The Capital Market of Montenegro and the Prospects for its Integration into the EU

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Abstract
The purpose of the report is to analyze the current state of development and the main barriers in front of the effective functioning of the capital market of Montenegro (candidate country for EU membership) on the basis of economic analysis of quantitative and qualitative indicators. The research includes results of empirical testing of main economic factors, influencing the development of this capital market. In the course of the research are outlined the main problematic aspects in front of the Montenegro capital market in view of its future integration into EU.

Keywords: EU capital markets, integration, stock exchange development

Introduction
The regional development and adaptation of the capital markets in Southeast Europe is a slow and difficult process. Progress can be noticed in the harmonization of laws in line with EU requirements. Still the applicant countries for EU membership have introduced only local trading electronic systems on their stock exchanges, while at EU level multiple stock exchanges are in progress of deepening their consolidation. Derivatives’ trading is in an inception phase and initial public offerings are exceptions. At the same time, it is expected that the economic function of stock exchanges is to assess the expected profitability of a large number of listed companies and to evaluate the entire stream of future profits from the ownership of capital. The capital markets of these countries are still far from effective implementation of their macroeconomic functions.

Problematic factors facing the capital markets in Southeast Europe remain the limited range of financial instruments and the significant fluctuations in the price of traded financial instruments. Under
development are new financial instruments such as warrants and derivative products, but this process will be long, given the lack of clearing infrastructures for this purpose. With the start of negotiations for accession to the EU the prospects in front of Southeast European capital markets will be to initiate a comprehensive process of adaptation to the European regulatory framework.

**Data and methodology**

The methodology of the research includes analysis of integration variables on the capital market of Montenegro as compared to benchmark markets in EU (Austria) in time and in regional aspect. The time period encompasses analysis from 2004 to 2014. Amongst the integration variables are investigated the convergence/divergence in the nominal long-term government securities interest rates and in the stock exchange indices of Montenegro and Austria (according to the methodology of Baele et al., 2004). The convergence in these integration variables predetermines the applicability of the law of one price in the course of the gradual removal of legal, regulatory and institutional barriers in front of investors for an immediate change in the structure of their portfolios.

Further on the research employs multiple regression analysis of such economic indicators for the development of the capital market of Montenegro as economic activity (real growth in GDP, government debt, inflation etc.); entrepreneurial activity (R & D expenditure); depth of the capital market (market capitalization); protection of investors (legal rights index) etc. according to Table 1.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Symbol</th>
<th>Source of data</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market capitalization as % of GDP (Y)</td>
<td>Market_Cap</td>
<td>The Montenegro SE</td>
</tr>
<tr>
<td>Real GDP growth in % (X₁)</td>
<td>GDP</td>
<td>World Bank</td>
</tr>
<tr>
<td>Foreign direct investments as % of GDP (X₂)</td>
<td>FDI</td>
<td>World Bank</td>
</tr>
<tr>
<td>Real Long-Term Interest Rate (X₃) %</td>
<td>LTIR</td>
<td>World Bank</td>
</tr>
<tr>
<td>Gross R &amp; D Expenditure as % of GDP (X₄)</td>
<td>R_D expenditure</td>
<td>World Bank</td>
</tr>
<tr>
<td>Legal Rights Index (X₅)</td>
<td>LRI</td>
<td>World Bank</td>
</tr>
<tr>
<td>Interest Rates on Deposits (X₆) (%)</td>
<td>DIR</td>
<td>World Bank</td>
</tr>
<tr>
<td>Gross Savings (X₇) % of GDP</td>
<td>Gross Savings</td>
<td>World Bank</td>
</tr>
<tr>
<td>Gross Capital Formation (X₈) % of GDP</td>
<td>Gross Capital Formation</td>
<td>World Bank</td>
</tr>
<tr>
<td>External Debt as % of GDP (X₉)</td>
<td>External Debt</td>
<td>World Bank</td>
</tr>
<tr>
<td>Inflation – Consumer Prices (X₁₀) (%)</td>
<td>Inflation</td>
<td>World Bank</td>
</tr>
<tr>
<td>Lending Interest Rate (X₁₁)</td>
<td>Lending Interest Rate</td>
<td>World Bank</td>
</tr>
</tbody>
</table>

