How to wake up the Slovenian capital market?

Photo by Jure Makovec

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The Slovenian capital market is still in a bad shape, which calls for change, but this has never been a priority in recent years. According to a new report on the state of the Slovenian capital market by **PwC** and BTA, the options are twofold: a further gradual decline of the organised capital market, with the eventual closure of the Ljubljana Stock Exchange and the loss of business of the remaining financial intermediaries, or the adoption of an active strategy to revive the

Slovenian market. How to achieve the latter was explored by financiers and decision-makers in a webinar.

Foto: Uroš Zagožen/PwC Slovenia

Primož Rozman, senior manager for financial advisory at **PwC Slovenia** and one of the authors of the report, notes that the number of issuers exiting the stock exchange far exceeds the number of those entering, and that the number of issuers fell from around 200 shortly after the turn of the millennium to a meagre 28.He points to the low liquidity of shares on the Ljubljana Stock Exchange, which he attributes mainly to the meagre supply. Liquidity is also poor in the bond market, although supply is higher thanks to government borrowing, but transactions are rare, as this segment is mainly of interest to institutional investors, who mostly buy bonds and hold them to maturity. Rozman warns that the government must take a decision to revive the capital market, otherwise it will accept the market dying in instalments, resulting in the closure of **the Ljubljana Stock Exchange**, a reduction in the number of financial intermediaries, and the remaining issuers opting for a foreign listing.

Ministry of Finance: a Capital Markets Union is needed now more than ever

Anka Čadež, Director of **the ATVP**, reminds that all stakeholders, including the state, need to recognise the benefits of a well-functioning capital market. The Ministry of Finance says that they themselves are aware of this and that it is important both for financing the economy and for opportunities for investors. "New issuers need to be attracted, including SMEs, which are the backbone of the economy," says **Urška Cvelbar**, Director General of the Financial System Directorate at the Ministry of Finance. "A strong and functioning Capital Markets Union is needed now more than ever."

Mario Nava, Director General of the Structural Reform Unit at the **European Commission,** considers the roadmap for the recovery of the Slovenian capital market to be appropriate and adds that the European Commission is ready to cooperate in this process. He stresses the importance of financial literacy in the plan.

Once one of Europe's more promising markets

Brian Taylor of BTA Consulting, chairing a panel on national capital market strategy, recalls that on his last visit the Slovenian capital market was one of the most promising in Europe. "Unfortunately, that has changed. But it is not too late", he believes. He sees supply as more of a problem than demand and points to the declining number of issuers on the Ljubljana Stock Exchange.

Justin Sullivan, from the Irish Department of Finance, explains how in 1987 only 50 jobs in Ireland were directly linked to the capital market. "Today there are around 100 000, half of which are linked to financial services for foreign companies. This results in higher wages, more taxes," he explains. He attributes the development of the local capital market to the market reform led by the Prime Minister's Office in cooperation with the Ministry of Finance. "Small countries have the advantage of being able to pursue a clearly defined common goal," Sullivan says of the Irish experience of capital market development.

Ipavec hopes the study will not remain in a drawer

Photo by Jure Makovec

Aleš Ipavec, CEO of the Ljubljana Stock Exchange, explained at the event that a new wave of privatisation would be needed, as well as the transfer of some private capital to the organised market. According to Ipavec, financial literacy among Slovenian companies is very low and something should be done in this area. He attributes the opportunity to do so mainly to the government, but as he notes, the capital market has not (been) among the priorities of this or previous governments. On the occasion of the new report, he recalls that a decade ago a comprehensive study was made on the shortcomings and necessary changes for the development of the Slovenian capital market, but that almost nothing has changed in the meantime. The shortcomings are the same. "I hope that this is not a new study that will end up in a drawer, but that we will do something towards a functioning capital market," says Ipavec.

Aleksander Nagode, Director General of the Directorate for Public Assets, recalls that in 2013 Slovenia established a list of 15 companies to be privatised. It sold stakes in companies such as **Aerodrom Ljubljana**, **Helios**, **Gorenje** and the like. After the sale, the companies left the organised capital market, which he describes as the negative side of privatisation for the stock market. On the positive side, **NLB was listed on the** stock exchange when it was partly privatised. He hopes that the demographic fund will be handled differently than in the past and that the state's exit from ownership will be similar to the IPO with the listing of shares on the local stock exchange.

