ISSUES OF FINANCING COMPANIES THROUGH THE STOCK MARKET

Artikova D.R.

Head of the Educational-Production ,Engineering Department
"UzAuto Academy" Department,"UzAuto Motors" JSC

Abstract: This article discusses problems and prospects for the development of issues of financing companies through the stock market, and several methods of assessing the economic efficiency of investment projects, directions of potential improvement of capital market activity are highlighted.

Key words: Financing, company, stock market, securities, capital market, financial assessment, central banks, NPV, WACC, IRR.

In the world, special attention is being paid to further improvement of financing of financial stability of companies through the stock market, to ensure their financial stability, and to meet their needs for resources. According to the World Bank, "the share of stock market capitalization in GDP in 2020 was 450 percent in Singapore, 180 percent in Great Britain, 120 percent in Japan, and 118 percent in Germany [1]. " It requires the formation of a healthy competitive environment in terms of supporting the activity of joint-stock companies in the stock market, removing obstacles in transactions with securities, and attracting resources based on conducting a transparent and open investment policy.

All central banks have a vested interest in ensuring the stability and efficiency of capital markets. Capital markets are important sources of financing for the real economy; they help spread risks and promote economic growth and financial stability. The critical nature of a strong enabling environment defined by macroeconomic stability, market autonomy, a strong legal framework, and effective regulatory regimes should be considered. In addition, market development is influenced by factors directly related to the specific functions of the capital market, such as disclosure standards, investor diversity, internationalization and deep hedging, and the stock market, as well as an efficient and robust market infrastructure. The ideas, which include six key areas, outline realistic strategies for policymakers to strengthen these factors, while recognizing that some are beyond the remit of central banks.

Developed and deep capital markets can play an important role in financing economic expansion, as well as in financial stability and the conduct of monetary policy. The ability of capital markets to serve the real economy depends on systems that promote safety and operational efficiency. While the private sector and securities market regulators typically take the lead in developing robust markets, central banks are important actors because the depth and liquidity of financial markets affect central bank policy objectives and responsibilities.

Central banks play a crucial role in many economies in terms of strengthening the capital market ecology. They usually play a key role in government bond markets in collaboration with the finance ministry; and in countries with less developed domestically stable capital markets, central banks often control the development of trading and emission areas. They often play a role in monitoring important areas of the payments infrastructure, including the repo, fixed income and currency derivatives markets, in part by overseeing banks. Central banks have historically played an important role in developing and modifying capital and interest rate regulations, as well as other prudential policies affecting capital market developments. In addition, they

---

[1]World Bank data https://data.worldbank.org

regularly monitor the performance of domestic capital markets as part of their macroeconomic and financial stability obligations. The role of central banks in increasing the importance of the securities market in the financing of joint-stock companies in foreign countries is significant. Thus, central banks can contribute knowledge to interagency capital market initiatives by leveraging their perceptions of internal market functioning, broad meeting powers, and interests in well-functioning and efficient market transmission mechanisms.

The functioning of the capital market is complex and it is difficult to summarize it with a single general number. The task force identified four aspects of market development. The first measure is market size relative to GDP, which indicates the ability of the real sector to support investment requirements. Market access encompasses the range of issuers that finance their operations through capital markets, and together with the trading of various instruments that transfer risk between market participants, it comprises the second dimension. Liquidity measures determine the ease with which investors realize the value reflected in securities and a portion of transaction costs. Finally, measures of resilience quantify the ability of capital markets to perform their functions during periods of stress. To assess progress on these indicators, the working group analyzed the available statistical indicators and the results of the Group's survey of market participants. The following sections detail the results of the analysis for each of the four dimensions.

Taking into account the experience of foreign countries, as well as the recommendations of UNIDO (United Nations Industrial Development Organization), the evaluation of the effectiveness of investment projects is carried out on the basis of two criteria, that is, through financial and economic evaluation. Both of these criteria for evaluating the efficiency of an investment project complement each other. Financial evaluation is used in the analysis of liquidity during the implementation of the investment project. In other words, the task of financial assessment is to determine whether the company will have sufficient financial resources to fulfill its total financial obligations in order to implement the project within the specified period . Economic assessment is used to determine the potential ability of an investment project, to maintain the value of the funds invested in this project and to create a sufficient level of their growth rate.

