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Issuing corporate securities in Slovakia against a background of globalization

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Abstract

Globalization creates pressure on all companies to become more competitive, including in acquiring financial resources. This paper assesses the current state and future development of the Slovak capital market in the light of that market's history. We use data on past trends to interpret current developments. Corporate securities emissions have risen, but are still very low relative to GDP. We argue that the narrow interest spread between bank deposits and bank loans reduces incentives to create securities. But that could be a viable alternative when companies are unable to borrow from banks. Using a case study of Tatry Mountain Resorts a. s., we argue that Slovakia could be a good environment for corporate securities emissions, for globally active companies.

Keywords: globalization; securities; emission; bank loans; Slovak Republic;

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1. Introduction

According to Smith (1997), it is obvious, that the CEOs of joint stock companies are managers of others' money, rather than of their own. Therefore it is hardly to be expected that they will treat that money with the same caution as partners in a private company, who manage their own money. Therefore there is very often negligence in the management of joint stock companies. Slovakia is a special case, because the majority of corporate financing is done via bank loans. That is why we characterize Slovakia as a bank economy. This partly reflects the financial nature of continental Europe. However, the further west we look, the greater is the ratio of securities to bank loans as sources of corporate finance. Slovakia also has its own history connected to capital markets, which is perceived rather negatively. But although Slovakia had a negative experience with bad bank loans before 2000, this experience obviously did not have a great effect on its methods of corporate financing.

2. Literature research

Jensen and Meckling (1976) are convinced that publicly held business corporations are an awesome social invention. Millions of individuals voluntarily entrust billions of dollars of personal wealth to the care of managers. The growth in the use of the corporate form as well as the growth in market value of established corporations suggests that at least until now creditors and investors have not been disappointed with the results, despite the agency costs inherent in the corporate form. Moreover there were alternative organizational forms available, and opportunities to invent new ones. Whatever its shortcomings, the corporation has thus far survived the market test against potential alternatives.

From global point of view, the world wealth division deepens. According to Sikula (1999), a significant part of the world's wealth is concentrated in the possession of a few dozen companies.

Shortly after the crisis years 2008 and 2009, an interesting phenomenon appeared in Slovakia. Several financial groups active in Central and Eastern Europe, with their headquarters in the Czech Republic or in Slovakia, had a substantial quantity of liquid financial resources. They decided to invest in new projects and acquire new assets. They funded new companies and decided to list them on the Slovak stock exchange. First, they brought new firms to the stock market, and shortly after, they started the emission of corporate bonds. But we are still only talking about a dozen companies. Therefore the aim of this paper is to investigate further opportunities in corporate securities emissions.

According to CFO.sk (2014) there is substantial room in Slovakia for corporate securities emissions as sources of financing. In 2014 the average deposit interest rate for 1-2 years deposits was 1.47 %. In the same period, banks offered 1-5 years loans over 1 mil. EUR to non-financial companies with average interest rate 5.93 %. This represents an interest rate difference of 4.5 percentage points. This should create enough room for corporate securities emissions, which offer better interest rates for investors and lower interest rates for the borrower. However, according to our own research, the values are quite different. We studied the deposit interest rates for bank deposits of longer than 2 years. We compared those values to bank loan interest rates for loans longer than 2 years. We did not consider loans intended for realties, because these often have lower interest rates than loans for other business purposes. We discovered that according to data from the National Bank of Slovakia (Table 1) during the 15 year period 1995-2014, there was not such a high spread in interest rates as CFO.sk (2014) list in their article. Thus, we might raise some doubts about the potential of corporate bonds emission from a cost-saving point of view. CFO.sk (2014) also mention that costs for corporate bond emissions could be as high as 2.5 % of a bond's nominal value. This would make bond emissions

rather cost-increasing than cost-saving. Of course, were it to be the only alternative way to obtain financial sources, it could be accepted.

The Slovak capital market is specific thanks to its high rate of inelasticity. Glasa (2013) mentions an example of the foreign corporate securities of Inaer Aviation, that at the time of the 2011 and 2012 crisis were trading at only 35 % of their pre-crisis price. In comparison, the corporate securities of Slovak companies were trading at the same price as before the crisis. The reaction of the Slovak stock market to the global situation was clearly not as might have been expected.

Table 1. Comparison of Deposit and Bank Loans Interest Rates 1995-2014.

Year	Deposit interest rates in % p.a.	Bank loans interest rates in % p.a.	Difference
1995	18.23	16.22	-2.01
1996	12.35	14.42	2.07
1997	12.83	14.91	2.08
1998	11.56	16.13	4.57
1999	13.60	16.50	2.90
2000	13.53	12.15	-1.38
2001	8.32	10.65	2.33
2002	7.06	9.71	2.65
2003	5.91	8.20	2.29
2004	4.95	6.71	1.76
2005	3.02	4.88	1.86
2006	2.60	5.81	3.21
2007	2.55	6.08	3.53
2008	2.54	5.99	3.45
2009	2.53	3.99	1.46
2010	2.61	3.97	1.36
2011	2.63	4.28	1.65
2012	2.69	3.91	1.22
2013	2.59	3.72	1.13
2014	2.53	3.75	1.22

According to the Institute of Economic Research of the Slovak Academy of Sciences (2008), Slovakia is a small and highly open economy, extensively penetrated by foreign investments. Therefore its development will further be influenced by foreign globalization and integration processes. The business environment is in need of complex developed institutions. The market system effectively coordinates companies in their activities and will continue to do so. Globalization changed the circumstances of doing business and it has increased the dynamic of change and opened a wide space for new opportunities. This mobilizes companies to cooperate on different levels with or without there being any capital connection between them. In this way they could achieve critical improvements in quality. The aim is a synergic interconnection of potentials represented by economies of scale, better market positions, innovation advantages, and a rationalization of organizational structures. Capital interconnection between companies is a prerequisite to influence global competition, to ensure higher returns on investments and to achieve such competitive advantage, which otherwise the companies would not be able to achieve. Unfortunately, studies show that it is not always easy to achieve these aims.

The Institute of Economic Research of the Slovak Academy of Sciences (2008) predicts the development of the financial sector in Slovakia. Dominant in this sector will be foreign-owned financial institutions, especially banks. Financing of domestic investments will most likely be via bank loans. The domestic capital market will likely be only a minimal source of finance. The market capitalization of the Bratislava Stock Exchange (BSE) has stagnated in recent years at around 10 % of GDP, and the ratio of trades to GDP is very low, around 1 %. The companies quoted on the exchange make only minimal

use of emissions of new securities or shares. In the current situation, we would assess the state of the risk capital sector in Slovakia as underdeveloped. The volume of capital market investments in Slovakia in comparison to developed or transition economies is very small.

According to Benova (2007) the financial market serves several purposes: it accumulates temporarily available financial sources and allocates them to different sectors of economy. Further it redistributes available resources and transforms them into investments as efficiently as possible. In the Slovak Republic, several companies emerged after the crisis year 2008 and listed their shares or bonds on the market.

The current situation on the Slovak financial market has also been assessed by Sabikova (2013), who assigns the dominant position to banks. In spite of globalization and integration of financial services under a single provider, the role of regulators in Slovakia has become even more difficult. The Slovak financial market has been regulated since 1 January 2006, and the integrated supervision is carried out by the National Bank of Slovakia. Strong financial groups may contribute to cost savings and risk diversification, but they make the role of regulator much more difficult. In the past, many listings were made that were not really suitable for placement on the stock exchange. In developed economies, listing a company's share on a stock exchange is considered as a major event in a company's life. These facts were the result of an historical development, but they damaged investors' trust in the financial market. Companies are now only rarely listing on the stock exchange. According to Sabikova (2013) this is caused by mistrust of the market and by high transaction costs on the stock exchange.

3. Current situation in Slovakia

Decisions of companies to use corporate securities as a source of financing could be influenced by Slovak tax legislation. According to J&T Banka (2015), there is no obligation to pay health insurance contributions from corporate bond revenues with Slovak IŠIN after 1 January 2014. The only tax which still needs to be paid is income tax, at 19 % for private persons and 22 % for companies.

Slovakia is different only in its relatively high proportion of company external financial resources that come from bank loans. In general bank loans are more important than capital market funds right across continental Europe. But the further west we go the more important is financing via capital markets. Of course this form of financing is most developed in the United States of America.

According to Gulka (2014a) there were 64 emissions of corporate bonds in Slovakia in 2013 and 2014. These were issued on a non-public market (not listed on the stock exchange). In Table 2, there is a preview of ten corporate bonds chosen from those 64. These are the bonds with the largest and the smallest coupon yields, with the highest and the lowest nominal values for their emissions, and they illustrate the size of the market and the yields in Slovakia.

Table 2. Preview of Corporate Bonds Issued on the Non-Public Market in Slovakia in 2013 and 2014, sorted alphabetically

Name of a corporate bond	Issuer	Year of issuer's establishment	Nominal value of whole emission	Coupon yield, p.a.
CSOB Leasing Fix 2018	CSOB Leasing, a.s.	1996	32,000,000 €	1.34%
D1 PARK	D1 Outlet (1), s.r.o.	2009	2,220,000 €	14.00%
Dlhopis EUSTREAM	Eustream, a.s.	2004	1,000,000,000 €	4.12%
Dlhopis Penta 12	Penta Funding, a.s.	2005	6,000,000 €	5.00%
Dlhopis Privatbanka 16	Privatbanka, a.s.	1995	3,000,000 €	2.00%
Dlhopis Salve Group	Salve Group, a.s.	2001	1,200,000 €	8.00%
Dlhoppis Penta 08	Penta Funding, a.s.	2005	12,000,000 €	5.50%
Finance - in 03	Finance in, s.r.o.	2003	332,000 €	7.10%
SPECTECH 001	Speciálne technológie, s.r.o.	2002	840,000 €	10.00%
Wellness KOVACOVA	Wellness KOVACOVA,	2003	1,000,000 €	6.50%

s.r.o.

Table 3. List of Slovak Companies that have Recently Issued Bonds or Shares on the Slovak Stock Market.

Nr.	Company	Date of emission	Shares / Bonds	Nominal Value (EUR)	Maturity	Coupon yield, p.a.
1.	Best Hotel Properties	26.6.2009	S	10	-	-
2.	Tatry Mountain Resorts	30.7.2009	S	7	-	-
3.	Tatry Mountain Resorts	17.12.2013	B	1,000	17.12.2018	4.50%
4.	Tatry Mountain Resorts	5.2.2014	B	1,000	5.2.2021	6.00%
5.	JTFG iii	21.6.2013	B	1,000	21.3.2016	6.00%
6.	JTFG V	12.12.2014	B	1,000	12.12.2018	5.25%
7.	CEETA	20.6.2013	B	1,000	20.6.2016	6.50%
8.	CEETA VAR	18.12.2013	B	1,000	18.12.2017	5.98%
9.	Joj Media House	21.12.2011	B	1,000	21.12.2015	0.00%
10.	Joj Media House	15.8.2013	B	1,000	15.8.2018	6.30%

Note: The table excludes expired bonds. Only currently listed bonds are shown.

There are substantial differences between public and non-public issues of corporate securities in Slovakia in 2013 and 2014. The differences lie in the number of bonds issued and also in their qualitative and quantitative characteristics, such as volume and yield. We could predict that investors were more likely to invest in bonds, which are emitted to a narrow circle of investors.

In this case they may often know each other personally or even have been involved in the company with previous capital investments. The problem is however more complex and it could be partially explained by the bad historical experience of investors with poor quality listings on the stock exchange. Further, low financial literacy could also be a reason why individual investors are unaware of or afraid to buy corporate securities. According to some surveys only 30 % of Slovak population could manage their money at even a basic level. However, high trading costs are also an obstacle. However these are obstacles that mostly affect small individual investors and not big companies.

According to The Bratislava Stock Exchange (2015) there had been 80 stock emissions by 61 different issuers registered at the stock exchange by the end of 2014. The market capitalization of stocks traded at BSSE by the end of 2014 were EUR 3.9 bln., which was an 11.5 % increase from the previous year. In 2014 the most important stock emission at BSSE, by traded financial volume, was Best Hotel Properties (EUR 35.18 mil.), Tatry Mountain resorts (EUR 13.85 mil.) and Vseobecna uverova banka (EUR 3.39 mil.). According to Iorgova and Ong (2008), the five largest companies in Slovakia hold more than 81 % of total market capitalization, which means the market is highly concentrated. At the end of 2014, 192 bonds were listed on BSSE, including 22 corporate bonds. The market capitalization of all securities listed at BSSE at the end of 2014 was EUR 37.39 bln., which means an increase of 6.25 % from previous year. According to Tendulkar (2015), the Slovak domestic corporate bond market experienced a growth of more than 16 % from 2005 to 2014.

Table 4. Market Capitalization of Shares and Bonds on the Bratislava Stock Exchange in 2000-2014 in bln. EUR.

Year	Shares	Bonds
2000	3.52	2.67
2001	3.92	6.87
2002	2.51	6.95
2003	2.67	8.06
2004	3.61	9.34
2005	4.01	11.15
2006	4.43	12.40
2007	4.74	13.38

2008	3.88	16.72
2009	3.55	20.24
2010	3.11	24.95
2011	3.65	28.40
2012	3.50	34.09
2013	3.48	35.14
2014	3.90	37.33

4. Practical example – Tatry Mountain Resorts, a. s.

A great example of corporate securities emission in Slovakia is a company called Tatry Mountain Resorts, a.s. (TMR), which is a joint stock company based in Slovakia, funded by Slovak capital and active in tourism (e.g. ski resorts and aqua-parks). It describes itself as the biggest tourism company in Central Europe with operations in Slovakia, the Czech Republic and Poland. Originally, it was established by the J&T Finance Group, one of the two biggest Slovak financial groups. According to details released in TMR’s Annual report 2013/2014 (2015), the structure also includes companies based in Cyprus and the Netherlands, which suggests a tax avoidance maneuver by big investors. It is therefore hard to find any further capital connections. In 2009 the company changed its business year from the calendar year to a period starting on 1 November and ending on 31 October of next year, in order to capture the whole of the most important winter season within a single business year. According to Debnarova (2014), Tatry Mountain Resorts was also one of three non-financial companies given an award in 2014 in a survey about the disclosure of information about corporate governance. TMR also lists its shares on three Central European stock exchanges: Bratislava, Warsaw and Prague.

Table 5. Structure of Shareholders on 31 October 2015.

Shareholder	Holding shares in %
C. I. Capital Industries Limited	18.8
J&T Securities management Limited	15.6
Belgomet, s.r.o.	15.4
Small Shareholders	15.0
Key Dee Limited	9.9
Tinsel Enterprises Limited	9.5
RMSM1 Limited	8.8
Mgr. Miroslav Vostiar	7.0

Tatry Mountain Resorts (2013) made a significant change in its capital structure in 2013. They decided to lower the nominal value of each share from EUR 33 to EUR 7. This lowering of equity was compensated by issuing two different types of corporate bonds. This shifted the company’s financial sources from equity to liabilities and it lowered the owners` capital involvement in the company. Furthermore, the investors were encouraged to invest the money they received from the equity switch into corporate bonds. The debt ratio rose from 13 % in 2011/2012 to 70 % in 2012/2013.

Behind this massive change in capital structure of TMR is also the national economic policy of the Slovak republic. Dividends are calculated from net profit, which is gross profit minus tax. On the other hand, the regular payments of coupon yield to bond holders are costs, which could be deducted from the tax base. This way, the management can satisfy investors by paying out higher coupon yields in comparison to dividends and at the same time reduce the tax base. The only difference for investors is the legal difference between bonds and shares as financial instruments. This change was of such significance that TMR decided to change its dividend policy. In 2009 it publicly stated that a pay-out ratio of 100 % was to be achieved by 2014. However, based on the mentioned facts, the company decided to change its 2009 public statement and after issuing the bonds changed the pay-out ratio to

zero. In this way investors, who owned only shares, lost their cash-flow from dividends. The volatility of TMR stocks on the stock exchange is very low, so shareholders cannot even think of trading the shares with some reasonable profit. Over the year the share price fluctuated around EUR 21.3 plus or minus EUR 0.5.

Gulka (2014b) compares the characteristics of two bond emissions by Tatry Mountain Resorts, a. s.

Table 6. Comparison of Two Bond Emissions of Tatry Mountain Resorts.

Basic information	TMR i 4.5 % 2018	TMR ii 6 % 2021
iSiN	SK4120009606	SK4120009614
Volume	70,000,000 EUR	110,000,000 EUR
Nominal value	1,000 EUR	1,000 EUR
Coupon yield	4.5 % p.a.	6 % p.a.
Payment of coupon yield	once per 6 months; always 17 June and 17 December	once per 12 months; always 5 February
Maturity	17 December 2018	5 February 2021

5. Conclusion

Multiple factors explain the current somewhat unsatisfactory situation of the Slovak financial market. For historical reasons Slovakia is a bank economy, where companies prefer to use bank loans rather than issue securities. There are also historical reasons for the widespread mistrust of the stock market, and for the poor financial literacy of individual investors. In addition there is little incentive for companies to use securities as sources of financing, because the spread between the interest rates on deposits and for bank loans is very narrow. But companies may find issuing securities attractive if their requirements are too large, or their activities are too risky to attract bank loans.

Despite these facts we showed that there is a current trend for new securities emissions on the domestic stock market. However we also showed that there are more corporate bonds issued on the non-public market, where the investors are more closely connected to the issuing companies than in the public market, perhaps already having some capital in that company. This is also a legacy of the widespread mistrust of the public stock market. Investors prefer to stay in the small circle of people they know and trust.

We finished with a case study of a Slovak company that arguably has been a pioneer in many areas since its establishment in 2009. Tatry Mountain Resorts a. s. has issued both shares but also two different sets of corporate bonds. It is listed on three stock exchanges: Bratislava, Prague and Warsaw. It is also included in the Slovak share index – SAX, and in 2014 it received an award for its disclosure of corporate governance information. This is proof that for large globally active players, the Slovak environment could be suitable for corporate securities emissions.

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