

SITUATION IN THE CAPITAL MARKET OF SLOVAKIA

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The Slovakia capital market development encompassing the beginning of 1989 when the political situation was changed till the present situation is analyzed. The main stages of privatization, namely small-scale and large-scale, and the first and second wave of the latter, are analyzed emphasizing their advantages and disadvantages. Protection of investors' rights is one of the main issues of the present capital market in Slovakia. The possible ways of dealing with this problem and consequences are discussed also. Statistical data showing the development of the Slovak capital market in the context of European countries are presented.

Introduction

The Slovak capital market was established exclusively on the basis of the coupon privatization. After the political system had been changed in 1989 the privatization process started to be oriented mainly towards transformation of the economy into market conditions. This process continued also after splitting up the common state. The greatest share in the transfer of the state-owned property to other subjects was taken by the small- and large-scale privatization.

The small-scale privatization was a first stage proceeding from 1991 to 1993. It was the time- and size-limited first step of the transformation which laid, together with restitu-

tions, the foundation for the private sector functioning in the business, services and in the local and small industry. In the small-scale privatization the public auction was utilized as the only denationalization instrument. At that time a stirring discussion was raised due to the so-called Dutch auction model which permitted a gradual reduction of the opening price to as much as a half, and in the case of the repeated auction even to a fifth. After the small-scale privatization had been officially completed, 9667 subjects of the accounting value of 12.3 mld. SK passed to the private sector, the total auctioneered sum achieving almost 14 mld. SK, i.e. approximately by 2 mld. SK more.

For the first wave of the large-scale privatization the government issued a decree about emitting and applying investment coupons. The coupon privatization ensured equal conditions, the well-proportioned distribution of property and the lowering of corruption in the denationalization process to a minimum. The main objective of this process was the transformation of enterprises into joint-stock companies and the transmission of their stocks into the hands of inhabitants not in the form of money but in the form of the so-called investment coupons paid by people in the amount of 1000 CSK. The first wave of the coupon privatization started on 14th May 1992 and finished by the end of the year. For this purpose the property of 484 companies amounting to 90 mld. CSK was earmarked. In June 1992, the mode of the privatization was also changed: the coupon method was abandoned and the so-called standard methods, primarily direct sales, were preferred.

In the first wave of the privatization, i.e. in the period 1991–1993, the property of 678 state enterprises in the total value of 169 mld. SK was alienated (by means of coupons or the standard method) to private subjects.

From the aspect of the contents, the second privatization wave (started in September 1993) was characterized by several principal changes in comparison with the first wave. The Parliament accepted the governmental amendment to the Act about the large-scale privatization, which annulled the exchange of coupons for stocks. Thus each owner of a coupon book received instead of stocks a publicly non-negotiable bond of the National Property Fund (NPF) of the nominal value of 10 000 SK with a due date of 31st December, 2000, i.e. for a period of 5 years. The state property from the portfolio of NPF was sold directly and

the gained money should be used for the repayment of bonds. In fact this was the transition to a direct sale and the substitution of the coupon privatization method by the method of bonds. The bond represented a certain form of compensation¹.

The coupon privatization was related to 503 joint-stock companies, and 2.6 million of the Slovak citizens participated in it. The problem of the coupon privatization rested in the too scattered property ownership. From among 93% of privatized enterprises the major share was acquired by the holders of investment books and by investment funds. Since there did not exist any regulation to allow small proprietors to defend their rights, their influence on the management of enterprises or on the investment funds was none at all. After accomplishing the sale of stocks their departure was possible only to the moment of settling the proprietary relationships, or in other words, mostly to the moment when the major investor gained 67% of stocks. However, the problem of the enforcement of the right of property was faced also by much bigger owners. With regard to the fact that corruptible courts were willing to recognize the doubtful results of General Assemblies, even a 51% owner could not be sure of his position. It was sufficient if the minority owners called the General Assembly in which the majority owners could not participate, if they nominated their representatives in the Board of Directors and the Supervisory Board; if they changed the articles of the company, then they achieved not only the necessary two thirds of votes for their withdrawal but also a rapid incorporation into the company's register².

