

2016/17 Knowledge Sharing Program with Bulgaria

Revitalizing the Capital Market in Bulgaria after the Crisis: the Lessons from the Korean Experience

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Introduction

□ Purpose

- Analysis of capital market revitalization policies in Korea
 - Explain main policies to revitalize capital market in Korea after global financial crisis
- Lessons from the Korean experience
 - Extract important lessons for policy-makers and stakeholders in Bulgaria to promote the capital market and to mobilize domestic capital for economic development

Introduction

□ Scope

- Market
 - The suggestions for Bulgaria mostly focus on the stock market
 - The narrower, the better
- Period
 - Basically we cover the post-crisis period
 - But some additional experiences before the global financial crisis were examined

Bulgarian Capital Market

□ History

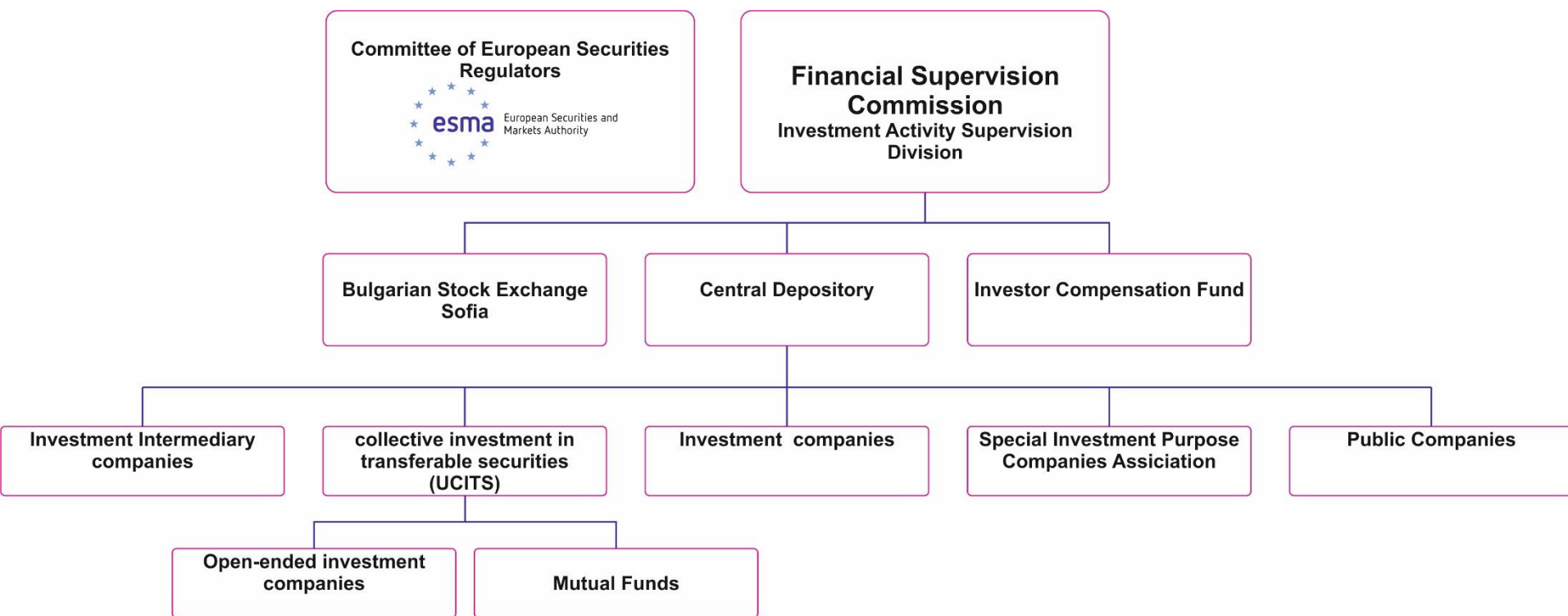
- The history of the Bulgarian capital market dates back to the beginning of the 20th century
 - 1907: the first provisional Stock Exchange Act was adopted
 - 1914, April 15th: the first real stock exchange, Sofia Stock Exchange, was established in Bulgaria
 - 1918: Sofia stock exchange started to operate
 - 1947: Sofia Stock Exchange ceased its operations
 - 1991, July: Sofia Stock Exchange activity was reinstated
 - 1995: the Bulgarian Stock Exchange was established
 - 1996: Central Depository was founded
 - 2000, October 20: the main stock exchange index SOFIX was set up
 - 2004: the first initial public offering (IPO) in Bulgaria

Bulgarian Capital Market

□ Legal and institutional framework

- The market operator of Bulgarian capital market is the Bulgarian Stock Exchange-Sofia (BSE) with a custody the Central Depository
 - The market is regulated and the Stock exchange is supervised by the Financial Supervision Commission
 - The BSE is a public body that regulates not only the capital market but also the insurance, health-insurance and the pension-insurance markets
 - The FSC was established in 2003 as an independent institution that is directly reporting to the National Assembly of the Republic of Bulgaria
 - The Government owns 50% of the BSE

