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MASTER’S THESIS

EXTERNAL SOURCES OF FINANCING FOR THE CORPORATE SECTOR IN MACEDONIA

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INTRODUCTION

The thesis External source of financing for the corporate sector in Macedonia analyzes the financial sources Macedonian companies use. The thesis gives overview of the theory of external financial sources, and of financing for the corporate sector in the European Union and Southeastern countries, with special attention devoted to Macedonia.

The first two parts of the thesis provide its conceptual framework. In the first part, the thesis presents the theory of the internal funds and external sources. The theory is based on distinguishing the sources of financing to internal and external, presenting their main patterns. In the continuation, the thesis analyzes the pecking theory, as one of the theories that explains a manager decision-making with respect to the use of internal and external sources of finances. The final section of the first part elaborates the types of external financing, dividing it to debt and equity sources. The debt sources are bank loans, leasing and corporate bonds. The equity sources are issuing stocks as ordinary and preferred and joint venture investments. Each of these sources is individually analyzed.

The second part of the thesis gives overview to the sources of financing the corporate sector in the European Union as well as in Southeastern countries. It analyses the structure and use of external funding sources in the two groups of countries.

With its third part, the thesis turns to Macedonia where the volume and structure of internal and external sources in the country are presented. The text also provides a comparative analysis of where Macedonia stands with respect to the structure and use of external sources vis-à-vis the two groups of countries, namely the EU and other SEE countries.

The fourth part of the thesis gives a detailed analysis of the use of each type of external sources in Macedonia.

The main hypothesis of the thesis is that bank loans are by far the most important source of external corporate financing in Macedonia. This hypothesis is tested by using official data from the National Bank of Macedonia and international financial institutions reports. Hypothesis analyzes the volume of loans channeled into corporate sector, as well as the bank conditions and terms of the loans. It also analyzes the credit activity and financial services of Macedonian bank for development and support. This bank represents a link between the international financial institutions and commercial banks. It negotiates and provides credits from international financial institutions and channels the credits through commercial banks to the final users, the companies. The Bank also provides other financial services, such as factoring and trade credit insurance for domestic and foreign liabilities.

The hypothesis tested in this thesis is *de-facto* starting from a position that other forms of external financing, such as leasing, issuing common and preferred stocks, and corporate bonds, are not widely used external financial sources by the corporate sector in Macedonia. This part of the hypothesis is being tested through of the number of new lease contracts, the volume of lease financing, and through an analysis of the reasons why companies prefer bank loans over the leasing services. Companies' use of financial instruments as ordinary and preferred stocks as well as corporate bonds will be based on official data from the Securities and Exchange Commission, the Macedonian Stock Exchange and National Bank reports. The analysis will discuss why companies do not use this kind of financial instruments, what the barriers to use them more often are and what should be done to stimulate this form of external financing for it. The second hypothesis gives overview of the other financial sources use, as business angels venture investments as an upcoming opportunity for start-up ventures. This hypothesis will be based on official data from the Macedonian business angel's networks.

1 CONCEPTUAL FRAMEWORK FOR CORPORATE FINANCING

1.1 Definition of corporate financing and its main patterns

The engine of country's economy is based on economic development and improvement of living standards in a continual increase of the productive capacity at microeconomic level. The development of companies relies on increasing the level of production and service capacities based on new investments.

Corporate financing is defined as an efficient and effective management of the company finances in order to achieve the objectives of the company. Corporate financing presents an area of making decisions how the company finances its operations. It incorporates accepting projects and analyzes profitability of the existing and future operations in order to lead the company to development and success. Corporate financing should provide an appropriate level of funds, at the time and volume needed in order to finance the existing and additional business working, at the lowest possible cost (Watson & Head, 2007, pp. 2-7).

Corporate financing relies on two key concepts: to help the manager's value alternative possibilities as the relationship between risk and return, and return and time value of money. The relationship between the risk and return shows that a company takes more risk only if higher return is offered as compensation. The time value of money refers that, the money value changes over the time and it is affected by a combination of three factors: time, inflation and risk.

Financial managers implement the corporate financing policy in practice. Financial managers need to have firm understanding of finances and management accounting in order to be able to make decisions based on current situation of the company. They should focus on managing the financial health of the company, protecting the interests of the shareholders and maximizing their wealth by sound investment, financing and dividend decisions. They should be also aware that their acting affects to all the stakeholders and is presented to the outside world in the same time. They seek for alternative sources of financing in order to be able to value the possibilities the company has. Financial managers make a choice from wide variety of financial instruments and institutions, since each source of financing has different features in view of the risk, availability, maturity and costs. The cost of financing is a very important factor that influences on the liquidity and profitability of financing the company. That is why companies pay attention to find appropriate sources of financing and adequate financial policy. Financial managers manage corporate funds. They are responsible for investment decisions, composition of fixed and current assets, the risk profile of the choices (Watson & Head, 2007, pp. 8-10).

Other objectives related to corporate financing policy of company is maximization of the sales (it is useful as a short-term objective, especially when the company enters into a new market), survival, social responsibility (improving working conditions of the employees). These objectives are of secondary importance for the financial managers.

1.2 The pecking order theory of corporate financing

To achieve efficient financial policy, the company needs to be aware of the available sources of financing. Sources of financing can be internal and external. One of the theories that explain the decision-making between internal and external sources of financing is the pecking order theory of financing.

According to Brealey and Myers (2003, pp. 511-515), the pecking order theory is based on asymmetric information, meaning investors do not know the real position of the company they want to invest in. The asymmetric information involves knowledge of company's prospects, risks, real value, and decisions that the investors do not know. The explanation relies on that managers have more information for company in over all situations, than the investors do. This theory indicates that managers can use this advantage to transfer signals to the potential investors in many ways. For example, when the company announces to pay or increase the regular dividend, the stock prices on the market increase. This step gives signal to the potential investors that the company is in good financial condition and has secured future earnings, making the potential investors comfortable to finance the company. The interest to invest in the company increases, and it affects to higher stock price. The investors establish their decision on their perception. The signal can also mean that the company needs finances and cannot allow borrowing from financial institutions. In

this position, financing through financial markets is the last option they have. That is why the asymmetric information can affect to the choice of the financial source, whether the company is to be financed by internal or external sources. The second choice is whether the external sources to be new issues of debt or equity. The pecking theory comes to a conclusion that the primary sources of financing are the internal, then the external as debt sources, and finally the external equity sources. The preference of debt is over the equity financing (Eckbo, 2008, p. 151).

Advantages of using internal sources of financing rely on flexibility of the management to operate the business, not having restrictions in choosing development projects. This is the main reason why managers prefer internal sources (Park, 2000, p. 1). It can be explained that shareholders and debtors would like to monitor the management in order to be sure that the financing will result by truly maximizing the market value of a company. Monitoring and checking is costly for individual investors, but the financial institutions are specialists for it. This means that when a company goes to a bank for bank loan or on the market for public issue of stocks or bonds, the management needs to have all the answers to justify their decision. In order to avoid the monitoring and checking, the use of internal funds is the most appropriate financial source (Brealey et al., 2001, p. 508).

Other reasons why companies prefer internal than external sources are (Watson & Head, 2007, p .31):

- Retained earnings are ready sources of cash
- There are no issue costs for its use
- There is dilution of control, which can occur by issuing new equity shares
- The managers cannot be restricted to use the cash flow

Watson and Head (2007, p. 32) explain that the need to use external source is the limited cash flow from the business operations. In order to raise funds for investment projects or to expand the operating activities, companies need to consider external sources of financing. The decision concerning the use of internal and external finances depends on a number of factors: the level of required finances, the cash flow from existing operations, opportunity cost of retained earnings, costs for raising external financing, availability of external financing and dividend policy.

The external sources present the second financing option. Financial managers have to choose between issuing debt or equity. According to the European Central Bank (2009, p. 30), debt financing is more dominant than equity financing. This explanation relies on that banks and other financial institutions have tradition in credit risk management and carefully analyze the company needs and current financial position. They also monitor the implementation of the financial projects, and require certain collateral in case the company is not able to meet its obligations. Equity is affected by the asymmetric information; since

investors on financial markets do not have the information that the banks and financial institutions have. That is why the financial managers consider equity issue as the last option to choose, believing that the company is unable to obtain money from other sources, intending that the investment is risky and the company has reached its affordable level of indebtedness (Mikocziova, 2010 pp. 68-70).

The theory does not define the most appropriate mixture of internal and external financing; it just gives the order of preferred and used sources. The theory explains that profitable companies do not borrow money at all. The problem of asymmetric information is the most significant to the external financing of the small and high tech, high-grown companies. The small companies have small volume of profit that cannot be used as sustainable internal financial sources. On the other hand, they do not have assets to serve as collateral in order to increase debt financing. Companies with innovative business consider to be risky because of competition increase, imitator appearance and investors are not strong confidential to invest in. Their need to finance the developmental projects turns them to conservative financing, bank loan, or debt financing as the first option of the pecking order theory (Brealey & Myers, 2003, pp. 511-515). Companies also use “informal” financing, as financial support by the family or friends, venture capital. Venture capital is the most appropriate to decline the asymmetric information and to provide the company sustainable financial support in order to establish a company that can further rely on internal and external financial sources.

1.3 Sources of internal financing and their characteristics

Internal financial sources indicate the cash flow generated by the existing assets and every day working of the company (Damodaran, 2010, p. 18). Internal financing focuses on maximizing the cash provided by business operations. In order to improve the internal cash flow, the company should evaluate and control the costs, and to review the budget, as well. It re-examines the credit terms given to customers and focuses on efficient receivables collection. The mixture of efficient and effective daily financial policy can lead the company to sustainable level of liquidity.

Other type of internal funding source is the working capital. Working capital actually means a balance between current assets and liabilities, obtaining the stock, trade creditors, cash and trade debtors. It is equilibrium of the income generating and resource purchasing activities of a company. Working capital has two objectives, to increase the profitability and to ensure level of liquidity to meet the company’s short-term obligations. The level of liquidity should be sustainable in order to finance operational needs, and additional costs related to unpredictable situations. Working capital needs careful managing in order to minimize the managers’ possibility in reaching wrong decision that can effect on the other company policies on short run.

There are three types of working capital policies. An aggressive policy regarding the level of financial means that the company increases the profitability by taking less cash to current assets. The disadvantage is increased risk of shortages and running out of stock. Conservative policy maintains larger cash balance. The company can direct this cash for buying short-term securities, offering more flexible credit terms to customers and holding higher levels of stock. Moderate policy presents the middle of the above-explained policies (Watson and Head, 2007, pp. 68-71). Even though there are no certain benchmarks for the policy category; the most important is the management to have control over the links of the departments that create the short-term financial situation of the company.

1.4 Sources of external financing and their characteristics

Sources of external finances can be divided into debt and equity sources. The thesis will go through the characteristics of these two groups of financing, giving accent on the most important forms of debt and equity finance.

1.4.1 Debt financing

Debt financing presents use of bank loans, corporate bonds and leasing. Debt financing creates fixed payment obligations to lenders. The lenders have priority claims in regular payment and principle.

According to Brealey and Myers (2003, p. 391), company should choose the type of debt by the needs and purpose of financing, following these questions:

- Should the company borrow on short or long term?
- Should the debt have fixed or floating rate?
- In which currency the borrowing should be.
- Which is collateral the company to present to the lenders?

The most important forms of debt financing are bank loans, corporate bonds, leasing, and main characteristics of each of them will be outlined in continuation of this chapter.

1.4.1.1 Bank loans

Bank loans; A loan is a debt instrument, where one of the sides, the borrower receives an amount of money or principal from a lender. The borrower is obligated to pay back the principal to the lender in defined period, increased by the interest.

Bank loan is primary source of financing for corporate sector in most economies. It is one of the most important sources of financing for the companies, no matter of the size, the needs and purpose of financial analysis in the bank.

Bank loan has several advantages. First, banks can provide small or large amount of money to company, according to the financial needs. Providing small amount of money is not affected by economies of scale, as issuing bond is (issuing bonds obtain costs and fees). Second, bank approves loan on the bases of the management projects and predictions for the future business. Regardless the company is well known or not, the decision is based on internal information, and not by the information, the manager's transfer to the public that affect the market value of the company. And third, in order the company to issue bonds , it has to be rated by rating agency in order to provide sufficient information to institutions, and according to the volume of financing, it can be more costly than bank lending (Damodaran, 2010, pp. 8- 9).

Banks give loans to companies at both fixed and floating interest rate. Bank charges the company for an agreement fee by fixed or floating charge. The repayment schedule often agrees between the bank and the borrowing company according to the financial needs and position of the company. The money is to be paid back in regular installments, or partial repayments; in an annuity, each installment is to be the same amount.

1.4.1.2 Corporate bonds

Bond; Bond is a debt instrument where the borrower (the bond issuer) agrees to repay the principal (or par value) at a specified time (known as maturity date) and to make periodic interest payments (Gregoriou, 2009, p. 45).

Corporate bond; Corporate bond is a debt instrument issued by company and sold to investors. Corporate bonds have standard coupon payment structure. It may also have call provisions to allow early prepayment if interest rates on the financial market change.

Companies issue corporate bonds. Corporate bonds are instruments that company uses to borrow money directly from the public (Bodie et al. 2009, p. 446). A corporate bond is exposed to default risk – if the issuing company has financial problems, the holder risks to get the promised payment. Since different companies bear different default rates, the larger the default or "credit" risk is, the higher is the interest rate.

Issuing bonds has few advantages. Firstly, issuing bonds can provide for the company better financial terms than a bank loan. Since bonds are shared to many financial market investors, it means that the investor risk is shared, as well. Otherwise, the bank takes over all the risks and sets the terms by credit risk management analyses. Second, the company individually sets the bonds terms such as maturity of the borrowing, periods of the fixed payments (monthly, quarterly, and semi-annual, annually), and the interest rates (fixed or floating rates). The bond can be convertible to common stock, meaning the bond can turn into equity.

The company can issue a corporate bond with call price before the maturity date. This kind of bond allows the company to buy back the bonds at a call price when the interest rates on the market are lower than the promised coupon rate to the bondholders. This option gives the company alternatives in using the financial sources. The company can call the bonds that have high coupon debt, and issue new bonds with lower coupon rate to reduce the interest payments or to replace the bonds with other type of debt. (Bodie et al. 2009, pp. 448- 449).

1.4.1.3 Leasing

Leasing; Leasing is a short to medium term financing, referring to hired assets under an agreement. The company hiring the assets is lessee and the company owing the assets is lessor (Watson and Head, 2007, p. 136). Company obligates to pay fixed payments to the owner of the assets in order to have the right to use them.

Leasing takes several forms. The most popular in the EU and SEE leasing sector are the operating lease and the financial lease.

Operating lease requires the lessor to service the equipment taken on lease. Other characteristic is that the rental payments are not sufficient for the lessor to cover the first value of the full cost for the assets. The agreement is signed for a period usually shorter than the economic life of the assets. The lessor covers all the costs by releasing or selling the assets. Important feature of the operating lease is a cancellation clause that gives the lessee right to return the assets before the agreement expires.