¹ Privatization decade in the Slovak Republic, Pravda 3rd January, 2000.

² www.ineko.sk/studia_zsos_marcincin.htm – More effective report of business companies.

The **object** of this article is the capital market in Slovakia. The **aim** of this article is to present the situation in the capital market in Slovakia. Using the **methods** of scientific literature and statistical information analysis, the author of this article **attempts** to:

- present the protection of the rights of investors in conditions of the Slovak capital market
- analyze market capitalization of companies on the Bratislava Security Exchange (BSE) in the present period
- present the development of exchange markets in Europe
- present the development trends of Bratislava Security Exchange after the entry into EU.

1. Protection of the rights of investors in conditions of the Slovak capital market

According to La Portu et al. (1999), a difference in the proprietary structures of publicly share-dealing companies, in the size of capital markets, dividend policy and in the approach of companies to external finances in different countries is given by a way, in which all investors (owners and shareholders) are protected by legislation from the expropriation by managers and majority shareholders. As the insiders are considered not only managers but also big shareholders. The expropriation exists either in the form of a simple stealing of the profit or in the form of selling the output or assets to another company (being in the ownership of insiders) for a price lower than the market one. Although these activities are usually perfectly legitimate, their effect is the same; they are regarded as a theft³.

³ www.ineko.sk/studia_zsos_marcincin.htm – More effective report of business companies.

The rights of outsiders are generally protected by an enforcement of the regulation and laws. The regulation of the governmental agencies and exchange involves some critical requirements in relation to a company, namely the publishing of data and their accounting interpretation. Both requirements are an inevitable condition for the information acquaintance of investors and for the exercise of their ownership rights. A great possibility to prosecute managers or any big shareholder for the expropriation is included in many other rights of shareholders. In most countries, the laws and regulations are enforced partially by market regulators, partially by courts, and partially by market participants. However, the courts often do not want or are unable to solve complicated disputes, they are slow and liable to political pressures, or they are also corrupted.

Consequences of the protection of investors are of three kinds:

- *the ownership model of companies. In countries where the protection of outsiders against the expropriation is weak, the control is concentrated in the hands of entrepreneurs*
- *development of financial markets and the dividend policy. The legal protection of the rights of investors helps financial markets. Investors protected against the expropriation pay higher prices for securities, which are then more attractive for issuers. This regards also creditors and the development of crediting the companies*
- *allocation of real sources. The development of financial markets can accelerate the economic growth by increasing savings and their application in real investments and, as a result, by supporting capital accumulation and improving the ef-*

*fectiveness of the allocation of sources after a more productive capital utilization.*⁴

The confidence of investors proceeding from the conviction that the invested capital will be protected against misapplication or unjustifiable appropriation by the company's management or shareholders possessing the controlling block of shares can be an important factor in capital markets. The managing bodies of companies, managers and the above-mentioned shareholders can take advantage of the possibility of being involved in the activities in which they could uphold their interests at the expense of minority shareholders. One of the ways in which the shareholders can enforce their rights is the possibility to initiate the judicial and administrative proceedings against the management as well as against members of the Board of Supervisors and the Board of Directors. The experience has shown that an important determinant of the level to which the rights of shareholders are protected is the existence of efficient methods for a suitable compensation of losses without unnecessary delays. Thus the confidence of minority investors will enhance, if the legal system incorporates mechanisms enabling the minority shareholders to claim their rights *per curiam*. Of course, this is possible if they have a sufficient evidence of the breach of their rights. In some countries they introduced alternative dispute resolutions such as administrative or arbitration proceedings conducted by self-regulatory authorities; it is an efficient method for resolving disputes, at least in the first instance. This mode brings about an advantage for courts overwhelmed by a great number of

unresolved disputes. As an example we can take Poland, which has adopted a rigorous Security Act aimed at the protection of shareholders. The Act demands the publication of a lot of information from issuers. It constitutes a commission for securities and for the exchange, the enforcing power of which is independent of courts.⁵

The Slovak Republic has nowadays a reputation of a country in which the rights of a minority shareholders are insufficiently respected and therefore its attempt to draw portfolio investments is unsuccessful. Since all big institutional investors have their own rules and guidelines, which must be maintained by them, they cannot realize risky investments.