Financial assessment (or financial soundness assessment) is an integral part of the investment process when investing in a proposed object. The investor does not have any relations with legal entities or individuals whose financial status is unknown. In countries with a developed market economy, it is normal for companies to publish their financial statements through the mass media or in the form of various collections. Information about the financial status of companies can be obtained through these collections. In world practice, several methods for assessing the economic efficiency of investment projects have been developed, which can be conditionally divided into two large groups:

- Simple (or statistical) evaluation methods;
- valuation methods based on discounting.

The first group includes:

- investment payback period (Payback Period, PP);
- coefficient of investment efficiency (Accounting Rate of Return, ARR).

The second group includes:

- the method of determining the net present value (Net Present Value, NPV);
- method of calculating the internal rate of return (Internal Rate of Return, IRR);

- the method of calculating the profitability of investments (Profitability Index, PI);
- method of calculating the discount payback period (Discount Payback Period, DPP).

Empirical evidence suggests that increased disclosure lowers borrowing costs. Between 1987 and 1991, Sengupta (1998) analyzed data from 103 corporations and found that greater disclosure was associated with lower issuance costs. La Porta et al. (2008) show that the size of a jurisdiction's capital markets is positively related to the existence of private enforcement mechanisms, such as disclosure, confirmation, and litigation rights, that allow investors to regulate transactions involving certain related parties or self-dealing. La Porta found a high correlation between stock market size and public disclosure regulations, as well as liability standards for non-compliance and an effective judicial system for enforcement.

Although the size of corporate capital markets is significantly related to the size of the institutional investor base, there are significant differences in the distribution of these assets between stocks, corporate financial bonds, and nonfinancial bonds. This suggests that, given the size of the institutional investor base, individual market development is determined by other factors such as laws and path dependence.

Institutional investors and capital markets have a two-way relationship. Capital market development allows collective investment funds to achieve economies of scale. This results in lower asset management fees, allowing additional savings to be financed through capital market investments.

Three main signals emerge from the evolution of capital markets over the past two decades. To begin with, there are persistent and material differences in the size of capital markets relative to GDP between economies. Second, fixed income markets have experienced rapid growth, bringing current balances closer to stock market capitalizations.

While the total market value of outstanding securities relative to GDP remains a key indicator of market size, it should be interpreted with the caveat that it reflects price changes that can be quite significant in addition to cumulative net issuance. Given this, the size of the equity market will remain relatively stable on average, while the size of the fixed income market will expand. Capital markets in developing countries have generally deepened, but they remain smaller than in developed countries.

Between 2000 and 2017, the average stock market capitalization of advanced economies (AE) grew from about 85% to 115% of GDP, while the capitalization of the emerging market (EME) group more than doubled, from 25% to almost 60% of GDP. When free swimming is considered, the difference between AE and EME becomes larger. On average, in EME, the free share of the total capitalization of the capital market is about 50%, while AE has an 80% share in the stock markets. However, when measured by issuance, EME and AE equity markets are more comparable. Since 2005, AE has raised approximately 0.95 percent of GDP through equity issuance each year. In 2011–17, annual equity issuance in EMEs averaged 0.75 percent of GDP, down from more than 1 percent in the previous five years.

Reliable, publicly available information is critical to the functioning of healthy capital markets. Well-designed accounting systems with prompt disclosure and high levels of transparency reduce the cost of information acquisition for diversified investors, saving them from what could otherwise be a repetitive, expensive, and highly asymmetric process of information gathering. Rules requiring prompt disclosure of material information, as well as the prospect of legal or regulatory penalties for violations, allow potential investors to determine the value of securities offered for sale in the primary and secondary markets, as well as detect market abuse. Improper disclosure has a number of negative consequences for market activity.

To begin with, incorrect or misleading information provided before market difficulties can lead to adverse selection. Second, delaying disclosure of material information creates moral hazard by giving insiders time to profit from trades or avoid losses. Both of these factors contribute to the loss of investor confidence in the market. Conversely, increased disclosure allows minority investors to take steps to prevent or sanction insider self-dealing. Based on the findings on the main drivers of capital market development, six broad areas have been identified as potential improvements in capital market performance:

1. Increasing market autonomy;

2. Strengthening the legal and judicial system;

3. Increasing the independence and effectiveness of regulation;

4. Deepening the base of local institutional investors;

5. Seeking to open bilaterally to international participation while preparing for deployment; and

6. Deregulation. The importance of these policy lessons varies from economy to economy, and most are not directly controlled by central banks. Nevertheless, they affect the viability of financial markets and the ability of central banks to achieve their objectives. Moreover, comprehensive initiatives that take into account a number of relevant characteristics may be more successful in building viable capital markets.

