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## Bangladesh is going to Catch the Spider: A New Investment Instrument for DSE

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# Bangladesh is going to Catch the Spider: A New Investment Instrument for DSE

Khaled Mahmud <sup>α</sup>, Md. Farhan Imtiaz <sup>σ</sup> & Md. Shakil Ahmad <sup>ρ</sup>

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## I. INTRODUCTION

It is almost twenty one years since the SPIDER is roaming at the world's largest stock markets. Only recently it has caught the eyes of the stock market regulators of Bangladesh. At the end of the current year DSE is going to catch that roaming SPIDER. The experienced and well known investors have already understood what this SPIDER means. For those who have not understood what this word SPIDER means, this article is for them. SPIDER is the name of the first Exchange Traded Fund (ETF) which was introduced in 1993 to track S&P 500 (SPDR- S&P 500 Depository Receipts). ETF is relatively new concept in comparison of other stock market instruments e.g. shares, mutual funds etc. As this is new to the investors of Bangladesh, there is little knowledge available to them regarding this lucrative and fast growing securities. This article describes this stock market instrument from the examples of its introduction in the other developed and developing countries. The readers of this will have a comprehensive idea regarding this stock market instruments, its difference from other related instruments (e.g. mutual fund, Closed-end funds, ETNs etc.), normal procedures of creation and redemption of ETF shares, its advantages and disadvantages, its usual buying and

selling procedures, its evaluation and so on. This instrument is very fast growing and very popular among the investors in every country in which it has been introduced. Will it be that much attractive to the investors of Bangladesh? The nature of the stock exchanges here is very much different than that of the stock exchanges of other developed and developing countries. This article also tries to find the answer of that question.

## II. EXCHANGE TRADED FUND (ETF)

Dhaka Stock Exchange has decided and is taking initiatives to issue Exchange Traded Fund (ETF) soon (Mufazzal, 2014). Now we need to know what this ETF is.

To simply think, ETF is a pooled investment vehicle like a mutual fund with shares that can be traded on a stock exchange throughout the day in a price which will be determined by the market. By a pooled investment vehicle it means that this instrument will pool the assets of multiple investors and invest those assets according to its investment objectives. Each share of this pooled fund will represent an undivided interest in the underlying assets of the fund (ICI, 2012). Most of the time ETFs are introduced to track the performance of any particular underlying index (LYXOR, 2013). They are designed to be traded at a price that approximates the market value of their underlying assets. By investing in ETFs, the investors get the benefit of diversification just like an index fund (A type of mutual fund with a portfolio constructed to match or track the components of a market index (Investopedia, 2014)), along with the facilities related with a general common stock such as the ability to sell short, buy on margin and purchase as little as one share (Investopedia, 2014). Therefore, it can be stated that when the investors buy the shares of an ETF, they are buying the shares of a portfolio that tracks the yields and returns of the native index fund but the difference between the index fund and the ETF is that Index funds try to outperform or beat the market and the ETFs try to be the market (Nasdaq, 2005).

### a) *ETF and Other Investment Products*

Now to understand more about ETF we have to identify the differences between ETF and other investment products.

#### i. *ETF and Mutual Fund*

More often ETF is considered as a mutual fund but it is not. There are some subtle differences between

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these two types of instruments. Mutual Funds are two types. One is open ended and the other is closed end mutual fund. Basically mutual fund means the open ended mutual but in the developed countries unlike Bangladesh. In mutual fund, shares can be bought or sold at the fund's net asset value (NAV) which is calculated at the end of the day. Unlike this, ETFs can be bought or sold at any time of the day on a stock exchanged at a market determined price. Therefore, normally though ETF tracks an index and the ups and downs of that index will have influence over the price of an ETF share but the ups and downs of price of the shares of ETF will not have any effect over the index. In mutual funds the Asset Manager (Who has the mutual fund to invest in the stock market) are not bound to report the daily portfolio of the investment to the shareholders but the Authorized Participants (AP) are required to show the daily portfolio to the shareholders (ICI, 2012). There are other differences of mutual funds and ETF on the types of costs and tax implications of these two instruments.

There are much more similarities between a Closed End Mutual Fund and an ETF. Both ETF and closed end mutual fund are traded on a stock exchange throughout the day. Therefore, in terms liquidity these two instruments provide the same benefit to the customers. Here the main difference between these two instruments is that closed end mutual funds are issued only at the initial stage of its life whereas ETF permits its Authorized Participants to create and redeem its shares on a daily basis. This enables ETF to move closely with the price of the assets underlying whereas the price of closed end mutual funds fluctuates and often remains different from the market value of their underlying assets.