2. Market capitalization of companies on the Bratislava Security Exchange (BSE) in the present period

The market capitalization of a particular company is equivalent to the number of the issued shares multiplied by their current market value. This variable can be expressed in different forms, for example, in the absolute value of a certain currency, or as a ratio to the gross domestic product (GDP) of a particular country.

As follows from Fig. 1, the market capitalization of all negotiable issues of the proprietary securities registered in the exchange markets represented 109.9 mld. SK (+4.7% in comparison with the year 2002), while the market capitalization of bond issues at the end of the year represented 331.9 mld. SK (+14.1% in comparison with the year 2002); from this sum 286.0 mld. SK were assigned to quotation

⁴ www.ineko.sk/studia_zsosa_marcincin.htm – More effective report of business companies.

⁵ The unified codex of the administration and management of companies based on OECD principles, September, 2002.

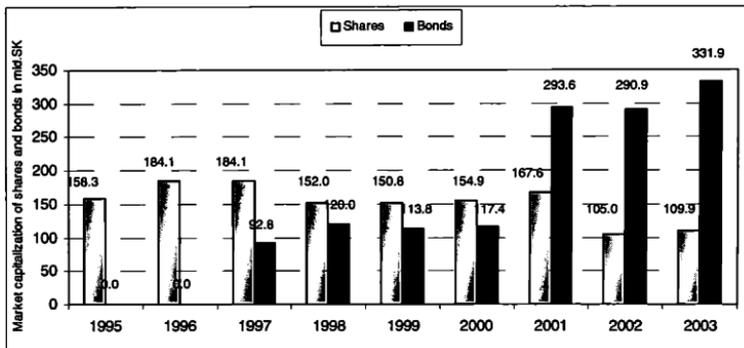


Fig. 1. Market capitalization of shares and bonds on the BSE in mld. SK (Source: BSE)

Table 1. Market capitalization of shares in selected markets of European countries at the end of 2003

Market	Natinal currency	Market capitalization in mil. EURO	Change from the beginning of the year in EURO	Change from the beginning of the year in the national currency
Germany	EUR	855 452.00	+29.9	+29.9
Austria	EUR	44 811.00	+39.0	+39.0
Spain	EUR	575 765.80	+29.9	+29.9
Switzerland	CHF	576 462.00	+10.5	+16.8
Italy	EUR	487 446.40	+6.4	+6.4
Great Britain	GBP	1 923 168.00	+12.6	+22.1
Euronext Market*	EUR	1 646 178.00	+11.4	+11.4
Czech Republic	CZK	12 287.94	+25.4	+28.6
Hungary	HUF	13 227.88	n/a	n/a
Polland	PLZ	29 349.76	+8.5	+27.3
SLOVAKIA	SKK	2 203.71	n/a	n/a

* The Euronext market includes exchanges in France, Holland, Belgium and Portugal. Source: FESE

issues (+17.3% in comparison with the year 2002). The amount of 45.5 mld. SK was allotted to bonds in the foreign currency. In this way, the total value of the market capitalization of issues by the end of 2003 comprised 441.8 mld. SK (+11.6% in comparison with 2002) on the BSE.

Due to the market capitalization and the volume of business transactions our market ranks permanently among the smallest ones in

Europe. A comparison of the size of the market capitalization of shares along with the selected markets of European countries is shown in Table 1.

