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Aspects of the Capital Markets' Development from the CIS Member States and Republic of Moldova

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Abstract

Evolution of capital markets is an important process for the all economies, irrespective their degree of development, while the trends emphasized during the last decades marked some common tendencies of evolution. Practically, most of the tendencies manifested on global capital market are also relevant for the securities market of the CIS member states, still, one of them possessing a more relevant character (capital concentration and centralization; regulation and deregulation of capital market; capital market informatization), while the other ones – a lower degree of relevance (ascension of institutional investors on capital market; implementation of financial innovations; capital market integration and international cooperation; compartmentalization of secondary capital market and development of alternative secondary market etc). This article emphasizes some of the tendencies specific for the development of the capital market from the CIS member states and the Republic of Moldova.

Keywords: capital centralization, capital concentration, regulation of capital market, privatization, institutional investors, institutionalization of capital market, stock exchange, capitalization of stock exchange, financial integration

Introduction

At any stage of the economy's development, capital market identifies some directions of its evolution and traces some tendencies.

At present, the main principles of global capital market are represented by the following directions: capital centralization and concentration, institutional investors' ascension, informatization, integration of capital markets and international cooperation, globalization, implementation of financial innovations, securitization and reciprocal penetration on other market' segments, disintermediation, regulation and de-regulation, compartmentalization of secondary capital market and development of alternative secondary markets.

Practically, most of the tendencies manifested on global capital market are also relevant for the securities market of the CIS member states, still, one of them possessing a more relevant character, while the other ones – a lower degree.

This work emphasizes the most important tendencies, which had a pronounced character in the development of capital market in the CIS member states, as well as in Republic of Moldova. Thus, the paper is structured into 5 sections that relate the general developments and evolution within: capital concentration and centralization processes, institutionalization of capital market, securities markets' regulation within the process of EU integration, reduction of stock markets' capitalization. All the most important statements are totalized in the section of general principles of capital markets development within the CIS member states. Conclusions and references end this article.

Capital concentration and centralization processes

Capital concentration and centralization processes on the capital markets can be considered as premises of *investors' institutionalization*. Thus, in Republic of Moldova, as in the majority of another CIS member states, *the processes of capital concentration and centralization in form of securities, was launched within the process of mass privatization of state ownership, at the beginning of 90s*. Thus, a good part of capital was concentrated within population (over 3.2 million citizens of the Republic of Moldova), while the privatization model being based on the following principles, forms and methods:

- Transfer to collectives for patrimonial vouchers the volume of up till 20% of ownership;
- Privatization for cash, with participation of foreign investors;
- Free transfer (up till 50%) from the ownership of processing enterprises to suppliers of raw materials.

In such a way, during the 1993-1996 period, more than 2235 Moldovan companies from industry, trade and social service sectors, as well as agricultural branch, were privatized for patrimonial vouchers.

At the same time, as a result of the privatization process, the first type of owners appeared – companies with a big number of shareholders, whose stocks were in free circulation. As a result of privatization by investment tenders (1998), the second type of owners appeared – companies with a sole shareholder and an insignificant number of „external” shareholders.

The capital concentration process in Moldova in conditions of mass privatization determined the creation of the securities market. Already, at the end of 1997, the total volume of shares’ issues on the capital market exceeded 6.8 billion Lei (total volume of shares’ issues from 1992 till 2009 registered 21.2 billion Lei). In 1992, first closed joint-stock companies (JSC) were created. The given period can be considered as the start of the national primary securities market development.

In short time, professional participants institutions of securities market were created, while once with the approval of The Law of financial institutions of Moldova (1995), the professional activity on securities market was allowed to commercial banks.

Appearance of various professional participants on the securities market (trust companies, independent resistors and brokers), the respective public organizations: Joint-Stock Companies Association, Professional Representatives Association led to the accumulation of work experience with securities, while the existence of different issuers and shareholders (having a different interest) on the capital market forced the creation in 1995 of the Stock Exchange – the institution with the role of activity’s equilibration and regulation’s insurance of capital market.

Thus, institutionalization of capital market took place by the appearance of market institutions, professional participants, issuers, as well as investors, including institutional investors.

Institutionalization of capital market

The *phenomenon of institutionalization* should be considered from the level of organization of different companies, mostly determined by the increase of capital mobility.

