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The Serbian and the Bulgarian Capital Markets within the Context of the EU Integration Processes

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Abstract: The aim of the paper is to make a comparative analysis of the current state of development of the Serbian and the Bulgarian capital markets within the framework of EU integration process. It will outline main challenges and barriers in front of the two capital markets at the institutional and microeconomic levels, and the preparation of the Serbian capital market for integration into the EU capital markets. The report will include evaluation of the capital market development in Bulgaria following seven years' of full membership of Bulgaria in EU and will draw some conclusions regarding the challenges that need to be further overcome.

Key words: European capital markets; capital market integration; capital market development
JEL codes: G19, G23, G29

1. Introduction

The integration processes on the capital markets of EU offer advantages as increased profitability and effectiveness, spreading and diversification of the risks and decreasing the level of information asymmetries among the parties. This process requires gradual movement to uniform and integrated financial infrastructures and strict application of the requirements of EU legislation (especially in the field of competition and tax treatment), thus leading to increased harmonization in the financial markets practices and instruments.

The Bulgarian capital market has made significant progress in the implementation of EU norms and requirements in the field of financial integration and has formulated a clear strategy for further EU integration through privatization of the Bulgarian Stock Exchange and the Central Securities Depositary. Thus, it is expected to achieve the set goals of increasing the effectiveness of the Bulgarian capital market and the supporting infrastructure. Yet this process is currently facing a retarded pace due to the political situation in the country and the various barriers that need to be overcome at institutional and microeconomic level.

Regarding the Serbian capital market it can be emphasized that the speed of preparation for EU integration has been accelerated by gradual harmonization of the Serbian legislation in the field of financial integration. This process, however, requires also approximation of the existing practices with EU standards, introduction of new financial instruments, as well as giving further impetus to the process of privatization of existing state-owned enterprises through the Serbian Stock Exchange.

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2. The EU Capital Markets Integration Process

In a theoretical aspect the effectively functioning capital markets assist in the optimum distribution of capital within EU and are conducive to boosting competitiveness and the access to venture capitals. Main advantages:

- profitability and effectiveness in execution of financial transactions and development of a reliable base for trade — clearing, settlement and depositary services;
- distribution of risks and effective utilization of financial resources;
- effective evaluation and measurement of risks in financial transactions;
- overcoming the asymmetry in the disclosure of information and the problem principal — agent in the intermediation in the financial sphere;
- improving financial stability in EU and raising the inflows of foreign capital in EU.

Financial integration strengthens the level of financial development and intermediation and contributes to the fulfillment of the goals set in the revised Lisbon strategy and Strategy "Europe 2020" for more jobs and opening up of business opportunities. The European Commission drives the process of integration in the financial sphere of the EU member states by the implementation of various regulatory acts that settle the relations between the parties on the capital market (Hristova-Balkanska I., 2012, p. 9).

The achievement of the main goal–an integrated capital market requires focus on several spheres, to which the institutional initiatives should concentrate their efforts according to the European Commission:

- development of integrated financial infrastructures — reaching high level of technical and technological compatibility among national securities settlement systems and implementation of adequate mechanisms to combat money laundering and fraud;
- development of mechanisms for maintenance of competition on the financial markets in EU;
- tax treatment — the differences in tax treatment appear to be a serious barrier to the effective distribution of financial resources in EU.

The lack of high degree of market integration due to remaining regulatory, administrative, tax restrictions as well as differences in the financial systems and the corporate governance systems show that still the capital markets in the EU member-states are not fully integrated.

General conditions for a fully integrated financial market in EU are:

(1) Availability of integrated financial infrastructures.

Stock exchanges and the markets of derivative instruments are undergoing transition to common securities trading, clearing and settlement systems. The engine, driving these changes, is mainly the market forces. One of the basic issues in this sphere relates to overcoming the legal restrictions in front of the payment and settlement systems. The Settlement Finality Directive predetermines the implementation of safe operational mechanism for limiting the systemic risk.

An important element for the mitigation of this risk is the application of the requirements for collateral in securities transactions. A step in further integration of capital markets are establishment of links (technical and platform) between depositaries of securities within EU. Further measures are needed which will guarantee the safety of the capital markets against money laundering attempts and frauds.