Financial repression - a policy that hinders the growth of capital markets and weakens the allocative efficiency of the economy - hinders the development of the capital market and reduces allocative efficiency. Thus, eliminating restrictive regulations and supporting market autonomy is an important step towards creating sustainable capital markets.

Funding sources are mainly attracted to finance some type of investment projects.

During the implementation of the investment project, initial and current costs are used. Base, forecast and calculated prices in soums and any other currency are used in their calculation.

1. Base prices - do not change during the calculation period and are defined as the market price at the time of calculation (N_b).

2. A forecast is a price to which corrections should be made, taking into account price dynamics, without taking into account inflation.

$$= \quad * \quad (1)^2$$

In this case, – t is the index of cost change in the accounting period compared to the initial period of the period.

Calculated - used to forecast the outcome of the project:

$$_h = \quad * \quad (2)^3$$

Here, is the inflation index.

A discount factor to bring all investment costs and their results to the same indicators at the initial stage
is used. This is calculated according to the following formula:

$$\alpha = \frac{1}{(1+E)^t} (3)^4$$

---

[2]Joëlle Miffre, The Conditional Price of Basis Risk: An Investigation Using Foreign Exchange Instruments, JBFA, August 25, 2004

[3]Joëlle Miffre, The Conditional Price of Basis Risk: An Investigation Using Foreign Exchange Instruments, JBFA, August 25, 2004

[4]John H. Cochrane, Discount Rates, Working Paper, April 2011

Here, t is the period, E is the discount rate, this indicator is determined independently by the investor company. In most cases, companies use their cost of capital as a discount rate.

Indicators such as net present value (NPV), profitability index (PI), internal rate of return (IRR) and payback period (PP) are used to determine the efficiency of the project. They are calculated using the following formulas:

1. NPV is net present value

$$NPV = \sum_{t=0}^{n} \frac{CF_t}{(1+R)^t} - I_0 \quad (4)[5]$$

In this case, if n represents the t period, CF is cash flow; I0-initial investment; R is capital appreciation.

If the NPV is greater than zero, then the project can be accepted; if the NPV is less than zero, then the project should be rejected.

The rationale behind the NPV method is very simple. If the NPV is zero, then

therefore, the cash flows from the project are sufficient

a) compensation of invested capital

b) providing the necessary income for this capital.

If the NPV is positive, then the project is profitable, and the greater the value of NPV, the more profitable this project is. If the company approves the project with a zero NPV, the return to the shareholders will remain the same - the company will get bigger, but the stock price will not increase. However, if the project has a positive NPV, shareholder returns and the market value of the stock will increase. The main factors to consider when evaluating NPV are cash flows and the discount rate.

The most important and most difficult step in the analysis of investment projects is the assessment of all cash flows associated with the project. First, it is the amount of the initial investment (outflow of funds) today, and secondly, it includes the values of the expected annual cash inflows and outflows in the following periods.

It is very difficult to accurately estimate all the costs and revenues associated with a large, complex project. For example, if the investment project is related to the introduction of a new product to the market, then in order to calculate the NPV, it is necessary to make a forecast of product sales and estimate the selling price per unit. These forecasts include the general state of the economy, elasticity of demand (dependency of the level of demand on the price of the product), the potential effect of advertising, consumer
based on an assessment of the advantages and the reaction of competitors.

In addition, it will be necessary to make a forecast of operating costs (payments), and for this it will be necessary to estimate in advance the future prices of raw materials, wages of workers, utilities, changes in rental rates, exchange rates.

The discount rate in the NPV formula is the cost of capital for the investor. In other words, it is the interest rate at which the investor company can attract financial resources. In general, a company can get funds from three sources:

- Debt capital (bank loan, bonds)
- Equity (shares)
- Use of internal resources (retained earnings)

---

[5]OndĜej Žižlavský, Net present value approach: method for economic assessment of innovation projects, 19th International Scientific Conference; Economics and Management 2014, ICEM 2014, 23-25 April 2014, Riga,
Latvia, 2014

Financial resources from these three sources come at a price. Debt capital does not cause any complications. This is either interest on long-term loans required by banks, or interest on long-term bonds if the company can issue debt instruments on the financial market. The cost of financing from the other two sources is more difficult to estimate. For such an assessment, financiers have long developed several models, the most widely used of which is the CAPM (Capital Asset Pricing Model). But there are other approaches.

The company's cost of capital (and the discount rate in the NPV formula) is the weighted average of the interest rates from these three sources. In financial literature, it is called WACC - "Weighted Average Cost of Capital".

1. PI is the rate of return. The rate of return is a relative indicator describing the level of income per unit of cost, that is, the higher this indicator, the higher the return on investment capital. If the rate of return on investment is equal to 1, then the investment is not profitable, and it will not be profitable, if the rate of return is less than 1, then the investment is unprofitable, if it is more than 1, then it is profitable.

The return on investment indicator can be used before the start of the investment, at each stage, and at the return of the investment. The use of the profitability index at different stages of investment allows the company to compare the real profitability of the project with previously estimated indicators. It is also worth noting that the profitability indicator is very convenient when choosing one of several alternative projects with the same indicators of the net present value of NPV, or when forming an investment portfolio or choosing one project with the maximum NPV when investing in indexes.

$$PI = \frac{NPV + I_0}{I_0} = \frac{PV}{I_0} \text{ (5)}[6]$$

In this case, NPV is the net present value;

PV - total monetary income from the project (discounted income);

$_0$ is the initial investment of the project, in soums.

2. IRR is the internal rate of return. IRR or Internal Rate of Return is the interest rate at which the present value of all cash flows of an investment project (i.e. NPV) is equal to zero. This means that at this interest rate, the company can return its initial investment as an investor. First, IRR is considered the internal rate of return or also the internal rate of return.

$$NPV = \sum_{t=0}^{n} \frac{CF_t}{(1+IRR)^t} - I_0 = 0 \quad (6)_{[7]}$$

In this case, if n,t represents the period,

CF is cash flow,

IIR is the internal rate of return.

The economic efficiency of investment projects is considered in terms of various criteria. Some of them show purely economic indicators, while others show the financial advantages of the project compared to others.

Determining the effectiveness of the use of investments is calculated depending on the investment goals, project implementation conditions and other characteristics. The methods used for calculations are divided into accounting (statistical) and discounting (dynamic) methods.

---

[6] Carlo Alberto Magni, ROI and Profitability Index: A Note on Managerial Performance, SSRN Electronic Journal, January 2015

[7] Carlo Alberto Magn , The Internal-Rate-of-Return approach and the AIRR paradigm: A refutation and a corroboration, The Engineering Economist, forthcoming

Accounting methods for evaluating the efficiency of investment use are used for the initial examination of investment projects, they can be used only in the short term when there are realistically calculated indicators at the beginning and end of the period. The essence of such methods is the comparison of information on benefits, costs and profitability.

References:

1. World Bank data https://data.worldbank.org
2. Joëlle Miffre, The Conditional Price of Basis Risk: An Investigation Using Foreign Exchange Instruments, JBFA, August 25, 2004
3. Joëlle Miffre, The Conditional Price of Basis Risk: An Investigation Using Foreign Exchange Instruments, JBFA, August 25, 2004
4. John H. Cochrane, Discount Rates, Working Paper, April 2011
5. OndĜej Žižlavský, Net present value approach: method for economic assessment of innovation projects, 19th International Scientific Conference; Economics and Management 2014, ICEM 2014, 23-25 April 2014, Riga, Latvia, 2014
6. Carlo Alberto Magni, ROI and Profitability Index: A Note on Managerial Performance, SSRN Electronic Journal, January 2015
7. Carlo Alberto Magn, The Internal-Rate-of-Return approach and the AIRR paradigm: A refutation and a corroboration, The Engineering Economist, forthcoming
8. Aligoriev OF Procedia of Theoretical and Applied Sciences. Volume 11 | Sep 2023, ISSN: 2795-5621 Available: http://procedia.online/index.php/applied/index
9. Aligoriev OF The Importance of Basic Financial Instruments Used in Islamic Banking. Texas Journal of Multidisciplinary Studies Peer Reviewed International Journal Volume 23 (2023) ISSN: 2770-0003. Available: https://zienjournals.com/index.php/tjm/article/view/4351