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Demutualization of Dhaka Stock Exchange: Opportunities and Challenges

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Abstract: The Dhaka Stock Exchange is the prime bourse of the country. Through its nonstop highly fault-tolerant screen based automated trading system, the exchange can offer facilities for transparent and highly efficient mechanism provisions for secondary market activities of shares, debentures and wide varieties of other securities. In this research paper, we used two stock exchanges that have already demutualized and gone public: Hong Kong Stock Exchange, and London Stock Exchange and analyzed pre and post-demutualization performance of them. The reason of taking two exchanges of different sizes is to provide better suggestion for Dhaka Stock Exchange. Using data from the financial statements from 1999 to 2013 and by the means of descriptive statistics analysis we show that all the two demutualized exchanges have a better post listing share and operating performance than mutual exchanges.

Keywords: Demutualization, DSE, HKSE, LSE

1. Introduction

Demutualization can be defined as a process by which a mutually owned stock exchange is converted into a company owned one by shareholders through transforming its existing legal structure into a business corporation. In contrast, a mutual stock exchange is a non-profit, mutual organization with monopoly power, owned by its members. Here, the owners are at the same time its clients who are the end users of its trading services. They share the profits of the company, based on their stakes. A demutualised stock exchange will provide most of the same services as a mutual stock exchange but a bit differently. A mutual stock exchange is owned by the members and most of the time it tends to favors the interest of the members only. This tendency at times does not recognize the rights of other stakeholders of the capital market. In a demutualised stock exchange, ownership is divided between members and outsiders. This is to some extent a balanced approach to remove conflicts of interest and advancing accountability. A mutual stock exchange is unable to respond quickly and decisively (this point is clear when we take the recent decision-making process of our stock exchanges into cognizance). It acts well when the interests of all the stakeholders are more or less homogeneous. However, with diverse stakeholders' interests and dynamic business conditions, the consensus decision making of a mutual governance model becomes slow and cumbersome. Bangladesh has initiated to get its exchanges demutualized in 2011. On October 9, 2012, the cabinet endorsed the draft of “The Exchanges (Demutualization) Act, 2012”. Both the stock exchanges in Bangladesh, i.e., Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE) have already made significant progress in this respect.

2. Literature Review

Some studies argued in favor of demutualization while others suggested against it. Those who supporter demutualization argues that it can help the stock exchange to modernize its technology achieve good governance, avoid concentration of ownership power in a particular group of stock exchange participants and, ensure financial decision-making - by ensuring that resources are allocated to business initiatives and ventures that enhance shareholders' value. On the other side, antagonists to demutualization argue that the above mentioned anticipated benefits of demutualization may in reality not be achieved. Rather, with certain conditions, those may be obtainable under a mutual or cooperative structure (Hansman, 1988; and Hart and Moore, 1996).

Thus, any cost-saving that caused by demutualization could be low in comparison to the benefits that can be obtained from the presence of brokers, with ownership interests in the exchange. In many developing countries, the creation of any financial institution is awfully hard, and the creation of investors is often harder than, the creation of the brokers (Lee, 2002). Demutualization may also allow for new risky businesses that usually do not take place when the stock exchange is under a mutual structure (Worthington and Higgs, 2006).

Nonetheless, now we shall try to find out those authors who have suggested for demutualization. According to Scullion (2001), demutualization is not merely converting into for profit organization owned by its members. An exchange is genuinely demutualized when it maximizes its potential of market capitalization to the fullest and alongside it also increases its shareholders value.

Cospormac and Altaf (2009) used simple descriptive statistics to analyze the data and found that demutualized stock exchanges hold a stronger operating performance and a better performance in term of shareholder's return than mutual exchanges.

Mendiola and O'Hara (2003) investigated the effects of the change of governance in stock exchanges on performance and evaluation. They found that exchange performance tends to improve after the change of governance.

Domowitz and Steil (1999) list several benefits of demutualization as compared to mutualized stock exchanges. They believe that demutualized stock exchanges should provide a better quality market than mutualized stock exchanges. In order to compete efficiently, stock exchanges must operate for-profit. The new recent technological changes have made the members' ownership structure less attractive. Thus, Hansmann (1988) pointed out that Exchanges must raise capital to compete efficiently and investor ownership is the obvious solution to solve.

