

REASONS FOR REDUCTION OF THE STOCK EXCHANGE ACTIVITIES IN THE REPUBLIC OF MACEDONIA

Abstract

The sharp crash in prices of the Macedonian Stock Exchange activities after 2007, when the Macedonian Stock Exchange Index has reached the highest value of its establishment and several-years reduced daily turnover of only about 2 thousand euros, indicates that the central institution of the capital market of the Republic of Macedonia has fallen in its own development crisis. Although there are listed more individual reasons for the state of the Stock Exchange, each of them separately is not sufficient enough to explain the occurrences. It is a matter of complex of reasons dominated by several ones in a certain period. There is no doubt that Macedonia faces the political and security risks, which reason the investors (both home and foreign ones) out of investing in long-term securities. The global crisis has an adverse influence upon the economic flows in the country, and that reflects negatively on the motivation of investing. It does not have to be underestimated the insufficient experience of working with long-term securities (as it was the adverse experience of some investors in 2007). It is talked least about the domestic investment climate as if there are no problems in the development and macroeconomic policy of the country. The improvement of the investment climate depends, in fact, upon the solving of problems and there can be explained the lost relationship between the prices of shares and their value in the Macedonian Stock Exchange.

Key words: Macedonian Stock Exchange, shareholding, shares, share price indices, boom and crash in prices, investment climate

Introduction

Upon the establishment of the market economic system in Macedonia, an important place and role have been given to the development of the shareholding and of the share market as an important segment of the capital market. Despite the certain delay, there were created formal legal and institutional conditions for the functioning of the Macedonian Stock Exchange in 1995. The first purchases and sales of shares were effected rapidly. The Macedonian Stock Exchange Index of shares started functioning too. However, about 10 years had to pass in order to be felt its presence in the economic life. That happened as a result of the boom of share prices in 2005 and later in 2007. Since then till now, it has come to reduction of the share prices due to the global crisis, and later due to the stagnant situations within the country's economy. In most of the quoted companies, the share prices dropped at a level lower than the one in 2005. The share price indices of the largest Foreign Stock Exchanges returned themselves at the pre-crisis level, whereas the Macedonian Index still does not show any signs of improvement, and it is far from reaching the pre-crisis levels. What is it which prevents it from pulling away from the bottom?

Within the response to this question, we will show the movements of the Stock Exchange and the reasons for the oscillations of the turnover and share prices. In that context, there will be indicated the problems that caused the Stock Exchange positions to be the way they are now and the manner of reviving the Stock Exchange. There are not any external events that should happen in order to be made a permanent switch in the economic development of the country, unless it is improved the domestic investment sphere at the same time. The Stock Exchanges have almost reached the pre-crisis levels of prices within the developed economies, whereas the Macedonian Stock Exchange Index-10 (MBI-10) is not even moved away from the bottom in a situation when the market prices of the best companies' shares are far below the level of their account values. Within this gap, in the first boom of share prices in 2005, the investors found a strong motive for investing. But, nowadays, it does not exist. The potential capital profits of the actual establishment of the relationship between the companies' account values and the market price of their shares is not even instigated. The credibility of investing in shares and acquiring the funds for investing through emission of shares is reduced.

Stock Exchange Boom and Crash

In its former existence, the Macedonian Stock Exchange of long-term securities went through all stages of development up to the stage of a representative market institution of the country. The Stock Exchange went through the so called “baby” development stage, which characterized itself with very little activity. In the period 1999 - 2003, the Stock Exchange was primarily performing the function of necessary market infrastructure of final privatization of the social and state capital and consolidation of the proprietary structures created by privatization. This was manifested in the form of domination of block transactions and state auctions in the attained turnover of the Stock Exchange, and in the absence of voluntary participation of the companies at the Stock Exchange.

Since 2004, it has begun to be slowly recognized the new life cycle of the Stock Exchange, where, despite the fact that the processes of consolidation of ownership in the companies have not been finished yet, it is notable the component which has to be a top objective – the Macedonian Stock Exchange to become a place, where at a moderate risk, it can be invested and doubled up the free funds of home and foreign investors. The significantly increased turnover in 2005, only justified that statement.¹ The rapid growth in the turnover of shares and the increase of the Macedonian Stock Exchange Index (MBI-10) in 2006 and 2007 indicated a switch in the working of the Stock Exchange, showing both the positive and negative effects.

