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DEBT VS. EQUITY FINANCING IN MACEDONIA

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BUSINESS ENVIRONMENT ACTIVITY

This report is prepared with support of the USAID Business Environment Activity. The Business Environment Activity is financed by the US Agency for International Development to sustain the achieved momentum in the economic sector and strengthen the enabling environment for doing business in Macedonia in order to encourage business formation and growth and address the issue of high unemployment.

Within its activities to increase capital investments in the country and increase access to finance through development of the non bank financial sector, the Business Environment Activity conducted several assessments of the available financing mechanisms for the companies in the Macedonian market. As a constituent part of the assessments, the Business Environment Activity subcontracted the Center for Economic Analysis to do a survey and an analysis of the external financing of companies through bank loans and issuance of securities.

This research represents a good statistical overview of the current trends in external financing of companies and impediments which need to be tackled in order to enable further development of the debt market in Macedonia.

Tatjana Lukanovska
Senior Financial Sector Advisor
USAID Business Environment Activity

Dear Reader,

This report illustrates the main findings from the survey conducted by the Institute for Democracy, Solidarity and Civil Society (IDSCS) – CEA partner in this project. The Questionnaire was developed by CEA, IDSCS and USAID Business Environment Activity (BEA) and the survey was conducted by IDSCS. The first version of the report was developed by the IDSCS. That version of the report was further developed by Mr. Marjan Nikolov, Ms. Vesna Garvanlieva, Mr. Vlatko Andonov all from CEA. Useful comments on the questionnaire and on the last draft of this report were given by Mr. Saso Arsov from the Faculty of Economics. The final report was developed by Marjan Nikolov.

This study draws important conclusions that are sensitive and require immediate action upon which the Government of Macedonia (GoM) should be urged. We suggest a follow up on this study that will be presented at sector level of Macedonian economy once before and then the second time after an all encompassing training of the managers and financial officers at the private companies is done. The GoM must take initiative upon this exercise, supported by the donor community, where the public administration should take part as well. *Nevertheless, all companies which responded, but also the majority of companies which refused to give answers to this survey, expressed readiness for cooperation in future studies, if this one shows some valuable analysis which could help to their future growth in the market.*

The results of this study reflect the lost decade and a half of implementing efficiently the basics of market economy in Macedonia and how they are still not fully implemented as the proper institutions from education to government are not fully achieving their mission.

I hope that the study will meet your expectations and will lay the foundations of our further cooperation.

Yours sincerely,

Marjan Nikolov, MSc

President of CEA

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Debt vs. Equity Financing in Macedonia

Executive summary

(1). A relatively small percentage of companies establish departments which deal with financial issues of companies. Most of the companies resolve the financial issues within the accounting departments rather than having separate financial departments.

(2). Of the surveyed companies, 84% used own resources for starting the company, 76% used or are using bank loans for financing activities, and insignificant percentage used financing resources from issuing corporate shares or bonds.

(3). No one of the companies used corporate bonds to finance their operations. Although 97% of the companies needed additional capital, 42% of them cannot answer the question if they can generate capital through issuing securities and 44% of them think they are not ready for that.

(4). In relation to the main determinants of making financial decisions, the ratings from most important to least important alongside the ratio between the two opposing perceptions would be: cost of capital (54%:28%), time needed for receiving the money (46%:24%), ownership structure (38%:50%), previous experience with a financial institution (34%:44%) and the transparency and familiarity with the financing terms (28%:52%).

(5). Conclusions about the impact of this ranking on the financing choices are mixed. Namely, the cost of capital is the most important determinant with respect to making financing decisions which is expected to stimulate the search for alternative sources of financing, compared to the traditional loan-based financing. On the other hand, the speed of the process of financing, the second most important factor, favors the use of bank loans. Certain improvement in the institutional setting (Initial Public Offering (IPO) advise, more efficient Securities Exchange Commission (SEC)) could have a positive influence in the direction of use of securities issues.

(6). Taking into account their sector characteristics, only 8% of the companies consider that financing through the capital markets is most beneficial for financing and maintaining the growth.

(7). Of the surveyed companies, 58% responded that they use the generated capital for investments in capital/fixed assets while 42% for improvement of their liquidity through investments in the current assets of the company.

(8). More than a half of the companies, or in 52% of the cases, estimated the terms and conditions of financing through the banking institutions of Republic of Macedonia in a median grade (where from 1 to 5; 1 being excellent and 5 being poor, 52% chose 3).

(9). Of the surveyed companies, 86% answered that the biggest obstacle to finance through banking loans is the high interest rate, while the least obstacle is the creditworthiness (eventual credit rating) of the company. This is a bit paradoxical in the case of Macedonia, as the companies though complaining of high interest rates still prefer loans to equity in raising capital. It shows the lack of elementary understanding of the financial markets as they do not comprehend the creditworthiness (credit rating) of the companies is directly linked to the price of raising capital i.e. the interest rates.

(10). A vast majority of the companies (58%) cannot evaluate the terms as they are not adequately familiar with the terms for issuing securities through public or private offer. There is a need for public awareness campaign, training of executive and financial managers and owners of the companies on the benefits of financing through the capital markets in Macedonia. Also, 36% believes that the management lack knowledge about the capital market in order to start issuing securities.

(11). However, among those companies which state to be familiar with the capital markets, 22% claim that the procedures are complicated to a point, and additional 2% of the respondents say that the procedures are too complicated.

(12). Regarding the transparency issue, almost half of the companies (42%) answer that the requirements for regular submission of financial reports is not an obstacle at all for issuing securities through public or private offer, while the most dissatisfied group of 6% of the companies perceives this pre-requirement as a definite obstacle. This is another indication that the companies in Macedonia are in an urgent need for training on the basics of the capital markets economy as well as specifics of what efficient capital market is and the importance of transparency.

(13). The management fear that their companies ownership structure may be altered or companies taken over in case of raising capital through new shares issuance, which again shows the lack of knowledge on the capital market in Macedonia. Almost one quarter (24%) of the surveyed companies had no clear idea on how to answer to this question.

(14). When ranking the factors for doing business in a scale from 1 to 5 (1 being most problematic) as most problematic were stated: inefficient public administration, 42% of the respondents, corruption 40%, economic instability 32%, criminal activities and theft 32%, access to finance 28%, tax rates 12%, insufficient work ethics 14%.

(15). Related to the factors for doing business, surprisingly high number, 24% of the respondents consider the factor of inappropriately educated labor force to be the least problematic, while inappropriate infrastructure 14%. Currency exchange regulations and inflation rate are generally not perceived as significant impediments for doing business in the country.

(16). Pretty fragmented responses were obtained for the costs for telephone, internet and communication from the surveyed companies. From one side, 22% consider this factor as the most problematic, while on the other, 18% have totally opposite opinion and consider this factor as the least problematic.

(17). In the case of restrictive labor policy, a rather high percentage of 32% of the respondents rate this factor with 4. Additional 20% think that this issue is not a significant problem. Only 10% regard the issue of restrictive labor policy as very problematic. Agriculture, food processing, textile industry and furniture production are the sectors that are not highly concerned with this problem.

(18) Last but not least, it seams that the knowledge of the capital markets in Macedonia is at a low level. The need for further training, informing and improving the corporate finance management must be a priority for the GoM. The GoM is taking the right steps with the initiative to educate the executive managers in business and corporate management, however the financial managers should be targeted as well[1]. The lack of efficient education system in Macedonia in the field of economy and finance thus raises the issue of Macedonian citizens paying twice for education system through taxes: once to the universities which do not produce knowledge and second as training for businesses to learn basic functions of how to run companies. During a decade and a half in Macedonia there haven't been serious efforts in implementing the market economy classes in the universities. CEA urges GoM to make the necessary reforms in the higher education.

(19) There may be other obstacles for doing business that are not covered by this study, such as: the exchange rate, inflation rate, labor market rigidity. However, the study reveals some obstacles such as the costs for internet, telephone services and communications.

(20) There is an interesting paradox that companies even though complaining of high interest rate of bank loans still prefers loans to equity in raising capital. At the same time, they are not concerned for the company credit rating which was stated as the least important obstacle to approach the banking sector and obtain a loan. Thus, there are at least two problems which should be tackled by the GoM: first, the businesses (people from the finance departments) lack basic knowledge of the capital market risk management and second, it seams that the businesses rely more on their relations with the bank management than to trust their creditworthiness so that the market forces can set the credit rating for them. The result is that they complain that the interest rates are high but negotiate with the banks and receive concessions on interest rates for other than market reasons and thus, not providing market environment for developing the equity capital market. This might be the reason that in spite of complaining on the high interest rates, the companies still prefer loans to equity when raising capital.

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[1] In this research of the 50 companies, the interviewees were: 18 CEO and/or owners, 14 CFO, 7 accountants, 2 sales managers, 4 office managers and 5 others.

(21) Finally, the overall situation adds to lowering the competitiveness of Macedonian economy, inefficient labor market (the companies do not have incentives to hire competitive skilled labor force), higher costs of capital, thin capital market, lower levels of economic growth.