Demutualization can permit the stock exchange to modernize its technology, create a flexible management structure that is more responsive to market conditions and, get an initial infusion of capital and allow for easier access to capital. It also enhances financial decision making by allocating resources to business initiatives and ventures that increase the shareholders' value (Lee, 2002). Thus, demutualized stock exchanges are in general expected to bring better performance of exchanges.

Sarah, Babar and Kashif (2011) stated that demutualization is an intricate process, which can result in increased efficiency, capitalization, governance, if done effectively.

Morsy and Rwegasira (2010) analyzed and evaluated the financial performance of demutualized stock exchanges between 1996 and 2004. They examined whether or not financial performance improved after implementing the demutualization program. Financial performance of stock exchanges that have undergone the demutualization program is measured in terms of eleven measures. Results were mixed and exhibited different change in performance for the samples of demutualized stock exchanges. But, in their examination, most of the profitability ratios showed significant increases.

Aggarwal (2002) took three demutualized stock exchanges: Deutsche Borse, the London Stock Exchange, and the Australia Stock Exchange, as sample to examine their performance. She found that in the form of the stock-price performance of the three exchanges that have been operating as publicly traded companies for at least one year—is encouraging.

Otchere and Oldford (2011) tried to examine whether corporatization of the exchange is necessary to improve the performance of the exchange. They found that both demutualized but member-owned exchanges and publicly traded exchanges exhibit higher levels of profitability and operating efficiency than mutually-owned exchanges.

Based on the above literature, we can say that there are some studies about demutualization in various countries, however a detailed research has not yet been conducted in Bangladesh context. Hence the present research is made on Comparative Research of "Demutualization of Dhaka Stock Exchange: Opportunities and Challenges".

3. Objectives of the Research

The objectives of the research are:

- To identify a trend of demutualization of stock exchanges all over the world over time.
- To explore the Performance & challenges for DSE in the process of demutualization.
- To reach some important recommendation whether DSE should be demutualized.

4. Methodology of the Research

The data collected for this research 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 research was predominantly from academic articles and books containing the relevant debates consistent with the pros and cons of demutualization. To evaluate the performance of demutualized stock exchanges, mainly two analyses have been performed: (1) descriptive statistics analysis of the stock market performance of the two sample demutualized stock exchanges; and (2) ratios analysis. For assessing the stock price performance of the exchanges, we have used cumulative stock return to see the difference with the comparable index (or benchmark) of the respective stock exchanges. Financial ratios, e.g., return on profit margin, return on equity (ROE), Return on Assets (ROA), are also used to research the operating performance of the sample exchanges. Daily stock prices are gathered from www.finance.yahoo.com. However, financial statements from the official website of the sample stock exchanges, i.e., www.londonstockexchange.com, www.hkex.com.hk.Relevant data relating to the research was collected from: Annual Research s of Dhaka Stock Exchange, Relevant books, Journal and Different articles, Monthly

Publication of Bangladesh Securities and Exchange Commission, Market Pulse of Lanka Bangla Securities Limited, Website of Lanka bangla Finance (http://www.lankabangla.com),www.londonstockexchange.com,www.hkex.com.hk,http://www.world-exchanges.org.

5. Conceptual Framework Demutualization

5.1. Overview of Exchange Demutualization

Demutualization 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. Demutualization 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.

5.2. Forms of Demutualization

A demutualized stock exchange might take different organizational forms. Some exchanges have demutualized and become public companies listed on their own exchanges. Other exchanges have demutualized but remained private corporations. Others are subsidiaries of publicly traded holding companies. Empirical examples include the Australian Stock Exchange which is a public company listed on its own exchange, the Amsterdam Exchange and the Toronto Stock Exchange which are presently private corporations, the London Stock Exchange arranged for an off-market trading facility for its shares and the Pacific Exchange in the United States converted its equity business into a wholly owned subsidiary of the exchange and the OM Stockhooms borsen AB is a wholly owned subsidiary of a listed company.

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. The only significant and important stock exchange which did not listed its share (despite the fact that it demutualized in 2001), is the Tokyo Stock Exchange. Also the United Sates, the Chicago Mercantile Exchange demutualized in 2000.

In 2003 CME conducted a later initial public offering (IPO) and listed its shares on the New York Stock Exchange. On April 20th, 2005 New York Stock Exchange announced that it is planning a merger with a publicly listed electronic exchange Archipelago, the new company becoming a public listed for-profit organization. It is worth noting that NYSE is one the last major global exchanges that is undertaking such an organizational transformation.

