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Abstract

In the period 2013-2017 Latvian corporate bond market had experienced the abrupt growth of the number of public Latvian corporate bond issues outstanding. The base of the expansion was formed by the financing activity of Latvian financial sector issuers (FSIs) with their weight in the pool of corporate bond issues listed in Nasdaq Riga at 85%. In 2019, FSIs remain the main issuer in Latvian corporate bond market (64% of the number of issues (Nasdaq Baltic, 2019)). The financing needs and preferences of the FSIs not only shape the segment profitability but also build Latvian corporate bond market sustainability. Academic papers provide broad motivation for corporate debt issuing: an efficient competition to bank funding, long-term financing, improvement of the cash flow by decreasing the cost of debt, optimization of the financial structure, and efficient ownership structure. The existing research is modest on the analysis of the FSI segment as the issuer segment in the debt market while academics do analyse the corporate bonds issuance by the FSIs where motivating factors stimulating FSIs to come to the public debt market are seldom separated while size and characteristics of the issuers are mostly scrutinised. The aim of this article is to analyse the determinant of the development of the FSI segment of the corporate bond market in Latvia by defining the factors stimulating the bond issuing decision made by the FSI segment. This article provides primary data analysis of both survey and in-depth interviews with Latvian FSI segment representatives run in the period June-August 2017. The results of the analysis indicate that bank borrowing is not treated as the funding alternative for FSIs where issuing debt and equity funding are the recognised funding sources of the FSI segment. The growing role of the peer-to-peer platform financing is recognised and will further influence the FSI segment alternative financing. The main factors motivating FSIs to come to the debt market are reputation a company gets as the result of the bond issue, strategical ambition to be present in the public market, cost of funding in the long-term (more than 3 years). The methods used in this article are scientific publication analysis, document analysis, expert survey, in-depth interviews, and statistical data analysis.

KEYWORDS: corporate bonds, corporate bond market, financial sector issuers, factors, Latvia

Introduction

There is vast academic interest in the methods and effectiveness of corporate financing, where the research could be grouped in to two categories: exploring the market-based financing (research conducted after the financial crisis of 2008-2013): Mertens & Thiemann (2018), Gupta & Gregoriou (2018), Karwowski & Stockhammer (2017), Maci & Valentova Hovorkova (2017), Hardie et al. (2013); and narrowing the subject of the analysis to the corporate choice between the market and bank-based funding decision (the research conducted before the financial crisis of 2008-2013): Levine (2002), Fujita (2000), Allen & Gale (2000), Boyd & Smith (1998), Rajan & Zingales (1999), Boot & Thakor (1997), Gerschenkron (1962). The further division and analysis of the factors as affecting the market-based funding decision of the company luck the consistency

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and major interest in the academic studies. The FSI segment, as indicated among the main forming segments of the corporate bond market in a country by Wyman (2015), is seldom separated for the discrete analysis by the academics. Both the corporate bond market and its FSI segment attract significant interest from the market stakeholders in Latvia. The country has indicated the robust growth of the corporate bond market segment in the period 2013-2017, while due to the disreputable shutdown of one of the main banks in the country (and one of the main issuers of the corporate bonds), the market has perceived substantial change (Nasdaq Baltic, 2019a). In the result, the corporate bond market in Latvia lost its issuing leader position in the Baltic region in the situation of growing activity in neighbouring Lithuania, while suffering from the loss of the main local issuer. Before its substantial transformation, the weight of the FSI issues in the pool of corporate bond issues listed in Nasdaq Riga reached 85%, while declining to 64% of the number of the issues outstanding in 2019 (Nasdaq Baltic, 2019). The dependency of the corporate bond market in Latvia on the FSI issuers should be unveiled and studied, where the factors stimulating the bond issuing decision made by the FSI should be identified and handled consistent with the corporate bond development strategy in Latvia. Moreover, the importance of market financing is supported by the increasing closure of the banks in Latvia and thus decreasing bank-based funding availability (Financial Times, 2019). No similar analysis of the corporate bond market in Latvia and its FSI segment has been made before.