Institutional Framework of Bulgarian Capital Market

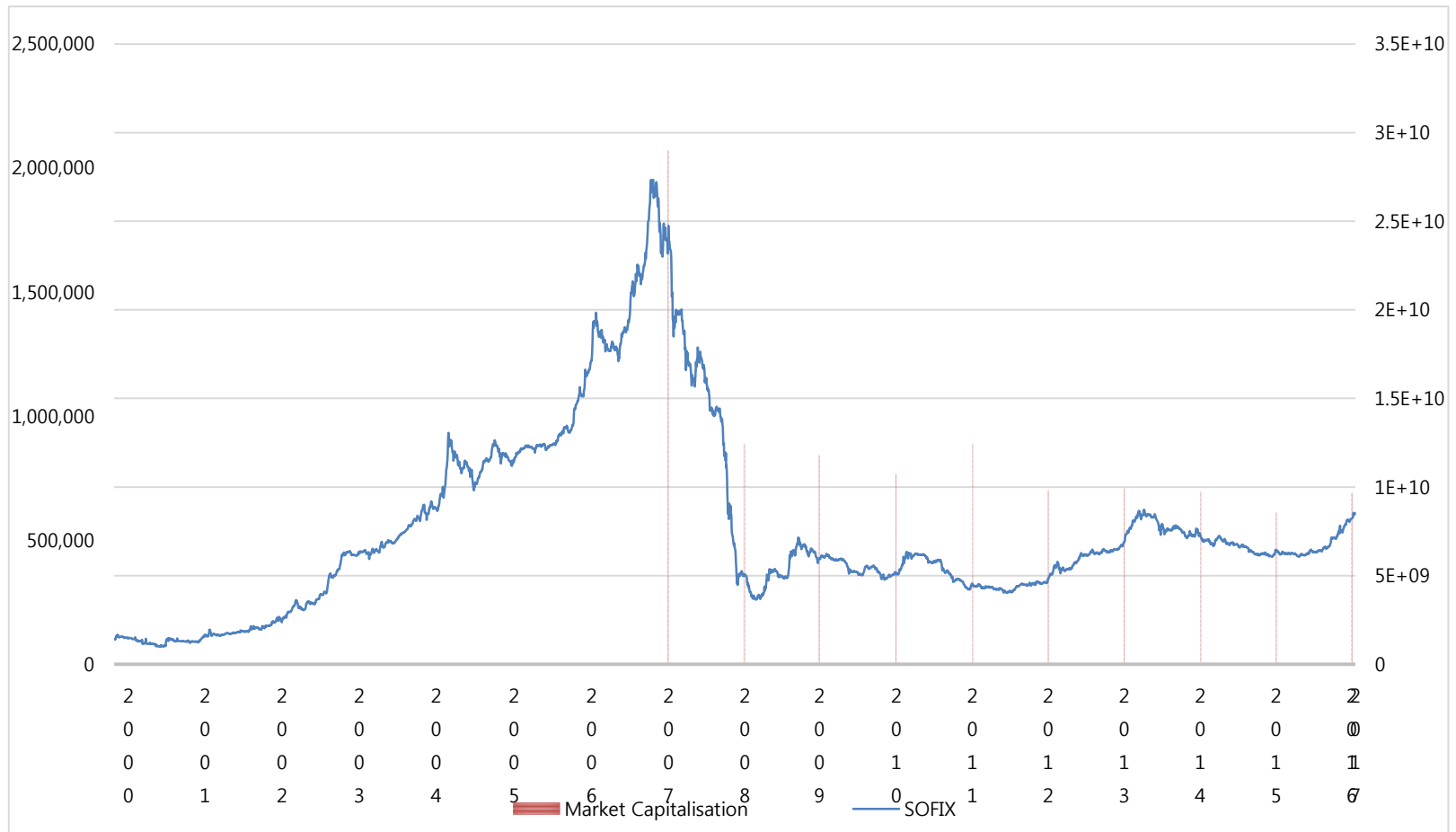


Bulgarian Capital Market

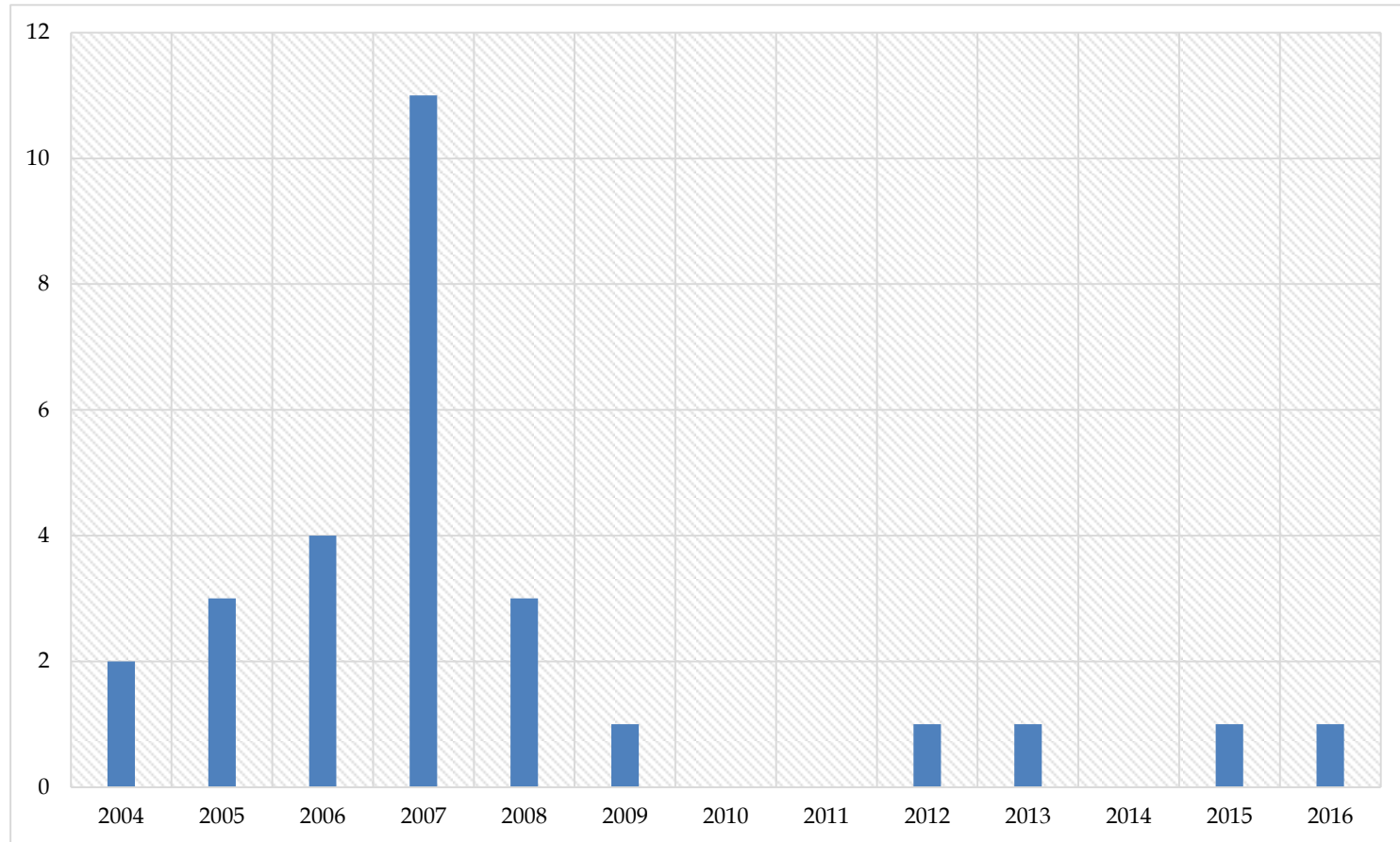
□ Development of the Bulgarian capital market

- Before the global financial crisis
 - Bulgarian capital market was booming in the environment of a high economic growth and a high credit growth
 - The peak was in 2007: at the end of 2007, the ratio of market capitalization to GDP increased to 55%
 - The global financial crisis led to a sharp decrease: market capitalization decreased by nearly 60% between 2007 and 2011
- After the global financial crisis
 - The capital market fell into a long depression
 - The market activity and the market price are not yet recovered
 - The interest in the initial public offerings (IPOs) is almost nonexistent

Trend of SOFIX and market capitalization



IPOs on BSE



Bulgarian Capital Market

□ Impediments to the capital market recovery

- Supply-side factors
 - Small number and limited attractiveness of traded companies
 - Little interest of the large blue chip companies in being listed
 - Decrease of listed companies due to delisting many companies offered through mass privatization
 - Too high entry and trading costs for SMEs
 - Concentration of supply
 - Limited access of start-up companies to the stock exchange
 - Limited variety of instruments
 - Administrative burden and slow processing for IPOs
- Demand-side factors
 - Too volatile market
 - Marginal dividend income
 - Restrictions to the institutional investors
 - Low level of investors' confidence
 - Poor financial literacy