Table 1

Results of the Stock Exchange Trading

- In bil. denars

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Classical trading	2	1.566	1.79	2.8	6.7	10.8	30.4	8.1	4.1	3.3	3.4	2.75

¹ From the opening of the sixth Conference of Macedonian Stock Exchange, published on the website of Stock Exchange, 16.09.2005

-Shares	0.941	0.857	0.51	1.3	4.6	8.6	28.8	6.7	2.8	2.0	2.1	1.6
-Bonds	0.981	0.709	1.28	1.5	2.1	2.2	1.6	1.4	1.3	1.25	1.3	1.2
Block transactions			0.27	5.2	1.7	14	11.2	4.1	2.6	2.5	8.96	2.4
Public stock-exchange auctions			0	0.40	0.44	6.2	0.10	0.10	0.02	0.04	0.32	0.35
Other securities		0.304	0.26	0.02	0	0.02	0	0	0	0	0.93	0.10
TOTAL	1.922	1.87	2.31	8.3	8.9	31	41.7	12.4	6.7	5.8	13.7	5.6
Average daily turnover in mil. denars	14.1	9.3	11.4	14	33	43	123	32.8	16.8	13.2	14.2	11.2
Average number of transactions	74	68	85	86	159	208	574	175	141	104	96	60
Number of quoted companies				68	57	43	38	38	36	34	32	32
Macedonian Stock Exchange Index	978	1095	1179	1352								
MBI-10 -4.01.2005				1000	2292	3703	7741	2096	2752	2270	1975	1731
Macedonian Stock Exchange Index of companies -18.06.2007-index=10000							8414	2214	3036	2459	2084	1735

Source: Made on the basis of the Annual Report of Macedonian Stock Exchange for the years given above

The total results of the Stock Exchange trading clearly show that the turnover of long-term securities, with the beginning of the new millennium, is in permanent growth, whereas the absolute record was achieved in 2007, when on all the grounds, there were traded nearly 42 billion denars. Out of this amount, 28.8 billion or 69% refer to the classical turnover of shares, 3.8% to trading in bonds and 26.9% to trading in block transactions, whereas the rest of the amount refers to trading in public stock-exchange auctions.

After the boom noticed in 2007, and during the global financial and economic crisis, it has come to a profound reduction in the Stock Exchange activities. By the end of 2012, the total turnover of securities has reduced itself by 7.4 times. The turnover of shares has reduced itself by 18 times, whereas the turnover of bonds by only 25%. The turnover of block transactions has reduced by 4.7 times.

The data of the average daily turnover speaks very illustratively about the dynamics of trading. From imperceptible 9 million denars in 2002, the average daily turnover increased to 123 million denars in 2007. It is also rapid the growth of the average number of transactions. From 68 in 2002, the number of transactions in the Stock Exchange mounted to 574 in 2007.

After 2007, it has come to a sharp reduction in the average daily turnover of the Stock Exchange. By the end of 2012, the daily turnover has decreased by 11 times, thus coming down to 11.2 million denars. The average number of transactions made in the Stock Exchange has decreased itself by 10 times.

To the Stock Exchange, it has happened what usually happens to the Stock Exchanges after periods of rapid growth of share prices. However, that happened not because it has to happen, but because the growth of share prices detached itself from their real values in 2007, and in accordance with the economic regularities, it had to be corrected.

Table 2

The market capitalization as a percentage of GDP

	2004	2005	2006	2007	2008	2009	2010	2011	2012
Market capitalization in billion denars	54.4	74.4	108.9	309.07	124.5	137	135.1	127.6	120.4
GDP in billion denars - current prices	272	295	320	365	412	411	434	462	
Market capitalization as a percentage of GDP	20.0	25.2	34.0	84.7	30.2	33.3	31.1	27.6	

Source: Calculation made on the basis of the data of Stock Exchange, and the GDP on the grounds of the Basic Macroeconomic Indicators of the Ministry of Finance

Through the share price fluctuation in the Stock Exchange, Macedonia overcame the situation of insignificant share in the market capitalization of GDP. The market capitalization had a share of 20% in 2004, and 25.2% in 2005. In 2006, its share increased to 33.3%, whereas in 2007, it surpassed a level of 84.7% of the social product. Of course, with the crash in prices of long-term securities, after 2007, the share in the market capitalization has reduced, and it was 27.6% in 2011. The low share in the market capitalization of GDP, before 2005, was a consequence not only of the little turnover, but also of the high depreciation of the securities traded in the Stock Exchange. The state changes itself along with the growth of the prices of auctions. The market capitalization had been increasing the share in GDP till the boom in 2007. However, after 2007, it has reduced itself with the crash in prices of securities.