This article aims to analyse the determinants of the development of the FSI segment of the corporate bond market in Latvia by defining the factors stimulating the bond issuing decision made by the FSI segment. The research methods used in this article are: analysis of scientific publications; quantitative research methods: survey; for the data obtained by survey, data grouping by different parameters (cross-tabulation) was performed; data was analysed by indicators of descriptive statistics: indicators of central tendency or location (arithmetic mean, mode, median), indicators of variability (range, standard deviation, standard error of mean); secondary data analysis (financial market indicators and data analysis based on data from Nasdaq Baltic), qualitative research methods: in-depth interviews. In the result of the analysis, the factors stimulating the bond issuing decision made by the FSI segment were analysed, where the main factors detected by the research were: the reputation a company got as the result of the bond issue, strategical ambition to be present in the public market, and cost of funding in the long-term (more than 3 years).

This paper contributes in two fundamental ways to the current research on the corporate bond issuance decision made by the FSIs in Latvia. Firstly, the authors provide an in-depth analysis of the academic development of factors supporting the corporate bond issuance decision (including FSI segment factors). Secondly, the authors gather the primary data and perform its analysis on the main factors motivating FSIs to come to the corporate bond market in Latvia. The structure of this paper commences with the review of the academic research on the factors supporting the corporate bond issuance decision: efficient competition to bank funding, long-term financing, improvement of the cash flow by decreasing the cost of debt, optimisation of the financial structure, and efficient ownership structure. The review of the academic research as focusing on the FSI segment decision for corporate funding is performed. The methodology of the primary data collection and analysis is disclosed, primary data is analysed. In the result of the data analysis, the main factors motivating FSIs to come to the debt market are presented, the expected outcomes are described as well as future areas of research are proposed.

Literature Reviews

Corporations come to the bond market to address their financing needs where long-term oriented and cost-effective financing forms the continuity of the company and builds its competitiveness in the market. The academic literature provides broad motivation for corporate debt issuing, where Maci & Valentova Hovorkova (2017) named the riskiness of businesses and costs of moni¬toring for the creditor, the accessibility of loan ratings of businesses, the overall eco¬nomic maturity of the country, the size, or phases, of life cycles of businesses, the communica¬tion of businesses with the investor community, the terms of the loan contract factors. Tocelovska (2008) revealed that efficient competition to bank funding, long-term financing, improvement of the cash flow by decreasing the cost of debt, optimisation of the financial structure, and efficient ownership structure among the main factors. Hameed (2007) supported efficient competition to bank funding and long-term financing factors adding the aspect of enhancing financial sector stability. The study of Faulkender & Petersen (2006) indicated that firms, which managed to raise debt publicly not from the bank, had 40% more debt and 50% higher leverage ratios. The latter was supported by the study of Hameed (2007) stressing that the bond issuer could apply its own chosen debt structure and attract additional finance without stating the specific need for it. Law & Singh (2014) disapproved on the view on raising the maximum corporate funding possible stressing on the presence of the optimal level, which should be identified and applied for a company in an efficient way.

The efficiency of corporate long-term financing via corporate debt was proved by Harford & Uysal (2014), Bose & Dipankor (2003), Demirguc-Kunt & Maksimovic (2002). Demirguc-Kunt & Maksimovic (2002) emphasised that the development of securities markets was more related to long-term financing, while the development of the banking sector to the availability of short-term financing. Harford & Uysal (2014) concentrated on the efficiency issues and concluded that constrained access to debt external financing encouraged managers to be more selective in their investment decisions. The choice for the financing instruments as the subject to the terms and amount of capital needed was found by the study of Bose & Dipankor (2003): large-scale, long-term fixed investments were best financed through long-term corporate debt. Braun & Briones (2006) found that the average maturity of corporate bonds was positively correlated with the size of the overall bond market and of the sovereign segment. Allen & Gale (2000), Fujita (2000) and Levine (2002) emphasised that market-based financing increased efficiency.

Corporate choice for bond funding from optimal capital structure perspective has been widely analysed in the academic studies. The study of Faulkender & Petersen (2006) revealed that large firms' decision on the capital structure was dependent on the capital market conditions. Ma et. al. (2005) provided the view that multiple financing channels (including the corporate bond market) improved firms' capital structures, promoted competition and encouraged innovation. The investment stage is often very costly for the company and the cash flow from the revenue-generating entities are seldom enough to finance all the new investments (Chorafas, 2005). Tetrevova (2007) stressed that issuing corporate bonds helped financial managers to form the optimal financial structure thus positively influencing its competitiveness. The study of Zelgalve & Romanova (2011) highlighted the increasing role of borrowing as the stimulus for growing the asset base for Latvian companies.

