The disharmony of regulations for the merchant banks creates a great ordeal for their operations.

M Mosharraf Hossain
Managing Director & CEO
Prime Finance Capital Management Ltd.

The past one year has been an acid test for all the merchant banks of Bangladesh. With the sheer liquidity crisis prevailing in the market, merchant banks have undergone a very tough time and are still amidst crucial volatility. Money market is the raw material for the capital market and in 2012 money market has served a crucial role. The lack of capital inflow is bound to affect the dynamics of any market negatively. Hence, the lack of liquidity in the money market which we have inherited in 2010 has affected our capital market in a big way in 2012. In terms of issue management, 2012 saw another withdrawal when no merchant bank adopted the book building method to determine their pricing. From the profitability perspective, all the merchant banks operating in the capital market do not seem to be operating in a decent position. The 42.5 percent tax was another imposition that we had to face in the past year which was later reduced to 37.5 percent. The listed merchant banks, will however, be given a provision of 27.5 percent of tax payable. Nonetheless, as per my concern, only one of the merchant banks is trying to enter the market till date. Though the market is very risky we intend to strengthen our capital base. We have been able to convince our sponsors to invest additional fund in the capital market. In comparison to other avenues of investment we are fully aware that generating even 20 percent from this market is a daunting challenge for us. Still, our sponsors are readily contributing to the market only for the sake of the capital market. Another important fact is that once we have started we cannot break the line. Thus, in order to serve the company better the management has decided to inflow more fund into the business. Currently, we have brought our capital to BDT 160 crore and within the coming time we plan to reach a target of BDT 200 crore and thereby go for IPO.

Categorically we are facing many financial dents. One such dominant crisis is the affected small investors' phenomenon. Considering the total portfolio, the affected investors constitute a large portion. Statistically, among the active portfolio of 15 lac, the affected investors account for almost 9 lac; in other words the 60 percent of the market belong to the affected investors. In the upcoming time there might be cases when an investor applying for an IPO in the affected investors' quota may not be getting IPO. Rather if he/she had applied in the non-affected investors' quota the probability of getting the IPO might be increased. Moreover, we have to pay from our own capital or profits to the affected investors. Another issue is the loss of capital in the secondary market. Supposedly, an investor comes into the market BDT 1 and avails another Our threats have already been crystallized and now its time to face them.

Force-selling of portfolio is inclusive in our agreement. However, off the record it is hindered and thus we cannot enforce this. If we could have implemented this power back when the capital market debacle happened, then we could have saved a large portion of our equity. All equity should not be equal in terms of fundamentals. It is not necessary that all equities should come in the market in terms of face value; they can have a justified pricing. But if we are forced to come to the market with our face value then it will not be fair to us. However, we are facing this imposition for the past one and a half years. Thus, such policies can be relaxed. The reason for such a policy is that the companies often fail to show their accurate revenues and thus they are asked to come at their face value. However, the revenue recognition and accuracy can be approved by the DSE or BSEC. Though there is an committee for the revenue recognition by the DSE, they are not given any authority to pass any decision. If they had the authority, they could have identified the categories of revenue that are not acceptable. But at present, with the current set of structure, it is often seen that such problems are prolonged. Another problem that we face is the limitation of the commission. As an issue manager, commission is one of the major sources of revenue and thus it has been a quite challenge for the merchant banks for the last couple of days to generate profit from this zone. The commission as per my suggestion can be based on the goodwill of the issue manager or the size of the IPO. We have communicated our concern with the regulators quite a time and we hope for a positive outcome. We have to make the regulators realize that if the merchant banks remain oil up, it will be a booster for the market.

The disharmony of regulations for the merchant banks creates a great ordeal for their operations. There are merchant banks which are subsidiaries of banks and insurance companies. The regulator of banks is the Bangladesh Bank and the insurances companies are regulated by the IDRA. Due to the difference in the regulations, the merchant banks under different institutions face different regulations. It is seen that there are four to five types of merchant banks including bank subsidiaries, insurance companies' subsidiaries which consists of life insurance and non-life insurance, Grameen Bank subsidiaries and stand alone merchant banks. Thus if the merchants banks could be brought under a unified regulation there will be a stable harmony in the market. Thus, this issue can be addressed that irrespective of the parent company, the merchant banks will be regulated under the single regulation of BSEC. Since I am a financial institution subsidiary, now I have to comply with Bangladesh Bank regulations. My suggestion is that all these regulations should be brought under a unified regulation so as that the merchant banks will not have to follow two regulations. The existence of many acts at the same time creates an imbalance in the operation of the merchant banks.

Corporate governance is important and it is self regulated. To my knowledge, the guideline for corporate governance that is provided to us is designed for the listed companies. As merchant bank association, the corporate governance is given due diligence from our part. It is the responsibility of the regulatory body to look after the corporate governance and we hope that a guideline for the non-listed merchant banks will be soon circulated.

The outlook of 2013 appears to be bleak. On one aspect we are running negative on equity. If the money market is positive then the capital market will remain boosted and so will be the merchant banks. On the other side, 2013 is an election year and thus bringing along much uncertainty. We should be ready to face a difficult scenario in 2013, if not even worse than 2012.

Interview is taken by Md. Ashaduzaman Riadh and Tanzina Ahmed Choudhury. All views and opinions expressed here are solely of the interviewed persons and neither represent the views of LankaBangla Securities Ltd. nor those of any of its associated institutions.