Table 1: Variables, included in the analysis and sources of data

Source: the author

The identification of the factors having the strongest influence on the Montenegrin capital market in the period 2004 – 2014 has been achieved by application of multiple regression analysis (Diaconu M. 2012).

**The current state and challenges facing the Montenegro capital market**

Montenegro Stock Exchange was founded in 1993 under the Law on currency and capital market, but the two most significant structural changes occurred in 2010 and 2013. In the first year the exchange merged with the created New Securities Exchange of Montenegro, which had already implemented an electronic trading system. This merger was undertaken due to the failure of two exchanges to operate competitively on an underdeveloped market (having 10 members to date) and is an example how this integration could be the key to the efficient functioning of the stock markets in Southeast Europe.

In 1995 the stock exchange of Montenegro aligned its activities with the Law on the stock exchange, the activities of the stock exchange and the trading agents. After receiving permission from the Federal Securities Commission of Yugoslavia in 2000, the Montenegrin Securities Commission issued a license for the establishment of a regulated market in Montenegro. In 2001 six financial institutions in Montenegro and the Association of the Business Brokers set up the New

Securities Exchange of Montenegro. During the period 1994 - 2000, the exchange traded mainly cash and short-term securities as required by applicable law. After the adoption of the Law on securities, the exchange already stated to trade debt and equity capital long-term instruments. The actual development of the capital market in Montenegro began in 2001 with the initiation of the voucher mass privatization of state enterprises.

Since 2006 the Montenegro Stock Exchange has been entirely private property as the Montenegrin Government sold its share of 5% stake in the exchange. The adopted Law on securities in 2002 regulates the conditions of issuance, public offering and trading of securities, the rights and obligations of capital market participants and the organization and the scope of authority of the Securities Commission. This commission is the main market regulator in Montenegro, established in 2000. It has the power to apply the provisions of the Law on securities, approve and supervise the public offering of securities, to license the market participants, regulate the collective investment units, as well as the mergers and acquisitions. In accordance with the Law on securities, trading in securities may be conducted only on the regulated market and therefore in Montenegro there is no over the counter market (OTC). The bond market is limited to the issuance and trading of government bonds issued by the Central Bank and the government and is characterized by insufficient levels of development.

In late 2013 the Istanbul Stock Exchange acquired 24.38% of Montenegro stock exchange, which is another step in the direction of its integration. Montenegro stock exchange is a member of the World Federation of Exchanges since 2008, the Federation of European Stock Exchanges and the Federation of Eurasian Stock Exchanges. It has concluded cooperation agreements with the stock exchanges of Vienna, Athens and with all stock exchanges of the countries of former Yugoslavia and with the International Finance Corporation. Montenegro stock exchange has also signed agreements for distribution of exchange information and data with Bloomberg, Thomson Reuters and Tenfore (Montenegro Stock Exchange, 2014).

In 2013 the total turnover of the stock exchange of Montenegro amounted to 30.77 million euros, which means a decrease of 5.81% as compared to 2012. A decline was also recorded in the average daily number of transactions: 26 in 2013, while for the previous three years this figure was respectively 29, 55 and 80 transactions. Its market capitalization marked relatively constant values in 2013 and 2014. The
main players in the stock market of Montenegro with the highest turnover and number of trades are "Crnogorski Telekom" JSC and "Crnogorski Elektroprenosni sistem", while financial institutions form a separate index - MONEX FIP. In the period January – May 2015 the market capitalization of the Montenegro stock exchange reached 3 billion while the realized turnover amounted to 18 million euro (Montenegro Stock Exchange, 2015).