Among the negative sides of the bond issue is the lengthy initial process of prospectus writing and the relevant document gathering. For every issue, a new documentation package is prepared to regulate the cooperation between the issuer and the investors of these bonds and results in providing the conditions of borrowing for the issuer and the appropriate degree of safety for investors. Still, the substantial workflow should be done only when preparing the first issue as every next issue is using similar documentation and is relatively fast from the administrative side. The other factor is the lack of flexibility. The diverse structure of bondholders makes the changes in the interest payment or nominal schedule impossible or inefficient.

While providing comparatively broad analysis on the motivation of corporate bond issuance, the academic literature is comparatively modest on the analysis of the FSI segment as the issuer segment in the debt market. Despite the importance of the FSI segment for the public debt segment as exposed by Braun & Briones (2006): the study discovered the difference between large and small bond markets in the way that in the large markets issuers tend to be disproportionably financial institutions; the analysis of the FSI sector issuing debt securities remained rather fragmented. Liu (2013) proved the external financing costs were less influenced by the size of the company than internal. Wijesiri, Yaron & Meoli (2017) found the relationship between the size and age of microfinance institutions to the efficiency of their access to finance. Tchakoute Tchuigoua (2014) found that the banking sector seemed to complement the microfinance sector given that microfinance institutions in countries with developed banking sectors are more leveraged. In the result, the existing academic studies do analyse the corporate bonds issuance by the FSIs where motivating factors stimulating FSIs to come to the public debt market are seldom separated and size and characteristics of the issuers are mostly scrutinised.

Methods and Procedures

The methods used in this article are an analysis of scientific publications; quantitative research methods: survey; for the data obtained by survey, data grouping by different parameters (cross-tabulation) was performed; data was analysed by indicators of descriptive statistics: indicators of central tendency or location (arithmetic mean, mode, median), indicators of variability (range, standard deviation, standard error of mean); secondary data analysis (financial market indicators and data analysis based on data from Nasdaq Baltic), qualitative research methods: in-depth interviews. In-depth interviews and expert survey to the FSI sector were run in the period June-August 2017. The rationale for primary data collection was instigated by the lack of representative historical secondary data present (the gradual development of the corporate bond issuance by the FSI segment in Latvia started in 2013 (Nasdaq Baltic, 2019)), where despite the growing presence of the FSI segment activity, any academic research in the area is absent.

The primary data analysed in this paper has been obtained via in-depth interviews and surveys to FSI sector run in the period June-August 2017 where the participation rate reached 90% and 70% from the total number of the FSI of the corporate bonds respectively (Table 1). The limitation for participants of the in-depth interviews and surveys was made to include the financial sector issuers of corporate bonds publicly listed in Nasdaq Riga: ABLV Bank, AgroCredit Latvia, Capitalia, Citadele banka, ExpressCredit, Moda Kapitāls, Mogo, Reverta, Rietumu Banka, VIA SMS group. No similar analysis of the corporate bond market in Latvia and its FSI segment has been made before. Questionnaires for expert survey and interview questions were tested on the sample group. In the result of the test, content change and rephrasing to 4 out of 20 questionnaire questions and 5 out of 18 interview questions took place.

Table 1
FSI segment participation in the survey: "Corporate Bonds in Latvia: Factors that affect Financial Sector Issuers", 2017

Companies participating in the survey	ABLV Bank, AgroCredit Latvia, Capitalia, Citadele banka, ExpressCredit, Moda Kapitāls, Mogo, Rietumu Banka, VIA SMS group
Companies participating in the interview	ABLV Bank, AgroCredit Latvia, Capitalia, Citadele banka, ExpressCredit, Rietumu Banka, VIA SMS group

Source: Authors' construction based on Natalja Tocelovska conducted survey "Corporate Bonds in Latvia: Factors that affect Financial Sector Issuers" conducted in June- August 2017

After the personal invitation for experts to participate in an expert survey and their acceptance, the questionnaire was sent to the respondents on June 19, 2017, with a weekly reminder. One of the questionnaires was fully translated into Latvian as requested by the company. Both English original and translated into Latvian versions were sent to the respective FSI. In-depth interviews process took place in the period June 27- August 3, 2017, in English, Latvian or Russian depending on the preferences of the interviewee. All interviews were recorded and transcribed.

Results

The results of the survey indicate the growing recognition of the corporate bond market by Latvian FSIs and increasing switch from bank financing where the main incentives are reputation, strategical factors and the cost of funding in the long-term. Tables 2 and 3 represent the summary of the descriptive statistics of questions: "My company when in need for additional funding chooses: borrowing from the group company; borrowing outside the group company (bank borrowing); equity funding; issuing bonds; organising initial public offering (IPO)" and question: "In my company the main motivation to issue bonds for a company is: cost of funding in the long-term (more than 3 years); cost of funding in the short-term (less than 3 years); cost of issue (documentation, issue organiser, etc.); cost of market entrance (registration fees, listing fees, etc.); demand from investors; lack of funding alternative; level of competence in bond issue process by the reasonable people in my company; regulatory policies; reputation a company gets as the result of bond issue (publicity, regular meetings for the issuers, etc.); strategical ambition to be present in the public market of the survey "Corporate Bonds in Latvia: Factors that affect Financial Sector Issuers" conducted in June- August 2017. One of the investigated questions analysed the selection of funding source when in need for additional resources, and the other analysed the factors, which acted as motivation to issue bonds for the company represented by the respondent.

Traditionally treated as the bank-based country, Latvian corporate funding has perceived the stable progress in the bank loans provided to the corporate segment with its persistent growth of the newly granted corporate loans dynamics in the period of 2014-2016 and the modest slowdown expected for 2017 (Tocelovska & Sloka, 2017).

Positive Latvian bank lending dynamics and the perceived availability of the bank borrowing for FSI segment is not supported by the results of the expert survey thus contradicting the results of Maci & Valentova Hovorkova (2017). As revealed by the analysis, the choice of funding for Latvian FSIs when in need of additional funding is strongly dominated by issuing bonds followed by equity funding alternative (Table 2).

Table 2

Main statistical indicators of expert evaluations on FSI choice for funding source in the survey: "Corporate Bonds in Latvia: Factors that affect Financial Sector Issuers" in 2017

	Mean	Std. Error of Mean	Median	Mode	Std. Deviation	Variance	Range	Min	Max
borrowing from the group company	5.5	1.018	5.5	5 and 8	2.878	8.286	8	1	9
borrowing outside the group company (bank borrowing)	5.11	0.949	5	3	2.848	8.111	8	1	9
equity funding	5.75	0.701	6.5	7	1.982	3.929	6	2	8
issuing bonds	8.11	0.351	8	9	1.054	1.111	3	6	9
organising initial public offering (IPO)	3.13	0.639	3	1 and 3	1.808	3.268	5	1	6

Evaluation scale *1 – 10, where 1- strongly disagree; 10 – strongly agree*

Source: *Authors' construction based on Natalja Tocelovska conducted survey "Corporate Bonds in Latvia: Factors that affect Financial Sector Issuers" conducted in June- August 2017*

Expert views on issuing bonds were homogeneous – the lowest evaluation was 6 and the highest evaluation was 9 with mode 9 (the most often chosen evaluation by the experts) and median 8 (half of the experts gave evaluation 8 or less, and half of the experts gave evaluation 8 and 9), arithmetic mean of the expert evaluations was 8.11 with standard deviation 1.05). IPO as the alternative equity funding was commented by one of the respondents to be currently an irrational step due to the high profitability of the FSI segment. Borrowing from the group is treated diversely with two modes of the range and a very broad range of the responses - both indicating the split of the opinions. Borrowing outside the group company is not estimated by the FSI segment as important or needed. The additional comments on the situation as provided during the in-depth interviews pointed on limited real alternative existing to the bond issuance. Bank lending was pointed to exist on the modest scope, where one of the respondents indicated that only two banks were willing to provide funding for the FSI segment.

