

Financial Market Extension and Capital Attraction with IPO Tools: Study of Uzbekistan

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Abstract

Recent trends in capital concentration show that emerging, developing and transition economies are supporting the transition process to financial market-based structure from bank-based ones. Development of financial markets requires the movement of main capital from bank accounts to markets for investing. Capital attraction and accumulation in financial markets in transition and developing economies often sourced from offerings and going public. This article studies the development, capital saturation and attraction in Uzbekistan based on comparative and cross-country analyses.

Keywords: financial market, capital attraction, IPO, Uzbekistan.

1. Introduction

Capital attraction to financial markets is critical to accelerate economic growth (Molineus, 2014). Efficient and stable financial markets are key to developing a broader and deeper economy. Financial markets ensures the optimal use of capital, and at the same time transfer, pool, mitigate and reduce the existing and potential risks through capital agglomeration, allocation and monitoring. In global context, financial globalization and capital mobility derived and developed from financial markets. Circulation of profit, enhancement of businesses, investment environment, cross-border trade are the very results financial globalization which is supporting back the financial market development, in turn, as economies are not linked by not only foreign trade relations, but also international investment relations with a large share of financial markets. In condition of developing and transition economies, mobility of domestic and international savings and their efficient allocation to the most productive uses in the economy, improvement in risk governance and firm performance, and diversification of financial system roots from financial market extension. Growing private sector and enhancing business environment go deeper into the corporate structures and governance systems via introduction of manager – principal relations which were novice for transition economies. Transfer of assets from public to private hands and establishment of new business entities have been influencing the domestic financial markets at large. Since the early 1980s, the privatization of state-owned enterprises has been very popular in many countries and has dramatically promoted the development of capital markets around the world (Choi et al, 2008).

In most cases, privatization policy was conducted through going public. State-owned enterprises were privatized and went public with IPO tools. In the last decade IPO tools gained the momentum in financial market extension and attraction of capital in most post-Soviet countries. Strongly concentrated public assets and absolute ban on private ownership and individual business, monosectoral industrial specialization and highly interdependent supply chain were broken by large-scale privatization and ownership reforms after the dissolution of communist economy. New independent states decentralized the state owned industrial structure and diversified the ownership status through IPO tools. As a consequence, post-communist economies created their national financial markets from the early basis to current progressively growing ones.

Financial market in Uzbekistan has been expanding the scope due to multiplying elements of financial sector. Composition of financial products embraces the nearly all financial market instruments in international practice. In that line, a driving factor of capital accumulation and capitalization in the market is mainly driven by primary market tools. Issuance, sectoral origin and distribution, circulation and profitability of IPOs have developed the market performance and expanding the horizon for transition from bank-based to financial market-based financial system. This article presents the findings and outcomes of research conducted on IPO's effect in financial market extension and capital attraction as a primary tool in Uzbekistan.

2. Literature Review

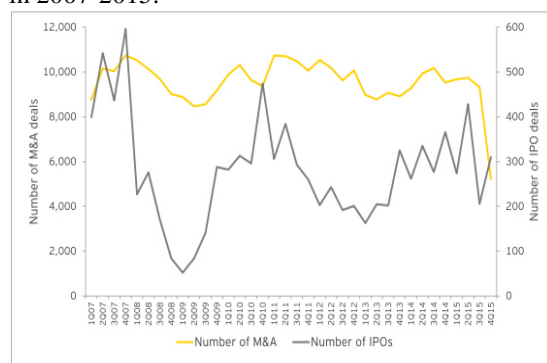
Along with studies of linkages between financial market extension and economic growth, capital attraction has widely discussed among policymakers and academic rounds, and has been under a special focus after global financial crisis. Till the capital collapses of 2008, capital attraction seemed a small scale research topic and had remained as an untouched area. Several researchers studied the capital attraction and accumulation issues in the