The capital market in Montenegro is small and is characterized by a high degree of reaction to changes in the business environment. It is defined as an emerging market and weak form of market efficiency tests can be applied to it. In its analysis of this market Tamara Vulic et al. (2014) used three tests of market efficiency: Dickey Fuller test, Run test and Autocorrelation function test. The results show that the capital market in Montenegro is not transparent and not all the necessary information is reflected in the stock prices. Therefore, there are players who can make excess profits due to their access to more information than others. This market seems to be efficient before the financial crisis while in 2004-2007 this efficiency is explained by the privatization process since almost all public enterprises were privatized precisely in this period. In the crisis period after 2008 the total market turnover fell by 1.3 billion to EUR 712 million euros and the average annual number of transactions decreased from 504,000 to 187,000, a situation similar to the Baltic states prior to their entry into the Eurozone (Hegerty S., 2015). During this period volatility was reduced, which is associated with settled market stability. The tests confirm that in recent years this market is associated with a weak form of efficiency, while the low volatility suggests that in the near future the capital market in Montenegro is expected to remain stable and to offer low level of risk to the prospective investors.

The activities for adoption of a new law on investment funds are expected to be accelerated, which will lead to establishment of a new type of investment funds by regulating their activities in view of increasing the depth of the capital market. It is necessary to further develop the secondary market of short-term government securities, corporate bonds and IPOs. The establishment of links with other regional markets is preferable in order to increase the volume of trade and to decrease the risks of investments. Montenegro has fully implemented the international standards for financial reporting in the framework of the accounting reform to eliminate speculative activities arising from
asymmetric information flows. It is also advisable to increase the quality of reporting at the Montenegro stock exchange in view of presenting performance indicators and the level of risks assumed by listed companies. This requires the establishment of a new modern trading system that defines precisely these indicators. This stock market reports some progress in the quality of corporate management of publicly traded companies, but it is expected that steps should be taken by companies to introduce a corporate governance code. Socially responsible organizations guarantee for the stability of their business and encourage the attraction of potential investors (Bakurdgieva R., 2010).

The Financial Supervisory Commission made efforts to improve financial literacy of the population by publishing brochures on the capital market in Montenegro and information about the voluntary pension funds. It should demand greater transparency in the regular publication of financial statements by issuers, as well as information on the activities of all other participants of the capital market, to ensure stronger protection of property rights of minority shareholders and to promote the underlying principles of corporate governance (Cerovic et al, 2013).

The Stock Exchange of Montenegro uses BTS trading system, which was developed jointly with the Ljubljana Stock Exchange. It is built on Windows and has transaction processing capacity of up to 400 orders per second, thus it is suitable for smaller-sized capital markets as the Montenegrin one.

<table>
<thead>
<tr>
<th></th>
<th>Official Market (Ђ)</th>
<th>Free Market (Ђ)</th>
<th>Total (Ђ)</th>
<th>Average daily turnover (Ђ)</th>
<th>Official Market</th>
<th>Free Market</th>
<th>Total</th>
<th>Average Daily Number of Transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>13,583.806</td>
<td>40,933.751</td>
<td>54,517.557</td>
<td>219,829</td>
<td>1.824</td>
<td>17.990</td>
<td>19.814</td>
<td>80</td>
</tr>
<tr>
<td>2011</td>
<td>32,921.848</td>
<td>26,051.788</td>
<td>58,973.636</td>
<td>238,760</td>
<td>4.967</td>
<td>8.499</td>
<td>13.466</td>
<td>55</td>
</tr>
<tr>
<td>2012</td>
<td>9,402.538</td>
<td>23,266.650</td>
<td>32,669.188</td>
<td>131,730</td>
<td>2.647</td>
<td>4.555</td>
<td>7.202</td>
<td>29</td>
</tr>
<tr>
<td>2013</td>
<td>13,404.380</td>
<td>17,367.223</td>
<td>30,771.603</td>
<td>124,581</td>
<td>2.506</td>
<td>3.941</td>
<td>6.447</td>
<td>26</td>
</tr>
</tbody>
</table>

