

STOCK MARKETS AND THEIR FUNCTIONING

A CASE STUDY OF THE STOCK MARKETS OF BELGRADE AND TIRANA

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Abstract

Instead of having a situation where business people would move towards the stock exchange and as such would make themselves and their business more interesting and visible to foreign investors, thus providing for themselves tools with lower cost for financing, the tendency of abandoning the stock market is clearly noticed by the companies both in Serbia and Albania. Analysts point out that the extraction of companies from Belgrade's stock exchange, is a consequence of the fact that they entered into the market as a consequence of previous rules (Law on Trade in Capital "Official Gazette of RS", No. 31/11 and Law on economic societies, "Official Gazette of RS" 36/11 and 99/11). However, in a situation when they did not succeed in utilizing market capital benefits, which corresponds with the favourable conditions for capital accumulation, improved management efficiency and strengthening the own image, companies decided to abandon it almost 10,000 shareholders by fulfilling the foreseen formal rules in this case and insufficient liquidity in the stock market (in accordance with the rules on the total turnover in the period prior to the withdrawal of shares, which was defined by the Law on Market of capital). Referring to these results, we'll try to present with this study the problems that have led to this situation in which the Belgrade Stock Exchange currently is, with the focus on a comparison of the functioning of the Serbian and Albanian stock exchanges, to analyze their symptoms, the main causes of the problems and to offer proposals for solving these problems.

Keywords: Stock market, Stock exchange, Financing, Serbia, Albania

INTRODUCTION

Instead of having a situation where business people would move towards the stock exchange and as such would make themselves and their business more interesting and visible to foreign investors, thus providing for themselves tools with lower cost for financing, the tendency of abandoning the stock market is clearly noticed by the companies both in Serbia and Albania.

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It was neither real nor expected that the Belgrade Stock Exchange would develop in a non-commercial environment, so the serious blame for such a situation should be sought in the state's passive position regarding the promotion of stockholding and stock market. As long as the situation remains as such, it is not possible to surely conclude that even these few companies, which are still trading in the stock market, will have an interest in future trading on this stock exchange. In fact, the current trend is that when someone withdraws the company out of the stock market, the same owner transfers the company into a LLC (Limited Liability Company). Such a situation in one hand attracts flexibility in managing the system, less operative expenses and obligations toward the investment opinion, but on the other hand by buying 100% of the shares he owns a massive capital, without the possibility of financing the business through the issuance of shares, the involvement of co-owners that would increase the efficiency of management and ultimately such a company is not exposed to the business assessment of the business opinion, which is an essential indicator of the results of the work of the economy in contemporary conditions.

Referring to these results, we'll try to present with this study; the problems that have led to this situation in which the Belgrade Stock Exchange currently is, with the focus on a comparison of the functioning of the Serbian and the Albanian stock exchanges, to analyze their symptoms, the main causes of the problems and to offer proposals for solving these problems.

A BRIEF HISTORY OF THE BELGRADE STOCK EXCHANGE

In 1930s of the 19th century, the first ideas and thoughts about the establishment of an entity whose core activity would be to control the developments in the value of money emerged in Serbia. The leverage for trade development of the time in Serbia - the Serbian Trade Association initiated the procedure for drafting the Law on public shares, the basis of which dated from November 1886, given that the same Law was passed by the Assembly, and later the official proclamation by the King of Serbia, Milan Obrenovic, followed. Eight years later, on November 21, 1894, in the founding convention of the Belgrade Stock Exchange, held in the Civic Casino, the governing bodies were established, the permanent directorate and the stock exchange brokers. The understanding for the formation of such an organization was to move forward in the area of trade regulation: securities, goods, checks, bonds and money.