Bulgarian Capital Market

□ Measures to revitalize capital market

- Council for Development of the Capital Market
 - Ambitious plan for encouragement of the market
- Main measures
 - Increase of variety of market instruments traded on the stock exchange
 - Promotion of foreign and domestic investors
 - Education to investors
 - Funding of IPOs by EU funded projects
 - PR and promotional activities for the capital market
 - One of the measures is to increase the soft limits for the SMEs sector
 - Decreasing administrative burden for listed companies
 - Greater access of SMEs to the capital market
 - Establishment of new markets for SMEs, startups, innovative companies, etc. maybe feasible.
 - Trust and predictability may be injected in the capital market if the Bulgarian Stock exchange is privatized by a large foreign stock exchange

Korean Experiences of Capital Market Revitalization

□ Brief history of capital market promotion

- Some key examples
 - 1956, February: Daehan Stock Exchange (predecessor of KRX) was established
 - 1968, November: the Capital Market Development Act was passed and ESOP (employee stock ownership plan) was introduced
 - 1972: IPO Promotion Act was introduced
 - From 1983 to 1987, the government introduced a series of policy measures to promote IPOs and seasoned equity offerings (SEOs). Also the government newly introduced the people's stock ownership plan (PSOP), which was chosen to privatize POSCO (1988) and KEPCO (1989)
 - 1996: establishment of the KOSDAQ
 - 1997, April: online trading system HTS (Home Trading System) was introduced