context of developed and emerging economies. Transition economies stayed out of endeavour due to their comparatively incomplete financial market profiles under reforms and structural adjustments. Orhangazi (2006) empirically explored the relationship between financialization in the U.S economy and real investment at the firm level by using data from a sample of non-financial corporations from 1973 to 2003 and found negative linkages. Financial market development Goldberg, Jędrzejczak and Fuchs (1996) studied the IPO-PLUS method as a means of capital attraction and concluded that initial public offerings provides efficiency. Recent studies on financial market capital accumulation in transition and developing economies actively investigated privatization IPOs as the main tool of market extension. Megginson and Netter (2001) and Djankov and Murrell (2002), analysed the significant post-privatization increases in efficiency, profitability, and financial strength in financial markets. In contrary, this contrasts sharply with Jain and Kini (1994), Mikkelson, Partch, and Shah (1997), Eckbo, Masulis, and Norli (2007) proved the poor subsequent operating performance for IPOs.

3. Effects of Financial Market Development and Capital Attraction in Economic Growth: International Practice

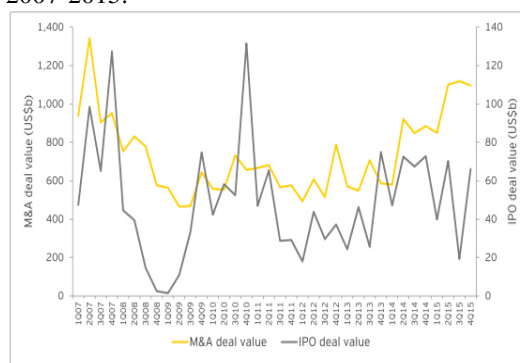
Financial markets help efficiently direct the flow of savings and investment in the economy in ways that facilitate the accumulation of capital and the production of goods and services (FED, 2005). Well-functioning financial intermediaries have played a significant role in economic growth. However, in the era of financial globalization, diffusion of best practices in financial market expansion is still weak in some group of countries owing to immature economic condition. Economic grouping of countries fully matches the list of development earners in the development level of financial market advancement and performance. Developed and emerging economies are progressively stepping forward, while developing and transition counterparts are still lagging behind due to the lack of adequate financial infrastructure, ongoing economic transformation and developing business atmosphere. After global financial crisis financial markets of developed countries gained more attention and governments tried to rescue the economy by recovering the financial markets in collapse. However, financial markets of transition and developed economies stayed out of global focus. Their development, extension and inclusion issues have remained unsolved. Cross-border analyses show that financial markets in developing and transition economies are expanding from attracting capital from new businesses and their going public. IPO issuance is serving as driving force of market extension and capital injection to the economy. It facilitates access to capital, mergers and acquisitions, diversification on national production lines, enhancing industrial image, mixture of corporate governance practices. In 2015, rapidly developing economies issued 55 per cent of global IPOs.

Figure 1. Global IPO and M&A by deal numbers in 2007-2015.



Source: EY, 2015

Figure 2. Global IPO and M&A by deal value in 2007-2015.



Source: EY, 2015

In recent years, Asia-Pacific region is leading the echelon of IPO-based capital by volume and number of IPO deals. Japan and ASEAN financial markets are performing well in economic development and boosting the gross output through attracting capital to new production and service facilities. Hong Kong Stock Exchange (33.5 billion USD in 117 deals), New York Stock Exchange (19.5 billion USD in 54 deals), Shanghai Stock Exchange (11.7 billion USD in 89 deals), London Stock Exchange (15.0 billion USD in 62 deals) Tokyo Stock Exchange (14.5 billion USD in 23 deals) and Shenzhen Stock Exchange (8.2 billion USD in 131 deals) were top IPO capital raisers.

Cross-border IPOs have tremendous effect on capital attraction and its circulation among countries and sectors. PwC explored the cross-border IPOs and found that despite the cross-country differences, IPOs stimulates the financial market condition through both financial and non-financial factors. Access to deeper pools of capital and liquidity, access to a more knowledgeable investor and analyst community, benchmarking against the right peer

group, limited domestic market, a component of an acquisition strategy, elimination of regulatory barriers in the domestic market stamp of credibility, informal clusters and networks of advisers, and raising brand awareness via IPOs sophisticate the domestic economic stance.

4. Financial Market and Capital Attraction: Current Condition in Uzbekistan

Numerous studies have proposed that the development of stock market is able to improve growth performance through its positive effects on capital flows, diversification of investment risk and pooling funding for the long-term industrial projects and provision of adequate liquidity (Wong and Zhou, 2011). Development of financial market drives financial innovation, greater resource allocation, efficiency, and technological advancement. As a transition and a rapidly developing economy, Uzbekistan need the very qualities of financial market development as they are prerequisites for economic transformation and diversification. From the early years of national independence Uzbekistan began large-scale reforms in financial sector and established the financial market as a new component of financial system. The financial market developed in several stages in consistent with economic reforms and stages of economic transition. Government support for business expansion and private ownership accelerated the formation process of full-fledged financial market which runs the capital mobility within the economy. Launch of medium and large enterprises, inflow of foreign investment and availability of financial tools facilitated the effective circulation and distribution of capital among sectors. These measures shifted the capital attractiveness of business environment. Injected capital enabled the sound functioning of both primary and secondary markets at the extent of transition economy.

Figure 3. Capital Accumulation in Financial Market of Uzbekistan in 2014-2015, billion UZS



Source: Author's compilations, 2016

Consequently, several sectors and fields of production developed through capital saturation and technology sophistication, which finally lead to the shift of openness for further capital for extension with financial tools. IPO activity became the key means of attracting capital and creation of a whole business chain in context of domestic production diversification. Investing the funding source to new businesses and making it public for bigger market share and production lines achieved by public offerings. Annual growth of amount of capital and issued IPO has been of progressive trend both in short and long-term scenarios (Figure 3). The demand for initial public offerings has increased dramatically, depending on overall market strength, the market's opinion, industrial and economic conditions, technological changes. Comparatively lower level of stock market volatility is one of the most inherent aspects of going public, which brings the expected positive results such as increased cash and long-term capital, increased market value, mergers and acquisitions and growth strategies.

In the economic context of Uzbekistan, capital attraction, concentration and effective distribution hugely impact on economic growth. Goldsmith (1969), Mckinnon (1973) and Shaw (1973) initially hypothesize that financial liberalization and financial market development promote economic growth through their impacts on the growth rate of savings, investment. They help developing and transition countries follow the appropriate economic policy or/and reshape the financial sector that supports its economic growth. Financial market liquidity is positively and significantly correlated to current and future rates of economic growth, capital accumulation, and productivity improvements. An efficient financial market contributes to attract more investment by financing productive projects that lead to increase production capacity, mobilize domestic savings, allocate capital proficiency, reduce risk by diversifying, and facilitate exchange of goods and services. Considering Uzbekistan's foreign economic policy and national economic development framework, financial markets accumulate drives

the investment policy as an accumulator of capital flows directed by foreign investors. Development and technological modernization of selected fields are highlighted as strategically important task in the agenda of foreign investment policy. Public offering of state-owned enterprises (1) and initial offering of newly established jointly authorized companies (2) are the key actions in financial market development and capital attraction.

5. Conclusion

Financialization and capital attraction issues are common in global scope. All economies pay considerable attempts to ensure a smooth capital circulation and feed the sectors with adequate amount of capital to keep them stable and up-to-date, marketable and profitable. However, as mentioned, developing economies need practical substantiation for strengthening the role of financial markets in capital movement and allocation, growth dynamics and quality of capital. As this article mainly focused on IPO tools of capital attraction and financial market extensions, applicability of successful public offerings and their impact on long-term economic growth are investigated under the case of Uzbekistan which is in economic transition with rapid economic growth. Author proposes recommendations in government (systemic) level and firm level based on the outcomes and findings from analyses. At government level, (1) further financial liberalization and privatization of state-owned enterprises, (2) stricter regulation and supervision on dividend structure and allocation by board of firm directors, (3) easing the public offering procedure. Firm-level recommendations mainly concentrates on market analyses and successful IPO principles. Considering the economic reforms and diversification, firms are advised to be more flexible and having ad hoc measures and resources to cover the lost and harms from financial market. Solid economics, strong fundamentals, and a well-prepared framework for market can provide a great foundation for a successful IPO. Firms should be highly selective in financial information, corporate governance, financial reporting procedures, risk and compliance, and selection of IPO schemes.

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