Financial or capital lease has the following features: does not provide service and it is not cancelled until it is fully amortized. The lessor pays rental payments and a rate of return on the amortized balance. The rate of return is close to the interest rate for a secured loan.

Lease is an attractive alternative for assets that relate to high technology and unpredictable technological obsolescence. It is also an alternative for companies that cannot predict their needs for certain assets and how long they will need them. Some lease agreements transfer the operating risk from the lessee to the lessor, as the lessor can keep the leased assets in good working position. Some companies find appropriate service for the leased assets to be provided by the lease company, since they are specialized in purchasing, servicing, and reselling certain type of assets (Bridham and Ehrhardt, 2005, pp. 704-705).
Bank loans and lease have some common features. The two instruments provide lending to the companies: banks provide money capital, and lease real capital. Both institutions bear the risk of non-fulfillment of payments by the company. Bank covers this risk by collateral, which is activated in order to return the given money capital. On the other hand, the leasing

company takes over the assets and gives them to another company for use. Since lease presents direct substitute for borrowing, the cost for borrowing is the interest rate for the assets. The lease company has also to calculate the price fluctuations on the lending and commodity market (Pojatina, 2008, pp. 7-8).

Leasing asset does not appear in the company's balance sheet, it is evidenced in the off balance sheet. The company does not lose its creditworthiness by using leasing asset.

The company can choose lease instead of bank debt financing by the following lease advantages:

- Service reasons: the service for the assets can be defined in the agreement. This service can be unique if the lessor purchases the asset or the lessor reputation allows to provide it. This issue is agreed when the costs of the exclusive servicing is high. In this case, it is better for the company to choose lease instead of bank loan.
- Flexibility: meaning the lease agreement states that the asset can be replaced or returned to the lessor during the life of the asset. It is used when the company cannot predict the needs or the asset suffers technological changes.

1.4.2 Equity financing

Equity presents the value of ownership and interest the shareholders have. The shareholders are owners of common and preferred stocks. The company can raise equity by selling common and preferred stocks to investors.

Even though equity mainly relates to common stocks, the equity claim can take variety of forms depending on the company's ownership and the company stage of development as well as type of business operations, growth, and risk characteristics.

Owner's equity is the basic equity in small businesses, providing the seed money and pulling back the earnings of the company into the business. These funds are basic for the growth and eventual success of the business. As the company extends the business operations, the owner's funds are not enough to cover the growth needs and investments. Venture capitalists or private owner investors provide equity financing to small and risky companies in the starting developing stage, in exchange for ownership of the company. Since the venture capitalist establishes a company with management, market, and financial position, the company can raise funds from alternative sources and/or to go in public by selling a part or all ownership as shares to individuals or institutions (Damodaran, 2010, pp. 94 -95).

The thesis will go through the most important forms of equity financing: issue of common and preferred stocks, Initial public offering, venture capital and business angels.

1.4.2.1 Common stocks

Common stocks; Common stock are equity securities, or equity, representing ownership in the company, giving right to the owners to vote on corporate issues in proportion to their ownership in the company and the right to receive dividend payments.

Common stockholders own the company. They can be individual investors or financial institutions such as banks, pension funds, and insurance companies. Each common stock entitles its owner to vote for any matters of corporate governance on the annual meeting and to share the financial benefits of the ownership (Bodie, Kane & Marcus, 2009, pp. 35-36).

The common stocks are usually sold and bought freely on one or more exchange stocks. Price of the common stocks of a new listed company is estimated by the issuing entity and it is called offering price. They must have a par value (nominal value) by law. It cannot be issued for less than this amount. The nominal value is presented in the balance sheet by the common stock account. Price of a common stock of existing publicly traded company is usually based on the current market price.

These stocks have two important characteristics, its residual claim, and limited liability features. The residual claim means that the common stockholders are at the bottom of the creditor hierarchy in case of liquidation of the company. They are ultimate bearers of the risk. These stockholders have a claim to what is left after all the claimants, such as tax authorities, employees, suppliers, bondholders, and other creditors are paid (Watson and Head, 2007, p. 95). If the company is not in liquidation, the stockholders have a part of the income, which can be paid as dividend in cash, or to decide to reinvest in the company. Limited liability means that the shareholders are not responsible with their personal assets for the company obligations.

1.4.2.2 Preferred stocks

Preferred stocks; Preferred stocks have characteristics of equity and debt, and are a part of the company equity where the company has obligation for fixed payment to the investors.

This source of financing provides the company with small amount for financing, and it is useful method of financing in mergers and certain other special situations. As a debt, the company has obligation for fixed payment to the investors. Even if the company does not pay dividend to the common stockholders, it still has the obligation to pay preferred stocks to the owners. In case when the company does not fulfill its payment obligation, it can offer the preferred stockowners voting rights. In this moment, the common stockholders

have to divide the control of the company with the preferred stockholders. This decision transfers black mark signal to the future investors.

Preferred stocks equity bears higher risk than debt for the following reasons. Preference stocks, unlike debt, are not secured financial instruments. According to the creditor hierarchy, preference dividends cannot be paid before the debt borrowers get the interest payments. It means, in case of liquidation, that the debt borrowers will be paid before the preference stockholders (Watson and Head, 2007, pp. 111-112).

1.4.2.3 Initial public offering (IPO)

Initial public offering; Initial public offering is a primary offering of new stocks by private company in public. It may be considered as a secondary offering when the venture capitalists sell some of their existing shares of the companies they finance.

IPO allows company to attract different range of investors that provide capital for future growth, financial working capital and payment of debt. IPO can be used as method for diversifying growth businesses by companies or daughter companies during hot markets when they can face with attractive opportunities to finance the business (Pettit, 2007, p. 60) The company is not required to repay this capital to the investors.

The set offering price should be in equilibrium: low enough to attract new potential investors, but high enough to gather the required finances without additional issue of stocks.

In order the company to issue IPO, the management knows that the information of the business operation should be presented in public. The outside investors need to have information for the market position of the company. This step helps the company to become more widely available to other sources of financing and to make diversification of the sources, to reduce the costs of financing, to increase the liquidity, to get prestige and public image.

A public offering is a complicated process, and it begins long before the company sells the stocks in public. The presence of depressed market can discourage the company from going in public. In order to minimize the risk and weight up the opportunities, the company should rely on experienced advisors.

Disadvantages of IPO relate to costs for legal counsel, arrangement of registration documents, fees for registration new securities, financial intermediate and marketing costs. It acquires reasonable time, effort, and attention by the senior management and additional finance and business information for the public.

The risk of underpricing the IPO exists and the risk of the overpricing, as well. It is difficult for the underwriters to estimate how much investors are willing to pay for the shares. If the investors get the shares by underprice, they get bargain at the expense of the shareholder issuing.

A company can have access to finances by external sources of equity capital, if it is on the list on a recognized stock of exchange. A listed company is likely to be more attractive to potential financial institutions and investors. These companies have obligation to present the business information and plans in public, and their credibility and reputation increase the security of the investors from potential risks. Unquoted companies have limits to the various types of financing that the equity market offers. They can fill in this gap by equity investment of venture capitalists.

1.4.2.4 Venture capital and business angels

Business angels; Business angels are wealthy individuals who invest their own capital in a startup company, typically at the seed stage, in exchange for equity stake in the company (Gregoriou, 2009, p. 20).

Creation of new innovative companies is the key growing element of every country's economy. There are three crucial factors for successful starting of a new company: innovative idea, experienced team, and enough capital to establish sustain and growth business.

Most of the new companies find as first initial source of financing the family funds and bank loans. As they grow, they need venture capital market finance to support their development. This support is required in the early stage of the business, when the access to the bank finance and other financial institutions is limited and in the same time extremely important. In this stage, institutions are not interested in financing these companies, and therefore they need alternative sources of financing to reach higher stages of development. Hence, providing finance to companies in this stage is one of the crucial conditions for their further growth.

Venture capital provides equity and knowledge to small risky business in exchange for a share of the ownership. This capital comes from corporate venture companies and wealthy individuals as business angels. However, these investors are not passive investors. They also invest their knowledge in the companies, which is important for the early years of the business, and play major role in recruiting the senior management team.
Business plan is the basic document that presents the proposed product, its potential market, the underlying technology as well as the resources (time, money, employees, plant, and equipment) needed for the success (Brealey & Meyers, 2003, p. 401). The business

plan contains financial stages in order the venture capitalists to get better view on the financial plan. Investors rarely give to a young company all the money at once. The success of the business plan relies on the effort that the managers put in realizing the business plan. Therefore, most of the venture capital investors make an agreement with the manager to create a strong intend to work hard.

Business angels are successful business people who invest in highly risky investments such as young companies with potential for rapid growth and high return of investment. They have built or managed one or several successful companies, and they want to invest a part of their wealth in young companies. Besides financial investment, they create management team of the company and transfer experience and knowledge.

Business angles can act by themselves, but usually act organized in a business angel's network association. The network activities are focused on identification and recognition of the potential business.

2 EXTERNAL CORPORATE FINANCING IN SELECTED EU AND SEE COUNTRIES

The second part of this thesis presents characteristics of external financing in the corporate sector in the European Union (hereinafter: EU), and Southeastern countries (hereinafter: SEE). As far as the latter group of countries is concerned, statistical data availability has requested one set of data analysis for the region excluding Croatia, and another set of data discussing Croatia's country case study. The results of the research will be used as a base for comparison of the external sources of corporate financing to Macedonian. Selection of the countries relies on similarity of their financial system and financial structure of the corporate sector, as well. The surveys are focused on to present and analyze the following issues in order to identify the main patterns of external sources of financing in the corporate sector in the selected countries:

- Structure of sources of corporate financing
- Use of external source of corporate financing

2.1 External corporate financing in the European Union

The research is based on the surveys of the European Central Bank, Eurostat, and two Directorates General – for Enterprises and Industry and for Communication – of the European Commission. There are two groups of surveys. The first group consists of surveys presenting external financial sources in corporate sector in 15 "old" and 10 "new" states of the EU in 2005 and 2006:

- SME Access to Finance, observing 15 “old” member states in EU, in the first half of 2005
- SME Access to Finance in the New Member States, Analytical report, observing 10 “new” member states (hereinafter: NMS)

These two surveys observe different countries in the period 2005 and 2006. ”Old” EU member states belonged to the EU financial system, and the NMS have their own financial system and legislation when they joined EU. These surveys serve as bases for comparative assessment for EU 27 in the following observing period 2009-2011.

The second group of surveys covers all EU 27 in the period 2009-2011:

- Access to finance, Analytical report, observing companies in 27 EU Member States in the first half of 2009
- SME Access to finance, Survey 2011, Analytical report, observing companies in 27 EU Member States in the first half of 2011
- Survey on the Access to Finance of SME in the European Area, observing companies in 27 EU Member States for the period April-September 2011.

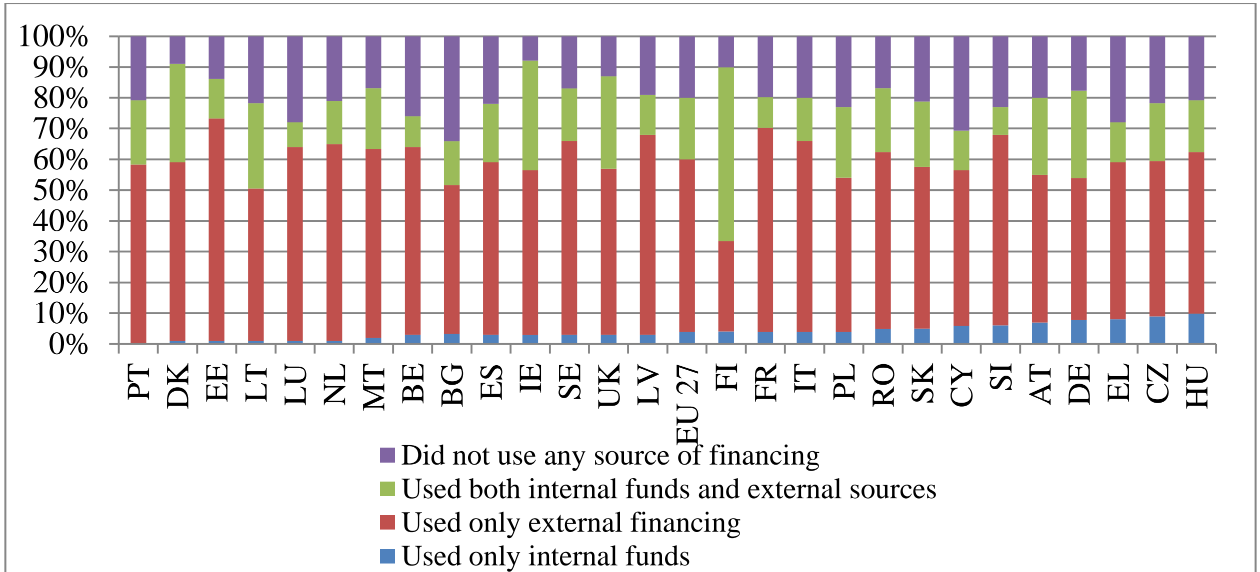
The methodology used in all above-mentioned surveys is fixed telephone interview. It obtains randomly chosen non-financial companies from all sectors (industry, construction, trade, and services). Companies range by size is by employment criterion, defining micro companies having 1-9 employees, small (10-49), medium (50-249) and large (equal and more than 250).

2.1.1 Structure of sources of corporate financing

Companies across the EU have different structure of corporate financing as a result of availability of financial sources, level of confidence to apply for external financing, patterns of main sector in the economy, regulation of the financial system by countries and the EU financial institutions. The survey defines sources of financing as internal and external, dividing external to debt and equity.