Reasons for the rise in prices of shares

The reasons for the rise in shares in the Stock Exchange in 2005 were primarily the profits that the investors could expect at a certain short time and with relatively little risk, purchasing shares at market prices, which in the concrete case were significantly underestimated. It comes down to a situation, where the market share prices of companies comprising the Macedonian Stock Exchange Index (MBI-10), did not reflect the real values of the companies, considering the already attained values and the possibilities for generating future profits. After the completed proprietary re-construction and initial determination of the capital value (registration of the companies' principal), they managed to function profitably and to increase the allocations for strengthening the capital base of the companies. However, as a result of the ineffective functioning of the capital market, the realistically increased values did not come to the fore in the Stock Exchange. The fact that the market prices of shares were far, not only below their account values, but also below their nominal prices, was a strong signal for the investors to purchase them. The investors who have understood the situation, started to purchase, and the more they buy, the more the share prices increase.

The increase in allocations for strengthening the base of development has caused the account value of the companies to be over their nominal value.

Table 3**Review of the account and nominal value of the companies' shares comprising the Macedonian Stock Exchange Index (MBI- 10) in 2004**

Company	Nominal price	Account price	Index 3:2
1	2	3	4
Alcaloid	1549	3697	239
Heating	3095	3514	114
Commercial Bank	5514	10675	194
Makpetrol	30658	32581	106
Skopje Market	3092	7280	235
Commercial Bank Bitola	3596	5199	145
Granit	369	679	184
Macedonia Tourist	1549	3539	229
Europe	2407	2817	117
Ohrid Bank	2470	3138	127

Source: Calculation made on the basis of the data of the Macedonian Stock Exchange and final calculations of the companies comprising the Macedonian Stock Exchange Index (MBI-10), available on the website of the Macedonian Stock Exchange

The data clearly shows that the account values of the companies surpassed their nominal value in 2004. However, due to the already mentioned reasons, the discrepancy between the market price of shares and their account value was present till 2004.² In 2005, there was a large growth in the share prices, but it culminated in 2007.

Despite the fact that the higher account values of the companies in relation to the nominal values of shares, were not decisive, they were very important for the

² There is a more detailed analysis by years in the Master's paper of Krste Shajnoski, published as "Macedonian Stock Exchange Boom in 2005 – Fiction or Reality" Vlabor, Skopje, 2006

fluctuation of the market prices of their shares. During the boom, the shares, whose account values were lower than the nominal prices, have shown significantly higher growth of their nominal values. However, before the rise in prices, the coefficient market price/account values of shares of the companies of the Macedonian Stock Exchange Index (MBI-10) varied from 0.13 to 0.66% in 2004, but in 2005, this coefficient showed everywhere that the market value of shares surpassed the account value. It is a fact that this discrepancy between the market price of shares and their account value, which guaranteed good contributions out of the deposits in purchasing the shares of the companies comprising the Macedonian Stock Exchange Index (MBI-10), did not stay unnoticed by home and foreign investors. Their more increasing demand was extorting a faster growth of the share prices. In conditions like these, the vendors did not hesitate to sell them, considering the long period of holding “valueless paper”. That brought to reduction of the discrepancy between the account and market prices of shares, whereas some market prices surpassed even the account values in the spring boom. That especially came to the fore in 2007, when the prices of the Stock Exchange reached the highest values. The market prices of most of the shares have surpassed the account values of the companies several times.

In the share price boom, in 2006, there were certainly signs of inflation of the share price bubble, but in 2007, the bubble burst. It was like that, not because of the beginning of the global crisis, but primarily, because the purchasing of shares by market prices of the Stock Exchange became unattractive, considering the existing and realistically expected values that the companies could attain. During the “market selection” of winners and losers at the Stock Exchange, it has been realized that the share prices depend upon the profit growth made during the year (including also the payment of dividends) and on the realistically expected profit in the next years.

Reasons for the crash in share prices

Following the logic of the fundamental analysis of the fluctuation in share prices of the Stock Exchange, which showed that the material base of the rise in share prices in 2005 was their underestimated value, it is normal the reasons for the crash in share prices of the Macedonian Stock Exchange after the boom in 2007, to be searched in the exaggerated, economically unjustified rapid growth of share

prices and, of course, in the objective non-maintenance of that situation at the market. If the relationship between the share prices and the existing or anticipated profit loses, sooner or later, it will come to imminent adjustment of the real values of the companies with the market value of the shares they have issued. If the values are underestimated (and the profits per share, in such a case, surpass the interest rates on deposits by far), the share prices are being corrected upwards, and vice versa, if the value of companies is overestimated (the profit per share falls below the interest rates on deposits), the share prices are being corrected downwards. That actually happened to the Stock Exchange. That could even be expected, but there were not any pessimists who would predict that the prices would fall below the level of 2004.

