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**CHALLENGES IN CAPITAL MARKET DEVELOPMENT
IN REPUBLIC OF MACEDONIA**

**IZAZOVI U RAZVOJU TRŽIŠTA KAPITALA U
REPUBLICI MAKEDONIJI**

Abstract

The capital market , which from the institutional point of view , is an integral part of the financial market, should provide in each national economy: the resources efficient utilization, the ownership transformation and expanding, the investing projects selection from the aspect of propulsion and profitability and creation of optimal structure of the investors' securities portfolio. Effective functioning of the capital market means meeting some socio-economic preconditions, institutional forms and legal regulative which should be in function of protecting the stakeholders' interests. The aim of this research is an analysis of the capital market functions in Republic of Macedonia, through the resources mobilization and allocation, current validation of the firms, the restructuring of the firms ownership, providing of the current and perspective liquidity, attracting foreign investments in the national economy, the investors' portfolio optimizing, etc. For this purpose we carried out a survey on a representative sample of Macedonian companies and the data will be analyzed with many statistical tools. This analysis will enable identification of the reasons and

limiting factors in the capital market functioning in Republic of Macedonia and a proposal of measures for its more dynamic development.

Keywords: capital market, stock market, portfolio, securities

JEL: G32, G23, G11

Sažetak

Tržišta kapitala, koja su sa institucionalnog stanovišta integralni dio finansijskog tržišta, u svakoj nacionalnoj ekonomiji trebala bi da osiguraju: efikasno korištenje resursa, transformaciju vlasništva, selekciju investicijskih projekata sa aspekta propulzivnosti i profitabilnosti te kreiranje optimalne strukture portfolija vrijednosnih papira. Efikasno funkcionisanje tržišta kapitala znači povezivanje socio-ekonomskih preduslova, institucionalnih formi i pravne regulative koji bi bili u funkciji zaštite interesa stejkholdera. Cilj ovog istraživanja je analiza funkcionisanja tržišta kapitala u Republici Makedoniji kroz mobilizaciju i alokaciju resursa, vrednovanje firmi, vlasničko restrukturiranje firmi, obezbjeđivanje trenutne i buduće likvidnosti, privlačenje stranih investitora u nacionalnu ekonomiju, optimizaciju portfolija itd. U svrhu provođenja istraživanja prikupljeni su primarni podaci na reprezentativnom uzorku makedonskih kompanija i podaci su analizirani primjenom statističkih alata. Ova analiza će omogućiti identifikaciju razloga i limitirajućih faktora u funkcionisanju tržišta kapitala u Republici Makedoniji te rezultirati prijedlogom mjera za dinamičniji razvoj.

Ključne riječi: tržište kapitala, berza, portfolio, vrijednosni papiri

JEL: G32, G23, G11

1. Introduction

Capital market has an important place in each national economy, because through it, the economy realizes various economic goals. Namely, the capital market enables capital direction into investing projects that are the most profitable at that concrete moment, *i.e.* have the highest profit rate of the invested capital. On the other hand, the capital market allows the investors (free financial resources owners) to make quick change of the structure and direction of their investing portfolios for optimizing their structure. In this way, we make an optimal allocation and financial resources use, and this accelerates the economic development of the national economy. The capital market has direct influence on the efficient working of the business entities,

improves the people's living standard and accelerates the country's economic development. Development degree of the capital market is an indicator of the national economy inclusion into the contemporary world economic trends.

2. Literature review

Financial markets, such as the bond and stock markets are important in challenging funds from people who do not have a productive use for them to those who do. Indeed, well-functioning financial markets are a key factor in producing high economic growth, and poorly performing financial markets are one reason that many countries in the world remain desperately poor. Activities in financial markets also have direct effects on personal wealth, the behavior of businesses and consumers, and the cyclical performance of the economy (Mishkin & Eakins, 2006, p. 3).

