INVESTOR BASE AS AN IMPORTANT FACTOR IN THE DEVELOPMENT OF CORPORATE BOND MARKET

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INVESTOR BASE AS AN IMPORTANT FACTOR IN THE DEVELOPMENT OF CORPORATE BOND MARKET

Abstract: The article aims to discuss and scientifically-practically analyse the role of investor base in the process of developing corporate bond market in a country. It is important to investigate fundamental factors in developing local corporate bond market. One of such important drivers of the bond market is the participation of investors. Based on research results, profound reforms could be introduced and it would be more effective in succeeding in the target. In the article, the corporate bond market in Uzbekistan has been analyzed in terms of the corporate bond investors including the current market instruments, major investors, recent innovations and constraints for increasing bond investors. Based on our research, conclusions and recommendations are made to extend the investors base on the way of stimulating corporate bond market in Uzbekistan.

Key words: corporate bond market development, investor base, institutional investors, liquidity, financial innovation.

Introduction

The promotion of well-functioning local currency bond markets is now more important than ever as economies in the region confront volatile capital flows resulting from uncertainty in global financial markets. Developed corporate bond market is likely to play an increasingly important role in reducing the negative impacts of volatile capital flows in countries. It is one of the major drivers for economies to focus on developing local bond market, as well as the consideration for capital resources for corporations. In Uzbekistan, recently the Development Strategy of Capital Markets in 2021-2023s has been adopted with the Presidential Decree on 13th of April, 2021.[1] In the introduction part of the strategy, it is claimed that efforts to attract large institutional investors with long-term financial resources to the capital market are slow and it should be accelerated. In the section 5 called “Expanding the investor base and increasing the financial literacy of the population”, it is noted that in order to provide a comprehensive solution to the existing problems of increasing the demand in the capital market and to stimulate the growth of demand in the capital market, it is especially important to take the following measures in various areas:[2]

- establishment of the procedure for remote opening of deposit accounts by legal entities, including non-residents of the Republic of Uzbekistan and application for initial public offering (IPO) and secondary public offering (SPO), purchase of government and corporate bonds and other securities;
- creating additional opportunities for non-residents of the Republic of Uzbekistan to purchase securities of local issuers;
- encourage the participation of insurance companies in the capital market;
- establishment of investment funds in cooperation with international financial institutions;
- introduction of sustainable mechanisms in the implementation of programs to increase financial literacy of the population on issues related to the capital market;
• Hold international conferences and other events to explain the essence, significance and implementation of the program.

**Literature review**

S.Thukral, S.Sridhar, and M.Joshi (2015) have concluded on the basis of their research on Indian corporate bond market development constraints that local institutional investors such as banks, insurance companies, pension funds and mutual funds are critical drivers of demand for debt securities in an economy.[3] According to O.Wyman (2015, April), investor base is vital to accelerate emerging capital markets.[4] R.Fabella and S.Madhur (2003) have analyzed several indicators of bond market development in East Asian countries and recommended a few initiatives to develop bond markets in East Asia should focus on, one of which is broadening the investor base.[5]

Hui Sui (2011), a Chinese scientist, has recommended to improve the corporate bond market in China that the variety structure of corporate bonds should be adjusted and innovated to pluralism. With the rapid development of national economy and increasing per capita disposable income, China’s current varieties of corporate bonds are far from satisfying investors’ demands.[6]

Heavy reliance on banks and lack of diversity among investors impede expansion of the investor base for corporate bonds. Corporate bond investors are primarily banks and insurance companies. The dominance of private placements is the main obstacle to widening the investor base. This is given as a challenge in local corporate bond market in the research by Seiwoon Hwang (2016)[7]

From Uzbek scientists, S.Elmirzayev, U.Berdiev and J.Buriyev (2021) have shed some light on the perspectives of corporate bond market in Uzbekistan and investor base is predicted to expand in the coming years.[8] S.Omonov and Sh.Otakhonova (2020) focuses on the essence and importance of institutional investors in the financial market as well as their activities in the global financial market.[9]

**Analysis and results**

Having learnt most researchers’ work on corporate bond market and its development, we have gathered main indicators of developed corporate bond market. There are several widely accepted factors as a precondition for well-functioning bond markets:
Expanding the investor base and diversifying bond products to suit investor preferences is critical to facilitating the corporate bond market. Corporate bond investors buy corporate bonds at the time of investment to receive pre-determined interest payments and principal payments until maturity. Even if the issuer performs well and reports high returns, the corporate investor will receive a fixed amount of investment benefit on a predetermined principal and interest payment. This makes corporate bond investors more likely to exhibit conservative investment behavior. To create a market that meets the needs of investors at this level, the issuance of corporate bonds by issuers with a stable credit rating is essential.