The final version of this report was prepared by Marjan Nikolov, President of CEA: makmar2000@yahoo.com.

Introduction & Methodology

The basis for the report is the data collected from the questionnaire of the conducted survey which includes 21 questions. This report contains explanations of the general frequencies of the collected data, alongside with the cross-tabulations by sector. The cross-tabulated sectors include the following industries: food processing, light industry, metal industry, chemical industry, construction industry, auto-industry as well as textile and agricultural industry. The report starts with the basics of the institutional set up in Macedonia, then it presents the results from the survey, and finally ends up with a rather brief overview of the Regional Development and Trends of Debt vs. Equity Financing in the region.

The sample of companies surveyed was generally designed and generated by CEA given the constraint of the total budget for the project. The industry, agriculture and construction sectors were targeted as they generate more than 60% of the Macedonian value added and were seen as proper for the nature of the project. The shares of the value added generated by the three sectors were used as a proxy to get the number of companies by sector as well. Also, the regional characteristic was preserved where companies from all over Macedonia were interviewed. However, the fact that Skopje is the Macedonian economic center was also taken into account as well. The list of the interviewed companies will be delivered separately.

Letter from the IDSCS that conducted the survey

"The survey was conducted on 50 companies in Macedonia using the qualitative methods of surveying (interviews), due to the specific answers required in the questionnaire. The respondents were Chief Executive Officers (CEO) of companies or the Chief Finance Officer (CFO). The response rate was approximately 50% (50 of 100 companies) which is quite satisfactory, although this rate could be higher if companies' perception of the importance on this issue was more profound. According to the company's representatives this was a survey conducted for the first time and some of the companies were hesitant in giving responses, considering the required data as secretive for their firms. Nevertheless, all companies which gave responds, but also the majority of companies which refused to gave responds in this survey, expressed readiness for cooperation in future studies, if this one shows some valuable analysis which could help to their future market growth.

The main criteria for sample construction were regions and sectors. The main economic region in Macedonia is Skopje with more than 50% share in national GDP. Therefore the respective *number of companies was from Skopje. The other companies were located in different economic regions such as Polog, Bregalnica or Pelagonia*[2]*. For the company differentiation by segment, the GDP composition by sectors was used, and therefore the survey included 12 companies from food processing sector, 8 from construction, 5 from agriculture (the share of agriculture in GDP is greater, but the number was limited to only 5 in order to enable greater segmentation among companies and because several food processing companies also participate in the agricultural production), 5 from metal industry, 3 from chemical industry, 3 from furniture production, 2 auto dealers and auto-parts, 5 textile enterprises and 7 from manufacturing. The profile of companies considering their yearly net income is as follows: 20% bellow 500,000 MKD, 26% between 500,000-3,000,000 MKD, 24% between 3,000,000-10,000,000 MKD, 8% between 10,000,000-30,000,000 MKD, 12% over 30,000,000 MKD and 10% did not responded.*

The number of interviewed companies (50) was determined in accordance with the budget available for the survey and the sample was representative for reliability of the gained data. However, for the future surveys considering this or similar issues, bigger number of companies should be surveyed (150-500) in order to achieve greater differentiation among companies by economic sector and by region".

Institutional set up

The capital market in Macedonia is comprised of primary and secondary capital market. The financial products of the capital market are traded through the Macedonian Stock Exchange where the public companies (corporations) and the government generate long term financial resources for financing their activities.

Macedonian Stock Exchange

The Macedonian Stock Exchange is the first organized stock exchange for long term securities in Macedonia, established in 1995 in Skopje as a not-for-profit corporation (public company). The founders of the MSE were banks and other financing institutions. Later on, with the amendments to the Securities Law adopted in 2001, the MSE has started to function as a profitable corporation. The first transaction through the MSE was completed in 1996 which represented the initial basic element of the capital market in Macedonia. The MSE trades in two market segments: official (super listing and listing) and unofficial/regular market (publicly held companies and free market) depending on the obligations and level of reporting, size and other variables.

Since the establishment of the MSE, the trading has been conducted mainly with corporations that transformed their capital from state to public; by now there has been only one IPO (in 2007)

[2] CEA note: This distinction of regions in Macedonia is in accordance with the IDSCS' internal code.

while the remaining offerings have been mostly private offerings where the priority for stock buy out was given to the existent shareholders or offerings for already known buyers.

In addition to companies' shares, the MSE also trades with bonds and in special cases with other financial instruments such as treasury notes. There is still no trading with other financial products such as financial derivatives.

Macedonian Securities Exchange Commission & Capital Markets Legislation

Macedonian Securities Exchange Commission (MSEC) is the financial regulatory body of capital markets in the country, established by the Macedonian Government in 1992, in Skopje as an independent legal entity. The main tasks of the MSEC are to regulate and supervise the participants in the securities market in the country and ensure legal and efficient functioning of the securities market in the country etc. The securities market in Macedonia is regulated by the following laws: Securities Law, Investment Fund Law, and Law on Takeovers, as well as the Company Law.

Central Securities Depositary

Central Securities Depositary (CSD) was established in 2001 when the existent securities were converted into "dematerialized" securities, and since then the CDS is the only valid evidence for proof of securities ownership. The basic functions of the CSD are to maintain the register of securities, issue of international securities identification number, clear and settle securities and provision of other services to the securities issuer.

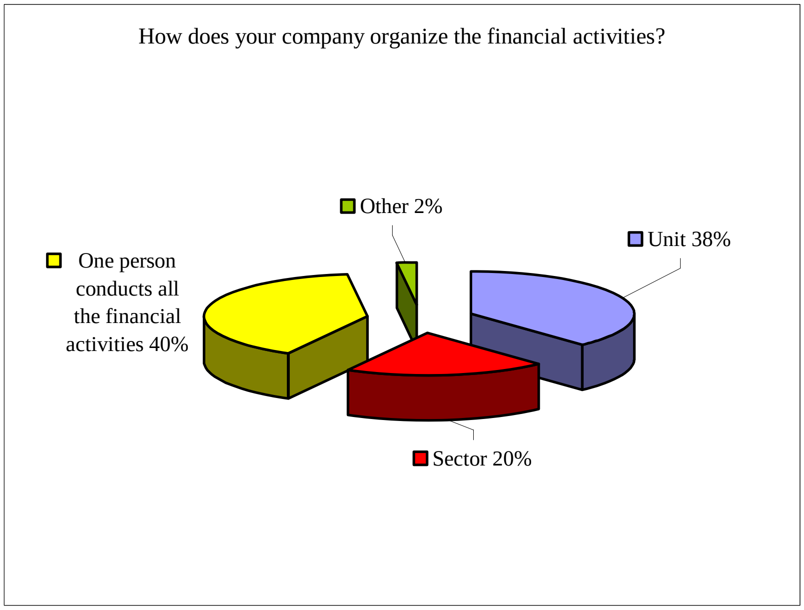
Survey Analysis & Findings

How financial department is organized within the companies?

The data collected from the survey conducted by IDSCS exhibit that the financial functioning of the companies in Macedonia is mostly organized by hiring a single person to deal with the financial issues of the companies. Namely, 40% of the companies have responded that they implement such a practice, while nearly the same percent (38%) of the respondents have a separate accounting unit within the company. Only 20% of the companies have an entire accounting department within the organizational scheme, while 2% of them have an alternative modus in dealing with finance.

This indicates that a relatively small percentage of companies have established separate departments that deal with the financial issues of companies. Most of the companies deal with the financial issues within the accounting departments rather than having separate financial departments. This fact also gives some indication on the prevailing attitude of the businesses which overlooks the importance of the implementation of proper financial

strategies for the success of the company and possible mixing the function of accounting with the one of finances.



The cross-tabulation of the data by sector shows that 80% of the companies dealing in agriculture optimize their financial operations through an accounting unit, while only 20% of the textile companies share the same practice. Half of the companies (50%) in food processing and car dealerships have separate financial departments while the “one person” approach is mostly present within the chemical industry (100%), the furniture industry (66,7%) and the textile sector (60%).