Table 2: Turnover and number of transactions on the Montenegro stock exchange, 2010-2014
Source: Montenegro Stock Exchange, www.montenegroberza.com
According to the table above for 2014 on the Montenegro stock exchange was realized a total turnover of 108 million euros, which is about 3.5 times higher than the turnover in 2013. The month with highest turnover was March, when the turnover reached 45 million euros, while the lowest turnover was realized in December, when its value stood at 1.5 million euros. Table 2 also shows that the exchange market segments of Montenegro stock exchange consist of official and free market. To be listed on the organized market, issuers must meet the following requirements:
- to be registered in the Securities Commission;
- to be registered in the Central Depository;
- their shares are fully paid in and freely transferable;
- the issuer fulfills the criteria for listing in accordance with the rules of trade of the stock exchange.

The official market is the prestigious segment of the stock exchange, and to be listed on this segment in addition to the general requirements above, the issuer must comply with the capital requirements, number of shareholders, the financial situation, the application of the governance code and the international accounting standards. This market consists of two sub-segments – list of "A" shares and list of "B" shares, primary sales and debt instruments. On the official market, there are limits regarding the evolution of the price of stocks within +/- 10%, using the continuous trading method. In 2015, the two lists included 19 share issues.

On the free market are quoted all other securities that are not included in the official market. It has the following segments:
- Free market shares;
- The shares of investment funds;
- Government Securities;
- Municipal Bonds;
- Corporate Bonds;
- Short-term Investments;
- Primary Sales;
- Special List (government securities, state funds offers, public offerings for acquisitions and takeovers);
- Sub-segment of free market.

The trading of securities on the free market is through the method of continuous execution of orders, excluding trade of instruments in the sub – segment of the free market, where the method of auction sale is used.
In the structure of turnover shares have the largest share (53% of total turnover), followed by block trades (20%), transactions with stocks in closed-end exchange traded funds and open-end exchange traded funds (21%), and bonds (6%). On the official market in 2014 are traded the shares of 22 companies and the realized turnover with shares of list "A" stood at 7.6 million euro, representing 7% of total turnover. On this market were realized 4 block transactions, which represented 4% of the total turnover achieved. In the "B" list on the official market was generated turnover of 464,668 euro (or 1% of total turnover). On the free market in 2014 were listed 90 shares issued by 39 companies and the turnover was around 12 million euro, excluding block trades, open-end exchange traded funds, closed-end exchange traded funds and bonds.

In 2014 on the Montenegro stock market were listed 5 closed-end funds and 2 open-end funds and the turnover on these two segments exceeded 6 million euro, representing 7% of total turnover on the stock exchange.

In the bond segment of free market trade in 2014 reached 57.4 million euro, or 54% of total turnover. Government securities had the largest share in turnover (81%), while the segment of corporate bonds was represented by one issue with a 18% share in the total turnover on the bond segment. In sectoral terms the highest turnover was recorded by the companies in the sector "Consumer Services" (24%), followed by the "Financial Services" (22%).

In 2014, the market capitalization of the Montenegro Stock Exchange reached EUR 2.9 billion and compared to 2013 reported an increase of 4.20%. For the first time in the same year on the stock exchange was
launched an IPO of corporate bonds for EUR 10 million. With the development of a project for establishment of links among the stock exchanges in Southeast Europe, the trading system of the stock exchange of Montenegro – BTS, provides real-time information from seven regional stock exchanges, namely Podgorica, Ljubljana, Sarajevo, Banja Luka, Varazdin, Skopje and Belgrade.