In this context, we present data which shows the discrepancy between the market prices of shares of the companies comprising the Macedonian Stock Exchange Index and the indicator profit per share in relation to the market price of the share.

Table 4

Movement of the indicator profit per share/price during the period 2004 – 2007 and in 2012

	% of profit/ price				
	2004	2005	2006	2007	2012
Alcaloid	9.7	6.5	5.2	2.7	10.0
Heating	15.7	6.3	1.7	2.4	1.0
Commercial Bank	54.3	6.9	7.0	7.3	17.7
Makpetrol	9.6	6.7	7.2	1.3	0
Skopje Market	42.9	9.8	16.4	4.0	5.2
Commercial Bank Bitola	19.9	12.2	5.0	5.7	0
Granite	49.7	28.8	20.7	5.9	28.5

Macedonia Tourist	21.5	12.2	9.5	4.6	13.7
Ohrid Bank	15.1	9.4	4.4	3.1	7.2
AW Pelagonija	#DIV/0!	9.0	8.8	5.9	55.7
Fershped	#DIV/0!	0.0	10.0	3.6	7.8
Teteks	#DIV/0!	0.0	17.2	0.3	0
Makstil	#DIV/0!	0.0	10.5	2.3	0
Beton	#DIV/0!	24.8	11.8	2.0	13.0
Replek					12.6
Tikvesh					0
TTK Bank					1.1
Vitaminka					21.5
Zitoluks					10.3
Zito Vardar					0

Source: Calculation made on the basis of the data submitted to the Stock Exchange, for the years given above

The data shows that the growth of share prices in 2006 and 2007 significantly reduced the percentage of the profit per share in relation to the market prices of shares, as a result of what, in 2007 the earnings fell below the interest rates on one year fixed-term deposits. That is, of course, not attractive at all to purchase shares. Thus, the reduced demand extorted an accelerated falling of the share prices at the end of 2007 and continued in the next five years. The expectations that the downward trend of share prices will stop soon, were not realized, because the falling of the share prices increases the profits made per share. That did not happen even till the end of 2012. The imminent adjustment of the real values of companies with the market values of shares was dropped out. It remains to hope that the investors will soon perceive the underestimated shares, expressed by the low coefficients of price/account value and the increased per cent of profit/price, and will accelerate the purchase of shares in order not to be late in the anticipated upward trend of an adjustment of the market prices of shares with their real values.

In terms of the already mentioned expectation especially speaks the indicator profit/price at the end of 2012. With the beginning of the financial and economic crisis, the large gap between the market prices and account values started to reduce, and at the beginning of 2013, it happened again, the account values of even the best companies to be higher than their market prices. There was formed a picture as if nothing happened at the Stock Exchange in 2004. The largest number of shares is sold by lower prices than the value of companies, according to their account value, but even besides that there is no demand. For some investors, it is not even important that some companies pay dividends at a rate higher than the interest rates on fixed-term denar savings.

The consequences of the crash in prices of the Stock Exchange are still felt, and a reason for that is also the slow recovery of the economies of the developed countries (although some of the Stock Exchanges in the developed economies reached the pre-crisis indices of shares), particularly the assessments of adverse influence upon the domestic economy.

Upon the crash in prices a strong influence, especially a psychological one upon the home investors, has the withdrawing of foreign investors from companies in Macedonia. After 2008, it has been constantly reduced the share of foreign investors in the home companies' principal, whereas the share of foreign legal entities and physical persons in the sales of the Stock Exchange was larger than their share in the purchase.

The reasons for the crash in prices, however, should be searched the most in the adverse climate of investment. The stagnant situations within the economy and the uncertainties for the further development of the country have an adverse influence upon the motive for investing. That is why the market of shares is still not started, and there is also no interest for starting new investments. Therefore, the interest for acquiring funds through emissions of new shares is imperceptible so that the investors' interest, especially of the institutional ones, will be increased, because it is difficult to prompt the individual investors that underwent losses in 2007.

Contrary to the turbulent occurrences at the secondary market of long-term securities, the occurrences at the primary market are not even noticed. From time to

time, there have been published notices of sales of shares of new emissions in separate companies, most often banks.