#### ii. *ETF and Exchange Traded Notes (ETN)*

Though these two instruments sound like the same, there are some significant difference between them. ETNs are exchange-traded securities designed to provide investors with a return that corresponds to an index. Though this is also the main characteristics of an ETF, ETNs are different from ETFs in the sense that ETNs are promises to pay a specific return (normally the return corresponds to the index or benchmark minus a fee) which is unsecured whereas ETFs represent an interest in an underlying pool of assets thus, it is secured. This difference has three significant implications. One is that in ETNs the investors are exposed to credit risk. As it is a promise, if the issuer goes bankrupt, the investor is in the position as all the unsecured creditors of the issuer whereas the underlying assets of any ETF are kept separately from the assets of the APs. Therefore, if the AP goes bankrupt, the fund will continue to be managed by the other managers or will be liquidated and the shareholders will receive cash representing the value of his or her share of the underlying assets. Another

implication is that as ETN is simply a promise, the yield will be precisely according to the movement of the tracking index but in case of ETF, it is a share of the pool of the assets it maintains thus it may or may not precisely reflect the performance of the underlying benchmark. The last implication is related with the concerning laws of these two instruments.

#### iii. *ETFs and Index Funds*

Both of these funds have a benchmark most of the time which is the stock market indices and both of these track the performances of those indices. But there are some delicate differences between these two. Kostovetsky (2003) has identified these differences by using three dimensions such as cost, size and time-horizon output. In comparison of cost index fund is more expensive than the ETFs as index funds incur some additional transaction costs through the brokerage house like Vanguard or Schwab account (Forbes, 2013). ETFs provide more liquidity than the Index fund. The reason is that index funds are alike mutual funds and valued at the end of a day trading whereas the investors can buy and sell ETFs at anytime of a day. Another aspect is that in index funds the investors do not remain worried about dividends as the dividends get automatically reinvested. For ETFs the investors will get the return on the shares and they can invest the proceed according to the wish they have in their mind. ETFs are much more flexible than the index funds. ETFs are used as a good alternatives of the future contracts and the contractors enjoy the relief of not preparing any special documentation or special accounts. From these perspectives and benefits, passive institutional investors and active individual traders love ETFs and the passive individual investors love index funds.

### III. ETF AND ITS PAST

It has been only twenty years since ETF has been introduced in the stock markets whereas mutual fund, its close competitor, has a very long history starting from 1774. In that year a Dutch merchant invented world's first close ended mutual fund. One and a half century later first open ended mutual fund has been introduced. ETF's most close cousin Index Fund has also been started a lot earlier. In response to an academic research suggesting the advantages of passive investing, Wells Fargo and American National Bank both launched index mutual funds in 1973 for institutional customers. Mutual fund legend John Bogle would follow a couple of years later, launching the first public index mutual fund on Dec. 31, 1975. This fund called the First Index Investment Trust, tracked the S&P 500 and started with just \$11 million in assets (Simpson, 2013).

"When was the first ETF introduced?" there is bit of argument regarding this issue. The website of Vanguard says in 1990 in Canada world's first ETF has been introduced (Vanguard, 2013). This is also

supported by Morning Star (Davidson, 2012). But Simpson (2013) says that first real attempt of ETF was made in 1989 which was the launch of Index Participation Shares for the S&P 500 (Simpson, 2013). Whatever the first attempt was, it was not a long wait the first ETF began trading in January of 1993. The S&P 500 Depository Receipt (called the SPDR or "SPIDER" for short) was the first of its kind and is still one of the most actively-traded ETFs today. Although the first ETF

launched in 1993, it took 15 more years to see the first actively-managed ETF to reach the market (Simpson, 2013). In 20 short years since their introduction in the United States, ETFs have taken the investment industry by storm. Today, U.S. ETF assets total more than \$1.4 trillion, invested in more than 1,440 ETFs (Source: Bloomberg.) (Vangaurd, 2013). The same effect has also been seen in the global economic environment. Figure 1 shows the impact ETF has made globally.