The historical dynamics of business development in the Stock Exchange can be presented in this way (<http://www.belex.rs/>):

- The first meetings of the stock exchange were held in hotel "Bosnia"– it's about a meeting of the stock exchange, in which case all the stock works (currency, effect and merchandise) were contracted in one environment, so that later the work of this activity would turn in two sectors: the sector for goods, in the same place named as productive stock and the for currencies and effects –Stock Exchange with its headquarters in hotel "Srpska Kruna". Belgrade's stock exchange in this period was the economic entity which the best organised and one of the oldest stock exchanges in Europe, while the prices inside it were defined as a pricing model for other European stock exchanges.
- At the beginning of the twentieth century, the trading was conducted through securities, whereas the most demanded ones were the securities issued by the state, due to lower trust in joint stock companies, where the shares were quoted through 140 currency entities. After a 4-year break, under very difficult conditions, after the end of the Great War, the Belgrade Stock Exchange's activities were geared towards preparing the legal basis for its re-development.
- In 1934 the Stock Exchange moved to the new address: Kraljev trg (King Square) no. 13 in which the activities, circulation and the number of participants increased significantly, until the emergence of the world crisis, the effects of which were multiplied in the business of our economy. On the eve of the entry of the then Yugoslav Kingdom into World War II, on 28 March 1941, the last meeting of the Directorate of Stock Exchange was held in the format of the time.
- In fact it operated until 1953, when it was officially dismissed with a decision of the Serbia's Government Presidium. During the war time and in the period immediately

following it, a large number of former participants of the stock exchange had died, been imprisoned or the wealth was taken over. Moreover, a considerable amount of documentation which proved the existence of the stock exchange during that period disappeared.

- The 32 largest banks of Yugoslavia, in accordance with the general changes in the society, in 1989 organized the Yugoslav Founding Assembly of the Yugoslav Capital Market, which in 1992 changed its name to the Belgrade Stock Exchange. In the following period it was traded with short-term borrowing securities of enterprises, state debtors, and so on.
- On that basis, as of 1991, started the first shares trade with Sintelon and Auto-Kikinda companies. However, the most serious trading on stock exchange would begin only in 2000, by the start of a more serious privatization process in Serbia. Along with the shares of privatized companies, it also started the trade of bills of Republic of Serbia issued on the basis of the need to cover the old foreign exchange savings.
- In the following years through a progress is evident through the development of BELEX trade system, in distance and continues trade was installed, and international cooperation with other stock exchanges was intensified, including the stock exchanges in the region. The first index of the Belgrade Stock Exchange BELEX was published at the end of 2004, while to date it is continuing with the development of other stock exchange indicators, so that a year later the first information services for the distribution of data from real-time trading started to operate. Activities in educating the general public on the advantages of the stock exchange followed, and as a result of the advancement of cooperation relations with the stock issuers we got the promotion of shares listing.
- As of 2008 the Belgrade Stock Exchange participates in organising Road show conference for domestic companies, while shares of Serbian companies have been included in an increasing number of international agency indexes which cover regional trade capital. In the first half of 2008 started the informative system BELEXFIX, in 2010 BELEX FIX API model was developed, through trade applications. In the same year, the shares of public enterprises were also traded, which was positively reflected in the volume of market activities.
- However, with the reduction of activities on the basis of privatization, the volume of business and activities in the post-2011 period decreases, which is reflected in the overall business results of this entity, which is going to be a subject of this study below.

IDENTIFYING KEY ISSUES

Looking at the business results in previous periods, it has been possible also the identification of the key problems that have conditioned the decreased level of activities in the Belgrade Stock Exchange.