Table 4

Number of emissions, types of long-term securities, type of offer

Year	Number of issued approvals	Volume (in mil. denars)	Shares	Bonds	Private offers	Public offers
2000	40	6.342	39	1	40	0
2001	20	2.585	20	0	20	0
2002	24	4.832	24	0	14	10
2003	25	2.383	25	0	19	6
2004	17	5.394	16	1	14	3
2005	14	11.475	13	1	14	0
2006	16	943	16	0	13	3
2007	10	1.728	9	1	10	0
2008	22	6.130	21	1	21	1
2009	7	5.395	7	0	7	0
2010	6	4.289	6	0	6	0
2011	11	3.655	11	0	8	3
Total	212	55.151	207	6	186	28

Source: Made on the basis of the Annual Report of the Securities and Exchange Commission for the years given above

In the period 2000-2011, the Securities and Exchange Commission of the Republic of Macedonia issued 212 approvals for emission of long-term securities in the amount of over 55 billion denars. The average value of a single emission is 260 million denars. However, it can be seen by years that the lowest average value per emission was noted in 2006 – with 59 million denars, whereas the highest value was recorded in the previous year i.e. 2005 in the amount of 820 million denars (this refers to a major effect because of the emission of shares upon the privatization of

the Macedonian National Grid, which had a share of 75% of the totally emitted securities in the mentioned year).

An essential characteristic of the emission of long-term securities in Macedonia is that it is dominant the issuing of proprietary securities (shares), but it is insignificant the issuing of debt securities (bonds). In the mentioned period, there have been approved 207 emissions of shares and only six emissions of corporate bonds. With reference to the mode of emitting securities, it is dominant the reaching out at the model of private offer, i.e. an emission to a known purchaser. In this way, there have been accomplished 186 approved emissions of long-term securities, whereas with the model of public offer only 28 emissions.

The data of the rapid growth of share prices in the Stock Exchange in the period 2005-2007 and of their vertiginous crash by the end of 2012, clearly shows that the Macedonian Stock Exchange experienced time of underestimated values and their imminent adjustment with the real ones, an occurrence of more intensive speculations where had been used events as a result of whose occurrence, there had to be opened a process of growth in prices of most of the shares, as an expression of the recovery of the economic and security situations in the country (becoming a member of NATO and EU).

With an experience like this, the existing and future investors have no more illusions about the capabilities of the Stock Exchange, and they are aware of the restrictions and risks of the Stock Exchange. This is particularly important for the potential issuers of new shares considering the need for a real presentation of the situation in the companies and of the anticipated investment revenues. Only such offers can attract a sufficient number of investors that will invest in purchasing shares emitted for acquiring funds for realization of certain projects. The exaggerated optimism in relation to the future revenues becomes unacceptable, as well as the offer of low and uncertain earnings. Given the fact that practically, in our country, it was shown that the income is generated in the real sector, and not in the financial one (although the sector's efficient functioning accelerates the income's growth), the argumentation about the attraction to new emissions has to rely on the real powerful company of generating profit, which would satisfy the interests of the potential investors. This means that in the current circumstances, when the expectations of the businesses are objected (due to the destruction of illusions of fast

earnings) there opens up a space for financing good projects and for emission of long-term securities. An assumption for that is the creation of conditions in which the potential investors can clearly see their interest of the investment.

The Stock Exchange boom and crash “sobered up” the players who “played their luck” at the Stock Exchange and marked the beginning of time when the investors will make their decisions on purchasing shares on the basis of the perception of the current profitability of the companies and the rate of returning the invested funds in purchasing their shares, including the estimations of the companies’ future profits. This means that it begins the time when the companies’ management will be assessed according to the values of shares managed by the companies, and because of that, they will pay more attention before now, to the increase in profit. All this is a good base, finally, for the profit to promote itself as a key motivational factor in the boards of directors. This is of interest to the shareholders, the potential investors and managers. The switch in this direction will approve the price paid by the investors in the phase of an on-going considerable correction (downwards) of the share prices in the several past years.

Conclusion

The several-years reduction of the turnover of the Macedonian Stock Exchange and, the almost unchangeable low level of the Macedonian Stock exchange Index (MBI-10) speak about a crisis in the functioning of the Stock Exchange. While explaining the reasons for this, there are listed more individual

reasons, but no one can separately explain the happenings in the last three years, particularly the fact that the prices of most of the shares are below the level of their account values, and some of them are below the level of the nominal ones, but there is no interest in investing in the purchase of shares. When the potential investors do not show interests despite the prices that promise profits, then obviously there is not something right with the entire atmosphere of investing. It has to be improved by creating conditions for the potential investors to see their interests of the investment clearly, with minimum risks.

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