In a document of the Central Bank of Montenegro containing recommendations to the Government (2015) are formulated such directions for the development of the capital market of the country as a continuation of activities to strengthen relations with regional and European markets; improving the protection of minority shareholders and respect for basic principles of corporate governance by promoting the adoption of a corporate governance code and the implementation and compliance with international financial reporting standards. Among the risks to the capital market, the Central Bank of Montenegro states the following:

- insufficient level of market liquidity and market depth;
- insufficient protection of property rights of minority shareholders;
- low level of transparency and quality of financial statements of publicly traded companies;
- delay in the privatization of remaining large state-owned enterprises.
In 2014 Montenegro has introduced a number of changes in the accounting legislation, which aim at achieving a higher degree of harmonization with EU directives but the application of international accounting standards and international standards for financial reporting remains weak. Back in 2006, the World Bank had prepared a Report on the Observance of Standards and Codes, which advocated the improvement of the quality of financial reporting in Montenegro. The Ministry of Finance has set up a National Accounting and Audit Council to improve the accounting and auditing practice in accordance with International Accounting Standards and the International Financial Reporting Standards.

Montenegro has signed double taxation avoidance agreements with over 40 countries. The applied withholding tax in the country is 9% of gross income from dividends, interest and royalties. The corporation tax is also 9% and Montenegro provides various tax incentives for newly created start-ups in economically underdeveloped municipalities in the form of tax holidays for a period of the first eight years in respect of corporation tax and physical persons’ income tax. All investors are free to transfer dividends, interest and profits without restriction. Foreign investors may invest in all sectors except the defense industry, which has imposed a limit of 49% of capital. Furthermore foreigners cannot own property rights over natural resources, public goods, agricultural lands, forests and woodlands, cultural monuments and immovable property situated within one kilometer from the coastline.

Montenegro has implemented a "one stop shop" system for registration of companies by the tax authorities. The registration procedure for setting up a company is greatly simplified and takes four days. The initial capital for registering a limited liability company is one euro and the number of required documents is only 4, so that Montenegro has become a leading country in the Southeast Europe region regarding business environment. It is greatly enhanced by the application of fundamental laws as the Law on Foreign Investment, the Law on privatization, The Law on free zones, the Law on professional organizations etc. These laws are in line with EU standards and build a better institutional framework for the conduct of economic policy. The country applies national treatment to foreign investors who can invest in the manner and conditions valid for local residents.

The law on professional organizations provides lower fees for the registration of companies and simplified registration procedures,
defining the rules of shareholders and in particular ensuring the protection of minority shareholders. The Accounting Act introduces the application of international accounting standards, the Law on current and capital transactions guarantees free transfer of capital and repatriation, in line with EU practices. The Law on foreign trade is fully harmonized in accordance with the principles of the WTO and the EU and ensures liberalization and equal treatment of participants in foreign trade transactions.

Moreover, the Free Zones Act of 2011 defines the free zones and the storage areas for products as part of the state territory by providing extraterritorial status for customs purposes and ensuring a smooth and efficient manner for execution of business. These zones are created in accordance with a program to encourage business development and are targeted for the creation of micro, small and medium-sized enterprises, mainly in the field of light industry such as food, textiles, furniture and consumer electronics. In 2015, there are free zone areas in 5 municipalities of Montenegro.

The main benefits that companies enjoy in the free zones are:
- favorable tax regime and exemption from payment of tax on personal income and compulsory social security contributions, exemption from payment of property tax;
- exemption from payment of municipal taxes;
- establishment of a public-private partnership model;
- reduced administrative costs.

In 2015, according to the Investment Agency of Montenegro, over 90% of state-owned enterprises will be privatized, thus over 400,000 citizens are expected to hold shares in companies or privatization funds. About 12 companies are to be privatized by tender, but more will be listed on the Montenegro stock exchange. Among the risks for foreign direct investments in Montenegro, the Central Bank described the increased competition for attracting investments in the region, the ongoing crisis in the eurozone, the bureaucratic procedures in the country, delaying the privatization of strategic enterprises, the weak coordination between state and local governments, the concentration of investments mainly in the services sector and the lack of greenfield investments in high technology and export-oriented sectors.

