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# THE WAYS TO ATTRACT FOREIGN INSTITUTIONAL INVESTORS TO THE NATIONAL CAPITAL MARKET

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**Abstract**
*This article has researched the role of institutional investors in the development of capital market and theoretical and methodological aspects of their impact on economic growth through the capital market. Scientific and practical proposals have been developed to attract foreign institutional investors to the capital market of Uzbekistan. The article suggests that to attract foreign institutional investors, it is required to develop a set of measures aimed at implementing international accounting and financial reporting standards for national economic entities, ensuring transparency and openness of information, further improvement of implementation of corporate governance principles through the participation of institutional investors in management, increasing the stock capital value of national companies.*
*Keywords: capital market, institutional investor, securities, financial system, investments*

## INTRODUCTION

Recently, attention has been paid to the development of the capital market, to create all the necessary conditions for its effective functioning in particular, special attention is paid to improve the legal framework. Nowadays, if on the one hand it shows that it`s crucial to reform this field, when the stock market capitalization to the GDP ratio is less than 1%, and from the other hand it shows that the unused potential to stimulate stable growth of the national economy is high. At the same time, the development of the capital market makes it possible to prevent the dependence of the economy on the banking sector and to reduce the participation of the government in the banking sector.

As it shown in a capital market development strategy for 2020-2025, developed by the Capital Market Development Agency of the Republic of Uzbekistan, among the goals and objectives of the strategy, the priority is given to attraction of institutional and portfolio investors. The role of institutional investors in the management of the company differs from the role of minority shareholders.

Because institutional investors have more shares, they support investment and monitoring activities. Also, institutional investors, participate more actively in corporate management than minority shareholders. Moreover, institutional investors are significantly demanding for overseeing the management's accountability for stock performance.

## REVIEW OF RELEVANT LITERATURE

Some researchers believe that integration with the global market is associated with decrease of capital price, improvement of credit ratings, increase of the value of the national currency and real economic growth (3).

E. Kim and B. Singal have researched the volatility of stock returns, inflation and exchange rates after the removal of restrictions on capital flows in 20 developing markets. The results of research has shown that there has been a rapid improvement in stock returns since the opening of capital markets, driven by increased demand of foreign investors for local securities. But after this rapid growth, stock returns fell slightly. The reason for this was the expectation of low returns by investors. In general, the stock market is more efficient to collect data over long period of time, making it difficult to predict stock returns. Improvement of efficiency of the market and unpredictability of the cost of stock are closely related to growing integration with the global market. As foreign investors use the developing market inefficiencies, the inefficiencies fall and costs affect new data rapidly (7).

US investors found out, that there is less desire for ownership of stocks in corporate structures with a high risk of expropriation from the part of controlling insiders. Since in companies dominated by insiders, obtaining information and its access to shareholders is limited (4).

## ANALYSIS AND RESULTS

Based on international practice, the quality of governance of a particular country plays a key role in determining the target country by foreign investors.  For example investors in a country with a high quality of corporate governance view the quality of governance as a decisive factor for investment purposes. At the same time, for the investors from countries, with undeveloped corporate governance, the level of corporate governance of target country can be less important.

For instance, the main factor of investing in the US is that, the investors from countries with poorly developed financial markets are willing to invest in developed markets.

One more aspect is asymmetry of information. Local investors have some advantages in obtaining information compared to foreign investors. It results in higher cost for foreign investors.

But due to the deepening processes of globalization, foreign capital became an important source of financing in many capital markets, and foreign investors began to mobilize most part of the resources abroad (10).

In our opinion, the weak point of the investor protection system is the lack of information transparency related to its asymmetry of information, caused by poor governance system of the country.

Empirical researches have shown the implementation of modern accounting and reporting standards, ensuring the rights of shareholders and legal mechanisms serve to attract more foreign investment. [1].

It`s reasonable to mention a number of advantages of investing through institutional investors. In particular:

- Professional investment management through rational diversification. An investor, who invests his resources in such management, can be sure that he is working with successful professionals on this investment.
- Institutional investors deal with large trading volume which in tun results in lower commissions compared to private investors.

Some economists in development of the financial system distinguish phases based on bank, market and securities (11). In the bank phase whole finance distributes through banks, in the market phase securities market and institutional investors start to develop, and in phase based on securities the institutional investors become to lead.

In our opinion, based on the above classification, in the most of developing countries development of financial system is still in bank phase. In particular, in Uzbekistan, the volume of financing through the stock market cannot compete with bank loans.

Nowadays in Uzbekistan, the total par value of the issued securities is 92.35 trillion UZS, of which securities in circulation amounts to 1.4 trillion UZS, or 1.5% of the total number of issued securities. The ratio of the par value of issued securities in circulation to GDP is 0.4%. To compare this figure in Singapore is 188%; in Malaysia is 112% and in Russia is 34%.