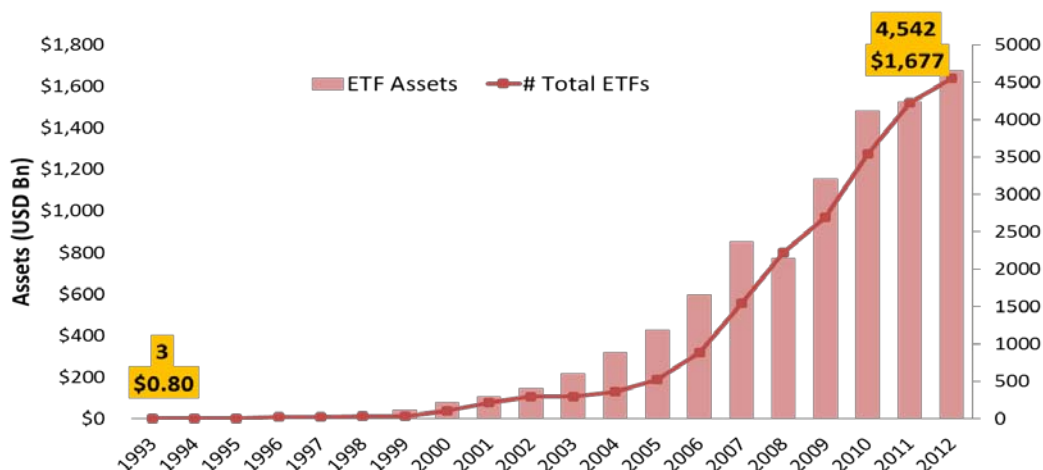


Figure 1 : Etf in the Global Market

Source: <http://www.blackrockinternational.com>

The SPDR fund (pronounced "spider") – the very first ETF – tracks the Standard & Poor's 500 stock index and is still the largest ETF on the market. With assets of around \$58 billion, it is the granddaddy of all ETFs, accounting for about 16% of all assets in the ETF market (WSJ, 2013). There were certain benefits of this new type of fund. There were no broker commission for trading this sort of fund (WSJ, 2013). That time the market was commission based and the brokers were keen to trade single stock instead of something by which the investors got a broad market exposure. "The migration from the commission-based financial adviser to the fee-only financial adviser is a trend that is ongoing," says Jim Ross, senior managing director of SSgA Funds Management at State Street Global Advisors. There were some other which triggered the booming of ETFs. "Initially, the brokerage community wasn't ready for ETFs – they were earning high commission rates then, and preferred to sell single stocks to their clients instead of something that got you broad exposure in one trade." (WSJ, 2013). But now, many investors would rather pay a straight fee or percentage of assets for advice on their investments rather than per-trade commissions. And financial advisers have gotten more comfortable that they can use ETFs – perceived as a passive product – in an active environment (WSJ, 2013). According to Ross clients are paying financial advisers to allocate their

assets and tell them when to reallocate, and advisers are looking for the best way to do that, which can be through ETFs. Financial advisers are a driver to growth in ETFs (WSJ, 2013). Yuvraj Patil (2003) has identified 6 factors that have driven the growth rate of ETFs (Patil, 2013). They are:

1. Large variety of indices of Equity, Fixed income, Commodity and other covered by ETFs
2. Facilitation of investor education & trading by large broking houses
3. Special market campaigns by many on-line brokers in an effort to win new accounts and cross-sell other products
4. Major fund platforms embracing ETFs
5. Regulatory changes in the US, Europe and many emerging markets that allow funds to make larger allocations to ETFs
6. Development and growth of investment styles that employ products like ETFs that deliver low cost beta
7. After the inception, innovations related with this financial instrument have never stopped. Started with the index, ETF now track Currency (Rydex Currency Shares), Commodities (The SPDR Oil & Gas Exploration & Production ETF-XOP, United States Oil Fund-USO), Metals Funds (Van Eck Market Vectors-Gold Miners ETF- GDX, iShares Silver Trust-SLV) etc.

#### IV. HOW ETF'S SHARES ARE CREATED AND REDEEMED

ETF has not been in Bangladesh yet. Therefore, nothing specific can be told regarding the process of the creation and redemption of it. But the usual practice in the world market of this process is described here. ETF shares are created and redeemed by a special agent who is called "Authorized Participants of AP". They are usually the large stock broker dealer in a stock exchange. Each business day, ETF publishes a "Creation Basket" – a list of names and quantities of

securities held by the ETF. To create ETF shares, an AP provides the creation basket to the ETF and receives in return a "Creation Unit". Creation Unit usually a very large block of shares containing typically 50,000 shares. Under certain circumstances, the AP may provide cash in lieu of some or all of the securities in the creation basket along with a transaction fee to offset the cost to the ETF of acquiring the securities. Upon receiving the ETF shares, the AP may sell some or all of them in the secondary market. This whole process has been stated here from Investment Company Institute(2012).

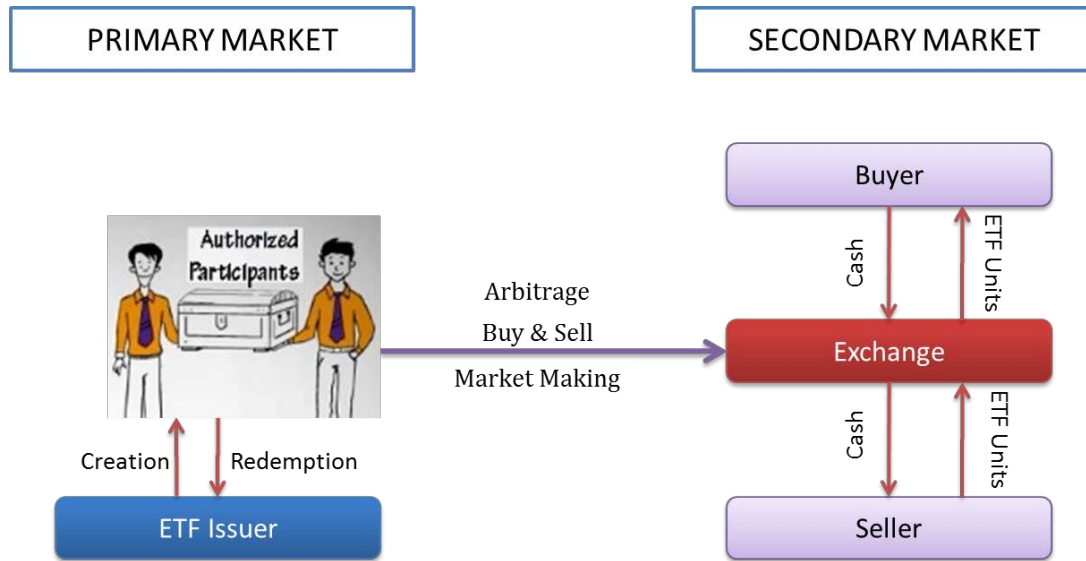


Figure 2 : Primary Structure Of Etf Shares

A creation unit is liquidated when an AP returns the specified number of shares in the creation unit to the ETF, in exchange for the daily "redemption basket" (a set of specific securities and other assets contained within the ETF's portfolio), cash, or both. The composition of the redemption basket typically mirrors that of the creation basket. If the AP receives cash in lieu of securities, it will pay a transaction fee to offset the cost to the ETF of liquidating the securities(ICI, 2012).