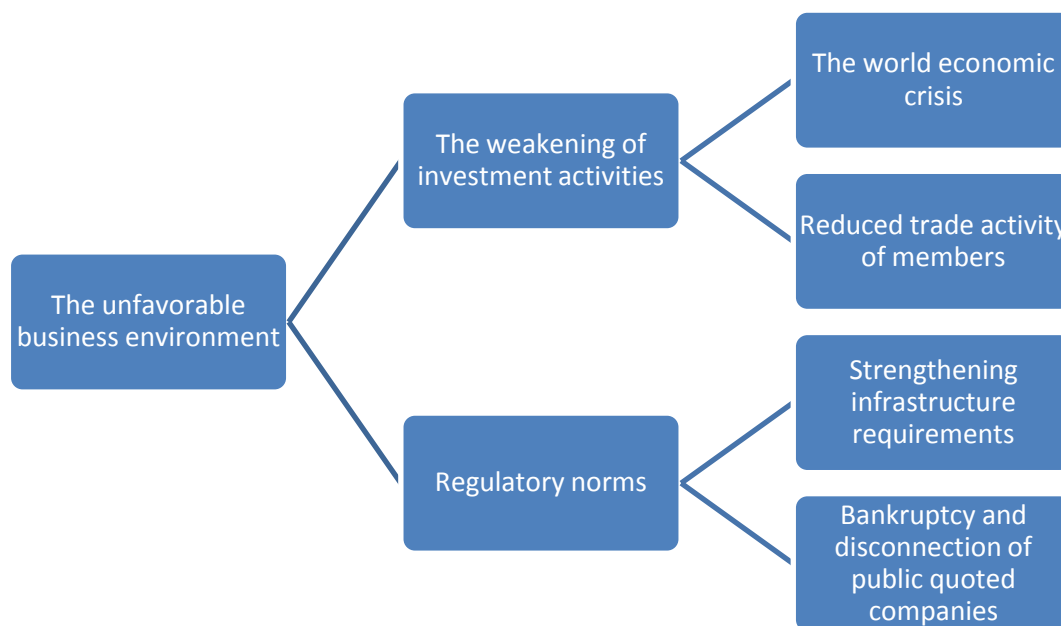


Figure 1: Schematic presentation of key problems in the functioning of the Belgrade Stock Exchange (<http://www.belex.rs/>)

Inappropriate business environment was also reflected in the state of revenues, but also on the expenditures of Belgrade Stock Exchange. The problems are even bigger if one takes into account the fact that a significant part of the losses is a result of the decrease of revenues from the basic activity, also on the basis of the decrease of the membership income, for performing listing works, provision revenues, compensation on the basis of use access to BelexFIX and revenues from data distribution.

There are two main segments, presented in scheme nr.1 which have conditioned such a situation— as they coincide with the weakening of the investment activity as a direct consequence of the economic crisis which came from abroad and due to the functioning of the system in Serbia and the decrease of the activities on the basis of the gradual completion of the privatization wave since the beginning of 2000.

On the other hand, weak investment activities normally are followed by regulatory norms, which even more aggravate the existing situation embodied in the tightening of infrastructure requirements, as well as bankruptcy and exclusion of public utilities quotations.

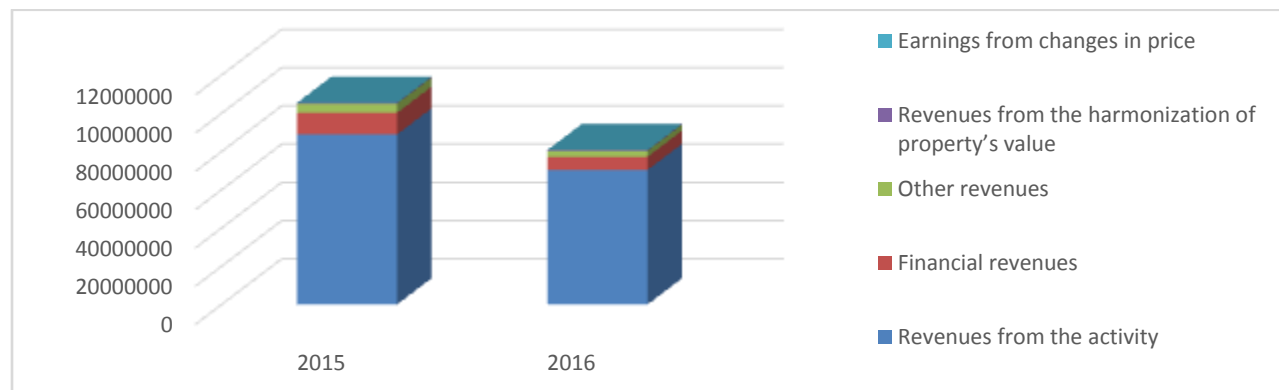
CLASSIFICATION AND ANALYSIS OF THE MOST IMPORTANT PROBLEMS - ACCORDING TO PRIORITIES

