Invisible Things in Bubbles in the Stock Market

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Recently, the Ministry of Finance, the SBV and the State Commission of Securities have had a meeting with the PM to discuss measures to control and supervise the stock market in its hot development while the market keeps experiencing huge increases in the prices. What is happening?

1. New floor brings about higher price?

Besides factors constituted by a fast growing economy, is there any non-economic factor that makes the stock prices hotter?

At the first glance, everybody sees that all companies gained good performance. This might be one of reasons why investors had high expectation of their prospective growth. With some suspect, however, we can ask ourselves, "Were shares of listed companies earlier underestimated and new they are exactly valuated when the market attract a large crowd of investors?"

This might be right. But until recently, what has made some shares dearer when they are sold on a new floor? For example, PPC stocks was sold at VND65,000 on the Hà Nội stock trading center and at VND105,000 on the Saigon one. This may come from differences in trading systems of the two centers.

The trading practice on the Hà Nội floor (publicizing the prices after matching orders) requires investors to estimate the price correctly. Because orders are matched continuously, those who fail to estimate the price exactly will suffer losses. For example, a holder decides to sell stock at its price -floor when the market accepts a higher one and many people are ready to buy it, he/she will lose some profit. On the Saigon center, on the other hand, the practice of matching orders on a periodical basis can determine the market price during a trading session (this price is usually higher than the price-floor unless the market accepts only a very low buying price), which help such a holder avoid some loss. This practice also allows many major investors to manipulate the market and create imaginary demand. That is why a new floor brings about a higher price.

2. Spiral of capital surplus

By studying information publicized by listed companies, we must recognize that the better part of their income comes from financial investment. This income gives a false impression of their business performance. The following table shows that some listed companies have risked their capital on financial investments.

Stock symbol	Profit/ pre-tax income (VND billion)	Equity/ financial investment (VND billion)
DTC	38/ 12	120.9/ 52.9
NAV	21/ 1.4	38/ 11.5
HAP	19/ 15	158/ 38.5
SMC	20.8/ 2.3	102/ 26
DHA	29.9/ 7	186.6/ 83.6

When the stock market becomes a source of considerable profit, major companies are inevitably present in order to earn some profit for their shareholders. This profit can help them regain their momentum and attract more investors while investors get a wrong impression of the performance of the companies they have invested in because they fail to realize what underlies the development of the companies. Investors can discover unreasonable factors in listed companies but they can hardly do so with unlisted companies. Đầu Tư Chứng Khoán Magazine dated March 15, 2007 said that of VND83 billion of after-tax profit earned by TIE Company, 30 billion came from investments in Eximbank shares.

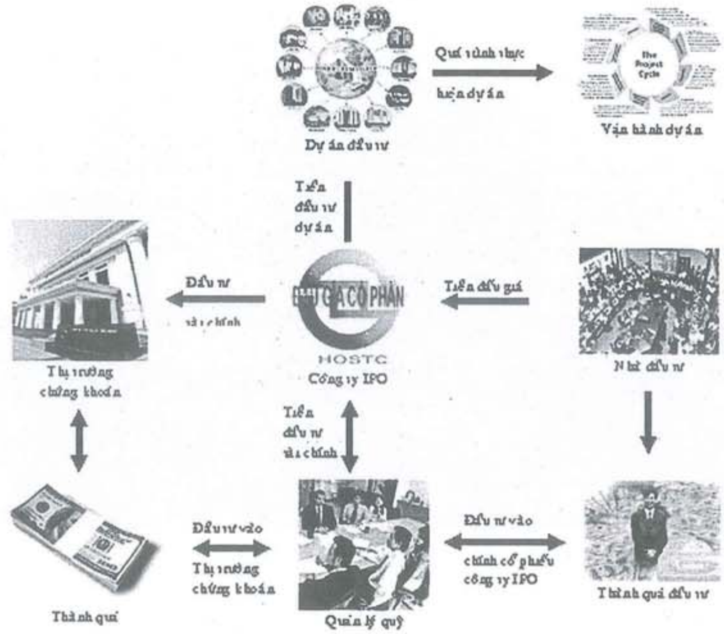
Can it maintain such a high profit in future as expected by investors?

3. Cooperation between companies and fund managers

When the stock market becomes hotter, authorities have issued warnings and new rules to make the development of the stock market more stable and sustainable. The potential risk, however, lies in financial investments made by joint stock companies because they are not experts in the financial investment and they may suffer risks any time. These investments enlarge the size of the stock market while the GDP doesn't increase accordingly, which constitutes an unstable factor in the stock market.

It's more dangerous when these investments are linked with IPOs. In implementing a project, it takes a rather long period of time to use up the sum of capital mobilized, this means that there is always some surplus capital and companies tend to turn it into financial investment.

With some arrangement with a fund management company, the company may have the latter use its surplus capital to invest in shares issued by the company. Realities show that there has been such arrangement that aims at boosting the price of its shares. The company has to do so because the company is not allowed by law to invest in itself. But the law doesn't ban a fund management company from using money from its client to invest in the client's company. This collusion may damage the sustainable development of the stock market. Fund management companies are professional investors and have more knowledge than ordinary investors. In addition, they have enough financial strength to carry out profitable and large-scale investing operations. And individual investors become late comers who volunteer to share their money with big players.



4. Ways to produce securities bubbles

At present, there is a tendency to increase the legal capital by issuing options and investors are eager to enjoy the fruit in the meeting of shareholders. Companies have the right to mobilize the capital but it should be taken into consideration if they use the capital mobilized to invest in the stock market. For example, the Board of Directors of the Viễn Đông Paper Company (VID), on March 12, 2007, decided to increase the legal capital to invest in securities. It issued high-discount options at a ratio of 1:1 (holder of one old share has the right to buy a new one) and sold them at face value. Thus, the company mobilized twice as much as its legal capital and put it in the stock market. Where will the stock market go if all joint stock companies do the same?

Another practice is that the company issues options with high discount rate at a price that is much higher than the face value in order to create surplus capital. This capital is considered as an instrument for boosting the price of shares when rumor has it that the company will give shares to shareholders as bonuses. A joint stock bank has recently announced that it would issue options at a ratio of 2:1 and a price that equals 150% of the face value. The surplus capital will be turned into bonuses for its shareholders.

The question is: why don't this bank issue options at a ratio of 4:3 and sell at the face value to raise the same fund as it planned? Is it right that by doing so it couldn't get any surplus capital to provide shareholders with bonuses and to boost the price of its shares?

If the securities authority keeps allowing joint stock companies to raise fund for financial investment according to the above-mentioned practice instead of using it for production, the stock market will collapse sooner or later. Is it about time the authority had to think of taxes on capital gain? ■