

**CAPITAL MARKET OF THE KYRGYZ REPUBLIC:  
AS ONE OF THE  
FINANCING OPTIONS OF COMPANIES**

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## **Abstract**

Chapter 1 of the thesis defines what a company is and describes how it is distinguished from other forms of the business. Chapter 2 investigates different types of organizational forms and indicates how they are different from each other. The last chapter provides a list of the financing options of the companies and conducts their assessment. Moreover, it analyzes the affect of the presence of the capital market on the economic opportunities of the companies.

Thus, the findings showed that the rules for the listing gin the capital market are too strict and sometimes financially unbearable for the small companies that are in search of the additional finance for their operations. Thus, affect of the presence of the capital market on the economic opportunities for majority of the companies equals zero. Capital market of the Kyrgyz Republic does not foster the conditions where the companies using their internal financing options could effectively raise capital for their needs.

## Introduction

The Kyrgyz Republic remains one of the poorest countries of the Former Soviet Union with its 880 USD GNI (gross national income) per capita in 2012.<sup>1</sup> The collapse of the Soviet Union (1991) has severely affected the economy of the country and started transition to a market economy which is still an ongoing process. Cooperation with major donors and international institutions has helped the government to generate an economic growth strategy, however, the political unrest, imperfection of the legislation and lack of transparency have been drawbacks in the country's further development. Moreover, Kyrgyzstan is not resource-rich, like most of its Central Asian neighbors, thus, the main development areas with big potential are industry, agriculture and tourism.<sup>2</sup>

While tourism is actively developing, the industry one of the leading sectors of economy is shrinking: from 27, 5% contribution to the GDP (gross domestic product) in 1991 it fell to 19, 4% in 2010. The number of enterprises in the industry sector is gradually decreasing: from 3 200 in 1991 it decreased to 2 000 in 2010.<sup>3</sup> The main type of economic activity in the Kyrgyz Republic – agriculture has decreased from 35, 3% GDP contribution in 1991 to 18, 5% in 2010. However, the gross nominal output of agriculture, hunting and forestry increased by large: from 44, 5 million soms (1991) to 116034, 7 million soms (2010).<sup>4</sup> Unfortunately, only 5 % of the outputs of the production

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<sup>1</sup> Doing Business, Section on Measuring Business Regulations. Ease of doing business in Kyrgyzstan, available at: <http://www.doingbusiness.org/data/exploreeconomies/kyrgyz-republic> (last visited June 3, 2012)

<sup>2</sup> Foreign and Commonwealth Office of UK, Asia and Oceania country profiles, Kyrgyzstan, available at: <http://www.fco.gov.uk/en/travel-and-living-abroad/travel-advice-by-country/country-profile/asia-oceania/kyrgyzstan/?profile=politics> (last visited June 3, 2012)

<sup>3</sup> National Statistics Committee of the Kyrgyz Republic, 20 years of independence of the Kyrgyz Republic: figures and facts, 15-16, available at: [http://stat.kg/index.php?option=com\\_content&task=blogsection&id=11&Itemid=51](http://stat.kg/index.php?option=com_content&task=blogsection&id=11&Itemid=51) (last visited June 3, 2012)

<sup>4</sup> National Statistics Committee of the Kyrgyz Republic, 20 years of independence of the Kyrgyz Republic: figures and facts, 17-19, available at: [http://stat.kg/index.php?option=com\\_content&task=blogsection&id=11&Itemid=51](http://stat.kg/index.php?option=com_content&task=blogsection&id=11&Itemid=51) (last visited June 3, 2012).

sector of the country are being processed.<sup>5</sup> All these numbers prove that the economic potential of the industry and agriculture is big and remains unexploited; a big number of enterprises operating in these sectors will lead to economic prosperity of the country.

Kyrgyzstan has only a few state owned enterprises<sup>6</sup>, leaving the market to the private enterprises. But they are not showing expected results and the production sector is shrinking further. There are some rational reasons for the private firms not succeeding in the market: the results of the Enterprise Survey of the World Bank indicated the major constraints of Kyrgyzstani enterprises. Fifty three per cent of the surveyed indicated limited access to finance as one their major constraints.<sup>7</sup> Thus, due to the lack of finance enterprises are not efficiently using the possibilities of the production sector of the country.

Limited access to finance is one of the major problems of Kyrgyzstani enterprises. The organizational legal form of the company plays a great role on the variety of financing options. Some companies due to their legal qualification have a right to issue stocks and securities and place them through offering privately or publicly in the capital market. Some companies are actively engaged in raising finance through the capital market, but it is the minor part of the enterprise sector of the

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<sup>5</sup> Union of Banks of the Kyrgyz Republic. Leasing 2011 [Lizing 2011], 11, available at: <http://www.ub.kg/ru/liz/> (last visited June 3, 2012)

<sup>6</sup> National Statistics Committee of the Kyrgyz Republic, 20 years of independence of the Kyrgyz Republic: figures and facts, 8, available at: [http://stat.kg/index.php?option=com\\_content&task=blogsection&id=11&Itemid=51](http://stat.kg/index.php?option=com_content&task=blogsection&id=11&Itemid=51) (last visited June 3, 2012).

<sup>7</sup> Doing Business, Section on Measuring Business Regulations. Kyrgyz Republic, available at: <http://www.enterprisesurveys.org/data/exploreeconomies/2009/kyrgyz-republic/> (last visited June 3, 2012).

country: according to the yearly report of the Kyrgyz Stock Exchange only eleven companies were listed in the capital market and the number of transactions was as low as 1678 per year.<sup>8</sup>

According to scholars capital markets are the best way to mobilize domestic funding sources and to reduce the reliance on foreign currency lending and the related foreign exchange risks.<sup>9</sup> Therefore, the main purpose of this research is to assess the regulatory and the legal framework of the capital market of the Kyrgyz Republic. The assessment is based on the EBRD Local Currency and Local Capital Markets Initiative 2010 that was conducted in Hungary, Kazakhstan, Poland, Romania, Russia, Turkey, and Ukraine.

Chapter 1 of the thesis investigates how the term “company” is describes within the jurisdiction of the Kyrgyz Republic. It also indicates the main features of the company and explains why they are important. Chapter 2 investigates different types of organizational - legal forms and indicates their differences from each other. A company gets certain rights according to the form it is incorporated by – including the internal financing opportunities. Chapter 3 of the research indicates the financing options of the company derived form its form, thus equity and debt financing are discussed and the availability of the capital market for the companies is assessed.

The research is based on the studies of a number of foreign doctrinal sources that provided with the knowledge of main concepts. Due to the lack of literature on corporate finance and company law of the Kyrgyz Republic much reliance was put on the national legislation. Hence, a

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<sup>8</sup> Kyrgyz Stock Exchange, section on [Analytics](http://www.kse.kg/ru/RussianAnalytics/1886/Otchet%20ob%20itogah%20deyatelnosti%20ZAO), available at: [Http://www.kse.kg/ru/RussianAnalytics/1886/Otchet%20ob%20itogah%20deyatelnosti%20ZAO](http://www.kse.kg/ru/RussianAnalytics/1886/Otchet%20ob%20itogah%20deyatelnosti%20ZAO) (last visited on June 6, 2012).

<sup>9</sup>2 Frederique Dahan and Jacek Kubas, [The EBRD’s legal and regulatory assessment – what limits development of local capital markets?](#), Law and Financial Markets Review, Volume 6, Number 3, May 2012 , pp. 218-223(6).

chapter of the Civil Code of the Kyrgyz Republic, four major laws constituting the company law of the Kyrgyz Republic, the Law on Securities Market Regulation and the rules of the trading of the Kyrgyz Stock Exchange were extensively analyzed. Besides, the factual content of the research is based on and derived from the reports and statistical data provided by the national governmental and non-governmental statistical agencies.