Korean Experiences of Capital Market Revitalization

□ Overview of capital market in Korea: structure

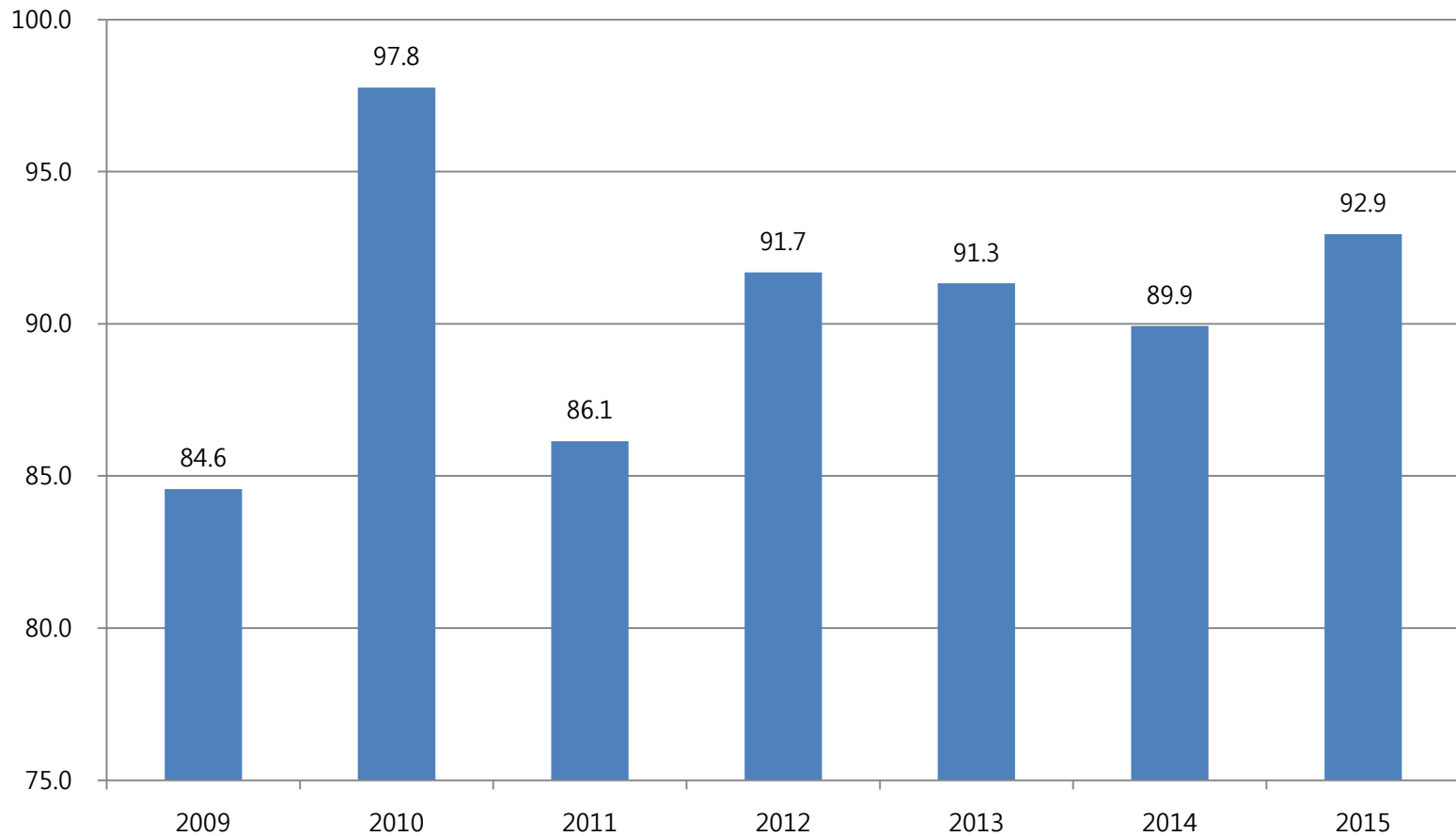
- KOSPI (Korea Composite Stock Price Index)
 - The main board market
 - The price index is KOSPI
- KOSDAQ (Korea Securities Dealers Automated Quotations)
 - To provide funds for SMEs in such tech-savvy area as IT (information technology), BT (bio technology) and CT (culture technology)
- KONEX (Korea New Exchange)
 - A new market established in 2013 for start-ups at the early stage