(2) The policy for competition preservation requires strict application of the norms and the requirements of the Treaties of Rome in the field of dominant position abuse, mergers and acquisitions, and state aid and measures. The European Commission encourages an approach of cooperation among banks and the other financial

institutions conducive to creation of integrated trading platforms, payment and settlement systems. On the basis of the Economic and Monetary Union in the integrated market heightening of competition will be an important driver for change, together with the interventionist policy of the regulatory institutions at micro and macroeconomic level (Hubenova-Delisivkova T., 2012, p. 10).

(3) Tax policy — it should be applied in a manner leading to harmonization of tax treatment of incomes, generated on the capital markets in EU. This leads to further reduction of risks, relating to tax treatment avoidance and distortion of market stimuli for investments and savings.

3. Problems of and Prospects in Front of the Bulgarian Capital Market Integration in EU

According to a report by the World Bank (The World Bank, 2011, p. 19) the Bulgarian legislation has achieved high degree of harmonization with the EU regulations and directives in the field of capital markets. In 2014 the process for implementation of the new EU legal framework is considered completed (regarding short sales, OTC derivatives, central counterparties and registers of transactions, alternative trade systems etc.). This process is an important priority for the Bulgarian regulatory body — The Financial Supervision Commission, and for the market participants in the country.

By 2013 the Bulgarian capital market remains limited in size and insufficiently well developed as compared to the Eurozone countries and Central and Eastern European member-states. A report by the IMF (IMF Working Paper, WP 2012/131, p. 6) outlines the necessity to continue development of the capital market in Bulgaria in view of accelerating economic growth and productivity through further structural reforms. It should also be emphasized that while most of the CEE countries (especially Hungary and the Czech Republic) are undergoing an intensified convergence process toward the EU economic structures, the expectations for Bulgaria are divergences from the average EU indicators to remain significantly pointed (Economic Research Institute at BAS, 2012, p. 16).

The most recent report of the World Economic Forum (WEF, 2013-2014, p. 20) places Bulgaria at 57th position out of 148 countries in the world according to global competitiveness index, and it takes last position by this indicator from CEE countries, while Republic of Serbia occupies 101st position. On the other hand, according to financial development index the country ranks 73th, while The Republic of Serbia is on 115th place. The main problematic factors in front of competitiveness and financial development for Bulgaria and Serbia remain the high corruption levels, the insufficient effectiveness of the institutional framework and the constrained access to financing. The National Programme for development of Bulgaria encourages overcoming these weaknesses by further optimization of the institutional capacities, active implementation of EU financial instruments for startup and growth-oriented SMEs and application of diverse policies to boost competitiveness, in accordance with the principles for sustainable development. Main priority for Bulgaria will be maintenance of the macroeconomic stability and high rate of growth in the medium-term (Kalaidjieva Zh., 2012, p. 11).

In the wake of the global financial crisis by 2013 the market capitalization of the Bulgarian Stock Exchange — Sofia AD (BulEx) as a share of GDP continued its downward development and reached 12.75%, while for 2012 it stood at 12.67% (Financial Supervision Commission, 2013, p. 3), yet it remains at considerably low level as compared to the Eurozone average (for 2013 standing at 58.1%, ECB Convergence Report, 2014, p. 15). The low liquidity is the chief shortcoming of the capital market in Bulgaria. It is explained with the low volume of free float as well as with the outflow of foreign investors from the Bulgarian capital market in the aftermath of the developments of the global financial and economic crisis.

In 2013 continued to predominate secondary public placements. The main reasons for the prevailing secondary public placements continue to be the high costs relating to fees and commissions, the requirements for disclosure of information under the Law on Markets in Financial Instruments and the Law on Public Offering of Securities, as well as the lengthy procedures for approval of prospectuses. In 2012 BulEx amended its Rulebook and introduced new segmentation of the markets, operated by it. On the one side, by 2013 **BSE market** includes *Premium shares segment* (7 issues), *Standard shares segment* (90 issues), *Shares of Public Companies with special investment purposes segment* (14 issues), *Collective investments schemes segment* (43 issues), *Compensation instruments segment* (3 issues), *Bonds segment* (60 issues) and *Structured products segment* (2 issues). On the other side, **BaSE market** is designated for trades in low liquidity shares which do not meet the set requirements regarding liquidity and corporate management quality. This market is composed of two segments: *Shares segment* (226 issues) and *Shares of Public Companies with special investment purposes segment* (50 issues).