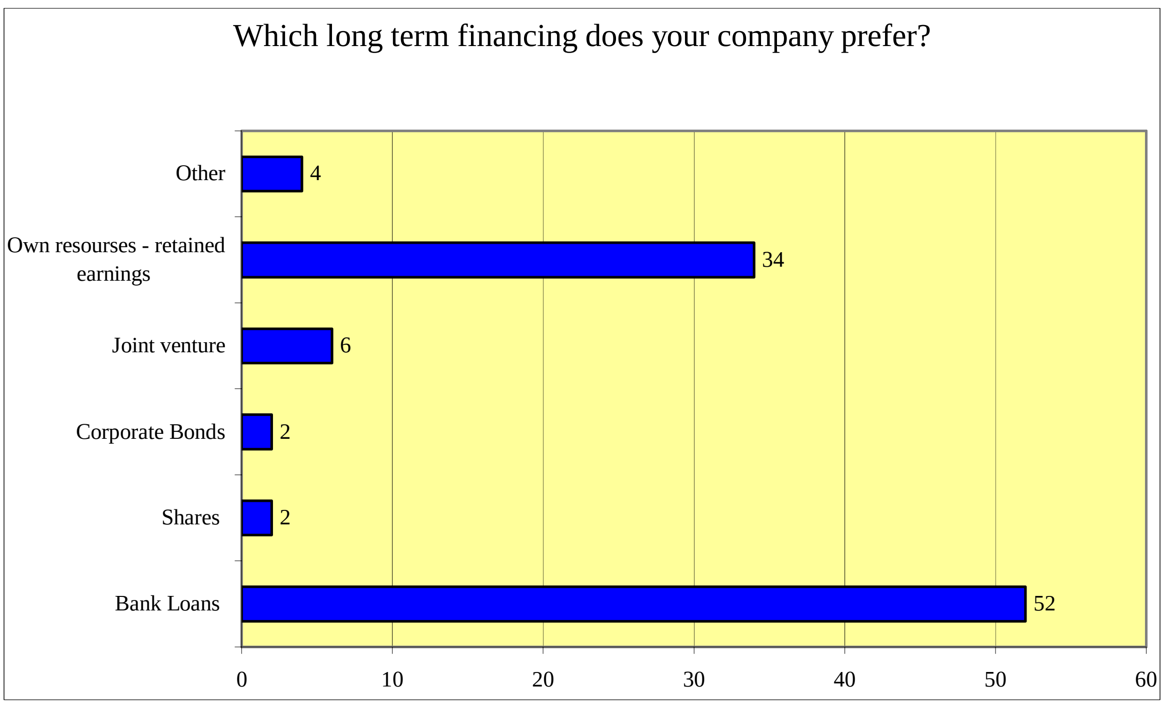
Are the companies acquainted with the capital market’s opportunities?

The second question regarding the level of knowledge of Macedonian companies concerning the financial possibilities of the capital market reveals that most of the companies are either fully of partially acquainted with the possibilities offered by this market. Specifically, 48% of the companies consider that they are solidly acquainted with the possibilities that the capital market offers, while 42% perceive their knowledge as partial in this regard. Only 10% of all interviewed companies think that they do not fully recognize all the possibilities offered by the capital market. The most thoroughly acquainted fields of the business sector in Macedonia in regards to the financial possibilities of the capital market are the auto-industry (100%), as well as the metal and the light industry (80% and 71,4% accordingly). The companies dealing with agriculture mostly perceive themselves as not fully acquainted (80%), followed by the furniture and textile industry (66,7% and 60%). The most uninformed sector seems to be the construction sector with 37,5% of the companies answering that they know little or nothing regarding the latter issue.

Regardless of the relatively high percentage of companies which consider themselves as well or partially acquainted with the financial possibilities that the capital markets offer, a very small percentage of the same have undergone any financing activity that the capital markets offer. **Of the surveyed companies, 84% used own resources for starting the company, 76% used or are using bank loans for financing activities, and insignificant percentage used financing resources from issuing corporate shares or bonds. This is a relevant indication of the level of development of the capital markets in the country.**

This is further confirmed by the question how do companies prefer to finance their long term activities. From the answers it can be concluded that most of the companies prefer bank loans as means of financing their operations (52%), while 34% of the respondents would opt for reinvesting of the profit (own resources). Joint ventures are an option for only 6% of the interviewed companies, while both stocks and bonds are considered by merely 2% of the companies as means for future long-term financing of the company.

Analyzing the cross-tabulations by business sector, it is obvious that bank loans are preferred by almost all sectors except for the agricultural sector. All companies working in the metal and the auto-industry consider banking loans as the best means for long-term financing, while stocks and bonds are an option for 8,30% of the food processing companies. Investments are preferred by one third of the companies operating in the chemical sector while reinvestment of the profits is remarkably high as an option in the agricultural segment (80%).



Segmentation of companies by their income

The third question of the survey deals with categories of local companies based on their net-income in the last three years. It is obvious that the structure of companies is naturally concentrated in the categories of lower net-income i.e. in the categories of “less than 500,000 MKD” (20%), the category between 500,000 and 3 million MKD (26%) as well as in the category between 3 million and 10 million MKD. Only 8% of the companies fall into the category between 10 million and 30 million MKD of net-income in the last three years while the richest group of companies with over 30 million MKD is comprised of only 12% of all interviewed companies. 10% of the respondents did not want to reveal the required data.

The lowest income category is mostly present among the light and the textile industry (42,9% and 40%), while the second and the third category are evenly distributed in almost all sectors. The companies that have a net-income between 10 million and 30 million MKD are mostly to be found in the auto-industry (50% of them) while the companies with highest net earnings are concentrated in the metal and the textile sector (40% both).

Financing options of the companies

The fourth question entails a number of financing options that companies use in their course of work. The situation is as follows:

- 76% of the companies have used bank loans to finance their operations
- Only 4% have done the same by using stocks
- Stakes have been utilized by 2% of the interviewed companies
- **None of the companies have used corporate bonds to finance their operations**
- Investing (investments) has been an option for 18% of the companies
- Own resources for financing have been used by 86% of the companies
- **Only 3% of the companies consider that they have had no need for additional capital**

Cross-tabulated by sectors, the following indicators can be considered as the most specific:

- Banking loans have been used by almost all business sectors. The leading companies that use this modus come from the metal and the auto-industry (100% both), as well as the food processing sector and the textile sector (91.7% and 80% accordingly).
- Only companies from the food processing segment have used stocks as a means of financing (16.7% of them)
- The same can be concluded for the use of stakes but to a lesser extent (8.30%)
- Joint venture as a means of financing is popular among the construction companies (37.5%) as well as in the food processing industry (25%)
- Chemical sector uses internal funds for financing its work (only 33.3%) while all other sectors use internal funds in financing their work in more than 50% of the cases
- One third of the companies in the furniture and the chemical industry perceive no need for additional capital. This opinion is shared by one quarter of the companies in the construction business as well as 14.3% of the companies operating in the light industry.

Main determinants for making financing decisions

The following, sixth question, deals with the issue of the main factors that influence the decision-making process in the companies regarding the source of investing in the business. Asked to rate the importance of every single factor from 1 (least important) to 5 (most important) the companies responded in the following manner:

- The highest ranking factor of all rated with 5 is the ownership structure by 30% of the respondents. It is followed by the cost of the capital with 28%, the time needed for receiving the funds needed (16%), the transparency and the familiarity with the financing terms (14%) and the previous experience with a financial institution (12%)
- The lowest grade of significance is mostly given to the ownership structure again (divided opinions) in 48% of the cases. This is followed by the previous experience (22%), the transparency and the familiarity with the financing terms (16%), the price of the capital (8%) and the time needed for receiving the assets (4%).
- **If one excludes the median answers present in all categories, and rates all the given possibilities as most important (5s and 4s together) or least important (1s and 2s together) the ratings of the variables (from most important to least important) alongside the ratio between the two opposing perceptions would be: price of capital (54%:28%), time needed for receiving the assets (46%:24%), ownership structure (38%:50%), previous experience with a financial institution (34%:44%) and the transparency and familiarity with the financing terms (28%:52%).**
- **The conclusions about the impact of this ranking on the financing choices are mixed. Namely, the cost of capital is the most important determinant with respect to making financing decisions which is expected to stimulate the search for alternative sources of financing, compared to the traditional loan-based financing. On the other hand, the speed of the process of financing, the second most important factor, favors the use of bank loans. Certain improvement in the institutional setting (IPO advise, more efficient SEC) could have a positive influence in the direction of use of securities issues.**

The cross-tabulations reveal the following indicators:

- The price of capital is the most important factor for the auto-industry and the light industry (71.4% and 50%). It is also the least important for the remaining half of the respondents from the auto-industry business indicating opposing views in this sector. This factor is the least important also for one fifth of the textile industry.
- The previous experience with other financial institutions is considered as important mostly by the chemical and the furniture industry sector (33% both). The remaining three thirds of the respondents coming from the chemical industry, however, consider it as the least important factor. 60% of the companies dealing with agriculture agree.
- The transparency and the familiarity with the financing terms is rated as the most important factor in the decision making process mostly within the group of respondents

coming from the construction business (37.5%). It is least important for the companies coming from the metal industry and construction (40% and 37,5%).

- The time needed for receiving the assets is rated as most important only in 6% of the cases in the agricultural sector, as well as in 4% of the cases both in the metal and the textile industry. This factor is the least important for 20% of the agricultural sector and rated with 2 and 3 by most of the other respondents in all sectors.
- The chemical and the auto-industry rate the ownership structure as the most important factor when deciding regarding the financing source (66.7% and 50%). Light industry businesses and furniture producers/dealers consider it as the least important factor (85.7% and 66.7%).