# 1 Chapter I. The Company Law of the Kyrgyz Republic

The goal of this chapter is to provide a general overview of the company law of the Kyrgyz Republic. The chapter defines the term “company” and analyses Kyrgyzstani companies for compliance with the generally accepted distinctive features of companies. The importance and implications of constitutive documents of companies and their state registration are discussed within section two.

## 1.1 The Company and its Distinctive Features

A company - is “a legal fiction. Its existence, capacities and activities are only such as the law attributes to it. Any proposition about a company necessarily involves a reference to a set of rules. A company exists because there is a rule...”<sup>10</sup> In the legislation of the Kyrgyz Republic “company” is referred to as “legal entity”, which describes the same phenomenon.

According to provisions of the Civil Code of the Kyrgyz Republic any organization with property and a separate balance sheet is a legal entity and acquires a legal personality<sup>11</sup> upon registration with the State Registry<sup>12</sup>. The moment of the state registration is an important event when the legal entity gains a legal personality and *unlimited capacity*<sup>13</sup> to engage in contractual relationships, be responsible for tortious and contractual liabilities and exercise ownership rights.

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<sup>10</sup> Eilis Ferran, Company Law and Corporate Finance, 81 (OXFORD University Press 1999).

<sup>11</sup> The Civil Code of the Kyrgyz Republic (Grazhadanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 83.

<sup>12</sup> The Civil Code of the Kyrgyz Republic (Grazhadanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 86.

<sup>13</sup> *According to the part 1 of article 84 of the Civil Code, legal capacity of legal entities is not limited, unless otherwise stated by the law or by its constitutive documents.*

Legal entities may be created in any organizational form explicitly provided by the Civil Code of the country. According to article 105 of Civil Code of the Kyrgyz Republic, legal entities with regard to the organizational-legal form may be separated in two major groups: *corporate*-enterprises, whose capital is divided into participatory shares, and *unitary*- State, municipal or treasury enterprises. Another important distinction line between legal entities may be drawn with regard to their economic goals: commercial and non-commercial organizations. The major difference between these two is profit orientedness of commercial organization, while the purpose of the non-commercial organizations is of a philanthropic nature, and even if its' activities bring profit; it shall not be distributed among participants.

Three distinctive features of company pointed out and described by Eilis Ferran<sup>14</sup>, separate legal personality, limited liability and separation of equity investment and managerial responsibility. Further analysis of company law of the Kyrgyz Republic will reveal provisions that safeguard the primary and distinctive features of companies.

### **1.1.1 Separate Legal Personality**

A separate legal personality grants companies a legal capacity to engage in the relationships with the third parties, therefore, it is important to analyze whether legal entities in the Kyrgyz Republic have separate legal personality and an ability to enter into contractual relationships without any implications for their shareholders.

As noted by Ferran, a company has a separate legal personality and is distinct from the people who hold its shares and the people who manage its operations.<sup>15</sup> She claims that possible changes of the shareholders and managers of the company do not affect the company's existence.

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<sup>14</sup> Eilis Ferran, Company Law and Corporate Finance, 13 (OXFORD University Press 1999).

<sup>15</sup> Eilis Ferran, Company Law and Corporate Finance, 13 (OXFORD University Press 1999).

Her argument that the company itself, not its shareholders or managers, acquires legal rights and obligations in case of contractual relationships with the third parties, therefore, incurring tortious liability and becoming a subject of criminal liability is very strong. It is true that the company cannot act itself; and a number of natural persons with diverse legal capacities stay involved in its operations. Thus, according to Ferran, there are many regulations which define and delineate those acts of natural persons that were performed on behalf of the company<sup>16</sup> and those which were not.

### **1.1.2 Limited Liability**

It is important for shareholders of the legal entity to have a limited liability; it fosters the entrepreneurial activity for many passive investors, who are ready to engage into business activity, but would like to avoid any consequential liability.

Ferran claims that the separate legal personality granted shareholders of companies an opportunity to limit their risks of participation in economic activities.<sup>17</sup> According to the principle of limited liability the company itself, not owners of its shares, is responsible for all of its debts. But, according to Ferran, the shareholders may indeed have some kind of responsibility, but the extent of it is a subject for regulation of the shareholder himself and is reflected in companies' constitutive documents. Ferran's claim that limited liability of companies promotes entrepreneurial activities allowing people (i.e. shareholders) to limit the overwhelming risk of personal liability for unsuccessful business decisions is very persuasive. She also notes that, limited liability facilitates engagement of those people, who do not want to play an active role in the management of the company, but are ready to invest their funds; and promotes more risk taking behavior among them.<sup>18</sup>

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<sup>16</sup> Eilis Ferran, Company Law and Corporate Finance, 14-15 (OXFORD University Press 1999).

<sup>17</sup> Eilis Ferran, Company Law and Corporate Finance, 16-17 (OXFORD University Press 1999).

<sup>18</sup> Eilis Ferran, Company Law and Corporate Finance, 17-19 (OXFORD University Press 1999).

The situation in the Kyrgyz Republic is similar to what is described above: according to the Civil Code,<sup>19</sup> shareholders of the legal entity shall not be held liable for its obligations. The doctrine of piercing the corporate veil attaches personal liability to the owners of the legal entities only under certain circumstances.<sup>20</sup>

### 1.1.3 Separation of Equity Investment and Managerial Responsibility

Ferran argues that typical corporate governance model is based on the division of company ownership and management: ownership of the company is enjoyed by its shareholders and the management of the company is carried out by managers who act as agents of the company within powers allocated to them in the constitutive documents.<sup>21</sup> In addition, all professional performance of the manager shall be in compliance with interests of the company, if they are otherwise, the manager breaches fiduciary duty to the company. In order to mitigate the risk of breach of duty, shareholders as owners of the company are guaranteed of a right to have control over the management of company; it is primarily exercised by the possibility of appointment and removal of managers. Ferran notes that, this model is irrelevant for one person companies, as shareholders are either single executive officials or closely involved in the management of the company. In daily business practice, they do not pay much attention to which role - shareholder or executive - they are playing.<sup>22</sup>

Legislation of the Kyrgyz Republic provides regulations on corporate governance for each type of legal entities in the Chapter 5 of the Civil Code, and in a separate law for each type of legal

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<sup>19</sup> The Civil Code of the Kyrgyz Republic (Grazhadanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 91.

<sup>20</sup> The Civil Code of the Kyrgyz Republic (Grazhadanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 91.

<sup>21</sup> Eilis Ferran, Company Law and Corporate Finance, 23 (OXFORD University Press 1999).

<sup>22</sup> Eilis Ferran, Company Law and Corporate Finance, 25-26 (OXFORD University Press 1999).

entity. However, unlike limited and kommandit partnerships, joint-stock and limited and additional liability societies have specific regulations, prescribing all formalities of operations and hierarchy in the management structure. Moreover, shareholders are granted rights to put additional relevant provisions on company management in the constitutive documents of the society.

Analysis shows that that terminology differences were not a constraint in the adoption of internationally recognized norms of company law into the legislation of the Kyrgyz Republic promoting entrepreneurial activity and equalizing positions of the shareholders and managers. The distinct features of companies are embedded in the company law of the Kyrgyz Republic and are easy to distinguish.

## **1.2 The Role of Constitutive Documents and the State Registration of Companies within jurisdiction of the Kyrgyz Republic**

The constitutive documents are important in regulating the “shareholder-company”, “shareholder-shareholder” and “shareholder – executive” relationships within companies. The role of the State Registration of the legal entities is vital, as only after the registration the legal entity is granted a separate legal personality and legal capacity to engage in any kind of legal relationships.

According to article 87 of the Civil Code, shareholders of the legal entity are flexible in regulating their internal affairs through the memorandum and articles of association. The same legal source outlines the minimum content of these two constitutive documents, thus:

- The Memorandum of Association, also referred as the “Charter”, shall contain full and abbreviated name of the company, the address/location of the permanently operating executive, company administration procedure and all other relevant information if so regulated by the laws directly regulating each type of company.

