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ПРЕГЛЕДНИ ЧЛАНЦИ

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EXTERNAL FINANCING SOURCES OF SERBIAN ECONOMY

Abstract

Cause and effect relationship between the financial system and financial risk on one hand, and economic growth on the other hand is theoretically and empirically verified. Financial System of a company in each case works better if the company has greater financial strength. Without safe internal and external financial resources it is not possible to establish a company and run the production process, i.e., it is impossible to provide continuous funding of current operations. It is impossible to imagine a developed national economy without developed financial markets. Unfortunately, our country the problem of funding is very prominent, because there is a shortage of capital due to low accumulation and lack of savings. Therefore, the sources can be provided with great interest and other financing costs, and under other unfavorable conditions. Financial markets are underdeveloped and financing by issuing securities and other forms of financing behind such financing in developed countries. Therefore, the paper will analyze the financing of enterprises and the economy, the functioning of the financial system of Serbia from the point of external funding sources.

Keywords: external sources of finance, securities, financial markets, financial system, financial risks.

ЕКСТЕРНИ ИЗВОРИ ФИНАНСИРАЊА СПРСКЕ ПРИВРЕДЕ

Апстракт

Узрочно последична веза између финансијског система и финансијских ризика с једне, и привредног раста с друге стране је емпириски и теоријски верификована. Финансијски систем предузећа, у сваком случају боље функционише уколико предузеће има већу финансијску снагу. Без сигурних интерних и екстерних финансијских извора није могуће оснивати предузеће и покренути производни процес, односно, немогуће је обезбедити непрекидно финансирање текућег пословања. Немогуће је замислiti развијену националну привреду без развијених финансијских тржишта. Нажалост, у нашој земљи је веома изражен проблем финансирања, зато што постоји мањак капитала због ниске акумулативности и недостатка штедње. Због

тога се извори могу обезбедити уз велике камате и друге трошкове финансирања и под неповољним осталим условима. Финансијска тржишта су неразвијена па финансирање емисијом хартија од вредности и другим облицима финансирања заостаје за таквим финансирањем у развијеним земљама. Због тога ће се у раду анализирати финансирање предузећа и привреде, функционисање финансијског система Србије са становишта екстерних извора финансирања.

Кључне речи: екстерни извори финансирања, хартије од вредности, финансијска тржишта, финансијски систем, финансијски ризици.

Introduction

Financial system in Serbia is characterized by extreme bank-centrality, and its growth in 2008 was sluggish compared to the previous year, due to the slowing down of credit activity. As in most countries in the region, bank interest rates have made growth, while the interest margin during the year was the highest in Serbia. Credit expansion slowed, and as the main risk in the banking sector still appears indirect credit risk, which is due to depreciation pressures caused by the crisis further intensified, because the real sector of the population and the lack of currency protected. Leading role in the growth of the financial system of Serbia is still owned by banks. Other financial institutions under the supervision of the National Bank of Serbia, despite the relatively low participation in a given financial system, show considerable potential for growth and to increase its contribution to the volume of financial intermediation, and the share in GDP. The financial systems of the Serbian banks have kept a very dominant position by managing 90% of total financial assets. Financial institutions participate in foreign-owned with nearly 80% of balance sheet assets of the banking sector. Global reduction of confidence in the financial sector, which is reflected in our market through the fall of investment expectations, was the factor that determined this year's developments in the domestic capital market. On the BSE, in the first half of the year, most liquid shares lost 23% of its value measured by index Belex 15, which returned to its level in January last year. The decrease in share price, besides reducing liquidity, influenced the increase in the reference interest rate and other interest rates on the domestic money market, as investment in money market alternative investments in the capital market. At the same time, a number of factors acting on the domestic and international money market influenced the increase in bank interest rates. Active weighted average interest rate of banks was increased from 11.3% to 16.61% annually. This increase was mostly contributed by significant increase of the reference interest rate.¹

The following analysis aims to, in the environment which is evident in the financial system of Serbia analyze the functioning of the financial system of Serbia, the financing of the economy, but with all aspects of external funding sources and commercial entities and the Serbian economy as a whole.