Korean Experiences of Capital Market Revitalization

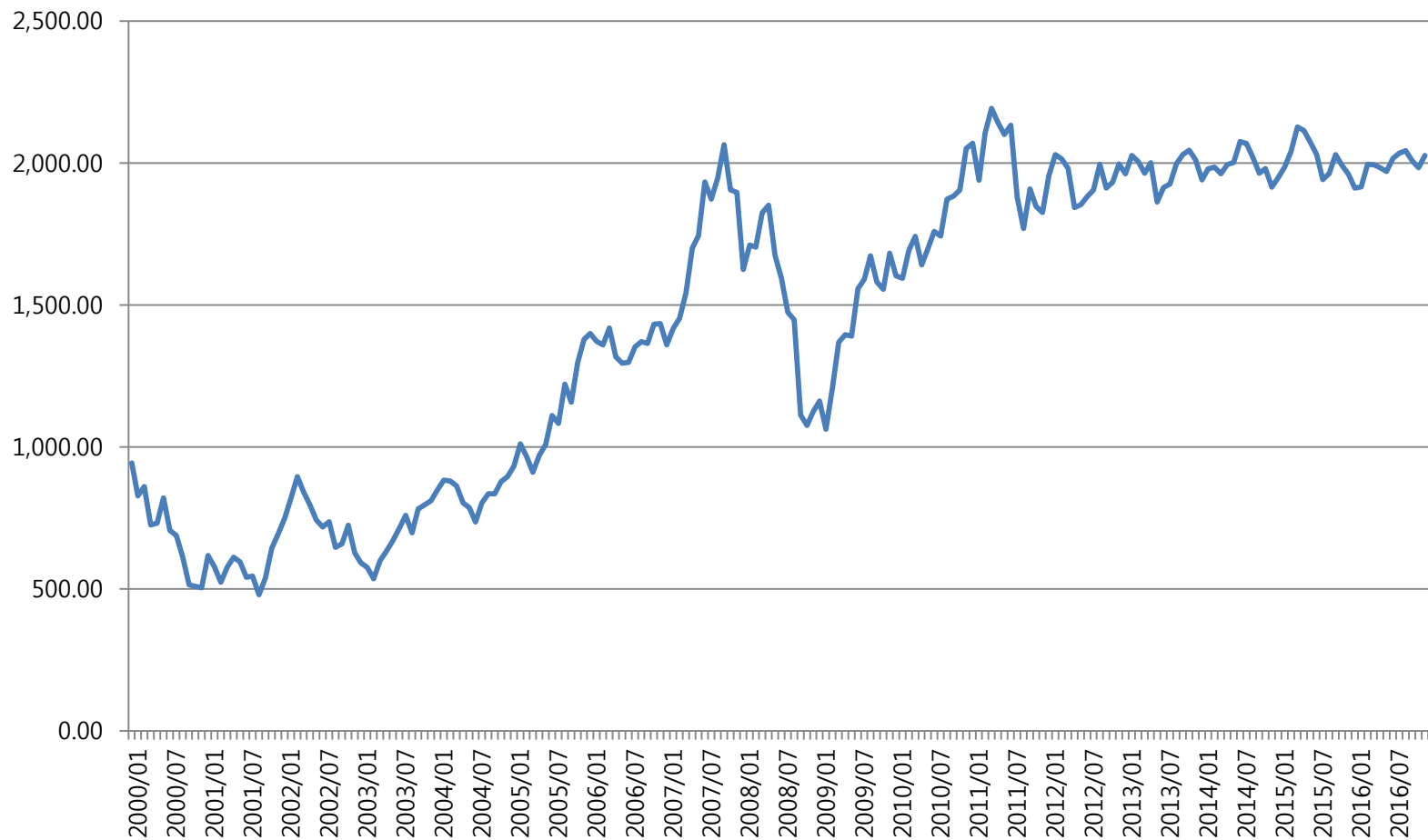
□ Overview of capital market in Korea: market condition

- Market size
 - Market size steadily increased until global financial crisis
 - Since then, hovering around 90% to GDP
- Stock price
 - Steady increase until GFC
 - After a big turbulence, hovering around 2,000 point level
- Trading volume
 - Trading volume declined recently
 - Capital market has stagnated
- Number of listed companies
 - Recently increased, but decreased in KOSPI market
 - IPO: mostly in KOSDAQ and KONEX markets