Moreover, the recent financial crisis of 2008-2013 tested the uneven presence of funding. 40% of the respondents mentioned peer-to-peer (P2P) platforms among the main alternative outstanding. While realising the favourable dynamics of the P2P funding, which "acts as the credit line", the respondents noted that P2P could not be the main source due to the strong dependence on one source as well as the unwillingness to shift the whole balance sheet to P2P. While frequently mentioned and discussed during the in-depth interviews, the "lack of funding alternative" factor was not supported by the descriptive analysis of the FSI sector motivation to issue corporate bonds in the survey- the factor was mentioned as the fifth most important out of ten analysed.

The results of the survey indicate that the main motivating factors for Latvian FSIs as approaching the corporate bond market are: reputation a company gets as the result of bond issue (publicity, regular meetings for the issuers, etc.), strategical ambition to be present in the public market and cost of funding in the long-term (more than 3 years) (Table 3). The revealed influence of the cost of funding factor supports the results of Tocelovska (2008). The dominance of the factors is strengthened by the low standard deviation indicator as well as a comparatively narrow range.

Table 3

Main statistical indicators of expert evaluations on FSI motivation to issue corporate bonds in the survey: "Corporate Bonds in Latvia: Factors that affect Financial Sector Issuers" in 2017

Motivating factors	Mean	Std. Error of Mean	Median	Mode	Std. Deviation	Variance	Range	Min	Max
cost of funding in the long-term (more than 3 years)	7.44	0.556	8	9	1.667	2.778	5	4	9
cost of funding in the short-term (less than 3 years)	6.5	0.598	6	6	1.69	2.857	5	4	9
cost of issue (documentation, issue organiser, etc.)	6	0.726	7	8	2.179	4.75	6	2	8
cost of market entrance (registration fees, listing fees, etc.)	5.67	0.687	6	4 and 7	2.062	4.25	6	2	8
demand from investors	6.78	0.662	8	8	1.986	3.944	6	3	9
lack of funding alternative	6.56	0.729	7	6 and 7	2.186	4.778	7	2	9
level of competence in bond issue process by the reasonable people in my company	5.56	1.002	7	1 and 7	3.005	9.028	8	1	9
regulatory policies	6	0.645	7	7	1.936	3.75	5	3	8
reputation a company gets as the result of bond issue (publicity, regular meetings for the issuers, etc.)	8.11	0.2	8	8	0.601	0.361	2	7	9
strategical ambition to be present in the public market	7.56	0.444	8	8	1.333	1.778	4	5	9

Evaluation scale 1 – 10, where 1- strongly disagree; 10 – strongly agree

Source: Authors' construction based on Natalja Tocelovska conducted survey "Corporate Bonds in Latvia: Factors that affect Financial Sector Issuers" conducted in June- August 2017

The cost of funding while mentioned among the key motivating factors was stressed by one of the interviewees to exceed almost two times the cost of bank funding, where another comment was the necessity to provide the pledge to the bank and inability of the bank to reasonably analyse the pledge. The information as gathered during the in-depth interviews broadened the reputation factor by complementing such factors as the desire for transparency as the stimulating factor for new and potential investors and the interpretation of the exchange-listed bonds as the bond repayment guarantee from the investor side. While the main motivating factors: reputation, strategical factor and the long-term cost of funding are revealed to be the primary drivers for Latvian FSIs to attract public debt financing, the elements influencing the main motivating factors need to be identified (Table 4).

Table 4

Correlation of the FSI sector motivation factors to issue corporate bonds in the survey: "Corporate Bonds in Latvia: Factors that affect Financial Sector Issuers", 2017

		cost of market entrance (registration fees, listing fees, etc.)	level of competence in bond issue process by the reasonable people in my company	strategical a mbition to be present in the public market
cost of funding in the long-term (more than 3 years)	Pearson Correlation	0.521	0.618	0.831**
	Sig. (2-tailed)	0.15	0.076	0.005
	N	9	9	9
cost of funding in the short-term (less than 3 years)	Pearson Correlation	0.277	0.762*	0.39
	Sig. (2-tailed)	0.507	0.028	0.339
	N	8	8	8
cost of issue (documentation, issue organiser, etc.)	Pearson Correlation	0.890**	0.63	0.731*
	Sig. (2-tailed)	0.001	0.069	0.025
	N	9	9	9
cost of market entrance (registration fees, listing fees, etc.)	Pearson Correlation	1	0.700*	0.576
	Sig. (2-tailed)		0.036	0.105
	N	9	9	9
level of competence in bond issue process by the reasonable people in my company	Pearson Correlation	0.700*	1	0.725*
	Sig. (2-tailed)	0.036		0.027
	N	9	9	9