¹. Data on the financial system of Serbia downloaded from websites and publications from the National Bank of Serbia and Belgrade Stock Exchange.

1. Characteristic attributes of financial market

In the financial market in Serbia, on the demand side, appear individual investors, foreign investment funds, domestic mutual funds and pension funds, and on the supply side, individual owners or companies that are listed in the process of privatization. On the financial market, despite the large number of transactions, there is a reducing of the relative and absolute volume of traffic, and as one of the reasons may be that the relative value of the stock (price, book value) in this market declines. The mechanism of discharge of the privatization of the market shares, is performed by operations during the period of concentration accelerates and the number of transactions grows, until the formation of a significant or majority share package, after which these actions will reduce turnover, which is understandable, that with the reduction in demand stock prices fall. Certainly, the cause of this phenomenon lies in the fact that the market basically does not work as the stock market, but as the market firms. The result of this phenomenon is that after a sufficient concentration of ownership of shares of companies is achieved (in the hands of one person or group of related persons, demand, trade and prices fall). As the new owner can not sell their stock shares, the shares are withdrawn from the stock market, and this mechanism explains the large difference between the level of capitalization and turnover in Serbia.

Intense concentration of ownership is a result of, above all, low protection of property rights of minority shareholders. Namely, there is a negative correlation between concentration of ownership and the quality of legal protection of investors.² Non-efficient corporate governance leads to increase of the cost of capital and slowing down the growth of the company and the national economy. Privatization, as part of the transition process, should ensure a minimum quality of corporate governance.³ If you do not increase the level of investor protection, the process of privatization will not result in improving the efficiency of firms. In contrast, the agency problem will be sharpened through various forms of expropriation of minority owners, including the processes of tunneling.⁴ The process of concentration of ownership eliminates the actions on the financial markets, in order to avoid the risk of possible loss of control and strengthen the ownership-control structure, leading to a series of negative consequences to the corporation itself, and the financial markets. In this way the corporation is deprived of one of the possible funding sources and become more prone to use, often more expensive sources, such as bank loans. Financial market becomes insolvent and deprived of their basic functions.

Certainly, these market properties have a significant impact on its future development, the development of the financial system and the national economy. The first consequence is definitely a low liquidity of the market. Namely, the liquidity of the market and the possibility of a quick withdrawal from a given investment are important

² . La Porta., Lopez-de Silanes F., Shleifer A., i R. Vishnu, " Law and Finance", NBER, Working paper 5661, Cambridge, 1996, page 28.

³ Stiglitz, J., Information and The Change in The Paradigm in Economics, Columbia Business Schol, Columbia University, New York, 2001, page519.

⁴Shleifer Andrel, Johnson Simon, " Privatization and Corporate Governance", MIT and Harvard University, septembar 2001, page 5.

factors in its attractiveness. The level of current and expected liquidity will affect the formation of a critical mass of interested investors on the demand side. Privatization market has a chance to stop the discharge process, but this market is highly sensitive to the behavior of demand and basically low liquid. If financial markets remain insolvent, it will have consequences on its fate and potential external funding companies that continue to exist as an open corporation. In the event that these conditions are not met, the lack of demand reduction will affect the price of shares of all issuers. For now, the usual phenomenon of reducing stock prices assumed firm. In the case to maintain the current configuration of the market benefit from the status of the company as an open society are minimized. This will lead to the closure of even those corporations that have the objective interest to operate as an open company. The market will in this form will die away. The number of initial public offering will be negligible, and the market will function until there are resources for redistribution.

The outcome of these circumstances is reflected in the impossibility of achieving the basic function of financial markets: 1) determining the prices, 2) allocate function, 3) Transfer functions; 4) function of liquidity 5) information functions, and 6) functions to reduce costs of trade. In such circumstances it is difficult to expect any market efficiency, while the question of its imperfection is completely irrelevant. As a main result of the current state of the market in the corporate sector, is the increased possibility of reducing the value of their shares, and property of their respective owners. This is consistent with the view that the weak corporate governance variability faced with higher demand due to rapid loss of trust into investors. These problems are coming to the fore especially in the period of declining performance of the company and capital market as a whole. Portfolio investors from overseas, in conditions of crisis, withdrew from the corporation in which the high risk of expropriation of their property and income.