According to the BRA (Business Registration Agency) data, the Belgrade Stock Exchange in the previous business year has recorded a loss of 28,035,670.74 dinars, namely after adjusting the prolonged tax losses for revenues and expenditures, it appears that it has recorded a net loss of 26,703,791.43 dinars.

Below is presented an analysis of all factors that have conditioned negative results, both on the revenue side as well as on the expenditure side.

Analysis of the factors that have conditioned the reduction of revenues

The total revenues in 2016 were in the amount of 80.510.549,54 dinars or for 23.69% lower than the total revenues collected in 2015.



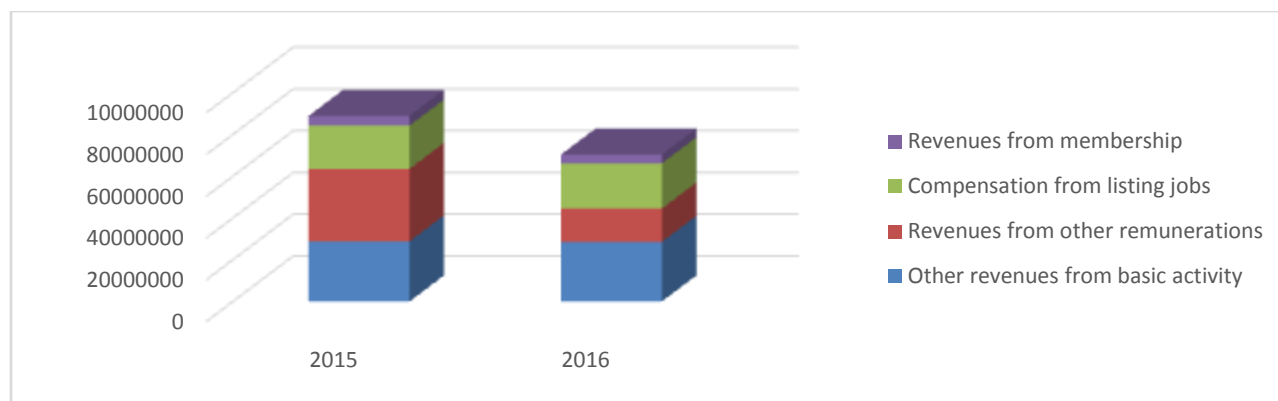
Graphic 1: The analysis of the general revenues (<http://www.belex.rs/>)

Because of the difference in the amounts disproportion, i.e. of negligible participation in the overall structure, the revenues from the reconciliation of asset values and the profit from the change realized in prices are invisible in graphic presentation.

The analysis of the downward trend of each of the mentioned revenues and factors that condition such a condition is presented below.

Revenue analysis on the basis of the activity

As could be seen in graphic 1, the revenues from the core activity which constitute 87.39% of the realized revenues, dominate the overall structure of revenues, while it consists of revenues based on membership, compensation from the publication of the listing, provisions, access and use of data by BelexFIX and revenues from data distribution.



Graphic 2: The analysis of business revenues (<http://www.belex.rs/>)

The downward trend of stock exchange members has resulted in the reduction of stock exchange members in numbers. This is perfectly logical, it has conditioned the reduction of revenues from membership for 10, 47% compared to the revenues realized in the previous business year, the total amount of which was 4,190,000.00 dinars.

Revenues from incorporation, listing and quoting of securities were the only ones that marked a slight improvement compared to the previous year (4.73%), which is a result of the trading of securities in the Prime Listing of Stock Exchange in a total amount of 21,653,000.00 dinars.