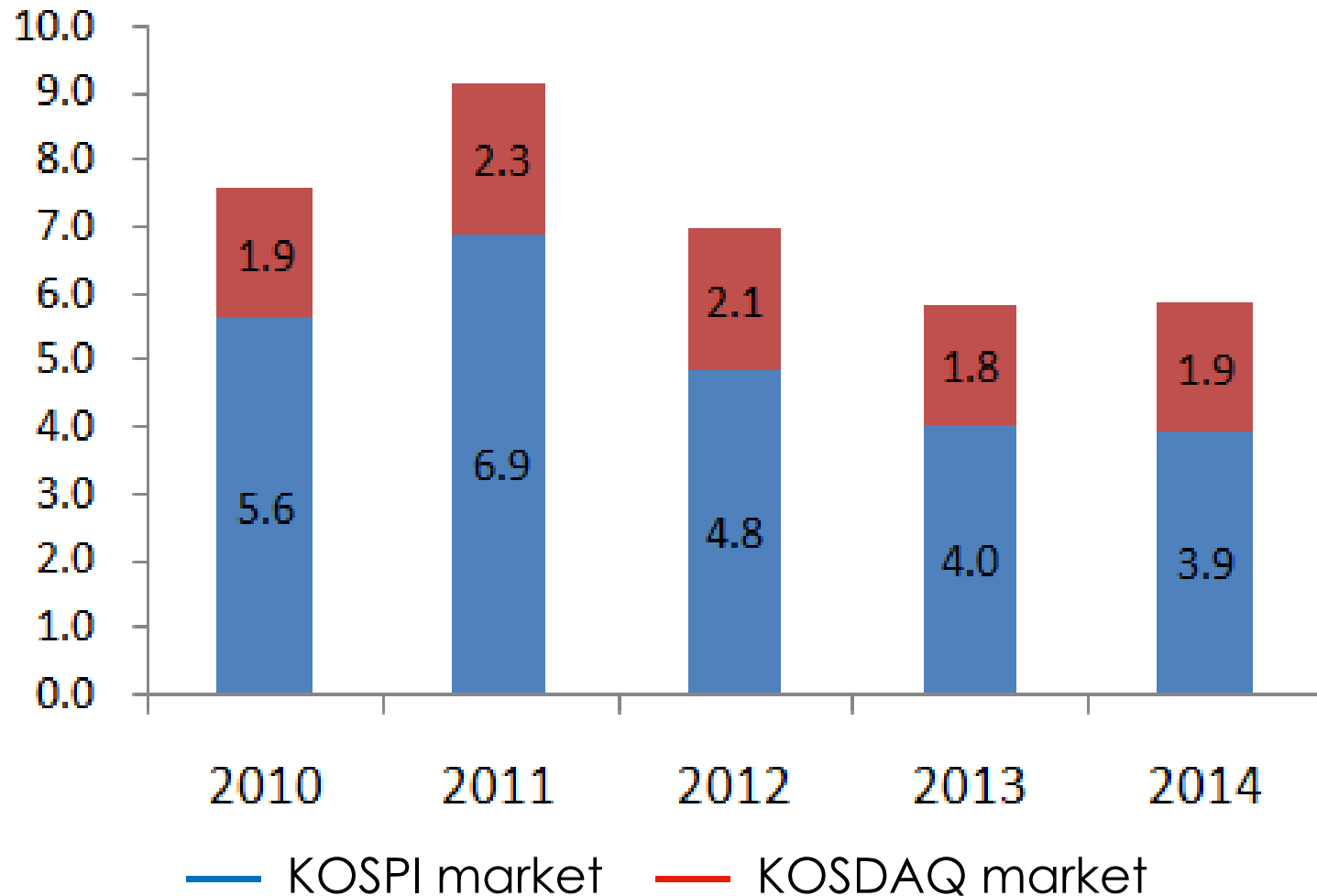
Market size



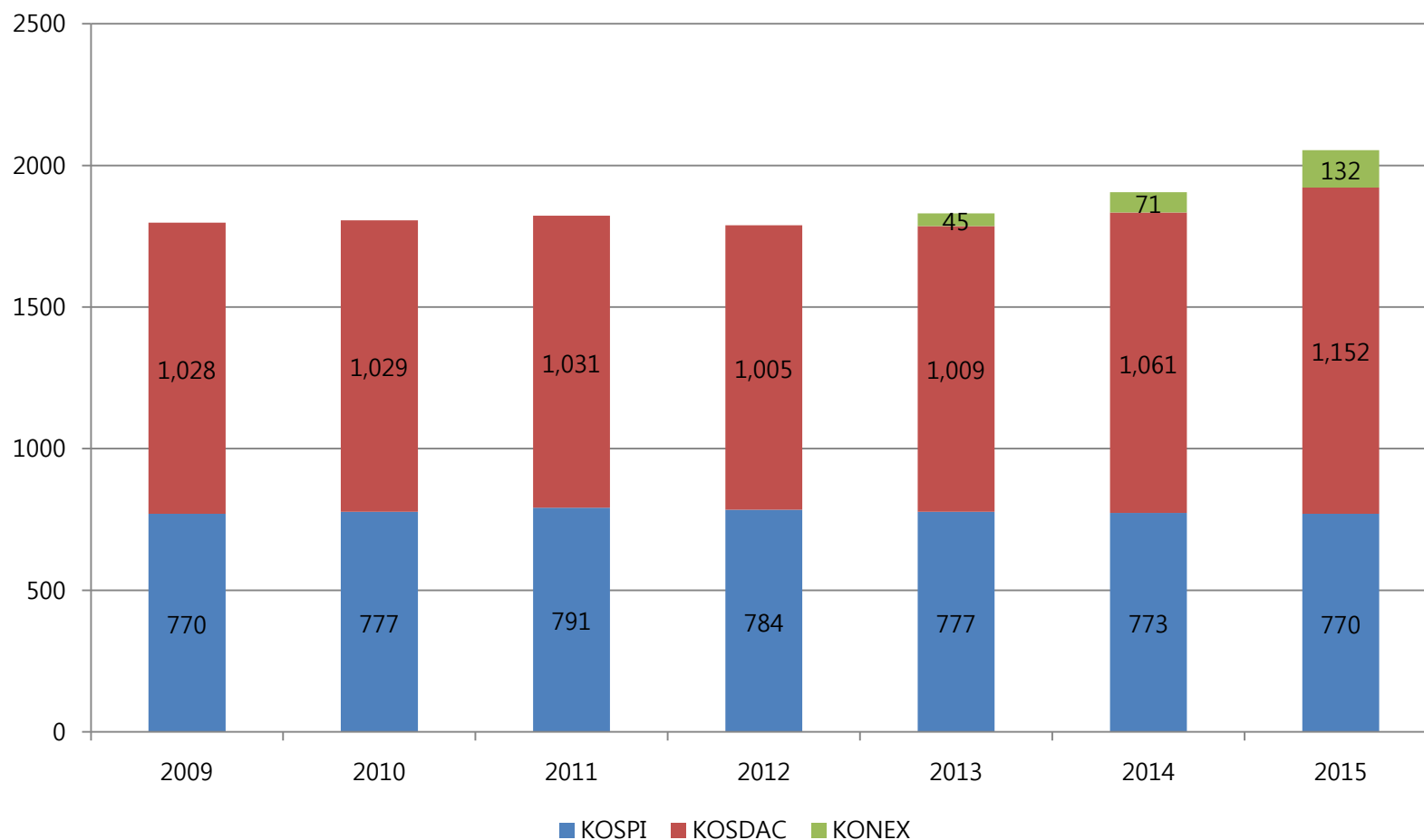
Stock price: KOSPI



Trading volume



Number of listed companies



Korean Experiences of Capital Market Revitalization

□ Problems of capital market in Korea

- Deterioration of supply and demand conditions
 - Supply side: lack of blue-chip stocks, start-up's difficulty in raising fund through capital market, lack of incentive to utilize capital markets due to high burden of listing and maintaining the status is too large
 - Demand side: weak demand base and very sensitive to external shocks, too much risk-averse investors, decrease of individual investors' investment
- Low efficiency and competitiveness
 - Weak market structure: large volatility, short time horizon
 - Limited role of institutional investors
- Decrease of investors' trust in capital market
 - Continuing malpractices: embezzlement, unfaithful disclosure, and unfair transactions are continuing
 - Too frequent change of largest shareholders
 - Capital fled away from stock market