According to the indicators of economic transition in countries compiled by the European Bank for Reconstruction and Development, Montenegro is well positioned in areas such as price liberalization,
privatization and liberalization of foreign exchange trading. According to the strategy to attract foreign direct investment for 2013 – 2015 the economy of the country shows indications for further opening in the context of its Euro-Atlantic integration.

**Discussion of Results**

In the analysis of the economic factors, influencing the development of the Montenegro stock exchange for the period 2004 – 2014, from 12 included independent variables (see Table 1 above), the stepwise regression analysis shows that only the independent variable lending interest rate strongly influences the stock market capitalization in Montenegro. The following results have been obtained:

From Table 3 above it can be seen that the coefficient of correlation between the independent variable lending interest rate and the dependent variable market capitalization is 0.815, which is indicative for strong correlation dependence. The coefficient of determination shows that 67% of the variation in the Montenegro stock market capitalization is due to change in the variation of the lending interest rate.

Similar dependence between the interest rate and the stock exchange index (as a proxy to the market capitalization) has been established in a research (Md Mahmudul Alam, 2009) of monthly data for the period 1988 – 2003 in 15 developed and developing countries among which Australia, Canada, Germany, Italy and Japan. For all the countries the author proved that interest rates have significant and negative relation with the changes in the stock exchanges. The interest rate is an important economic variable, which is directly linked to the economic growth and is associated with the cost of capital. When interest rates on deposits rise, the interest rates on loans also increase, which in turn leads to squeeze in
investments in the economy and is a cause for a fall in market capitalization (prices of shares).

Besides, Fama E. (1981) also established that the expected inflation (which can be presented by the changes in short-term interest rates) is negatively correlated with the returns on the stock market and with the expected level of economic activity. Zhou (1996) researched the link between the interest rates and the stock prices and found that the interest rate have an important impact on the stock exchange returns in the long term. For Lee (1997) the link between these two variables is not stable in time and gradually changes from significantly negative to lack of dependence and even positive (but insignificant) dependence. Negative dependence is reported also by Hsing (2004) (as well as by Zordan, 2005; Uddin & Alam, 2007), who applied structural VAR model of the dependence between stock prices and the interest rate.

The analysis of the dependencies between the Austrian stock exchange index ATX and the Montenegro stock exchange index Monex20 for the period 2004 – 2014 shows the following results:

1. The coefficient of correlation between the independent variable Austrian stock exchange index ATX and the dependent variable Montenegro stock exchange index Monex20 is 0,651, which is indicative of average correlation. The coefficient of determination indicates that 42 % of the changes in the variation of the Montenegro stock exchange index are due to variations in the Austrian stock exchange index.

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>-4839,908</td>
<td>3536,839</td>
</tr>
<tr>
<td>ATX</td>
<td>6,659</td>
<td>1,198</td>
</tr>
</tbody>
</table>

a. Dependent variable: Montenegro_Index MONEX20

2. According to Table 4, the regression coefficient $b_1$ shows that the rise in the Austrian stock exchange index by one unit leads to an increase of the Montenegro stock exchange index by 6,659 units. The coefficient $b_1$ is statistically significant because for it Sig. 0,000 < $\alpha$ =0,05.

The analysis of the dependences between the long-term interest rates on Austrian and Montenegro government securities for the period 2004
– 2014 leads to the following results:
1. The coefficient of correlation between the independent variable long-term interest rates on Austrian government securities and the dependent variable long-term interest rates on Montenegrin government securities is 0.082, which is indicative of weak correlation dependence. On the other hand, the coefficient of determination shows that only less than 1% of the change in the variation of the Montenegro long-term interest rates is due to variations in the Austrian long-term interest rates.