What is characteristic is the fact that many domestic companies issue shares is not considered as one of the possible sources of obtaining capital, because the owners do not want to lose ownership and control of the company. Namely, the stock markets means increased transparency of operations, open to the public and publish information. On the other hand, many new companies have accumulated profit and are forced to use external sources of funding. Certainly, the process of issue of shares and the stock market uncertain, claims costs and use the services of investment banks, which are new companies oriented to the use of bank loans. The Serbian financial system is presented with hierarchy theory, which explains the choice of funding sources, expressed in terms of information asymmetries, given that managers have more information about the profitability and business enterprises, and investors do not objectively assess the value of the company.

However, there is a possibility that successful Serbian companies list on foreign stock exchanges and thus obtain a higher amount of capital, but that would bypass the domestic market would be left without the quality of securities that is to life and encourage a wave of other public offerings. For the further development of the financial sector in Serbia, are certainly inevitable changes in the banking sector, which is increasing its capacity (supply of credit) and efficiency (reducing costs of mediation). An important step in further development of the banking sector certainly has made

enactment in 2008, by bringing the new Law on Deposit Insurance in the amount of 50,000 euros.

Also basic strategic goal is to increase the efficiency of banking, and reduce costs of financial intermediation. The fact is that the costs, profits and other parameters of efficiency of banks in Serbia have highly negative values. Increasing the level of security of banking and financial system and reduce its risk level, should allow its easy integration into European processes and reduce the cost of transfer. Supervision of banks and other financial institutions need to modernize in the institutional and technical sense. It is necessary to activate a new channel of financial intermediation, non-banking financial institutions, savings and micro credit institutions. By activating this system will help increase the efficiency of the system and increase the competitiveness of the market capital and deposits. The development of the of sector non-bank financial institutions is possible to establish supervisory capacity in the insurance sector and the adoption of medium term development strategy for this sector.

The formation and functioning of the financial system of Serbia, is greatly influenced by lack of financial regulation, which is primarily related to the legal regulation of financial markets. Namely, there are gaps in the protection of investor's interest, applying sanctions and protection of market integrity. In the stock exchange there are, on the one hand, companies that appeared on economic performance can not be corporations, on the other hand, companies were allowed to be listed on the B stock exchange, without publishing a prospectus and information, and business. Also, the Commission for the Securities is not sanctioned trade based on confidential information, nor is it sanctioned non-compliance with obligations offer redemption of shares of small shareholders in case of acquisition of majority ownership of related persons. Not even the bond market follows trends in other developing countries, especially as there was no issue of state bonds, and became the additional problems that concern both procedures for the issue, and interest rates. The procedure involves determining the bond issue's credit rating and finding of financial intermediaries to participate in the process. Interest rates would have to be high, since it would include a double-digit inflation and it would be difficult for investors in domestic companies' bond yields to be satisfied with less than 18%.

National Bank of Serbia, through the interest rate on repo operations, as the primary instrument of monetary policy, manifested impact on the functioning of the financial system. This means that the determination of exchange rate leaves the market, and that the fight against inflation by increasing the reference interest rate on repo operations, which achieved the highest amount of 16% of early 2009. , and from June this year was lowered to 13%. From such a monetary policy of the NBS, using pull-out banks, as their repo operations does not make only nominal rate of the dinar, it also makes additional profit by the fall of the exchange rate. Namely, banks convert foreign currency into dinars and thus earn a yield of nearly 16% annually, and when they collect dinar interest rate they can buy foreign currency at a lower rate than the original, which is why wages in euros during 2008 based under investment in repo operations amounted to over 40%. Given that the Bank may, with little risk to earn high profits on the basis of approved consumer loans and residential population, lack of motivation and interest crediting the economy, so the company moved to foreign creditors.

