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Demutualization: Pros and Cons for Dhaka Stock Exchange (DSE)

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Abstract

The purpose of this study is to examine the implications of demutualization for Dhaka Stock Exchange (DSE). And this is done by examining the existing literature for the stock exchanges that have already been demutualised. The result of the study indicates that all benefits that go with demutualization are not applicable for Bangladesh. Rather the benefits are contingent upon some factors unique to Bangladesh. So in the process of demutualization the authorities concerned should focus on those factors from which optimum benefits can be derived. However, demutualization is not without risk. So along with benefits risk should be focused on so that appropriate policy can be formed that will ensure successful implementation of demutualization. This study is important to investors, academics and policy makers as it demonstrates what benefits demutualization will bring and what challenges it will create. Since demutualization is a very new concept in Bangladesh, the study extends the literature by demonstrating its pros and cons in the context of Bangladesh.

Key Words: Demutualization, Mutual Organization, Corporate Governance.

1. Introduction:

A dramatic shift in the economic and power structure of the securities industry is currently in progress. Although competition to traditional markets from electronic trading markets may be the precipitating cause of this upheaval, more than technology is driving these changes. The worldwide rise in stock exchange trading volume, global integration of the capital markets and competition for trading profits are leading to disintermediation at a rate that the securities markets have not experienced since the unfixing of commission rates. Decimalization, which is now underway, will further cut the conventional trading increment to a penny or less. Futures exchanges similarly have been buffeted by technological change and global competition. One important response to these challenges is demutualization.

The demutualization of stock exchanges is a recent new phenomenon in the economic world with a history of approximately 20 years, meaning that till the early 1990s; most of world stock exchanges were non-profit, mutual organizations with monopoly power, owned by their members. Their most important characteristic is a very strong and close identity between the owners of the stock exchange and its clients, final consumers of its trading services, because usually, the owners are at the same time its clients, sharing the profits of the company in accordance with the level of their participation in the ownership. Due to the recent years' technology improvements and competitive environment changes, new opportunities alongside with new threats are created for stock exchanges. As an answer to these new threats stock exchanges began to change their ownership organizational form.

Demutualization by some key foreign exchanges has proceeded at a faster pace, demonstrating some of the challenges that demutualized exchanges face in today's new competitive climate. This trend is recent. The first exchange to demutualize was the Stockholm Stock Exchange in 1993, but by the end of the year 2000 numerous additional stock and futures exchanges had demutualized, including the Amersterdam Stock Exchange, the London Stock Exchange, the Paris Bourse and the CME. On February 2, 2011 the authorities of Dhaka Stock Exchange (DSE) has decided to demutualise the organization with a view to curbing the influence of brokers. The decision came following the finance minister's allegations that those operating the brokerage houses were business and also leading the DSE. Dhaka bourse owners, moreover, were forced to form a ten-member committee headed by Md Fayekuzzaman, managing director of Investment Corporation of Bangladesh (ICB), recently on demutualization of exchange under the immense pressure of the government. The Finance Minister said that there is no alternative to demutualization and it must be completed with the tenure of this government. This committee and Dhaka bourse authorities have been trying to select a model based on international practices and setting a time frame to complete the process. So it can be said that demutualization is likely for DSE.

2. Objectives of the study:

The study has the following objectives -

- To discuss what demutualization is and the factors leading to demutualization
- To provide a trend of demutualization of stock exchanges all over the world over time.
- To discuss the general advantages and disadvantages of demutualization for stock exchanges
- To discuss the advantages and disadvantages of demutualization for Dhaka Stock Exchanges (DSE)
- To explore the challenges for DSE in the process of demutualization and
- To provide a recommendation whether DSE should be demutualised.

3. Methodologies of the study:

The data collected for this study is mostly secondary data, which was originally collected for other studies. This data includes both qualitative and quantitative data. The quantitative data was collected mostly from different journals and web sites. Qualitative data collected for the study was predominantly from academic articles and books containing the relevant debates consistent with the pros and cons of demutualization.

4. Demutualization:

Demutualisation is the process of converting exchanges from non-profit, member-owned organizations to for-profit, investor-owned corporations. More specifically “Demutualization” in the context of a stock exchange, means separating ownership from the right to use the exchange’s trading system. In the mutual ownership model, a broker seeking to trade on the exchange had first to be approved as an owner. Conversely, only brokers who wished to trade on the exchange would be approved as owners. If a broker resigned from the exchange or left the business, its membership (ownership) would cease. Demutualisation separates these roles so that one no longer need be a shareholder (owner) to be granted trading privileges and one can be a shareholder without being a broker.

Demutualization, a change in the corporate governance structure of an exchange, is not an end in itself. The exchanges that have demutualised have done so because they found that their mutual governance structure, which once served them well, had become a hindrance to positioning themselves competitively in a global trading environment.

The traditional model of an exchange as a purely national, or even local, entity organized on a mutual basis by market intermediaries is on its last leg. The big trading houses are now global and have no loyalty to any particular market or exchange. And their big clients, the institutions, no longer need brokers to funnel their orders to exchanges: in an electronic environment, investors can access trading systems directly. This means that the exchanges must change their business model entirely to survive. First, the concept of “membership” is irrelevant with electronic trading—the marginal cost of adding an additional trader to an electronic network is rapidly declining toward zero, meaning that only transaction based charging can survive. Second, exchanges cannot afford to have their strategic focus dictated by brokers, who are naturally determined to prevent disintermediation of their services. Demutualization is imperative—not to raise capital, which is a smokescreen—but to disenfranchise the members who block trading system expansion and innovation. Providing direct remote access for investors, foreign and domestic, is increasingly essential to attracting, and even keeping, their business.

5. Factors leading to Demutualization:

All major exchanges are facing increasing competition from other exchanges and/or alternative trading systems. Moreover, the development of technology has meant that services once offered exclusively by the local exchanges are now available elsewhere, creating competition for order flow and listings.

Old member-owned association structure fail to provide the flexibility and the financing needed to compete in today’s competitive environment. Consensus decision-making is slow and cumbersome and frequently leads to decision grid lock as competing interests attempt to influence the strategic direction of an exchange. With the separation of ownership and trading privileges, an exchange will achieve greater independence from its members with respect to its regulatory functions. The promise of demutualization is that shareholders of the newly demutualized exchanges will provide a new corporate governance structure that is far more effective in managing conflicts among market participants. The following factors are very visibly responsible leading to demutualization.

5.1 Rapidly changing marketplace:

With technological developments in information processing and transmission, the exchange as a physical-location has lost its meaning. Access to trading is not restricted by geographical location and the frontiers between markets and investors have collapsed. A conscious policy of fostering integration of financial markets as in Europe has liberalized market access for overseas competitors.

Multiple listing of securities in exchanges cutting across national boundaries and the near round the clock trading offer choice of trade execution to investors, who can trade in foreign markets as easily as they do in their domestic markets. All these have fostered competition between securities markets. Technology has also brought in competition from non-exchanges, especially in developed markets. Initially popular among institutional investors for trading among themselves, Alternate Trading Systems (ATSs) have become integral to the market and are competing with exchanges. They provide access to trading at a much less cost with anonymity and convenience of time. As in 2000, ATSs had cornered over 30% of the total share volume in NASDAQ securities and 3% of share volume of listed securities.

Exchanges have to be efficient and be nimble in order to survive in this environment. They are no longer organizations to serve the interests of the intermediary; they have to offer value to investors. Member owners who derive profits from non-member transactions may resist technological and institutional innovation that would reduce their intermediation role, even if such innovation would enhance the economic value of the exchange and cater to the larger interests of investors. Choice of trade execution results in liquidity moving to the most efficient exchange amongst the same risk class. There is thus a pressure on exchanges to cut costs, reduce the risk of trading and pass on the gains of efficiency to investors. Intermediary owned exchanges have no motivation to do so.

The results of the BTA survey reaffirms this position, as 75% of mutual exchanges that responded believed that they are not free to pursue optimum commercial options. And hence the emphasis is on separation of ownership and the right to trade and reducing the control of intermediaries over the management of the exchange. Significantly, exchanges not facing competition have been slow in responding to changes.

5.2Expansion and technology investment:

Expansion and investment in technology are critical to survive in this environment. This requires resources of a substantial magnitude. The willingness and ability of the members to fund expansion and technological up-gradation in a mutualized exchange is rather limited. In sharp contrast, demutualised organizations like ATSs take investment decisions faster and have access to funds from a large pool of investors. Traditional exchanges have to explore new funding avenues and hence demutualization and the subsequent listing of shares give them the market image and access to funds from a wide spectrum of investors. Though compulsive, the above argument has its detractors. Raising capital, it is argued, is more likely a secondary aim, as many exchanges have no need for fresh capital. Amsterdam, in fact, used the demutualization opportunity to return excess capital to members.

5.3Conflict of interest:

A mutualized exchange is subject to conflict of interest. Decisions of the exchange could affect the trading interests of members, individually or collectively. So their ability to protect investor interest and enforce rules is viewed with suspicion. Worse still, members entrusted with regulation attempting to derive gains from their position are not uncommon. Indian capital market has witnessed many such instances. Such instances are not uncommon even in developed markets. The NYSE, for instance, has been reported to have failed to enforce federal laws and NYSE rules against unlawful proprietary and discretionary trading by floor brokers. Institutional and foreign investors are weary of trading in markets where enforcement is perceived to be lax. Cross border alliances and mergers between exchanges are feasible only if the partners in the alliance feel that member interest in the other exchange would not override common interests and that issue would be dealt with in a fair and transparent manner. A demutualised exchange with the management free to decide on operational issues is perceived to be effective and fair in enforcement.

6. Trends of Demutualization in the world over the Years:

Starting in the early 1990s, stock exchanges around the world have been undergoing major organizational and operational changes. In 1993, the Stockholm Stock Exchange became the first exchange to demutualize. It was followed by several others, including the Helsinki Stock Exchange in 1995, the Copenhagen Exchange in 1996, the Amsterdam Exchange in 1997, the Australian Exchange in 1998, and the Toronto, Hong Kong, and London Stock Exchanges in 2000. A study conducted by the WFE determined that more than 70% of WFE exchanges had transformed their legal structure into commercial businesses and changed drastically their corporate culture to adopt more business-oriented and customer-focused policies. This high percentage indicates that profit has also become a goal for a large majority of exchanges. The new commercial approach adopted by most exchanges has also obliged most of them to pay more attention to issuers and customer needs, but also to concentrate on their owners' expectations of increased shareholder value, especially in the case of publicly listed companies. The study also found that "listed exchanges were by far the most profitable exchanges". For a complete list of the exchanges that have demutualized, see Table 1.

7. Advantages of Demutualization:

Global competition and advances in technology costs are causing stock exchanges around the world to examine their business models and become more entrepreneurial. Many exchanges have responded by demutualizing, which is bringing about major shifts in ownership and corporate governance structure.

By converting member-owned, non-profit organizations into profit-driven investor-owned corporations, demutualization will give exchanges access to capital that can be used both for investment in new technology and for participation in the ongoing consolidation of the industry. In the process of providing the exchanges with capital, demutualization is also expected to strengthen the corporate governance of the exchanges.

Exchanges develop and enforce market conduct rules. These rules encourage a fair and transparent market, which in turn attracts market participation and enhances liquidity. Market conduct rules include prohibitions on market manipulation, front running of clients and insider trading as well as the accurate marking of trades to honor the allocation method used on the exchange. An exchange may also develop and enforce business and sales conduct rules, which govern the relationship between the client and the dealer.

A shift from not-for-profit mutual organization to for-profit organization with ownership separated from access to trading may allow the exchange to respond more effectively to competitive pressure and to act separately from the interests of individual members thereby creating a more streamlined and market-oriented exchange. Some of the advantages of demutualization are given below-

- Mutual exchanges often lack focused strategic goals and business purposes and tend not to have clear accountability. This is in part because most are structured as not-for-profit organizations for which creating shareholder value is not a priority. It is often exacerbated by a potential disconnect between the owners and the exchange. The members may be more concerned about their business interests as brokers than the exchange's interests as a whole. Members in a mutual, not-for-profit organization will not have the same view as shareholders in a corporation because they will not directly benefit, through a higher share price or dividend stream, from the exchange's growth (although they may benefit indirectly through lower transaction fees). Management's (and the organization's) interests are more easily aligned with shareholders than with members.

- Mutual exchanges also can become mired in attempts to build member consensus on issues before bringing them to a conclusion, slowing the decision-making process considerably. The members may not be of one mind on many or most issues.
- The governance structure of a mutual exchange serves only one stakeholder: the stockbroker. Listed companies and investors, whose participation is crucial to a successful market, have no role unless appointed as "public" or "independent" members of the board of directors. They may see the exchange as a "private club" either opposed to their interests or not inclined to treat their concerns as a priority.

- Mutual entities cannot tap the equity markets for capital. Their inability to access equity markets may also limit their ability to access debt markets on the same terms as comparable corporations. This may expose the members to levies to cover expenditures or shortfalls, as the exchange has no other financing option. In some exchanges the members' liability is limited but for other exchanges it is unlimited.

- In the new competitive environment, the promise of demutualization is that, along with the capital necessary for investments in technology, the shareholders of the newly demutualised exchanges will provide a new corporate governance structure that is far more effective in managing conflicts among market participants.

- In addition to raising equity capital, demutualised exchanges can use their stock as currency in acquisitions and mergers and to facilitate strategic alliances. Stock option and purchase plans can also be significant compensation mechanisms for management and staff. Demutualization in Hong Kong and Singapore facilitated the merger of stock and futures exchanges. Demutualisation of the Pacific Stock Exchange (PSE) facilitated an alliance with Archipelago, an alternative trading system that operates the PSE's now fully-automated equity market and which, it has just been announced, is to merge with the New York Stock Exchange (NYSE).

8. Challenges of Demutualization:

Demutualization is not a legal project, but is a multi-disciplinary issue. As exchanges demutualise, many challenges come to the fore. The commercial nature of the exchange, namely profit maximization, may contradict with its role as a public entity providing a service. The challenges that the demutualised stock exchanges usually face are as follows -

Self-regulation: A mere conversion from a not-for-profit organizational structure to a for-profit structure would neither ensure better regulation nor would it instill investor confidence. A for-profit enterprise owned and operated by members distributing the surplus earned is no different from a mutual not-for-profit organization. The Deutsche Börse and the Paris Bourse prior to the public offering in 2001 were structured as for-profit companies owned almost exclusively by members. Over 90% of the shares of the Borsa Italiana are still owned by Italian intermediaries. Operationally, such exchanges are no different from a mutualized exchange. Demutualisation can be successful only if the interest of investors, issuers and other stakeholders are of prime concern to shareholders. A demutualised exchange, focused on profits, may not take its self- regulatory role seriously. The benefits of effective regulation are not visible, while the expenditure on regulation is. Allocation of resources for self-regulation, both human and monetary, may be compromised. If this indeed happens, the fundamental objective of separating ownership and usage would be defeated.
Divesting the exchange of its regulatory role and entrusting it to a separate organization, either independent or a subsidiary of the exchange, has also been mooted to overcome this apprehension. However, the extent to which such an independent organization would be subject to the authority of market regulator, the efficacy of centralizing regulation and the confidence that such an arrangement would generate among investors are issues of concern. Such a move may weaken investor protection, is another thought. The limited experience with demutualised exchanges has not revealed instances of sacrificing regulatory responsibilities. With intense competition, any exchange that compromises on self-regulation and which is perceived to be lax in enforcement may eventually lose the patronage of investors. Thus in a competitive environment, self-regulation is expected to be stronger.

*Self-listing:*An entirely new conflict arises if the exchange lists its shares on itself. The exchange derives advantages by listing its shares – enhanced visibility and reputation, accountability, transparency and market discipline, to name a few. But can an exchange self-regulate itself? Does this conflict with other competing companies that are also listed on the exchange? The conflict is apparent not only in satisfying listing requirements continuously. There could be conflicts in the corporate objectives of the exchange and its regulatory role. A classic case was the bid made by the self listed Australian Stock Exchange (ASX) for the shares of the Sydney Futures Exchange. A counter bid by Computershare Ltd., another listed company, cast doubts about the obligation of the exchange to enforce listing rules. Some attempts have been made in resolving this conflict. The Australian Securities and Invesments Commission has been made responsible for administering listing rules in the case of the ASX. When the London Stock Exchange decided to change its ownership structure in June 1999, its regulatory role of the primary market was transferred to the Financial Services Authority. The Monetary Authority of Singapore is authorized through a Memorandum of Understanding to monitor compliance with listing requirements of the Singapore Exchange. Yet, self-listing would remain an area where adequate safeguards have to be evolved as experience with demutualization is gained.

Transferability of shares: Like any other company, would the shares of the listed exchange be freely transferable? And if so, what would be the consequences, if after a hostile takeover; the interests of the new shareholder are not aligned with the role of the exchange as a public entity? Exchanges that have demutualised have been sensitive to this issue. A limit on the shareholding has been imposed to prevent concentration of holding and the consequent transfer of control. In most of the cases, the shareholding limit is 5%, except the ASX where it is 15%. The Stockholm exchange does not prescribe any limit, but has the powers to assess the qualification of the proposed shareholder who intends to hold more than 10%. It can also require any shareholder who has excess holding, to bring his holding to less than 10%.

Governance: Another concern is whether demutualization and the drive for profits would compromise the position of stock exchange as a public entity. An appropriate governing structure balancing the interests of shareholders and the public at large is a possible remedy. Inclusion of outside Directors on Board to serve as a check and promote integrity in the decision making of the Board could reduce this risk. Statutory duties may be imposed on such public directors. A wide ownership may also create public ownership and check excessive zeal to profit. Regulatory restrictions on the appointment of senior executives in the exchange may ensure that right persons are appointed and that they act in public interest, apart from being responsible to shareholders.

Financial concerns: A demutualised corporate structure provides ample opportunities to diversify and set up other business operations. There could be conflict of interest due to such diversification. Methods to deal with such conflicts and the internal segregation between various business interests have to be evolved. In the meanwhile, greater regulatory oversight may be necessary to spot such conflict situations. Continued financial viability of the exchange is of paramount importance. Other commercial activities of the exchange should not expose it to financial risk. From this perspective, whether it is advisable to impose capital adequacy norms on the exchange is a critical issue. If such norms are found necessary, should it be applicable to the exchange per se, or made applicable also to the holding company owning the exchange is unclear. While the corporate ownership structure may not justify imposition of such norms on the holding company, the risk of financial instability of the latter should not impact the exchange. No firm view has evolved on this issue. Pricing decisions of the exchange in this scenario may be anything, but logical. Improving the market share may drive the exchange to price its service uneconomically, thereby impacting the quality of regulation. Yet, monopoly status or the lack of adequate competition and the pressure to generate profits may induce it to price the service at a high level. As per the FIBV, demutualised exchanges recorded the highest return with an average return of 45% in 1999, sharply increasing over the 37.4% return reached in 1998 and the 17.7% in 1997. It is not clear if such a growth in profits is due to efficiency gains or the exchanges have taken advantage of their monopoly status. If it is the latter, designing a suitable market structure that would foster a healthy environment with adequate disincentives to prevent exchanges from taking advantage of their market position is the need of the hour.

9. Demutualization in the perspectives of DSE:

The above discussed advantages for demutualization do not necessarily go with all demutualization. Because it is not the only panacea that will automatically resolve all the problems. Specific situations or factors bring different advantages for demutualization for different countries. The following are the benefits of demutualization in the context of Bangladesh.

9.1 Spreading Ownership Risk: Demutualization, assuming the shares are widely held and freely transferable to non-members, would achieve the objective of spreading ownership risk which currently lies solely with the members of each exchange. However, in reaching that situation, DSE would need to make it more attractive as investment opportunities. However, if the shares in the demutualised exchange are issued only to the members, they become the sole shareholders and retain control of the company which acts against the following benefit; i.e. that of making the exchange less susceptible to Members' vested interests. There are a number of models of demutualization that have been used to counter this including distributing a proportion of the shares amongst other stakeholders. This has been successfully carried out in situations that do not involve "seats". However, a "free" distribution to other stakeholders would be inappropriate in these circumstances. One option would be to have an IPO from the outset. However, this would be contrary to the listing regulations which require a company to have a track record. A second option would be to offer a proportion of the shares in new company to institutional investors. The difficulty here would be in determining the proportion and the issue price. Furthermore, if the objective is ultimately to list the company on the exchange, this pre-placing of shares could damage the success of any future IPO. Ideally, the IPO would take place once new company has established an adequate track record for listing purposes and would be carried out by existing members disposing of at minimum 75% of the holdings in new company. Limitations should be put into the Articles of Association of new company on the amount of holdings that can be held by any single person or persons acting in concert (this should be capable of being waived by the SEC should circumstances permit – e.g. in the case of a take-over where SEC determines that this is in the public interest).

9.2 Making the exchanges less susceptible to Members' vested interests: DSE has gone some way towards improving its governance structure by the addition of non-members on the boards. However, the perception is that the boards are still susceptible to members' vested interests. This is further evidenced by the Committee structure that exists in the exchange and these should be drastically reduced. In order to further limit members' vested interest in the area of supervision, the exchanges should establish Regulatory Review Committees. The committee should give an independent assessment of whether or not the exchange is fulfilling its regulatory function giving greater comfort to the SEC that the exchange is properly carrying out its SRO duties. The committee would set policy and direction in applying regulatory function, review the policies and procedures, provide reports and express opinions, receive quarterly reports etc.

9.3 Providing greater access to capital: Demutualization would enable the exchanges to tap the equity market if they needed capital rather than the more restricted options open to them currently of selling new trading rights or selling land.

9.4 Providing greater speed and flexibility in decision making: With boards of 24 and 25 directors respectfully plus their various committees below that, decision making must be a cumbersome affair. A streamlined board together with fewer committees and a more professional approach to management of the company rather than looking after members' interests would lead to streamlining of the decision making process.

9.5 Diversifying into other markets and services: Being a "mutual" does not prevent an exchange from diversifying into another market or to ffer other services. There are numerous examples of product diversification amongst the exchanges of the world. For example, the Colombo Stock Exchange, and its Debt Securities Trading System (DEX) – whilst existing members opposed demutualization and an extension of membership to newcomers they approved the creation of a separate category of membership for the trading of government bonds on the exchange; and indeed, the London Stock Exchange did this with membership of its London Traded Options Market twenty years ago.

However, the advantage of being demutualised is that the exchange company has a much broader range of options available to it e.g. the New York Stock Exchange's plans for the acquisition of Archipelago Holdings. This could not be achieved without the NYSE's conversion into a public for profit entity.

9.6 Adopting Clearer and Simpler Governance: Large boards and large numbers of committees with duties and responsibilities that inter-relate have the effect of creating an environment that often results in management time and resources servicing the board and its committees rather than getting on with the job of managing the business.

Decisions by exchanges to demutualise are based on the recognition that the old member owned association structure fails to provide the flexibility and the financing needed to compete in today's competitive environment. Over the long run, for-profit exchanges run by entrepreneurs and disciplined by profit-seeking investors will produce better-financed organizations with greater ability to respond quickly to preserve the value of their franchises. Besides helping exchanges adapt to a fast-changing marketplace, demutualization is also expected to promote the exchanges' efforts to leverage their brand values by expanding into new businesses. Equipped with better financing, more flexible decision mechanisms, and heightened accountability (to shareholders), demutualised exchanges are emerging as leaner, more competitive, and more transparent organizations.

*9.7 Greater flexibility in negotiations with others***:** If a mutual exchange wishes to enter into a contract with another exchange or supplier of services, it has limited options as to how it would pay for the service or how it would negotiate on the contract. Payment will either have to be in cash or in kind or a share of revenue resulting from the new service. Demutualization opens up the possibility of paying through an issue of shares or granting an option on the shares of the exchange company.

9.8 Bringing market discipline: Management and more particularly the board will be encouraged to, in fact, must adopt a more proactive and business- like approach to the running of the exchange company. Under a mutual structure, board and management can all too often fall into the civil service mentality because there is no profit incentive. Mutual exchanges are not-for-profit and although board and management will wish to operate to budget, they know that budget variations will be acceptable. Senior management is accountable to the board but the board is (only) accountable to the membership. "Only" because mutual exchanges are "clubs" and very few club members criticize their peers. In a shareholder owned environment, shareholders will criticize if the company fails to perform and directors and management may risk losing their positions as a result.

9.9 Incentivizing Management: By and large, managing directors of stock exchanges (and the writer once was one) were not incentivized by financial reward but by the position they held. Historically, managing directors or chief executives of exchanges were appointed from within and the post was one for life if the incumbent so desired. Very rarely were the MDs of stock exchanges sacked or "asked to resign". However, in recent years that has changed. Only one CEO of the London Stock Exchange has resigned voluntarily in the last 25 years. CEOs of major exchanges are now very rarely appointed from within. Most are in fact appointed because of their business acumen rather than their knowledge of securities markets. Running a mutual stock exchange is a major undertaking. Running a demutualised stock exchange is big business and requires very different skills. At this level, position is very important but money and financial reward come more to the fore. Many companies have found that management and workers are more incentivized if they have a share in the business they are working for and more importantly, helping to build. This cannot happen in a mutual exchange.

9.10 Facilitate Merger: As stated earlier, the demutualization of the Dhaka and Chittagong stock exchanges will simplify the process by which a merger of the two exchanges can take place.

10. Risk Associated with Demutualization for DSE:

There is no doubt that demutualization resolves many of the problems faced by the mutual organization. But it does not mean that demutualization necessarily solves all of the problems. It is not without risk. Some of the risks that might be involved in the process of demutualization of DSE are as follows -

- Although demutualization has many benefits, it is not without risk. One is that once ownership and use are decoupled, brokers may not feel any loyalty in the market and may easily turn to alternatives (domestic or foreign markets or alternative trading systems). They may develop alternative trading systems to internalize their order flow rather than send it to the exchange. However, in some markets (e.g. the London Stock Exchange and Nasdaq) this occurred before demutualization and the need to compete with these new systems itself became a catalyst for demutualization
- The second is the exchange's ability to transform itself. Once it demutualises, it must become a profit-oriented, competitive organization accountable to its shareholders. If the exchange also becomes a public company (as many have), it will also become subject to the disciplines of the market, having to release bad news as well as good, meet financial and periodic reporting obligations and meet market earnings expectations. Many exchanges adopted a two stage demutualization process where the shares initially issued to the members were not transferable for a period of time. This was to give the exchange time to change its internal culture.
- Third, the exchange can become a potential take-over target, although this can be managed through ownership limits. The London Stock Exchange lifted its limits to facilitate a merger with the Deutsche Börse, which opened the door to a competing take-over bid by OM Gruppen. Both bids ultimately failed.
- Fourth, the conflicts of interest that exist in a self-regulatory organization may be exacerbated in a for-profit environment. The exchange may adopt anti-competitive rules (e.g. restricting the ability of trading participants to trade elsewhere). A for-profit exchange may not adequately fund its regulatory activities because there is insufficient return on investment. Conversely, the exchange may view its regulatory programme as a profit centre and begin to aggressively fine trading participants for minor rule infractions. Confidential information about trading participants' activities garnered for surveillance purposes could be leaked to the business side. Concerns about such conflicts forced the Toronto Stock Exchange to spin off its

market regulation functions into a new body jointly owned by it and the Investment Dealers Association of Canada.

- Demutualization also brings new conflicts, as an exchange pursuing business opportunities may find itself in conflict with one or more of its listed companies. The Australian Stock Exchange competed against Computershare, a listed company, in a take-over bid for the Sydney Futures Exchange (neither was successful)
- The demutualised exchange's ability to quickly respond to new pressures and opportunities may be thwarted if it is still subject to excessive regulatory oversight, with lengthy periods required for rule and policy changes to be approved, while alternative trading systems can implement changes overnight.

11. Conclusions and Recommendations:

The fundamental problem with the Dhaka Stock Exchange (DSE) lies with the issue of corporate governance. The authorities have embarked on a series of reforms and made a good progress. However more can and needs to be done to reform the capital markets. Demutualising of DSE is a crucial step in bringing about better governance to the stock exchange. The successful act of demutualization will result in many benefits to the Bangladesh economy and the people. It will spur the economic growth by increasing the amount of Foreign Direct Investment (FDI) , increase domestic consumption as the public becomes more confident in the economy and is more willing to spend. There will also be a new wave of job creation as new industries such as credit rating industry, investment banks, accounting profession will experience a surge in demand for their services. Capital markets will also be seen as additional source of funding for mainland enterprise. This is especially important for the sustaining growth of the economy.

The improvements to the Dhaka Stock Exchange (DSE) such as improved regulatory framework, streamlined decision making and operations and new business models will also strengthen the domestic stock exchange in the face of strong competition from other exchanges. With the increased confidence in capital market the investors will also see the benefits in diverting their savings into investment. The benefits are plentiful but most importantly it will create a more even distribution of income, thereby relieving the poverty pressure and increasing the living standard of majority of the people of Bangladesh. But it should be kept in mind demutualization is not without risk. The most challenging issue is to identify those risks and take appropriate measure to mitigate those risks in the process of successful execution of demutualization.

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Appendix

Table 1: Exchanges Privatization/Demutualization

Demutualized Exchanges		**Proposed Demutualizations**
Stockholm Stock Exchange	1993	NYMEX
Helsinki Stock Exchange	1995	International Petroleum Exchange
Copenhagen Stock Exchange	1996	Chicago Board of Trade
Amsterdam Stock Exchange	1997	Chicago Board of Options Exchange
Borsa Italiana	1997	
Australian Stock Exchange	1998	
Iceland Stock Exchange	1999	
Simex	1999	
Athens Stock Exchange	1999	
Stock Exchange of Singapore	2000	
Hong Kong Stock Exchange	2000	
Toronto Stock Exchange	2000	
London Stock Exchange	2000	
Deutsche Börse	2000	
Euronext	2000	
London Stock Exchange	2000	
The Nasdaq Stock Market	2000	
Chicago Mercantile Exchange	2002	