By 2013 the turnover on the regulated market of BulEx registered a rise by over 43% as compared to the same period of 2012 due to the rise of turnover with traded shares and shares in collective investment schemes. The two main stock exchange indices SOFIX and BGTR30 marked a further push-up by 43% and by 27.98%, respectively as compared to 2012. As from 2012 the BulEx introduced lengthened trade sessions schedule to achieve further synchronization of trades' terms to that of European capital markets.

The implemented amendments in the National Corporate Governance Code (BulEx, 2012, p. 13) are intended to reach harmonized corporate practice to that in the other EU countries through application of the "comply or explain" principle. The principle requires in case of non-observance of some of the recommendations contained in the Code, the respective public entity to outline the reasons thereof. The good corporate governance guarantees strict abidance by the requirements for transparency, public disclosure and business ethics, as well as safeguarding equality of all shareholders.

Regardless of the high degree of harmonization of the legislative framework and the market practices to EU levels, the capital market in Bulgaria still faces a number of barriers hindering its effective functioning, after seven years of full EU membership. More specifically, **at a micro-level** can be outlined some of the following limitations: low quality of publicly listed companies taking the form in low levels of free float, low capitalization; the companies which achieve higher capitalization levels are leading players in their respective industries and sectors and are often targets of interest for large national or foreign institutional investors; low liquidity, which leads to higher costs for execution of deals with predetermined volumes and rising price volatilities.

On the other hand, **at institutional level** continue to exist limitations as: lack of established adequate clearing infrastructure, which incapacitates the development of a derivative market in Bulgaria; the deliberately retarded process for integration of the central securities depositary to the European settlement infrastructures; the appreciable differences of the Bulgarian capital market as regards the developed European markets, the lack of political will for reforms of the capital market of Bulgaria etc.

The successful removal of these barriers is contingent on the leading role of market stimuli and forces through an adequate evaluation of expected costs and benefits. The institutional structures are called upon to eliminate the still remaining legal, tax, regulatory and other limitations in front of the capital market and to execute an ongoing monitoring over the market and its participants in view of preserving financial stability and prevention of systemic risks.

The status of a public entity of BulEx is part of the strategy of the stock exchange for its development, raising the transparency in its operation, and last but not least, for further provision of market liquidity. This process is in accord with the tendencies in Western Europe for transformation of stock exchanges in public shareholding entities mainly along the lines of their privatizations. The increased state share from 44% to 50% plus one share aims at blocking attempts from hostile takeover of the stock exchange. The public flotation of the shares of BulEx is driven by an incentive for raising transparency and enhancing liquidity of its own shares. The prospective strategic alliance of BulEx with foreign-owned stock exchange can be expected to lead to improved public well-being and raised consumer surplus in the long run in accordance with public well-being theory.

The adopted conception for integration of BulEx and the central securities depositary for further integration through initiated privatization procedure in 2012 aims to increase the effectiveness of the Bulgarian capital market though "...its consolidation with a world or European leading exchange operator or exchange alliance" (BulEx, 2012, p. 13). The privatization procedure envisages selling of over 50% of the capital of the two targeted entities on the basis of qualitative and quantitative criteria to potential candidate among which: realized at least EUR 2 billion total average monthly turnover on the cash market, or total average monthly number of derivative contracts of at least 20 million (representing transactions concluded solely through an electronic trading system). The shareholding structure of the prospective buyer should not include state direct or indirect share of over 50% in the capital. Besides, an important criterion for the final selection will be the prospective candidate to have a formulated strategy and vision for the development of BulEx and the central securities depositary and for the supporting infrastructure of the capital market through implementation of high-tech based and flexible trading system.