- The Articles of Association (“founding agreement” as referred to in the Civil Code in English language) is a formal internal contract of shareholders, containing detailed provisions on how the joint activities of founders with regard to establishment of a company shall be undertaken. As stated in article 87 of the Civil Code, it also should define the procedure of the transfer of capital or other tangible assets to the charter capital of company and terms of participation in its activities. “The agreement shall also define the terms and the order of distribution of profits and losses among founders, the terms of the management of the legal entity's activities, and the terms of the founder's withdrawal from the legal entity. By the founders' mutual consent, other terms may be included in the founding agreement”.<sup>23</sup>

It is important to note that according to the provisions of the Civil Code, if the initial versions of these two documents were amended or modified during the course of business of the company, any changes will have effect with regard the third parties only after state registration of the newly amended agreements or in circumstances prescribed by law after proper notification of registration bodies. Thus, constitutive documents play a major role in the life cycle of the legal entity: they contain obligations of the company towards its shareholders and vice versa, set out mutual responsibility of the owners and executives and are a contract between the shareholders on operations of the business.

State Registration of the company is linked to the formal existence of the enterprise, thus, article 86 of the Civil Code explicitly states that legal entity exists only “from the moment of Registration” in the State Registry. Hence, because of the constitutive nature of the registration, its

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<sup>23</sup> The Civil Code of the Kyrgyz Republic (Grazhdanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 87.

role for legal entities of the Kyrgyz Republic is very important – their formal existence and legal capacity start only “from the moment of State Registration”.<sup>24</sup>

Therefore, the role of constitutive documents and the state registration are important in the life cycle of the legal entity. Constitutive documents regulate internal relations of shareholders and executives, as well as for their relationships with third parties. The importance of the Registration cannot be even argued as the formal existence and legal capacity of the legal entity start only “from the moment of State Registration”.

The analysis of the legislation of the Kyrgyz Republic precludes that, regardless of the terminology differences internationally recognized principles of company law were embedded in the company law of the Kyrgyz Republic and are easy to distinguish. Relationships of shareholders and managers with third parties are regulated by the constitutive documents. and legal existence of the company starts only “from the moment of State Registration”. These principles promote entrepreneurial activities through safeguarding equal positions of the shareholders and managers.

The next chapter provides with an overview of the types of companies allowed by the legislation of the Kyrgyz Republic. It is important to analyze types of companies, as the financing options of companies vary one from another depending on the legal form.

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<sup>24</sup> The Civil Code of the Kyrgyz Republic (Grazhadanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 86.

## 2 Chapter II. Types of companies in the Kyrgyz Republic<sup>25</sup>

This chapter provides definitions to all types of commercial legal entities foreseen by the legislation of the Kyrgyz Republic and describes their basic features. This information is important with regard to financing options granted to different types of companies. The analysis distinguishes more popular types of business forms among Kyrgyz entrepreneurs - joint stock societies, limited and additional responsibility societies, full and limited (kommandit) partnerships, and less popular types are: production cooperatives, unitary enterprises and subsidiary/branch/representative companies.

Typically commercial organizations are incorporated in the form of “joint stock societies, limited and additional responsibility societies, full and limited (kommandit) partnerships, production cooperatives, unitary enterprises and many others (small enterprise, subsidiary/branch/representative, simple enterprise, joint enterprise)”<sup>26</sup>. While the non-exhaustive enumeration is provided for the non-commercial organizations, thus, they may be formed as consumer cooperatives, social or religious organization/association, institutions, philanthropic and other forms of provided by law.<sup>27</sup> Non – commercial organizations are out of the scope of this section, as economic goals of such legal entities are contradictory to the primary goal of the research.

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<sup>25</sup> *The content of this section is fully based on the Chapter 5 of the Civil Code of the Kyrgyz Republic dated May 8, 1996 No.15 and laws specific to certain types of legal entities: Law of the Kyrgyz Republic “On commercial partnerships and societies” dated July 15, 1996 No. 60, Law of the Kyrgyz Republic “On joint-stock societies” dated March 27, 2003 No.64, Law of the Kyrgyz Republic “On production cooperatives” dated June 11, 2004 No.70. Due to the large number of normative provisions analyzed, the author’s interpretation is not supported by the direct citations of articles as the original source of the statement.*

<sup>26</sup> The Civil Code of the Kyrgyz Republic (Grazhdanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 85.

<sup>27</sup> Ibid.



## 2.1 Joint – Stock Society

Joint – stock societies are regulated by the articles 139 to 149 of the Civil Code and Law of the Kyrgyz Republic “On Joint-Stock Societies” dated March 27, 2003 No.64.

A joint stock society is a legal entity with charter capital divided into common stocks specified in its charter. It may be established by one or several founders. If there is more than one founder, the founders meeting is held in order to unanimously adopt the decision to create the society, confirm the charter, value any contributions in kind and appoint management bodies.

The joint-stock society is formed on the basis of the charter which has to be accompanied by the founding agreement. The founding agreement sets forth the procedure of administering joint activities regarding formation of the company: the amount of the charter capital of the company; categories of issued shares and the procedure for dividends distribution; and the rights and obligations of the stockholders with regard the company. The charter shall contain the provisions on categories of stocks issued by the company, their face value and amount; the rights of shareholders; the amount of the company's charter capital; the composition and the competence of the company's managing bodies and process of major decision making.

Joint-stock societies are either open or closed. A joint stock company in which participants can alienate their stocks without the consent of other shareholders is recognized as an open joint stock society; these companies are subject to strict public accountability rule and are required to publish financial reports and balance sheets yearly. A company the shares of which can be distributed only among its founders or other prior determined persons is recognized as a closed joint stock company. The number of stockholders of the closed joint-stock company shall not exceed

fifty, if it does so within specified period of time it shall be transferred into an open joint - stock company. Such a company has no right to conduct an open subscription for issued stocks or offer them in some other way to the general public. Closed joint-stock companies are not subject to public scrutiny.

The required minimum charter capital is one thousand times the minimum amount of payment for labor, which is not the same phenomenon as minimal wage<sup>28</sup>. The charter capital of a joint-stock company shall be divided into a definite number of shares and be fully paid up upon its' registration. Dividends are declared once a year, unless the joint-stock society has some of the conditions of insolvency prescribed in the legislation.<sup>29</sup> They may not be paid to those stockholders who acquired the stocks in less than 30 days before the declaration of dividends. No more than twenty-five per cent of profit of the company may be paid up for dividends. The decision to distribute part of the profit in the form of dividends is taken by the general meeting of the stockholders.

Administration/Operations. The highest management body of the joint-stock society is the general meeting of stockholders, which has exclusive enumerated powers of: amending and modifying of the charter; deciding on the reorganization and liquidation of the company; deciding on the increase/decrease of issuance of stocks and conversion of securities into stocks; deciding when the pre-emptive rights of shareholders are not applicable; deciding on conversion of

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<sup>28</sup> *Minimum amount of payment for labor is the minimal monetary reward for labor. It is not the same phenomenon as minimal wage but during circumstances pointed by the Decree- functions as minimal wage. Minimum amount of payment is artificially established by the government, is fixed by the government and is changed by Government's decree from time to time (currently the minimal amount of payment equals 100 soms= approximately 2,50 USD) adopted by the Decree of Government dated November 25, 1999 no. 642 with last amendments of June 17, 2005)*

<sup>29</sup> The Law of the Kyrgyz Republic "On joint-stock societies" (Zakon Kyrgyzskoj Respubliki ob akzionernyh obshestvah) of March 27, 2003 # 64, Article 32 (1).

preferred shares into common; deciding on the payment of dividends and its amount; appointing and recalling members of the supervisory board, executive directors and other committees and etc. Holders of common stocks of the company are entitled to participate in the general meeting and holders of preferred stocks only in circumstances prescribed by law.