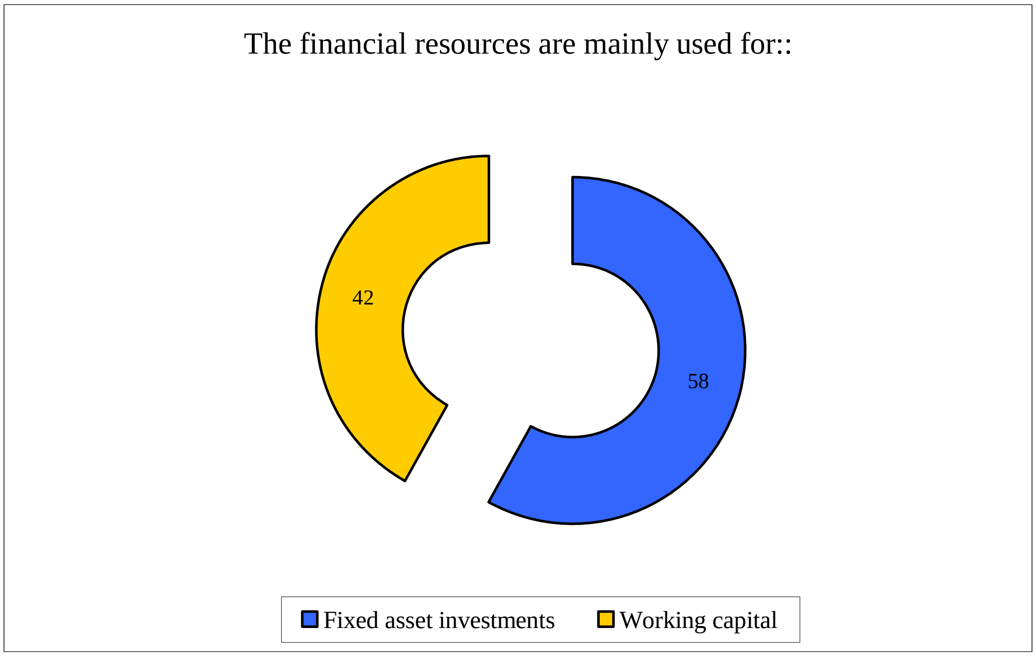
The following complex question directed toward the respondents was “taking in consideration the sector characteristics under which your company operates, which type of financing do you consider most beneficial for financing and maintaining the growth of your company?” Bank loans once again got the highest support from the respondents with 38% followed closely by strategic partner locating with 36%. **Only 8% of the companies consider entering the stock exchange while 14% have other methods in mind**.

Banking loans in this context are very popular among the furniture industry (66.7%) as well as among the light industry (57.1%). Entering the stock market is an option mostly for the remaining third of the furniture industry as well as for one fifth of the companies in the metal industry. Finding a strategic partner is attractive for all textile companies, 60% of the agricultural companies as well as 50% of the companies in the auto-industry.

What is the generated capital used for?

The eighth question refers to the utilization of financial resources gained through some of the mentioned means in the previous question. **58% of the companies responded that they use them for investments in capital/fixed assets while 42% utilize the resources for improvement of their liquidity through investments in the current assets of the company.**

Investments in fixed assets are most popular in the textile industry (80%) and in the light industry (71.4%) while investments in the working capital (for improvement of the liquidity) are widely accepted in the auto-industry (100%), the furniture industry (66.7%) as well as the metal industry (60%).



Evaluation of terms, conditions and obstacles of financing through the bank system

Most of the companies when asked to evaluate the terms and conditions of financing through the banking institutions of Republic of Macedonia give a median grade – 52% of the cases. Only 12% of the companies consider the terms as good while 26% say that the terms for financing in this context are not satisfactory. 10% grade the terms and conditions even more radically saying that the terms are "bad".

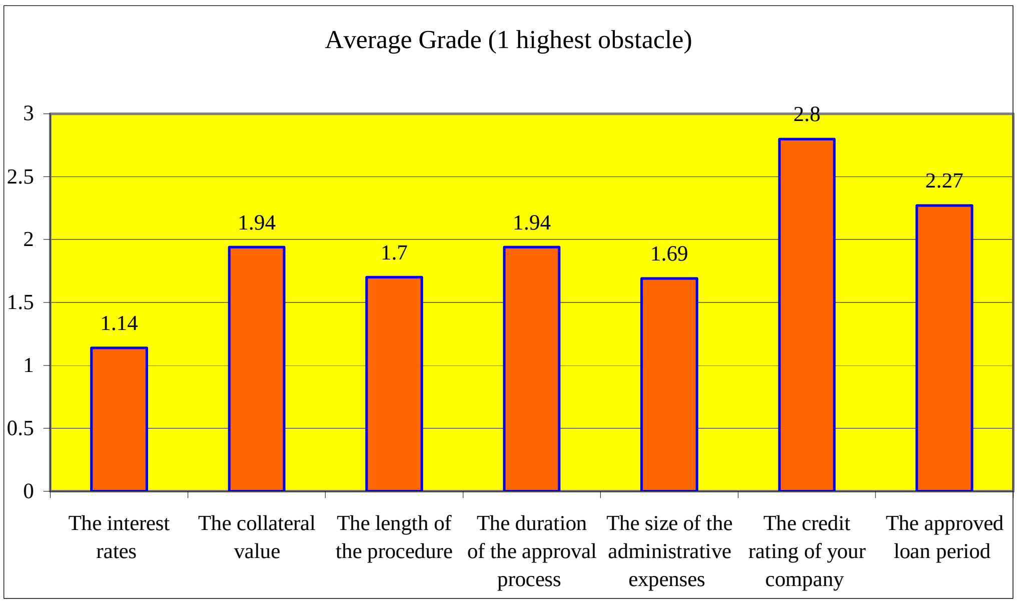
The biggest pessimists come from the textile industry (40%-bad) as well as from the metal industry (40%- not satisfactory). Although a vast majority of the respondents belonging to various sectors rate the terms with medium grade, this statistical category is mostly represented in the auto-industry (100%) and the light industry (71.4%). The biggest optimists come from the chemical industry where one third of the companies consider the financing terms and conditions as good.

The next question required that the companies rate the obstacles in the financing by bank loans in the respective sector. This is how the respondents rated the obstacles starting from the biggest one and the respective percent of the respondents supporting such an opinion:

- High interest rates – 86%
- The complexity of the procedures – 44%
- The administrative costs – 44%
- The period of approval – 34%
- The amount of collateral – 26%

- The period of loan return – 20%
- The credit rating of the company – 4%

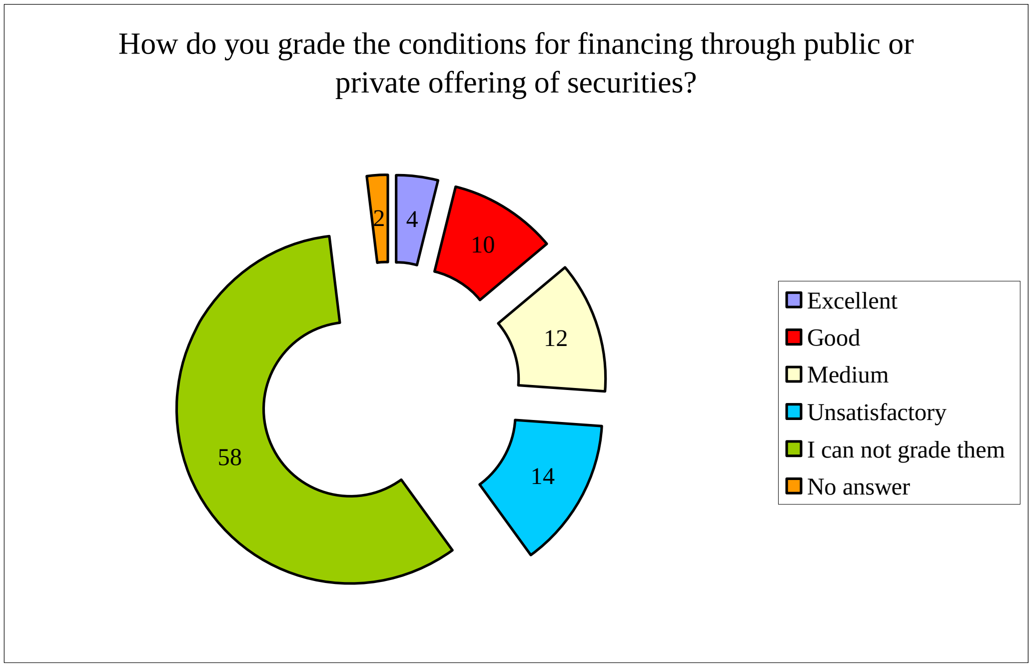
The high interest rates are a problem for almost all industries equally (auto-industry, construction, textile and light industry in first place), while the amount of collateral is perceived as a challenge in the textile and auto-industry. The complexity of the procedures mostly bothers the textile companies and the chemical industry, while the business entities in the textile and the light industry find the long period of approval as a considerable problem. The companies from the textile industry also protest against the cost of the administrative procedures (80% of them).