In contrast to issuers with relatively low credit ratings, it is necessary to develop a product scheme in which investors can share the profits of issuers. Such a scheme creates a market structure that meets the requirements of investors. In particular, warrants or convertible bonds can cover specific credit risk, creating an opportunity for investors to benefit. This helps investors with different risk profiles to offer conditions that can meet their individual needs through bonds with different structures.

What will help develop the corporate bond market are plans to expand the ranks of professional investors. Because corporate bonds have different credit ratings, complex structures, and large trading units, it is difficult to make investments public. This underscores the need for policy requirements to expand the investment base through indirect investment instruments. Professional investors are able to make large investments based on the analysis of the creditworthiness and product characteristics of issuers. Attracting professional investors and facilitating indirect investment instruments will certainly expand the investment base for corporate bonds.
When we look at the trade volumes and main bond investors in Uzbekistan’s bond market, during 2020, 79 deals were made with bonds of 4 issuers for a total of 67.34 billion UZS. The largest volume of deals was recorded with corporate bonds of JSC “Uzpromstroybank” (SQB6) - 49.85 billion UZS; in addition, the largest number of deals was made with them.

**Table 1. Trade reviews in corporate bond market in Uzbekistan in 2020**[11]

<table>
<thead>
<tr>
<th>№</th>
<th>Bond Issuer</th>
<th>Number of deals</th>
<th>Number of traded bonds</th>
<th>Volume of deals, mln UZS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Asia Alliance Bank</td>
<td>31</td>
<td>12932</td>
<td>13 418,5</td>
</tr>
<tr>
<td>2</td>
<td>Invest Finance Bank</td>
<td>1</td>
<td>1</td>
<td>1,0</td>
</tr>
<tr>
<td>3</td>
<td>Uzpromstroybank</td>
<td>35</td>
<td>49850</td>
<td>49 850,0</td>
</tr>
<tr>
<td>4</td>
<td>Uzbek Leasing International 1</td>
<td>10</td>
<td>250</td>
<td>2 528,6</td>
</tr>
<tr>
<td>5</td>
<td>Uzbek Leasing International 2</td>
<td>1</td>
<td>100</td>
<td>1 039,9</td>
</tr>
<tr>
<td>6</td>
<td>Uzbek Leasing International 3</td>
<td>1</td>
<td>50</td>
<td>504,9</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>79</strong></td>
<td><strong>63183</strong></td>
<td><strong>67 343,1</strong></td>
</tr>
</tbody>
</table>

The main buyers of corporate bonds were legal entities, the volume of deals of which amounted to 99.96% of the total volume. The predominant share was acquired by banks and insurance companies (44.55% and 27.17%, respectively).

Another essential condition which motivates corporations to buy corporate bonds is the presence of diverse corporate bonds meeting the demands and purposes of institutional investors. Corporations tend to purchase a type of corporate bond for the following four reasons.

**Figure 2. Main reasons for investing corporate bonds**[12]

Corporate bonds can be a lower-risk way to gain exposure to corporates than equities because they pay investors relatively stable cash flows. However, in
Uzbekistan both equity and stock markets are not exposed to volatility due to ineffective market structure. Therefore, corporate bonds are not especially used to reduce risk.

Corporate bonds are expected to provide investors with a relatively high excess yield over term deposits and government bonds in the medium term, as illustrated by the chart below, which shows the historical excess yield of the average coupon rate of corporate bonds Fund over term deposits.

![Yield Comparison in percentage, 2020](chart.png)

Figure 3. Yield comparison of corporate bonds and corporate bank deposits[13]

Investors in an actively managed corporate bond fund can spread their portfolio risk by being exposed to a range of issuers, industries and geographies. Typically, when investors have exposure to a large number (upwards of 100) of securities it minimises the impact of a default or systemic event on the portfolio. Nevertheless, there is a lack of diversity of different industries in the bond market in Uzbekistan, which makes allocating risk over industries for investors.