The supervisory board exercises the general direction over the activity of the society and may decide on all questions not delegated to the competence of the general meeting of stockholders. The supervisory board members are elected by the general meeting of the stockholders and may consist only from natural persons that are not necessarily stockholders of the company. The executive body directs daily activity of the society and may be either a board of directors or one director. Unlike the director of the supervisory board who acts on behalf of the company with regard to the collegial decision of the board, a single manager of the company may solely represent interests of the company and conclude transactions without power of attorney.

Reorganization: the joint-stock society may be transferred into limited liability society or production cooperative.<sup>30</sup>

## 2.2 Limited Liability Society

Limited liability societies are regulated by articles from 127 to 137 of the Civil Code of the Kyrgyz Republic and the Chapter 3 of the Law of the Kyrgyz Republic “On Commercial Partnerships and Societies” dated July 15, 1996 No. 60.

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<sup>30</sup> *In the legislation of the Kyrgyz Republic reorganization - is a blanket term to denote one of five ways in which the organizational-legal form may be altered: merger, accession, division, separation and transformation, regulated by the provisions of the Civil Code of the Kyrgyz Republic.*

Limited liability society, also known by the acronym “OcOO”, may be founded by one or several natural persons. However, it is not prohibited for the legal entity to form limited liability society as long as it is not the single founder. Maximum number of participants allowed is thirty, if it is exceeded, the OcOO shall in one year either reduce the number of its participants or transform into an open-joint stock society. If the number was not reduced or transformation did not take place within specified period the organization shall be a subject to liquidation.

Constitutive documents of a limited liability company are the memorandum of association, signed by all founders, and the articles of association approved by them. If the company is founded by a single person, the founding document of such company shall be the articles of association.

The charter capital of an OcOO consists from participatory shares, there is no required legal minimum for the charter capital and the participants define it in their founding documents. At least fifty per cent of the charter capital should be paid up upon the time of the registration of the company, and the remaining half shall be contributed within that year. If it is not paid up within determined period the charter capital shall be reduced in the founding documents and registered or the company itself shall be liquidated. A reduction of the charter capital may occur only after all creditors have been informed, as they have a right to insist upon performance of their obligations before time and for compensation of losses incurred. It is prohibited to exempt shareholders from making contributions to charter capital or to allow such contributions in the form of set-offs to satisfy the demands of shareholders against the company.

Administration/Operations. The management of the limited responsibility societies consists of general meeting of shareholders and executive body. The highest management body of a limited liability society is the general meeting of its shareholders. Shareholder bears responsibility for the obligations of the society only to the extent of his contributions to charter capital, unless his

contribution is not paid up in full. In this case, the shareholder will be liable jointly and severally to creditors of the company to the extent of the unpaid contribution. An executive body (board or a single person) of the limited liability company performs day-to-day management and is accountable to the general meeting of the shareholders. In case the company has a single person manager, he is to be appointed from outside the group of shareholders. The general meeting of participants has exclusive powers to amend the charter and changing the charter capital, appoint and recall members of the executive bodies of the company, approve annual reports and balance sheets, decide on distribution of profits and losses, decide on reorganization and liquidation of the company and elect company's auditor.

The shares of participants may be transferred to other members of the limited liability society or third persons. Existing shareholders have a preemptive right over third persons to shares that are being alienated by the original holder. If the articles of association prohibit transfer of shares to third parties, the company itself shall buy out shares subject to transfer. A participant has the right at any time to withdraw from the society, in which case he must be paid the full value of his participatory share in the charter capital from all assets of the company.

Reorganization: The limited liability society may only be transferred into joint stock society.

## 2.3 Additional Liability Society

Additional liability societies are regulated by the article 138 of the Civil Code of the Kyrgyz Republic and all regulations relevant for the limited liability societies of the Chapter 3 of the Law of the Kyrgyz Republic “On commercial partnerships and societies” dated July 15, 1996 No. 60.

Additional liability society, known by acronym OsDO, differs from the limited liability society by the shareholders' willingness to bear additional liability for obligations of the society in a

multiple of their contribution. If a participant of the OsDO withdraws from it, he is to be reimbursed the full amount of his contribution. However, if the member of the OsDO becomes bankrupt, his liability is distributed among the remaining participants proportionally to their contributions, unless another procedure for apportionment of liability is provided by the company's founding documents.

## 2.4 Full partnership

Full partnerships are regulated by articles 108-121 of the Civil Code of the Kyrgyz Republic and the Chapter 1 of the Law of the Kyrgyz Republic “On Commercial Partnerships and Societies” dated July 15, 1996 No. 60.

Full partnership is a legal entity where each participant is liable for the partnership's obligation with all of his personal property. The legislation does not provide specific requirements with regard to legal status of the participant, but from the content of provisions, it is clear that both - natural persons and legal entities may be participants of the full partnership. However, a person can be registered as a partner only in one partnership within the same period of time. The partnership is formed on the basis of the founding agreement, which simultaneously plays role of the charter of the partnership, and is signed, by all of its participants as founding agreement.

Administration/Operations. The partnership operates on the basis of the common consent of its participants, each having one vote irrespective of the amount of his contribution, unless the constitutive contract of the partnership provides otherwise. Each participant of the partnership has the right to act in its name, unless the constitutive documents designate one or several participants to do so. In this case the other partner should have a power to attorney when they act in the name of the partnership. These limitations do not affect the rights of third persons, as members of the

partnership may not cite the constitutive contract in relations with third parties; unless the partnership proves that the third person knew or should have known at the moment of entering the transaction that the partner concerned was not empowered to act in the name of the partnership.

Partner may transfer his commensurate property of the partnership to other partner or third party upon the agreement of all partners. Withdrawal from the partnership requires six months' prior notice. Expulsion from a partnership is possible only by the general agreement of all partners, and in cases, when a member of the full partnership is declared to be a missing person, to lack legal capacity / to be restricted in legal capacity, and a reorganization is enforced by the court judgment. Full partners of the partnership have the right to start court proceeding to expel other partner by virtue of the unanimous decision of the remaining participants and existence of gross violation of his duties or discovered inability to reasonably conduct the business of the partnership.

Benefits/Liabilities. Profits and damages of the partnership are distributed among the full partners in proportion to their capital contributions, if it is not stated otherwise in the constitutive contract. The liability of partners for debts of the partnership is subsidiary, meaning that it ensues only if the property of the partnership is not sufficient to cover debts. It is also joint and several, the debt may be fully collected from any of the partners, who then can recourse against the rest. The responsibility of the partner continues for two years after withdrawal from the partnership, but is related only to obligations which arose while the participant was a partner.

Reorganization:<sup>31</sup> the partnership continues to exist after the withdrawal of partners unless the constitutive documents provide otherwise; however, if only one partner remains, within six

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<sup>31</sup> *In the legislation of the Kyrgyz Republic reorganization - is a blanket term to denote one of five ways in which the organizational-legal form may be altered: merger, accession, division, separation and transformation, regulated by the provisions of the Civil Code of the Kyrgyz Republic.*

months the partnership must either be liquidated or transformed into limited or additional liability society.

## 2.5 Kommandit (Limited) partnership

Kommandit partnerships are regulated by articles 122 to 126 of the Civil Code of the Kyrgyz Republic and the Chapter 2 of the Law of the Kyrgyz Republic “On Commercial Partnerships and Societies” dated July 15, 1996 No. 60.

The kommandit partnership contains two groups of participants. The first, consists of full partners who carry on entrepreneurial activity in the name of the partnership and who are liable for its obligations, in cases when the property of the partnership is insufficient for repayment of the creditors debts. The second group consists of the contributors who take no active role in the affairs of the partnership. Both natural persons and legal entities may be participants of kommandit partnership, but the Civil Code of the country explicitly prohibits one to be a partner in the full partnership and a full member of limited partnership simultaneously. The kommandit partnership is formed on the basis of the constitutive contract, which plays the role of the charter of the partnership, and is signed only by full partners, whose contributions are individually specified. The contributions of kommandit partners are shown as an aggregate sum.