The terms and procedures of issuing securities and transparency: Awareness

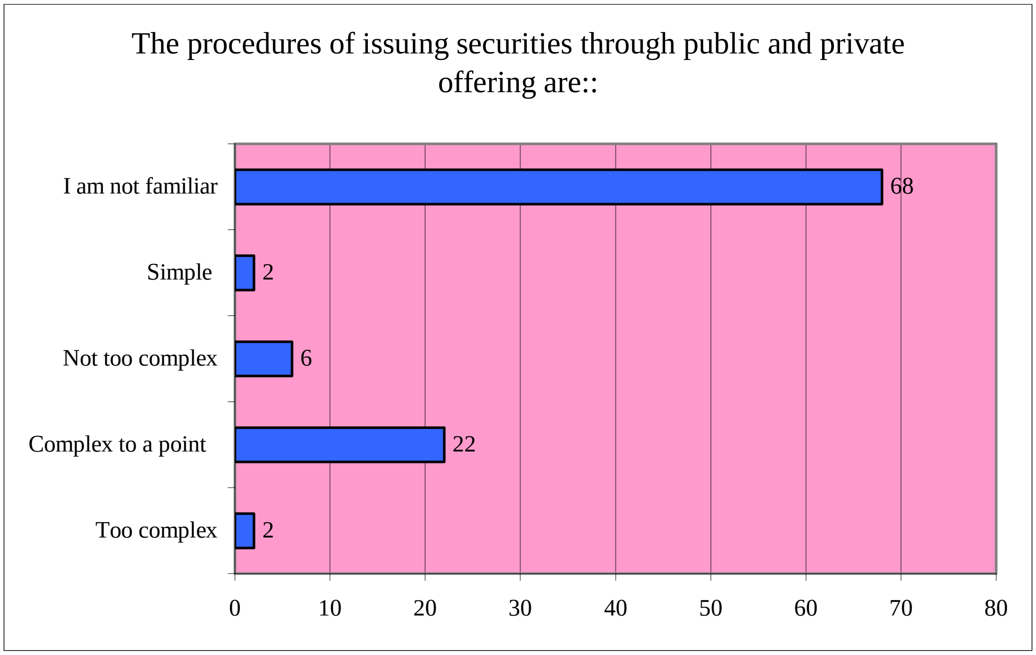
The eleventh question refers to the evaluation of the terms for issuing securities through public or private offering. **From the collected data it is visible that a vast majority of the companies (58%) cannot evaluate the terms due to not being adequately familiarized with the terms of issuance.** However, 14% of the companies perceive these terms as unknot satisfactory while additional 12% perceive them as being median. However, 10 % of the companies positively estimated the terms for issuing securities as good and additional 4% said that those are excellent.

By looking at the cross-tabulated results it becomes obvious that the agricultural sector is completely uninformed regarding the securities issuance (100% of the interviewed companies expressed that they can not evaluate the terms). Companies operating in the auto and metal industries (50% and 40 %) are not satisfied, as well. The chemical industry is more optimistic (33.3%-good) as well as the construction business (12.5%-excellent).



The following question deals more specifically with issuing securities but from the aspect of the procedures. **One can conclude that, similarly to the previous question, a high percent of 68% of the interviewed companies stated that they are not familiarized with the procedures for issuing securities either through private or public offering. However, among those companies that are familiarized, 22% claim that the procedures are complicated to a certain extent, and additional 2% of the respondents say that the procedures are too complicated.** Only 2% of the respondents stated that these procedures are simple, while 6% of the companies' management thinks that the procedures for issuing securities are not too complex.

Although most of the companies, again very similar to the cross-tabulations of the previous question, are not familiarized with the procedures, the companies from the textile industry (20%) stated that the procedures are simple. Conversely, 14.3% of the companies from the light industry perceived the same procedures as too complex . The companies from auto-industry and the agricultural segments consider the procedures as being complex up to a certain extent (50% and 40% of the cases).



The terms and procedures of issuing securities: Is the requirement for regular submission of financial reports an obstacle?

The thirteenth question deals with a sensitive topic requiring from the respondents to answer whether the regular submission of financial reports as a requirement is an obstacle when issuing the securities. **Almost half of the companies (42%) answered that this practice was not an obstacle at all, while additional 16% of the companies perceived this practice as having no influence on their decision to issue securities.** Although 26% of the companies did not have a definite stand point on the issue, 10% said that the practice of submitting financial reports was partially an obstacle for them, while the most dissatisfied group was comprised of 6% of the companies perceiving this pre-requirement as a definite obstacle.

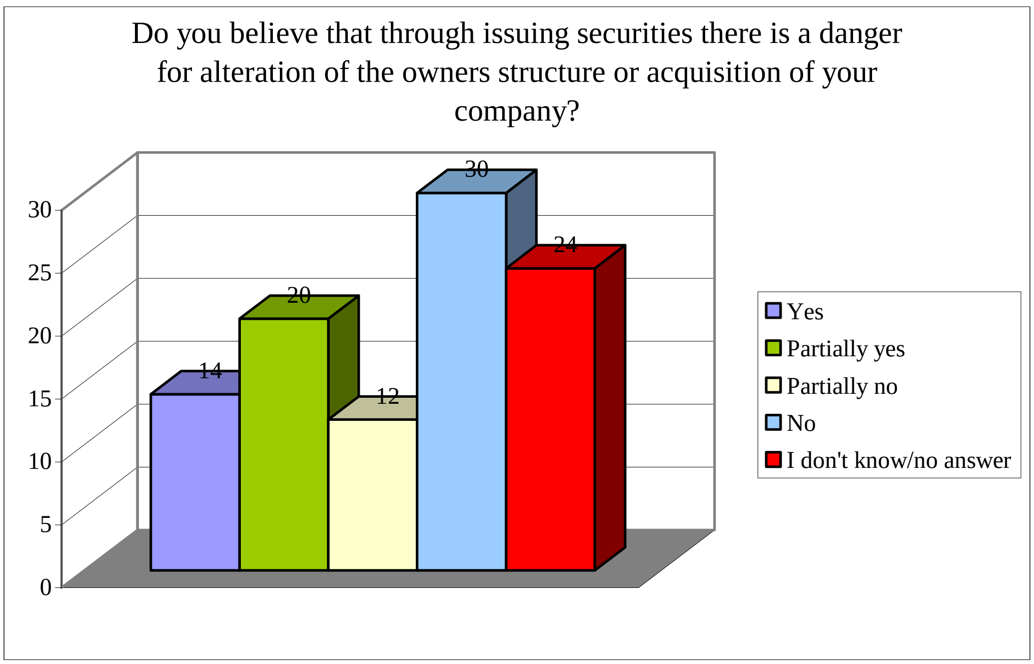
The companies that show discontent with the regular financial reporting are solely located in the food processing industry (25% of them). The companies in the furniture industry share unison of not having a stand on the issue, while “not being an obstacle” option is evenly distributed in all industries (around 50% in most of the cases). This practice being a partial obstacle is an opinion shared mostly in the construction business (25%) and the metal industry (20%).

The terms and procedures of issuing securities: Is there a fear of altering the ownership structure?

The fear of the management that their ownership structure may be altered or their companies overtaken by third persons if they decide to issue shares brings us to the fourteenth question.

Although one quarter (24%) of the companies has no clear idea how to answer to this question, 30% of the respondents agree that they do not perceive a threat of this kind, while additional 12% think that there is a very slight chance for such an occurrence (12%-partially no). On behalf of the opposing opinion, 14% of the companies perceive a very clear threat of ownership alteration or overtake, while 20% of the companies are more moderate answering with "partially yes".

The biggest skepticism concerning the possibility of overtaking or ownership change is located within the companies operating in the chemical industry (33.3%) and the metal industry (40%). On the other hand, the companies coming from the light and the textile industry do not perceive this as a specific threat in 71.4% and 60% of the cases accordingly.



The terms and procedures of issuing securities: Does going public gives a possibility of providing resources?

The following question addresses the opinion of the interviewed companies regarding the possibilities of getting resources through issuing securities on the Macedonian Stock Exchange. A vast majority of the companies (42%) have no answer to this question while the ones that do have an answer to this question are more concentrated in the optimistic group. Namely, 40% of the companies answered positive to the question of acquiring resources through issuing securities on the Macedonian Stock Exchange, while only 18% of the companies did not see such an opportunity.

The high percentage of companies having no answer to this question matches the previous conclusion that the level of knowledge about this opportunity is on a very low level.

The companies that could recognize the above-stated opportunity mostly originate from the auto-industry (100% of them) and the textile industry (60%). The skeptical companies come mostly from the light industry sector (42.9%) and the agricultural sector (40%).

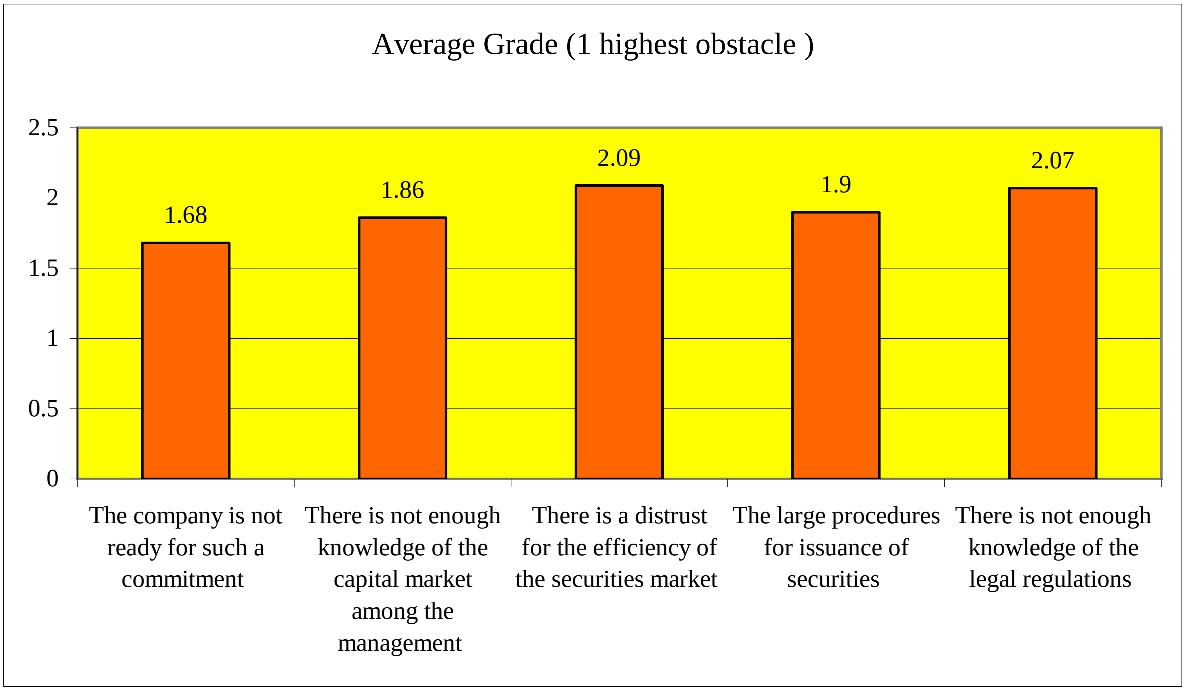
The terms and procedures of issuing securities: What are the biggest obstacles?

The point of the sixteenth question is to locate the obstacles that the companies perceive concerning their financing through participating on the stock exchange market. In this regard the companies were asked to rate the obstacles (on a scale from 1-biggest obstacle to 3-the smallest obstacle) for financing themselves through issuing securities. This is how the companies rated the obstacles from the biggest obstacle to the least one:

- The company is not prepared for such a move – 44%
- The lack of knowledge by the management regarding the capital market – 36%
- The complexity of the procedures for issuing securities – 24%
- The lack of knowledge regarding the legal framework – 24%
- The lack of confidence in the capital market – 18%

In regards to the cross-tabulated results the most characteristic statistical occurrences follow:

- The company not being prepared for issuing securities is the biggest obstacle for 100% of the companies operating in the agricultural sector as well as for 66.7% of the companies working in the furniture business
- The lack of knowledge regarding the capital market is an obstacle for the companies from the construction and the textile sector (50% and 60%).
- The lack of trust in the capital market is a problem predominantly in the auto-industry (50%) and the textile segment (40%)
- The complexity of the procedures is located as the biggest obstacle mostly in the auto-industry (50%) and the agricultural business (40%)
- The lack of knowledge concerning the legal framework is perceived as the biggest obstacle in the construction sector (62.5%) as well as in the textile industry (60%)



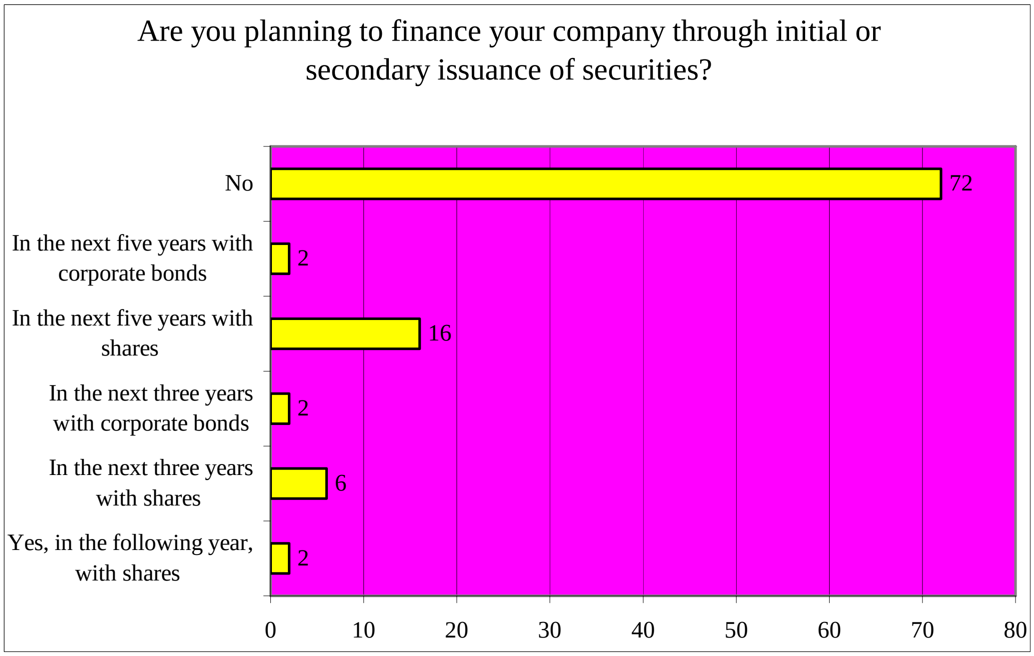
The terms and procedures of issuing securities: Near future plans?

The seventeenth question refers to the concrete plans of the companies to finance their activities through a primary or secondary share offering. **The data clearly indicate that a vast majority of the companies does not have plans of financing their operations through this modus – 72% more precisely.** However, the rest of the companies have chosen different options for self-financing i.e. 2% of the companies chose corporate bonds in the following five years, 16% chose stocks also in the following five years, additional 2% chose corporate bonds but in the following three years, stocks in the following three years are an option for 6% of the respondents while stocks in the following year is a choice of 2% of the interviewed companies. Although these figures are relatively low, if all these declarations are fulfilled, they could mean a considerable progress compared to the current situation

Regarding the sector cross-tabulations the most indicative statistical markers are as follows:

- The companies that do not consider financing their activities through a primary or additional issuance of shares are evenly distributed in all sectors
- Only 50% of the companies in the auto-industry consider stocks in the following year as an option
- Stocks in the following three years is an option for 33.3% of the companies in the furniture sector as well as for 20% of the textile companies
- Corporate bonds in the following three years are an option only for 8.3% of the companies in the food industry

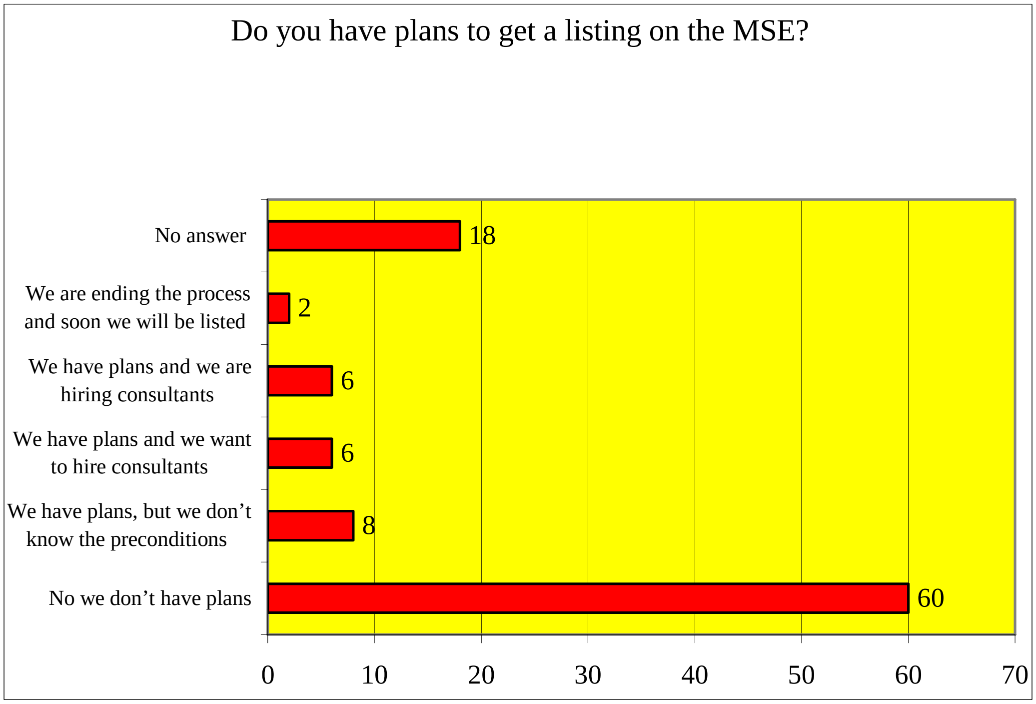
- 42.9% of the companies in the light industry and 25% of the food processing companies plan to finance their operations with stocks in the following five years
- Only 8.3% of the companies in the food industry plan to finance their operations through corporate bonds in the following five years



In an effort to acquire the percent of the companies planning to get a listing on the Macedonian Stock Exchange, the nineteenth question bluntly asked the respondents on their plans in this regard. Although 60% of the companies do not plan to participate in the Macedonian Stock Exchange (plus the 18% that do not know yet) in the near future, out of those having such plans 8% said that although they planed they did not have the adequate preconditions. Additionally 6% also have plans on joining the stock exchange and plan on finding consultants while additional 6% plan to participate and will hire consultants in the near future. Only 2% have almost ended the procedure and will very soon be present in the stock market.

The answers to this question reveal that the companies do not recognize the advantages of being a public company. This is in line with some of the previous conclusions about the lack of knowledge in this area.

The cross-tabulations by sector in this question reveal that companies that do not plan to participate are equally distributed in all sectors. The companies that do not know the adequate preconditions for entering the stock market mostly come from the furniture industry (33.3%) while businesses that are planning to find consultants mostly come from the textile sector (20%). 20% of the companies in the metal industry will soon hire consultants in order to get a listing on the MSE and 50% of the auto-industry companies are almost ready with the procedure and will very soon enter the stock market.



The terms and procedures of issuing securities: Will tax exemptions stimulate the activity?

Speaking of the statistics regarding tax exemption as a stimulating measure for issuing corporate bonds, one could come to a conclusion that a large number of companies (42.9%) are not acquainted with this option. Furthermore, 35.7% of the respondents say that the tax exemption do not affect them in a stimulatory manner in order to decide to issue corporate bonds. Only 21.4% of the interviewed companies find the tax exemption as stimulating for issuing corporate bonds.

The companies that do not find the tax exemption as stimulating (100% negative answers) come mostly from the metal, chemical and construction industry. The companies that find the measures stimulating are concentrated in the food processing industry (40%) and the light industry (25%).

What are the most problematic factors for doing business?

The next question has been a composite question that requested the respondents to grade (on a scale from 1 to 5, 1 being the most problematic) the most problematic factors for doing business. The suggested list of factors included the following aspects: inefficient public administration;

access to finances; corruption; instability of economic policies; tax rates; taxation regulations; insufficient working ethics of the working force; criminal and thefts, unstable governments, inappropriately educated working force, inappropriate infrastructure; currency exchange regulations; restrictive labor policy; inflation and costs for telephones, internet and communication.

Inefficient public administration is the biggest problem for 42% of the respondents, while additional 48% regards it as problematic (20% graded this factor with 2 and 28% graded it with 3). The cross-sector analysis pinpoints that the agriculture sector (100%) and the industry sector (80% of the companies working in this sector) appear to be mostly concerned with the inefficient public administration. Additionally, the median grade (3) provides a relatively equal distribution over 6 sectors.

The next factor, access to finances, has provoked a rather evenly distributed assessment for the first four categories i.e. 28% with grade 1, 22% with grade 2 and 20% a piece with grades 3 and 4. On the other hand, the cross-tabulation by sector shows that access to finances is the most problematic factor for doing business for 40% of the respondents coming from the light and metal industries, as well as the agriculture and textile sectors. On the other hand, 27% of the food processing companies regard this factor as least problematic (grade 5).

Corruption is widely regarded as a significant obstacle for doing business, as 40% of the companies assessed it with grade 1. The other grading categories are relatively equally distributed. The chemical (100% of respondents graded 1) and the metal (80% of respondents graded 2) industry seem to be most heavily burdened by corruption, while 27,3 % of the companies from the food processing sector perceive corruption as the least problematic factor.

Instability of economic policies has been assessed in the following ranking pattern:
- Grade 1 (most problematic for doing business) - 32%
- Grade 2 – 34%
- Grade 3 – 24%
- Grade 4 – 6%
- Grade 5 (least problematic for doing business) – 2%

The cross-tabulated data by sector demonstrate that 80% of the respondents working in the metal industry regard the instability of economic policies as the most problematic factor for doing business. Accordingly, 80% of the textile companies, 62% of the construction companies and 66,7% of enterprises engaged in the furniture production describe the instability of economic policies as problematic.

The tax rates as obstacles for the business climate in the country are evaluated with the median grade (34%). A lower percentage of respondents (12%) regarded this factor as very problematic; while additional 28% consider it to be problematic (grade 2). Accordingly, most industries consider tax rates to have a median effect on doing business. Tax rates appear to be a significant problem (grade 2) for the construction companies (60%) and companies working in the metal industry (40%). 40% of the light industry companies consider this factor to be very problematic (grade 1).

The taxation regulation variable produces an almost identical distribution of percentages as in the case of tax rates (with identical 34% inclining towards the median value). The cross sector analysis shows an inconclusive frequency of percentages that are rather equally distributed.

Insufficient labor ethics of the labor force is a significant problem (grade 1) for 14% of the respondents. Additional 18% regard this factor as problematic (grade 2), while 28% of the respondents opted for the median grade. Nevertheless, 28% of the surveyed companies consider insufficient labor ethics of the labor force to be the least problematic (grade 5). In this sense, the least concerned industries with this problem are the metal, textile, construction and the food processing industry.

The issue of crime and thefts is considered as the biggest problem for 32% of the specific population. Additional 30% of the respondents opt for the median grade (3). 14% see this factor as a problem (grade 2), while 16% consider it to be the least problematic (grade 5). The cross-tabulation of the data by sector shows that 60% of the metal industry companies and 67% of the companies working in the chemical industry consider the crime and thefts to be the biggest threats to their conduct of business.

The next factor, unstable government is perceived as a problem of median value, with 32% of the respondents opting for grade 3. The other categories are generally equally distributed. However, political instability is perceived as most problematic by 66% of the companies in the chemical industry. On the other hand, the agriculture sector seems to be the least concerned with the problem of political instability.

Surprisingly enough, 24% of the respondents consider the factor of inappropriately educated labor force to be the least problematic. Another 24% evaluate this problem as average (grade 3), while 22% think that it is problematic (grade 2). Cross-tabulated into sectors, the figures demonstrate that 40% of the textile companies have problems with the level of know-how of their workers, while one third of the companies from the furniture and chemistry industry consider this to be the biggest barrier to a more competitive business environment. On the other hand, agriculture (60%) is the sector that is the least concerned with this problem.

Inappropriate infrastructure is a factor of median consideration for 28% of the respondents. The other grades are distributed accordingly: grade 1-14%, grade 2-20%, grade 4-18% and grade 5-16%. Respectively, 40% of the respondents from the metal industry enlisted infrastructure as their biggest problem, while half of the construction companies consider the infrastructure as problematic (grade 2). On the other hand, two thirds of the furniture producers regard the infrastructure as the least problematic.

Currency exchange regulations are a factor that in general is not perceived as a significant impediment for doing business in the country. While 38% of the surveyed companies assessed this factor with the median grade, additional 40% perceive it as not problematic (20% for grades 4 and 5 accordingly). Regarding the later issue, the cross-tabulation of data by sector shows that one third of the companies working in the sectors of food processing, furniture production and chemical industry have no significant problems with the currency exchange regulations.

The last three factors that have been suggested are not considered as obstacles for doing business in Macedonia. In the case of restrictive labor policy, a rather high percentage of 32% of the respondents rated this factor with grade 4. Additional 20% think that this issue is not a significant problem. Only 10% regard the issue of restrictive labor policy as very problematic. Agriculture, food processing, textile industry and furniture production are the sectors that are not highly concerned with this problem.

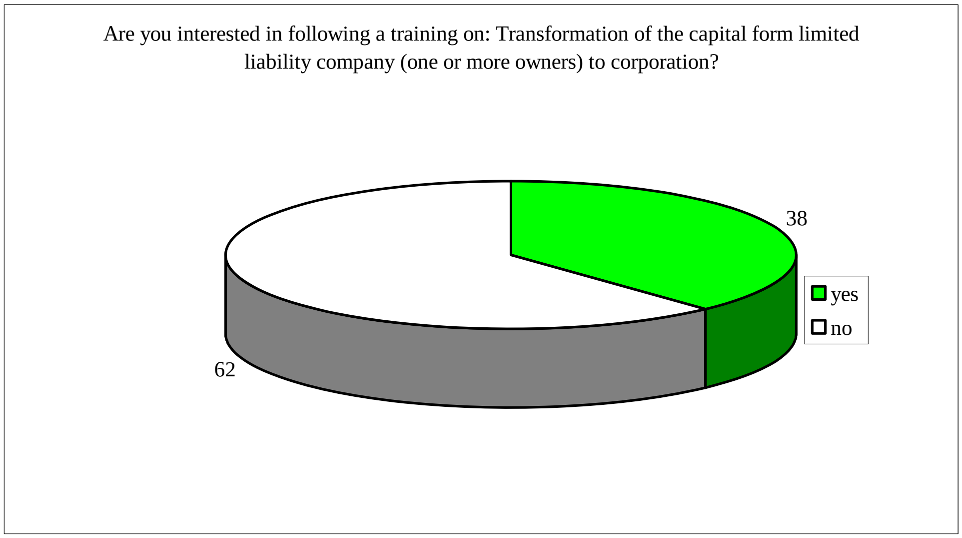
Inflation is even more underlined as a factor that does not cause much harm to the business ambiance. Accordingly, 36% of the respondents consider inflation as the least problematic factor, with 20% marking it with grade 4. Another 26% gave the median grade. Such a distribution is noticeable also in the cross-sector analysis where only the companies working in the chemical industry and furniture production showed some concerns.