Table 2. Bonds review in the market[14]

<table>
<thead>
<tr>
<th>Issuer</th>
<th>Sector</th>
<th>Maturity</th>
<th>Bonds</th>
<th>Interest rate, (%)</th>
<th>Date of issue</th>
<th>Maturity date</th>
</tr>
</thead>
<tbody>
<tr>
<td>O’zbekiston Sanoat-Qurilish Banki JSCB</td>
<td>Banking</td>
<td>3-years 10-years</td>
<td>50 000 10 000 IR + 2 IR + 1</td>
<td>19.11.2019 10.08.2012</td>
<td>18.11.2022 15.08.2022</td>
<td></td>
</tr>
<tr>
<td>Kapitalbank JSCB</td>
<td>Banking</td>
<td>7-years</td>
<td>50 000 IR + 5</td>
<td>24.04.2020</td>
<td>23.04.2027</td>
<td></td>
</tr>
<tr>
<td>Asia Alliance Bank JSCB</td>
<td>Banking</td>
<td>7-years</td>
<td>45 175 IR + 4</td>
<td>28.06.2019</td>
<td>27.06.2026</td>
<td></td>
</tr>
<tr>
<td>Uzbek Leasing International JV</td>
<td>Leasing</td>
<td>1-year 2-years 3-years</td>
<td>8 000 8 000 9 000 18 19 20</td>
<td>03.02.2020 03.02.2020 03.02.2020</td>
<td>03.02.2021 03.02.2022 03.02.2023</td>
<td></td>
</tr>
<tr>
<td>Imkon Finans microloan organisation</td>
<td>Finance</td>
<td>3-years</td>
<td>4 000 23</td>
<td>15.12.2020</td>
<td>14.12.2023</td>
<td></td>
</tr>
<tr>
<td>Company</td>
<td>Sector</td>
<td>Duration</td>
<td>Amount</td>
<td>Devalu.</td>
<td>Start Date</td>
<td>End Date</td>
</tr>
<tr>
<td>-------------------------------</td>
<td>---------------</td>
<td>----------</td>
<td>---------</td>
<td>---------</td>
<td>------------</td>
<td>-----------</td>
</tr>
<tr>
<td>O’zavtosanoat JSC</td>
<td>Automotive</td>
<td>5-years</td>
<td>50 000</td>
<td>9</td>
<td>30.05.2017</td>
<td>28.05.2022</td>
</tr>
<tr>
<td>Uzreport LLC</td>
<td>Mass Media</td>
<td>5-years</td>
<td>30 000</td>
<td>n/a</td>
<td>03.12.2020</td>
<td>02.12.2025</td>
</tr>
<tr>
<td>First Developing Group LLC</td>
<td>Construction</td>
<td>1-year</td>
<td>5 125</td>
<td>8+devaluation</td>
<td>13.01.2021</td>
<td>12.01.2022</td>
</tr>
<tr>
<td>Mind Asia LLC</td>
<td>Construction</td>
<td>2-years</td>
<td>126 000</td>
<td>9+devaluation</td>
<td>29.01.2021</td>
<td>28.01.2022</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>395 300</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

We can see from the table that there are overall six sectors over industries in the current corporate bond market. Financial sector has been active in bond market as both an issuer and investor, particularly banks. In the recent years, other industrial companies have also started to apply to bond market to attract resources after the legal permission for Limited Liability Companies to issue bonds.[15]

In addition, some innovations have occurred in types of bonds to attract interest from investors, such as coupon rate with devaluation. Such changes drive the market as it meets some investors’ demands.

**Conclusion**

We can come to the following conclusions after analyzing the corporate bond market as for the investor base:

- investors and issuers base are too small to catalyze the bond market in our country and almost all the deals with bond contracts occurred in the primary market;
- there is no liquidity in the secondary market due to low demand for bonds and liquid corporate bonds are limited;
- diversity of bonds is limited over industries to allow companies to manage financial risk by investing over industries;
- yield to bond investment has been over the average deposit rate in the last year. However, risk rate ranges over coupon rates as well;
- some innovations have initiated to attract investors to corporate bonds and reduce some other external risks. As an example, we have seen that two construction companies have offered coupon rate attached to currency devaluation.

To sum up, in order to promote corporate bond market, investor base, especially institutional investors are of high essence. In Uzbekistan there is a lack of institutional investors except a few active banks. On the way of bond market development, it is important to make profound changes and improvements in this sphere. The following recommendations are made so as to increase investor base in our country:

- privatization should be made as soon as possible to pave a way for private business, which is fundamental for both economic growth and capital market development;
- developing private pension funds and insurance. They are the main players in the sound development of long-term bond market. There should be plans to
develop these investors because life insurance, pension funds and mutual funds are developments which improve the welfare of the population, but the plans will be longer-term. It may be possible to expedite the process by permitting foreign firms to enter the market for these products.

- legalizing some risky bonds to be introduced in the market without government registration in order to give speculative investors motivation to enter the market;
- Financial literacy among the population who will be the customers of these investors will need to be transformed. It will motivate individual investors to enter the bond market;
- Providing a supply of good, attractive investment products which are correspondent to the motives of investors’ objective in purchasing corporate bonds.

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