Administration/Operations. Only full partners take part in the management of the partnership; their rights and responsibilities remain the same as it is described for the partners of full partnerships. Unlike full partners, contributors have only one duty – to pay up contributions; it will be certified by a certificate issued by the partnership. Contributors have a right to: receive a part of the partnerships profit proportionate the contribution, familiarize with yearly reports and balance sheets of the partnership, withdraw from the partnership and receive the contribution back, transfer



the participatory share or a part of it to another limited partner or to a third person. The transfer of participant's share to another person shall terminate his participation in the partnership. If the partnership is liquidated the contributors have a preferential right against full partners to receive back their contributed capital, but only after the creditors of the partnership were fully repaid..

Reorganization: The limited partnership must have both full partners and contributors; therefore, if all contributors withdraw from the partnership, it must be liquidated or reorganized into a full partnership. One full partner and one contributor are sufficient to retain the limited partnership.

## 2.6 **Subsidiary and Holding companies. Production cooperatives. Unitary enterprises**

These organizational legal forms are the least popular among the Kyrgyz entrepreneurs. The provisions regulating these types of companies are prescribed in the Civil Code of the Kyrgyz Republic and other laws regulating each type of legal entities.

A legal entity is a holding company, if it holds more than twenty per cent of voting stocks of another participating company. The company holding the shares is the principal and those enterprises whose stocks are held by the holding company are subsidiaries.

A subsidiary company - is a company where the principal company/partnership due to its dominant participation in the charter capital or provisions of the founding contract, has the right to participate in the management of the subsidiary. A subsidiary is not liable for the principal company's/partnership's debts.<sup>32</sup> If the principal company/ partnership have the right to give the latter mandatory instructions, it shall be jointly liable for all transactions carried out for purposes of

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<sup>32</sup> Law of the Kyrgyz Republic "On commercial partnerships and societies" from July 15, 1996 No. 60, Article 8-1 (2).

such instructions. In case of bankruptcy of the subsidiary due to the principal company's fault, the latter shall bear secondary liability on its debts.

A production cooperative is a voluntary association of natural persons for joint production or other economic activity. Each member has an undivided share in the cooperative. It is required for all cooperative members to contribute their personal labor. The profits are distributed in accordance with contributed labor or to the amount of contributed share capital. The highest management body is the general meeting of cooperative members and the executive bodies: the board (for those cooperatives where the number of shareholders exceed ten) and the chairman. Members of the cooperative may withdraw at any time or be expelled for failure to perform or for improper performance of prescribed duties. In such cases the member has a right to be paid the value of his share in forms of capital or in kind.

Unitary enterprise is created by the decision of the owner or duly empowered agency and operates on the basis of a charter, which is the constitutive document of the enterprise. Unitary enterprises are of two types: those based on the economic jurisdiction (state and municipal enterprises) and those based on the operative management (treasury enterprise of the state or municipal level). The unitary enterprise is subject to the state registration.

Analysis of the widely popular business forms - joint stock, limited and additional responsibility societies; full and kommandit (limited) partnerships, and for the less popular production cooperatives, unitary enterprises and subsidiary/holding companies shows that only some of them enjoy a legal right to issue stocks.

### 3 Chapter III. Financing options of the non - listed companies

Share issues (equity), debt (security issue) are among three basic sources of finance which a company can finance its operations.<sup>33</sup> The legislation of the Kyrgyz Republic allows some forms of businesses to issue stocks and securities.<sup>34</sup> Therefore, first section of the research will be devoted to analyzing companies' opportunities to issue stocks, while the second section investigates how efficiently companies may use securities emission to finance their operational and charter capital needs. The third section assesses the capital market of Kyrgyzstan: how efficiently the capital markets can be used by the companies to raise finance.

#### 3.1 Equity financing

Equity financing is “the act of raising money for company activities by selling common or preferred stock to individual or institutional investors. In return for the money paid, shareholders receive ownership interests in the corporation”<sup>35</sup> (within this research “corporation” shall be understood as “legal entity”).

##### 3.1.1 Emission of stocks by joint-stock societies

Joint-stock societies may raise finance through emission of new stocks or through splitting the existing shares.<sup>36</sup> However, emission rules are different for open and closed joint-stock societies. Open joint-stock societies are entitled to trade their issued stocks and securities by a public offering,

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<sup>33</sup> 2. Louise Gullifer and Jennifer Payne. Corporate Finance Law. Principles and Policy, 8. (hart Publishing 2011).

<sup>34</sup> The Law of the Kyrgyz Republic “On joint-stock societies” (Zakon Kyrgyzskoj Respubliki ob akzionernyh obshchestvah) of March 27, 2003 # 64, Article 27, 39.

<sup>35</sup> Online Dictionary “Investopedia”, available at: <http://www.investopedia.com/terms/e/equityfinancing.asp#axzz1wcRtKP2E> (last visited June 3, 2012).

<sup>36</sup> The Law of the Kyrgyz Republic “On joint-stock societies” (Zakon Kyrgyzskoj Respubliki ob akzionernyh obshchestvah) of March 27, 2003 # 64, Article 23(2).

while the closed joint-stock society's shareholders have preemptive right to purchase newly issued or alienated shares.<sup>37</sup>

“Share is a security certifying the right of its holder (shareholder) on receipt of the profits of the company in the form of dividends, to participate in the management of the company and on the part of the assets remaining after its liquidation.”<sup>38</sup> The stocks of a company shall be bearer and inscribed;<sup>39</sup> they may be common and preferred. Common stocks are voting stocks, moreover, they grant the holder a right to receive dividends, transfer the ownership of the stocks (part of it) to other parties and all the rights assigned to the holder of the common stock by the article 25 of the Law on Joint-Stock Societies.

Stocks are referred to as preferred, because they entitle their holders to receive the prescribed amount of dividends, regardless the economic performance of the company and grant a priority position for the assets of the company in case of its insolvency.<sup>40</sup> Preferred stocks are non voting stocks, unless otherwise specified by the charter,<sup>41</sup> as well as they do not give the holder the right to

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<sup>37</sup> The Law of the Kyrgyz Republic “On joint-stock societies” (Zakon Kyrgyzskoj Respubliki ob akzionernyh obshestvah) of March 27, 2003 # 64, Article 7.

<sup>38</sup> The Civil Code of the Kyrgyz Republic (Grazhdanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 47.

<sup>39</sup> The Law of the Kyrgyz Republic “On joint-stock societies” (Zakon Kyrgyzskoj Respubliki ob akzionernyh obshestvah) of March 27, 2003 # 64, Article 22(2).

<sup>40</sup> The Civil Code of the Kyrgyz Republic (Grazhdanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 47(2).

<sup>41</sup> The Law of the Kyrgyz Republic “On joint-stock societies” (Zakon Kyrgyzskoj Respubliki ob akzionernyh obshestvah) of March 27, 2003 # 64, Article 26 (1)

participate in the management of the company.<sup>42</sup> The quantity of preferred stocks may not exceed twenty-five percent of the charter capital.

Decisions with regard the number of the declared stocks and securities, an increase or reduction of the par value, the redemption of stocks issued, the splitting or consolidation of stocks, the cancellation of stocks not fully paid up are competences of the general meeting of shareholders.<sup>43</sup> The agenda of the general meeting of the shareholders is formed by the council of directors upon the requests of shareholders (submitted to the council no later than 30 days after the end of fiscal year).<sup>44</sup> Council of directors has a competence to recommend the general meeting on quantity of placed stocks and changing the par value of the stocks. The procedure of the placement of stocks and other securities of the joint-stock society are determined by decision of the council of directors unless its charter provides otherwise.