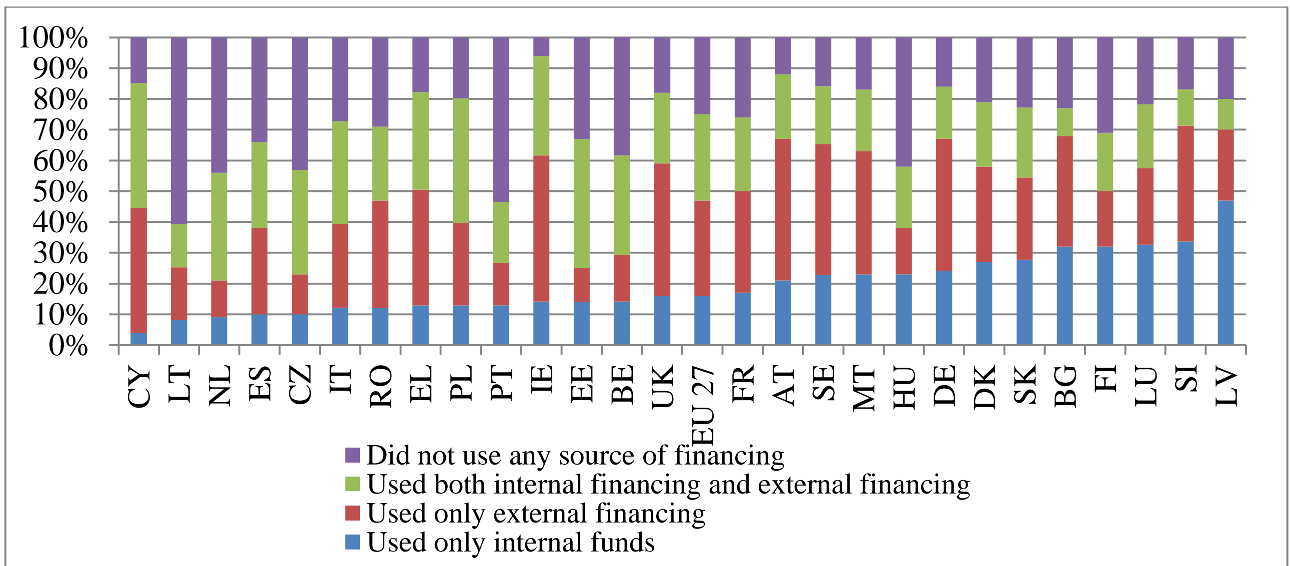
Companies financing sources structure by the Member States and EU 27 average level for 2009 and 2011 presents the figure below:

Figure 1. Financing Structure: Use of Internal Funds and External Financing in First Half 2011



Source: European Commission, *SMEs' Access to Finance, Survey 2011, Analytical Report,* 2011, p. 16.

Figure 2. Financing Structure: Use of Internal Funds and External Financing in First Half 2009



Source: European Commission*, Access to Finance, Analytical Report 2011*, p. 29.

The survey defines the internal funds as retained earnings or sales of assets. External sources include bank loans, bank overdrafts, trade credits, leasing, hire purchasing, factoring and debt securities.

According to the report of 2011, the use of internal funds dropped in many countries (except Finland and the Czech Republic) compared to 2009. The decrease started in the second half of 2009 and followed in 2010 with similar data having the first half of 2011. The figures 2.1 and 2.2 show that 16 per cent of the companies used only internal funds to finance their business operation in 2009 and it dropped to 4 per cent in 2011. At the same time, the proportion using external sources of financing doubled from 28 per cent in 2009 to 56 percent in 2011, debt and equity included. A world financial crisis is the major factor for these changes. Financial institutions strengthened their credit policy at once at the end of 2008 and beginning of 2009. It effected to decreased access to financial sources of the companies, especially of the traditionally external sources of financing. Even though internal funds have always been the most available source of financing the companies, during this period, most of them found the internal funds to be the only source to rely on. In 2009, the uncertainty on the global financial markets did not give any prediction for the further direction and deepening of the crises. The pressure of using internal funds could not sustain for longer period, which explains the need for external sources increases in the second half of 2009, as the decreased availability of the internal funds to finance the business for longer period. Gross Domestic Product (hereinafter: GDP) growth rate in EU had additional effect. It was -4.4 per cent in 2009, 2.1 per cent in 2010 and 1.5 per cent in 2011. The increased rate of GDP relates to economy recovery and increased business activity of the corporate sector. It leads to increased need of financing the companies. The use of internal funds was mostly decreased in Bulgaria, Greece and Ireland. Companies started to be innovative and to find alternative external sources to finance the business.

Since internal funds present retained earnings of the company, positive expectations for their future availability mean that companies predict better business climate and should achieve better results in the forthcoming period. In 2011, report showed that 48 per cent of the managers expected the availability of internal funds to remain unchanged within the next six months (until the end of 2011). Improvements for future availability of the internal funds about 23 per cent of managers expected, while 12 per cent expected deterioration (European Commission, 2011, pp. 81-87).

2.1.2 Use of external sources of corporate financing

External sources of financing include the debt and equity financing. Both types of finances were totally used by 54 per cent of the companies in 2011, and 31 per cent in 2009 (European Commission, 2009, p. 29; European Commission, 2011, p. 16). Companies mostly used external sources to finance the working capital than to finance investments in buildings, land.

2.1.2.1 Debt financing

The surveys define as debt financial sources the bank loans, grants or as subsidized loan, a bank overdraft, trade credit, other loans, leasing, factoring.

The EU average of companies that have used at least one source of debt financing was 75 per cent in 2011 and it was 68 per cent in 2009. The data per country is presented in the figure below:

Figure 3. The Proportion of Companies that Have Used at Least One Source of Debt Financing, 2009 and 2011

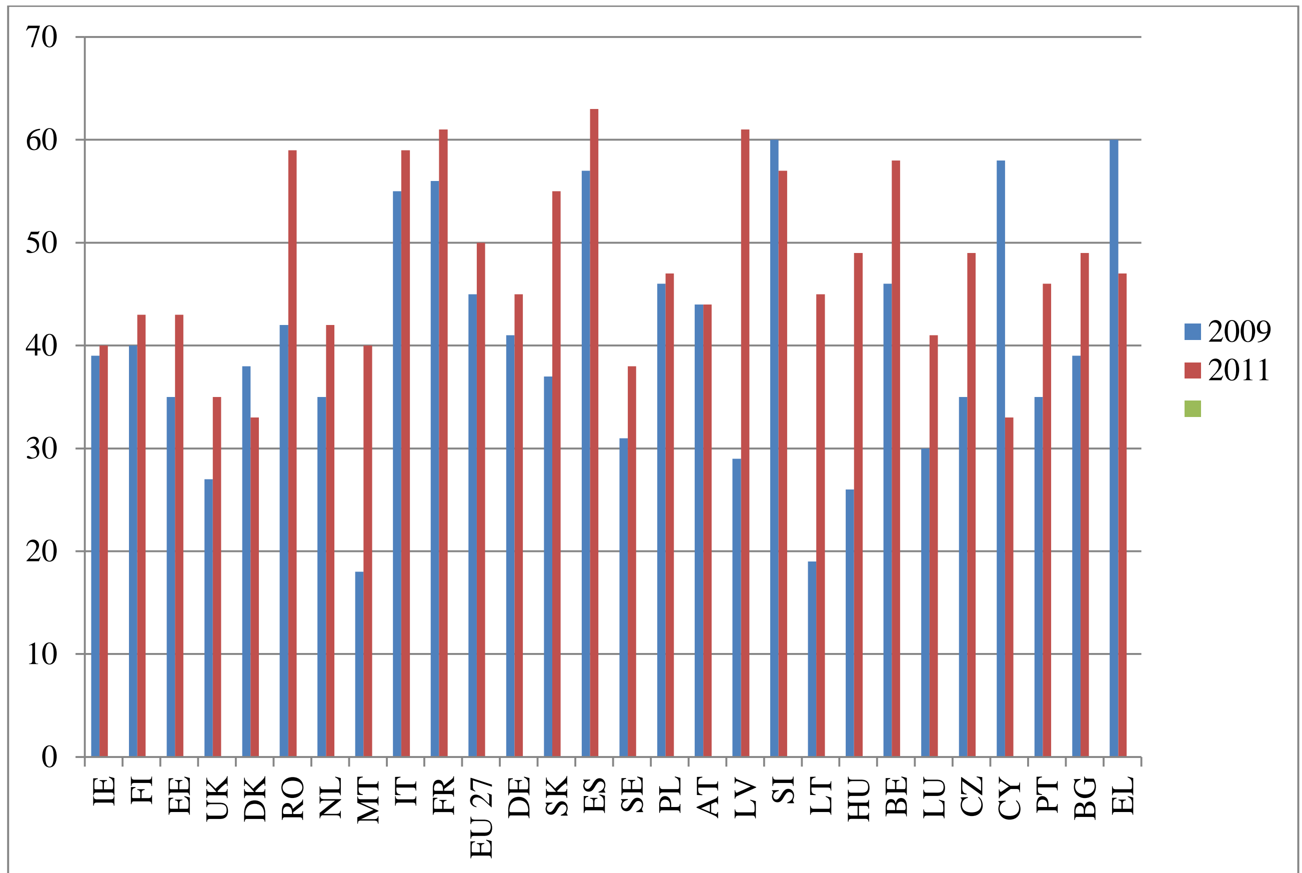
Source: European Commission, *SMEs' Access to Finance, Survey 2011, Analytical Report,* 2011, p. 20.

Bank loans have been mostly used as external financial source in the EU companies. This is the reason for wider analysis of the use of this source.

Banks are the most common provider of loans to companies in the EU, providing 88 per cent of the total amount of loans in 2011 and 87 per cent in 2009. Other creditors are private individuals (friends or family), micro financial institutions, and government related to sources (European Commission, 2011, p. 35).

The EU average number of companies that have used bank loan was 46 per cent in 2009 and 50 per cent in 2011. The data per country is presented in the figure below:

Figure 4. The Proportion of Companies that Have Used Bank Loan, 2009 and 2011



Source: European Commission, *SMEs' Access to Finance, Survey 2011, Analytical Report,* 2011, p. 32.

The dominant purpose of taking bank loan is financing working capital. According the figure 2.4, 46 per cent of the companies used the bank loan to finance working capital in 2011 and 45 per cent in 2009. Greece has mostly used bank loans for working capital – 85 per cent in 2011 and 59 per cent in 2009. Other countries that have increased the use of loans for working capital were Bulgaria (70 per cent in 2011 and 49 per cent in 2007) and Slovenia (60 per cent in 2011 and 33 per cent in 2009). Second purpose is investing in land/ buildings and equipment (44 per cent in 2011 and 43 per cent in 2009). These countries have significant decrease in using the loans for lands, buildings, equipments, or vehicles: Bulgaria (26 per cent in 2011, 45 per cent in 2009), Slovenia (48 per cent in 2011, 60 per cent in 2009), Greece (14 per cent in 2011, 28 per cent in 2009) (European Commission, 2011, pp. 37-38).

Bank conditions, willingness and terms are important factors to analyze the availability of bank loans to the companies and the success rate in getting loan. For analyzing period, 2005-2011, the interest rate was the main reason not to get a bank loan. In a survey of 2005, 32 per cent of the managers of the NMS say that the interest rate was high. In comparison with 2006, 61 per cent of the old Member States found the interest rate as a

reason not to get a credit (European Commission, 2005, p. 13; European Commission, 2006, p. 15). For the period of 2009 to 2011, according to managers opinion in all 27 EU the level of the interest rates significantly increased from year to year (37 per cent of managers in 2009, 50 per cent in 2010 and 60 per cent in the first half of 2011). Other reasons that companies had to get loan was the bank demand for too much information, defined by 72 per cent, 77 per cent of the managers for the period 2005 and 2006, while for 2009-2011, other reason is collateral requirements point 33 per cent of the managers.

In 2007, 84 per cent of the companies were successful in getting loans, and 64 per cent in 2010. In 2010, the combined rate of only partly successful and unsuccessful financing requests doubled for external sources of financing, especially for loans. Since bank loan is the most targeted source, it has the most declined successful rate. The main reason for choosing a particular bank for the period 2007-2010 was "being already a client" by half of the managers. Banks interest rates and terms were the second reason by 17 per cent of the managers in 2007, and 16 per cent to choose a bank in 2010 (Euro stat, 2011).

Compared to 2009, a survey showed deterioration of availability of bank loan decreased from 45 per cent to 15 per cent by managers' opinion in 2011. This means that banks became more available to companies to finance their business operations in the first half of 2011 (European Commission, 2011, p. 53).

According to the size range of companies, 45 per cent of managers in large companies expect increase in the amount of approved bank loans compared to 35 per cent of the managers of SME in 2011. Large companies declare that the interest rates have decreased for their loans, and that the banks have increased the credit line. This is noted from managers of greater SMEs, as well.

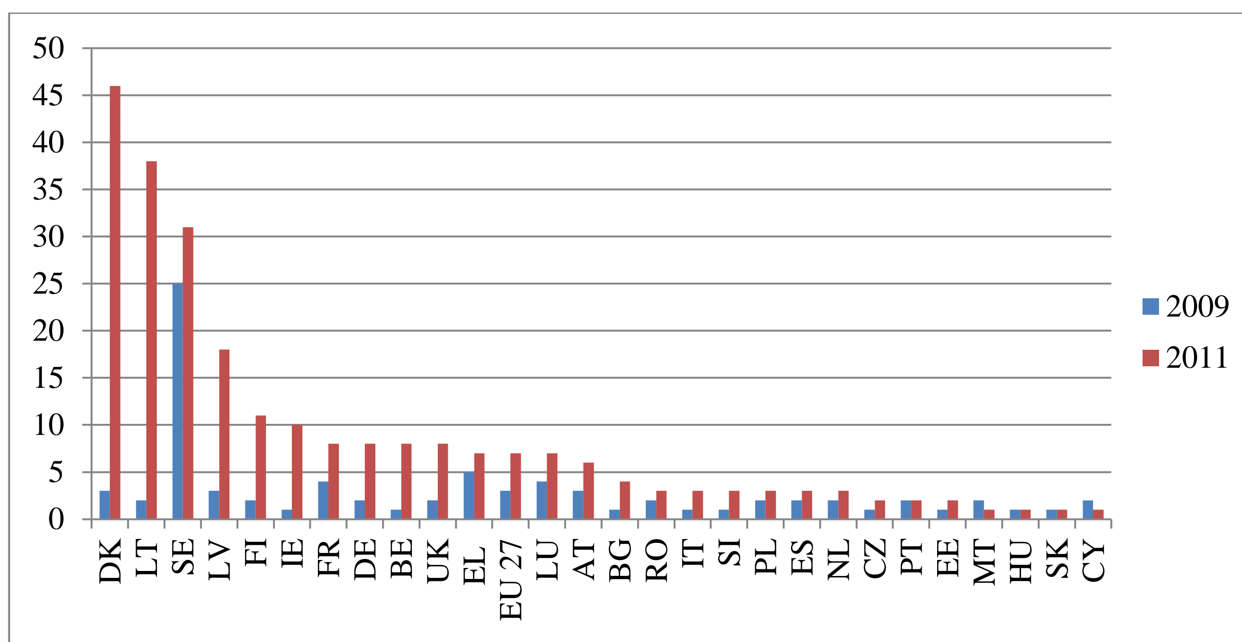
Predictions of the managers are optimistic for the future period of two or three years. They have confidence in bank loans financing. Greek companies' confidence is on the lowest rate. Indeed Greek confidence fell from 66 per cent in 2009 to 26 percent in 2011.

Bank loans have remained the most favorable in the forthcoming years (among 63 per cent of the companies in 2011, compared to 57 per cent in 2009) (European Commission, 2011, p. 73).

2.1.2.2 Equity financing

The survey defines capital finance venture as an equity sources of financing.

Figure 5. The Proportion of Companies That Have Used Equity Financing, 2009 and 2011



Source: European Commission*, SMEs' Access to Finance, Survey 2011, Analytical Report,* 2011, p. 21.

The EU 27 average level presents use of equity sources of financing by 4 per cent of the companies in 2007, 3 per cent in 2009, 2 per cent in 2010, and 7 per cent in 2011. For the future period of 2011-2013, 9 per cent of the managers will use this source for financing business operations.

The willingness of investors to invest in companies' equity improved in 2011. In 2009, 7 per cent of the managers considered that investors' willingness had deteriorated, while in 2011, 3 per cent of the managers shared that opinion (European Commission, 2011, p. 55). Countries that reported highest level of deterioration were Greece (14 per cent), Ireland (11 per cent), and Portugal (8 per cent).

Between 2009 and 2011, there was a significant rise in the proportion of managers who have confidence about financing of companies with equity investors and venture capital investments. Here are some data for the countries: France (17 per cent to 23 per cent), Germany (11 per cent to 20 per cent) and Latvia (11 per cent to 35 per cent), while Greece non-confidence doubled from 20 per cent to 40 per cent. Most of the companies with confidence were the SMEs (European Commission, 2011, p. 71). Still 67 per cent of the managers in 2009 and 74 per cent in 2011 did not find applicable equity financing as source for financing the companies.

The success rate in obtaining equity financing was 67 per cent in 2007 and 52 per cent in 2010. In the same period, the rate of partly successful and failure appears to be increased (Eurostat, 2011).

The analysis presents that the decrease in use of internal funds shifted and to the use of equity financial sources. Even though most of the companies find it not applicable, companies slightly increase the use of this source.

One of the equity sources is the venture capital. Venture capital was an almost nonexistent form of financing according to a survey in 2005. Only 2 per cent of companies in NMS used the venture capital as source of financing, but 1 per cent by the old Member States in 2006. Even though in 2009 and 2011, 16 per cent of the managers had confidence in talking about equity investors/venture capital companies still their use was on significant low level.

European Business Angels Network (hereinafter: EBAN) represents the angel market and network of more than 250 business angel networks in the European Union. It was established in 1999 by a group of pioneer angel networks. The network counts 20.000 angels, and receives nearly 40.000 business plans a year. Today EBAN gets together over 113 member organizations in 26 countries. In 2009, EBAN opened up its full membership to early stage of venture capital funds in an effort to represent all actors involved in bridging the equity gap in Europe (The European Trade Association for Business Angels, Seed Funds and Other Early Stage Market Players, 2009, p. 3).

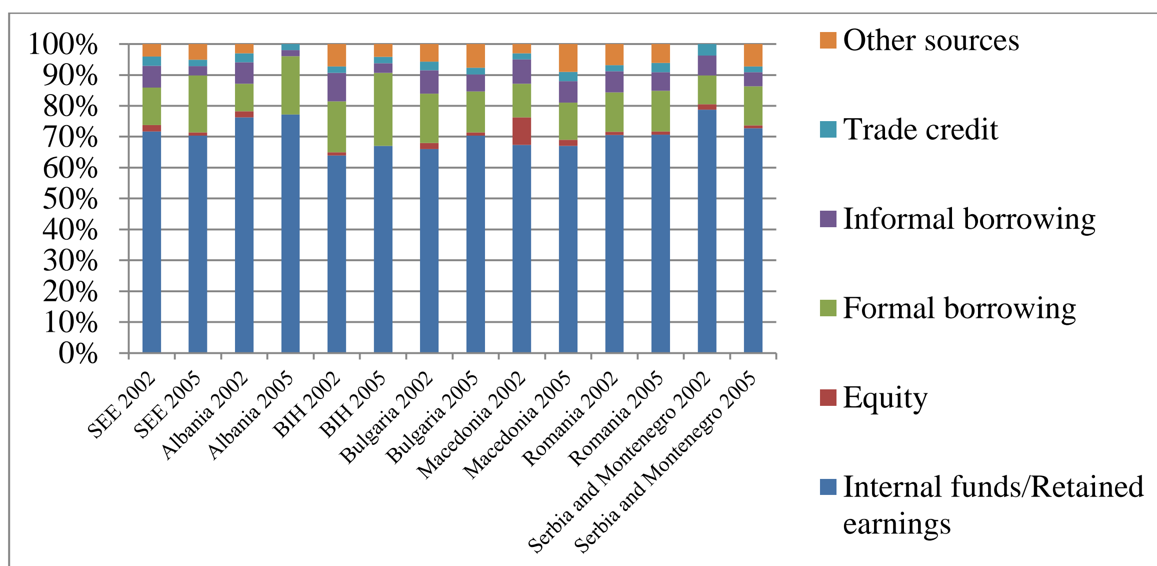
2.2 External corporate financing of the Southeastern countries with exception of Croatia

The Southeastern region of Europe, as covered within this chapter, includes Albania, Bosnia and Herzegovina, Bulgaria, Kosovo, Macedonia, Montenegro, Romania and Serbia. Bulgaria and Romania are not discussed in this analysis, as they have been full EU member states since 2007. The data for these countries presented in this chapter are used for additional comparison with the rest of the SEE countries.

2.2.1 Structure of sources of corporate financing

Economic growth is directed by the growth of corporate sector in each country. Corporate sector development is based on the set of regulations, legislations, and functional law, political and economical system, covering the issue of accessing to finance. Structure of the sources of financing in the SEE countries is presented in the chart below:

Figure 6. Sources of Financing in the Corporate Sector in the SEE Countries, 2002-2005



Source: European Commission, *Bringing the Gap, Access to Risk Finance for Early-Stage SMEs in SEE,* 2009, pp.33-44.

The chart is constructed by Business Environment and Enterprise Performance Survey (further mentioned as BEEPS). It shows that internal funds and retained earnings are the most significant source of financing used by 70 per cent of the companies in the SEE (including Romania and Bulgaria). During the period of 2002-2005, companies slightly reduced the reliance on internal funds, increasing the use of bank loans. In the same time use of informal borrowing decreased, and increased proportion of equity and trade credit as source of financing. The increased use of formal external sources in spite of the informal external sources explains that the regulatory framework and the reforms in these countries strengthen the position of the financial institutions and its credit related to information.

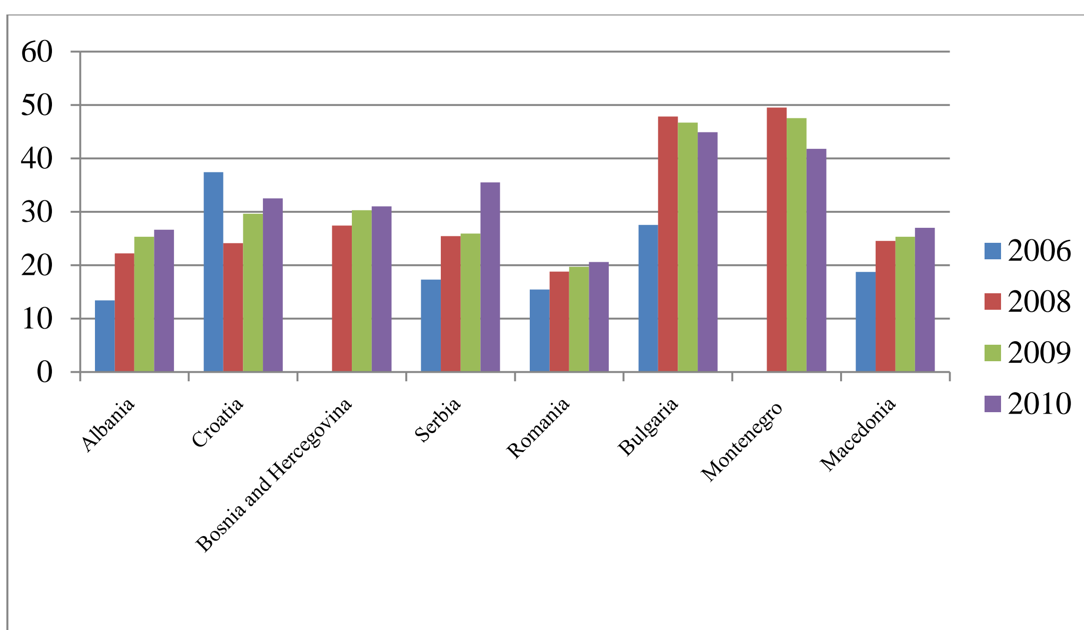
2.2.2 Use of external sources of corporate financing

In the period 2000-2008, the SEE region experienced economic boom with rapid GDP and credit growth, following the global economic boom and easy liquidity conditions. In the same time, the SEE region expected to join the EU, which was additional signal to domestic and foreign investors that the boom will last. The influence of the world financial crises decreased the GDP and companies' growth.

Banks as main drivers of the corporate sectors and economic growth in the past decade have provided efficient allocation and concentration of financial assets, which has been a basic precondition for dynamic and stable economic growth. Therefore, dynamics and quality of economic growth mainly depend on the efficiency of projects that can be financed by the banks.

Banks have been predominant external source of financing in the SEE countries in pre-crises period. Banks have provided easily acceptable loans at reasonable rates, allowing many companies to thrive and develop. The level of credit growth had approximately more than two percentage points of GDP on average for the region within the period of 2005-2007. The negative side was that companies became dependent on this source of financing. The seriousness became obvious during the crises, when banks turned from positive loan policy to conservative, effecting serious slowdown in the growth in corporate sector (USAID, 2010, p. 12). In the second half of 2008, the SEE countries experienced a decline in lending, which deteriorated further on in the beginning of 2009. The lending reached its bottom in the end of 2009. Economic recovery started at the end of 2009 and lasted within 2010. The figure below presents the volume of bank loans for the period of 2006-2010:

Figure 7. Bank Loans to Corporate Sector as Percentage in GDP, 2006, 2008, 2009 and 2010



Source: National Bank of Macedonia, *Annual Report for Financial Stability in Macedonia*, 2009, p. 46; *Annual Report for Financial Stability in Macedonia*, 2010, p. 55.

Real estate and construction sectors are the most attractive sectors to invest in. According to USAID (2010, p. 18), SEE banks have financed more than a half of the loans in these two businesses.

Mechanisms of sharing credit-related information are implemented in all SEE economies. Even though credit bureaus and collateral registers are well developed, countries should take measures for their full adoption and coordination within the international standards in

order to improve the coverage and reliability of the data included in the bureaus and registers.

The EU status is one of the main factors that determine the level of financing. Bulgaria and Romania as the EU full member states having their large population (relating to the SEE countries) and high levels of GDP per capita have attracted a bulk of investments in the region. Croatia and Serbia are in the second group of countries having significant level of foreign investments. Albania, Bosnia and Herzegovina, Kosovo, Macedonia and Montenegro, are defined as countries that are not able to attract investments.

Until SEE countries officially join EU, they can review the opportunity to attract investments form worlds growing economies. Projections for development of the region consider the China's ambitions. Today China generally prioritizes acquisitions of major strategic entities to a global position. In the years around 2014, when some of the SEE countries due to accede in the EU, projections were that China would have interest to use the SEE manufacturing and outsourcing hub for their EU-market-related operations. Growth indicators of the EURO zone would also define the interest of Chinese investments in the SEE region (USAID, 2010, p. 8). Same predictions take India, Russia and the Middle East into consideration as stakeholders for their diversification of the financial portfolio and risk alleviation.

The SEE companies show increased interest to equity financing in the years prior to crises. The report Access of financing in the SEE: Before and after the Crises presents that 81-equity investor was identified and 26 invested in real estate and construction industry in 2009. In the period 2007-2008, they mostly invested in service sector in the SEE countries (USAID, 2010, pp. 16-17).

Venture capital and business angels have scarce activity in the SEE countries. Promotion of this source of financing can increase the informal equity financing. The presence of international financial institutions calls for clearer legal and regulatory framework (Investment reform Index, 2010, p. 7; Organization for Economic Co-operation and Development (OECD)).

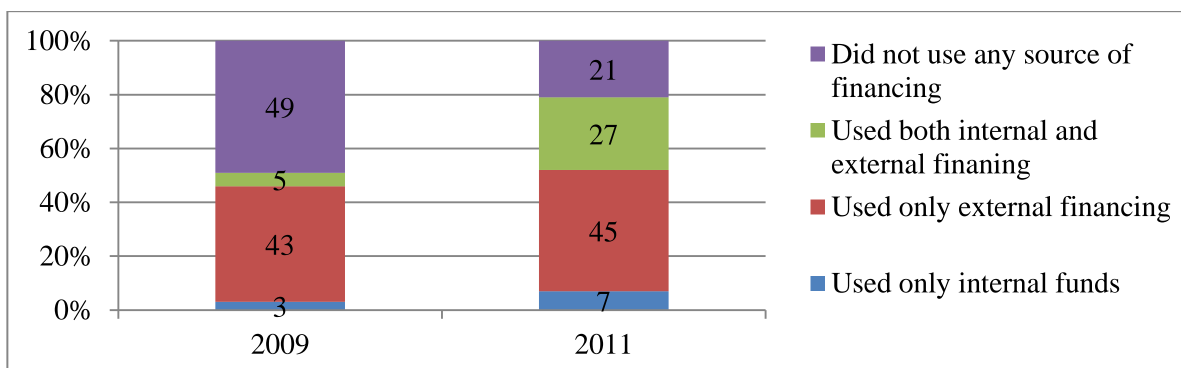
2.3 External corporate financing in Croatia

The analysis for external corporate financing in Croatia relies on the surveys issued by the National Bank of Croatia, Croatian Financial Services Supervisory Agency (hereinafter: HANFA), Croatian Business Angels Network (hereinafter: CRANE), the European Bank for Reconstruction and Development (EBRD). It also relies on the surveys of the European Central Bank, Eurostat, and two Directorates General – for Enterprises and Industry and for Communication – of the European Commission.

2.3.1 Structure of corporate financing

The basic structure of the sources of financing for the period 2009-2011 presents the figure below:

Figure 8. Basic Structure of Sources of Financing, 2009 and 2011



Source: European Commission, *Access to Finance, Annex,* 2009, p. 29; *SMEs' Access to Finance, Survey 2011, Analytical Report,* 2011, p. 16.

After the hit of the world economic crises in 2009, the Croatian economy recovered in 2010 and 2011. In 2009, the GDP growth was -5.8 per cent. In 2010, the economy was still declining, but at much slower rate (-1.4 per cent), while in 2011 it increased for 1.3 per cent. The economy growth was led by the growth of corporate sector. The increased business activities required increased need of financing. According to the figures above, the corporate sector increased the use of all the available financial sources, internal and external included. There were a great number of companies that used a mixture of internal and external sources. It means that companies tried to find the best financing combination, evaluating the risks and availability of sources, creating a strategy of financing for the future period. The number of companies that did not use any source of financing dropped to 21 per cent in 2011, while their number was 49 per cent in 2009.

2.3.2 Use of external sources

External sources of financing include the debt and equity financing. Both types of finances were totally used by 45 per cent of the companies in 2011, and 43 per cent in 2009 (European Commission, 2009, p. 29; European Commission, 2011, p. 16). Companies mostly used the external sources to finance the working capital than to finance investments in buildings, land.

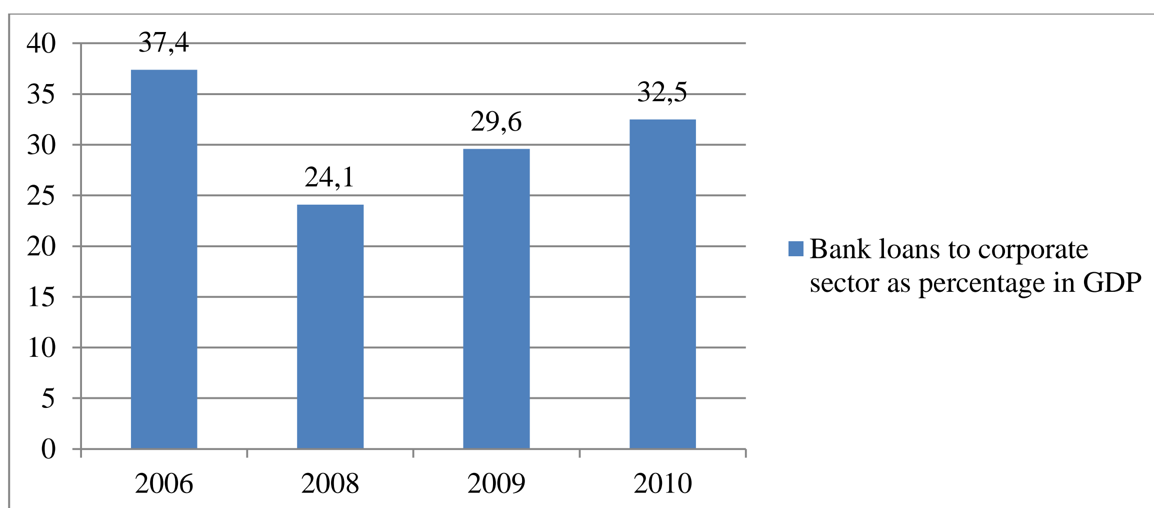
2.3.2.1 Debt financing

External sources of financing in Croatia are debt financial sources. The thesis will give detail analysis to bank loans.

2.3.2.1.1 Bank loans

The volume of bank loans in the corporate sector as percentage in GDP is presented in the figure below:

Figure 9. Bank Loans to Corporate Sector as Percentage in GDP, 2006, 2008, 2009 and 2010



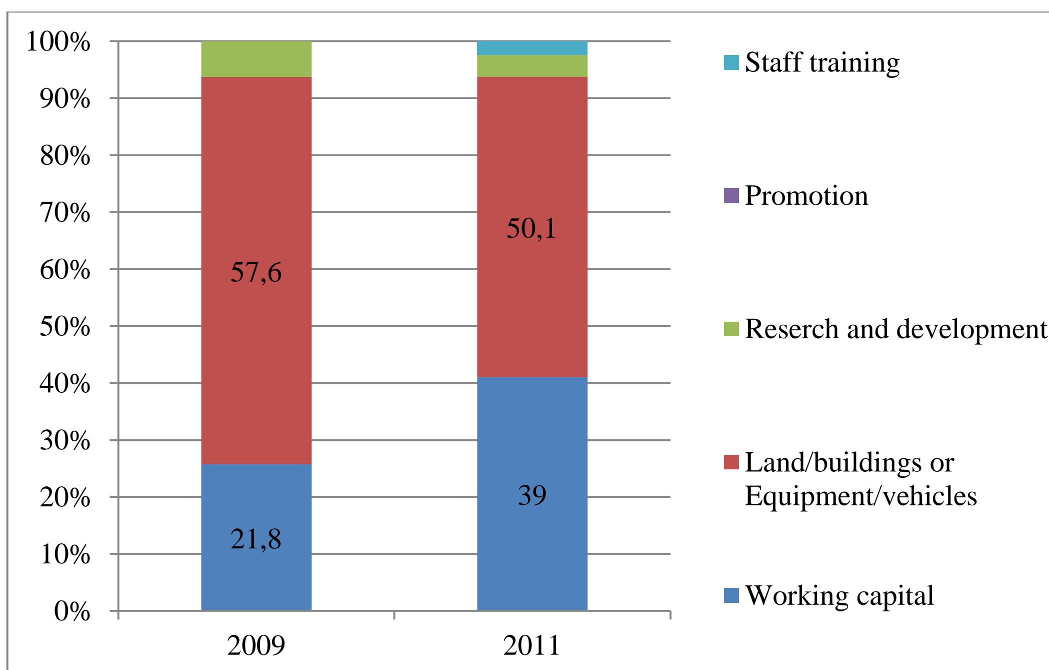
Source: National Bank of Macedonia, *Annual Report for Financial Stability in the Republic of Macedonia*, 2007, p. 47; *Annual Report for Financial Stability in the Republic of Macedonia*, 2009, p. 46; *Annual Report for Financial Stability in the Republic of Macedonia*, 2010, p. 55.

In 2008, the volume of bank loans decreased as a result of the world financial crises and the effects spilled over to the finance and real sector. In 2009 and 2010 the volume of bank loans was not significantly increased as a result of strengthened bank conditions and terms of financing the corporate sector, low level of investment projects offered by the companies, pessimistic expectations for economic growth both in Croatia and the region and the Euro zone stability, as well. These factors also resulted in the foreign investor's activities and their perception on Croatia as a country with higher risk level. The increased volume of bank loans was a result of new approved short-term loans to the companies in 2010. Banks searched for new and qualitative clients turning the interest to financing sectors that had not been in the focus of the bank's policy before. Banks started to finance education, culture, tourism and other service sectors, projects for saving environment and supporting development of sustainable energy resources.

Companies that have used bank loans are highly prone to interest rate and currency risk. The interest rate risk relates to the fact that 90 per cent of the total bank loans to the corporate sector have fluctuating interest rate. This means that banks can change the interest rates according to the bank policy in any time. Since 85 per cent of the bank loans were foreign currency-denominated loans, the corporate sector was exposed to currency risk (the National Bank of Croatia, 2011, p. 37).

Croatian companies mostly use the bank loans to finance the working capital and to hold a position of liquidation. Investments in land, equipment, and vehicles are the second purpose for bank loans. According to the figure below, the percentage of companies that use bank loans to finance the working capital increased from 21.8 per cent in 2009 to 39 percent in 2011, while for land, buildings, equipment and vehicles decreased from 57.6 per cent in 2009 to 50.1 percent in 2011.

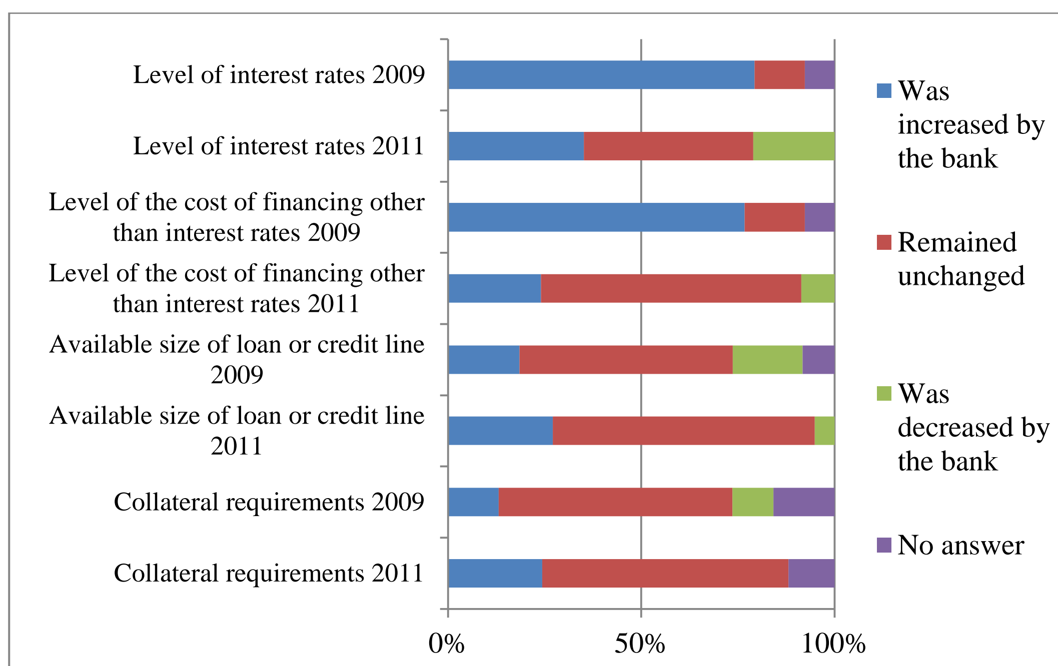
Figure 10. Purposes for the Bank Loan, 2009 and 2011



Source: European Commission, *Access to Finance, Annex,* 2009, p. 210; *Results by Country.*2011.

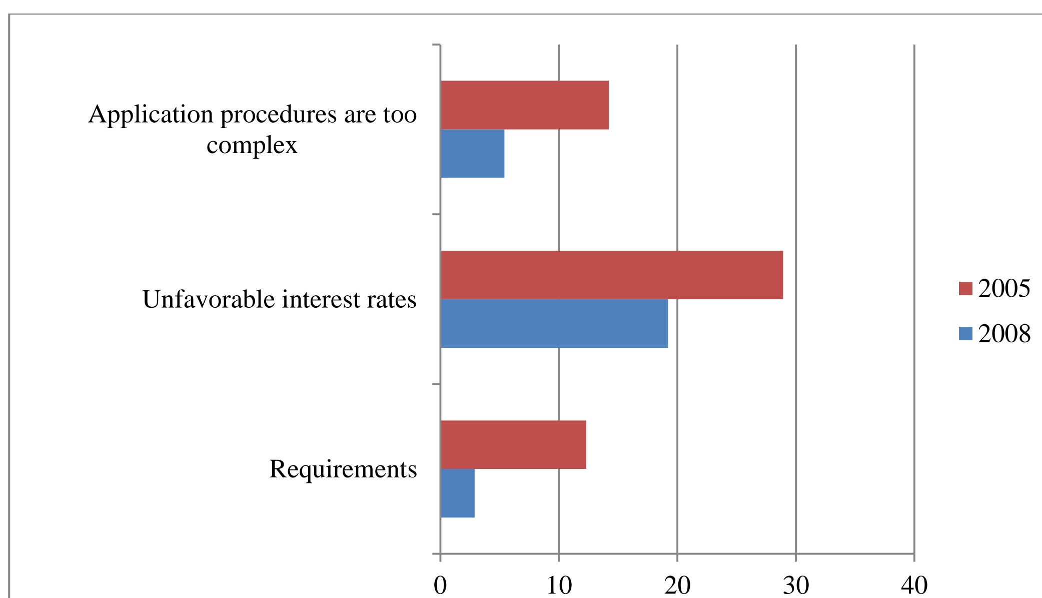
The figures bellow present the bank terms and conditions that the corporate sector defines as obstacles to get a bank loan:

Figure 11. Most Limiting Factor to Get a Loan, 2009 and 2011



Source: European Commission, *Access to Finance, Annex,* 2009, p. 234; *Results by Country* 2011.

Figure 12. Most Limiting Factor to Get a Loan, 2005 and 2008



Source: World Bank, *BEEPS at-a Glance*, 2008, p. 14.

Through all the observing period 2005-2011, the interest rate remained as the most important factor that determined access to bank loans. Other factors as managers say were the complex administration procedures, collateral requirements.

The most preferred source of financing in future will be the bank loan, having 65.4 per cent of the managers opinion, other loans (trade credit, related company, shareholders) have 7.7 per cent, and equity (including venture capital investments and business angels) by 8.7 per cent (European Commission, 2011).

2.3.2.1.2 Factoring

Factoring is a financial transaction where the company sells its receivables to a third party, the factor at a discount. The factor provides financing of the company by already agreed percentage of the purchased receivables as a factor's discount fee (commission).
Croatian financial institutions enlarged their portfolio with factoring as a service by regulation in 2005. These are the results for period 2007-2010:

Table 1. Amount of Factoring in Croatia 2007-2010 in HRK (in millions)

Year	Total factoring	Domestic factoring	Export factoring	Import factoring
2007	1.430	1.308	42	79
2008	2.162.	2.019	44	99
2009	2.000	1.922	15	62
2010	2.266	2.158	64	44

Source: HANFA, *Annual Report,* 2010, p. 124; *Annual Report,* 2008, p. 99.

Factoring in Croatia run credit institutions and institutions registered for factoring. They provide domestic, export and import factoring. Domestic factoring has dominated in the structure by 91-96 per cent within the whole period. The increase of the use of this service for 37 per cent during crises period indicates that companies find benefits to use it in the financial policy. The forecast is that this service will take greater market share for financing corporate sector in future.

2.3.2.2 Equity financing

As mentioned above, the external sources of financing in Croatia are the debt sources. Equity sources are in the startup phase and the only sources of this kind are funds from the Croatian business angels' network.

Croatian business angels' network is CRANE. Companies or persons can apply for grant by sending project to the contacts on the web site www.crane.hr. It is not a financial institution and it only connects the owner of the project and the business angel.

CRANE has professional team that periodically analyzes the received projects and evaluates them by internal criteria. The team analyzes only the project having all the requested information including financial analysis or feasibility study. CRANE replies to all submitted projects no matter they are denied or selected to be further analyzed. The selection is done by each member of the CRANE team by marking the projects with stars from one to four giving short comment for the mark. If the CRANE team finds the project interesting, they invite the owner to show case event in order to present additional information and explanation for the idea. Further investments in projects do not relate to CRANE anymore. It sets to be a business relation between the project holder and the investor, business angel.

In most of the cases, the CRANE business angels invest EURO 20,000-100,000 per project. The amount is not limited and even few business angels can make joint venture for one project. Until now, CRANE business angels have invested in nine projects in total amount of EURO 700.000,00.

3 CORPORATE FINANCING IN MACEDONIA

3.1 Volume of corporate financing in Macedonia

Macedonia as a part of the Southeastern Europe has undergone the transitional process in the last twenty years. During this period, Macedonia faced with major political and economical situations, such as embargos, increased unemployment, hyperinflation, civil war, giving a picture of unwanted destination for domestic and international investments. In the 90's, the country rejoined the international community, including international financial institutions, which were crucial for a young country and for the economy to enter in the international flows. The reforms in each segment have created potential and opportunity for a stable and rapid economic growth; strengthened by legal regulations and establishing functional financial, institutional, legal and political system.

Within the transition process, private companies have overtaken the state company's position in the economy. Economic growth in market plan economies has led to the private companies. In the beginning of the transitional process, financial support to the companies from external sources has had a minor role. Financial institutions have started to create a quality portfolio not based on speculative information and projects as in the past when they financed state companies. New established corporate sector recognized that external sources of financing could be used for evaluation of their projects. The development of corporate sector, its need to invest in new plants, renewing and enlarging of the existed facilities, financing of daily business operations appears to be an increased trend of financing supporting the same.