The key revenues that once reached a participation of 1/3 of the total revenues from the basic activity - the provision income, practically halved in relation to 2015 and reached a total value of 15,931,885.87 dinars (a drop of 54%). Their decline was the logical consequence of declining activities and the decline in the number of stock exchange members.

From other revenues of the basic activity, are notable the revenues from the distribution of data for local professionals and stock exchange members, compensation for access and use of BelexFIX data, revenues from the International Stock Exchange Conference, education activities of the stock exchange, different compensations from the report and processing claims, in the total amount of 28,581,052.25 dinars, which is a negligible decline compared to the previous year (less than 1%).

The analysis of financial income

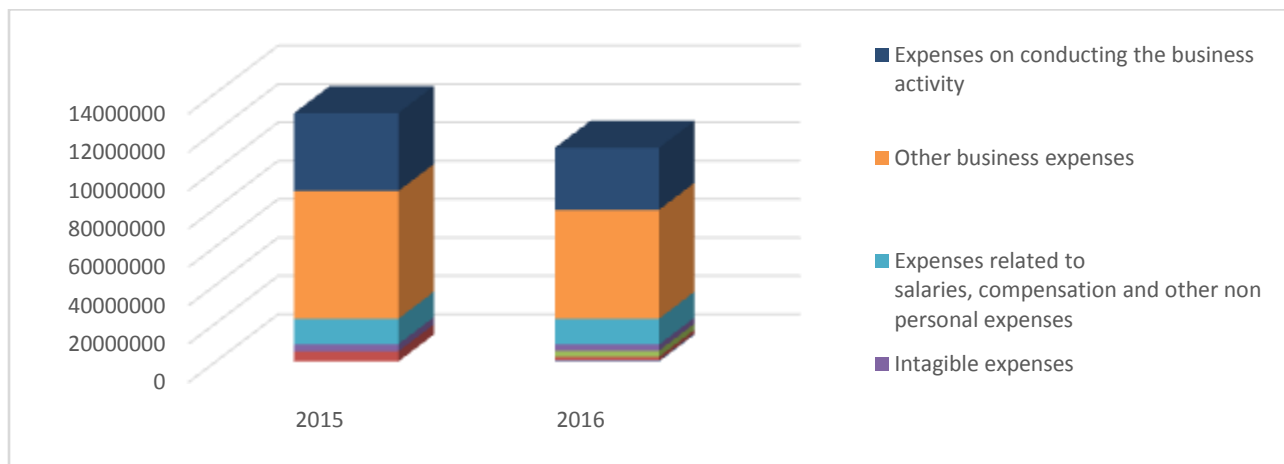
The general declining trend of interest rates conditioned the reduction of financial incomes from the previous year to 38.98% and include the income from the interest on the basis of term deposits in banks and other revenues based on the provisions of the foreign exchange clauses and foreign exchange differences/changes. The total amount of financial revenues at the end of 2016 was in the amount of 6,877,716.35 dinars.

The analysis of other incomes

In this group of revenues, which also show a decrease compared to the previous year - 34.99%, revenues from collection of claims and unrecorded revenues are included. Their total amount at the end of 2016 was 3.133.608,78 dinars.

Analysis of the factors that have influenced the size of the realized expenditures

Reduced business activity has as a logical consequence the reduction of costs, but their decline was not correlated with the dynamics of revenue cuts, but it is at a much lower level.



Graphic 3: Analysis of total financial expenditure (<http://www.belex.rs/>)

The total expenditures at the end of 2016 were in the amount of 108,546,220.68 dinars and for 16,58% lower compared to the expenditures of the year 2015. Most of the expenditures fall in the costs of wages/salaries, amortization and other business expenses. When talking about wages/salaries, during the previous year, the general condition which prevailed in the stock exchange has imposed the necessity of issuing a decision to reduce salaries/earnings of employees. From the perspective of financial stimulation, this move affected the additional deterioration of the stock exchange in relation to the competitors. This measure ensured a saving of 10.96% compared to 2015, while the total amount of salaries allocated to the employees with the respective contributions was in total of only 42.904.699,94 dinars.