Korean Experiences of Capital Market Revitalization

□ Capital Market Revitalization Measures in Korea

- Goal of capital market development policies
 - Capital market with efficiency, fairness, stability, and innovation
- Basic direction
 - Broadening and deepening capital market through enlarging and enhancing supply and demand conditions
 - Increasing efficiency and promoting innovation through improving infrastructure
 - Enhancing public awareness through ensuring market credibility and strengthening investor protection

Main policy measures in Korea

Main category	Sub-category	Measures
Enlarge and deepen market base	1) Differentiation of market segments	<ul style="list-style-type: none"> - Clarifying identification between KOSPI, KOSDAQ, and KONEX by strengthening management autonomy of each market - Easing of requirements for moving to upper markets
	2) Promotion of listing	<ul style="list-style-type: none"> - Reduction of IPO regulation - Education of SMEs for IPO - Introduction of SPAC (Special Purpose Acquisition Company) - Incentives for IPO management companies - Increase of IPO management company's role - Introduction of HTS (home trading system)
	3) Introduction of new products	<ul style="list-style-type: none"> - Invigoration of existing derivatives - Introduction of new derivatives products
	4) Increase of institutional investors' participation	<ul style="list-style-type: none"> - Enlargement of stock investments by public funds - Establishment of a stewardship code
Enhance efficiency and competitiveness	5) Reduction of trading cost	<ul style="list-style-type: none"> - Reduction of bidding unit - Introduction of electronic securities
	6) Improvement of market flexibility	<ul style="list-style-type: none"> - Enlargement of daily price movement limit - Publication of more information on firms
	7) Strengthening stabilization measures	<ul style="list-style-type: none"> - Circuit breaker, price limit regime, sidecar and restriction on short selling
Strengthen market credibility and public awareness	8) Enhancing market credibility	<ul style="list-style-type: none"> - Strengthening disclosure rules - Introduction of disclosure rules for short-selling positions
	9) Protection of investors	<ul style="list-style-type: none"> - Strengthening education of public notification - Strengthening of real examination system in KOSDAQ market
	10) Expansion of public awareness	<ul style="list-style-type: none"> - Education of the public on asset management - Settlement of sound investing environment and culture through investor education - Advertisement of success stories in capital market

Evaluation of Applicability of the Korean Experiences to Bulgaria

- Before extracting useful policy recommendations for Bulgaria from the Korean experience, we need to compare two markets and select which measures would be applicable to Bulgaria

□ Comparison of two countries

- Many differences but share some similarities
- Market conditions
 - Size and IPOs are small in Bulgaria
- Problems of capital market
 - Many similarities
 - Less activated in Bulgaria
- Policy measures
 - Various policies have been set up and tried in Bulgaria
 - The Exchange is even listed: in Korea, that is one idea to vitalize the stock market

Comparison of capital markets

	Bulgaria	Korea
Market size	Less than 10% to GDP	Over 90% to GDP
Stock price	No recovery after plunge	Recovery after plunge
Trading volume	Still small	Somewhat declined
Listed companies	Declined and little new IPOs	Recently increased

Comparison of problems

	Bulgaria	Korea
Supply condition	<ul style="list-style-type: none"> - Not many blue-chip companies - Little incentive to companies: small profit and compensation - Few access of start-ups and SMEs to the market: entry barrier - Debt financing >> equity financing 	<ul style="list-style-type: none"> - Very similar
Demand condition	<ul style="list-style-type: none"> - Little incentive to investors: small profit - Few instruments - High trading cost - Sensitive to external factors - Many restrictions for institutional investors - low trust of investors in the market - Frequent changes in regulation - Poor financial literacy 	<ul style="list-style-type: none"> - Very similar - Others: Too risk-averse, Large volatility, Short-term horizon and too high turnover ratio, Fleeing away of money, Too frequent change of largest shareholders

Evaluation of Applicability of the Korean Experiences to Bulgaria

□ Evaluation of applicability

- Consideration of fundamental differences of constraints
 - External constraints: the Bulgarian capital market is regulated according to the EU rules
 - Internal constraints: economic development and the practices in its financial system
- Based on the comparison of market structures, market conditions, and inherent problems, and also on the consideration of external and internal constraints under which policies are designed and implemented, we evaluated the applicability of the Korean experiences to Bulgaria
 - Among the policies implemented in Korea not only after but also before the global financial crisis, those in the first category to broaden and deepen the capital market base though enlarging and enhancing supply and demand conditions seem to be most applicable to Bulgaria
 - Some policies in the second category to increase efficiency and competitiveness of the market and financial companies through promoting innovation and improving infrastructure are also applicable. But most of them may not be unique experiences of Korea, and are expected to be adopted as the Bulgarian capital market introduces more advanced techniques for the capital market
 - Regarding the policies in the third category to ensure market credibility and enhance investors' trust through promoting market stability and strengthening investor protection, Bulgaria has already adopted higher requirements than Korea, following EU regulations. Only a few policies to enhance public awareness of the benefit of capital market will be desirable to apply to Bulgaria
- Summary table based on Table 2-8 and 2-9