Why are there no successful manufacturing companies on the stock market?

Photo by Jernej Lasič

Bojan Ivanc, Chief Economist at the **Chamber of Commerce and Industry,** sees reserves on the Slovenian demand side for securities mainly in domestic pension fund managers and insurance companies, and less in retail investors. Among the companies he particularly misses on the market are successful companies in the manufacturing industry that are not state-owned. Why are they missing? "The average debt of these companies is 0.9 times EBITDA, which means that even for a relatively large acquisition they can raise funds from the bank," Ivanc explains. He does not see any ambition to raise capital via the stock market, but he thinks it would be possible, at least if a company such as **Krka** decided to do so.

Daniel Medved, Head of Investment Banking at **NKBM,** explains that for many companies, bank sources are now much more accessible than raising funds on the organised market. "In today's environment, the latter is also more expensive. Judging by the issuance of new shares and debt securities, the market seems almost dead," Medved says.

Ivanc believes that the government could list energy companies on the stock exchange. "However, it should be borne in mind that the government may have different objectives than investors. This is not easy to unify," Ivanc warns.

Taxes as a brake

Tomasz Jedwabny, a Polish financial and legal expert, analyses the Slovenian tax system and notes that the tax regime in Slovenia is not such that it could support the development of the capital market. On the other hand, tax revenues from taxation of capital gains of retail investors in capital markets are very modest (about one per cent of the total in 2018). Slovenia's capital gains taxation is one of the highest in Europe, he points out.

Commenting on the data, **Tina Humar, Director** General of the Directorate for the Tax, Customs and Other Public Revenue System, says that the Ministry is aware that taxes are not only revenue generating, but can also influence the development of capital markets. However, she explains that a market development strategy would be needed to prepare taxes that are more capital market friendly. As for the possible reduction of capital taxation, she says that they are following the **OECD'**s recommendations, which are primarily to reduce the share of taxation on labour, not on capital.Tina **Humar, Director General of the Directorate** for the System of Taxes, Customs and Other Public Revenues, says that the Ministry is also aware of the fact that the role of taxation in the development of capital markets is not only revenue generating, but can influence the development of the market.

We need more saver-friendly savings rules

The State provides a fiscal incentive to save in the second pillar, but the current system has shortcomings. According to **Blaž Hribar**, a member of the Board of **Pension Company A**, investors would prefer this type of savings if at least partial payouts were possible in certain life situations. "For example, in the event of illness, to finance the purchase of a home, etc. Some flexibility would increase interest," he explains. Also in the area of switching between the different life-cycle funds in Pillar 2 - i.e. from riskier ones with a higher share of shares to less risky or guaranteed ones, which invest mainly in bonds. Particularly in the current era of low interest rates, this can pose a high risk of not achieving financial targets.

Andrej Petek, a member of the Management Board of **Triglav Funds,** points to a similar problem. He believes that while life-cycle funds are a great asset for Slovenian savers, they should go a step further and improve the mechanism of switching between differently risky funds. "In the current system, it can even be dangerous for an investor to switch from a risky fund to a safer one at the very time of a negative market cycle. This can lead to a much more modest return and therefore these switches should be made more continuous and stretched over a longer period of time. The area of fund redemptions should also be improved, as the lifetime of funds is getting longer and it is not optimal to be very conservative with the remaining funds at the time of redemption," explains Petek.

An opportunity to develop the capital market through fintech companies?

The authors of the report on the state of the capital market in Slovenia also see opportunities in the fintech sector, i.e. companies developing new financial technology services. They also point out that this is an opportunity for small countries like Slovenia to make a rapid qualitative and developmental leap in the functioning of the financial and capital markets through lower prices, a greater range of services and the inclusion of more players in the market.

Slovenia ranks low in international comparisons on indicators of fintech sector development, the number of such companies is limited, and there is a lack of digitised and accessible public databases. In the light of the evolving EU legal framework, the cornerstone of which is the EU's recast Payment Services Directive, which came into force a few years ago, action by legislators and regulators to accelerate the development of the sector is therefore seen as necessary.

Aleš Butala of the ATVP says that the Agency does not have a clear mandate to act in this area, but it is trying to be proactive and communicate with emerging providers. But to develop the sector faster, all stakeholders will need to work together, he adds.

He would be cautious about fintech developments, which he said should not come at the expense of user protection. However, the trend of the fintech sector's development is inevitable, and it is therefore necessary to facilitate the registration procedures for new clients of such providers, for example by adapting the rules for the prevention of money laundering, which are even stricter in Slovenia than at EU level, Butala says.

Davor Pavič, a member of the **KDD** Management Board, points in particular to Slovenia's lagging behind in the digitisation of databases and the integration of various public registers. This complicates the procedures for new parties to enter the field.

Change processes, for example towards so-called distributed ledger technology (DLT), where a record is not held in a central place but each participant in a scheme has the same comprehensive record with all the information about all the other participants, should therefore be accelerated, he adds. According to Pavič, KDD is the only one currently offering such a DLT product, the KDD Digital share register.

He believes that fintech companies will eventually see how to leverage this infrastructure for new customer services and, with the transposition of the new European Shareholder Rights Directive into national law, he sees opportunities in the digitisation of the currently rather ossified shareholder meetings.

How to adapt the system to new digital services?

Nena Dokuzov, Slovenia's representative in the European Blockchain Partnership and Head of the New Economy and Blockchain Technologies Task Force at the Ministry of Economy, recalled the **package for the development of digital finance adopted by** the European Commission in September last year, which is the first basis for further legislative development of the area of innovative digital financial services and the cryptoassets market in the EU.

However, it has a caveat for all traditional financial intermediation institutions. With further technological developments, especially after the expected introduction of the digital euro as an official electronic complement to cash in the coming years, the situation will change radically, she says, and the current players will have to transform themselves and find new roles. This is something that needs to be thought about today, she believes.

In this context, he also mentions plans to set up a kind of national testing laboratory to look at ways of adapting regulation to emerging business models.

Butala points out that, unlike in some other European countries, the legislation in Slovenia is quite restrictive, as it does not allow laboratory services to be exempted from the current legislation. Thus, legislative changes would be needed, he says.

How to develop the private capital market in small Slovenia?

One of the questions in the report on the Slovenian capital market is how to boost the private equity market, where Slovenia is at the tail end of the EU.

Maja Tomanič Vidovič, Director of **the Slovenian Enterprise Fund,** points out that access to finance is still the biggest problem in the EU when it comes to the faster growth of small and start-up companies. In Slovenia, the situation is even more difficult, as it is a small and less attractive market, where even more effort needs to be put into attracting capital.

Why is Slovenia at the bottom of the EU? On the one hand, there is a small number of institutional investors on the market, only a few players with experience in the field, it is difficult to convince foreign players to enter the market, tax breaks for venture capital funds have been abolished, and there is no systemic framework for the development of the private equity and venture capital sector, says Tomanič Vidovičeva.

Photo by Jure Makovec

Luka Podlogar, CEO of **Generalija** Investments, which manages one of the two private equity funds in Slovenia, the Generali Growth **Equity** Fund, sees three main limitations - insufficient foundations in the development of the entire financial sector, an unfavourable environment, especially tax, which has led to the establishment of such funds elsewhere in the region, such as Croatia, and a lack of good practices.

The solution, she says, lies in finding regional partnerships and joining larger regional platforms, as well as in attracting investors and operators from the region. "We simply have to be more attractive, there is a lot of competition from countries," she adds.Another aspect is highlighted by **Dejan Jelisavac**, director of the private equity fund **Alfi,** who points out that even when the fund raises enough funds, there are simply not many interesting targets for investment. In a small market, it is difficult to find good deals, companies with development potential, good management and a strategy to strengthen the region, he makes clear.

And who should play the main role in the development of the private equity market? **Primož Damjanovič**, Deputy Director of the ATVB, believes that this depends on the framework that would be set. If it is too broad, the agency will not have sufficient resources. For now, the agency will focus on alternative investment funds, where Damjanovic sees plenty of room for growth.

Tomanič Vidovič believes that a working group of government, regulator and financial sector representatives should be set up to draw up an action plan to create a better functioning private capital market.

However, neither Damjanovič nor Bojan Ivanc see the possibility of uninformed retail investors investing in private equity funds as a form of alternative investment. Informed and institutional investors should therefore be the catalysts for market consolidation.

Ivanc also points out that there are a number of successful family-owned companies, but the current owners, for various reasons, are reluctant to let a fund into the ownership structure, even though it could bring faster development.