As for the shares, the market capitalization of BSE is very low. A certain proportion in this state arises from the fact that Slovakia, unlike other V4 countries, did not privatize on the basis of free sellings any "packages" of important companies through the exchange.

The leaders of exchanges in the Czech Republic, Hungary and Poland are primarily previous national telecommunication companies. The largest market capitalization is accomplished by the Czech Telecom, TPSA and Mativ it exceeds in each of these companies after calculation 100 mld. SK. The largest Slovak company, Slovnaft Inc., Bratislava demonstrated its market capitalization by the end of 2003 approximately in the amount of 26.4 mld. SK, which constitutes about a quarter of the total market capitalization of shares of the whole BSE. The fact that the exchange can exist without such attractive issues as the shares of telecommunication firms is reflected also in the low total volumes of business transactions.

The ratio of the market capitalization to GDP in a particular country enables us to make an international comparison. It points to a significant role of the share market in the eco-

nomics of each country as well as to its significance for firms and for detection of the scope of financial sources necessary in financing individual entrepreneurial projects.

As Fig. 2 shows, the real market capitalization, i.e. the market capitalization of the part of shares with which at least one good currency-producing business was made (except the shares of investment funds and participation certificates) increased by 19.2% versus the level of 2002 (89.7 mld. SK in the last business day). The quotation issues achieved the capitalization of 42.3 mld. SK, which represented a 15.3% growth.

Owing to the thousands of illiquid issues registered on the BSP, which have been gradually discarded from the share market since 2000, the total market capitalization of the share market in the Slovak Republic has already been made artificially for several years. It is mainly the case of the issues of securities,

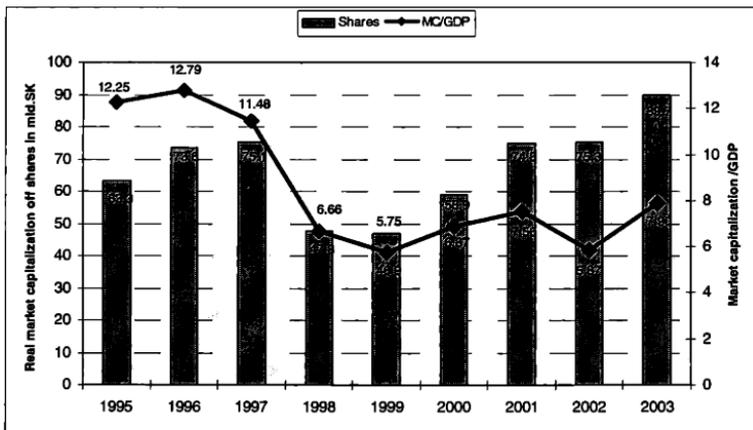


Fig. 2. The real market capitalization of shares* on the BSP and the proportion in GDP (Source: BSP)

* Only shares which were negotiated in the currency-producing business transactions at least once; they do not include the nominal value of other shares, investment and participation certificates.

the turnover of which is insignificant or none because their issuers do not show any interest in persisting in the market and do not fulfill even their information obligations as provided by law. From the aspect of evaluating the Slovak market, the major callable ability is assigned to the indicator of the market capitalization of quotation shares, the number of which has varied in recent years between 10 and 15 titles (14 titles in 2003). However, the market capitalization level of quotation shares being close to over 3% of GDP is not only the smallest from among OECD countries but very far from the average of this group of countries and also of the member countries of EU (which is at the level of about two thirds of GDP).

3. Development of exchange markets in Europe

In recent years, the fusion of individual European exchanges has resulted in the development of the large-scale exchange markets which are achieving a much higher market capitalization and liquidity in comparison with separate exchanges.