This tendency is evident both across different continents as well as across stock exchanges that trade different types of securities. Also India, Pakistan, Brazil, the Philippines, and some other countries' stock exchanges announced in 2005 their plans to demutualize and to list their shares. While the largest derivative exchanges (CME, LIFFE, Eurex, International Securities Exchange and CBOT) are already publicly listed, others including the New York Mercantile Exchange (NYMEX) and International Petroleum Exchange have demutualized and are planning public listings. This seemingly unstoppable organizational transformation of exchanges from member owned mutual to joint-stock companies is unparalleled.

A research 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 research also found that "listed exchanges were by far the most profitable exchanges". Following table shows the major demutualization cases across the world.

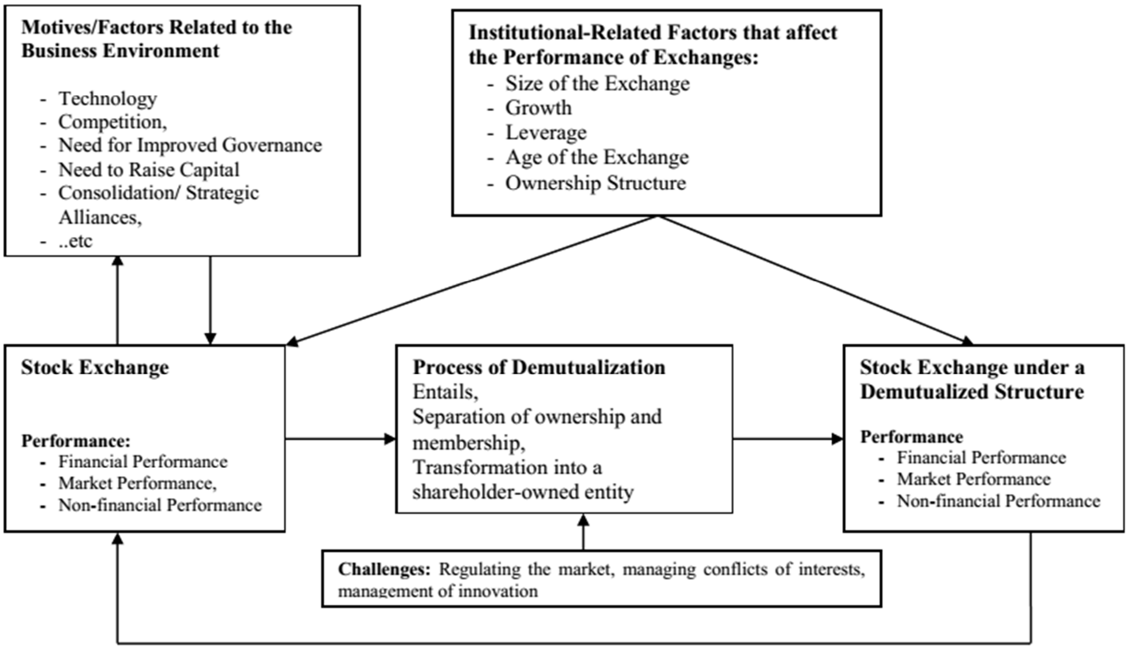

Figure 1. *Conceptual framework and impact of demutualization.*

Table 1. *Year of Demutualization of major exchanges (Source: WFE).*

Name of the Exchanges	Year of Demutualization	Year of Listing
Stockholm Stock Exchange	1993	1998
Borsa Italiana	1997	-
Australian Stock Exchange	1998	1998
Singapore Stock Exchange	1999	2000
Hong Kong Stock Exchange	2000	2000
London Stock Exchange	2000	2001
Deutsche Borse	2000	2001
Euronext	2000	2001
Toronto Stock Exchange	2000	2002
The NASDAQ Stock Market	2001	2002
The Philippine Stock Exchange	2001	2003
Osaka Stock Exchange	2001	2004
Tokyo Stock Exchange	2001	2006
New Zealand Stock Exchange	2003	2003
Bursa Malaysia	2004	2005
Bombay Stock Exchange	2005	-
New York Stock Exchange	2006	2006
Mexico Stock Exchange	2006	2007
NYBOT	2006	2007
Teheran Stock Exchange	2006	2006
BOVESPA(Brazil)	2007	2007
Boston Stock Exchange	2007	2007
Bolsa da Colombia	2007	2007
Thai Exchange	2007	2008
Tokyo Commodity Exchange	2008	2008
Chicago Board Options Exchange	2009	2010
Warsaw Stock Exchange	2010	2010
Bucharest Stock Exchange	2010	2010
Islamabad Stock Exchange	2012	2012