The procedure of the stock and security is regulated by the Law on Securities market of the Kyrgyz Republic and are discussed in detail in section 3.3 of this chapter.

## 3.2 Debt Financing

Debt financing is the “type of financing, when a firm raises money for working capital or capital expenditures by selling bonds, bills, or notes to individual and/or institutional investors. In

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<sup>42</sup> The Civil Code of the Kyrgyz Republic (Grazhdanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 47.

<sup>43</sup> The Law of the Kyrgyz Republic “On joint-stock societies” (Zakon Kyrgyzskoj Respubliki ob akzionernyh obshestvah) of March 27, 2003 # 64, Article 38.

<sup>44</sup> The Law of the Kyrgyz Republic “On joint-stock societies” (Zakon Kyrgyzskoj Respubliki ob akzionernyh obshestvah) of March 27, 2003 # 64, Article 43.

return for lending the money, the individuals or institutions become creditors and receive a promise that the principal and interest on the debt will be repaid.”<sup>45</sup>

Securities are regulated by articles 37-50 of the Civil Code of the Kyrgyz Republic. According to the article 37 of the Civil Code, securities are a legal fixing a right to the property by inscribing (“paperless” securities as referred to in the Civil Code) them or issuing bearer security. In case of bearer security an exhaustive list of rights assigned to it and all the requisites of the issuer shall be indicated on the document, which also shall be issued on the specifically prescribed form. If the prescribed rules on the form of the bearer securities are not followed they shall be void.<sup>46</sup> Bearer securities are transferrable to the new holder – transfer of the document from one holder to another is sufficient.<sup>47</sup> In case the security is inscribed, the rights fixed to them shall be registered by the issuer company. All transactions with the inscribed securities (transfer or limitation of the rights fixed, change of the holder) shall be recorded by the officials of the company or the specially assigned persons (notary, underwriter).<sup>48</sup> The Civil Code provides with an exhaustive list of persons who are subject to the rights assigned to securities: the bearer of security, the registered person and the person authorized by the owner.<sup>49</sup>

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<sup>45</sup> Online Dictionary “Investopedia”, available at:

<http://www.investopedia.com/terms/d/debtfinancing.asp#ixzz1wcSLeKIf> (last visited June 3, 2012)

<sup>46</sup> The Civil Code of the Kyrgyz Republic (Grazhadanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 38.

<sup>47</sup> The Civil Code of the Kyrgyz Republic (Grazhadanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 41.

<sup>48</sup> The Civil Code of the Kyrgyz Republic (Grazhadanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 39.

<sup>49</sup> The Civil Code of the Kyrgyz Republic (Grazhadanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 40.

After the security was placed, all the rights fixed to it will pass to the holder. Lack of obligation deriving from the security and/or invalidity of the security is not the grounds for issuer's non-performance.<sup>50</sup>

The Civil Code provides a list of securities: bonds, bills of exchange, checks, bank certificate, bank guarantees, bills of lading, shares, and other documents.<sup>51</sup> Bond is a security certifying the right of its holder to receive from the issuer within specified period of time its indicated face value or any other asset equivalent to the face value.<sup>52</sup> According to the Law on Commercial Partnerships and Societies it is the only security permitted for emission by limited and additional liability societies, and closed joint-stock societies.

### **3.2.1 Emission of bonds by Joint-Stock Society**

Joint-stock societies are entitled to issue bonds and other securities. Council of directors has a competence to decide to issue non-convertible securities with a total nominal value of up to fifty percent of book value of assets of the company at the date of the decision to issue such securities.<sup>53</sup> Emission of other types of securities is decided by the general meeting of the shareholders. Quantity, placement rules and other necessary information shall accompany the decision of the shareholders or of the directors. The society may determine the possibility of early

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<sup>50</sup> The Civil Code of the Kyrgyz Republic (Grazhadanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 44.

<sup>51</sup> The Civil Code of the Kyrgyz Republic (Grazhadanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 38.

<sup>52</sup> The Civil Code of the Kyrgyz Republic (Grazhadanskij kodeks Kyrgyzskoj Respubliki). Part 1 of 8 May, 1996 # 15 (with latest amendments of 23 January, 2009 # 23), Article 44.

<sup>53</sup> The Law of the Kyrgyz Republic "On joint-stock societies" (Zakon Kyrgyzskoj Respubliki ob akzionernyh obshestvah) of March 27, 2003 # 64, Article 54.

redemption at the request of the bond holders, in such a case a decision to issue bonds must be supplemented par value and repayment period.

Net value of issued bonds shall not exceed the charter capital of the society. Emission of the bonds may take place only during the third year of existence of the company and if the balance sheets of at least previous two years were approved by the auditor; and after all bonds of the previous emission were placed. However, securitized by the company itself or the third parties bonds are not restricted by the time and faith of the previously issued bonds. The procedure, conditions of emission, distribution and redemption of bonds are prescribed in the Law on Securities Market.

### **3.2.2 Emission of bonds by limited and additional liability societies**

The difference between the additional and limited liability society is in the extent of the liability: members of the limited liability are responsible for the debts of the company to the extent of their contribution, while shareholders of additional liability society bear liability in a multiple of their contribution. Regardless of the liability both additional and limited liability societies are entitled to issue bonds. The distinction is made with regard the nature of the bond if the bond is securitized (by the company itself or the third parties upon its request) the company has no limitations in it emission.<sup>54</sup> While in case of ordinary bonds pre-required conditions shall be met: if the annual balance sheets of the limited liability society have been approved by an independent auditor two times – on the third year of its operations it may start issuing bonds in the amount not exceeding its charter capital.<sup>55</sup>

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<sup>54</sup>Law of the Kyrgyz Republic “On commercial partnerships and societies” (Zakon Kyrgyzskoj Respubliki o Khozyaistvennyh tovarishestvah i obshestvah) of July 15, 1996 # 60, Article 39(2).

<sup>55</sup> Law of the Kyrgyz Republic “On commercial partnerships and societies” (Zakon Kyrgyzskoj Respubliki o Khozyaistvennyh tovarishestvah i obshestvah) of July 15, 1996 # 60, Article 39(1).



The section analyzed the legal framework that regulates financing options of legal entities. With regard their organizational - legal form, companies have diverse possibilities for issuing stocks and bonds. Hence, emission of stocks is allowed only for the joint-stock societies, with different regulations for open and closed joint-stock society. The legislation does not grant the right to issue securities for kommandit and full partnerships. Limited and additional liability societies are entitled to issue bonds. However, all information discussed above is the legal right of companies to enjoy benefits of their forms. The next section investigates the procedure of emission in accordance with the Law on the Stock Exchange.

### 3.3 Emission of stocks and securities: procedure

Open joint-stock society is the only explicitly recognized by the law “public company.”<sup>56</sup> Public companies are a subject to strict regulations: the prospect of issued stocks, conditions for their release, experts’ reports are to be scrutinized by the securities market regulating authority. According to the Law on Securities Market, stocks issued by open joint-stock societies require all issued stocks be placed by listing in the stock exchange. Therefore, all the stocks and securities issued by the open-joint stock society shall be placed through listing in the securities market.

Stocks of the closed joint-stock society may not be placed publicly, because they are a subject to the limited subscription to the stocks by incumbent shareholders. However, emission of bonds by the closed joint-stock may be placed publicly, but through private offering in the “non-listed”<sup>57</sup> list of securities.

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<sup>56</sup> The Law of the Kyrgyz Republic “On Securities Market” (Zakon Kyrgyzskoj Respubliki o rynke tsennyh bumag) of July 24, 2009 # 251, Article 1.