Expenses for utilities, post services, telephone, amortization and services on subsequent maintenance of basic assets at the end of 2016 were in the amount of 32,271,953.24 dinars, which is 20.5% less than in the previous year. Even in this case, in relation to the decline in the volume of business activities, the reduction is not at the desired level, since revenues from the

basic business recorded a decrease of almost 18 million dinars, while the decrease of expenses, corresponding to the mentioned expenditures above, are only 8 million dinars.

The costs of licensing, auditing, advocacy services, representation and membership, and then tax expenses, fall into the group of intangible expenditures, and in 2016 they record an increase of 2% compared to the previous year, and in total they were 13,510. 407.99 dinars. Representation expenses related to the organization of the Upgrade Conference in Belgrade affected this level of total amount of expenditure.

Finally, as a result of the exchange rate variation during 2016, financial expenditures on the basis of timely foreign currency assets through the placement of banks have decreased considerably and amount at 1,981,972.97 dinars, which is 62.47% less compared to the same period of the last year (<http://www.stat.gov.rs/website/default.aspx>).

Significant observations that derive from parallel analysis of realized revenues and expenditures - SWOT ANALYSIS

Table 1: SWOT analysis of the state and measures taken in the functioning of the Belgrade Stock Exchange (Mileviq M)

Strength	Weakness
Increase of net losses by 4% in a situation when the turnover value of shares had fallen over 60%, high degree of financial independence	Rationalization of salaries, which acts negatively on the incentives of the members and the quotation of the Stock Exchange at the international level
Chances	Threats
Promotion of initial public bids both in private and public sectors, enriching the BelexFIX platform for trading in order to be more functional despite of different types of trading orders.	The increase of tendency to reduce the trade activity of members, their number is constantly decreasing, as well as bankruptcy and the abolition of a large number of quoted public companies.

THE DEFINITION OF NECESSARY MEASURES IN ORDER TO OVERCOME THE ISSUES AND THE DIFFICULT SITUATION THE BELGRADE STOCK EXCHANGE IS FACING ON

In this regard, in the situation characterized by negative trends in the local capital market, the large size decrease of investing activities as well as the illiquidity of secondary market of capital, the definition of necessary actions and measures aiming at overcoming the current situation, all of this burden is not easily affordable for carriers working on the implementation of these

activities. For the needs of this study as some of the measures whose regular implementation can contribute to improving the situation, we can specify the followings (Porter M^b):

- It is necessary to carefully *monitor the macroeconomic situation* and the effects that have an impact on the capital market. There are positive warnings about the gradual regulation of the overall economic situation, as we could witnesses in the following year, so that the activities in the well-being of the Belgrade Stock Exchange have to be maximally adjusted, of course to the extent that this is possible, the expected impact of the components and external factors of the business.
- To develop as much as possible the number of measures in terms of keeping the existing members and attracting new ones - through the implementation of projects that would contribute to the expansion of stock exchange activity and source of revenues, by keeping on at the same time the role of the key partner of investment companies, by which the Belgrade Stock Exchange would achieve its goal of developing the internal market. Partnership with other stock exchanges, then building infrastructure that would contribute to the implementation of the provision based on reorientation towards the new trading systems is one of the solutions.
- The maximum activity of the design department in terms of receiving donations for innovations, designing applications and other accompanying innovations by the EBRD and other financial organizations, that would advance the existing infrastructure and business basement.
- In regard to the operation of external components referred to paragraph 1 of this study's chapter, mobilization of all the potential powers available to the bearers of management activities in the Belgrade Stock Exchange are needed to contribute the progress of the business environment and overall investment climate, which undoubtedly have an impact on the overall stock market. This is possible by providing ongoing proposals and an active policy in terms of correcting pre-marketing and pre-shorthand rules and procedures, according to the models of developed countries.