The creation and redemption process of ETF leaves an arbitrage opportunity for the APs. The creation and redemption mechanisms help ETF shares to trade at a price close to the market value of their underlying assets. When ETF shares begin to trade at a price that is higher than the market value of their underlying assets (at a "premium"), APs may find it profitable to create ETF shares by buying the underlying securities and exchanging them for ETF shares, and then sell those shares into the market. Similarly, when ETF shares begin to trade at a price lower than the market value of their underlying assets (at a "discount"), APs may find it profitable to buy ETF shares in the secondary market and redeem them to the ETF in exchange for the

underlying securities. These actions by APs, commonly described as "arbitrage opportunities," help to keep the market-determined price of an ETF's shares close to the market value of their underlying assets (ICI, 2012). Figure 3 gives a simple structure of ETF.

#### V. ETFS TO THE INVESTORS

Now that we have understood what ETF, how it differs from the other investment instruments and how it works, we can understand its usage to the investors. Individual investors can use ETFs to build a portfolio which risks are diversified across the whole market for the long term. ETFs can also be used to gain the market exposure to one particular asset class which underlie any particular index that the ETF tracks. The portfolio can also be built for the short term.

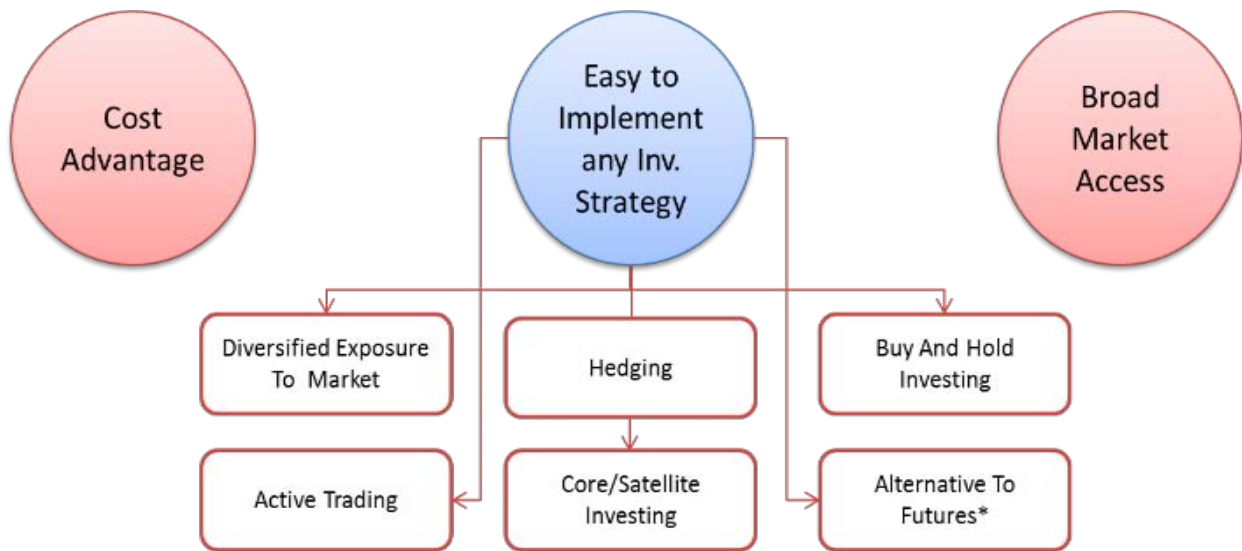


Figure 3 : Key Benefits Of Etf

Source: Patil, 2013

Institutional investors and other traders may use the ETF in the same way. They may also use the ETFs for gaining a short term exposure of the whole market or any particular market or to hedge other investments in a portfolio. For an example, institutional investors like mutual funds or pension fund can invest in ETFs to obtain any interim to a particular market while gradually investing directly in that market. And this is possible as ETFs can be sold directly for cash in the stock market anytime throughout the day.

In a word, ETFs provide both the institutional and individual investors the flexibility of going in or out of the market easily. This flexibility is more in ETFs than other such type of investment instruments because as most of the transactions of ETFs held in stock exchange, they do not affect the fund or the shareholders directly which means those trades do not represent any in and out of money from the fund and for this reason the authorized participants do not need to react by trading other securities. These reactive activities incur costs for the fund and as these activities are avoided the ETFs remain less expensive from other securities. The costs incurred in creation and redemption of ETFs are absorbed as APs do those transactions on an in-kind basis and try to absorb those costs with the transactions costs of the ETF's underlying securities rather than with the fund itself. This is how ETFs gives the investors the cheapest financial services. Here a chart has been given (Figure-3) which illustrates the process of key benefits and the usage of ETFs to the investors.

There are some other significant benefits of investing in ETF shares. The benefits ETFs stated in the above picture are similar to a mutual fund but the extent of those benefits for ETFs is very deep in terms of

mutual funds. We all know how the investors get the above benefits from investing in ETFs.

Along with the above benefits some other unique benefits are:

a) *Tax Efficiency*

It is said that ETFs are more tax efficient than the other investment instruments. This is not a hard and fast rule. There are some options which can be applied for getting the tax benefits from the investment of ETFs. Those options are low portfolio turnover strategies and in-kind redemptions. ETFs that do not employ those two options may not be more tax efficient than the mutual funds and in fact may be less efficient from the mutual funds that employ those two options(ICI, 2012).

b) *Transparency*

This is the benefit that ETF investors get and the investors of close ended mutual fund do not. Especially in the developing countries where the stock exchanges are less regulated, the asset managers of close ended mutual fund enjoys the facility of investing the fund in the securities they want. They are not required to express their portfolios on a daily basis to their investors. They are not also required to express any kind of bench mark by which the investors can predict the performance of the portfolio than has been constructed by their own money. Whereas the investors of ETF regularly get their update of their portfolios and as they know the bench mark or the asset underlying the ETF they can track and predict the performance of their investment.

These benefits are the main reasons why this fund has accumulated almost half of the total value of the mutual fund across the world in a very short time.

## VI. COSTS ASSOCIATED WITH ETFs

Along with the benefits ETFs also include some costs that the investors should be aware of. These are typical costs of investing in any EFT share. These costs may differ with the nature and environment of the stock exchange across the world.

### a) *Operating Expenses of Fund*

Like mutual funds, ETFs charge fees to cover operating expenses, such as advisory services, administration, and recordkeeping, among other things. These fees are detailed in the fund's summary prospectus and long-form prospectus, expressed as a percentage of fund assets paid annually. This percentage is commonly called an expense ratio." ETFs typically have lower total expense ratios than retail share classes of comparable mutual funds. Typical ETF administrative costs are lower than an actively managed fund, coming in less than .20% per annum, as opposed to the over 1% yearly cost of some mutual funds (Nasdaq, 2005). Even ETFs' expense ratio is lower than the cheapest index fund. For example, comparing the Vanguard 500 Index Fund, often cited as one of the lowest of the low-cost index funds, and the SPDR 500 ETF. The Vanguard fund's expense ratio of 21 basis points is significantly lower than the 100+ basis points often charged by actively managed mutual funds. But when compared to the SPDR's 9.5-basis-point expense ratio, the Vanguard fund's expense ratio looks quite high. In fact the SPDR is 45% lower, which is tough to argue with (McWhinney, 2013).

### b) *Brokerage Commissions*

Because ETFs are exchange-traded, investors must buy and sell ETFs through a broker, who is typically compensated for this service. Some brokers charge a flat fee for each transaction, while others may assess a fee based on the total assets in the investor's account (ICI, 2012).

### c) *Bid/Ask Spread*

When buying or selling ETF shares on the secondary market, there is typically a difference between the highest price a buyer is willing to pay for an ETF share (the "bid"), and the lowest price a seller will accept to sell an ETF share (the "ask"). As a result, an investor will typically buy ETF shares for slightly over "market" price and sell for slightly less. Bid/ask spreads are typically lower for larger ETFs and those that are heavily traded and/or highly liquid (ICI, 2012).

### d) *Loss for Premium/Discount Volatility*

ETF shares are designed to trade on the secondary market at a price that approximates the market value of their underlying assets but at times their market price may be higher (a "premium" to) or lower (a "discount" to) than the estimated market value of their underlying assets. Premiums and discounts are not

direct costs to an investor, but changes in premiums and discounts (i.e., volatility) may affect the value of the investor's ETF shares—for example, if an investor buys shares at a premium and sells at a discount, he or she incurs a loss.

## VII. BUYING AND SELLING OF ETFs BY AN INVESTOR

Investors buy and sell ETFs on the secondary market at a market-determined price. This means that they enter their trades through a brokerage account, and typically pay a brokerage commission. The whole process is just like trading a stock.

When placing a trade order through a brokerage account, there are two basic options: market orders and limit orders. The selection will impact how (and possibly whether) an investor's order is executed. The way any investors place those two types of orders for any common stock or closed end mutual fund, same way will also be used here.

## VIII. EVALUATING AN ETF BEFORE INVESTMENT

There are certain factors that should be considered by the investors before investing in any kind of ETF. Investment Company Institute (2012) has identified six such factors. These factors differs with the nature of the ETFs in any stock exchange and the economic environment of the stock market.

### a) *Performance*

While past performance is not an indication of how an ETF may perform in the future, an investor may wish to evaluate an ETF's performance against its stated objective or benchmark. For an index-based ETF, this is measured by the ETF's tracking difference. When evaluating an actively managed ETF, an investor might look at how the ETF has performed compared to its stated benchmark. An investor in an actively managed fund might also wish to consider whether the ETF's portfolio managers have changed, i.e., whether the ETF's past performance is attributable to the current managers.

### b) *Tracking Difference*

Tracking difference is the extent to which the ETF's return deviates from the return of its benchmark index. Tracking difference can be influenced by a number of factors, such as how an ETF seeks to track the index (i.e., whether it invests in every security in the index or in a representative sample of securities in the index), the ETF's operating expenses, and how the manager handles index rebalancing and corporate actions. Tracking difference is sometimes called "tracking error," but tracking error more precisely refers to the standard deviation of the differences between the performance of the fund and its benchmark.

c) *Cost*

There are a number of costs associated with investing in an ETF, including fees charged by the ETF sponsor, brokerage commissions, and/or account fees associated with receiving financial advice (e.g., wrap fees). An investor may also wish to consider indirect costs, including those stemming from the bid/ask spread and any premium/discount volatility.

d) *Premiums/Discounts*

Although ETF shares are designed to trade on the secondary market at a price that approximates the market value of their underlying assets, at times their market price may be higher (a “premium” to) or lower (a “discount” to) than the estimated market value of their underlying assets.

e) *Liquidity*

Liquidity refers to how easily shares can be bought or sold without moving the market for those shares. Securities with high trading volumes are generally considered more liquid. ETF liquidity should be considered with respect to both the ETF shares and the underlying securities the ETF holds. Highly liquid ETFs and ETFs that have highly liquid underlying securities (even if the ETF shares do not have high trading volumes) typically have narrower bid/ask spreads than ETFs that trade less or hold less liquid securities.

f) *Bid/Ask Spread*

When buying or selling ETF shares on the secondary market, there is typically a difference between the highest price a buyer is willing to pay for an ETF share (the “bid”), and the lowest price a seller will accept to sell an ETF share (the “ask”). As a result, an investor will typically buy ETF shares for slightly over “market” price and sell for slightly less. Bid/ask spreads are typically lower for larger ETFs and those that are highly liquid. Investors should consider the bid/ask spread of shares of ETFs in which they consider to invest their hard earned money.

These factors may not be equally applicable to all types of investors in any market. The impact of each of these factors will vary with the investor type. However, these factors cover all the aspects that an investor should consider before building a portfolio of ETFs.

The analysis and background given above cover almost all the basic aspects of ETF. Now the main purpose of this article which is implied by the title “Bangladesh is Going to Catch the SPIDER”, should be served. After almost 58 years of the inception of formal transactions on the stock exchanges and 21 years of the inception of the SPIDER, Bangladesh is going to introduce ETF in Dhaka Stock Exchange, one her two stock exchanges(Dhaka Stock Exchange, 2011). On September 21, 2014, the authority of DSE has asked for the permission to issue Bangladesh Stock Exchange

Commission (BSEC)(New Age, 2014; Mufazzal, 2014). Dhaka Stock Exchange Managing director has told that Bangladesh Securities and Exchange Commission should allow the bourse to launch two index-based exchange traded funds [ETF](New Age, 2014). Proposal has already been submitted to BSEC for the approval. Finally in Bangladesh SPIDER is going to be traded.

g) *ETFs to be Introduced in Bangladesh*

Nothing detail has been published for the people regarding this instrument as it has not been formally introduced here. What information has been stated here is collected mostly from Newspapers.

As per the MD of DSE Mr. Swapan Kumar Bala, two ETFs will be introduced on the bourse. That two ETFs will be formed based on DS30, the blue-chip index of the DSE, and DSES, the Shariah index of the bourse. To quote his saying “The DSE has made the proposal of launching ETFs in a bid to diversify its business as part of its business plan which was earlier approved by the commission with its demutualization scheme”(New Age, 2014). Now if the regulator allows, these two ETFs will be introduced soon with the introduction of its new trading system. The launching of this new investment instrument is now the priority issue for the bourse. The authority of DSE has already discussed with several Asset Management Companies to launch the product. As per the opinion of a senior official of DSE, the role of DSE will be to design the model of the ETFs and provide necessary information of a selective index to the asset management company who will operate the fund. The Asset Management Companies (AMC) will invest into the companies under the indices as per the provided guidelines of DSE or the ratios. This will ensure the same return that any investment would get if the investment is diversified among the shares of the companies underlying the indices. DSE will not make any investment in this fund.

h) *Rules Concerning ETFs*

As per the authority of DSE, the ETFs will be introduced here as an open-end Collective Investment Scheme (CIS) that continuously issues and redeems its shares of stock in creation of unit in exchange for basket and representing an index (Business News, 2014; Mufazzal, 2014). As this will be introduced as Collective Investment Scheme (CIS), the rules and regulation concerning CIS will be applied here. The rules and regulations of CIS covers only the property related investment, therefore, a fine tuning will be needed here. According to the opinion of DSE MD “The regulations of existing CIS covers only the property related investments. We will be able to issue the ETF by bringing amendment to the regulation of CIS” (Mufazzal, 2014). He has also told that an AMC will issue the ETFs and the investors will be allowed to purchase the shares of this fund on the basis of availability. Regarding the formulation of new rules and regulation he told that the



regulations will be formulated considering the matter of risk minimization. This fund will be listed in the stock exchange though it has the characteristics of an open-ended mutual fund. Therefore, the regulation will also include the provisions by which ETF will be listed on the bourse.

### IX. ETFS IN BANGLADESH: AN EVALUATION

Recently just a couple of years earlier, Bangladesh has gone through its one of the worst stock

market crises ever. This crisis has been preceded by the world's one of the largest financial crises. Many research and analyses have been made on this crisis and the reasons behind this catastrophe have been identified. If we look at the factors that have triggered the crisis, we will see the following factors which were identified in a working paper of Centre for Policy Dialogue (CPD)(Moazzem& Rahman, 2012):

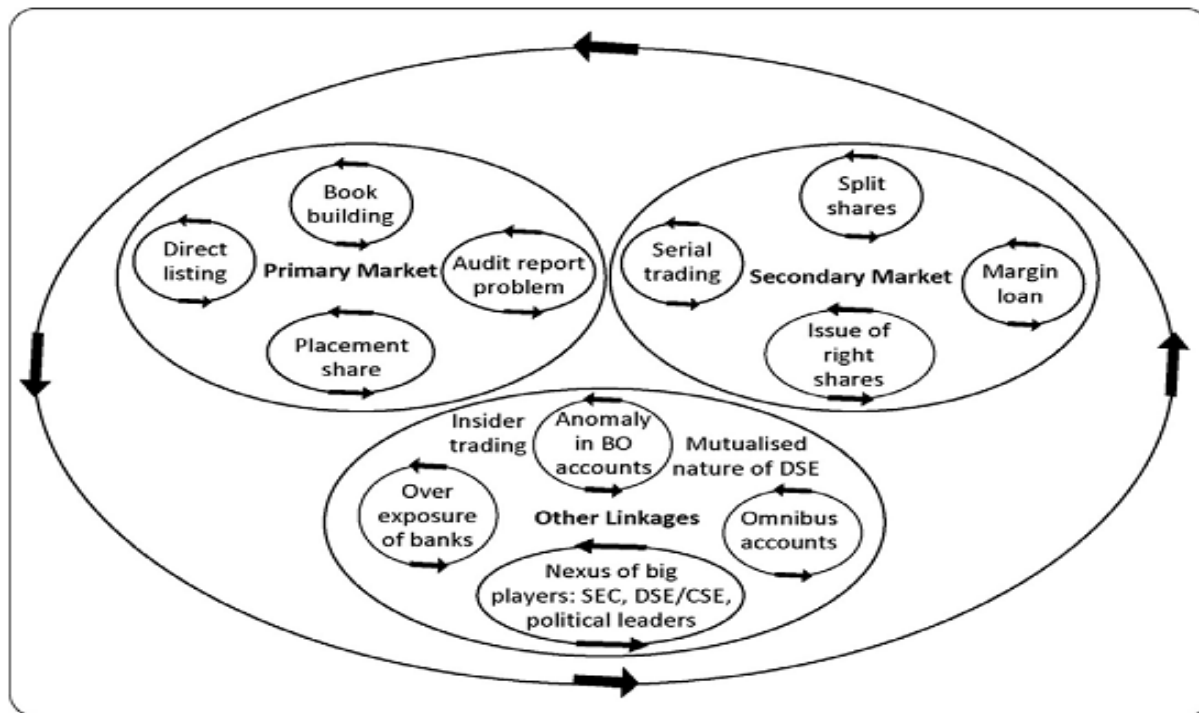


Figure 4 : Factors of the Crash in 2010-2011 in Bangladesh

Source: Moazzem & Rahman(2012)

1. Informational Market Inefficiency
  2. Lack of Transparency
  3. Presence of Bull Cartels
  4. Book Building System not Monitored
  5. Rampant Use of Placement Shares
  6. Malpractice of Serial Trading
  7. Heavy Insider Trading
  8. Faulty Audit Reports of the Listed Companies
  9. Faulty Operations of Excessive Number of Merchant Banks
  10. Retailer-like Behavior of Institutional Investors
- And 8 other such factors.

The authors of that working paper has shown those factors as the toxic elements of Stock Market. Still Bangladesh is trying its best to recover herself from this crisis. The DSE and BSEC have gone through many reformations and the monitoring of these regulatory authorities has been increased and the regulators are trying to remove those toxic elements from the market. In the last two years they have been successful in their

efforts as we have seen 30% increase in the DSE30 index of DSE. But there still remains some of the toxic elements in our stock market. For example, recently we have seen the second largest Asset Management Company of Bangladesh, LR Global Bangladesh Asset Management Company Limited making forgery with fund of the Mutual Funds it operates (Mohajon, 2014). It broke the fundamental law (Mutual Fund Regulations, 2001, Sec-27) on which it is based which states that AMC's cannot be the entrepreneur or trustee of any mutual fund, even cannot be related with the governing body of any company. In this forgery, they have broken this rule and invested the hard-earned money of the investors in a crappy private company which is alleged to be the company of the MD of that AMC. Even after that this company is running (Mohajon, 2014). In Bangladesh most of the Mutual Funds are Closed-end Mutual Funds even here Mutual Fund means the closed end mutual fund. Therefore the disadvantages of mutual funds will have serious implications in the economic environment of Bangladesh.

1. *Lack of transparency & knowledge:* The AMCs of closed end mutual funds are not required to express the portfolio of the assets in which they are investing the investment of risk averse investors. A stock market researcher, Md. Itrat Hossain says, though in the developed countries the asset managers publish their portfolio quarterly, the biggest and largest companies here in Bangladesh do not publish their portfolios in years. As the share market of Bangladesh is like what the evidence stated above proves, the AMC has little accountability of the usage of the fund they have of the investors.
2. *Management Fees:* In closed end mutual funds, AMC charge the investors for utilizing their specialized knowledge in the market from the investors. Asset Managers like LR Global will invest in the crap companies in one hand and on the other hand they will also charge the investors for investing there. As the structure of our markets are weak asset managers can do that and exploit the hard earnings of the investors.

Here we see the weaknesses of stock exchanges and the operational lacking of the mutual fund in Bangladesh. In this background ETFs are being introduced in this stock market. Let's have a look at this funds advantages from the perspective of Bangladesh.

a) *Transparency*

This is the most transparent investment instrument as the investors will always know how its performance will be by tracking the benchmarks or the assets underlying it. Therefore, the AMCs will not have any such power to gamble with the money of the investors. For Bangladesh, where the AMCs can do anything with the money they have of the investors (As the evidence suggests- Mohajon, 2014), this transparency will boost the confidence of the investors on the stock market.

b) *Low cost*

This fund as described in the earlier part of this article is the cheapest of all the funds. Here the AMCs do not possess any specialized knowledge that he can use and charge the innocent investors as the investment will be made as per the instructions or ratios provided by the DSE. The shares of this fund will be traded like the common stock. Therefore, the investors will have to pay the same costs for ETFs as they pay for the common stocks.

c) *Diversification*

As per Md. Itrat Hossain, most of the investors here in Bangladesh are small investors and possess very little knowledge about the market and have a very low amount of money to invest in all the shares of DSE30 to have the broad diversification in the investment. With the investment in ETFs those small individual investors will be able to have the broadest diversification they can ever have in the stock market.

Their investment will be almost unsystematic risk free. The systematic risk will be the same as the market indices. They will also be able to invest in those shares which usually remains out of their reach. This will be a great boost in the confidence of the investors.

d) *Trading like Common Stock*

According to the opinion of that researcher, the normal investors of Bangladesh are simple and they do not want to enter in any kind of complexity. Therefore, for the common investors, this fund will be very easy to understand as this fund is traded like the common stocks. Here the investors will be able to use this share for their short term, medium term and long term investment. Therefore, this fund will be warmly welcome by the common investors of Bangladesh.

e) *No Agency Conflict*

The asset managers sometimes gamble with the money of the investors thinking that they are doing all the research and the investors are taking only the profit earned by us. Here in case of ETFs it is not possible because here there is a passive management from the investors to the fund. Here the asset managers or the authorized participants will not have to work very hard or continuously to be in track with the benchmarks it follows as the investment is made specifically in the design designed by DSE itself to track the underlying benchmark or asset class. This reduces the possibility of managerial cost of Agency for the investors.

Therefore, from the above evaluation, evidence and opinions presented we can say that the introduction of ETF in DSE will bring a new dimension in the history of Stock Market of Bangladesh.

f) *Opinions of International Experts*

Regarding the introduction of ETFs here in Bangladesh, DB X-Trackers said that Bangladesh is one of the emerging frontier markets in the world with some exciting propositions where ETF will have an excellent future (Smith, 2012). Eagle Financial Publications, (2014) has also considered Bangladesh one of the 10 most emerging financial markets in the world and predicted a great future of ETF shares here. ETFs are very much successful in the other developing and our neighboring countries such as India, Singapore, Thailand and Philippines (Patil, 2013).

## X. CONCLUSION

SPIDERS are in process to roam the stock market of Bangladesh. In a very short time this investment instrument has been able to be in a competition with the mutual funds, it's very old cousin. Now Bangladesh faces some serious problems regarding the regulatory bodies of stock exchanges and their structures. There is little the government can do in this sector without strengthening the structure of this sector. Here, the introduction of ETFs with its

transparency, low costs and flexibility what will bring, this is question now among the researchers and investors. Nothing certain can be expressed before its formal introduction. But as the evidence states and ETFs' past in the other countries, this investment instrument will bring confidence among the general investors. The transparency that ETFs provide is the rarest thing that the investors of Bangladesh normally experience. This may open a new dimension for the investors here and they may become a fan of the transparency and become very aware of their investment. All of these now we can anticipate but we cannot tell for sure what will really happen. Therefore, let's whether the SPIDER be able to form the net of confidence among the investors of Bangladesh.

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