

Revitalizing the Capital Market in Bulgaria: The Lessons from the Korean Experience

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Outline

- The Bulgarian capital market after the crisis. Supply and demand side weaknesses.
- Why Korean Experience?
- What would work ?

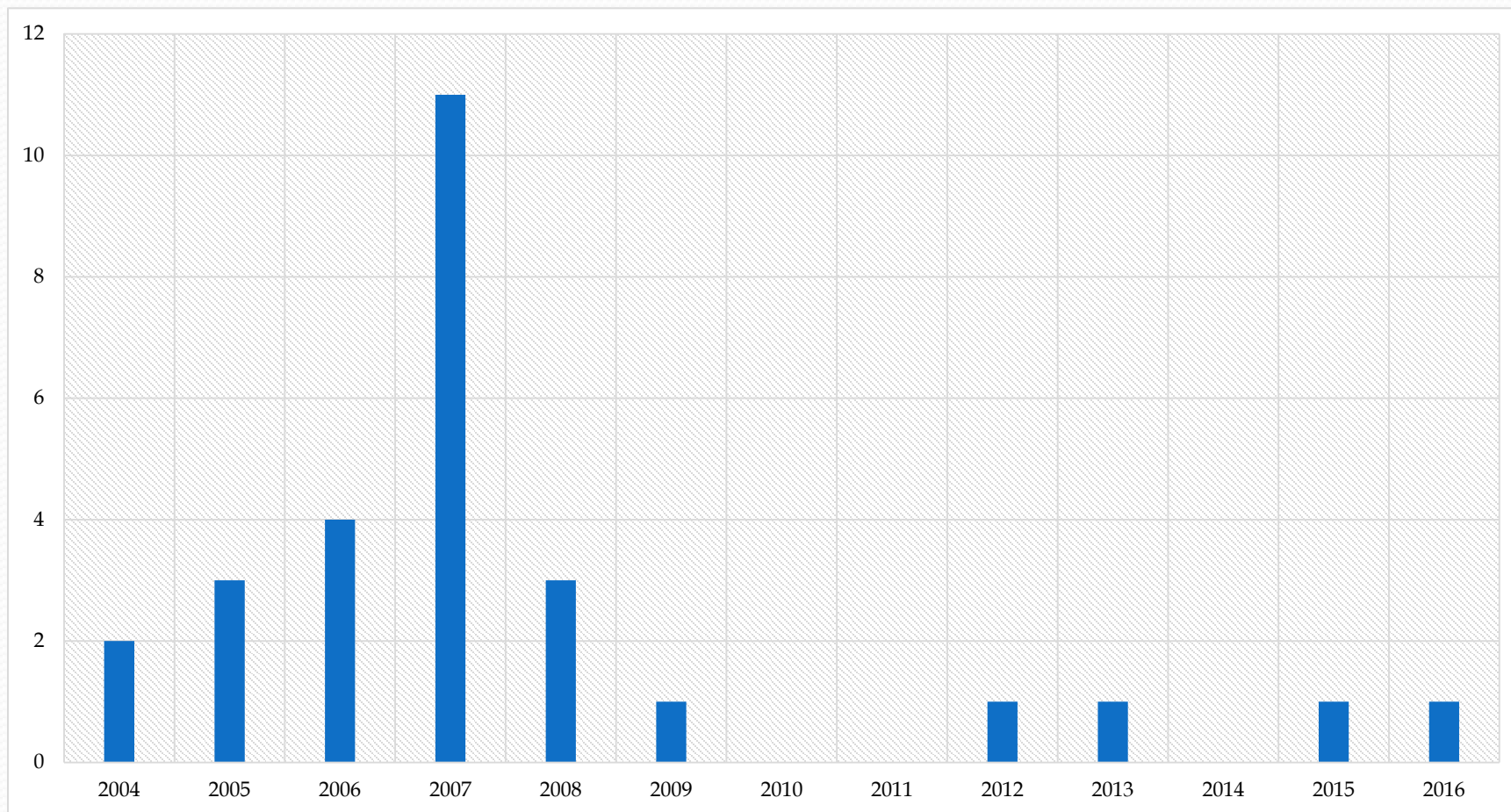
The aim of the project is :

- To extract practical lessons from the Korean capital market experience by underlying policy applicability;
- To implement best Korean practices for development of Bulgarian capital market.