In the surveying period from 2006 to 2010, volume of the corporate financing indicated positive trend. It positively correlated to the increased rate of economic development, measured by the GDP. The table below shows the volume of corporate financing and rates of GDP for Macedonia in the surveyed period:

Table 2. Volume of Corporate Financing in Macedonia, 2006-2009

Year	2006	2007	2008	2009
GDP growth (in per cent)	5.0	6.1	5.0	-0.9
Volume of corporate financing (in million EUR)	13.413	14.988	16.688	17.963
Growth rate of the volume of corporate financing (in per cent)	0	11.7	10.20	7.6

*Note.** Volume of corporate financing relies on information on corporate balance sheet, by calculations of NBRM based on information from the Central Register of Macedonia.

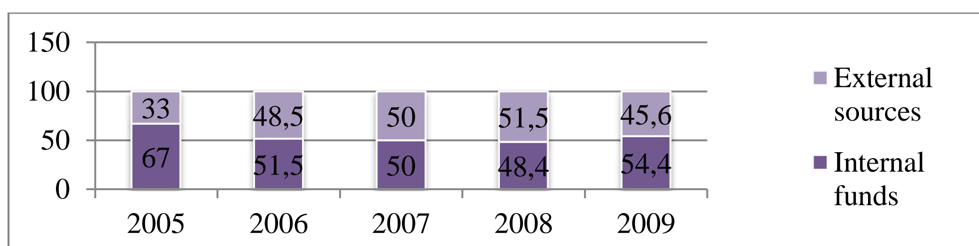
Source: Eurostat, *Real GDP Growth Rate-Volume, Percentage Change on Previous Year*, 2011; National Bank of Macedonia, *Annual Report for Financial Stability in Macedonia*, 2009, p. 36.

Corporate sector financing has rapid rates of increased volume for the period 2006-2008. This trend is based on increased financing of working capital and investments in new facilities or extension of the existing capacities. The influence of the financial crises had its first signals in the fourth quarter of 2008 when domestic economy reached its boom. Financial institutions started to follow the global trend by strengthening the conditions and implementing more conservative financial policy, which effected to decrease volume of financing in the corporate sector. These measures based on predictions for the economical situation in Macedonia, estimated lasting of the financial crises, increased demand of collaterals; worsened expectations of the economic activity, strengthened monetary policy, increased cost and availability of the sources of financing and worse expectations of servicing obligation of the companies. This situation could be seen mostly in the first half of 2009.

3.2 Structure of corporate financing

The structure of corporate financing in Macedonia in the period 2002 – 2009 is presented in the figure below:

Figure 13. Structure of Corporate Financing, 2005-2009



*Note.** For 2002 and 2005, the results are used from the search BEEPS. For the period 2006-2009, volume of corporate financing relies on information on corporate balance sheet, by calculations of NBRM based on information from the Central Register of Macedonia.

Source: World Bank, *Macedonia BEEPS at-a Glance,* 2006, p. 11; National Bank of Macedonia, Annual *Report for Financial Ability in Macedonia*, 2009, p. 36.

Corporate sector has used its internal funds to finance its business operations by 50 per cent in the total volume of financing. High level of capital provides higher level of financial stability of the sector, making it less sensitive to unpredictable external impacts that can affect its liquidity position or indirectly to its credit ability. The companies' position affects the stability of the financial system having the influence upon the level of credit risk to all financial institutions in Macedonia.

Bank loans, trading credits and leasing have become the most favorable external sources of financing in comparison with the financial market that has played minor role especially in financing of the sector.

Banking sector had major role for financing companies in the period 2006-2009. Banks availability to finance companies relied on stability and safety of the banking system in Macedonia and stability of its available sources of financing. In December 2011, index credits/deposits went up to 90 per cent. This index signalized that banks has potential to increase their credit activities. On the other hand, banks took the rate of risk into consideration by macroeconomic stability and liquidity position of the companies as a base for further dynamics of crediting (the National Bank of Macedonia, 2012, p. 53).

Accounts payable are important external financial sources to Macedonian companies through the period 2006-2010. This source of financing is based on companies with well-established trading relations. Companies find this source more available since domestic and foreign partners submit insurance for them. If the company has good financial position, domestic and international insurance companies insure the liabilities. This source of financing does not claim any costs for domestic companies since partners cover all the fees and provisions for the service they use. In other cases, depending on the contract, it

patterns with low interest rates in comparison with costs of other external sources on the market. This source of financing is mostly of short term, meaning that companies use it to finance its current business operations.

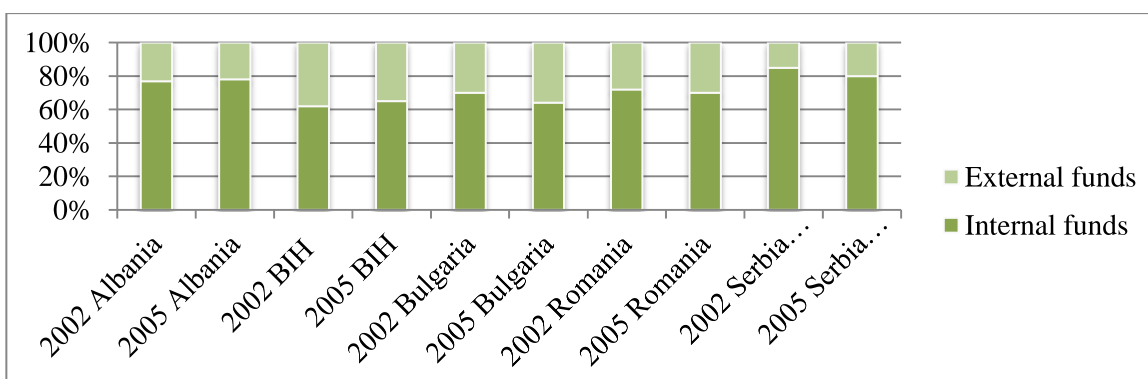
The segment of lease was the fastest developing segment in financial sector in Macedonia in the period 2005-2008. Its negative trend of working started in 2009 caused by the financial crisis. Leasing companies strengthened the financing conditions by increasing the interest rates and participating amount of the client. Results of the working were decreased amount and number of active contracts. This segment was additionally hit by change in legislation allowing import of used cars in Macedonia. Leasing companies did not expand their product portfolio through the years. The segment is still focused on the ordinary products, especially on new contracts for vehicles.

Financing through issuing stocks and bonds or equity, has minor role in the total volume of financing the corporate sector. More information for this source of financing is noted in part 4.4 of the thesis.

3.3 Comparative analysis of external funding sources for the corporate sector in Macedonia vis-à-vis the EU and SEE

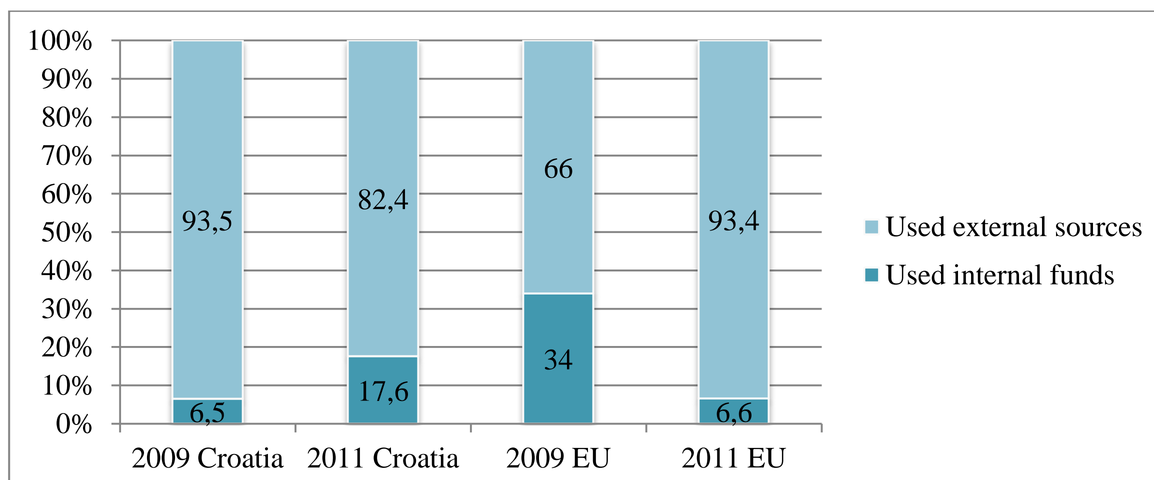
The analysis in this chapter is based on data and analysis presented in part 2 and in chapter 3.2. The main objective of this sub-chapter is to compare the use of external sources for corporate financing in Macedonia with those ones in the EU and in SEE countries. The analysis is based on figure 3.1 that presents the data for Macedonia for the period 2005-2009 on one hand and on the other hand, the data for SEE counties for period 2002-2005 and the EU and Croatia for the period 2009-2011.

Figure 14. Proportion of Used Sources of Finance in SEE, 2002-2005



Source: Yes Foundation, *Bringing the Gap, Access to Risk Finance for Early-Stage SMEs in SEE,* 2009, p. 33-44.

Figure 15. Proportion of Used Sources of Finance in Croatia and EU, 2002-2005



Source: European Commission, *Access to Finance, Analytical Report,* 2009, p. 29; *SMEs' Access to Finance, Survey 2011, Analytical Report,* 2011, p. 16.

Even though the figures include data from different sources and for a decade period of time, it gives a clear picture of external sources observed by the corporate sector in the countries.

Croatia and the EU corporate financing structure are presented for the period 2009-2011, when the economies recovered from the financial crises. This period is characterized by low level of use of the internal and high level of use of external funds compared to the SEE countries and Macedonia. In 2011, the level of used internal funds decreased as a result of negative spillover of the financial crises to the real sector, decreasing the growth of countries and companies and without precise expectations for the crises length, the earnings and financing by the internal funds were additionally affected. On the other hand, the strengthened credit policy by the financial institutions and decreased access to finance to the companies, especially of the traditionally external sources of financing, forced the companies to find other sources of finance than the traditional ones. The surveys present that the companies changed the use of the internal funds to external ones, putting an accent to the increased use of equity financing sources, venture investments. This is especially case for the EU countries, since only 3 per cent of the companies used the equity funds in 2009, and 7 per cent in 2011.

The proportion between the internal and external funds relied on several characteristics that the EU and Croatian markets had had before the crises: economic growth and direct relation to the world economic growth, easy liquidity conditions provided by the financial sectors and international financial institutions as well as rapid development of financial sectors supported the domestic demand. Other characteristics are that these countries have

developed financial system on much higher level than the financial system in SEE and Macedonia. Developed and well-structured financial system allows the companies better access to the financial sources and their availability, no matter if they are debt or equity funds resulting with high proportion of use in the total financial sources on corporate level. In 2009, 93.5 per cent of the external funds were used by companies in Croatia, and 82.4 percent in 2011, while in EU 82.4 per cent in 2009 and 93.4 per cent in 2011.

In comparison with Macedonia, more than a half of the companies used the internal sources to finance its business. During the period 2005-2009, companies started to reduce the reliance on internal funds, increasing the use of bank loans and other forms of formal borrowing, such as equity and trade credit as a source of financing. In period 2006-2009, the use of internal funds remained to 50 per cent, which is much higher than 6.5 per cent in Croatia and 34 per cent in the EU. It is a result of the slow transitional period of twenty years resulting with lazy positive trend of the economy and reforms that reflected to the overall functioning of the legal, economical and institutional system. In this situation, most of the companies found the only way to finance themselves through well managing with its own funds and hardly use the poor offer of external sources. The increased use of formal external sources in spite of the informal ones explains that the regulatory framework and the reforms in these countries have strengthened the position of the financial institutions and its credit related information. The same situation was in the SEE countries. The SEE average of used internal funds was 71 per cent in 2002 and 69 per cent in 2005. In the same period, the percentage of used formal borrowing increased from 12 per cent in 2002 to 18 percent in 2005 while the informal borrowing decreased from 7 per cent in 2002 to 3 percent in 2005.

4 SOURCES OF EXTERNAL CORPORATE FINANCING IN MACEDONIA

Financial system in Macedonia is bank-oriented. Bank assets present 88-90.5 per cent of the total assets in the financial sector for the period 2006-2010. The rest of the assets remain to leasing, pension fund, and insurance sector. Financial system in Macedonia has absence of financial institutions that offer various ranges of complex financial products. It patterns with low level of financial intermediation and only offers ordinary financial instruments. The connection between the segments in the system is presented through capital investments of banks in other financial institutions. Banks as a dominant sector are the base for stability of the financial system. This part of the thesis concentrates on the analysis of bank loans, but it also discusses all other important external sources of corporate financing in Macedonia, such as leasing, factoring and financial market.

4.1 Bank loans

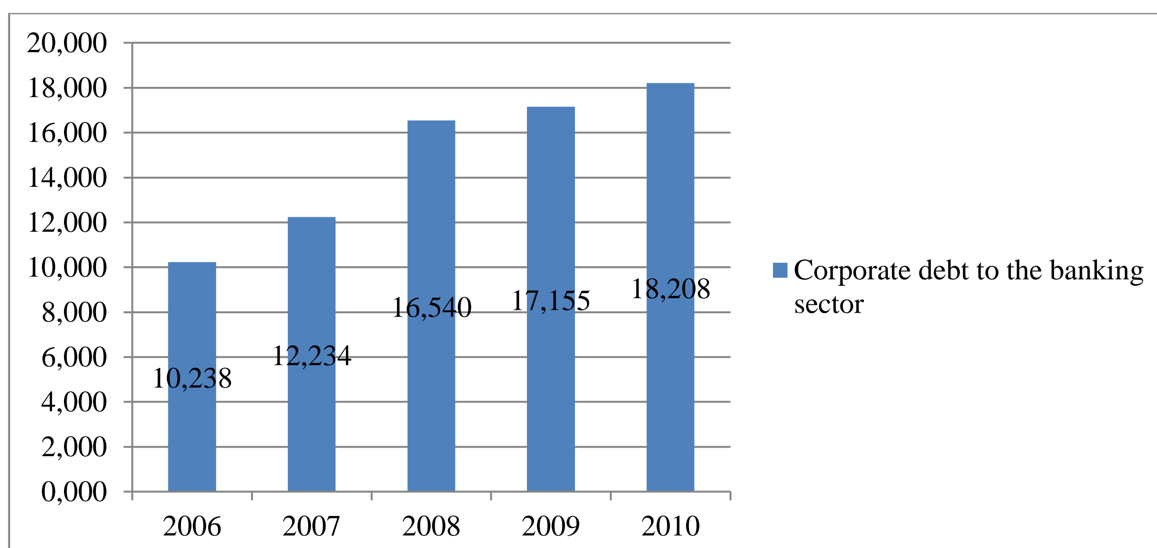
This part of the thesis focuses on the bank loans provided by the commercial banks in Macedonia and the bank loans that the Macedonian bank for development promotion channels through the commercial banks to the final users, the companies. It gives overview to the terms and conditions of the bank loans.