However, it should be noted that even among developed countries, due to the peculiarities of the financial system model, there are differences in the development and leadership of the banking system and the securities market. For example, in the United States and in countries with the Anglo-Saxon model, the stock market is very large and has certain advantages over the banking system, while in the countries of continental Europe, especially in Germany, the leadership of banks can be noticed. Also in Japan, the banks perform specific functions depending on the scale of financing and their role in the management of companies.

On the average, in rich countries, banks, non-banking institutions and stock markets are larger, more active, and more efficient (8).

It is determined in international practice, that the liquidity of the stock market and the level of development of the banking sector are important factors affecting economic growth (9). In our opinion, stock market carries out endogenous factor, which causes economic growth, through stimulation of long-term investments. And bank credits have significant positive impact on stimulating economic growth in a relatively short period of time.

In addition, through the securities market, it is necessary to take into account the system of institutional investors that indirectly affect economic growth. In many researches there have been studied institutional investors, such as: connection between pension fund assets and growth of GDP (5). Nevertheless, institutional investors are more developed in financial systems, where the securities market is leading compared to banks.

However, the transformation and distribution of risks is admitted by some researchers as a weak point of Anglo-American capital market, which led by pension funds (2). In this regard, financial system based on leadership of banks, due to the monopoly dominance in financing of funds, the accumulation of reserves can reduce such risks.

However, in a model based on bank leadership, borrowed funds and capital ratios are so high, that it can lead to bankruptcy of large banks, which can have dangerous consequences for the entire financial system. That`s why in this model, important banks, which form the system, consider as the separate regulation object.

Usually institutional investors prefer to invest in countries with significantly high liquidity and market capitalization. Institutional investors also differ from performance-oriented retail traders, that they rely on a longer period to assess risk and return.

World practice shows that investments in countries that have shown good results in the reform process, expected having low risk and high returns. The successes achieved in liberalization, fiscal and regulatory reform, can provide for the country a large portfolio of investment flows.

It can be observed that in recent years rapidly developing countries have seriously started to increase the attractiveness of the national securities market for attracting foreign investment. For example, by the second half of 2018 Indian Board of Securities and Stock Exchanges announced a number of conveniences to attract foreign institutional investors to Indian market. Particularly:

- after the IPO, the period for listing shares on the stock market was reduced from 6 to 3 days;
- regulatory changes were made to facilitate the listing of local companies abroad;
- simplified “Know Your Customer” (KYC) requirements for foreign institutional portfolios / institutional investors;
- Bombay Stock Exchange and National Stock Exchange allowed to trade commodity derivatives.

In our opinion, to use the full potential of institutional investors in the development of capital markets in developing countries, it is necessary to implement the following two directions:

1. To form the system of national institutional investors. It`s mainly about investment banks, pension funds, insurance companies, investment funds (venture funds, mutual funds, exchange-traded investment funds), sovereign wealth funds. At the same time, institutional investors also play the role of market makers.
2. Actively attract foreign institutional investors into national capital market. Firstly, this will ensure the appearance of qualified institutional investors in the national capital market. Secondly, it will stimulate capital market and induce issuers involved in capital market, to comply with international standards relevant to the field. In our opinion, it would be reasonable for real and financial sectors to utilize the potential of foreign institutional investors in placing stable and promising companies’ IPOs and SPOs.

## CONCLUSION AND OFFERS

In our opinion, in Uzbekistan, the problem of dependence of economy on the banking sector cannot be solved in a short time. In particular, the level of assets of the banking sector is insufficient for the economy of our developing country.

Therefore, it is necessary to take measures to strengthen the participation of commercial banks in the authorized capital of joint stock companies. On the one hand, it serve as an important instrument of the bank`s investment activity; on the other hand, it increases the capitalization of the stock market. If sufficient conditions are created for the investment banking, this type of institutional investors will not only positively affect the quality of corporate governance, but also, through the formation of a corporate control market, will contribute to the emergence of external governance mechanisms by promoting the formation of a corporate control market.

In the current condition of low public confidence in the financial system and low financial literacy in Uzbekistan, the national system of institutional investors can play a decisive role in launching a mechanism for converting funds into investments. Therefore, it is necessary to take measures to soften the restrictions, related to existing legal form of institutional investors and investment activities, and to remove them in accordance with the development of the capital market.

To attract foreign institutional investors, it is required to develop a set of measures aimed at implementing international accounting and financial reporting standards for national economic entities, ensuring transparency and openness of information, further improvement of implementation of corporate governance principles through the participation of institutional investors in management, increasing the stock capital value of national companies.

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