

The Impact of Capital Market Failure and Investors Responses in Bangladesh: The Case of Chittagong Stock Exchange during 2010-11

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ABSTRACT

Capital Market is the backbone of an economy. This study's main object is to find out the impact of capital market failure in Bangladesh i.e. Chittagong Stock Exchange during the year 2010-11 and to find out responses of investors in CSE. While conducting this research, 140 investors are selected from CSE and out of this 120 investors responded properly, the response rate is 85 percent. A questionnaire was prepared for this study which consisted of different questions on four dimensions of investors for the investment. In this study, some statistical measures such as descriptive statistics and regression analysis were used to examine the impact of capital market failure in Bangladesh. The study discovers four dimensions such as exposure of bank, availability of authentic information, knowledge about risk management, and efficiency of Securities and Exchange Commission which had positive and significant effect on investors' responses towards CSE. Findings also suggest that investors had unfavorable responses toward all those dimensions which led to capital market failure especially in case of CSE. This paper will help both investors and policy makers to know the impact of capital market failure and to make proper decision to manage and invest in future to the capital market in Bangladesh.



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1. INTRODUCTION

Capital market is one of the most important financial institutions of any economy as well as Bangladesh. The background of this study is to find out the impact of capital market failure in Bangladesh during the year 2010-11 and the way out to prevent the failure in the capital market in future and to make good responses of investors to invest in the capital market. This section of the study describes about history, functions, core values, mission and vision of Chittagong Stock Exchange Limited. Besides in this part of the study deals present status of the capital markets and investors. The Chittagong Stock Exchange (CSE) started its journey from October 10, 1995 and it got permission on 12th February 1995 from Security and exchange commission. It was finally opened at the end of year 4th November. It is the country's second largest stock exchange in Bangladesh. Currently CSE has 310 enlisted companies. Functions CSE; increase business turnover, modernize trading system, ensure effective relationship management, achieve high level of confidence & professionalism, engage in product and market diversification contribute to capital market policy development, ensure exchange related quality services. On the other hand, core values of CSE; value for people, transparency, excellence, harmony, commitment and integrity. CSE has specific missions; practice a set of core values to build competency in compliance, diversification, and technology so that an accessible platform, market confidence and wealth maximization scope can be ensured. Besides, CSE has a certain vision to build a global standard transaction place of securities and financial product. Capital markets are great financial institutions for economic growth provided that if those are managed properly. Some well-funded theories have been established by scholars after studying the operation of capital market in the developed world. Finally, general investors are still dissatisfied for the volatile conditions of the capital market to invest their capital as experiencing massive market crash trend for the long time both the examples set by the years 1996 and 2010.

2. STATEMENT OF THE PROBLEM

To best of the researchers' knowledge, there had been a dearth of empirical research which focused on investors' responses with respect to capital market failure in CSE. This papers, thus, shows the critical phenomena of the impact of capital market failure in Bangladesh during the year 2010-11 in CSE and investors' impression toward the market and investment decisions. It also tells about changing pattern of investors' behavior (negatively) rapidly to the market and leaves from the market as quickly as possible. As a result economic growth of the country decreases gradually, investors lost their faith to make an investment decision due to massive capital market crash.

3. RESEARCH GAP

Several studies had been conducted to find out the reasons for capital market failure in the past in Bangladesh. Those studies basically focused on traditional assumptions to examine the causes of catastrophe in the capital market. However, the researchers noticed a significant dearth of contribution in the field of investors' psychological responses with respect to capital market behavior. In addition, to the best of the researchers' knowledge, not many empirical studies were carried out to find out the dimensions influencing investors' responses and satisfaction toward Chittagong Stock Exchange (CSE). These gaps had stimulated the researchers to conduct an empirical study on "The Impact of Capital Market Failure and Investors Responses in Bangladesh: The Case of Chittagong Stock Exchange during 2010-11".

4. SIGNIFICANCE OF THE STUDY

This study investigates the out the impact of capital market failure in Bangladesh of 76 major reform, stabilization, bailout, and macro-control policies over a wide time span from 1994 to May 2017. Furthermore, to examine the long-term structural changes in volatility, the study divides its sample period into several market stages according to the market development, policy initiation, and previous studies. Note that policy factors in the stock market cover broad categories. Among them, stock market policies, including reform, stabilization, and bailout policies, are the main factors that affect the capital market (Rahman and Hassan, 2011). In addition, because security analysts predict the capital market, usually on the basis of important macroeconomic conditions, it also takes macro-control policies into consideration but still pay more attention to the capital market policies.

