Advantages And Risks Involved In Financing Companies Development Through The Capital Market

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Abstract: The financial market offers to companies a certain number of sources of for financing, each of them, or a combination of them, representing the optimal solution, at a certain moment, for a particular investment. The choice of financing methods depends on the volume of financial resources required, the period of time they are intended to be mobilised, the price of the borrowed resources and, in particular, on the ability of the firm to repay the contracted funds. Through the stock exchange, the economic agents aim to obtain the financial resources necessary for the development of their activity and, at the same time, the transformation into liquidity of the securities (whose issuers they are), both in order to capitalize their current performances and to cover the risks associated with them. This paper wants to show that the stock exchange is one way for shareholders to recover their investments. Thus, the listing of the financial securities on the stock exchange ensures their dissemination to the holders of capital and allows the shareholders to recover the invested capital and to collect the added value with which the risk assumed at the time of acquisition of the respective securities is remunerated.

Key-Words: securitie, bonds, capital market, stock exchange, financial risk, bank loans, stock exchange listing

1. Advantages of financing the firms through the capital market compared to the banking market

Self-financing is the main option for an activity development. But when their own sources are not sufficient, firms have to resort to raising capital, through various forms of lending, either from the banking market or from the capital market.

The financing of firms through borrowed resources is a very difficult decision, which can affect not only their economic and financial performance, but even their ability to survive. To these factors are added the way of managing the activity, the company's relations with suppliers and customers, the management of the revenue and payment flows, as well as the financing policy of the company, the way in which it decides to use the profits resulting from the current activity. Depending on all these factors, as well as other factors specific to each company, they must opt for one of the following external financing solutions:

- Bank loans (loans), contracted for different periods of time (short, medium or long term);
- Financing obtained through the capital market, through the issuance of shares or bonds.

Each of these financing options has both advantages and disadvantages, which will make them more or less attractive for those looking for financial resources.

Bank loans are currently, on the Romanian market, a less used form of acquiring financial resources necessary for the development of the economic activity of a company. Whether it is a question of short credit terms, usually used for the purchase of goods and services and to finance an operating cycle, or long-term loans to finance investments or real estate purchases, bank loans are no longer preferred by economic agents, as was the case in the early 2000s (to the detriment of capital market loans).

However, banking companies have increasingly diversified their credit offerings for corporate clients. Loans are granted for the construction of new production facilities or capacities, for the expansion, modernisation and upgrading of existing capacities or for the purchase of machinery, equipment, means of transport or other fixed assets. There are also loans for large enterprises or small and medium-sized enterprises that meet the repayment capacity of each potential borrower.

In general, the amount of the loan that can be contracted is established depending on the scale of the investment project, and the duration of granting the loan is established depending on the size and complexity of the project, the volume of the loan, as well as the repayment capacity of the debtor.

However, financing through a long-term bank loan has the disadvantage of high costs and an increase in the firm's indebtedness, factors that may affect its activity in the next period (for example, it may affect the eligibility of the firm for certain tenders).

As regards the granting of lending, the European banking sector faces a major challenge, and namely non-performing loans (NPLs), which are putting enormous pressure on national banking systems. Non-performing loans have a negative impact on banks' profitability and their ability to lend including SMEs. In consequently, policies aimed at improve banks' capacity to deal with non-performing loans are very useful. Possible solutions include:

- ✓ ways to promote frameworks and foreclosure frameworks, more efficient and predictable, that allow for rapid recovery of by secured creditors;
- ✓ mproving transparency so that potential buyers in the secondary market for non-performing loans to acces the market for these loans.[1]

Financing through the capital market is an alternative to bank loans. This alternative takes the form of public share and bond issues. In fact, one of the particularly important roles of the capital market is to attract financing for companies that want to grow their businesses.

Capital market financing is more advantageous than financing through banks. In the case of bank financing, firms are at the beck and call of banks and their regulations to raise the funds they need to do business, but when securities are issued to the public, the issuing firm dictates the terms on which the securities are sold. Listing a company on the Stock Exchange also brings benefits in terms of the cost of financing, i.e. attracting financial resources at favourable cost conditions, as well as improving its image.

If until 2005 few companies were interested in entering the stock market ring, but on the contrary, many companies opted to withdraw from the Stock Exchange, since 2005 more and more companies want to be listed on the Stock Exchange. Between June 2019 and May 2020, the main sources of financing used by companies remained internal resources, becoming more important than external resources during this period, mainly due to the substantial advance in profit reinvestment and asset sales, with 37% more companies preferring this type of financing than in the previous period. Bank loans remain a much less used option, and the number of companies opting for commercial loans and bank overdrafts continued to decline over the period[2].

The Bucharest Stock Exchange offers a financing alternative both for mature companies, which can attract capital on the Main Market, and for start-ups and small and medium-sized enterprises, for which the AeRO market was created. Shares and bonds can be issued on both markets. The main reasons that can lead a firm to start listing procedures on the stock exchange may be the growth of the firm and its market to a level that requires financing.

The participation on the capital market has as a first stage the transformation of the joint stock company from "closed company" into "open company" by making a public offer authorized by the ASF (Financial Supervisory Authority). The objective of this public offer is to attract money from the capital market through new issues of other securities (shares, bonds, etc.). The public company must draw up a public offer prospectus stating that it plans to list on the stock exchange as a next step. Listing on the Stock Exchange facilitates any subsequent operation to raise capital from the market, thus enabling the company to find the necessary resources to further develop its business. Compared to the "closed" companies, where the real value of the shares is more difficult to measure, the companies that have the shares registered at the BVB Share can more easily resort to loans, because the creditors find it easier to use the stock market value of the already existing shares, than the theoretical approximation they have to make in the case of unlisted issuers.

In general, investors are tempted to buy shares of issuers quoted or to be quoted rather than unlisted ones. This trend will facilitate the "open" companies registered with the BVB Share, the successful conclusion of new securities issues and the attraction of such important financial resources on the capital market.

The registration at the BVB Share brings with it more practical ways of financing, materialized by the existence of a wide range of instruments specific to the capital market. This category includes issues of

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[1] FMI, Global Financial Stability Report, April 2014 and April 2015.

[2] Sondaj privind accesul la finanțare al companiilor ... – BNR https://www.bnr.ro › DocumentInformation

convertible bonds or shares with warrants attached. These instruments grant the subsequent purchase right of the issuer's shares at a predetermined price. Investors will be attracted faster to the purchase of such instruments, which give the right to buy further shares listed on BVB, than unlisted, due to transparency and accessibility on this stock market.

Another advantage of listing the shares of a company on the stock exchange is advertising. All companies that have securities registered with the BVB Quota benefit from publicity in the country and internationally, through the following ways:

- the appearance of the name of each company in the pages of the main newspapers and on the tv stations in the country, after each trading session;
- the appearance of the name of the issuers listed on the international network Dow Jones telerate.

Also, companies that have securities registered with the BVB Quota enjoy a reputation that can lead to the growth of the commercial market segment on which they operate, which is an important element against competition. The growth of reputation is manifested directly – through the commercial credit and payment facilities that the issuer can obtain from its suppliers and customers.

International statistics show that the admission to the stock exchange of securities issued by a publicly owned company increases its reputation and there is an increase in the price of its shares by an average of about 20%.

The listing of securities issued on the BVB increases the value of the company's assets, since when the issuer's business is in good condition, the market value of its shares is higher than their book value, as they are in high demand on the market and, as a result, command an increasingly higher price. Listing on the stock exchange also increases the goodwill and liquidity of the securities.

The Bucharest Stock Exchange is a specific institution of the capital market, which by its means requires listed companies to distribute information related to their activity and financial situation to the general public. This information reaches the final investor directly or through studies by analysts and specialized consultants. The transparency of the issuers quoted on the BVB contributes to the easy tracking of transactions and quotations on the stock market and attracts investors through easy and fair access to this capital market, thus increasing the liquidity of securities. Other advantages offered by the listing on the stock exchange of the shares of a company:

- **the interest of the employees through the distribution of shares –** by the transparency of the market avoiding the social tensions that could arise at a certain moment;
- **the existence of a recognized value on the market –** the potential creditors of the emitter having the possibility to compare the book value of the shares with their market value;
- **increasing the market manager's share** – this being influenced by the activity of the listed company, a situation known on the market;
- **simplifying the registrations in the shareholders' registers**, the issuers registered with the BVB Quota concluding a Register Contract with BVB, by which the obligation to keep records of the ownership right of the issued securities is transferred to the BVB;

A possibility of financing for Romanian companies is the listing on other exchanges. The main advantages offered by this solution are:

- better protection of small investors;
- increasing the volume of transactions and liquidity of shares;
- access to financing sources at a level well above what the Romanian capital market can offer.

But listing on other exchanges is risky because investors' interest in those securities cannot be estimated.

2. Issue of the financial securities - a source of medium and long-term financing of companies

The capital market performs a particularly important function, namely to attract financing resources in the medium and long term for expanding companies, and not only. This way of financing involves the public issuance of shares and bonds, a simple action, but which is often avoided by companies, bank loans being preferred, although the latter are not always the easiest ways to attract financing. Thus, most Romanian companies gather to the banks' counters trying to meet the increasingly complex criteria required for financing, given that, on the capital market, in the case of public securities issues, it is the issuing company that dictates the conditions under which the sale is made, the only constraint being the meeting of the offer with the investors' demand, so that the sale is successful.

So, the firm that needs money to develop its activity or finance an investment project puts up for sale financial securities (shares, bonds etc.) through a financial investment services company (SSIF), and the money paid by the buyers of these securities goes to the issuing firm, which uses them for investments and development.

Public offerings are special operations through which large packages of shares are bought or sold. As a result, public tenders can be divided into two main categories:

1. **Public offers for sale**
2. **Takeover bids**

Offers for sale are divided, too, into two other categories:

1a) Primary public offers – through which the newly issued shares are put up for sale, in order to obtain financing sources, the money resulting from the sale being collected by the company issuing the shares.

1b) Secondary public offerings – through which a shareholder sells existing shares on the market, the money resulting from the sale being collected by the selling shareholder of the securities.

As I mentioned earlier, a company that wants to participate in the capital market must be an 'open society'. The public offer for sale in order to open the company to the public, also called the "initial public offering" (IPO), is a special operation of increasing the share capital, through which the newly issued shares are offered to the public.

The conditions of the public offer for sale are imposed by the company issuing the shares, namely: the duration of the offer, the number of shares issued, the percentage of the current share capital, the price at which the shares are offered, etc.

In order to carry out its offer to the public for sale, the intermediary company shall draw up a "prospectus", based on the data provided by the issuer.

The issue prospectus shall include[3]:

- Presentation of the companies and persons who participated in the creating of the issue prospectus;
- Information about the shares put up for sale and the rights for ahareholders conferred by them;
- Information about the public offer (period of progress, manner of development, distributors, price of shares, number of shares offered, subsequent listing, etc.);
- information about the issuer (identification data, nature of activities, share capital, co-ownership, shareholders);
- the issuer's activities (operations, economic and financial performance, head offices, research and development, legal proceedings, salaries, interventions, sources of development);
- Accounting statements (financial reporting, indicators);
- Management information;
- Future prospects;
- Risk factors.

The initial public offers held on the Romanian capital market attracted the attention of foreign investors. The new companies listed on the BVB market represented investment opportunities for the diversification of the portfolio held by investors, but also an important source generating the increase of the value of BVB transactions and stock indices after the launch of the shares. In most cases, during the subscription period of the Initial Public Offering, there were net inflows of foreign capital on the Romanian capital market and net purchases, but the overall performance of the stock exchange influences the results of such an analysis.

When the issuer has successfully concluded the public offer for the sale of shares and has a contract concluded with a registry company, it will initiate the procedure of registering the shares at the stock exchange listing (listing the shares).

In order to be listed on the stock exchange of an issuing company, it must draw up and submit to potential investors a series of documents regarding:

- the organization of the company and its activity;
- the economic and financial performance of the company (resulting from the analysis of the balance sheet and of the profit and loss account);
- the work programme for the next period and the objectives proposed.

All these documents are analyzed by the specialists of the stock exchange, in order to verify the compliance with the regulations in force of the stock exchange, regarding the procedure of listing on the stock exchange.

[3] https://www.intercapital.ro/tipuri-de-finantare/

Finally, the decision to list it on the stock exchange is taken by a special commission – the Listing Commission of the stock exchange, made up of specialists of the capital market.

In general, the stabilization of the share price occurs in the case of initial public offerings, when very high sales occur and the share price could collapse. This situation is possible because new shares do not have a benchmark price in the market. Thus, the shares will not be attractive to potential investors, which leads the intermediaries to intervene by launching large buy orders or purchase offers to stabilise the price. Also, the intervention of the SSIFs is allowed in cases where there is an arifical increase in the share price. All these interventions have as final goal the transformation of the Stock Exchange into a reliable market, with certain rules, which will make it more and more attractive.