Evaluation of applicability

Main category	Sub-category	Applicability
Enlarge and deepen market base	1) Differentiation of market segments	- KONEX market principle is applicable since Bulgaria is a SME-based economy
	2) Promotion of listing	- Relevant: Also limiting of delisting is needed
	3) Introduction of new products	- Not applicable: The Bulgarian market is still young
	4) Increase of institutional investors' participation	- Applicable: The pension funds can become a more important source of long-term financing of the economy, fostering capital market development
Enhance efficiency and competitiveness	5) Reduction of trading cost	- Not relevant: The infrastructure of capital market in Bulgaria is well developed
	6) Improvement of market flexibility	- Not relevant
	7) Strengthening stabilization measures	- Not relevant
Strengthen market credibility and public awareness	8) Enhancing market credibility	- Applicable: More measures are needed to improve corporate governance and FSC efficiency
	9) Protection of investors	- Relevant: But Bulgaria has stronger protection system
	10) Expansion of public awareness	- Relevant: Education programmes for companies, investors, and for public at large

Policy Recommendations

□ Selection of six policies

- From the comparison of two markets and from the evaluation of applicability of the Korean experience to Bulgaria, we specifically selected six policy recommendations, which are believed to be the most feasible and to have the most significant influences on revitalization of the Bulgarian capital market
- Supply-side linked suggestions
 - Establishment of SONEX
 - Adoption of IPO inducement Act
- Demand-side linked suggestions
 - Encouragement of institutional investment
 - Expansion of ESOP and PSOP
- Both-side linked and more general suggestions
 - Education on both supply and demand sides
 - Enhancement of market fundamentals

Policy Recommendations

□ Supply-side linked suggestions

- Establishment of SONEX
 - The KONEX market is particularly for SMEs at the early stage
 - Considering the market size and SME-based industrial structure in Bulgaria, it would be better to establish a KONEX-like market, say SONEX (Sophia New Exchange) market
 - Two things to consider: provide incentives to utilize the SONEX market, vitalize the transferring to the upper market
- Adoption of IPO inducement Act
 - There are several important features of the IPO promotion acts, in particular 1972 ACT
 - IPO was mandatory for the companies receiving above a certain amount of government financial support
 - There were big fiscal incentives for listed companies; lower corporate profit tax and recognition of special depreciation
 - The government provided special treatment for income tax on dividend revenue from listed companies.
 - Besides measures to promote IPOs, the Korean government also introduced a series of other policy measures including seasoned equity offerings

Policy Recommendations

□ Demand-side linked suggestions

- Encouragement of institutional investment
 - The Korean government introduced various plans to boost the stock market investment demand from institutional investors
 - The Capital Market Development Plan in June 1985 to mobilize pension money for stock investment, mostly from government employee pension funds
 - Very recently after the global financial crisis, the Korean government also enlarged stock investments of the Korea Post and banks, and allowed public funds to invest more than 10% of its assets in stocks
 - In Bulgaria, the size of public funds to GDP is relatively larger and they are believed to play a bigger role in revitalizing the capital market than in Korea
- Expansion of ESOP and PSOP
 - Employee's stock ownership plan (ESOP) and people's stock ownership plan (PSOP) to enlarge the investor base
 - The ESOP was first introduced in 1968, but began to be widely accepted after 1974, when the Korean government supplemented the plan with a package of supporting measures: a loan program for employees who wish to purchase company shares; bonuses and severance payments in the form of company shares; nonpublic firms' allocation of 10 percent of IPO stocks to employee stock ownership associations; and companies' sale of their shares at a discount to their employees
 - The PSOP was introduced together with the privatization of major state enterprises such as POSCO and KEPCO
 - Bulgaria has already adopted these policies. If these policies are implemented with supplementary supporting measures, they will also contribute to revitalization of the capital market in Bulgaria

Policy Recommendations

□ Both-side linked and more general suggestions

- Enhancement of market fundamentals
 - Ensuring market fundamentals are essential to lead to a successful result, together with good implementation of those policies
 - The introduction of the KONEX market achieved a great increase of the number of IPOs in Korea. Actually, there were many SMEs which wanted to access the capital market to raise funds, but were limited the opportunity in the existing stock markets or in the banking market. Once the Korean government launched the new market with lower entry barrier, many SMEs could join the market
 - To apply this experience to Bulgaria, the following questions should be considered, on the supply side. Are there a lot of Bulgarian SMEs which are willing to turn into public companies if the listing requirements become loosened? Are there many fast growing start-ups? Can they have easy access to bank loans and/or EU funding programs? Do venture capitals play some important roles in financing venture firms?
 - Also the successful implementation of this experience in Bulgaria needs ensuring of market fundamentals on the demand side. For a successful result, sustainable demand for risky stocks is required, which requires sufficient indirect investment base.
- Education on both supply and demand sides
 - Probably, the most basic precondition for capital market revitalization is public awareness of the benefit of stock market. The stock market provides benefits for companies on the supply side, for investors on the demand side, and for the economy as a whole.
 - In Bulgaria, the general public do not seem to well recognize these benefits of the capital market, and do not have much incentive to participate in
 - Expansion of public awareness about the benefits of the capital market through education of investors on the demand side as well as companies on the supply side is necessary to expand the market base and to recapitalize the capital market