7. Organizational Transformation of Stock Exchanges

According to the data of the World Federation of Exchanges the weight of mutual dropped out dramatically from 40% in 1999 to only 15% in 2013. In the same period of time, the number of demutualized stock exchanges raised from 10% in 1999 to 62% in 2013. Also looking at the situation of the most important world stock exchanges, from 10 of them grouped by market capitalization in 2005, we observe that 80% demutualized, and 7 stock exchanges from those 10 have already self listed.

The fact that almost all major exchanges have undergone demutualization and became public companies is showing the necessity of having a structure that will allow the exchange to be able to respond to the industry challenges.

As it shown in figure 1 it is absolutely clear that the majority of stock exchanges have already changed their organizational structure. As we can see 62% of the entire stock market capitalization is at this moment on demutualized and listed exchanges. Stock Exchanges that demutualized but have not yet listed their shares account for other 32%. Also we can see that Europe and Americas are dominated by listed exchanges i.e. 67% and 85%.

In Asia demutualized and listed exchanges represents 43%, but the total weight of demutualized stock exchanges represents for 62%.

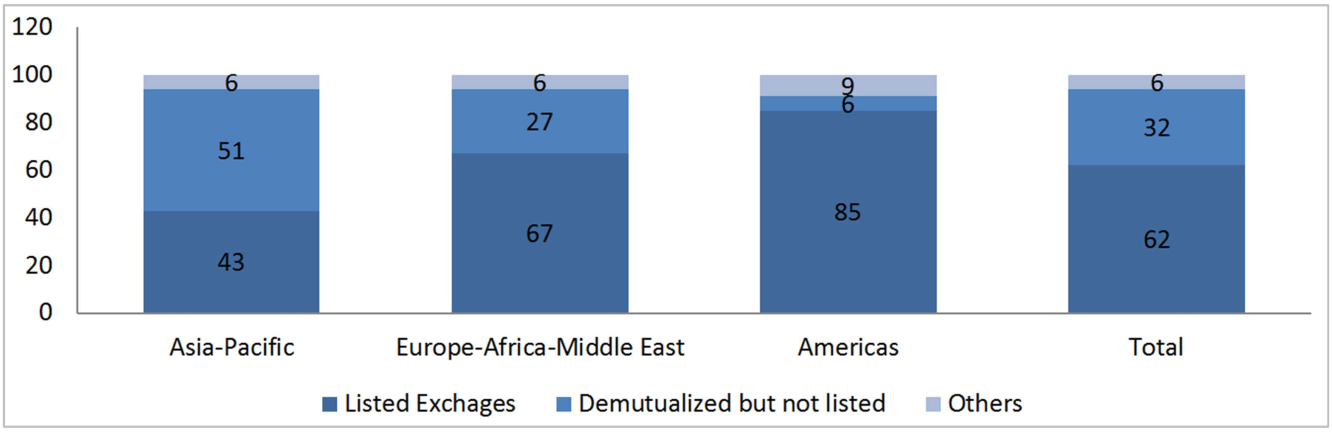

Figure 2. *Scenario of Stock exchanges in percentage (Source: WFE).*

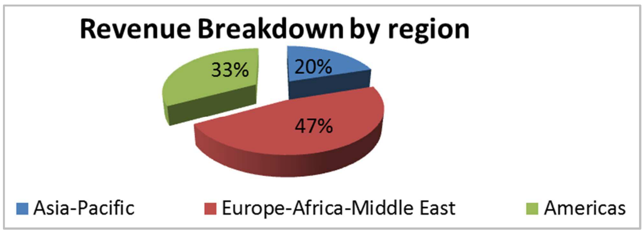

Figure 3. *Revenue Breakdown by region (Source: WFE).*

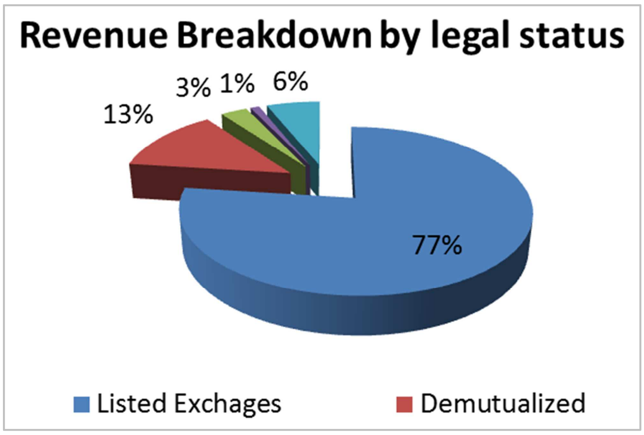

Figure 4. *Revenue Breakdown by legal status (Source: WFE).*