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Regression</td>
<td>1,784</td>
<td>1</td>
<td>1,784</td>
<td>0.258</td>
<td>0.614a</td>
</tr>
<tr>
<td>Residual</td>
<td>262,661</td>
<td>38</td>
<td>6,912</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>264,445</td>
<td>39</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Independent variable: (Constant), Austrian_LTIR
b. Dependent variable: Montenegrin_LTIR

2. Table 5 regarding the check of the hypothesis for the adequacy of the regression model shows that the empirical characteristic $F_{\text{stat}}$ is 0.258, while the critical value at $\alpha = 0.05$ from $F$ – distribution tables is $F_{\text{critical}}$ 4.17. Since $F_{\text{stat}} < F_{\text{critical}}$, the null hypothesis $H_0$ cannot be rejected and a conclusion is made that between the long-term interest rates on Austrian and Montenegrin government securities do not exist statistically significant dependence, which is confirmed by Sig. $0.614 > \alpha = 0.05$.

**Conclusion**

The capital market of Montenegro is characterized by legal and institutional framework established on the basis of the Law on securities and an effective oversight exercised by the Securities Commission. In the country presently there is not functioning over – the –counter market. The bond market includes programs for issuance of and trade of bonds issued by the central bank and the government and is characterized by insufficient levels of development. As a step in the regional integration of the Montenegro Stock Exchange is considered the acquisition of 24.38% stake by the Istanbul Stock Exchange. The capital market of
Montenegro is small and is characterized by a high degree of reaction to changes in the business environment. It is defined as an emerging market and weak form of market efficiency tests can be applied to it.

The stock market uses BTS trading system, which was developed jointly with the Ljubljana Stock Exchange. As part of the project to link exchanges in Southeast Europe, the trading system of the stock exchange in Montenegro provides real-time information from seven regional stock exchanges. Montenegro applies favorable tax treatment (9% corporate tax) and a number of tax incentives for start-ups. An empirical analysis of this market found an average correlation between the stock market of Montenegro and the Austrian capital market (correlation coefficient 0.651). Regression analysis shows that the most important factor that influences the stock market capitalization in Montenegro is the lending interest rate in the country (a correlation coefficient of 0.815, Stefanova J., 2014).

The privatization process in the country has not been yet finalized and this influences the volatility on the capital market. Many of the companies in the economy are confronted with problems relating to insolvency, high indebtedness, restricted access to financing, ineffective management of the assets and own equity; low level of flexibility of the capital structure of the public companies. Besides, in the course of privatization sales to strategic investors or management or employees’ buyouts dominated rather than listing of residual state shares on the stock exchange, which led to high ownership concentration. The level of regulation on the capital market of Montenegro needs to be further increased, thus leading to better disclosure of public information, decrease in information asymmetries, fall in transaction costs and the risk of low liquidity.

The stock exchange of Montenegro reached highest capitalization levels and trade turnovers in the years just preceding the global financial and economic crisis after which reasonably these indicators started to fall down and an outflow of foreign investors was registered as well. The financial crisis led to deterioration in market liquidity, rise in interest rates and slowdown in the operations of the financial system.

Among the challenges for the development of the capital market of Montenegro remains improvement in the liquidity of the government securities market (especially the secondary market), development of the repurchase market and the instruments traded on this market.

The capital market of Montenegro remains limited in size and
insufficiently developed as compared to benchmark markets in the Central and Eastern Europe. Main problematic aspects in front of the competitiveness and the financial development of the stock exchange in Southeast Europe remain the high levels of corruption, the insufficient effectiveness of the institutions and the limited access to financing. Irrespective of the ongoing harmonization process in the legislative and institutional framework, various barriers still operate on the Southeast Europe capital markets, which distort their effective functioning. The highest potential for rapid integration into EU capital markets show the stock exchanges of Montenegro and Serbia due to the attained level of capitalization, realized turnovers etc.

References:


