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NEW INSTRUMENTS IN ATTRACTING INVESTMENTS: THE CAPITAL MARKET AND ETF AS AN IMPORTANT FACTOR IN INCREASING THE INVESTMENT ATTRACTIVENESS OF THE REGION

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ABSTRACT

The article discusses alternative ways to increase investment attractiveness, including through the activation of the capital market and the introduction of new instruments. As well as, the author presents the essence of ETF and its working mechanism.

KEYWORDS: *Investment Attractiveness, Investments, Capital Market, Stock Exchange, Denationalization, Privatization, Stocks, Bonds, Mutual Funds, ETF.*

1. INTRODUCTION

In recent years, in all spheres of society of the Republic quality changes have been taking place, in particular, special attention is paid to unlocking the economic potential of the region. It is important to note that the further development of the economy, its reform and restructuring mainly depend on the intensification of investment activity, optimization of the legislative framework and the introduction of new instruments to increase investment attractiveness. The main source of ensuring the welfare of the region is investment in the formation and development of industries. A necessary condition for solving the problems of mobilizing finance is the choice of the optimal investment instrument. Today, the capital market could act as such an instrument. As the experience of foreign countries shows, the stock market is one of the main sources of additional financing for enterprises and one of the most effective mechanisms for attracting investments for further development of production.

As for the capital market of Uzbekistan, since 2018, significant changes can be noticed in this area. Thus, over the past 3 years, several IPOs and SPOs of large industrial enterprises have been held, an increasing number of private investors are being attracted, and systematic work is underway to attract the population to investment activities, including by improving its financial literacy. Despite a significant increase in exchange turnover (see Figure 1), the country's securities market lags far behind even the capital market of the nearest neighboring countries. For example, the turnover of the Kazakhstan Exchange in August 2021 alone amounted to 898.1 million US dollars. The main reason for this delay is the imperfection of the market infrastructure and the lack of a range of investment instruments. In addition, the fragmentation of exchanges, whose activities are regulated by different legislative acts (sometimes contradicting each other), different trading mechanisms in many respects oppose the full development of the market. At the moment, only such types of securities as shares and corporate bonds are represented on the stock exchange, while it is possible to purchase government bonds on the currency exchange and it is possible only for banks. **[1]**

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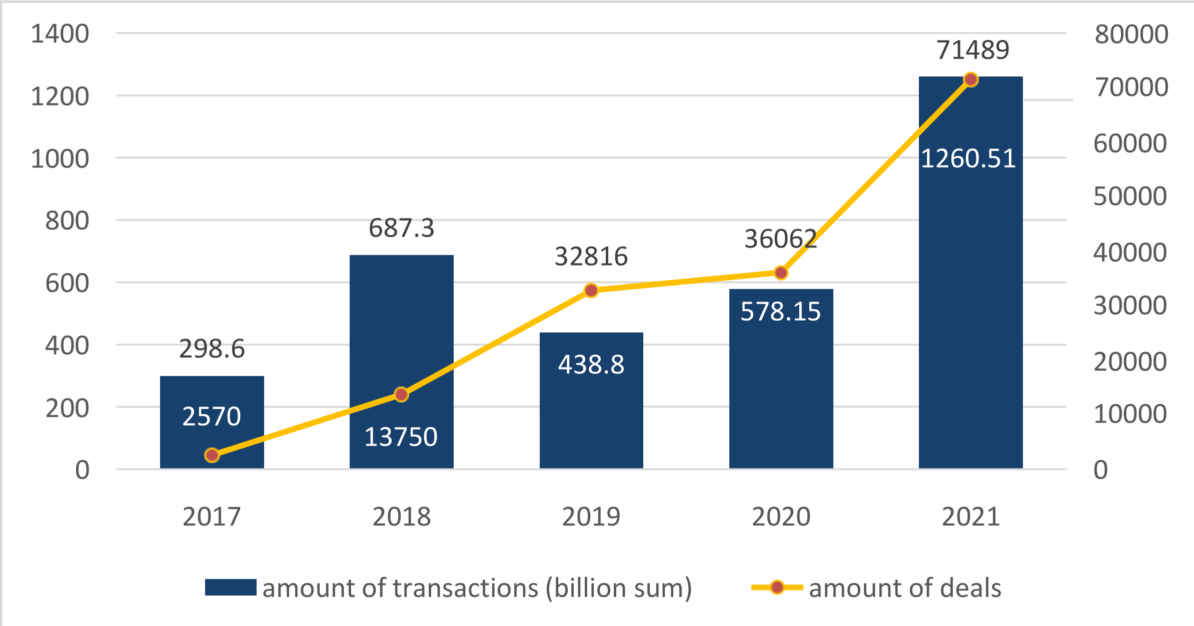
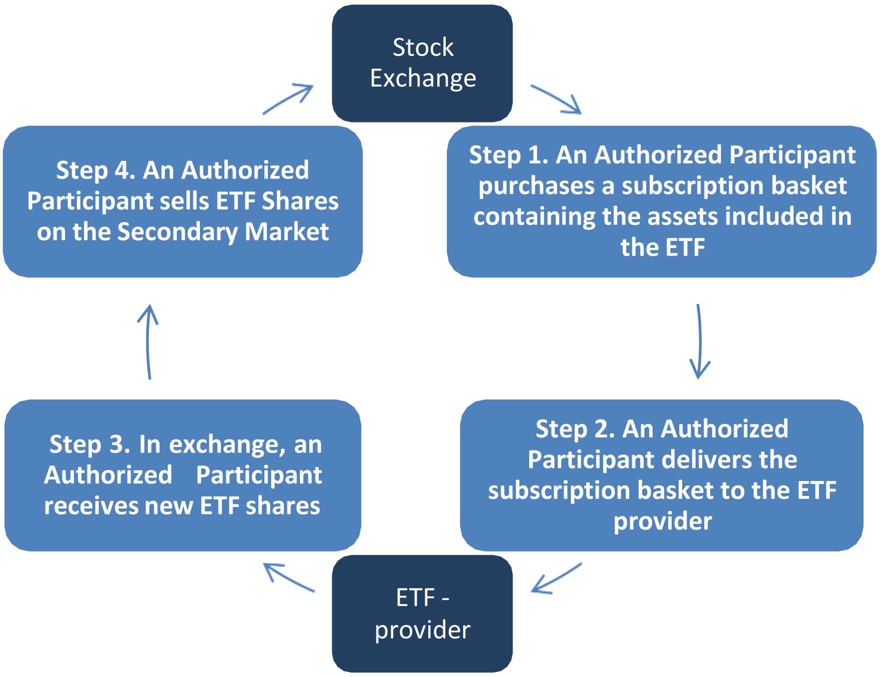
FIGURE 1 EXCHANGE TURNOVER OF THE RSE "TOSHKENT" FOR THE PERIOD SINCE 2017



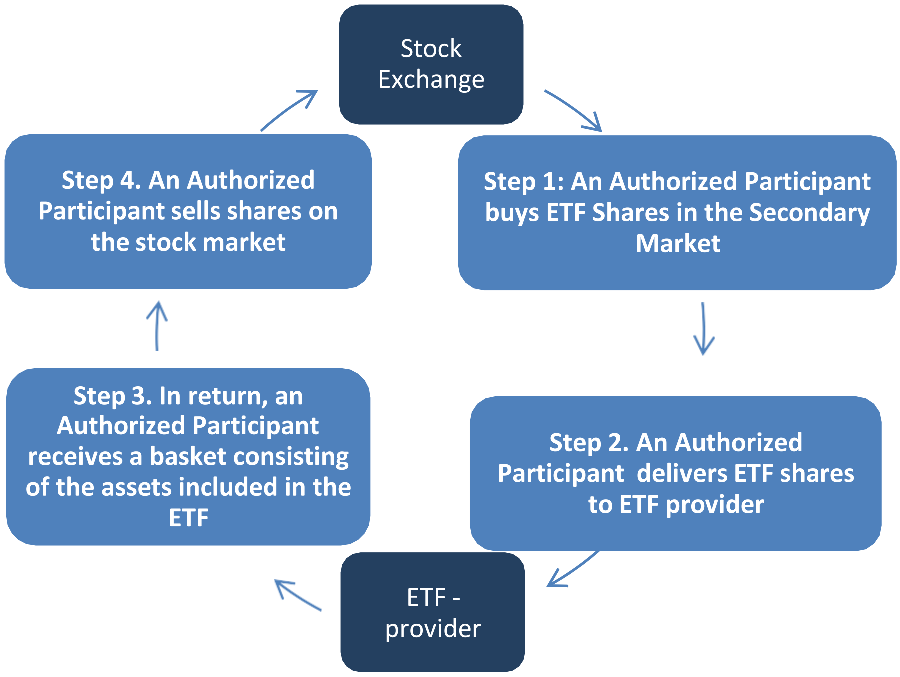
The implementation of derivative financial instruments, depository receipts, exchange-traded bonds and other types of securities, their free circulation on the stock market will attract both foreign and local investors. One of the most effective and popular instruments in the world markets is the ETF. ETF (Exchange Traded Fund) is an exchange-traded collective investment instrument traded like an ordinary share and allows you to gain effective access to a “basket” of instruments without buying each asset included in it separately. ETFs can be issued for stocks, bonds, commodity indices, real estate, and exclusive commodities such as gold.

Taking into account the measures taken by the government to reform enterprises with the participation of the state and privatize state assets, the sale of the state share of some enterprises by combining them into one portfolio and launching them on the market in the form of ETFs would significantly speed up the process of denationalization and attract more investors to the market, including local ones. More than 82% of large portfolioof shares that put up for sale in one lot on the special platform for accepting applications of the RSE "Toshkent" to determine a potential buyer for concluding transactions in the negotiation auction section of the Nego Board has been put up several times and even the price reduction have not cause to its sell. Unlike mutual funds that is familiar from the first wave of privatization in the 90s, ETF is more accessible to a wide layer of investors, and the infrastructure of authorized participants and administrators/custodians ensures the functioning of a continuous subscription and continuous mechanism both in money and in kind (in this case, the authorized participant hands over a basket of securities appropriate to the fund's investment objective and in exchange receives new shares in the ETF). **[2]**

FIGURE 2. SUBSCRIPTION PROCESS



With an efficient subscription and redemption process, the price of an ETF always remains close to its fair value. Since an ETF is traded like a stock, its price can fluctuate throughout the trading day due to supply and demand dynamics. If the price of the ETF at some point begins to significantly exceed the fair value, the authorized participant first analyzes the deviation and compares it with the costs of arbitrage transactions. If the cost deviation exceeds the threshold value, it is worth to act. To realize this, an authorized participant purchases a basket of assets (stocks, bonds) in the underlying market in proportion to the index. He then changes a basket of stocks or bonds directly in the fund to ETF shares and sells them on the market, bringing the price down to a fair price. **[3]**



The reverse is also fair: when an ETF is traded well below than its fair price (at a discount), an authorized participant buys shares in the ETF, exchanges them from the fund for shares in the companies that make up the index, and sells them on the open market of the basic assets.

Thereby, the arbitrage process keeps the ETF share price close to the fair value of its basic assets. How close the price will be to fair value is determined by the liquidity of the basic assets (how close are the buying and selling prices of the instruments that make up the fund in the market), as well as the costs of arbitrage operations - the cost of executing transactions in the ETF market and basic assets (brokers' commissions) and capital required for arbitrage operations.

The second important advantage of the subscription and in-kind redemption process is the reduction in the costs of the fund itself and its final investors. All costs associated with new ETF share subscriptions or its redemptions are held by the authorized participant. Unlike trust funds (or mutual funds), they are not passed on to investors.

According to Greenwich Associates, the share of ETFs in the portfolios of US institutional investors increased from 19% to 25% over the year. Such growth, according to Greenwich analysts, is due to the migration of institutional investors' assets from active funds to passive ones. In this case, the purposes of use could be completely different. Thus, 72% of respondents use ETFs for tactical allocation, 56% for international diversification, 68% as the main portfolio allocation, and 54% for liquidity management. The main reason for using ETFs by institutional investors is their ease of use, low fees, liquidity, and easy access to various markets and assets. **[4]**

Thus, it is possible to say with certainty that the capital market could serve as the most effective and modern instrument for attracting foreign investment. As well as improving the infrastructure in general and the introduction of ETFs in particular, it will not only attract more investors to the market and speed up the privatization process, but also activate the capital market and help increase the investment attractiveness of the region in the international arena. The development of the domestic stock market and the strengthening of positions at the international level is a necessary condition for ensuring continuous share and debt financing of enterprises, which in turn will increase the competitiveness of the national economy in the international arena. **[5]**

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