Within the *CIS member states*, the increase of number of institutional investors, which represent the main type of investors from the securities markets, determines the growing demand for financial instruments (see table 1).

Table no. 1. Number of institutional investors and volume of assets from the CIS member states

Country	Number of institutional investors		Volume of assets, thousand USA Dollars	
	At 01.01.2008	At 01.01.2009	At 01.01.2008	At 01.01.2009
Armenia	66	68	2.713	3.615
Belarus	61	65	25.400	51.200
Kazakhstan	527	588	2.960.000 (580.000)*	3.690.000 (1.140.000)*
Kyrgyzstan	6	8	-	1.224,9
Republic of Moldova	At present, none of active institutional investors exists			
Russia	1.430	1.595	32.089.984	22.707.919
Tajikistan	16	17	13.435	17.521
Ukraine	796	1.177	4.976.583	7.865.768

* in parenthesis - volume of investment assets

Source: adapted by authors in base of data from www.cnpf.md

Analysing the data of table 1, it can be mentioned that the reduction of number of institutional investors' assets during 2008-2009 was attested only in Russia. Practically, all the countries registered an increase in the number of the professional participants on securities markets, representing the improvement of market's infrastructure (see table 2).

It is to mention that the most dynamical growth of the number of professional participants was registered in *Armenia* (nearly 3 times) and in *Ukraine* (by 19%), due to the increase of the number of organizations

that perform the trust, brokerage, dealer, investment portfolio management activity.

In *Moldova*, the number of professional participants on the market attested a reduction (by 20%). Thus, if the number of professional participants during the period of national securities market development (middle of 90s) exceeded 140, in 2010, it was limited only to 44 organizations, without considering investment funds, which, at present, are in process of liquidation. Practically, the securities market does not possess force operators, as institutional investors – efficient administrators of investments.

Table no. 2. Number of organizations that perform a certain type of professional activity on securities market¹ from CIS member countries

Country	At January 1 st 2008	At January 1 st 2009
Armenia	29	87
Belarus	171	179
Kazakhstan	212	217
Kyrgyzstan	72	81
Republic of Moldova	68	55
Russia	3.670	3.710
Tajikistan	4	7
Ukraine	1.631	1.942

Source: adapted by authors in base of data from www.cnpf.md

The most representative institutional investors on the Moldovan capital market appeared in conditions of privatizations and were privatization investment funds. Although already by 80s, the tendency of institutional investors' ascension on the capital market was strongly pronounced; in *Moldova*, this tendency still now is poorly manifested. The legal attempt to create an investment bank (in 1991) had no success. The activity of other institutional investors (like non-government pension funds, insurance companies etc.) on domestic capital market is not essential and poorly sizable, although legal provisions relating to them exist.

¹In case if any organization doesn't perform some of the types of professional activity, this organization is considered in this table according to each type of activity

The concentration and centralization processes on the capital market were also extended over the professional participants. This tendency was manifested through: consolidation of professional participants' organizations, augmentation of the volume of managed funds, extension of the assortment of rendered services, as well as through the minimization of their number in conditions of a strong competitiveness.

Securities markets' regulation within the process of EU integration

Cooperation among CIS member states in the domain of securities markets' regulation offers the possibility of exchange the experience and contributes towards the improvement of the principles of the activity and the continuous development of stock exchanges. The necessity of such collaboration is explained through the possibility of re-distribution of investment means and credit flows from the CIS markets and other developing ones towards countries and financial instruments with a low level of risk, which corresponds to the process of globalization, characteristic to the global capital market.

In *Republic of Moldova*, the process of national capital market integration into the European Union financial sector is associated with conformation of national legislative framework towards the European Union directives and foresees a radical restructuring of market infrastructure. Majority of directives establish „minimal standards” that should be practiced by member states, each country having the possibility to fix more severe provisions on its territory. Thus, the scope of directives is to homogenize and create certain common standards, regulating only those aspects of the capital market that are connected to relations among different states. A major part of regulations is mostly related to the legislation of each member state, but that are not contrary with the Community legislation.

For the achievement of this objective, *the Strategy of non-bank financial market development for 2011-2014* was developed, which purpose is the conformation of the national legislation in the domain of non-bank financial market to European standards, and, as a result, the realization of the European integration objective, while the principle domains of development stipulate the adjustment of national policies, towards the best practices at international level. Thus concrete legislative

measures were elaborated and created² in relation with the regulation reform, having as major objective the *development of a well regulated and transparent market, financial stability and implementation of a new architecture of non-bank financial supervision*.