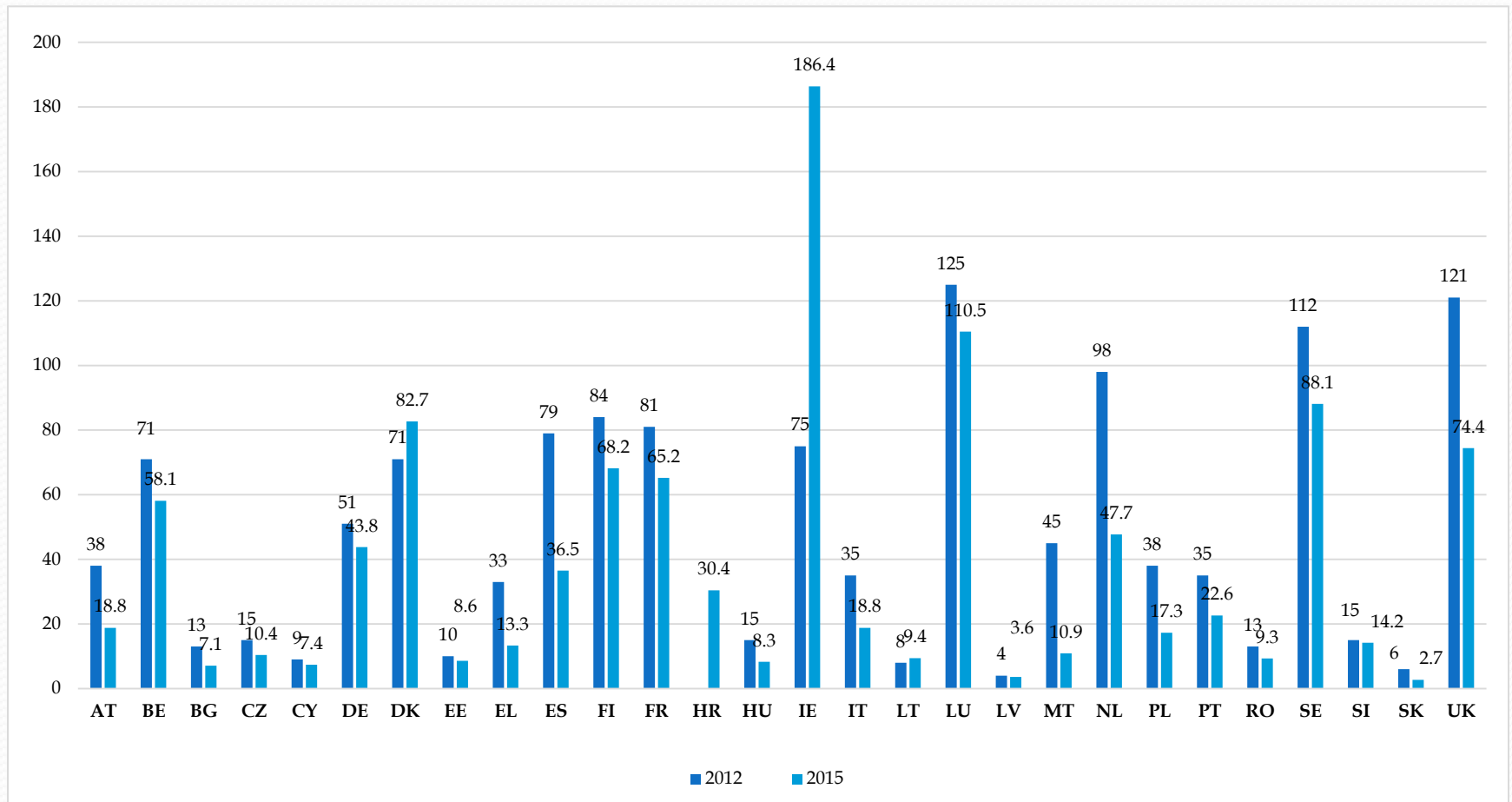
Bulgarian capital market before the economic crisis: Was the growth sustainable?

- BSE market capitalisation and market capitalisation/GDP ratio, reached their peaks in 2007, as a result of the increased number of local and foreign investors, higher market prices of the Bulgarian public companies and the improvement of the business environment in the country.
- After the application of the Regulation of the mutual funds (2005), a significant increase of retail investors' deals was sought.
- By the end of 2007, the number of listed companies was 30, which provided an opportunity for a professional management of assets, amounting to a value of BGN 900 million, managed by 60 Mutual Funds.

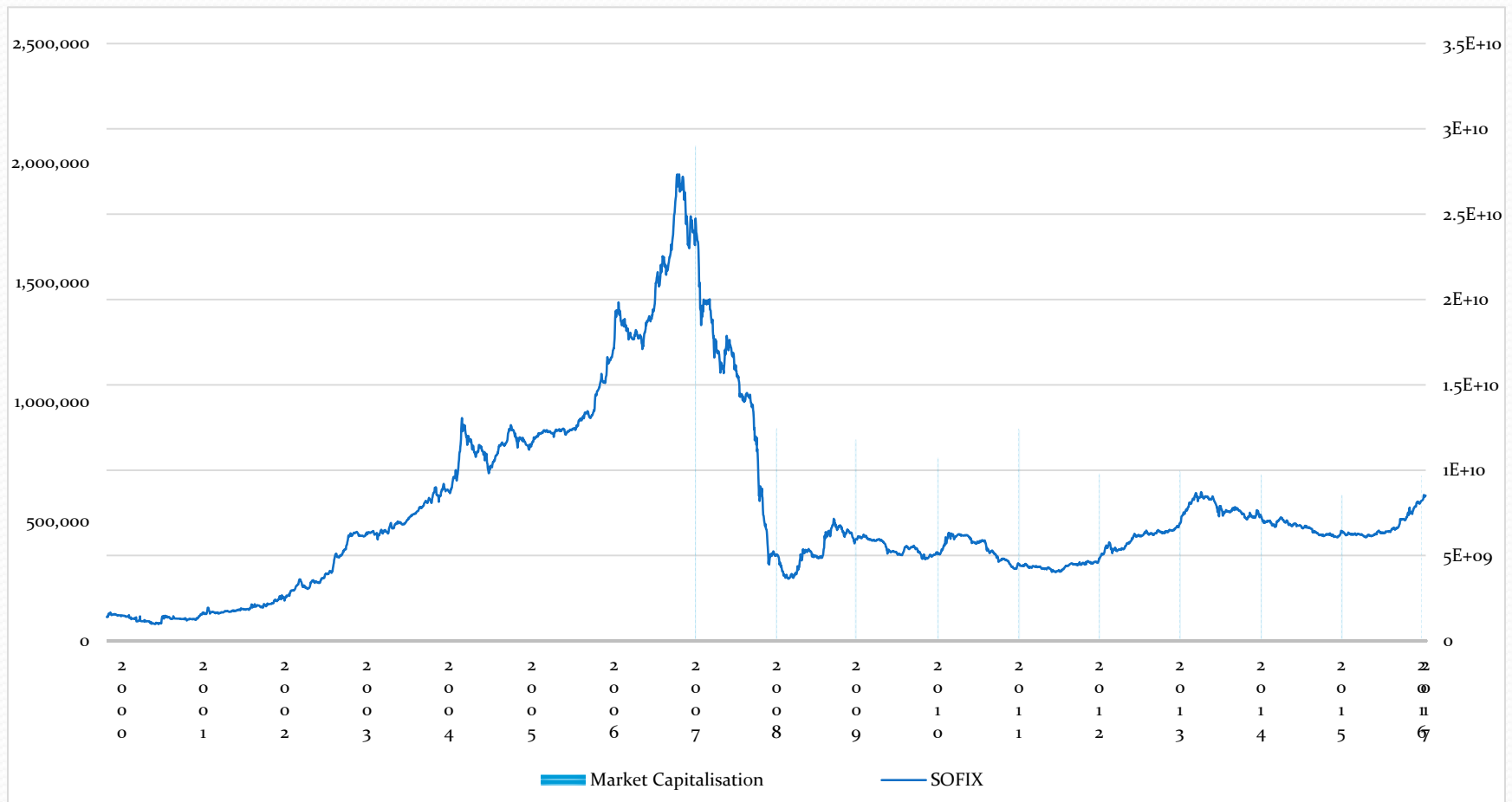
Initial public offers (IPOs) on BSE-Sofia, 2004-2016



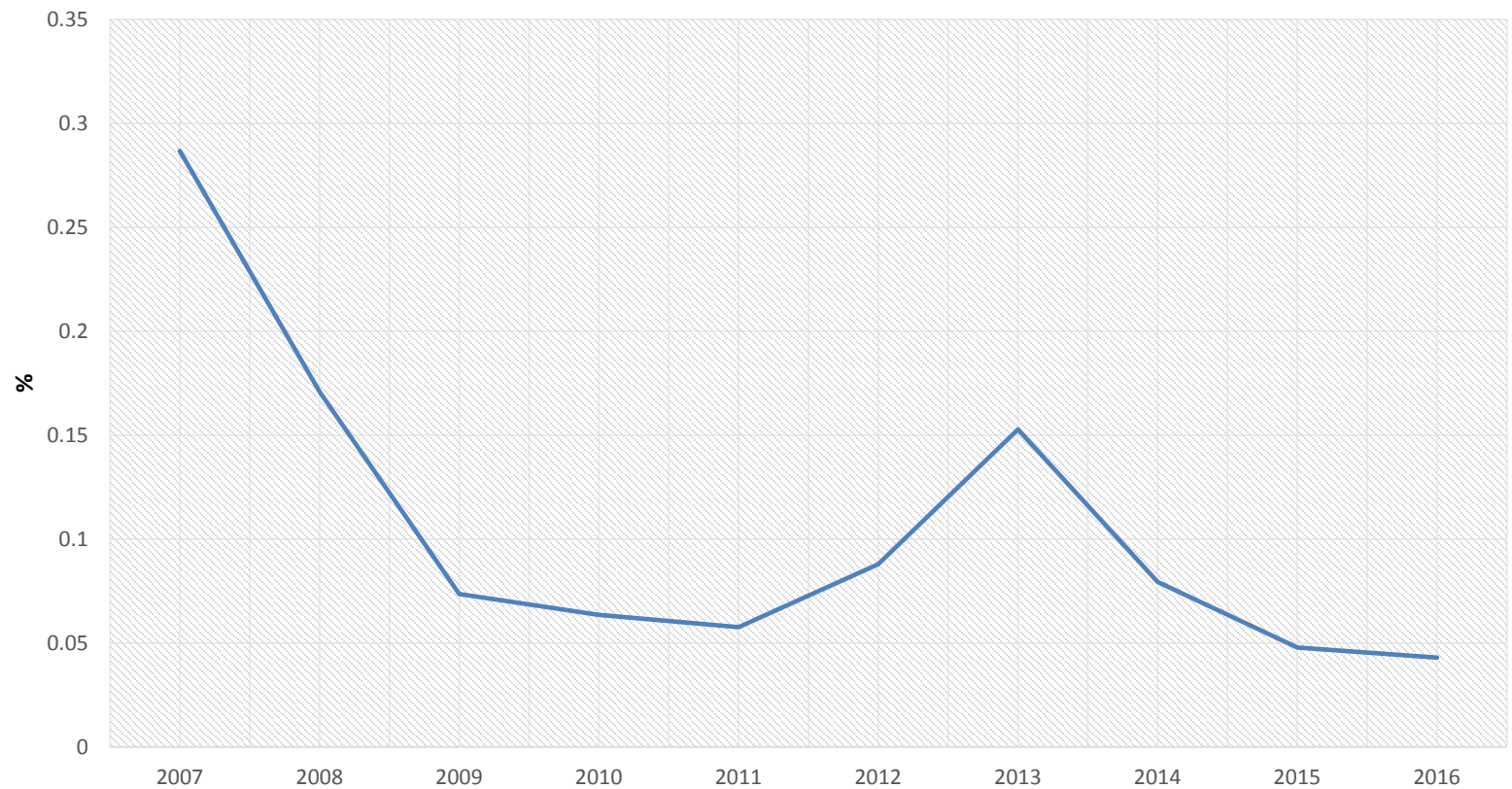
Stock market capitalization (% of GDP)



SOFIX and market capitalization BSE-Sofia



Turnover of BSE - Sofia as a share of market capitalization, 2007 – 2016



Should we blame the crisis?

The pre crisis period

- The pre-crisis booming market was fueled strongly by the state offering of SOEs. The loss of its main driver at the end of privatisation pushed the state out of the market.
- The pre-crisis development was also associated with more foreign investors in the market, most of whom withdrew.
- The slow recovery of the Bulgarian capital market is due to fundamental structural, legal and institutional problems that need to be resolved in order to revitalize.
- Several legal events adversely affected the interests of minority investors in public companies. Following the accumulation of such errors, both physical and institutional investors lost to some extent their confidence in the Bulgarian capital market.
- The capital market development was not a priority for the Bulgarian Governments.
- The market kept expecting that the state will continue offering stocks on the market while many listed companies delisted. The fundamental problem is that the Bulgarian companies are not active in entering the capital market.

The crisis

- The global financial, and sovereign debt crisis has led to a sharp decrease in the the stock exchanges' indices in the world and in Bulgaria.
- Market capitalization and market capitalisation as a share of GDP decreased by nearly 60% between 2007 and 2011.
- **Impact of the crisis**
- *Capital market has not the proper role for the economic recovery and its support for the real sector was weakened.*
- *The basic role of the capital market to mobilize domestic capital for economic development was also declined.*

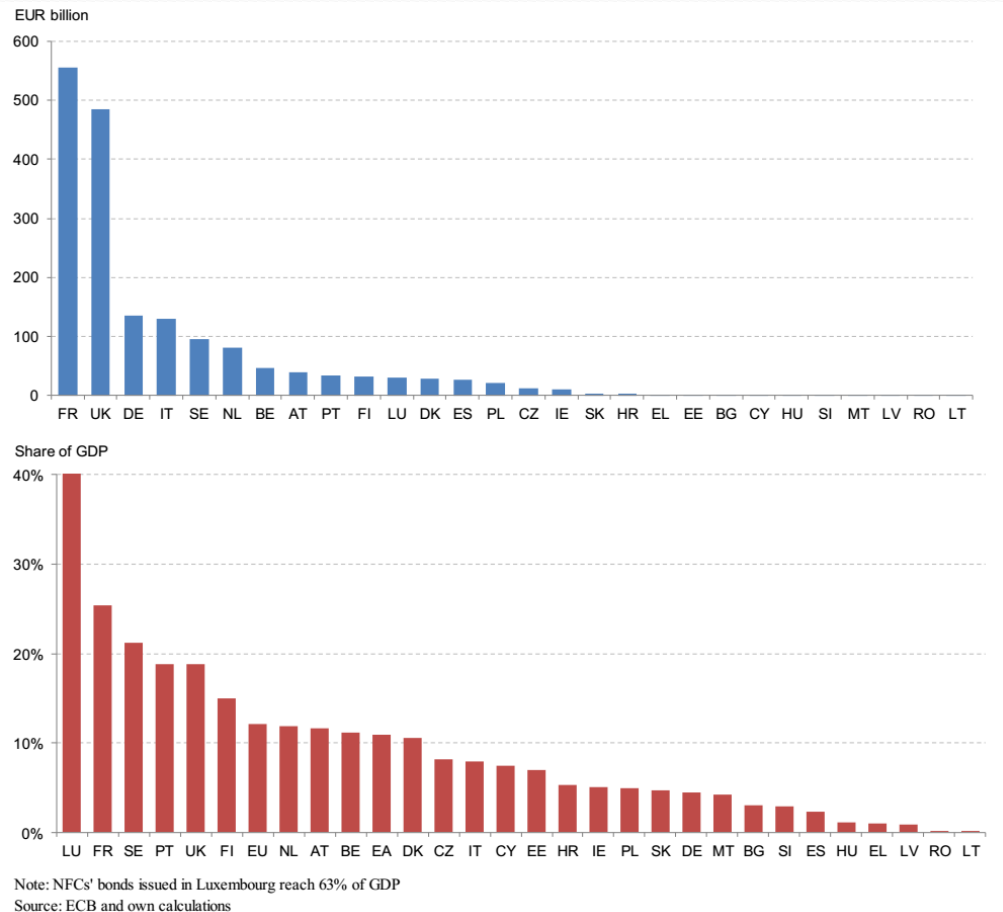
Recent developments

- In 2013, the market value of the listed companies on the main market amounted to BGN 8.7 billion, and on the alternative segment - about BGN 2.1 billion.
- A positive trend for BSE deals in 2015. The average dividend yield on stock was around 4%, and the calculated investors' dividends amounted at BGN 153 million.
- In 2016, the negative yield on banks' deposits gave reason to invest the increased savings in shares. The interest rate on banks' deposits amounted to less than 1%, which make investments in shares profitable.
- SOFIX increased with 27.24% (31.12.2015 - 31.12.2016)

Corporate Bond market

- The bond market deteriorated severely after the crisis mainly due to lost confidence among investors.
- Both institutional and retail investors lost interest in investing in corporate bonds and the market lost its depth and liquidity.
- The issuance of corporate bonds is a rather marginal source of financing in the EU as well as in Bulgaria.
- Developments of corporate bond issuance are affected by cyclical factors because the supply of funding is driven by the economic cycle and the bank-based system of financing of the companies;
- There were instances of restructuring issues of some publicly offered bonds. COMPANIES issued bonds at some foreign stock exchanges like the Warsaw stock exchange.
- There were a few cases of delayed repayment of interest and/or principal on issued bonds.

Corporate Bond market





Impediments to the capital market recovery, **Supply side factors**

- Small number and limited attractiveness of traded companies.
- Most of the large blue chip companies are not interested in being listed.
- Delistings further decrease the investors' interest in the stock market.
- SMEs practically have no access to the capital market.

Impediments to the capital market recovery, **Supply side factors**

- Concentration of supply. The trade is concentrated in finance sector 50,92% and real estate 19,29%. Manufacturing represents only 19%.
- Companies find debt financing easier than equity financing. According to a recent study (November 2016) of Economic Research Institute BAS among 1300 Bulgarian large, medium and small companies no one has intention to be listed in the current conditions
- Start-up companies have limited access to the stock exchange;
- Limited variety of instruments
- Administrative burden and slow processing

Demand side factors behind the sustainable downturn of the capital market:

- Too volatile market discourages investors;
- Marginal dividend income;
- Restrictions to the institutional investors;
- Low level of investors' confidence;
- Poor financial literacy of most of the population.

BULGARIA: there is a good potential for the capital market to grow

Prerequisites to grow and to catch-up the pre-crisis peak levels:

- Growing economy beyond the EU average. The economic growth accelerated from 0,9% in 2014 to 1,3% in 2015 and 3,6% in 2016.
- Developed legal and institutional framework: further improvements on the agenda
- Fast growing innovation and start up businesses: creating risk capital market and a segment for start-up SMEs could be helpful for the innovative type of economic development!
- Equity financing badly needed by the companies: A possibility is also for the SOEs to raise capital at market in order to fund investments
- Attractiveness for the investors rises - A positive tendency: More than 5 % is the yield of shares of the most actively traded companies on the BSE (2016). The historically lowest levels of interests on bank deposits offer an incentive to invest in the capital market.
- The two main political parties include in their pre-election programmes as a priority dedicated to the revitalisation of capital market in favour of innovative growth and further restructuring of the economy.
- The Capital Market Council set up and a consensus built on the reforms to be implemented. Stakeholders' are motivated to go ahead .
- THE ROADS MAP for the revitalisation is on the agenda to be implemented.

Why Korea?

- Korea capital market is one of the main drivers of the Korean economy
- The crisis also hit the Korean capital market but the stakeholders agreed and started implementing a comprehensive package of measures to revitalise the capital market
- Lessons learned by Korea from the Asian (1994-1996) and the recent global crisis (2008-2009) can be really useful.
- Strong SMEs focus (segmentation of the market) and synergies between the Government policies to encourage the innovation, the SMEs and the stock exchange policies.
- The experience of Korea being in line with the intentions and priorities of revitalise the Bulgarian stock market.
- Fast growth of IPOs after the crisis.
- Similar problems revealed by the crisis

The concept about implementing the Korean experience

Promotion of several important ideas:

- the holistic nature of the capital market as instrumental for the development of the economy by stimulating the growth of companies through adequate investments;
- On the Capital market exercise impact a variety of internal domestic and external factors on which the economy depends (type of economic growth, size of the prevailing enterprises, structure of economic entities and the domestic and external market dependency of the production of the businesses). How does this synergy of factors work better?
- The goal of the Capital market is to serve better the need to raise efficiency, fairness, stability and innovation of the economy as a whole.



There are **3 basic directions** to attain the goal to broaden and deepen the capital market base :

- Enlarging and enhancing **supply and demand conditions**
- through promoting innovation and improving infrastructure of the capital market **increasing efficiency and competitiveness of the non-financial and financial companies**
- Ensuring **market credibility and enhancing investors' trust** through promoting market stability and strengthening investor protection.

The enhancement of supply side conditions is achieved by specific actions

KOREA

- To differentiate the segments of stock market between KOSPI, KOSDAQ and KONEX
- creating grounds to foster the upward trend of development of a growing company through the 3 segments of the Capital market: KOSPI, KOSDAQ and KONEX. The enterprises have the choice to grow up as follows:
- *from a start-up at the KONEX,*
- *through the creative and innovative company's growth access at KOSDAQ market and*
- *reaching the KOSPI market as a blue chip company.*

BULGARIA

- To create better segmentation of the market and develop the linkages on the basis of introducing new segments of the market (for the SMEs as well as a secondary market for the Government bonds);
- to diminish the administrative barriers for listing and delisting of the companies at the capital market;
- The capital market has to provide for the maintenance of the **innovative type of economic growth** by stimulating the risk capital market development.

OTHER SUPPLY ENHANCING MEASURES TO REVITALISE THE CAPITAL MARKET: lessons from Korea

LISTING AND NEW INSTRUMENTS

- Promotion of Listing and reducing the administrative burden of the listed companies
- Reduction of IPO regulation
- Education of SMEs for IPO
- Introduction of SPAC (Special Purpose Acquisition Company)
- Incentives for IPO management companies
- Increase of role of IPO management company
- Introduction of HTS (home trading system)
- Introducing new derivatives products
-

Increasing the Institutional investors' participation

- Enlargement of stock investments by public funds;
- Establishment of a stewardship code.

Evaluation of Policy Applicability to Bulgaria:

Main issues of concern

- The **external constraints** reveal the unfavourable trends of stagnating world and European markets
- Bulgarian capital market strongly **depends on the changes in EU** market regulation and the ongoing reforms in the financial sector.
- **the non-economic factors** (corruption, malfunctioning of the judicial system, lack of proper law enforcement) may further constrain capital market functioning and may delay its revitalization.
- **Financial literacy at all levels** to be improved;
- **Considering economic and non-economic internal factors**, Bulgaria is basically a SME-centered country and the role of vitalisation of SMEs is very significant for the capital market to be revitalized.



The revitalisation of capital market

- Should be part of and consistent with the overall economic policy;
- Should be based on the prospective structural developments in the Bulgarian economy;
- Should be an effort of all stakeholders.

We can capitalise better on our own experience by learning the Lessons from the Korean experience!



THANK YOU FOR YOUR ATTENTION!