From previous we will point out several conclusions: 1) in terms unstable market and the falling trend of stock Listing, as well as ignorance of the procedures of issue of securities is a major problem providing capital in this manner, 2) high interest rates are a major problem for the emission of bonds, 3) trading on the stock market is not legally sufficient moderated, which creates resentment investors and issuers of securities to shares as a source of financing business, and 4) monetary policy chooses the amount of interest rates and financial market turns in the market repo operations.

2. Sources of financing of the economy

In all countries the most important sources of financing of the economy are the company gains, in other words, their own sources. In European countries in transition, 65% of investment is financed from profit, while the lower percentage in Latin America and higher in Asia. About 20% of funding comes from bank loans (domestic and foreign), only 5% of the share issue. However, unlike Serbia, the bond market worldwide is growing, though still not a significant source of funding. In addition, a dominant state bonds, unlike corporate bonds which are lagging behind in almost all European transition countries, because only 8% of issued bonds comes from corporations.

If the development of capital market in Serbia was measured by indicator of market capitalization (the sum of all shares of all issuers in transactions in a given market), which had a high rate of growth in recent years we would have the conclusion that the Serbian market since early 2003 had a strong expansion. The value of market capitalization in the case of the Serbian market is very similar to that in the period from 1998 to 2004, recorded the country such as Slovakia, Lithuania, Hungary, Slovenia, Czech Republic and Poland. The amount of the market capitalization of the BSE market is closest to the market in Estonia.⁵ According to the second standardized measure the level of development of the market (the relative level of capitalization relative to GDP), market shares in is comparatively speaking a little. However, changes in the relationship of market capitalization and GDP in Serbia is moving uphill since 2003, which was not the case in most countries of Eastern and Southeastern Europe. The number of listed shares, as one of the following indicators of development of capital markets, suggests the expansion of the market in Serbia.

The total market capitalization of companies on the BSE was approximately 20 billion or 49% of gross domestic product of Serbia in 2007 in comparison to previous years, this indicator is doubled. According to this measure, Serbia can be compared to other countries in the region with about 40% of gross domestic product.⁶ The larger increase in the value of the stock exchange in the last few years had only Ukraine and Bosnia and Herzegovina. However, the sale of shares does not represent a major source

⁵ . Stijn Slasesns et.all, ibidem " The Future od Stock Excenges in European Union Accession Countries", Coraporation of London, May 2003 page 56.

⁶ Andritzky, J., "Capital Market Development in Small Country: The Case of Slovenia", IMF Working Paper No.229, 2007

of financing companies. Market Capitalization shows how the value of the shares of companies listed on the stock market and all companies listed on stock exchanges on the basis of privatization and the required majority of shares are not traded. Namely, in Serbia there is no company that is primarily collected by selling shares of the capital for the functioning and successful business. Thus, market capitalization, regardless of whether it is absolute or relative values in relation to GDP, is a useful index of little importance from the aspect of the stock exchange to finance companies. However, the situation is similar in most less developed countries. They are very rare in cases where the ratio of capital collected by issuing shares and GDP exceed 1%.⁷ In Bosnia and Herzegovina and Croatia, this indicator is 0.1%, in the stock markets of Latin America ranges from zero to 1.5%, and it is slightly higher in Asian and African stock markets (Hong Kong 35.6% and Jordan 23.7%).

Due to the platitude of the capital market in Serbia, the companies used loans as significant external source of financing. In 2008, companies were the most important committee of the banking sector. The structure of total loans, credits the company reaches an amount of 512 billion or 54% of the total approved credit. The relationship between the total approved loans and private sector GDP in 2008 amounts to over 38%, which is the case in other transition countries of Europe. Growth of credit companies, and their relative increase in loans is relative to other sectors in 2008, is under question mark, given the fact that there is still a tendency, and the continuation of direct borrowing abroad. As an alternative to borrowing in foreign banks themselves, that they separated the statutory reserve, companies are debit directly abroad and thus a part of the corporate portfolio of banks directed to related institutions abroad. According to available data, the state debt companies abroad in 2008 amounted to over 9.5 billion euros, almost 30% of GDP. The structure of private sector lending Serbian economy to repay about 60% of the population with 40% and this ratio is stable with a slight increase in participation of the population. This is unfavorable distribution of loans and other developing countries share of the population as a recipient of the loan ranges generally range from 25 to 35%.

In Serbia there is a possibility that the company loan money at different developmental state institutions, such as: Development Fund, the Agency for the development of small and medium enterprises, the Fund for insurance and financing foreign trade operations (Labor), the Agency and Insurance exports (Tax System), the Guarantee Fund and the Agency for Foreign Investment and Export Promotion Agency (SIEPA). Listed companies credit institutions, provide guarantees to banks for lending to companies; provide advisory and technical assistance and other ways to help business enterprises.

In addition to the security of the National Bank of Serbia, bonds market and other debt securities do not exist, and above all, there is no issue of corporate bonds. Anything less is traded in old savings bonds, only 1% of the total trade of securities in 2008, even less in short-term bills.

⁷ . Iorgova, S. and L. Ong, " The Capital Markets of Emerging Europe: Institutions, Instruments and Investors", IMF Working Paper No. 103, 2008 page 116.

Significant increase is present in trade bills of the National Bank of Serbia in the structure of trade in all securities in the Serbian market, NBS bills in the value of transactions involved with about 95%. The value of these securities transactions in 2008 amounted to over 70 billion euros, and the repo transactions, have become the main form of trade in securities. Note that the huge turnover of money in the repo operations result of two factors: the first is the high amount of funds that invest in the repo business, and the other is short term return on the money, it is always 15 days after the National Bank of Serbia in this period, usually does repo operations. After that period the money returned plus interest, to make it re-invested bank, and each transaction is calculated as a new trade, regarding the fact it is investment in the same paper.

For the recovery of financial markets it is necessary that states think about introducing a new range of securities, because if something does not happen soon, when it comes to improving the supply there could be a fall of confidence in market mechanisms, but bringing into question the collective investment such as investment and pension funds. Growth stock price on the stock market early 2009 has a result in the fact that the actions of some companies underestimated and do not reflect the real level of their business and profit. The fall turnover on the stock market is partly a consequence of the economic crisis, but part of the solution and the absence of an acute lack of liquid securities. Lack of initial public offers, debt securities, corporate bonds, are just some of the reasons why traffic to the stock exchange is at a high level. In the last five months of 2009, the total turnover on BSE amounted to 10.7 billion dinars, or 113 million euros. In the same period, there was an increase of participation of foreign currency savings bonds in the total trading, nearly a quarter of total turnover 24.35% realized in the trading of bonds.

Despite the crisis, it is still significant that there is participation of foreign investors, so on the purchase of shares of their participation in the period from January to May was 43.6%, and on the sale of shares of 49.19%. General characteristics of capital markets is that there are few individual investors, and only 20,000 citizens, or about 0.3%, ever traded on the stock market or bought or sold at least one action. Belgrade Stock Exchange is trying to organize a variety of free training to educate citizens who own shares, but for now it is still in its beginnings.

Signals coming from the stock exchange, not only ours but the world needs to take advantage of those who manage the crisis and to see it as a sign that investors have the capital, but they need to meet with the new offer, which will carries greater certainty of yield with them.

Summary

Financial system and financial risks will be motivation and the limiting factor, from the standpoint of external sources of financing of business entities and the Serbian economy as a whole to the extent to which resolved the question of survival and development of financial markets, especially now in terms of the global economic crisis. In order for the financial market in Serbia to survive and to have sense, it is necessary to develop its basic functions. In order for market to achieve its specified financial and strategic goals, it is necessary to readjust legislation. This is primarily thinking of the

Law on Securities, which in 2007 gained the new version, and in the year 2008 it has already been prepared for its proposal for the amendment. For further development of financial market in our country, we need greater state role in motivating companies to primary issuance of securities to get the necessary funds. The state could participate in the preparatory stage shows, educates, trains, and even to take cover costs of securities emissions. Of particular importance is that the shares are traded on stock exchanges abroad, instead of the domestic market, where many companies would be successful and competitive and would be able to way to obtain funds in the most rational way.

Positive impact on the development of financial market would have the state issued bonds to finance public expenditure, provided that the funds used to finance productive public spending.

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