Evaluation scale *1 – 10, where 1 - strongly disagree; 10 – strongly agree*

*** Correlation is significant at the 0.01 level (2-tailed).*

** Correlation is significant at the 0.05 level (2-tailed).*

Source: *Authors' construction based on Natalja Tocelovska conducted survey "Corporate Bonds in Latvia: Factors that affect Financial Sector Issuers" conducted in June- August 2017*

The correlation analysis observes the statistically significant correlation with relevant significance level between the strategical ambition to be present in the public market and: cost of funding in the long-term (more than 3 years), cost of issue (documentation, issue organiser, etc.) and level of competence in bond issue process by the reasonable people in the company.

Moreover the cost of issue (documentation, issue organiser, etc.) is statistically significantly correlated with the cost of market entrance (registration fees, listing fees, etc.), while the level of competence in bond issue process by the reasonable people in the company with the cost of funding in the short-term (less than 3 years) and cost of market entrance (registration fees, listing fees, etc.). Thus, revealing that four indirect factors influence the choice of Latvia FSIs for corporate debt market.

The additional motivating factors as mentioned during the in-depth interviews are taxation and regulatory issues. The authors recommend further research on the taxation and regulatory issues as the motivating factor for Latvian FSIs bond issuance.

Conclusions

- The annual growth rate of the number of public Latvian corporate bond issues outstanding rose 7 times in 2013 afterwards stabilising at 40% per annum. The base of both growth and current issues outstanding is formed by the corporate bonds issued by Latvian FSIs with the weight of FSIs in the pool of corporate bond issues listed in Nasdaq Riga at 64% (dropping from 85% due to the closure of AB.LV bank and thus removing the public bonds of the company). FSI segment is the forming segment of Latvian corporate bond market. The financing needs and preferences not only shape the FSI segment profitability but also Latvian corporate bond market sustainability. The importance of market financing is further supported by the increasing closure of the banks in Latvia and thus decreasing bank-based funding availability.
- Academic papers support the view that the financial markets are not the natural first choice for the company and provide broad motivation for corporate debt issuing. Most of the academic papers stress efficient competition to bank funding, long term financing, improvement of the cash flow by decreasing the cost of debt, optimization of the financial structure, and efficient ownership structure. The existing academic research is comparatively modest on the analysis of the FSI segment as the issuer segment in the debt market where academics do analyse the corporate bonds issuance by the FSIs where motivating factors stimulating FSIs to come to the public debt market are seldom separated and size and characteristics of the issuers are mostly scrutinised.
- This article provides primary data analysis of both survey and in-depth interview with Latvian FSI segment run in the period June-August 2017. The results of the analysis indicate that bank borrowing is not treated as the funding alternative for FSIs where issuing debt and equity funding are the recognised funding sources of the FSI segment. The growing role of the peer-to-peer platform financing is recognised and will further influence the FSI segment alternative financing. The main factors motivating FSIs to come to the debt market are reputation a company gets as the result of bond issue, strategical ambition to be present in the public market, cost of funding in the long-term (more than 3 years).
- The information as gathered during the in-depth interviews broaden the reputation factor by complementing such factors as the desire for transparency as the stimulating factor for new and potential investors and the interpretation of the exchange-listed bonds as the bond repayment guarantee from the investor side.
- While focusing on the main factors, the correlation analysis indicates the sub-factors influencing FSIs' motivation: cost of issue, cost of market entrance, cost of funding in the short-term and level of competence in bond issue process by the reasonable people in the company.
- The strong presence and issuing initiative by FSIs are found to further shape the corporate bond market in Latvia. While all the identified corporate debt issuance motivating factors are long-term based: reputation, strategical market presence, and long-term funding cost, the respondents stressed the importance of taxation stability and Financial and Capital Market Commission role in the corporate bond market.
- The study recommends further research on the taxation and regulatory factors as the motivating factor for Latvian FSIs bond issuance. Both issues should be further analysed and challenged for the sustainability of their perception by Latvian FSI segment.

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