This paper will help to understand both investors and regulators about usefulness of demutualization of Stock Exchanges. Stock Exchanges of Bangladesh are controlled by its members under the supervision of Bangladesh Security and Exchange Commission (BSEC). But such control creates conflicts of interests in the market. Government will be able to realize to force Exchanges to be demutualized. In this regard, government can take the help of any donor agency (World Bank or Asian Development Bank) to develop necessary infrastructure. This study focuses on 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. This paper also asks to ensure integrity and efficiency of SEC members and staffs and also co-ordination between SEC and Stock Exchanges. From this study commercial banks will be able to realize heavily on capital market by investing directly and indirectly (Margin Loans) that creates high risk on depositor's money and also understand to introduction. This study shows the importance on 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.

5. LITERATURE REVIEW

Review of literature is an integral part of conducting a research. Review of past literature helps conceptualization, formulation and choice of tools of analysis. It also helps in arriving at meaningful conclusions. With this view a brief review of past studies and concepts relevant to the present study are highlighted: According to Sultana et al., (2016), recurrent changes in margin loan ratio, surplus liquidity, opening a broad variety of brokerage house are the central determinants responsible for the unsteadiness in capital market of Bangladesh. They also advocated that the collapse of capital market in 2010 took place due to increased SLR and CRR, unpredictable directives of SEC, and removal or withdrawal of reserved money by banks. Moreover, dearth of capable and proficient financial analyst in the capital market, well-informed manpower, managerial and other supportive activities, better scripts, improved

monitoring, and investor awareness program were found to be some other key reason causing the crisis. Chowdhury (2012) found that some policy makers termed the capital market of Bangladesh as ‘wicked’ and “gambling casino”. Alam (2012) remarked that primary factors which created problems were faulty listing methods, IPO overpricing and secondly problems creating factors were stock split, manipulation and so on. Ullah et al., (2012) are of the view that as a vital part of the economy of the country, well-functioning of the capital market is a must for the industrialization process of a developing country like Bangladesh but un-stability in the same may negatively affect the total financial system. Therefore, all related corners including Government, Regulatory bodies, Listed Companies, Brokerage houses, institutional investors, and retail investors should act rationally to maintain the stability in the capital market for the greater interest of the country. Sarker et al., (2012) on the other hand elucidated that gap between the demand and supply of stock, extraordinary overpricing of the stock, market manipulation, lack of knowledge of stock and investment management

Saha (2012) opined that the government lifted the restrictions on listing access and improved the delisting system of listed companies to enhance the efficiency of resource allotment in the capital market. This drew fund flows into value stocks and growth stocks, and led them away from junk stocks. The implementation of IPO reform in 2012 helped to guide rational investment. SEC launched the stock index futures in 2010 to provide a hedging mechanism for systemic risk, and launched the securities margin trading business in the same year to implement long and short two-way trading. Ahmed (2004) demonstrated that policy factors are the primary reason for market movements in a similar period with 16 huge market fluctuations, whose amplitudes exceeded 20%. Rasul (2013) recommended that Security and Exchange Commission (SEC) of Bangladesh and government should encourage more public limited companies to offer more share to meet the current demands. In order to get back the confidence among the existing investors regulatory body may introduce Income tax rebate, Injection of Market Stabilization Fund, Mandatory holding certain percentage of share among the board of directors, short term incentives packages etc. Government over the years had taken several measures which included amendment of laws to stabilize the capital market. Afroz (2004) however, mentioned that even after taking several regulatory measures by the government to augment the institutional investment in the capital market, this market will still suffer from various setbacks as a consequence of the 1996 share market shock.

From the above literatures it is very clear to study that capital market always influences macroeconomic behavior of a country (Chowdhury et al., 2006). As a volatile tendency of the capital market especially Chittagong Stock Exchange investors feel always unsafe and avoid investing such kind of market.

6. OBJECTIVE OF THE STUDY

The overall objective of the study is to find out the impact of capital market failure in Bangladesh i.e. Chittagong Stock Exchange in the year of 2010-11 and to find out investors’ investing responses. To some extent, the specific objectives (Malhotra, 2007) are:

- i) To identify the dimensions that lead to capital market failure in Bangladesh.
- ii) To analyze investors’ responses toward specific parameters such as exposure of bank, availability of information, knowledge about risk management, and efficiency of SEC.
- iii) To examine the degree and strength of relationship between investors’ satisfaction toward CSE and the identified parameters.

- iv) To find out the relative importance of the dimensions that influence investors; satisfaction toward CSE.
- v) To provide some suggestions for stability of the capital market and increase satisfactory responses of investors to invest in the capital market especially in CSE.