In 2000, the Euronext exchange established by fusion of the exchanges in Amsterdam, Brussels and Paris became the first exchange in the world dealing with business in several countries. The newly established pan-European exchange became the biggest in the continent and outpaced even the continental exchange in Frankfurt considered the biggest up to that time. In the first half of 2000 the Euronext system was joined by the exchange in Lisbon and later on, in 2002, also by Liffe, the exchange of derivatives from London. Although the Euronext during its foundation was the biggest exchange in the continent, the exchange on British islands was even bigger by

the volume of its business transactions and by the volume of the market capitalization of firms dealing with the exchange. The exchange of derivatives, Euronext.Liffe, is today the world's biggest exchange of derivatives with regard to the volume of its daily business transactions conducted in the markets in Amsterdam, Paris, London, Brussels and Lisbon.

However, also the smaller "players" such as Virt-x, Newex or Norex Virt-x act on the European market. The Virt-x is the new name of the previous Tradepoint Financial Networks. The pan-European exchange was developed from the Swiss Exchange (SWX) and the British electronic platform TP Group. Both SWX and TP Group own 38.9% shares of the Virt-x each. The exchange debuted in June 2001. The New European Exchange (Newex) in Vienna was established in January 2000 as a common company of the German and Austrian exchanges oriented to shares of the companies from Central and Eastern Europe. The market started up its business activities in September 2000 on the German platform Xetra with the accounting system Clearstream and Euro as the accounting currency. The volume of business activities was not sufficiently high and therefore after nine months the Newex exchange transferred its business activities to Frankfurt. From ten companies acting on the quotation market seven are Russian (Aeroflot, LukOil, Sibneft' and others), one is Austrian (telecommunication S&T), one Hungarian (alimentary Globus) and the Slovak Zentiva, Inc. The exchange dealings proceed also with the shares of Nafta Gbely, Inc., Váhostav Žilina, Inc., Slovnaft. Bratislava, Inc., VSŽ Košice Inc. (US Steel) and with bonds of Železnice SR, Inc. (Railways) and Slovenský plynárenský priemysel Bratislava, Inc. (Slovak Gas Industry).

The Norex is a common exchange of the Scandinavian capital market. Its start dates back to 1997 when the Copenhagen and Stockholm firms agreed on the rise of the common market. In the same year, participants of the common exchange decided to postpone the project until the new common platform SAXESS was prepared instead of the Danish SAX. Two years later the system was already applied in both countries. The FTSE International and Norex exchanges introduced a new index, FTSE NOREX 30. At the turn of the years 1999 and 2000 the exchanges in Oslo and Iceland as well as the Baltic exchanges in Riga, Tallinn and Vilnius were interested in the entry into the Norex. However, the co-operation among partners was temporarily interrupted in 2001. The exchange in Helsinki has been a separate one so far.

At present, the fusion of the relatively small exchanges in Central and Eastern Europe becomes the topical subject. It is probable that the Baltic exchanges will join the Scandinavian exchange Norex. In the case of the exchanges in Central Europe the question of the integration of exchanges in Prague, Budapest and Bratislava, and similarly the question of the integration into the Newex in Vienna has been a subject of discussions. The before-said Newex has already tried to gain part of the business activity from the share markets in neighbouring countries. Unfortunately, it met an indifferent interest from the side of the issuers of shares and of dealers, except the exchange in Budapest which merged into the exchange in Vienna at the end of May 2004.

The absolute majority of share exchanges can be characterized by a typical low liquidity and – besides Warsaw – also by a small number of primary issues. The unified platform should allure more investors. It is very much

probable that the integration of “strong” will be followed also by “weaker” exchanges.⁶

Conclusions

From the aspect of the prospects of BSE after the entry into the EU, the solution can be searched for in the following possibilities: a) in the functioning of BSE as an autonomous organization, b) in the functioning of BSE as an affiliated branch of the other foreign exchange, c) in the fusion of BSE with the other exchange or exchanges, d) in the dissolution of BSE.

If we consider the first potential variant, there does not exist practically any real future in the functioning of the BSE as an autonomous organization after the entry of Slovakia into the EU because of the earlier-mentioned facts and due to the non-fulfillment of at least some fundamental functions of the exchange. The subjects that will have at their disposal the money for the issue of shares will place them rather in some more renowned exchanges abroad, since there exists a much greater chance to place the whole issue in the market and finally to acquire the necessary entrepreneurial capital.

The risk of both unnecessarily expended funds and an unsuccessful placement of the emission of shares in the small Slovak capital market big. For this reason, is the future in the functioning of BSE is envisaged as an affiliated branch of another foreign exchange, for example, Euronext. In this way it would enable the successful local companies to carry on business with their shares also in lucrative foreign markets and would lead to a price de-

⁶ European Capital Markets in a Whirlpool of the Consolidation, *Hospodárske noviny* 24.6.2002.

crease of their shares, to the improvement of advertising and to a greater interest in the Slovak capital market and in the investment in Slovak companies within the sphere of foreign investors. It is clear that the current worldwide trend is to carry on business outside borders. However, there is a question whether the Slovak capital market is interesting for foreign investors and what it can offer to them. From the viewpoint of future revenues the Slovak capital market is certainly interesting, because it is undeveloped and has a great potential of growth. In comparison with the situation abroad it will certainly offer its investors much higher capital revenues in the near future in comparison with advanced and stable capital markets.

The future of BSE might be conceivable also in its integration with another exchange or exchanges. All advanced countries go ahead in this sense at a rapid pace. Various global exchanges are being developed as, for instance, Euronext and Norex, with which national exchanges are integrated at a local level, and surely Slovakia, like other countries, will not avoid this development in the future. If the integration proceeds with some of these great alliances, the main disadvantage of this possibility would be the weak position of BSE in the alliance. As the most acceptable variant might be the integration with the Prague secu-

rities exchange, which is at the moment a pursued goal.

As the next possibility can be regarded the mutual integration of all Central European exchanges suffering from a scarcity of liquidity and almost from no offer of the primary issues in the market. As a consequence of this fact, an effectively functioning liquidity market could be established. However, in Europe several smaller exchanges exist, and after the expansion of the Union the route to the integration seems to be a simpler logical variant just because of the unified legislation. In the years to come it is likely that among individual markets there will be no obstacles preventing investors and issuers to pass from one exchange to another.

As the last possibility can be considered the dissolution of BSE, which, of course, would have a considerable negative impact on the development of the small- and medium-sized companies in the future. The issues of shares necessary for obtaining the entrepreneurial capital in foreign capital markets will be useful only when they will be of a high value and when the amounts corresponding to the needs of the small- and medium-sized companies within our economics will be sufficient. Finally, the future does not need to be seen only in the unified big exchange but also in a large number of smaller exchanges, which will be competing with one another.

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SLOVAKIJOS KAPITALO RINKOS YPATUMAI

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Santrauka

Pavienių Europos biržų susijungimas pastaraisiais metais lėmė didelių apimčių kapitalo rinkų plėtrą. Susivienijusių biržų rodikliai, pavyzdžiui, rinkos kapitalizacija ir likvidumas, palyginti su atskirų nacionalinių biržų rodikliais, yra gerokai aukštesni. Dabar Vidurio ir Rytų Europos valstybių biržų susivienijimas tampa vienu iš aktualiausių klausimų. Dauguma nacionalinių biržų galima apibūdinti esant žemo likvidumo ir – išskyrus Varšuvos – dažniausiai jos turi mažai pirminių emi-

sijų. Biržų suvienijimas turėtų pritraukti daugiau investuotojų. Slovakijos nacionalinės biržos ateitis taip pat sietina su integracija – susijungimu su kitos valstybės birža ar biržomis. Valstybės, kuriose išplėta kapitalo rinka, vystosi labai sparčiai. Priimtinausias variantas Slovakijai būtų susijungti su Prahos vertybinių popierių birža. Dabar tai vienas iš svarbiausių ir lauktinų žingsnių, siekiant sparčiau plėtoti Slovakijos kapitalo rinką.

Įteikta 2004 m. gegužės mėn.