<sup>57</sup> The trading rules of the Kyrgyz Stock Exchange differentiate list of securities to listed and unlisted. Listed securities are the securities of companies that have undergone the procedure of listing with the stock market. The

The table below reflects all the procedural steps and documents required for private and public offering of stocks and securities. According to the article 35 of the Law on Securities Market regulation, the procedure of issuing the securities consists from two stages: the first, issuance of the stock/ security and, the second, the registration of the issued products.

**Table 1. The procedure of the security issuance**

Stage	Procedure
<b>1. Issuance</b> The issuance procedure shall include the following stages:	<b>Private Offering</b> <ol style="list-style-type: none"> <li>1. Issuer's decision to issue securities for trade;</li> <li>2. registration of the issued securities with the regulating authority;</li> <li>3. for materialized form - publishing shares and/or security certificates;</li> <li>4. trading/alienation of securities;</li> <li>5. reporting on the results of the alienation.</li> </ol>
	<b>Public Offering</b> <ol style="list-style-type: none"> <li>1. All the requirements listed above for the private offering +</li> <li>2. Registering the public offering with regulatory agency</li> <li>3. Advertising public offering.</li> </ol>
<b>2.Registration</b> Documents for registration:	<b>Securities issued for private offering</b> <ul style="list-style-type: none"> <li>• application for registration;</li> <li>• a copy of the Decision on securities issuance;</li> <li>• copies of the constitutive documents;</li> <li>• documents certifying payment of the fee for registration</li> </ul>
	<b>Securities issued for public offering</b> <ul style="list-style-type: none"> <li>• all listed above and +</li> <li>• sample of publishing share-for materialized form of issuance.</li> </ul>

Source: Articles 5 and 35 The Law of the Kyrgyz Republic "On Securities Market" of July24, 2009 # 251

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companies that offer their stocks and securities to the stock exchange without getting listed, place their issued securities in the list of companies that are non-listed in the stock exchange.

Once the procedural requirements for emission of securities and stocks have been met, they are subject to the approval and registration of the securities regulating authority and may be released for the placement in the securities market.<sup>58</sup>

### **3.4 Legal and regulatory assessment of the securities market of the Kyrgyz Republic**

This section assesses the legal and regulatory framework of the Securities Market of the Kyrgyz Republic; it will be based on the assessment of capital markets of transition countries conducted by the EBRD Local Currency and Local Capital Markets Initiative 2010. The relevance of this model of assessment for the securities market of the Kyrgyz Republic may be justified by many factors: the countries assessed in the original research are transition economies with the similar legal history and current legislation.

Thus, the legal and regulatory framework of the capital markets of the Kyrgyz Republic will be evaluated on thirteen factors outlined by the Initiative of the EBRD: capital requirements, policies on buying locally issued debt securities, insider trading protection, enforcement of investors right in case of debt securities default, investor remedies against market participants for market abuse, disclosure rules and procedures, availability of shelf registration, costs of issuance, rules of issuance in the local markets, governing law requirements, credit ratings requirements. The assessment of the author is based on the previously discussed sections on the organizational-legal form, the corporate governance structure of the types of legal entities and the Law on the Securities Market of the Kyrgyz Republic.

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<sup>58</sup> The Law of the Kyrgyz Republic “On Securities Market” (Zakon Kyrgyzskoj Respubliki o rynke tsennyh bumag) of July 24, 2009 # 251, Article 26; The rules for the Stock trading of the Closed-Joint Stock Company “Kyrgyz Stock Exchange” approved by the Supervisory Board on January 15, 2009. (Pravila Birjevoj trgovli ZAO “Kyrgyzskaya fondovaya birja” yтверждена Решением Совета директоров от 25 января 2009 года), Article 2.

**Table 2**

*Assessment of the legal and regulatory framework for the securities market of the Kyrgyz Republic*

<p><b><i>Capital requirements:</i></b></p> <p>What are the stimuli which certain capital requirements provide for holding local debt securities - incentives for the holding of locally issued debt securities are clear risk-weighting rules applied appropriately and on a non-discretionary basis.</p>	<p>Articles 62-65 of the Law on Securities Market cover the issues of the legal stimuli for holding local debt securities. These articles provide the list of illegal operations with the securities; however, there are no clear rules how to mitigate the risk related to the security. The investors (buyers of the securities) are fully for their operations with regard the securities purchased. Investors are entitled to receive the reimbursement of the securities, if the issuer company or its authorized agents will be charged in the illegal operations on the securities market and as a result of the court judgment the share of the investors will be returned and the profits will be confiscated.<sup>59</sup></p>
<p><b><i>Policies on buying locally issued debt securities:</i></b></p> <p>Policies are facilitating the securities market development, if there are no limitations/prohibitions applicable to banks, other financial institutions and regulated investors on buying debt securities issued by issuers based in the jurisdiction; and there are informal/unwritten policies, applied by regulators, creating incentives for banks, other financial institutions or regulated investors to</p>	<p>Prohibition or limitations for the banks and other financial institutions to investing into the local debt securities cannot be traced from the current securities market regulation. However, there are no policies promoted by the state regulatory agency that create incentives to invest in the locally issued debt securities.<sup>60</sup> Consequently, the local securities market regulatory authority, which has a primary goal of developing the capital market, does not imply the promotion of local debt financing.</p>

<sup>59</sup> The Law of the Kyrgyz Republic "On Securities Market" (Zakon Kyrgyzskoj Respubliki o rynke tsennyh bumag) of July24, 2009 # 251, Articles 62-65.

<sup>60</sup> The Agency of the Kyrgyz Republic on the Supervision and Regulation of the financial market under the Government of the Kyrgyz Republic, section on the Agency, available at: <http://www.fsa.kg/?id=28> (last visited on June 6, 2012).

invest in locally issued debt securities	
<p><b><i>Insider trading protection:</i></b></p> <p>if there are regulations requiring banks and other regulated investors in the jurisdiction to maintain “firewalls” or the like between non-public information received separately from borrowers of the bank and/or from their capital markets investment activity and the information used to invest in debt securities issued by the same borrower and/or client entities, and that such regulations are effectively implemented and enforced.</p>	<p>Article 62(2) of the Law on Securities Market provides the list of illegal operations with regard the securities; insider trading is listed among them and therefore is sanctioned in accordance with the civil legislation.<sup>61</sup></p>
<p><b><i>Enforcement of investors rights in case of debt securities default:</i></b></p> <p>there are no formal or informal impediments to enforce payment obligations with respect to debt securities in insolvency proceedings or otherwise; laws, regulations and practices show that investor enforcement rights and options are optimal.</p>	<p>The Law on Joint-Stock society requires the consent of all creditors to restructure the corporate debt – in practice it may be highly complicated. However, the holders of the securitized bonds have a preemptive right for repayment, but their quantity issued by the company shall not exceed 25 % of the charter capital, therefore, their quantity in the market is comparatively low. Besides, the judicial enforcement procedure might take a long period of time.</p>
<p><b>Investor remedies against market participants for market abuse</b></p> <p>foster the development of the capital markets when there are laws providing for specific remedies for investors against market</p>	<p>Article 63 of the Law on Securities Market lists the illegal operations of the market participants, which include manipulations of the par value of the securities through misleading by orders, transactions and providing the misleading information. However, the fact of the illegal</p>

<sup>61</sup> All transactions on the stock market are regulated and the consequences are assigned as prescribed by the Civil Code of the Kyrgyz Republic.