4.1.1 Commercial bank loans

The volume of bank financing positively relates to the economic growth and companies' needs for finances. Economic activity and international trade operations of the corporate sector increased and resulted with higher need to finance the business in 2010. More stable domestic, regional and global macroeconomic ambient stimulates optimism and expectations in banking and corporate working. In 2010, banks increased the volume of approved bank loans by 6.8 per cent (or EUR 1.053 million) compared to 2009.

The volume of Macedonian corporate debt to the banking sector in the period 2006-2010 is presented in the figure below:

Figure 16. Corporate Debt to the Banking Sector in Period 2006-2010 (in Millions EUR)



Source: National Bank of Macedonia, *Annual Report for Financial Stability in Macedonia*, 2010, p. 49.

Corporate debt to the banks obtains credits, interest rates and other liabilities. More than 98 per cent of the total debt is the debt as a result of bank loans, including the bank loans from international financial institutions provided through commercial banks to the corporate sector. These loans are negotiated by the Macedonian bank for promotion of development, further explained in part 4.1.2.

Banks strengthened the credit terms and conditions at end of 2008. In the last two years, banks have focused on to create and retain quality credit portfolio. In 2010, banks approved higher amount of new loans in comparison with 2009. One of the reasons is decreased average annual interest rate by 0.3 per cent in 2010 compared to the average of interest rates to new approved loans in 2009. Decrease of the interest rates relates to the low level of EURIBOR on the EU financial market and decrease of the basic rate by the National Bank of Macedonia. Banks only followed the market signals and did not make significant changes in relaxing the credit policy.

In 2010, 71.4 per cent to 87 per cent of the companies (depending on the sector) had bank loans with flexible interest rates. This means that the corporate sector is highly exposed to interest rate risk, which can indirectly affect the banks stability. In 2010, 85.4 per cent of the bank loans were foreign currency-dominated loans, exposing the corporate sector to high value risk (the National Bank of Macedonia, 2010, p. 45).

Average payment period increased by 0.1 per cent per year and it was 2.6 per cent in 2010. Long-term bank loans presented 83.1 per cent in the total amount of new approved in 2010. It was a result of applied projects for investments in existing or new capacities. Short-term bank loans remained on the same level as in 2009 that come to the conclusion that companies only renewed the existing contracts for short term financing which was important for daily functioning of the companies (the National Bank of Macedonia, 2010, p. 49).

Banks evidently worsen servicing of bank obligations by 2.4 per cent or EUR 19.5 million in principal payment in 2010 in comparison with 2009. The probability of default in payment increased by 0.5 per cent in 2010. Non-functional and risky loans marked by “B,” “C”; “D” decreased which was a result of writings off that the banks made during 2010 and activating mortgages to pay the receivables. The amount of mortgages increased to EUR 1.79 million until September 2011, compared to EUR 1 million in 2010 (increased rate of 80 per cent) (Kapital, 2012).

The balance off debt includes future liabilities that companies have towards other creditors or suppliers. It increased by 15.5 per cent or EUR 55 million in 2010 compared to 2009. More than 90 per cent of the total amount refers to letter of credits and bank guarantees to the clients from industry (mostly manufacturing industry), then construction and trade industry.

4.1.2 Credits from the Macedonian bank for development promotion

The Macedonian bank for development promotion is the only one development bank in the Republic of Macedonia. The bank negotiates with international financial institutions for credit lines and provides them through commercial banks to the final users, the companies. The Macedonian bank has significant role to insure credit lines with payment and interest rate conditions in order to facilitate the access to finances of the companies to the commercial banks. This means that companies sign contracts with the commercial bank they choose, while the commercial banks have payment obligations to the Macedonian bank. The Macedonian bank for development promotion obtains credit activities and by using its own sources of financing (using the same distribution channels to the companies), besides the sources of international financial institutions and bilateral credits.

The bank loans conditions and terms are presented in the continuation of this chapter.

4.1.2.1 Credit lines from own sources

4.1.2.1.1 Credit line for trade SME

The credit line for trade SME can use new or established trade SME. Main aims of the credit line are to improve the competitive advantage of the companies and creating new working places. Companies can use the credit line to supply fixed and working capital, on condition that 50 per cent from the amount of the credit line are to be used for fixed assets. Companies that provide technology development and increase working places have priority to be financed.

4.1.2.1.2 Credit line for financing production for export

This credit line is used by companies to finance the working capital. The credit lines will be approved on the amount of inflow of export. The aim is to support the export and to effect the structure of trade and payment of balance of the Republic of Macedonia. The interest rate of the credit line was 7 per cent in 2010 (it was 8 per cent in 2009).

4.1.2.1.3 Credit line for fixed capital

The credit line is in an addition to the revolving fund of Bilateral credit line from Italy (explained further on in the text under point 4.1.2.2.2). It is designed for SME to finance fixed capital according to their business operations. In 2010, two applications for credit were approved amounting to EUR 60.000,00.

Table 3. Credit Lines from Own Sources of MBDP in 2010

Type of credit line	Amount per project (in EUR)	Repayment period	Interest rate	Number of approved applications	Volume of credit approved
Credit line for trade SME	from 15.000 to 500.000	to 8 years, including grace period to 1 year	8 per cent per year	14	2.337.000
Credit line to finance production for export	from 30.000 to 2.000.000	to 1 year no grace period	7 per cent per year -0.5 per cent	4	1.606.950
Credit line for fixed capital	from 30.000 to 300.000	to 3 years no grace period	8 per cent per year	2	60.000
Total					4.003.950

Note.*-0.5 if the Macedonian bank for development promotion insures the export
Note.** The amount of insured export receivables was EUR 5.5 milion in 2010

Source: National Bank of Macedonia , *Annual Report for MBDP,* 2010, p. 19.

According to the sector structure, 46 per cent of the approved credit line go to food processing industry, 26 per cent to the rest of the processing industry, 13 per cent to services, 9 per cent to furniture production and 3 per cent to transport and construction.

The amount of approved credit lines in 2010 decreased by 72 per cent in comparison with 2009. The main reason was the new approved credit line of the EUROpean Investment Bank (further mentioned as EIB) to the amount of EUR 100 million. These assets were allocated to the companies through comercial banks, having 5.5 per cent fixed interest rate and longer repayment period for financing of fixed and working capital.

4.1.2.2 International financial institutions credit lines

4.1.2.2.1 The European Investment Bank (EIB) credit line

Credit line of the EIB was EUR 100 milion for Macedonia in 2010. These credits were considered to be used for financing fixed and working capital of the corporate sector. The bank allocated this credit line to the corporate sector through the three credit programs, namely investment credits, credits for fixed assets and credits for priority projects. Main characteristics of each of the credit schemes is presented below:

Table 4. Investment Credits from EIB

Amount of each approved credit	Credits to micro companies up to 45.000 EUR
	Credits to small companies up to 450.000 EUR
	Credits to medium companies up to 3.500.000 EUR
Repayment period:	to 5 years
Included grace period	to 1 year
Purpose:	Support of selected projects for financing:
	Capital goods
	Real estate (except land)
	Equipment
	Woking capital (no more than 30 per cent of the amount of the credit)
	Investments in intangible property (costs related to planning , evaluating , research and development)

Source: Macedonian Bank for Development and Promotion , *Annual Report for MBDP,*2010, pp. 24-25.

Table 5. Credits for Fixed Assets from EIB

Amount of each approved credit	Credits to micro companies up to 20.000 EUR
	Credits to small companies up to 200.000 EUR
	Credits to medium companies up to 666.700 EUR
Repayment period:	2-3 years
Included grace period	to 6 months
Purpose:	Supporting permanent increase of needs for working capital in conditions of the company business activities expansion

Source: Macedonian Bank for Development and Promotion *Annual Report for MBDP,*2010, p. 25.

Table 6. Credits for Priority Projects from EIB

Amount of each approved credit	to 12.500.000 EUR
Repayment period:	to 15 years
Included grace period	to 3 years
Purpose:	Financing of priority projects in iindustry, education, culture, environment, est.

Source: Macedonian Bank for Development and Promotion , *Annual Report for MBDP,* 2010, p. 25.

First installment of this credit line was withdrawn in the amount of EUR 12.465.771 for financing 35 projects at the end of 2009 and five instalments were withdrawn in total amount of EUR 52.552.157 for 234 projects in 2010. The number of companies that applied for the credit line increased in 2010. It was a result of the decreased interest rate from 6 per cent to 5.5 per cent annualy. Summary, EUR 65.017.928 were withdrawn and 72 per cent of the amount was used to finance investment projects while 28 per cent for fixed and working capital.

4.1.2.2.2 Bilateral credit line from Italy

This is a bilateral credit line between Italy and Macedonia. The contract was signed to the amount of EUR 12.7 million in 1999. The credit line financed companies for purchasing equipment, machines and technology from Italian origin for new facilities, modernization and finishing technology processes, removing the bottle neck. The credits were allocated to the corporate sector through commercial banks. The assets of this credit line have been used on the whole. Revolving fund established the paid amount to finance fixed and working capital, having repayment period of three years. In 2010, two credit applications for revolving fund amounting to EUR 112.500 were approved. The total amount of approved assets by the credit line and revolving fund made EUR 4.761.450 (The Macedonian Bank for Development promotion, 2011 , p. 27).

4.1.2.2.3 Agriculture credit discount fund

The assets of this fund provide the Instrument for Pre-Accession Assistance (further mentioned IPA), EIB and PSDL. The fund is active from October 2003 until 31.12.2010.The credit line was supported by the Ministry of Finance (MF), and starting from 01.07.2010, MBPD continued to support this credit line. MBDP included two commercial banks more just to make the access to finance easier for the companies.

Structure by credit applications shows that 94 per cent of total number is to the amount of EUR 100.000, 5 per cent of credits for SME for manufacturing industry make 300.000 and 1 per cent to the amount of EUR 200.000 for export-oriented companies. Value structure shows that credits for primary production have EUR 28.6 million or 58 per cent of allocated credits. Second, 38 per cent or 18.8 million have been allocated to the food processing companies, and 4 per cent or EUR 2.3 million to companies export-oriented.

Compared to the previous period, 2010 patterns with strengthened credit criteria from all commercial banks in general affected the small accepted credit applications and approved amount, as well.

Table 7. Approved Credits by Agriculture Credit Discount Fund

Year	2003	2004	2005	2006	2007	2008	2009	2010	total
Number of approved credits	18	400	761	1.131	435	1.183	513	391	4.832
Amount of credits in million EUR	0,3	2,1	2,6	4,5	2,0	12,2	10,5	3,8	38,0

Source: Macedonian Bank for Development and Promotion, *Annual Report for MBDP,*2010, p. 32.

4.2 Factoring

Factoring is a service that enables selling products and services with deferred payment where the Vendor immediately receives a portion of the invoiced amount.

MBDP provides factoring directly to the final users, the companies. It buys out invoices and pays in advance 80 per cent of the amount. The bank does factoring to receivables having no longer payment than 180 days. The interest rate is 8 per cent annually. The fee is 0.33 per cent of the bought receivable, paid at once. Factoring covers realized and insured export receivables by companies having 51 per cent of private ownership. The bank treats those companies as priority that are net exporters, companies having increased export at least 5 per cent annually and companies that increase the number of employees.

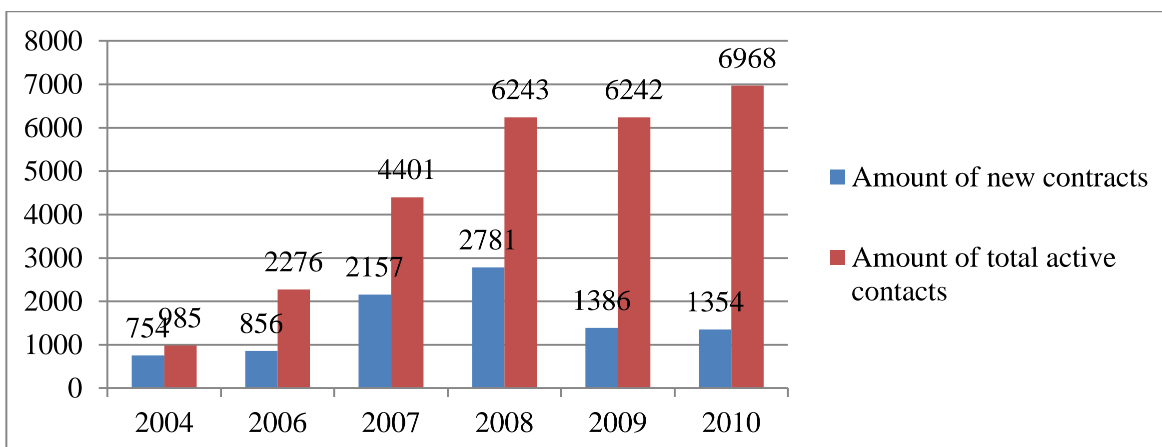
The Macedonian bank for development promotion realized the first export-factoring contract in December 2011. In the first three months of working, the bank makes export

factoring to eight export companies in wine production, confectionaries and chemical industry. For this short period, the bank supported exports towards: Poland (to the amount of EUR 26.906,21), Romania (EUR 34.245,37), Bosnia and Herzegovina (EUR 57.086,37), Germany (EUR 143.313,70), Croatia (EUR 147.751,00). Potential export countries are Albania and Serbia. It enables the export companies to access to finance without additional guarantees and collateral.

4.3 Leasing

Leasing was the fastest growing segment in the Macedonian financial system in period of 2004-2008. Growth of this segment negatively affected by changes in legislation: allowed import of used cars on one hand, and increased interest rates and participation of the lessee, on the other hand. These factors lead to decreased number and volume of new leasing contracts. Difficulty in payment and undeveloped secondary market for selling leasing goods caused additional pressure on the negative trend.

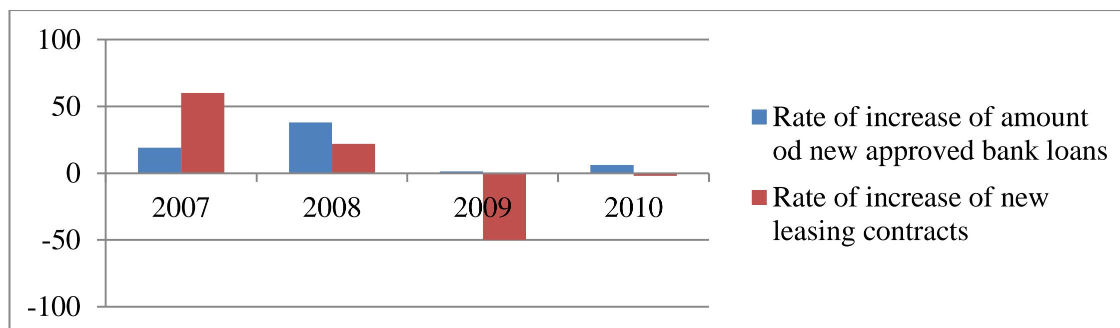
Figure 17. Amount of New Contracts and Total Active Contracts for Period 2004-2010



Source: Securities and Exchange Commission, *Annual Report for Securities and Exchange Commission*, 2006, p. 102; *Annual Report for Securities and Exchange Commission,* 2007, p. 113; *Annual Report for Securities and Exchange Commission*, 2008, p. 140; *Annual Report for Securities and Exchange Commission*, 2010, p. 155.