In 2013 listed exchanges represented 77% of revenues which is shown by region wise as well legal status. 8. Performance of Demutualized Stock Exchange

8. Performance of Demutualized Stock Exchange

In this part of the research by the means of descriptive statistics we are evaluating the performance of London Stock Exchange and Hong Kong Stock Exchange after demutualization using post listing market performance alongside with the analysis of the most important financial ratios using the official financial statements of the above mentioned stock exchanges.

8.1. Market Performance

In this section we discuss the case of the London Stock Exchange and Hong Kong Stock Exchange as examples of the stock market performance that have successfully listed their stocks. According to World Federation of Exchanges, there is a positive relationship between demutualization and the number of companies listed on the exchange and the market capitalization. The domestic market capitalization increased 300.16% and 397.40% for LSE and HKSE. Market capitalization both domestic and foreign is increased rapidly after demutualization for both the exchanges. In 2013 market capitalization was $2509 and $310 billion in LSE and HKSE.

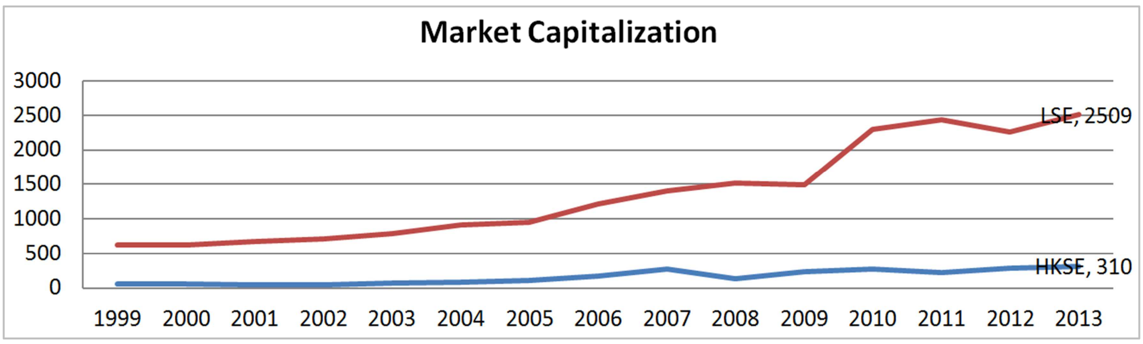

Figure 5. *Total market capitalization of LSE and HKSE.*

8.2. Number of Listed Companies

After changing organizational structure the number of listed companies increased for LSE by almost 22.70% since 2000 (year of demutualization), for HSE by 107.97% since 2000 (year of demutualization). At the end of year 2013 number of listing company in LSE and HKSE is 2746 and 1643 respectively.