<p>participants that issue or trade debt securities based on false or misleading information they have provided to prospective purchasers (or have otherwise engaged in “market abuse”) and such laws are implemented; there is a regulatory institution which can bring enforcement claims where they are not brought by private investors; such claims are actually brought; the jurisdiction has an “ombudsman”-type entity (advocate) for investors with securities law claims; governmental issuers are not treated differently from other issuers with respect to such remedies/enforcement.</p>	<p>operations shall be decided by the court. The Law on the Securities Market does not regulate the securities issued by the state. Therefore, there are no clear remedies for the market participants’ abuse and the regulations covering these issues are not fostering the development of the capital markets.</p>
<p><b>Disclosure rules and procedures:</b></p> <p>the disclosure requirements do not impede local debt securities’ issuance; the offering process is speedy and efficient; there is a central repository of offering documents to which the general public has access; there is a process of approval/ filing, with a regulatory institution, information materials used to market debt securities and such process is efficient and prompt; large, sophisticated and/or institutional investors are subject to less rigorous disclosure requirements; the underwriting and legal costs for local issuance of debt securities are reasonable; any listing requirements, if applicable, do not create an impediment to issuance of debt securities; any updating disclosure requirements do not create an impediment to issuance of debt securities; no</p>	<p>According to the Law on Securities Market there is a central repository of offering documents to which the general public has access; there is a process of approval/ filing, with a regulatory institution, information materials used to market debt securities and such process is efficient and prompt. However, listing requirements, if applicable, create an impediment to issuance of debt securities; securities that are not in compliance with the listing rules of the Kyrgyz Stock Exchange are subject to termination, if the requirements were not met within the predefined period of time. Updating disclosure requirements create an impediment to issuance of debt securities, as they securities are subject to a short term termination. Having strict disclosure rules is handy for protection of investors from the</p>

documentation issues impede local capital markets activity.	market abuse, but it is impeding the process of issuance of securities.
<b>Availability of shelf registration:</b>  If "shelf" programme (one in which, following an initial approval process with the relevant regulatory institution, subsequent public offerings can be made without further approval) is available and is used, functions well and is efficient.	The shelf registration is not available for the security issuers of Kyrgyzstan: after registering with the relevant regulatory authority, all the issuer shall register in the Kyrgyz Stock Exchange in compliance with their rules. <sup>62</sup>
<b>Costs of issuance:</b>  if the cost of issuance of debt securities is such that it encourages local issuance of debt securities.	The cost of issuance of the securities completely under the discretion of the issuer: the legislation provides a possibility of issuing the inscribed and bearer securities. In case the issuer emissions inscribed security it is required to register all the rights fixed to the security and the owner in the registry books of the company. The decision of issuing inscribed or bearer security is decided by the general meeting or the council of directors of the company. Thus, the legal framework allows the issuer to decide the costs of issuance, but in general it is low.
<b>Rules of issuance in the local markets:</b>  if the rules on issuance of debt securities in the local markets encourage local issuance of debt securities, minimum or maximum term, as well	The Law on the Securities Market and corporate governance principles of legal entities of Kyrgyzstan leave all decision with regard the term of issuance, denominations of the securities, on

<sup>62</sup> The rules for the Stock trading of the Closed-Joint Stock Company "Kyrgyz Stock Exchange" approved by the Supervisory Board on January 15, 2009. (Pravila Birjevoj trgovli ZAO "Kyrgyzskaya fondovaya birja" yтверждена Решением Совета директоров от 25 января 2009 года), Article 1.

as minimum denominations are reasonable; no or reasonable limitations on requirements on currency of denominations; early redemption rights permitted; no or reasonable maximum interest rates.	currency of denominations, early redemption rights and the interest rates for the governing bodies of the companies. There are regulations for indicating term and denominations, but in general are also within the competence of the shareholders general meeting or council of directors.
<b>Governing law requirements:</b>  is given if local law allows that locally issued debt securities be governed by foreign law and foreign language be used for documentation.	The legislation of the Kyrgyz Republic does not explicitly allow or permit locally issued debt securities be a subject to the foreign law and be used in the foreign documentation. Kyrgyz Stock Exchange provides services in listing in the international securities markets, but however, the rules on which law will be governing such transaction is not openly indicated information.
<b>Credit ratings requirements:</b>  The capital markets are positively affected if locally issued debt securities are required to have a rating from a reputable credit rating agency with appropriate experience in the local market; overall, the credit rating requirements encourage local debt capital markets activity. There could be no legal requirement but there is a market practice to use a rating from a credit agency with appropriate experience in the local market.	There are no legal requirements to credit rate within the jurisdiction of the Kyrgyz Republic. Moreover, there are no established reputable credit rating agencies. The only credit rating practice is applied by bigger financial institutions (banks) which have an internal credit rating system and database.

Source: the methodology of the table is based on the assessment strategy used by the EBRD Local Currency and Local Capital Markets Initiative 2010<sup>63</sup>

<sup>63</sup> 2 Frederique Dahan and Jacek Kubas, The EBRD's legal and regulatory assessment – what limits development of local capital markets?, Law and Financial Markets Review, Volume 6, Number 3, May 2012 , pp. 218-223(6).



The analysis showed that from eleven criteria to assess the availability of the securities market for the issuers of the securities, the legal framework of the Kyrgyz Republic meets only two. Thus, the underdeveloped securities market does not allow the mobilization of the domestic funding, impeding the opportunity of internal funding of the companies. The companies – issuers of stocks and securities, are subject to liberal company law and corporate governance rules, face hardships in placing their issued stocks. According to reports of the Kyrgyz Stock Exchange, there were eleven companies engaged in the stock trading as listed companies in 2011<sup>64</sup> and only 1678 transactions on the securities market throughout the same year. Thus, because of the inefficient and excessive capital markets regulations, it is not exploited by the Kyrgyz companies as an efficient source of the local lending.

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<sup>64</sup> Kyrgyz Stock Exchange, section on Analytics, Financial Report of the Kyrgyz Stock Exchange for 2011, available at: <http://www.kse.kg/ru/RussianAnalytics/1886/Otchet%20ob%20itogah%20deyatelnosti%20ZAO>, last visited (June 6, 2012).

## Conclusion

According to scholars capital markets are the best way to mobilize domestic funding sources and to reduce the reliance on foreign currency lending and the related foreign exchange risks.<sup>65</sup> Therefore, the main purpose of this research was to assess the regulatory and the legal framework of the capital market of the Kyrgyz Republic.

The assessment was based on the EBRD Local Currency and Local Capital Markets Initiative 2010 that was conducted in Hungary, Kazakhstan, Poland, Romania, Russia, Turkey, and Ukraine. The legal and regulatory framework of the capital markets of the Kyrgyz Republic were evaluated on eleven factors outlined by the Initiative of the EBRD: capital requirements, policies on buying locally issued debt securities, insider trading protection, enforcement of investors right in case of debt securities default, investor remedies against market participants for market abuse, disclosure rules and procedures, availability of shelf registration, costs of issuance, rules of issuance in the local markets, governing law requirements, credit ratings requirements.

The results of the research showed that underdeveloped securities market does not allow the mobilization of the domestic funding in Kyrgyzstan, impeding the opportunity of internal funding of the companies. The capital markets regulations proved to be inefficient as out of eleven criteria of the assessment of the capital market regulation only two were fostering the development of the capital market or promoting the use of the capital market for purposes of raising finance. Thus, the capital is not exploited by the Kyrgyz companies as an efficient source of the local lending, because according to reports of the Kyrgyz Stock Exchange, there were eleven companies engaged

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<sup>65</sup>2 Frederique Dahan and Jacek Kubas, The EBRD's legal and regulatory assessment – what limits development of local capital markets?, Law and Financial Markets Review, Volume 6, Number 3, May 2012 , pp. 218-223(6).

in the stock trading as listed companies in 2011<sup>66</sup> and only 1678 transactions on the securities market. Companies – issuers of stocks and securities are subject to liberal company law and corporate governance rules, but face hardships in placing their issued stocks either by the securities market regulations or the rules of the local capital markets.

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<sup>66</sup> Kyrgyz Stock Exchange, section on Analytics, Financial Report of the Kyrgyz Stock Exchange for 2011, available at: <http://www.kse.kg/ru/RussianAnalytics/1886/Otchet%20ob%20itogah%20deyatelnosti%20ZAO>, last visited (June 6, 2012).

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