At the same time, in Moldova, as well as in other CIS member states, a less restrictive tendency of market regulation is attested for its significant liberalization, expressed through: liberalization of *transactions* with securities (for ex., existence of legal provisions on using multilateral trading systems (MTF)), possibility of introducing new financial instruments (derivatives, municipal bonds etc.), attraction of new market operators with a high potential, inclusively the ones from EU, as well as the access of national operators on European markets, while the existent legal framework is going to be substituted with the one specific to European standards.

Reduction of stock markets' capitalization

Another tendency characteristic for the development of the capital market from the CIS member states (from the end of first decade of the XX-th Century) is the diminishing of liquidity, limitation of access to credit and investment resources, increase in credit costs, worsening of financial estate of many issuers, reduction of securities' costs traded on national stock exchanges, as well as, as a result, the reduction of stock markets' capitalization (see table 3).

²Appearance of a whole set of legislative acts' projects like: Law on National Commission of Financial Market; Law on capital market; Law on non-bank financial organizations; Regulation on the prior approval of large transactions, investment of own capital in social capital of a commercial company and taking credits by insurers (re-insurers); Regulation on derivative financial instruments and requirements for their disclosure; Regulation on the principles of an efficient organization of the Governing system; Law on facultative pension funds; Law for modification and completion of Law nr. 397-XV of 16.10.2003 on local public finances; Instruction on state registering of securities; On changing and completion the Instruction on public securities offering on secondary market.

Table no. 3. Capitalization of stock markets from CIS member states

Country	Capitalization of stock markets (million USA Dollars)		Capitalization of stock markets /GDP (%)	
	According to situation of 01.01.2008	According to situation of 01.01.2009	According to situation of 01.01.2008	According to situation of 01.01.2009
Armenia	105	176	1,00	1,50
Belarus	Data is not available	103	Data is not available	0,18
Kazakhstan	53.830	31.130	40,84	23,64
Kyrgyzstan	1.057	1.216	25,24	25,91
<i>Republic of Moldova</i>	663	716	14,04	11,85
Russia	1.266.442	365.413	99,80	26,40
Tajikistan	4	430	0,1	8,4
Ukraine	109.164	23.542	76,48	19,08

Source: adapted by authors in base of data from www.cnpf.md

According to the data reflected in table 3, the highest reduction of capitalization of stocks traded on the organized market was registered on markets with a high integration degree in the world economy, like *Ukraine* (with a 4,6 times reduction), *Russia* (with a reduction of over 70%) and *Kazakhstan* (with a reduction of over 40%). Securities markets from other countries were lower exposed to the influence of crisis. For example, the markets of *Armenia*, *Kyrgyzstan* and *Tajikistan* registered a capitalization growth.

In *Republic of Moldova*, once with the increase of stock market's capitalization, its weight in GDP was diminished (from 14.04% to 11.85%). Beginning with 1998, the ratio of cumulated volume of issues to GDP registered: in 2005 – 48.5%, in 2006 – 42%, in 2007 – 37.1%, in 2008 – 32.8%, while in 2009 – 35.3%. The indicator of stock exchange capitalization to one Leu of GDP registered 14-15 bani during 2009-2010. In the developed countries this indicator registers higher levels and even exceeds the GDP volume. The rotation speed of stock exchange and OTC transactions in *Moldova* is low in comparison to the same indicator from developed countries.

Table no. 4. Volume and number of securities issues, registered by national regulation bodies of securities markets from CIS member states

Country	Number of issues		Volume of securities at placement price, thousand USA Dollars	
	At 01.01.2008	At 01.01.2009	At 01.01.2008	At 01.01.2009
Armenia	6	14	8.119	36.840
Belarus	5.347	5.094	8.052.100	15.303.700
Kazakhstan	2.788	2.792	11.510.000	14.200.000
Kyrgyzstan	79	95	53.723	150.958
<i>Republic of Moldova</i>	87	155	112.598	78.283
Russia	2.291	10.358	-	-
Tajikistan	27	55	3,6	430
Ukraine	2.698	2.614	14.178.530	12.489.075

Source: adapted by authors in base of data from www.cnpf.md

On the other hand, during 2006-2007, the annual growth of capital market of Moldova was more accelerated, in comparison to GDP growth. As a result, in 2007 the weight of 5.88% of capital market penetration in national economy was reached. During the previous year, the growth of penetration level reached 4.07% (with a 1.58% increase from only 2.48%). This rhythm is too slow and represents insignificant results in comparison to very high levels of this indicator in developed countries or the ones with developing capital markets.