4. The Preparation of the Serbian Capital Market for EU Integration

The striving of EU to encourage stability and democracy through integration in Southern and Eastern Europe (SEE) is connected with a number of challenges. Leading place in the process of convergence to EU occupy the structural reforms in the region, establishment of the principles of active market economy, democracy and rule of law. It is expected the EU candidate countries in SEE to undertake the process for preparation through devising macroeconomic programmes for action, structural reforms and competitiveness. The EU reckons that in respect of the SEE region an entire strategy and policy of the enlargement process is needed since the fragmented initiatives will not lead to stable economic growth. An emphasis in the enlargement strategy is placed on the necessity of development of regional cooperation, which is considered as a main indicator of the readiness of the SEE countries for accession to EU.

This on its part presupposes a research into the process of regional convergence of the capital markets of the EU candidate countries in SEE and outlining the problems, restrictions and challenges in front of the process of their integration to EU via comparative analysis.

During the last twenty years the Belgrade Stock Exchange (BELEX) has been developing in a manner similar to that of the remaining countries in SEE. A successor of the former Yugoslav capital market, BELEX initially traded only with debt instruments and government bonds and it was not until 2000 that shares from the previous privatization process had been quoted on the secondary market. The first shares of public companies have been listed on BELEX in 2010. The exchange is a full member of the Federation of the Euro-Asian Stock Exchanges and has concluded cooperation agreements with the stock exchanges of Ljubljana, Zagreb, Bania Luka, Saraevo, Montenegro and Skopie to promote the regional markets development.

The capital market in Serbia is regulated by the Law on the Capital Market adopted in 2011. The regulatory changes are directed toward harmonization with EU legislation and IOSCO principles making the Serbian market attractive to both domestic and foreign investors and reduce the costs of securities issuance. The Securities Commission controls participants involved in the trading process, including BELEX, Central Securities Depositary, commercial banks, as well as public enterprises, whose shares are traded on the stock exchange. Non-resident legal entities and individuals need a tax representative with Serbian residence, who will obtain identification number on their behalf. Yet it takes more than just regulatory reform to stimulate the capital market growth in Serbia. Three years after the adoption of the Law on the Capital Market that has laid the foundations of a clearer legal framework relating to initial public offerings (IPO), still not a single IPO has been initiated (Foreign Investors Council, 2012, p. 4).

BELEX is 10.34% owned by the Republic of Serbia. The market capitalization of BELEX in 2013 is EUR 8,778 million, its members are 42 and the participation of foreign investors in the total turnover during the last year shows a rising trend despite the deep fluctuations (Belex, 2013, p. 1). Following the significant fall of the stock indexes, forced by the developments of the global financial and economic crisis in 2008, and the concomitant fall of economic activity in 2011, the two indexes BELEX15 и BELEXline started their upward trend in 2012 and 2013. This may serve as a proof that BELEX follows the right direction in its development toward greater openness and higher profitability. An empirical analysis (Stefanova J., 2014, p. 12) establishes strong correlation links between BELEX and the Vienna Stock Exchange index ATX (correlation coefficient of 0.91), BELEX and BulEx index SOFIX (correlation coefficient of 0.993) and BELEX and Montenegro stock exchange index MONEX20 (correlation coefficient of 0.727) during the period 2005-2013. Only the correlation links between BELEX and the Macedonian stock exchange index MBI10 are rather weak (correlation coefficient of 0.122).

Securities' trading on BELEX is carried out on two markets: regulated market and OTC market. There are three levels of listing on the regulated stock market: prime market (4 issues of shares and 1 bond issue), standard market (4 issues of shares) and open market (67 issues of shares). The total turnover on the regulated market by 2013 represented 96.40% of total turnover. Shares represented 77.54% of total turnover, while RS Bonds — 22.46% (Belex, 2013, p. 13). More than 1700 joint stock companies established in the process of privatization trade on the OTC market. OTC is allowed for debt securities and equities of private companies but not of equities of public companies. The participation of foreign investors in the total turnover on Belex by June 2014 is 30.58%. In a research on the empirical relationship between performance and ownership concentration on the Serbian capital market (Jefferson Institute, 2012, p. 5) by analysing the companies with more than 20% foreign-owned stocks, it has been established, that the average annualized daily stock returns for these companies is 30% while for the other companies it is 24%.