Finally, costs for telephones, internet and communication are factors that show a little bit more fragmented responses from the surveyed companies. While on one hand, 22% regard these factors as the most problematic, on the other hand 18% have opposite opinion and consider these factors as the least problematic. Additional 22% assessed the costs for telephones, internet and communication with grade 4. The sector cross-tabulation indicates that these costs are a major concern for the majority of companies working in the sectors of furniture production (66,7% grading with 1) and metal industry (40% grading with 1).

Is there an interest for training?

The last question analyzed the interest of companies to participate in trainings covering several topics. The data lead to several conclusions:

- 62% of the respondents are not willing to take part in trainings for transformation of the capital from a limited liability company into a corporation.



- 42% of the respondents would participate in trainings in “Issuing of Corporate Bonds” and “External Financing by Factoring”
- 38% of the respondents are eager to attend trainings in “External Financing by Leasing”
- The respondents are not interested in suggesting other topics for trainings.

Cross-tabulated by sectors, the following indicators can be considered as the most specific:

- The trainings in “Issuing of Corporate Bonds” are most attractive for the managers of the companies working in the light industries sector (71%)
- Managers working in the sectors of metal (60%) and light industries (71%) are mostly keen on taking part in trainings in “External Financing by Factoring”
- “External Financing by Leasing” is a training topic that is attractive for the light industry companies (71.4%) and to some extent for the construction companies (50%)

Overview of the Regional Development and Trends of Debt vs. Equity Financing

The overall Central and Eastern European (CEE) capital markets are developing capital markets in their infant stages. This especially holds for trading with financial instruments such as bonds and/or other financial derivatives. An exception to the above-stated are the Polish, Czech and Hungary capital markets where we see more “innovative” financial instruments for corporate financing and with higher market liquidity compared to the remaining markets, including the Balkans.

A significant factor supporting the above-stated is that most of the Balkan securities markets i.e. the stock markets are a result of the transitional economy where the state owned enterprises were privatized through the stock exchanges. The stock exchange was mainly used as an instrument for majority owner capital concentration rather than collection of finance for long term

investments/funds. This is reflected in the low liquidity, low market capitalization and higher risk for foreign investments.
In order to give a context to the above analysis of the Macedonian situation we will present a short description of the developments in the neighboring countries.

Serbia

- As well as in the other Balkan markets, there is an increasing trend for stock market interest in Serbia. This can be seen from the 220% increase of the market capitalization (April 2006 to April 2007, 220% increase)
- There is an increase in the number of listed companies as well as in the liquidity of the stock
- However there are no IPOs so far, but there are preparations for state owned companies to be privatized through IPO (such as: the oil, telecom, utilities, and other ‘strategic’ companies not listed yet)
- There is no financial derivative trading
- Corporate reporting improved, but still needs to be more frequent
- Market capitalization forecast for 2007 is estimated to be approximately 20 billion EUR

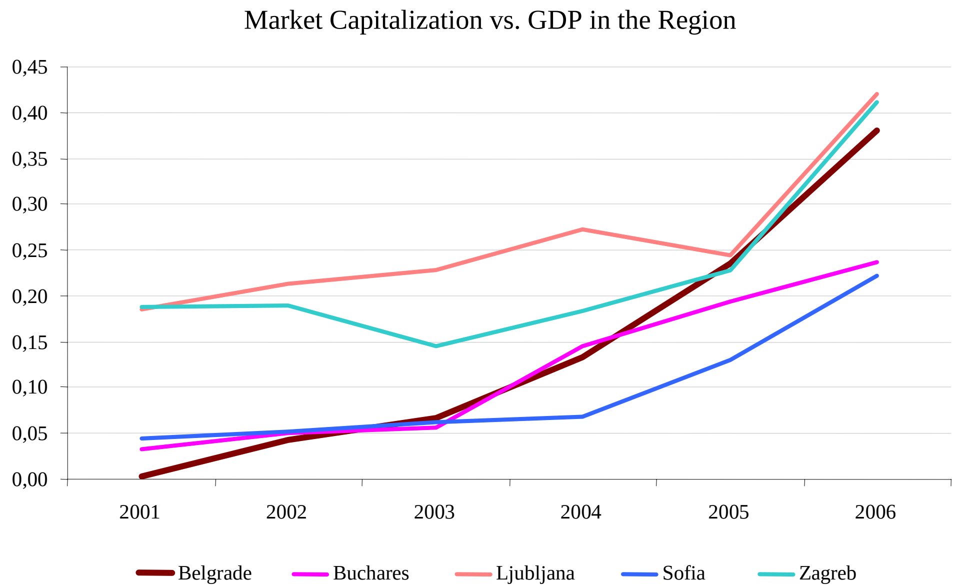
Croatia

- The market in Croatia shows that there have been few recent IPOs where state owned companies have been transformed to corporations
- There is an increased interest in debt financing, especially after the fall down of loan interest rates
- The equity investment opportunities are considered scarce
- There is still underdeveloped corporate bond market with only few corporate bond issues, which is influenced by the relatively high costs of bond issue and lack of credit ratings
- Government debt is still a dominating investment
- There are “innovative” corporate and municipal fixed income financial instruments developed
- Market capitalization forecast for 2007 is estimated to be approximately EUR 50 billion

Slovenia

- Compared to the rest of the ex-Yugoslav republics Slovenia has rather more developed stock and bond market
- There are significant number of corporate bond issues
- The bond issuance is not at a significantly high level to make it competitive to the bank loans which leaves the private sector still highly reliant on the bank financing
- There are no asset backed securities yet
- There are no organized derivatives market however there is a small Over-The-Counter derivate market
- Unlike the other ex-Yugoslav countries the Slovenian stock market has not been used as a channel for privatization

- Market capitalization forecast for 2007 is estimated to be approximately EUR 24 billion.

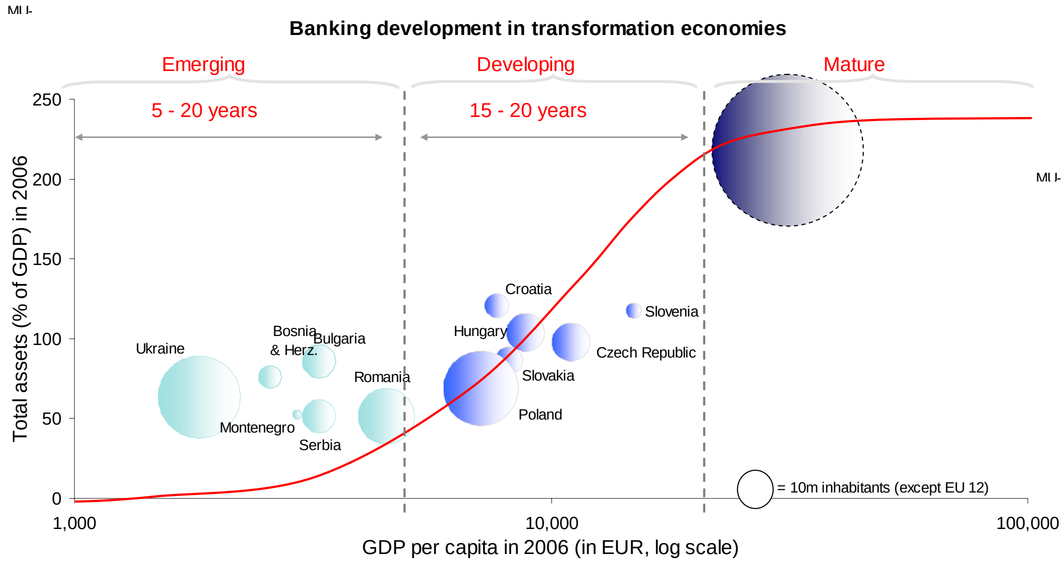


Source: Third Annual Conference: The future of the capital markets of the Balkan http://www.ekonomist.co.yu/konferencije/srp/arhiva/jun_2007.jsp#prez

Banking Sector

The banking system in the Balkan countries has been a significant factor for the development of the region in the last 15 years. Although still underdeveloped in comparison with the western markets, the banking system has undergone a significant development in this period.

The banking system is still the most relevant source for financing of the private sector in the Balkan. This can be seen from the still high interest rates to the offering of classical financial instruments without innovation. An illustration of the lagging of the Balkan banking sectors behind the developing and the mature economies is the figure bellow which ranks the CEE countries according their level of development.



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Sources:

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4. www.pfsprogram.org/
5. http://www.seeurope.net/files2/pdf/rgn0905/6_SEECapitalMarkets.pdf

NOTE: