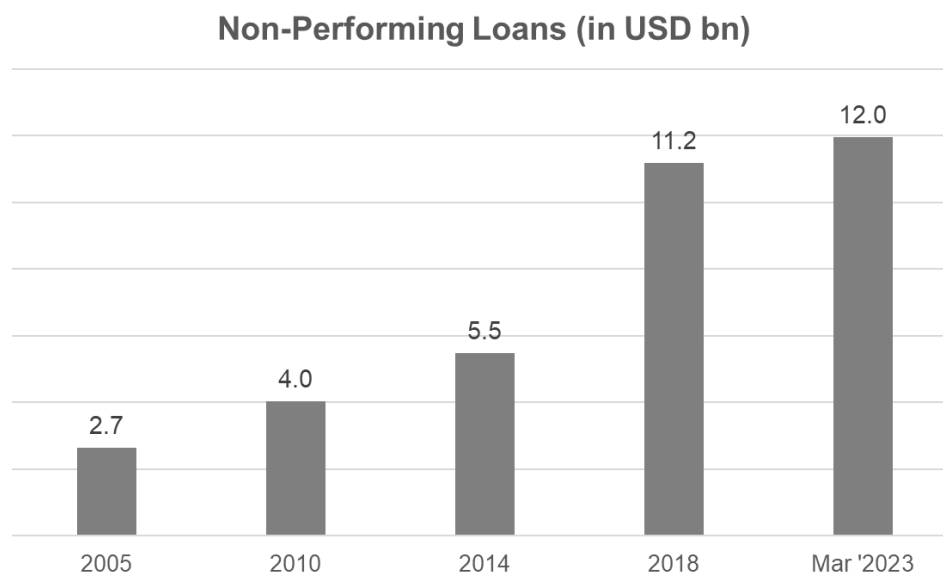
Finally, when it comes to taking the step to an IPO, the entire process, from review to the flotation of shares, needs to be sped up to match the internationally best standards. The Bangladesh Securities and Exchange Commission (BSEC) did announce a two-week IPO process in late 2021 as an initiative towards streamlining the process; that being said, respondents, including business owners and investors, have yet to witness or experience a smooth IPO that isn't time-consuming.

¹³ National Budget FY2022-2023, Ministry of Finance

¹⁴ "The government will have to give incentives to increase IPOs in the capital market", The Business Standard, 10 March, 2022

3.2 Cutting Off Lending to Weak Companies

In the last six years alone, non-performing loans (NPLs) rose from USD 8.6 billion to almost USD 12 billion in March this year—a ~40% rise.¹⁵ Even then, it is an underestimated picture because we haven't considered increasing rescheduled loans. This distressing state in the banking sector is suggestive of lax lending to weak or ineligible companies.



*ULAB CES Visual based on data from “NPL’s unstoppable rise”, The Business Standard
N.B. All BDT figures have been converted to US Dollar figures at their respective year’s average exchange rate*

If bank lending is tightened, not only will the number of weak companies reduce, but the squeezed banking channel will drive many companies to turn to the stock market for growth capital. In addition to increasing the importance of the capital market, companies will change their management style by default to increase their chances of survival, resulting in a significant improvement in corporate governance. And if strong corporate governance is sustained, which is also subject to regulatory oversight, we will see an enhanced pipeline of decent companies for both the stock market and the debt market, resulting in greater market diversity.

However, in this case, the outlook is hopefully positive as regulators have reportedly taken initiatives to amend the existing Bank Company Act of 1991 and other relevant acts, aiming to address the challenges associated with the high NPL problem.

¹⁵ “NPL’s unstoppable rise”, The Business Standard, 10 June 2023; Figures in BDT converted to USD at respective year’s average exchange rate

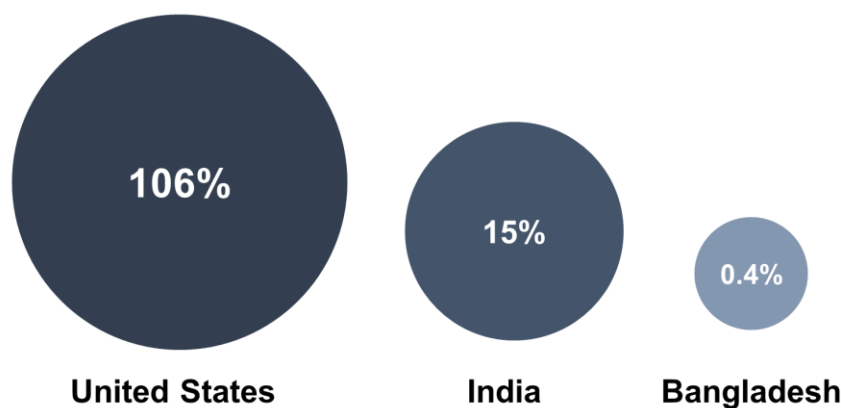
3.3 Incentivizing Investing in Mutual Funds

Given the low financial literacy rate and a need for market depth, mutual funds are excellent intermediating vehicles to improve market conditions. The ideally expert and experienced fund managers behind these strictly regulated mutual funds act as the enablers for turning speculative capital into patient capital that is long-term focused.