All over the world, the capital market has played significant roles in national economic growth and development. One intermediary in the market that operates as a rallying point for the overall activities is the stock exchange. It is a common postulation that without a functional stock market, the capital market may be very illiquid and unable to attract investment. Essentially, the stock market provides liquidity, contributes to capital formation, and investment risk reduction by offering opportunities for portfolio diversification (Levine, 1991, p. 1445).

Capital markets have several beneficial features for different participants in the economy. For a company or entity in need of funding, domestic capital markets provide an alternative source of funding that can complement bank financing. Capital markets can offer better pricing and longer maturities as well as access to a wider investor base. They can also offer funding for riskier activities that would traditionally not be served by the banking sector and by doing so contribute significantly to innovation in an economy. For investors and savers, capital markets can offer more attractive investing opportunities – with better returns – than bank deposits, depending on risk profile, liquidity needs, and other factors. Further, with a wider range of securities and instruments offered, capital markets can help investors diversify their portfolios and manage risk (IFC, 2017).

Also, they improve the implementation of fiscal, monetary, and exchange rate policy. These benefits occur through a number of complementary channels. However, despite these potential benefits, not all countries have well developed capital markets. Moreover, government-led initiatives to develop local capital

markets have had mixed success. The development of local capital markets has been a long-standing policy question. Over the past decades, many countries have implemented significant reforms to foster domestic capital market development. Such reforms were often preceded by or part of broader reform agendas to develop financial systems and make them more integrated with the global market, including the removal of restrictions and controls on banking and the capital account (Laeven, 2014, p. 3). Moreover, the development of local bond markets was seen as critical for governments to finance large fiscal deficits without having to resort to financial repression or foreign borrowing with exchange rate risk and to facilitate the sterilization of large capital inflows (Turner, 2002, p. 2).

According to Bernard Black, an important challenge for all economies, at which only a few have succeeded, is creating the preconditions for a strong market for common stocks and other securities. A strong securities market rests on a complex network of legal and market institutions that ensure that minority shareholders (1) receive good information about the value of a company's business and (2) have confidence that a company's managers and controlling shareholders won't cheat them out of most or all of the value of their investment. A country whose laws and related institutions fail on either count cannot develop a strong securities market, forcing firms to rely on internal financing or bank financing – both of which have important shortcomings (Black, 2001, p.781).

In addition to providing for the depth and breadth of domestic financial markets in general, and of bond markets in particular, institutional investors are a force for change for other reasons as well. First, the development of the asset management industry brings along higher standards for investor protection, transparency and governance practices. Second, many observers regard institutional investors as a countervailing force to existing commercial and investment banks, arguing that pension funds foster competition and improve the efficiency of loans and primary securities markets. Third, institutional investors are a paramount force in promoting financial innovation and the modernization of trading systems. It should be noted, however, that in some instances institutional investors face restrictions of an institutional or regulatory nature that may hamper their appetite for innovation (Mihaljek, Scatigna & Villar, 2002, p. 36).

This paper is giving an overview of the challenges faced in the development of capital markets in the Republic of Macedonia, including preconditions needed and potential undesirable consequences of local capital market development.

3. The capital market conditions in Republic of Macedonia

The capital market in Republic of Macedonia is organized as a primary and a secondary market. On the **primary capital market in Republic of Macedonia**, there is a primary issuing of securities, approvals for offering sale of own shares and approvals for giving public offer for redemption of securities, mainly state bonds with different validity, state records and shares through private or public issuing.

Table 1 presents data on the value of long-dated securities issues for the period of time from 2011 to 2015. As per the data, the highest success in the capital market of Republic of Macedonia was realized in 2012, when long-dated securities at the amount of 20.497 million denars were issued. Significant decrease was seen in 2015, when the issues value was 12.016 million denars, which is rather lower compared to 2012. This situation is a result mainly to the drastic share issues decreasing, which value in 2015 was 120 million denars.

Table 1. *Long-dated securities issues structure, from 2011 to 2015 (million denars)*

Realized long-dated securities issues	2011	2012	2013	2014	2015
Value of the realized long-dated securities issues	1,845	10,466	12,359	13,362	11,896
1.Two-years continuous bonds	0	0	3,055	4,841	899
2.Three- years continuous bonds	0	2,082	1,417	912	2,800
3.Five- years continuous bonds	1,168	7,768	7,085	4,213	0
4.Ten- years continuous bonds	0	0	0	2,782	3,209
5.Fifteen- years continuous bonds	0	0	0	0	4,402
6.Bonds for denationalization	677	616	802	615	586
Value of the realized long-dated non-state securities issues	3,531	10,032	121	6,325	120
1.Corporative bonds	0	0	0	0	0
2.shares	3,531	10,032	121	6,325	120
-issued by banks	3,314	2,546	0	0	0
-issued by other financial companies	217	191	111	267	3
-issued by non-financial companies	0	7,295	10	6,059	117
Total value of the realized long-dated non-state securities issues	5,376	20,497	12,481	19,687	12,016

Source: www.mse.mk (Accessed: October, 2017)

Namely, the Securities Commission of Republic of Macedonia, from 2011 to 2015 approved 49 requests for securities issuing. All of them were for shares issuing, and in this period there was no request for bonds issuing. Table 2 presents data on shares issuing in the analyzed period in the primary capital market in Republic of Macedonia.

In the period from 2011 to 2015, 90% of shares issues were realized by a private offer, and only 10% of the shares issues were realized by a public offer (table 2). In 2015, the non-financial companies were the most active shares issuers, which through a private offer, realized only three new shares issues, at the total amount of 117 million denars, which has not got some higher significance for increasing the total sources for the business entities financing. During 2015, The Securities Commission of R. M, issued totally four approvals for shares issues, all realized through a private offer of ordinary shares. One of the issues were made based on the Law for converting debt of Republic of Macedonia, on the basis of public expenditures into long-term deposit in the companies AD “Ohis” Skopje, “EMO” AD Ohrid, “Tutunski kombinat” AD Prilep and “11. Oktomvri-Eurokompozit” AD Prilep (Official gazette of Republic of Macedonia, No.159/2008), for increasing the basic principal and creating conditions for undisturbed companies’ regular working.

In the last 3 years, also the financial institutions have not been especially active in the primary capital market, so any shares issue by the banks has not been seen, while the other non-bank financial institutions have issued new shares in almost insignificant amount, *i.e.* only 3 million denars (see Table 1).

Table 2. *Shares issues situation from 2011 to 2015*

Primary capital market (recording new securities issue)				
Period	No. of approved and realized issues	Issues total value, expressed in million denars	Issues value, expressed in million EUR	Offering kinds (private/public)
2015	4	120,37	1,95	Private offerings
2014	12	6,325,58	102,64	11 private; 1 public
2013	6	121,38	1,97	Private offerings
2012	16	10,031,54	163,1	15 private ; 1 public
2011	11	3,655,12	59,42	8 private; 3 public

Source: www.finance.gov.mk (Accessed: October, 2017)

Bonds issuing, as an alternative for providing additional capital, is not practiced by the Macedonian non-financial companies. This is mainly due to the lack of expertise relating to structuring and promoting this type of securities. The first public offering for corporative bonds in Republic of Macedonia, was realized in 2008, and the issuer was NLB Tutunska banka. These bonds were issued for the needs of the structural liquidity managing, provision of long-term sources for financing the bank's activities and managing the interest risks. The issue was realized by a success percentage of 88.86%, *i.e.* NLB Tutunska banka realized revenue of 10,663,000 EUR, mainly through a sale of 10,633 bonds. During 2016, in the period of time from 06/09-06/12/2016, there was a public offering for recording corporative bonds of Stopanska banka AD Bitola, when, after the end of the term for realizing the public offering, from the offered 5,000,000 long-dated debt securities (bonds), no one bond was sold, and the public offering was not realized. In the period from 2011-2016, no one issue of corporative bonds, was realized.

Secondary capital market in Republic of Macedonia is composed of the official and the regular market of the Macedonian stock exchange AD Skopje. The stock exchange started working on 28/03/1996, and the same year, it became full member of the Federation of Euro-Asian stock exchanges (FEAS). The Macedonian stock exchange has signed a Memorandum for collaboration with the Ljubljana stock exchange, the Athens stock exchange, Stock exchange center from Thessaloniki, the stock exchange in Zagreb, the Belgrade stock exchange, the Bulgarian stock exchange, and the Vienna stock exchange.

One of the recent projects of the Macedonian securities stock exchange, is the project for regional diverting of trading accounts-SEE Link, which from 29/03/2006 has become operative, while the promotion of the official start of the platform was held within the Annual conference of the Macedonian stock exchange in Skopje. The key event on the conference was inauguration of the regional platform for diverting trading accounts SEE Link, in the presence of the directors of the stock exchanges participating in the project (Bulgarian, Zagreb and Macedonian stock exchanges) and representatives of the European bank for reconstruction and development (EBRD), by which financial support this platform has been developed. The Ljubljana and Belgrade stock exchanges became participants in SEE Link at the beginning of December 2016. Three more stock exchanges have taken activities for joining SEE link: The Athens, Banja Luka, and Podgorica stock exchanges, and several stock exchanges from the region are also interested in joining the project.

Table 3 shows the realized turnover of the Macedonian stock exchange from 2010 to 2016.

Table 3. *Realized turnover of the Macedonian securities stock exchange in the period 2010-2016*

Turnover on the Macedonian Stock Exchange		
Period	Turnover (denars)	Turnover (million EUR)
2016	3,023,394,172	49,09
2015	2,660,494,514	43,17
2014	8,704,057,897	141,16
2013	3,234,557,987	52,50
2012	5,600,304,948	91
2011	13,655,857,674	221,94
2010	5,842,963,073	94,98

Source: www.mse.mk (Accessed: October, 2017)

According to the data shown in Table 3, the highest turnover on the stock exchange was realized in 2011, as a result of the increase of the securities issues of the companies which had to be listed on the stock exchange.

The development of our total market on the offer side, is based on the two projects for obligatory quotation in 2001 and in 2013, *i.e.* the market value of 115 listed companies is about 1.6 billion EUR and in relation to GDP is about 18%. The average indicator for this in EU is 65%, while in USA, UK and Switzerland; the figures go even above 100%. This is an indicator that shows what kind of enterprises structure and what kind of structure of the financial market, have been created in these 25 years of market economy in the country. It is obvious that there are not many big and quality shareholding companies on the stock exchange, or, there is not appropriate validation of the listed shareholding companies on the levels as is the average in EU. After 2011, the stock exchange has seen continuous decreasing of the realized turnover with securities.

4. Factors influencing the capital market development in Republic of Macedonia

The capital market has an important place within each national economy, because through it, significant economic goals can be achieved. Namely, it has direct influence on the efficient working of the business entities, improves the

people's living standard and accelerates the country's economic development. In Republic of Macedonia the capital market development is on a very low level. This is due to the influence of the following factors, *i.e.*:

- **Limited offer for financial instruments**, in which the investors could direct their free financial resources. This situation is due to the fact that the business entities are not interested in mobilizing financial resources through shares and bonds issuing. Namely, the business entities in Republic of Macedonia have realized up to now only a small number of securities issues in order to provide capital which will be used for financing the current and developing working. Most often, they finance the investing projects by using expensive banking credits, that significantly decrease their profitability. On the other hand, the Macedonian stock exchange has not been trading with options, futures and other derivative financial instruments yet, that in the developed capital markets are used as instruments for increasing the portfolio performance and as instruments for risk managing.
- **Poor financial infrastructure**. Within each national economy, non-deposit financial institutions (investment funds, insurance companies, pension funds) have a big importance for the capital market development. The basic task of these financial mediators is to enable safe and favorable disposal of people's small savings. As per the Statement for financial stability of NBRM, the total resources in the finance system of Republic of Macedonia at the end of 2015, amounted to 493,591 million denars. Because of the highest participation, the banks are the most important factor for maintaining the stability of the entire financial system, but also the stability of the other institutional segments. In fact, they participate with 85.8% into the structure of the total resources of the financial system. On the other hand, non-deposit financial institutions participate with only 13.6% in the total assets of the financial system. So, there is a need for building an appropriate strategy for their further growth and development, and for establishing an appropriate system for risks managing, which would have key role in the further development and readiness for coping with crisis situations in future.
- **The investors are not interested in investing their free resources into financial instruments**, and this is mainly due to: the potential investors are poorly informed on the advantages of investing into securities, the limited offer for financial instruments which is restricted only to shares and bonds, not-educated economic agents about the possibilities to invest on stock exchange, absence of foreign portfolio investments, instable macroeconomic situation of the Macedonian economy, *etc.*
- **The banking institutions' conservative investment policy**. The largest

part of the securities portfolio of the Macedonian banks consists of debt securities (over 90%). Within the debt securities, the state records and the treasury bills of NBRM have the highest participation, which are characterized by a low risk, and a low return ratio.

- **Investment banking does not exist.** In the developed market economies, the investment banks have crucial role in the process of preparing and placing the new securities issues. These banks also offer technical expertise for scanning the business entity's financial state, selection of the securities which would be issued into the market in a function of mobilizing financial resources, defining the price for selling the securities, determining the true moment for securities issuing, *etc.* In Republic of Macedonia, only one bank offers services from the investment banking area, while the existing banking institutions do not offer investment banking services.

5. Survey about the capital market situation in Republic of Macedonia

The purpose of this paper will be to define relevant indicators and factors that influence and determine the supply of the financial instruments on the capital market. Based on the main objective, through this work the following sub-goals will be carried out:

- To identify the sources of companies' financing,
- To explore the awareness level of the companies 'with the advantages of securities investing,
- To receive quality information on scientific and technical basis that will contribute to better understanding the limiting factors that affect the companies' decision for financing through securities issue.

In order to test the level of awareness of business entities in the country, a closed questionnaire of six questions was prepared. Some of the questions are dichotomous yes-no questions, and some questions have multiple answers from which the respondents could choose one or more. The questions were carefully chosen to get a clearer picture and a better quantitative analysis of the current situation related to the opportunities offered by the market to mobilize capital through the issuance of securities. The questionnaire was carried out on a representative sample of 63 business entities (small and medium enterprises), and an answer was received by 48 entities. The survey was carried out from July 20 to August 15, 2017 generally through direct contact or e-mail with representatives of the management team in the business entities.

On the first question, “Do you have, within your organization, a special sector that analyzes the possibilities for capital market financing?”, of the polled 48 firms, only 4.16%, or 2 firms, answered that they have special sector which explores the possibilities for capital mobilization through issue of securities.

Concerning the second question, “In which way do you finance your needs for financial resources”, all polled firms answered that they finance themselves by using bank credits and their own capital. Based on the conducted poll, it can be concluded that no one of the polled firms has mobilized resources through issue of securities.

On the question “Which is the reason that makes you being not interested in mobilization of necessary capital through securities issuing?”, the largest part, *i.e.* 85.4% of the respondents, *i.e.* 41 firms, answered that they are not informed enough on the advantages of using this kind of financing, while 4.16% of the respondents, answered that they are afraid of losing the controlling interest. More than a half, *i.e.* 52% of the respondents, said that they have not made securities issuing because of the fear that the securities they will offer to the capital market, will not be sold, while 93.75%, *i.e.* 45 business entities do not know very well the procedure for issuing and placing the securities (Figure 1).

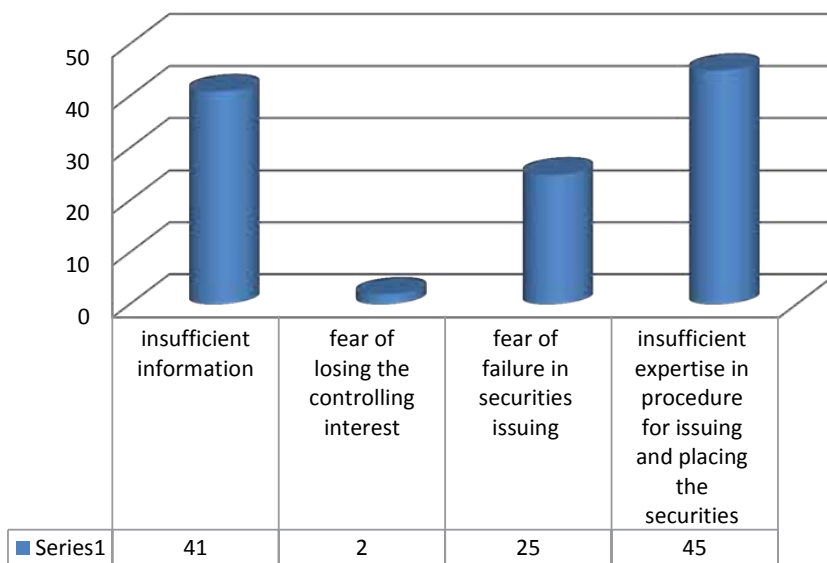


Figure 1. *The reasons why the investors are not interested in mobilization of necessary capital through securities issuing*

Source: Authors’ research

On the fourth question, “Does the existing law regulative in Republic of Macedonia motivate you to mobilize capital through securities issuing?”, the largest part, *i.e.* 85% gave negative answer.

On the last question, “Do you think about capital mobilization through securities issuing?”, only 6.25% of the firms, *i.e.* only 3 firms, said that they think about resources mobilization through capital market (Figure 2).



Figure 2. Do the firms think about capital mobilization through securities issuing

Source: Authors' research

6. Conclusions and recommendation for further research

The capital market is of crucial importance for the development of each national economy. The capital market development in Republic of Macedonia is on a very low level, as a result of: limited offer for securities, insufficient development of the investment banking, poor financial infrastructure, conservative investment policy of the banks, investors not interested in investing free resources in financial instruments, *etc.*

1. Having in mind the data obtained in the conducted analysis of the capital market situation and the results of the survey about the business entities financing through issue of securities, we suggest the following recommendations, which implementation will be in function of more dynamic development of the capital market in Republic of Macedonia:
2. Organizing seminars and workshops for education of the firms' managers about the affirmation of the capital mobilization through securities issuing, which will decrease the role of the bank credits in financing the current and developing work of the firms.

3. Organizing seminars, specialist courses and other forms of education of the potential investors, especially the small potential shareholders, and the employees in the financial institutions, about the advantages of investing into securities, which will increase the possibility for earning and the offer for services connected with the investing in various financial instruments.
4. Stimulating the possibilities for trading with derivative financial instruments, which will significantly increase the offer in the capital market and will create the securities portfolio structure that will maximize the yield at a definite risk level.
5. Boosting the development of the investment banking, with which the banks will enrich their range of offered banking services, *i.e.* services connected with the preparation and placement of securities, and appropriate services associated with the choice of the most appropriate way of the firms financing.
6. An aggressive promotion campaign by the non-deposit financial institutions, especially the investment funds, because they can attract bigger number of small potential investors who will invest their capital and will use their advisory services.
7. Liberalization of the law regulative that regulates the establishment and functioning of the non-deposit financial institutions (investment funds, pension funds, insurance companies). Furthermore, it is indispensable to make changes in the tax policy, which should be in function of the capital mobilizing through securities issuing.

Further researches in this area should be directed towards analysis of the capital markets conditions in the countries of the West Balkans and learning the possibilities for establishing a regional stock exchange, by using the positive experiences of the capital market functioning in the developed countries.

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