The period 2008-2010 characterizes the trend of higher increase of new bank loan contracts VS the new leasing contracts. As a result of not paid obligations by the lessees, the number of canceled contracts increased from 131 in 2009 to 242 contracts in 2010. The payment risk affected the quality of credit portfolio of the lease segment, setting higher criteria and interest rates for new signed leasing contracts. The negative trend of activity of the leasing sector continued in 2009 and 2010, having slower recovery compared to the banking sector activity.

Figure 18. Rate of Increase of New Leasing Contracts VS New Approved Bank Loans, 2007-2010



Source: National Bank of Macedonia, *Annual Report for Financial Stability in Macedonia*, 2010, p. 153.

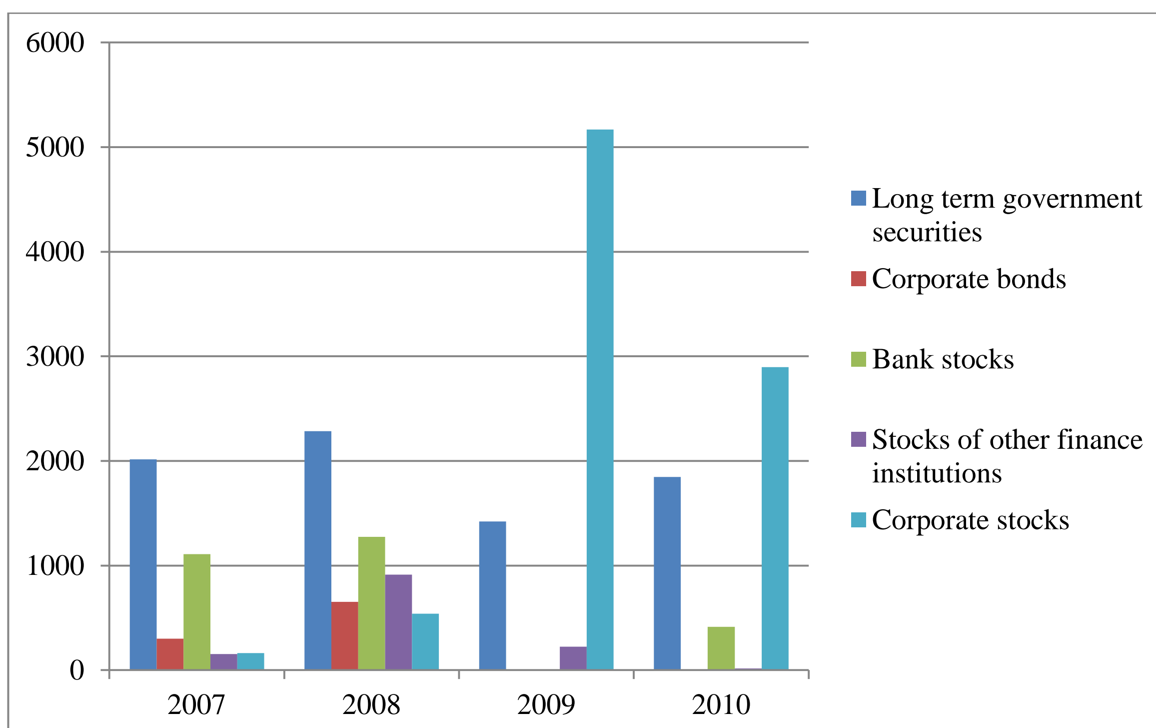
Leasing sector does not offer various range of services. The most used service is leasing of vehicles. Companies are dominant users of the leasing services. Corporate sector had 69.5 per cent of the amount of new signed contracts in 2008, 66 per cent in 2009 and 73 per cent in 2010. Value of new contracts signed by companies has opposite trend on the new approved bank loans. 51.1 per cent of the new approved bank loans in 2010 were used by persons, while in leasing sector, companies effected increase of new signed contracts (The National Bank of Macedonia, 2010, p. 154).Average term of the leasing contracts is 5 years. It affects higher risks and uncertainty to the leasing sector. However, in case of continuous negative trend, these kinds of contracts will affect sustainable leasing acting. Leasing sector does not relate to the banking sector as dominant segment in the financial system in Macedonia. Leasing sector depends on stability and functioning of the insurance sector since all objects of leasing are insured. Law regulation makes difficulty to leasing companies as a result of double taxes. Meaning, a leasing company pays all the taxes including VAT by purchasing the object on leasing for its own purpose. The lessee pays the same taxes by signing the contract.

4.4 Financial market instruments

Financing through stock of exchange by issuing stocks or bonds is an alternative external source of financing of the corporate sector. The importance of issuing new stocks or bonds is to create financial pool to financial future business plans or daily operations. This move let the company finances its development, strengthen its market position, and create working places, providing the economy benefit of its working. Companies that have not reached this level of awareness find easier way to finance themselves through bank loans.

The structure of the primary market issuance securities shows the presence of corporate sector on the figure below:

Figure 19. Structure of Primary Market Securities by Amount



Source: National Bank of Macedonia, *Annual Report for Financial Stability in Macedonia*, 2008, p 162; *Annual Report for Financial Stability in Macedonia*, 2010, p. 69.

The further analysis is focused on corporate stocks and bonds.

4.4.1 Corporate stocks

The following table shows the number of approvals and value of new issues of stocks of the corporate sector in the period 2007-2010:

Table 8. Number of Approvals and Value of New Issuing in the Corporate Sector, 2007-2010

	Type of issues	Number of approvals for new issuing of stocks	Value of new issuing of stocks (in million MKD)
2007	Private offer	1	163,72
2008	Private offer	2	708,98
2009	Private offer	3	5.169,00
2010	Private offer	1	2.896,84

Source: Securities and Exchange Commission, *Annual Report for Securities and Exchange Commission*, 2008, p. 11; *Annual Report for Securities and Exchange Commission*, 2010, p. 12.

During the observing period 2007-2010, the number of approvals for new issuing of stocks was between 1 to 3 per year. In 2007, company issued the private offer in order to sell shares to two limited liability companies to merge (Security and Exchange Commission, 2007, p. 15). In 2008, two companies issued stocks, AD Beton and Tikves. In 2009 and 2010, the number of approved issues and value were result of issuing stocks on the Macedonian stock exchange by companies that turned their obligations - taxes into debt to the Republic of Macedonia. During 2010, the Security and Exchange Commission approved one (1) issue of stocks to a liability company from the economy. Issuer of the stocks was the Joint Stock Company Organic Chemical Industry Naum Naumovski Borce (OHIS) which issue for new stocks was conducted in order to transform the receivables of the Republic of Macedonia on the base of public taxes and dues as permanent deposit in the company.

4.4.2 Corporate bonds

The issue of corporate bonds of the Macedonian stock exchange equals to zero issues by the corporate sector. The only entities that have issued are two banks: Procredit bank, having issue value of MKD 300 million in 2007 and NLB Tutunska Banka, having issue value of MKD 653 million in 2008.

Experts state that corporate sector does not issue bonds as a result of not having interest for this source of financing and not having expertise to promote and support it (The National Bank of Macedonia, 2010, p. 69).

Even though the Macedonian economy noted improvement in 2010, the stock exchange turnover kept decreasing. Investors postponed their activities on the Macedonian stock exchange and were restrained to overtake risks. Besides slightly increase of foreign investors, the trend of their non-presence on the Macedonian stock exchange continued in 2010. Potential of foreign investor's capabilities relates to recovery of the global economy and global financial markets, its impacts in the region and domestic economy, positive results of domestic companies and achievement of higher outputs of investing in domestic securities. Resident persons have significant part of the total turnover. Their investment decisions are based on economic logics, meaning they follow the signals of MBI 10 to buy and sell. The last quarter of 2010 and the beginning of 2011 was an exception. This category of buyers and sellers patterns with short investment horizons relates to information of joining the EU and NATO.

Concentration ratio of stock exchange turnover of the five/ten most traded stocks presents the offer limitation of different type of securities and other financial instruments that positively effect on market liquidity and buying and selling of securities. In 2008, the turnover with the five most traded shares was 63.3 per cent of the stock exchange turnover,

then 74.3 per cent in 2009 and 81.5 per cent in 2010. The turnover with the ten most traded shares was 86.9 per cent in 2008, 91.9 per cent in 2009, and 93 per cent in 2010 (The National Bank of Macedonia, 2010, p. 74).

The number of new approvals for issuing shares does not relate to the interest of the corporate sector to finance its business operations through capital market. Even though bank interest rates are high to meet companies' financial needs, companies still prefer this source of financing.

The difference in the capital costs explains that managers do not have basic knowledge of financial markets and the link between capital cost and interest rates in the market economy. Most of the companies do not have ability to estimate the conditions that effect IPO or PO because of lack of knowledge and education. Major role plays the fear that the Macedonian managers have overtaken a company by issuing additional stocks or bonds on the market.

The data that 93 per cent of the stock exchange turnover is based on 10 liquid stocks explains that MSE has only 10 companies well positioned on the market and financially stable that is attractive for investment. MSE needs to attract new companies to be present in order to offer diversified portfolio to domestic and foreign investors. The MSE should take the following steps:

- To stimulate limited companies to transform into joint venture companies and to offer new shares on the market
- To encourage companies to be more transparent and to create awareness to the investor in public and the shareholders should be informed for the company's financial and market position
- To invest in promotion of the possibilities in MSE financing
- To start activities to educate managers in MSE financing
- To start activities to create managers' awareness for alternative sources of financing.

The effects of appearance of new companies diversify portfolio to domestic and foreign investors and make the companies more attractive to invest in. It additionally affects the decrease of interest rate level since companies find alternative financial sources to the bank loan and bank dependence on loan availability.

Following the global trends, it is more than obvious that the capital liberalization will happen to the MSE. Even though it seems to be too far in the future, the idea for regional connectivity of the Balkan stock exchange exists for a certain period and waits for a suitable moment to be realized. The pool of different shares will attract foreign investors to

the region, and will additionally encourage the companies to finance the business using the stock of exchange.

4.5 Business angels

I2B is the first official business angel's network in Macedonia. The network was established by The Competitiveness Project by USAID in March 2011. In the first year of acting, the network had two innovation dinners where the chosen ideas were elaborated in front of the potential investors. Until the moment of submitting the thesis, there are no official data of realized investments or number of supported projects by the Macedonian business angels.

Balkan Unlimited is a non-profit-making foundation that holds the Balkan Forum on 18th and 19 April 2012 in Skopje. This foundation supports innovation and entrepreneurship in the Balkans, promotes economical and cultural connections in the Balkans and encourages the accumulated joint potential to accumulate in new projects. This foundation relates to business angles networks in the Balkans, business incubators, The European Investment Fund, educational institutions, and the USAID. Companies that present the projects are elected by products and/or services offered, are innovative, technologically advanced, of better quality or lower price or somehow have distinct competitive advantages; company's team has the necessary skills and experience to grow the business; the company has clearly identified the type of partnership and/or investment that they are looking for. The effects of this forum and network will be oriented in future approving its existence.

CONCLUSION

Sources of financing of the corporate sector are divided into internal and external sources. Internal sources include the working capital and the retained earnings of the daily working. External sources can be debt or equity. The debt sources are bank loans, corporate bonds, leasing, factoring. Equity sources are venture investments and business angels.

The main objective of this thesis has been to make an analysis of the corporate sector financing in Macedonia of its overall structure consisting of both internal and external sources and of specific characteristics of its external funding sources. This thesis gives an overview of the structure of internal and external sources of financing that are used by corporate sector in the EU and the SEE. The comparison with EU and Croatian companies is presented in the table below:

Table 9. Use of Internal and External Funds in Croatia, EU and Macedonia in 2009

Year 2009	EU	Croatia	Macedonia
Use of internal funds (in percentage)	6.5	34	54.4
Use of external funds (in percentage)	93.5	66	45.6

Source: World Bank, *Macedonia BEEPS at-a Glance,* 2006, p. 11; National Bank of Macedonia, *Annual Report for Financial Stability in Macedonia*, 2009, p. 36; European Commission, *Access to Finance, Analytical Report,* 2009, p. 29; *SMEs' Access to Finance, Survey 2011, Analytical Report,* 2011, p. 16.

Macedonian companies rely on formal external sources, such as bank loans, leasing, and equity. It was explained by the more developed financial system and the easier access and higher availability of external funds. The Macedonian and SEE structure of sources find similarity because companies mostly use internal sources, and then increase the use of formal sources than informal, as a result of regulatory framework and the reforms that strengthen the position of the financial institutions and its credit related information in these countries.

The hypothesis this thesis has aimed to test is that bank loans are by far the most important source of external corporate financing in Macedonia. The hypothesis relies on the volume of the loans channeled to the corporate sector as well as the bank conditions and terms of the loans. It also analyzes the role of the Macedonian bank for development promotion. This bank represents a link between the international financial institutions and commercial banks in Macedonia for channeling loans to the final users, the companies. The hypothesis has been strongly confirmed through the analysis. Companies, indeed, mostly rely on the bank loans making it number one of external financial source. This position is strengthened by the Macedonian bank for development promotion, which makes the access to finance easier because supports the corporate sector with bank loans having attractive interest rates and payment period. The Macedonian bank should consider offering options to the Macedonian companies not only in the range of crediting such as to provide seed finance and consulting to startup companies. Creating business incubator can increase the number of surviving companies in the first few years. The business incubators should be established in few different towns in Macedonia, to provide total treatment of possible brilliant projects.

All other external funding sources are of a minor importance in Macedonia. Macedonian companies do not apply leasing, insurance of ordinary and preferred stocks, and corporate bonds as important sources of their external financing. As far as leasing is concerned, this

has been confirmed through an analysis of the number of new leasing contracts and the volume of leasing financing. Further on, regulatory the obstacles are also mentioned as reasons why the companies prefer bank loans over leasing services. The data present the leasing sector as marginal player in financing of corporate sector. During the crises companies rely more on financing through bank loans, which affect better recovery of the bank activity compared to the leasing sector. Law regulation of the double taxes has additional impact upon the sector, making it less attractive, especially in leasing contracts for real estate.

Companies' use of financial instruments as ordinary and preferred stocks and corporate bonds focused on why companies do not use this kind of financial instruments, what the barriers to use them more often are and what should be done to stimulate this form of external financing for it. In order to create easier access to finance the Macedonian companies, the financial system should offer wide range of financial instruments supported by different financial institutions. Financial instruments- shares and bonds will have an impact on decrease of the interest rates, competition between the financial institutions, creating new financial instruments according to characteristics of countries economy and main sectors. It will effect with diversified range of financial sources and investments for the companies and the investor in the economy. The importance of factoring can be noticed in future period, since the thesis analyzes the first three months of its use.

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