7. METHODOLOGY

An exploratory followed by descriptive study was carried out where the researchers used both in depth interview and survey questionnaire to obtain the responses from the participants selected for this study. The target population of this research was investors in the Chittagong Stock Exchange Limited who were investing as investors since 2007. Both primary and secondary sources had been used to collect data for the study. Primary data were collected through a structured questionnaire which was administered personally to the investors in the different enlisted brokerage houses of the Chittagong Stock Exchange (CSE). On the other hand, secondary data were collected from various research papers, journals, individual articles, websites, newspapers, books and other available authentic sources. Among various brokerage houses, this study only considered 15 enlisted brokerage houses under the Chittagong Stock Exchange Limited situated at Dhaka City in Bangladesh. Convenient sample technique has been used in this study. For conducting this research, 140 investors from the selected brokerage (trading) houses' were interviewed and out of them 120 investors response properly, the response rate is 85 percent. Other 20 respondents' responses were incomplete which are not considered in this study. The researchers analyzed the data based on four dimensions such as "exposure of banks & financial institutions", "availability of authentic information for the investment", "knowledge about risk management", "efficiency of Securities and Exchange Commission" to control over the Chittagong Stock Exchange. The questionnaire was developed by using a five point *Likert* scale, where 1= strongly dissatisfied, 2= dissatisfied, 3= neither satisfied nor dissatisfied, 4= satisfied, 5= highly satisfied. Specific statistical tools like mean, standard deviation was performed to find out investors' responses toward specific parameters such as exposure of bank, availability of information, knowledge about risk management, and efficiency of SEC. Besides a multiple regression analysis was conducted to examine the degree and strength of relationship between investors' satisfaction toward CSE and the identified parameters and to find out the relative importance of the dimensions that influence investors; satisfaction toward CSE. A cross tabulation analysis was also carried out to examine how satisfaction (high and low) toward CSE relates to another categorical variable named gender (male and female).

8. HYPOTHESES DEVELOPMENT

On the basis of the various factors affecting on capital market especially CSE failure during the year 2010-11, following hypotheses are developed for the study:

- H₀1: Exposure of Bank has no relationship with investors' satisfaction toward CSE.
- H₀2: Availability of authentic information related to stock market has no relationship with investors' satisfaction toward CSE.
- H₀3: Knowledge about risk management has no relationship with investors' satisfaction toward CSE.
- H₀4: Efficiency of SEC has no relationship with investors' satisfaction toward CSE.
- H₀5: The participation in the stock market is not different for males and females.

9. DATA ANALYSIS

To analyze investors' responses toward specific parameters such as exposure of bank, availability of authentic information, knowledge about risk management, and efficiency of SEC, the researchers calculated the mean values associated with each parameter. As shown in the Table 1, the investors had neutral attitude (Mean = 3.06) with respect to exposure of bank which suggests that investors experienced limited exposure of banks & financial institutions. It was also evident that the investors had negative responses regarding availability of authentic information (Mean = 2.52) as well knowledge about risk management (Mean 2.63).

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Exposure of Bank	100	1	5	3.06	.930
Availability of Authentic Information	100	1	4	2.52	.745
Knowledge About Risk Management	100	1	4	2.63	.800
Efficiency of SEC	100	2	4	3.08	.706

In other words, investors' thought that they did not receive adequate authentic information related to stock market plus their knowledge about risk management was not satisfactory. In addition, their response toward the efficiency of SEC remained neutral. All these unfavorable results might result in capital market failure to a great extent.

In the next phase of this study, the researchers conducted a multiple regression analysis in order to determine the degree and strength of relationship between investors' satisfaction toward CSE and the identified dimensions.

Table 2: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.730 ^a	.533	.513	.43658

a. Predictors: (Constant), Efficiency of SEC, Exposure of Bank, Knowledge About Risk Management, Availability of Authentic Information

As shown in Table 2, there was a strong positive association ($R=.730$) between investors' satisfaction and the identified predictors such as exposure of bank, availability of information, knowledge about risk management, and efficiency of SEC. R square indicates that 53.3% variation in the investors' satisfaction be explained by the predictor variables included in the model. The value of adjusted R square ($R^2 = .513$) is closer to R which signifies that the additional predictors after adding the first predictor contribute in explaining the variation in dependent variable.

Table 3: ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	20.643	4	5.161	27.076	.000 ^a
	Residual	18.107	95	.191		
	Total	38.750	99			

a. Predictors: (Constant), Efficiency of SEC, Exposure of Bank, Knowledge About Risk Management, Availability of Authentic Information

b. Dependent Variable: Satisfaction toward CSE

Table 3 suggests that the null hypothesis (R^2 in the population is zero) is rejected as $p < .05$. Table 4 shows the relative importance of exposure of bank, availability of information, knowledge about risk management, and efficiency of SEC in influencing investors' satisfaction with CSE.

Table 4: Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.148	.307		-.480	.632
	Exposure of Bank	.291	.049	.433	5.981	.000
	Availability of Authentic Information	.309	.063	.368	4.902	.000
	Knowledge About Risk Management	.321	.057	.411	5.665	.000
	Efficiency of SEC	.156	.064	.176	2.448	.016

a. Dependent Variable: Satisfaction toward CSE

The results of multiple regression coefficients as shown in Table 4 show that exposure of bank, availability of authentic information, knowledge about risk management, and efficiency of SEC positively and significantly affect investors' satisfaction. Therefore, H_{01} , H_{02} , H_{03} , H_{04} were rejected from the study as $p < .05$. From the Table 4, it is also evident that knowledge about risk management plays the most important role in influencing the satisfaction level of the investors followed by the availability of authentic information.

From these results the researchers can conclude that any problems or errors associated with the above mentioned variables will lead to negative responses from the investors which ultimate will results in capital market failure. If knowledge about risk management reduces by one unit, investors' satisfaction will reduce by .321 times. The same statement will be true for the other variables as well.

10. DISCUSSION OF THE FINDINGS

Based on the findings, it appears that investors had overall negative responses regarding the dimensions selected in this study. These unfavorable responses as evident from Table 1 were responsible for Chittagong Stock Exchange (CSE) failure during the year 2010-11. It is also found that the most negative responses came for availability of authentic information. Despite having so many sources of information such as peers, brokerage houses, newspapers,

financial institutions, manipulators and so on, it was the dearth of authentic information which led to CSE failure. The researchers also found that all the dimensions used in this study had significant and positive effect on investors' satisfaction level with CSE and it is the knowledge about risk management which had the most significant effect on investors' satisfaction. Because when the investors are less knowledgeable about how to management risks, they cannot get their expected returns. Even, sometimes, their whole investment goes in vain.

11. LIMITATIONS OF THE STUDY

This study had a major limitation on sampling as the study included only 100 respondents which limit the scope of generalization of study. The data obtained from Likert scale were treated as interval as per Malhotra et al., (2007). But many traditional statisticians oppose the use of parametric test with Likert scale data. Moreover, many respondents were not willing to disclose their investment related information which created troubles for the researchers.

12. CONCLUSION AND RECOMMENDATIONS

The study uncovers the impact of capital market failure in Bangladesh and investors' responses toward the capital market especially during 2010-2011. In this study there are considered four major factors which represent most of the causes of stock market failure as affect it seems to be vulnerable conditions of the investors as they are mostly dissatisfied. Security and Exchange Commission as well as government should properly guide and supervise and deploy all mechanisms in the capital market operations so that investors' can be satisfied and feel safe in terms of investment is concerned. The study finds after analyzing data dissatisfactions of investors toward Chittagong Stock Exchange Limited such as; there is limited exposure of banks & financial institutions, lack of availability of authentic information for the investment, limited knowledge about risk management, inefficiency of securities and exchange commission which lead to failure Chittagong Stock Exchange very often in Bangladesh. All the four dimensions of the study such as; exposure of banks & financial institutions, availability of authentic information for the investment, knowledge about risk management, efficiency of Securities and Exchange Commission indicate that majority of investors are highly unhappy and unsafe on these dimensions which are analyzed and developed hypothesis. Therefore, calculated value is negative of major dimensions which make poor impression of investors that cause of capital market as well as Chittagong Stock Exchange massive failure in Bangladesh. As a result investors are not satisfied to invest in the capital market in Bangladesh. The study provides some recommendations for preventing capital market i.e. Chittagong Stock Exchange failure in the future such as: i) the regulators and government should have developed role and functions for the capital market protection, ii) all agencies relating to capital market need to introduce new tools, strategies, directives, rules and regulations for capital market development and to prevent this kind of market crash these are necessary plans such as: i) restriction of faulty accounting practices and methods, ii) recruiting honest officials, iii) providing authentic information about capital market to the general investors, iv) taking strict actions against manipulators and improving the situation. It is now quite required to prevent this kind of situation. Training programs should be arranged for investors so that they may have knowledge on risk management for making investment decision in the Chittagong Stock Exchange. It is also necessary to finding out manipulator(s) and to take proper steps against them. Finally, this paper suggests that regulators of the capital market should review existing rules & regulations and to increase investors' good responses toward Chittagong Stock Exchange. It requires preventing different

kinds of malpractices of market operations by the manipulators and others in future. Therefore, investors will response positively to make investment decisions which may lead a strong base of the economy of Bangladesh.

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