Similarly, expert portfolio management by mutual funds can cater to institutional investors like provident funds and pension funds by forming specialized mutual funds for them that match their desired risk-reward profile.

Unfortunately, regulators currently impose a big tax on capital gains from mutual funds and provident funds—about 10%-20% tax on dividend income for mutual funds and as high as 27.5% tax for provident funds.¹⁶ Whereas, our neighbor India once exempted mutual funds from taxation as one of many initiatives to successfully grow their equity market to its current behemoth size. High taxation on mutual funds may prevent a large portion of the economy's savings from being invested to expand Bangladesh's equity market at a time when the market is still very much in its early stages.

Mutual Fund Industry as % of GDP



ULAB CES Visual based on data from "EDGE Master Guide to Mutual Funds", EDGE Asset Management

Exempting mutual funds and provident funds from taxation and expanding the mutual fund industry in the country will allow Bangladesh to deploy a significant portion of its retail investments for the long term based on market fundamentals, provided that asset management companies and companies that operate mutual funds and provident funds have good governance and capable management.

¹⁶ Bangladesh Highlights 2023, Deloitte, <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-bangladeshhighlights-2023.pdf>

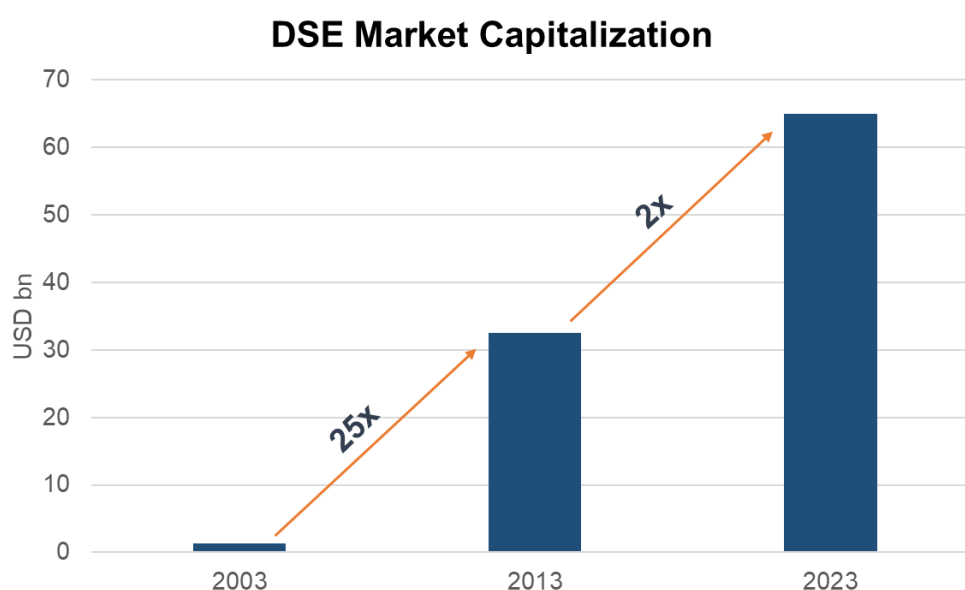
3.4 Introducing User-Friendly Digital Trading Platforms

Electronic trading systems like desktop and mobile apps already exist, but they are particularly designed for the equities or stock market. Of course, there's still room for more improvement in functionality and user interface (UI). Bangladesh Bank also developed a web-based platform called Government Securities Order Matching (GSOM) for the real-time display of the order book for Treasury auctions. However, orders on the GSOM can be executed and modified by only member dealers, i.e., banks. Individuals and other non-members can place orders through these banks. Despite the existence of this platform that isn't directly open to retail investors, the Treasury auctions in the debt market rely a lot on trading by bargaining over the telephone.

The technological backwardness of the existing platforms prevents them from tapping a larger investor population. Bangladesh Bank and related authorities must introduce well-designed platforms that allow individuals to invest in both the equities and debt markets from the comfort of their homes. Even private entities like brokers and technology companies should be encouraged to develop trading products for the capital market as that will create competition for state-of-the-art products. The fact that a few firms have already launched their own trading platforms is a promising indicator. In today's internet age, great trading platforms can considerably increase market activity and contribute to its depth. However, as such privately designed platforms emerge, the regulator must remain watchful to ensure investor protection.

4. Growth Expected in the Long-Term: Strong Macro Factors Support Capital Market Growth in Bangladesh

Bangladesh's capital market expanded exponentially, mirroring the country's extraordinary economic growth, albeit somewhat lagged. The DSEX index increased by around 73% during the same period that Bangladesh's GDP increased about 3X from USD 150 billion in 2013 to around USD 486 billion in 2023. The almost two-fold increase in the Dhaka Stock Exchange's market capitalization to nearly USD 65 billion during this period was aided by the addition of more companies and increased investor participation. Over time, with a larger and more diverse investment basket, the capital market's growth could better emulate the growing economy. As the economy matures and becomes more formalized, maturing markets and rising income levels will generate a larger pool of quality companies, as well as a larger sophisticated investor base with a higher risk appetite.



ULAB CES Visual based on data from Bangladesh Securities & Exchange Commission and Dhaka Stock Exchange

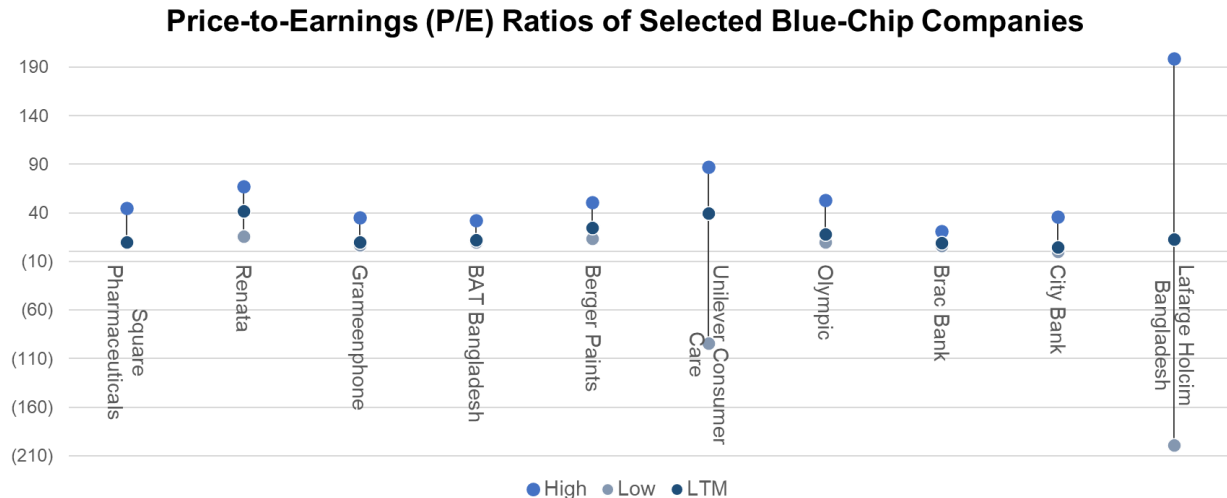
The introduction of the DSE SME board¹⁷, also known as the Small Capital Platform, for Small & Medium Sized Enterprises (SMEs) to further diversify in the alternative asset class category holds testament to Bangladesh's capital market's gradual but continued sophistication.

4.1 Current Low Price-to-Earnings (P/E) Ratios: A Bargain in the Long Run

Although some may consider current stock prices to be high, the majority of equities, particularly blue-chip firms, are selling at historically low P/E values—a ratio to measure

¹⁷ "Trading of SMEs begins at Dhaka bourse", The Daily Star, 1 October 2021

relative valuation. Regardless of the short-term volatility expected from equities, as witnessed in the global capital markets price trajectory, current prices are a bargain in the long run because current valuations are typically expected to rise as the economy and, by extension, the capital market grow.



LTM: Last 12 Months

ULAB CES Visual based on data from EDGE Research & Consulting Ltd

However, that is not to say investments at random will guarantee long-term growth. Rather, consciously investing in well-researched stocks or other securities will increase your chances of catching the growth train over a long period of time.

4.2 Capitalizing Macro-Tailwind Propelled Growth and Sustaining it

Bangladesh is currently benefiting from its demographic dividend, a relatively young phase of a country's population when the majority of it is capable of the highest level of productivity. But, as with many good things, there is a caveat to it. The growth-conducive macroeconomic factors we're experiencing now are largely a byproduct of this demographic dividend i.e., the current young population. Over time these factors will weaken as the country's population ages with a declining or low birth rate as observed in most of the first industrialized countries in the first world. For this reason, these factors offer once-in-a-lifetime opportunities that aren't sustainable into the distant future.

Hence, the future of not only Bangladesh's capital market, but her entire economy will depend on how robust our policies are in generating growth in the long run in the absence of the demographic dividend's gust. The country should maintain its efforts to evolve its capital market with the goal of global integration because history has shown that the countries with the best financial markets long after their growth period has ended are the ones with the most globalized financial markets.