RISK FACTORS

Some of the risks that must be clearly identified in the procedure for implementing the measures are (Bilton, Kris):

- The possibility the Stock Exchange, due to the influence of objective circumstances, or of external macroeconomic facts, not to reduce operating costs to the desired extent in a near future.

- Legal actions and restrictions that vary in the areas of interest of the Stock Exchange, both in national and international level - change of tax rules and the likes.
- Dealing with price pressures in the country and in the region. The risk of money placement in securities and the term deposit in banks is the daily functioning of the stock exchange members.
- Possible instability in the credit and capital market, expressed in investment activities in the securities market, which is closely related to the preceding paragraph.
- Rapid growth and the change in the region's stock exchanges, their empowerment and expansion of their activities and work.

However, it must be stressed that in this regard Belgrade Stock Exchange has long recognized the necessity of risk management as a very important element for its own business, so has developed a whole range of security and safeguards measures - by setting the risk restriction, ie the limit at which deviations in the execution of some of the works are allowed, in such a way not to jeopardize the liquidity of the Stock Exchange. It's about the following types of risks (Porter M^a):

- Liquidity risk – the emergence of circumstances that could jeopardize business continuity
- Price risk – fluctuations and price changes
- Credit risk – non-fulfillment of obligations from the side of other contracting party
- Risk of cash flow – the risk of non-payment of debts

TIRANA STOCK EXCHANGE AND ITS FUNCTIONING

Tirana Stock Exchange was opened on May 2, 1996, as a kind of department of the Bank of Albania (as integral part of it). Like in all Central and Eastern European countries, with a similar past like Albania, the state was the promoter and main supporter of stock exchanges. However, in Albania a different model was applied compared to the experiences of all these countries, as it was decided that the Tirana Stock Exchange would be administrated by Central Bank. This happen because there was a lack of a previous tradition in this regard, there was a limited range of financial instruments, and so on.

Thus, the private sector was weaker compared to other Central and Eastern European countries, consequently, the lack of shares and securities from the private sector;

- Privatisation of strategic enterprises had not yet started;
- Small chances of insurance, within a short period of time, of the economic efficiency of this new institution;

- Lack of relevant experts and experiences, outside state institutions of the financial sphere (Bank of Albania in our case).

Conscious that the activity of this Stock Exchange would not be the stock trading in a medium term, the Government, in cooperation with the Bank of Albania and the Securities Commission, decided to organize the primary and secondary treasury bills market in Tirana Stock Exchange. Although these activities are not "natural" activities of stock exchanges, these activities served more to other objectives, such as:

- Creation of tradition for the Tirana Stock Exchange functioning and operational activity;
- Conducting a marketing (without explicit cost) and educating the public and institutions on the operation of the Stock Exchange, investing in Stock Exchange and the functioning of financial intermediaries;
- To get a necessary expertise on the principles of trading, purification and regulation of securities by the Tirana Stock Exchange existing staff;
- Gradual, theoretical and practical preparation of this staff to further address the Tirana Stock Exchange's engagement in new activities in the future.

Briefly, the Government's goal was to: create, support and development an institution that, despite the fact that private economy and market forces do not support and develop it even today, will become a major national institution in the future to serve not only the state for achieving its strategic objectives for the development of the market economy but also the private business, orienting and incorporating it into financial system institutions. Normally, Tirana Stock Exchange should have incorporated privatization process that would follow after 1996 (mainly strategic), the listing of joint stock companies, and further consolidate the treasury bills market. But, currently in the Tirana stock exchange:

- There is no single share listed yet, either of the privatization companies (strategic or non-strategic) nor private businesses;
- The primary treasury bills market is no longer in the Tirana Stock Exchange since August 1, 1998 (is conducted by the Monetary Operations Department of the Bank of Albania);
- No single transaction has been carried out on treasury bills since February 1999, while in Albania the secondary market of treasury in the Tirana Stock Exchange is not the only secondary market for this instrument; privatization bonds were never traded on the Stock Exchange, never becoming a real trading object.

OPERATIONAL ASPECTS AND DYSFUNCTIONALITY OF STOCK EXCHANGE SECURITIES

Banks in Albania, like in other countries, are mostly focused on two activities, deposits and crediting. They also pay attention to the investment activity where, in the Albanian reality, banks invest more in treasury bills. As these activities (lending and investing in securities, mainly treasury bills) make the most of the bank's profit, the bank's operational activities are neglected. In operational activities we can mention various banking transactions such as bank transfers, bank commissions, payments for (telephone, various fines, electricity), foreign exchange, etc. From the personal experience in the banking system, I consider that there is not much attention to the operational aspects due to the fact that their income is lower compared to the one generated by lending activity and investment in securities. But if the banks do not have the client first, then there will be more dissatisfaction. This dissatisfaction will reduce the number of bank customers and subsequently the number of potential customers interested in deposit and lending.

According to data and reports of international financial institutions it is clear that in the countries where securities exchanges are developed, the banking system is more developed. So there is a fair link between the stock exchange and the banking system development. Therefore, the lack of proper functioning of the stock market has conditioned the investment of banks in Albania, which are mainly focused on investing in treasury bills. Furthermore, the operation of the stock exchange would create suitable conditions for further development and economic growth. This directly affects the banking system. The more customers for the bank and the more liquidity in circulation are the results of a healthy economy and an economic growth. Thus, the functioning of stock exchanges at the appropriate level has a very important positive role in banking system.

CONCLUSIONS

Basic resources for endurance of contemporary stock exchanges are reflected in the minimization of operating expenses and maximization of business revenues based on the basic activity.

Reflection and analysis of historical development of Stock Exchange, results and achievements of past economics should not mislead the bearers of activities in managing this entity. It is a fact that times are changing, the changes are huge and permanent at all levels of the functioning of society, which is undoubtedly being expressed in the performance of Stock Exchange. For this reason it is very important to be up to date with current events and at any moment to identify key problems in the functioning of this system. Some of these problems are

easily identifiable and some other more difficult, in some of them it is possible to influence, others are a consequence of objective circumstances from outside and as such remain outside the intervention domain. What is common is the fact that we should not be indifferent to their influence.

For this reason is necessary to the extent that this is possible, making a careful analysis of all the components that have an impact on both the size of the expenditures and the size of the revenues, to make their cautious classification and systematization of the final effects on business outcomes. Indeed, reflection of power and opportunities, chances and threats is needed, so in one word SWOT analysis is needed.

The study also underscores the current and future risks of implementing measures and policies in the process of realizing long-term business goals. The aim is to reflect as much number of risks as possible and to take them into consideration. It of course represents a good basis for starting a whole range of new measures and activities, but not the guarantee that they will produce results at any cost, taking into account the frequent changes that we witness in our daily lives of the society functioning.

However, if referring to the quality ground, on the basis of good projections, the study can, in the most appropriate way, to pave the way for historic recovery and in every other sense of the great system such is the Belgrade Stock Exchange. The way in which it will be realized and the effects of its realization are something that at the time of its compilation and still represents an unknown for the author and the one that commissioned the study, but also to permanent perfection through the recognition of all essential elements that might influence the final outcome of the realization.

RECOMMENDATIONS

- Finally, we think that the resurgence of Stock Exchanges such as the ones of Belgrade and Tirana will be possible through a support and political and strategic will of governments that would guarantee the functioning of this market and stock exchange, which is a consequence of the economic development of the country, but above all of the high level of informality.
- Increasing the efficiency of financial markets by promoting competition, decentralization and increasing transparency in general.
- Increase the economic efficiency of businesses by improving the quality of management administration.

- To have higher efficiency of fiscal and monetary policies of state institutions, contributing to economic growth and consolidating economic standards and benchmarks for different financial products and services.
- To establish conditions for entry of new operators in these markets (brokerage houses, investment advisors, investment funds, management firms of securities, etc.).
- To develop courses, trainings for quality improvement and development of financial economic culture in Serbia and Albania.

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