Although the primary issuance process is functional, Serbia's government bond market lags behind the other SEE markets in terms of secondary market development. Liquidity on the secondary market is low and the corporate bond market remains entirely undeveloped. The most commonly traded instruments in the financing market remain government securities. The money market also is in its infancy stage in terms of market infrastructure and market activity (EBRD, 2014, p. 21).

The lack of derivative market on the Serbian and the Bulgarian capital markets and of financially innovative products as futures, options, structured financial products impact negatively on the market liquidity and discourage investors due to impossibility to hedge risks. Still a majority of the publicly listed companies are characterized with a low degree of transparency in their corporate governance and disrespect toward their minority shareholders. According to a report (Djordevic B., 2012, p. 7) investor relation activities in the Serbian capital market are still in the formation phase. Only 35.4% of listed Serbian companies in Belex index show current share values and historical share values for specific periods on their sites.

The option facing the Serbian and Bulgarian capital markets is to follow an evolutionary path for organic development by preserving the national identities of their stock exchanges and gradually follow the trend toward product diversification, development of suitable clearing and settlement infrastructures and an impetus toward progressive deepening of regional integration through cooperation agreements and increasing the degree of harmonization of processes, interfaces and market practices.

The Serbian and the Bulgarian capital markets according to regional comparisons remain small in size, low-liquid and do not offers possibilities for cross-border settlements. The financial crisis of 2009 and the outflow of foreign investors led to significant decline in market capitalization and trade turnovers with the main exchange indexes following the falling trends of regional markets' indices.

The successful development of trade in structured products involves the readiness of financial institutions to issue such instruments (the supply side) and the desire of the investment community to trade in them (the demand side) respectively. An important direction toward diversification of trade is eliminating the technical obstacles to margin buys and short sales. Through initiation of short sales of shares included in the main BulSE and BELEX indices the exchanges can have the opportunity to offer trade in derivatives such as futures contracts based on the respective index. The main problems relating to margin buys and short sales arise from the lack of effective system for collateral management under the respective trades.

A factor of paramount importance for the effective functioning of the capital market is raising liquidity, lowering transaction costs, stimulating trades through alternative trading systems and attraction of retail investors. Main customers of multifunctional alternative trade systems could be institutional investors, which are not directly allowed to trade on the exchange. The effectively functioning stock exchange can be considered as a public good. The stock exchange generates profits from increasing the volume of trades, which depends on the quality of offered services and the established exchange reputation.

The boost of liquidity on the primary market (where in 2013 on BulEx and BELEX there is not a single IPO) is crucially dependent on reviving of liquidity on the secondary market chiefly along the line of encouraging trade of retail and mutual funds. Market liquidity requires also increasing the percentage of free float and adjusting the levels of transaction fees according to the volume of executed transactions.

The development of a derivative market and the supply of financially innovative products as derivative instruments based on shares, bonds, options and futures in a medium term are expected to boost market liquidity and encourage the investment activities through opportunities to hedge risks. The initiation of such market depends on the presence of effectively functioning clearing institution and high degree of liquidity of the underlying assets. The low liquidity of the underlying assets creates conditions for easier manipulation of their prices and higher risks of significant fluctuations in the prices of derivative instruments.

An important aspect in attracting new issuers and investors is the scheduled placements of states shares for privatizations through the stock exchange. The activities of the pension funds is also of importance since they are the only institutional investors given the low level of intensity of mutual funds on the capital market. Irrespective of the fact that the pension funds are predetermined investors on the capital market, their investment opportunities are limited, due to the existence of legal restrictions. The share of their investments in equities declines while that of investments in benchmark foreign securities is on the rise. The only way to give an impetus to their activities on the capital market is through transforming the pension funds into public companies in order for them to act strategically for the development of the capital market in Bulgaria and in Serbia. An indicative is the example of the pension funds in Poland, which invest on average over 30% of their assets under management in shares at the Warsaw stock exchange.