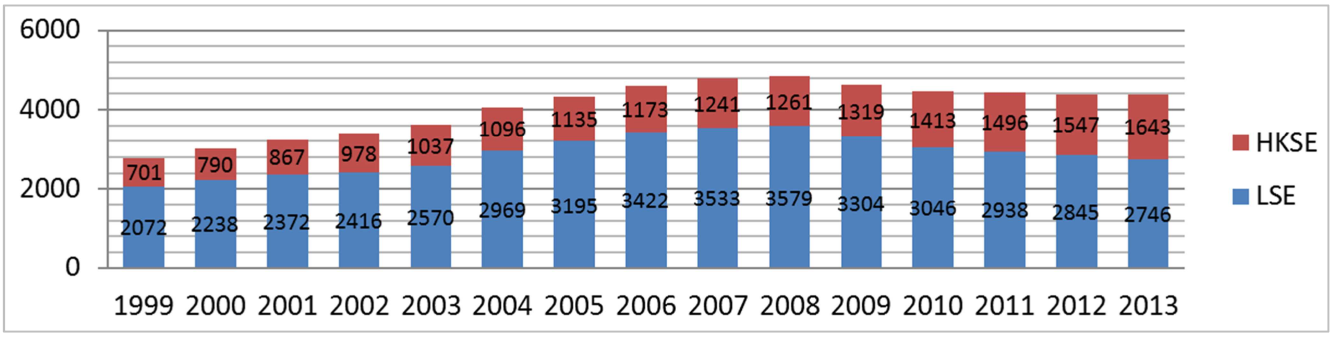

Figure 6. *Total Number of listed companies in LSE and HKSE.*

8.3. Operating Performance

In our analysis of operating performance we used some widely used measures such as the Profit Margin, Return on Equity, Return on Assets and Earning per Share during 15 years between the years 1999 and 2013. We have calculated these ratios for all the two sample exchanges which are shown in Tables to in Appendix.

8.3.1. Profit Margin

Profits of the analyzed stock exchanges showed a strong growing tendency, profit margin for LSE and HKSE at the end of year 2013 was 24.14% and 61.24% respectively which almost two times more than pre demutualization Figure-7 shows that after demutualization both exchanges maintained an increasing trend except LSE in 2009 when it experienced negative profit margin due to global financial crisis and economic conditions have deteriorated significantly since the merger (with Borsa Italiana), leading to greater uncertainty about the future.

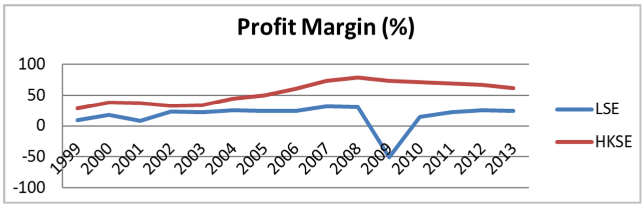

Figure 7. *Profit Margin of LSE and HKSE.*

Income sources

Also an interesting feature to observe is the structure of the revenues of London Stock Exchange and Hong Kong Stock Exchange. Thus the most important sources of LSE in 2013 were income from trading services with 36%, income from sale of information with 7%, income from listing activities with 31%. For HKE the situation is different. Thus, the major sources of its income were: trading activities (same as trading services) 37%, post trading activities (Clearing and settlement fees + Depository, custody and nominee services fees) 26% and investment activities 15%. In table-2 & 3 as well as in figure-8 & 9 the differences between income sources are shown in a more detailed way.

Table 2. *Major income sources of LSE in year 2013.*

LSE income sources				**mil £**
Post trade Services	Issuer Services	Trading Services	Information services	Other Services
24%	31%	36%	7%	2%

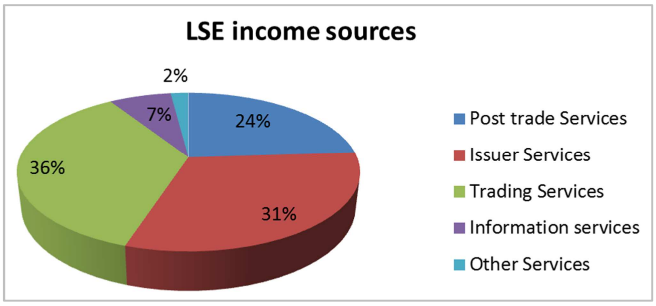

Figure 8. *LSE income distribution.*

Table 3. *Major income sources of HKSE in year 2013.*

HKE income sources						**mil $' 000**
Trading fees and trading tariff	Listing fee	Clearing fee	Depository services	Information services	Investment income	Other Services
37%	8%	19%	7%	8%	15%	6%

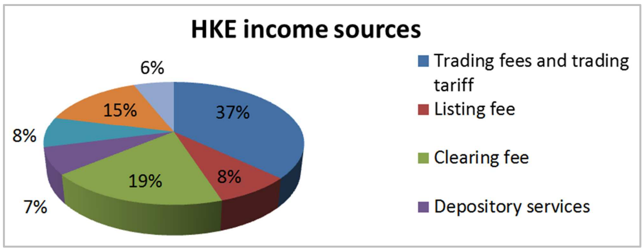

Figure 9. HKSE income structure.

8.3.2. Return on Equity (ROE)

One of the most important features that describe the company's performance is the ROE. Both of our stock exchanges have a double-digit number for return on equity. After demutualization the ROE for tow stock have increased notably. At the end of the year 2013 the ROE for London Stock Exchange was 11.98% and the ROE for Hong Kong Stock Exchange was 54.88%. While pre-demutualization ROE of HSE 12.65% in 1999 and LSE 6.5% in 1999.

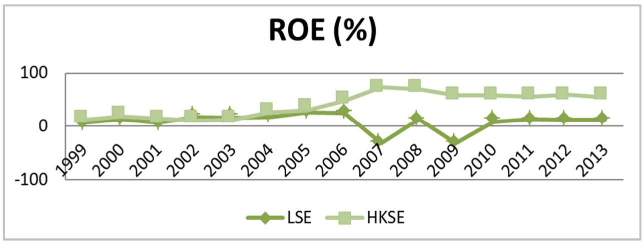

Figure 10. ROE of LSE and HKSE.

8.3.3. Return on Asset (ROA)

The EPS of both the stock is increased after demutualization. At the end of the year 2013 the EPS for London Stock Exchange was 79.87% and the EPS for Hong Kong Stock Exchange was 4.94%. While pre-demutualization EPS of HSE. 50% in 1999 and LSE 4.95% in 1999.

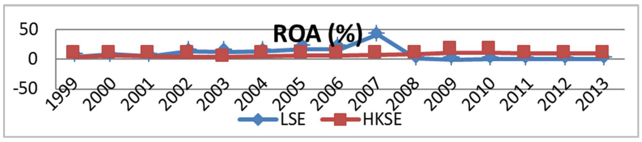

Figure 11. ROA of LSE and HKSE.

8.3.4. Earnings per Share (EPS)

The EPS of both the stock is increased after demutualization. At the end of the year 2013 the EPS for London Stock Exchange was 79.87% and the EPS for Hong Kong Stock Exchange was 4.94% while pre-demutualization EPS of HSE 50% in 1999 and LSE 4.95% in 1999.

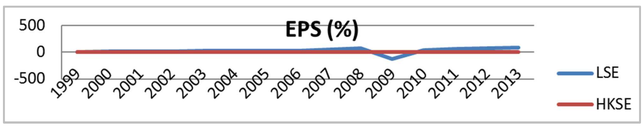

Figure 12. EPS of LSE and HKSE.

9. Demutualization in Dhaka Stock Exchange

Dhaka Stock Exchange is the leading and the largest stock exchange of Bangladesh. It is also the first stock exchange of Bangladesh. Before liberation it was known as East Pakistan Stock Exchange (1954). Its directory board consists of 24 members, among them 12 are elected and another 12 are nominated by the non-DSE members and approved by the Bangladesh Securities and Exchange Commission. 22 members out of 238 members are registered by the BSEC for conducting securities business. DSE has recently attempted to convert itself into a demutualized stock exchange, and submitted its concept paper to the commission, and parliament of Bangladesh has published the Gadget on the Demutualization Act after the approval of the President. DSE has submitted a Memorandum of Association to the Registrar of the Joint Stock Companies to starts its operation as a Public Limited Company. The summary of Memorandum of Association is given below:

9.1. Access to Capital

In the Memorandum of Association, submitted by DSE, it has clarified that, Dhaka Stock Exchange will be a Public Limited Company with Authorized share capital of Taka 25,000,000,000, which will be divided into 2,500,000,000 shares with a face value of Taka 10 each. And Exchange has the right to reduce or increase its capital and can convert its shares into different classes.

9.2. Business Expansion

Demutualization will give the exchange (DSE) the power to acquire any company or to establish its subsidiary or to take part in the management of other companies. These facilities are not limited in the country; it has also permitted for foreign operations. It will have full power to operate its activities.

9.3. Diversification of Ownership Risk

Demutualization helps to diversify the ownership structure of the stock exchange. In the Demutualization Act it is clearly stated that any individual, other than the strategic investor, can hold not more than 5% issued shares. Again for the Strategic Investor this limit is 25%. And any company holding the TERC (Trading Right Entitlement Certificate) and registered with the commission cannot hold more than 40%, share issued by the exchange. So it's much more diversified than the traditional exchanges, where ownership risk lies only on the members.

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.

10. Benefit of Demutualization in DSE

10.1. 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).

10.2. 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 research s and express opinions, receive quarterly research s etc.

10.3. 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.

10.4. 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.

10.5. Diversifying into Other Markets and Services

Being a "mutual" does not prevent an exchange from diversifying into another market or to offer 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.

10.6. 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.

10.7. 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.

10.8. 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.

10.9. 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.

10.10. 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.

11. Risk Associated with Demutualization on 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 researching 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 program 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.

12. Recommendation

Nevertheless, Stock exchange demutualization is a challenging issue, both from regulatory and business perspectives in a developing country like Bangladesh. Members' participation in the process is vital, as is the cooperation of the regulatory authorities. After passing the Demutualization Act by the parliament in Bangladesh, the actual process of demutualization will be started by the exchange. At that time DSE may face some sort of challenges and threats. In the following, we have stretched out some challenges, threats and made some suggestions to DSE:

- Managing conflicts of interests is a main challenge for exchanges. However, it can be attained through having an efficient corporate governance system, rigorous regulatory oversight, enhanced transparency; and the separation of the commercial activities of the stock exchange from regulatory functions. Hong Kong Stock exchanges and Clearing Limited (HKEs) give some example of applying these principles in order to recognize, minimize and manage conflicts of interests.
- The exchange can become a potential hostile take-over target when it goes for public (self listing). Defending the take-over bid involves significant costs. Although this hostile take-over can be managed through ownership limits. However, from the official website and annual research s of LSE we found that after demutualization and self-listing the London Stock Exchange experienced several hostile take-over bids. Dhaka Stock Exchange can also impose ownership restriction on shareholding by single entity to avoid any potential hostile take-over. The Exchange and its directors have a legal duty to act in the public interest, and to place the public interest first in the event of any conflict between it and the exchange's business interests.
- The maximum shareholding is 5% unless exempted by BSEC (Bangladesh Securities and Exchange Commission)
- The Board of DSE has public interest directors (appointed by Government)
- The Exchange maintains strict separation of its Regulation and Risk Management Dept. from business units.

13. Conclusion

It is hoped that demutualization will be a blessing for Dhaka Stock Exchange. It will ensure efficient corporate governance and attract foreign investments through the exchange. Many multinational institutions in Bangladesh have to follow a series of regulatory framework according to the guideline of their parent companies. Demutualization is one step to ensure the level playing field for those companies and let the local companies adhere to it.

The more accurate the structure of the stock exchange, the more interest will be the investors to divert their savings. Demutualization will also create new jobs in the investment banks, brokerage houses, credit rating agencies and banks. The most challenging step will be to teach the general investors about the effect and reasons for demutualization. But as the time will go by, general investors will get the benefit of demutualization.

We are quite optimistic that if the given suggestions of this paper are implemented then the Dhaka Stock Exchange may be able to overcome its present problems and may contribute in the rapid development of the economy of Bangladesh..

Appendix

Total Number of listed companies

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
LSE	2072	2238	2372	2416	2570	2969	3195	3422	3533	3579	3304	3046	2938	2845	2746
HKSE	701	790	867	978	1037	1096	1135	1173	1241	1261	1319	1413	1496	1547	1643

Total Market capitalization

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
HKSE	61	62	51	46	71	86	105	171	265	133	231	271	226	283	310
LSE	619	627	680	711	789	910	949	1212	1407	1515	1497	2300	2440	2263	2509

Profit Margin (%)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
LSE	9.6	18.27	7.81	23.14	22.21	25.44	23.95	23.76	31.35	30.8	-50.34	14.39	22.46	25.23	24.14
HKSE	28.69	37.78	37.04	32.55	34.25	44.15	49.72	60.73	73.53	79.13	73.53	71	69.23	66.87	61.24

ROE (%)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
LSE	6.5	13.1	6.28	17.74	16.38	17.42	26.32	24.48	-31.32	13.33	-32.09	8.77	13.33	12.54	11.98
HKSE	12.65	17.91	14.14	10.72	12.35	26.21	30.67	47.9	73.64	70.32	58.6	58.05	55.61	59.28	54.88

ROA (%)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
LSE	4.15	8.7	4.6	13.4	12.1	12.93	17.26	17.09	41.03	0.86	-0.9	0.1	0.13	0.17	0.31
HKSE	3.6	6.17	5.39	4.19	3.49	4.93	5.83	6.22	7.01	8.16	10.38	10.52	9.43	9.87	10.19

EPS (%)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
LSE	4.95	11.31	15.2	18.3	20.9	21.3	23.5	27.4	49.4	71.9	-126.1	33.5	55.9	76.3	79.87
HKSE	0.5	0.84	0.71	0.56	0.66	1	1.26	2.34	5.72	4.75	4.36	4.67	4.72	4.81	4.94

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