Still, a positive moment results from emphasizing an uptrend in the evolution of penetration level of capital market in national economy of Moldova, the fact that promises a growth of foreign direct investments (FDI) in future in the national economy, by means of capital market.

The number of securities' issues registered by national regulation authorities, practically, increased in all CIS member countries, against the augmentation of transaction cost on stock exchanges (see table 4).

Given changes on securities market were generated by a relatively limited access to credit funds from bank sector, as well as, in certain measure, by the development of securities market and an increasing financial qualification, both if issuers and investors.

Table no. 5. Volume of transactions with financial instruments on organized market of the CIS member countries

Country	Total volume of transactions on primary and secondary market (thousand USD)	Volume of transactions /GDP (thousand USD)
Armenia	13.516	0,001
Belarus	571.900	0,010
Kazakhstan	230.351.246	1,749
Kyrgyzstan	234.625	0,049
<i>Republic of Moldova</i>	95.842	0,016
Russia	2.037.110.000	1,462
Tajikistan	6 000	0,001
Ukraine	4.870.650	0,040

Source: adapted by authors in base of data from www.cnpf.md

According to the volume of transactions performed on the organized securities market, the biggest markets are the ones from Russia, Belarus, Kazakhstan and Ukraine. At the same time, the volume of transactions in GDP, in most of countries remains at minimal levels (see table 5).

According to data from tables 3 and 5, a low ratio of capitalization level and volume of transactions to GDP is attested in all CIS member states, that demonstrates a low degree of development of securities markets. Still, this fact also determines the existence of a considerable potential of the national markets future development, in conditions of their competitiveness insurance, comparing with the markets from the developed countries.

General principles of capital markets development within the CIS member states

Development of capital markets of some CIS member states can be characterized by the following *principles*:

1. Insufficient integration of the capital markets of CIS member countries in the world's economy that allowed *the avoidance of the direct and immediate effect of global financial crisis*. Only prices of

stocks issues in *Russia* and *Kazakhstan* suffered changes, the bills of exchange and deposit receipts of which are traded on London Stock Exchange.

2. Improvement of legislative framework on capital market takes place on the following directions:

- Creation of a unique record basis of rights on securities;
- Improvement of evidence of ownership right transfer over securities;
- Modification of recognition order of transactions performed on the organized market with the scope of manipulation and implementation of the sudden reaction system, development of the collective investments system (for example, adoption in *Ukraine*, at December 18, 2008, of the Law „On collective investments institutions, mutual and corporate investments funds”), which refer to assets management companies of venture organizations);
- Development of corporate bonds market;
- Granting facilities for income taxation, as a result of transactions with securities on an organized market;
- Establishing a taxation mechanism of transactions with derivative financial instruments, inclusively, those with the scope of hedging.

3. Sources' extension of creating the companies' social capital and of financial instruments' types that are traded on market. Thus, in *Republic of Belarus*, the main source for social capital creation of companies and banks in 2007 was from own resources, while in 2008, the situation totally changed: 71% from investments in the social capital of the companies was financed on account of stocks' issuance. Also, stock exchange bonds were implemented on the market of Belarus. These ones are issued without any state registration, insurance or prospectus' publication, but only in the dematerialized form with the maturity of till one year.

4. Activation of the information activities regarding the securities market functioning and increasing the professionalism degree of its participants.

Conclusions

Peculiarities of development of CIS member states' securities markets characterize them as the developing ones from economic and

organizational point of view. It can be supposed that regulation of the given markets, by consideration of the related characteristics, will encourage the liquidities' growth and national securities markets' attractiveness.

At the same time, it is important to mention that the capital markets from developed countries have multiple common characteristics, distinctions related to their peculiarities of activity being unessential, while in the transition countries, depending on the degree of their economic development, the given peculiarities are more significant, with well pronounced specific characteristics. Determination of these peculiarities allows identifying the main development tendencies of the national capital markets, as well as their impact over the whole economy.

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