The boost of investment interest into the Serbian and Bulgarian capital markets also requires an increase in the activities of the stock exchanges regarding organization of international road shows, seeking the viewpoint of investors, providing regular seminars, training courses to the members of the exchanges and the investment community Another possibility for attracting investors is the stock exchanges to organize niche markets for trade in shares of innovative SMEs similar to the OTC START market, maintained by the Prague stock exchange. A preliminary condition for this option is the countries to encourage financing of SMEs through various venture capital forms. The complexity of the existing financial and economic conditions in the crisis and post-crisis periods lead to a restricted access of SMEs to bank lending, which presuppose evaluation of venture capital investments with the view of the further development of the capital markets in Bulgaria and Serbia.

Last but not least, the attraction of foreign investment companies back to the Serbian and Bulgarian capital markets requires an entire improvement in the conditions of the business environment. This includes reducing the administrative burden and red tape, simplification of the rules for acquisition of public companies etc. Such obstacles to economic activities sharply worsen the effectiveness of the capital market. An important indicator in this regard is the control over corruption. The high levels of corruption hamper private investors from exercising their rights through the court.

5. Conclusions

The Bulgarian capital market remains limited in size and insufficiently developed as compared to Central and Eastern European capital markets. Main problematic factors in front of its competitiveness and financial development remain the high level of corruption, insufficient effectiveness of the institutional structures and the restrained access to financing. Irrespective of the high degree of harmonization of the legal framework to that of the EU, seven years following membership in EU there continue to exist numerous obstacles in front of the effective functioning of the capital market at micro- and institutional level.

Problematic factors on the Serbian capital market remain the limited range of traded financial instruments and the significant fluctuations in their prices. Under process of development are new financial instruments, but this will be a long way ahead due to the lack of established infrastructure for this purpose. With the initiation of negotiations for EU accession the prospects in front of Belex are to start an entire process of adjustment of the Serbian capital market to the European legislative framework in the field. Irrespective of the significant problems that this market faces, by market capitalization the Serbian stock market preserves its leading place among the stock exchanges of the other EU-candidate counties in SEE. Besides, it shows strong correlation links to other stock exchange markets in SEE and Central and Eastern Europe.

Based on the comparative analyses of the Bulgarian and the Serbian capital markets and the PEST and SWOT analyses above, both capital markets have good opportunities to record long-term positive development. In the short-term these capital markets can be considered as less stable and efficient due to the above-outlined weaknesses and threats at micro and institutional level.

The potential model for the future development of the Bulgarian and the Serbian capital markets passes along an evolutionary organic overcoming of their intrinsic limitations through various forms of regional cooperation and integration. Main prerequisites for the success of such an integration model is the high degree of legal harmonization with EU requirements and the potential for implementation of unified market practices, establishment of links between the exchange trade systems, introduction of common quotation rules, clearing and settlement processes.

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Application 1

Table 1 SWOT and PEST of Factors, Affecting the Bulgarian and the Serbian Capital Markets

<table>
<tr>
<td>
Strengths
1. Political Factors
Bulgaria:
The Bulgarian government adopted a strategy for the development of the Bulgarian Stock exchange, which envisages attraction of new issuers, development of new instruments, orders and consolidation with a recognized European or world stock market operator.
Serbia:
The government is shaping attractive environment for doing business and the legal framework is intensely underway to being harmonized with EU requirements.
2. Economic Factors
Bulgaria:
The Currency Regime introduced in 1997 guarantees the preservation of financial stability.
The reported budget deficit for 2013 amounted to 1.5% of GDP and remains sufficiently below the EU reference value of 3%.
The ratio gross domestic debt to GDP by 2013 stood at 18.9% sufficiently lower than the EU reference value of 60%.
The long-term interest rate in 2013 stood at 3.5%, sufficiently below the EU reference value of 6.2% according to the criterion for interest rate convergence. The same applies for the level of inflation.
The uniform tax rate of 10% (equally applied to personal income tax and to corporate income tax) is lower compared to other EU countries.
The main stock exchange index on BulEx follows a fluctuating trend throughout the years after the initiation of the global financial and economic crisis:
<table>
<tr><td>Year</td><td>Evolution of SOFIX index on BulEx</td></tr>
<tr><td>2008</td><td>-79.71%</td></tr>
<tr><td>2009</td><td>+19.13%</td></tr>
<tr><td>2010</td><td>-15.19%</td></tr>
<tr><td>2011</td><td>-11.11%</td></tr>
<tr><td>2012</td><td>+7.25%</td></tr>
<tr><td>2013</td><td>+42.28%</td></tr>
</table>
Serbia:
Monetary policy implementation has been successfully streamlined since the introduction of inflation targeting.
Withholding tax for institutional investors is 25%, for private investors is 15%. The capital gains tax is 20% for legal entities and 15% for private entities.
<table>
<tr><td>Year</td><td>Evolution of BELEX15 index</td></tr>
<tr><td>2008</td><td>-75.62%</td></tr>
<tr><td>2009</td><td>+17.44%</td></tr>
<tr><td>2010</td><td>-1.81%</td></tr>
<tr><td>2011</td><td>-23.43%</td></tr>
<tr><td>2012</td><td>+4.98%</td></tr>
<tr><td>2013</td><td>+6.51%</td></tr>
</table>
By 2012 the long-term foreign currency rating by S & P for Serbia is BB Stable.
3. Social Factors
Bulgaria:
</td>
<td>
Weaknesses
1. Political Factors
Bulgaria:
The current political instability in the country which began in 2013 and the scheduled preliminary parliamentary elections for October 2014 which create conditions for unpredictability.
Serbia:
Enactment of adequate legislation is a necessary, but not sufficient prerequisite for boosting the activity on the capital market.
2. Economic Factors
Bulgaria:
Prior to the global financial and economic crisis the conditions of Currency Board were stimulating the economic growth and created pressure for heating up of the economy.
Following the onset of the global financial and economic crisis, the economy of the country shrank abruptly, which was associated with a fall in GDP, outflow of FDI and low levels of imports.
The capital market in Bulgaria remains small in size and underdeveloped as compared to the Eurozone and Central and Eastern Europe member-states.
Most problematic factors for doing business in Bulgaria remain the high levels of corruption, difficult access to financing, political instability and inefficient government bureaucracy.
The low liquidity remains the main shortcoming for the Bulgarian capital market which is due to the low level of the free float and the lack of diversified financial instruments.
Serbia:
The capital market is still shallow and insufficiently liquid market, and not a single IPO has been conducted. The financial instruments market is currently undeveloped.
The share of the banking sector in total assets of the financial sector is over 90%, as in Bulgaria.
According to the Law on Foreign Exchange non-residents are not allowed to invest in short-term securities.
State presence in the economy is significant and state-owned companies continue to accumulate losses (direct state support of state-owned companies reached 2.5% of GDP, IMF, 2013, p. 17)
The functioning of the market mechanism is hampered by legal uncertainty and corruption and the informal sector remains an important challenge (European Commission, 2013, p. 2)
Rising government indebtedness has kept total external debt high at 83.7% of GDP (well in excess of the set administrative limit of 45% of GDP), general government deficit exceeded 6% of GDP in 2012, inflation pushed up to 12% (2012) and current account deficit came up to 10% of GDP.
3. Social Factors
Bulgaria and Serbia:
Low quality of the public companies which finds expression in low capitalization, insufficient level of disclosure of information and low corporate culture.
Low level of transparency in the management of public companies and disregard of the interests of the minority shareholders
In Serbia quoted companies are way back compared to American and British companies, regarding provision of information to investors and other interested groups via digital communication on the Internet (Djordjevic et al., 2013, p. 8).
4. Technological Factors
Bulgaria and Serbia:
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<table>
<tr>
<td>The adopted Corporate Governance Code in 2006 is an important factor for boosting the competitiveness of the Bulgarian capital market.
Serbia:
The Corporate Governance Code is the result of the cooperation of Belex and the International Financial Corporation and contains provisions for desirable corporate governance practice.
4. Technological Factors
Bulgaria:
The BulEx has concluded agreements for exchange of information with the Macedonian and the Serbian Stock exchanges and is a member of the Federation of European Stock Exchanges and of the Federation of Euro-Asian Stock exchanges.
Serbia:
The proprietary trading platform of BELEX (introduced with donation by the Luxembourg stock exchange) provides real-time data to domestic and international investors and creates positive investment climate.</td>
<td>Lack of established links of the BulEx and Belex and their central depositaries with European or regional stock markets, and lack of proper information infrastructure, which relegate both capital market in the “periphery” of the integration processes.</td>
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<td><u>Opportunities</u>
1. Political Factors
Bulgaria:
Further reforms will be necessary in order to establish effectively functioning and independent judiciary system in the country, especially when the size of the grey unofficial economy remains significant.
The S & P long-term foreign currency credit rating of Bulgaria is as follows:
<table>
<tr><td>Year</td><td>Credit Rating</td></tr>
<tr><td>2008</td><td>BBB (stable)</td></tr>
<tr><td>2009</td><td>BBB (stable)</td></tr>
<tr><td>2013</td><td>BBB -</td></tr>
<tr><td>2014</td><td>BBB-</td></tr>
</table>
The implementation of EU legislation in the field of capital markets guarantees stability, fairness, transparency and further opportunities for deepening of integration into EU capital markets.
Serbia:
Within the Stabilization and Association Agreement with EU, Serbia continues aligning its legislation, and the process is monitored in accordance with the National Plan for the Adoption of the Acquis for the period 2013-2016.
The Pre-Accession Economic Programme for 2013-2015 foresees a mild recovery and GDP growth of 3.5% in 2014 and 4% in 2015.
2. Economic Factors
Bulgaria:
Overcoming the consequences of the global financial and economic crisis the economy is expected to further improve the business and institutional environment, thus attracting of inflows of FDI and boosting the potential for growth of the Bulgarian economy.
Serbia:
The pension system reform is expected to provide a considerable contribution to the future development of the capital market.
Amendments to the Law on Foreign Exchange Operations are passed, which are expected to further liberalize capital transactions for natural and legal persons. Alignment in the area</td>
<td><u>Threats</u>
1. Political Factors
Bulgaria:
The outcomes of the pending parliamentary elections and the prospects for ongoing political instability in case of impossibility for forming a Cabinet and the current weaknesses of the banking sector.
Serbia:
The uneven and slow enforcement of laws and unfinished structural reforms have an impact on doing business.
There exist external risks as higher global risk aversion which may raise the cost of financing.
2. Economic Factors
Bulgaria:
Following from the political instability the economic and financial stability of the country may be further endangered.
Serbia:
In view of the difficult economic situation, economic reforms have progressed slowly. Achieving a sustainable fiscal position and tackling the obstacles to growth remain a challenge.
The National Bank of Serbia maintains floating exchange rate policy which may lead to exchange rate volatility.
External financing flows have been volatile and foreign direct investments fell to 0.8% of GDP. Government borrowing crowded out private sector inflows and turned into main source of financing of the current account deficit.
The volatility and liquidity on the Belex are time-varying and related to the political events in Serbia (Jefferson Institute, 2008, p. 5)
3. Social Factors
Bulgaria:
The prospects for further loss of confidence by investors in the Bulgarian capital market and withdrawal of investments due to political instability.
Serbia:
The underdevelopment of the capital market and the rare trade in large number of inactive shares leads to lack of sufficient knowledge of investors about the operations of the stock market and to information asymmetry.
4. Technological Factors
Bulgaria and Serbia</td>
</tr>
</table>

of free movement of capital and financial services is still is moderately advanced. Instruments to hedge against currency risk need to be developed (as forward contracts) in view of the existing exchange rate volatility and increased level of euroisation of the economy (IMF, 2013, p. 18). 3. Social Factors Bulgaria: No restrictions for free access of foreign investors on the Bulgarian capital market. The investors just need to choose financial intermediary company, the number of which by 2013 exceeds 60. Serbia: The introduction of new financial instruments and raising the liquidity on the secondary market would attract more retail and institutional investors on the Belex. 4. Technological Factors Bulgaria: The implemented XETRA of Deutsche Boerse offers large capacity and technological compatibility with some of the largest EU stock markets.	The delay in the introduction of new financial instruments, exchange traded funds, development of derivative market may lead to further loss of interest in the capital market.

Source: the author