Overall, the opening of a company and its listing on the Stock Exchange Listing is conditioned by a complex analysis of the advantages[4] and disadvantages arising from the company's listing, the risks and conditions that the firm can accept

Advantages	Conditions
Notoriety - Permanent advertising in business circles for the public, in the country and abroad. ***Capital raising*** - Access to financial resources has a low cost; the use of a wide range of stock products. ***Financial consolidation*** - Separation between long-term (majority) and minority or casual investors. ***Offering actions as incentives for employees*** - Employees are transformed into partners in business development through the distribution of shares.	***Informing the public*** - The need for strict compliance with the rules imposed by securities market authorities. ***True and consistent performance*** - The malfunction, the failures, the losses have a direct echo on the Stock Exchange, having negative repercussions on the company and its image. ***Risk of losing control*** - The company may be subject to inadious purchase offers from third-party companies, which are usually companies in the same field of activity, but competing.

3. Conclusion - advantages and risks of stock exchange trading

From the point of view of the issuing firm, the listing of the securities on the stock exchange gives it the possibility to appeal to the public savings, thus multiplying its sources of financing and their volume. Also, the listing on the stock exchange provides a better image of the issuer, both in front of investors and in front of current and future business partners. Especially when the capital market is in a process of growth and development, there are real chances that the issuer's notoriety and prestige will also be increasing.

But beyond all these advantages, offered to both issuers and shareholders, listing a company on the stock exchange also presents a number of risks. These will be reflected both in the expenses of the issuer, which will have to bear a whole list of commissions occasioned by the share of quotation and maintenance at the stock exchange, and in the shareholding structure. The initial shareholders may find themselves in the situation of losing control of the company, when following the issuance of shares a significant percentage of them will be held by new shareholders. Thus, the introduction to the stock exchange is a major strategic decision in the life of a company. In addition, although there are enough motivations, and the beneficial effects of the quotation of its products on the stock exchange are obvious, however, the company must be sufficiently prepared to have at hand the means to prevent possible surprises inherent in entering the market.

The objectives of stock exchange listing within the management of a company are related to a better management of the capital and the development of the firm.

Stock exchange market listing has a number of important immediate advantages in the development of the firm. Thus, the capital already divided into shares becomes mobile, which gives the firm an extra liquidity; quotation allows the determination of a trading rate that can be used in a future transaction and that gives a real picture of the value of the issuing firm; the dispersion of capital through its holding by several persons leads to the reduction of the risk for the capital holders; by the evolution of the share price, the market presents an objective assessment of the issuer's risk.

[4] Dumitru G. Badea – Piaţa de capital şi restucturarea economică, Ed. Economică, Bucureşti, 2000

Thus, listed companies can more easily obtain the necessary capital, as the listed shares have a higher degree of liquidity and have a price that reflects the supply and demand for capital.

For „closed companies" (wich are not registered at stock exchange list) , which are not listed on the stock exchange, there is no need to distribute the dividend and likely maximize the value of the shares. The listing on the stock exchange allows the increase of the number of shareholders and equity, factors that have a leverage effect on the value of the issuing company.

A positive effect of a company's quotation on the stock exchange is the possibility of calculating the risk-profitability correlation and the utility of investments. Thus, it was possible to establish a link between the capital held by an investor to make the investment, his wealth at a certain time and the possibility of gain (or the anticipated return). Also, it was possible to identify the existence of two categories of risk, reflected in the risk of a financial title:

- the specific risk of the issuing firm;
- systematic risk, determined by the overall evolution of the capital market.

The stock exchange listing allows to obtain an additional liquidity and to increase the rates of return on capital, and it can be appreciated that there is a link between the internal risk of the firm and the stock exchange rate, due to the transparency that must characterize the capital market, thus the financial information being public and allowing a complex financial analysis from potential investors. However, there are not enough instruments in the way to determine the link between the firm's internal risk, the share price and the risk of holding shares. Most often, indicators such as: dividend yield, annual growth rate, capitalization coefficient, rate of return required by shareholders are used. But in order to analytically track the influence of risk on the share price, stock models must be used and indicators that reflect the unit of risk per unit of return or the unit of return per unit of risk must be calculated, using forecasts made based on possible scenarios – optimistic, moderate or pessimistic.

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