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FOREIGN EXPERIENCE OF FINANCING JOINT STOCK COMPANIES THROUGH SECURITIES MARKET

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Abstract:
All central banks have a vested interest in ensuring the continued health and efficiency of capital markets. Capital markets are critical sources of funding for the actual economy; they aid in risk allocation and promote economic growth and financial stability. The paper discusses how to construct viable capital markets. It addresses the critical nature of a strong enabling environment defined by macroeconomic stability, market autonomy, robust legal frameworks, and effective regulatory regimes.

Keywords: stock, joint stock companies, securities market, foreign experience, bonds

INTRODUCTION

Additionally, market development is influenced by drivers that are more directly related to specific capital market functions – such as improved disclosure standards, investor diversity, internationalisation, and deep hedging and funding markets, as well as efficient and robust market infrastructures. The ideas, which span six main areas, outline realistic strategies for policymakers to bolster these drivers, while acknowledging that some are beyond central banks' purview.

Capital markets that are developed and deep can be critical in funding economic expansion, as well as impacting financial stability and monetary policy transmission. Capital markets' ability to serve the actual economy is dependent on frameworks that promote safety and operational effectiveness. While the private sector and securities market regulators normally take the lead in developing robust markets, central banks are important players since financial market depth and liquidity affect central bank policy objectives and responsibilities.

Central banks play a critical role in many economies in terms of strengthening the capital market ecology. They frequently play a key role in government bond markets, generally in collaboration with the finance ministry; and in EMEs with less developed domestic fixed income markets, central banks frequently oversee the development of trading and issuance venues. They often play a role in overseeing critical areas of the payment infrastructure, including the repo, fixed income, and currency derivatives markets, in part through their control of banks. Central banks have also historically played a significant role in developing and modifying capital and interest rate regulations, as well as other prudential policies affecting capital market development. Additionally, as part of their macroeconomic and financial stability responsibilities, they regularly monitor the operation of domestic capital markets. Thus, central banks can contribute knowledge to interagency capital market initiatives by using their insights into domestic market

functioning, their broad convening powers, and their interest in well-functioning and effective market transmission mechanisms.

Capital market functioning is complex, and it is difficult to summarize in a single summary number. The Working Group defined market development in terms of four dimensions. The first dimension is market size in relation to GDP, which indicates the capacity to support the real sector's investment demands. Market access encompasses the range of issuers that finance their operations through capital markets, and coupled with the trading of varied instruments that transfer risk among market participants, it comprises the second dimension. Liquidity indicators quantify the ease with which investors can realize the value embodied in securities and some of the transaction costs. Finally, resilience measures quantify the capital markets' ability to perform their functions during times of stress. To assess progress along these dimensions, the Working Group analyzed available statistical indicators and the findings of the Group's market participant survey. The following sections detail the analysis's findings along each of the four dimensions.

LITERATURE REVIEW

Empirical evidence demonstrates that increased disclosure lowers borrowing costs. Between 1987 and 1991, Sengupta (1998) analysed data from 103 corporations and discovered that greater disclosure was related with lower issuance costs. La Porta et al. (2008) demonstrate that the size of a jurisdiction's capital markets is positively related to the existence of private enforcement mechanisms, such as disclosure, approval, and litigation rights, that govern and allow investors to sanction specific related-party or self-dealing transactions. La Porta et al. (2006) discover a high correlation between equity market size and public disclosure rules, as well as liability standards for noncompliance and an efficient judiciary for enforcement.

A diverse investment base contributes to liquidity, depth, and stability. With lengthy investment horizons and minimal leverage, insurance companies and pension funds can provide long-term capital and are less likely to aggravate volatility by selling into short-term declines. Additionally, they frequently advocate for stricter disclosure norms that eliminate information asymmetries and promote market vibrancy. Collective investment funds, such as mutual funds, lower the cost of risk diversification and make professional fund management services easily accessible to regular investors, encouraging the financialization of savings. Additionally, their shorter investment horizons can aid in price discovery and liquidity creation.

Niggemann and Rocholl (2010) see a significant increase in stock and bond issuance in the years after pension fund reforms. Scharfstein (2018) demonstrates that the option between prefunded and pay-as-you-go pensions has a significant impact on the size of an economy's capital market, with the latter's generosity limiting market development.

While the size of corporate capital markets is significantly connected with the size of the institutional investor base, there are considerable cross-country disparities in how these assets are allocated among stocks, corporate financial bonds, and non-financial

bonds. This shows that, given the size of the institutional investor base, individual market development is determined by other factors such as laws and path dependence.

Institutional investors and capital markets have a bidirectional link. Capital market development enables collective investment funds to achieve greater economies of scale. This results in decreased asset management fees, which allows for the financialization of additional savings through capital market investments (Vittas 1998)

DATA ANALYSIS AND RESULTS

Three main stylized signals emerge from the evolution of capital markets during the last two decades. To begin, persistent and material disparities in the size of capital markets compared to GDP exist between economies. Second, fixed income markets have experienced rapid growth, bringing current outstanding balances closer to stock market capitalisation. Finally, EME capital markets are catching up with AEs but have not yet closed the gap.

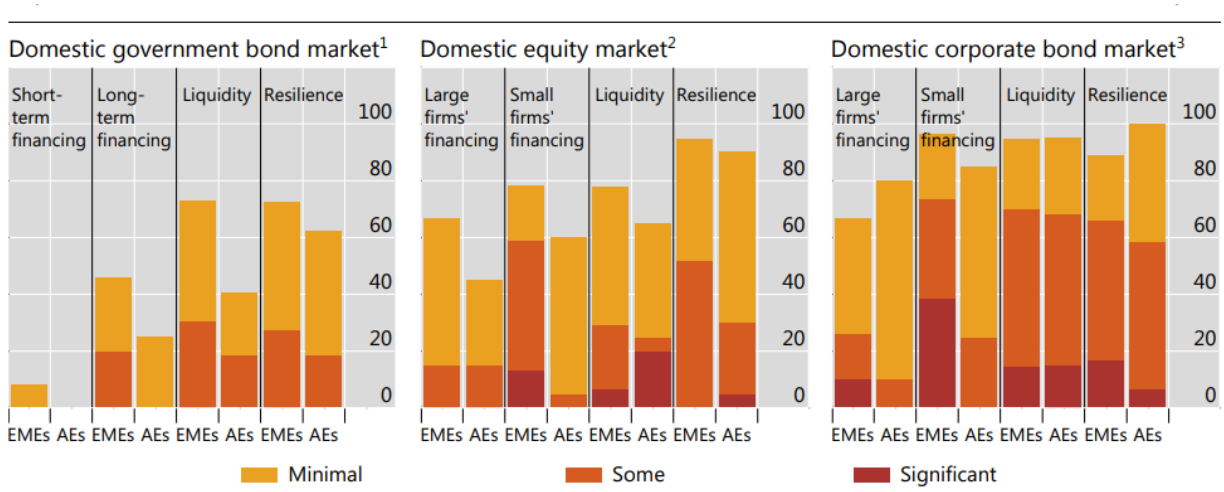


Figure 1. Concerns about domestic capital market functioning

Source: CGFS Working Group survey

A high-level overview of responses to the Working Group's poll on market functioning serves as an excellent preview of the messages from the subsequent sections' discussion (Figure 7). Market participants showed the least anxiety about government bond markets (left-hand panel) and slightly more concern about stock markets across all dimensions (centre panel). The primary source of concern was the operation of the corporate bond market (right-hand panel). Concerns regarding access were addressed primarily about smaller enterprises, particularly those in EMEs. Market players were more concerned with liquidity and resilience than with the provision of capital market credit for large issuers.

While the total market value of outstanding securities as a percentage of GDP continues to be a popular indicator of market size, it must be interpreted with the caveat that, in addition to cumulative net issuance, it also reflects valuation changes, which can be quite significant in the period following the GFC. With this in mind, the size of the equities market has stayed relatively stable on average, while the size of the fixed income

market has expanded. Capital markets in EMEs have generally deepened, but they remain smaller than those in AEs.

As evidenced by the unabated cross-sectional dispersion of the box charts in Figure 8, heterogeneity in capital market size remains significant. Indicatively, the AE equities and fixed income markets double in size as they progress from the smallest to the one at the 25th percentile (distance between the bottom of the line and the bottom of the box), from the 25th to the 75th percentile (box height), and finally from the 75th to the largest (the top of the line). The pattern holds true throughout EME markets, but with greater precision.

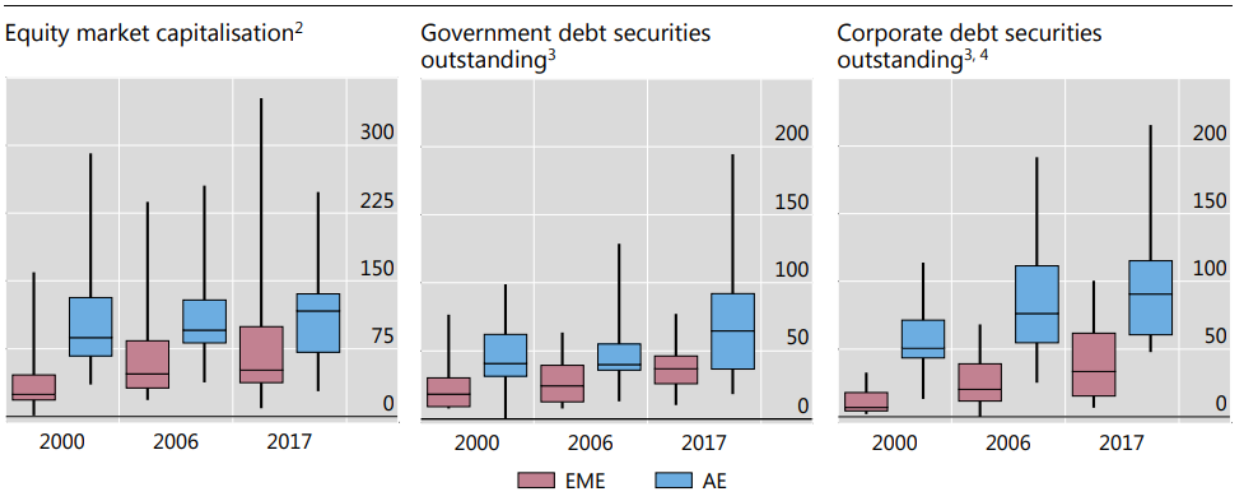


Figure 2. Market capitalization of securities

Sources: IMF, World Economic Outlook; World Bank; Datastream; national data; BIS debt securities statistics.

Between 2000 and 2017, the median AE equity market's capitalisation increased from roughly 85 percent to 115 percent of GDP, while the EME group's capitalisation more than doubled, from around 25 percent to almost 60 percent of GDP. When free float is considered (eg the value of shares excluding insider holdings such as management, controlling owners, or governments), the gap between AEs and EMEs is greater. In the median EME, the free-float percentage of total equity market capitalisation is roughly 50%, compared to 80% in AE equity markets. However, when measured by issuance, the EME and AE equity markets are more comparable. Since 2005, AEs have raised approximately 0.95 percent of GDP annually through equity issue. Annual equity issuance in EMEs averaged little under 0.75 percent of GDP in 2011–17, down from more than 1% in the previous five years.

Over the last two decades, bond markets have been catching up to equity markets (Figure 2, centre and right-hand panels). In AEs, robust finance bond issuance was followed by robust government issuance in the years preceding the GFC, whereas in EMEs, both non-financial corporate and government debt instruments outstanding have increased substantially over the last two decades.

In AEs, the median amount of outstanding government securities climbed from roughly 40% of GDP in 2000 to 50% in 2017. (Figure 2, centre panel). However, the size disparity within AEs has grown significantly, indicating the post-GFC surge in government bond issuance in certain jurisdictions. The median size of government securities markets in EMEs expanded from roughly 20% to 35% of GDP over the same time.

Reliable, publicly available information is critical to the operation of healthy capital markets. Prompt disclosure and well-developed accounting systems with a high degree of transparency reduce the cost of information acquisition for dispersed investors, economizing on what would otherwise be a duplicative, costly, and highly asymmetric process of information collection. Rules requiring prompt disclosure of material information, as well as the prospect of legal or regulatory fines for infractions, enable potential investors to determine the value of securities offered for sale in the primary and secondary markets, as well as to identify market abuse. Inadequate disclosure has a number of negative consequences for market functioning. To begin, inaccurate or misleading information supplied in advance of market difficulties can result in adverse selection. Second, delaying crucial information disclosure causes moral hazard by providing insiders time to profit from trading or prevent losses. Both of these factors contribute to investors' loss of confidence in the market. By contrast, increased disclosure enables minority investors to take action to prevent or sanction insider self-dealing.

Six broad areas are identified as potential enhancements to capital market functioning based on the findings regarding the key drivers of capital market development: I promoting greater market autonomy; (ii) strengthening legal and judicial systems; (iii) enhancing regulatory independence and effectiveness; (iv) deepening the domestic institutional investor base; (v) pursuing bi-directional opening to international participation while preparing for spillovers; and (vi) deregulation. The significance of these policy lessons varies every economy, and many of them are not directly controlled by central banks. Nonetheless, they have an effect on the vitality of financial markets and the ability of central banks to fulfill their objectives. Additionally, given the breadth of the forces mentioned in the preceding section, comprehensive initiatives that consider a number of relevant characteristics are likely to be more successful in building viable capital markets.

Financial repression — policies that obstruct the growth of capital markets and weaken the economy's allocative efficiency – hinders capital market development and degrades allocative efficiency. As such, eradicating restrictive regulations and supporting greater market autonomy is a critical first step toward creating sustainable capital markets.

Approvals over merit-based frameworks can assist defend against some elements of repression, such as paternalistic substitution of market players' judgment to prevent losses and governmental influence on issuance processes. However, upgrades and tighter oversight of disclosure standards, as well as a stronger enabling environment, may be necessary to promote the development of market capacity for screening and determining market access.

The proposals below complement a broad push for increased market autonomy by enhancing markets' effectiveness and efficiency.

Strengthening legal and judicial institutions can make a significant difference in terms of capital market depth. According to experience, critical components of capital markets include efficient, timely, and predictable contract enforcement, the possibility of sanctions and legal remedies for corporate insider breaches of duty, changes to company law to strengthen minority shareholder rights, and efficient and predictable regimes for dealing with corporate distress and insolvency.

Strengthening legal systems. At the heart of any well-functioning legal and judicial system is the judiciary's independence, staffed by competent judges. Courts and judges can be held more accountable by making cases public and open to higher judicial review. Additionally, establishing specialized financial courts can improve the technical competence, efficiency, uniformity, and fairness of financial legal processes. For instance, the United Kingdom established the Financial Services and Markets Tribunal (now incorporated into the Upper Tribunal – Tax and Chancery) as an independent judicial body to hear financial cases; and China just built a financial tribunal in Shenzhen and Shanghai.

By increasing access to legal remedy and lowering litigation costs, the scope for private contract and fiduciary duty enforcement expands. Where applicable, access can be significantly improved by lowering admissibility requirements and streamlining the judicial process for accepting cases. The cost of enforcement, particularly for retail investors, can also be reduced by expanding the scope of group litigation (e.g., through class action actions) or by creating new structures that enable cost pooling among or on behalf of dispersed investors. Additionally, it can be beneficial to establish systems for resolving disputes, such as arbitration and industry organizations, that are subject to appropriate control.

CONCLUSION

Promoting well-defined property and contracting rights while allowing for flexibility to changing conditions. Property and contracting rights are critical for minority investors' protection and, when clearly defined, can help shield businesses from unnecessary litigation. Additionally, effective legislation necessitates systems that keep pace with the continually expanding capital markets. Common law legal systems frequently excel in both areas by drawing on and adapting established precedent in an environment where the spirit of contracts is generally followed (La Porta et al. 2008). Where such flexibility is lacking, for example in economies with a civil law tradition where laws are largely codified by legal scholars, enhanced protection and adaptability could be achieved by establishing mechanisms for systematic application of experience-based lessons, allowing for timely amendment of judicially based rules.

Consolidating corporate legislation to increase minority shareholders' influence and access to information. Improved governance generally results in more effective capital management and utilization, as well as higher and more stable firm valuations and a reduced reliance on debt. The IMF's Global Financial Stability Report (IMF (2016))

observed that while EMEs have recently improved their corporate governance frameworks, further progress may be helped by adopting the G20-OECD Principles of Corporate Governance. The G20-OECD standards include key elements such as amending company law to expand board members' powers and ensuring the separation of the roles of chief executive and board chair, establishing mandatory and independent committees to audit the board on a regular basis, giving minority shareholders more influence over board selection, establishing formal rules governing shareholder meetings, and strengthening rules governing controlling shareholder changes (Allen F, 2017).

Finally, by improving the predictability and efficiency of insolvency and restructuring proceedings, capital market access can be expanded. This is especially true for smaller, riskier, and frequently more inventive businesses. A recent OECD research (Andrews et al. (2017) makes several valuable policy recommendations based on experience. Numerous insolvency regimes, in particular, can be enhanced by incorporating design aspects that facilitate the early identification and resolution of company issues and debt distress (eg preventive restructuring frameworks such as pre-insolvency regimes). This technique provides a viable debtor enduring transitory strains with an alternative to formal insolvency proceedings. Simultaneously, in circumstances when formal insolvency is warranted, streamlining procedures to minimize delays and costs can help limit deterioration of recovery values and promote the effective reallocation of assets and resources to more productive uses.

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