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Capital markets promote best practices for corporate governance in the CEE

Capital market development is important for any country and its effects go beyond financing. Specifically, in the CEE region capital markets are important promotor of best practices for corporate governance. Companies that are listed on the market adhere to higher standards of corporate governance and serve as a role model for other companies. If the listing is successful and other companies follow suit, positive economic and social effects of good governance spread throughout the economy.

However, the importance of promoting and adhering to higher standards of corporate governance does not mean that financing part of the equation is not important. Especially in times of crisis, one can clearly see that the companies with strong balance sheet, that are adequately capitalized, fare better. Such companies have less need to shrink their business, and weather the storm much better than companies that use a high leverage based on debt. As a result, social costs of adjustment for those companies are much smaller. Croatian experience from previous financial crisis that started in 2008 had shown exactly that. Croatian companies that were highly leveraged experienced significant problems and had to adapt to new reality where financing was scarce with significant costs. This change also affected lenders, with non-performing loan ratio for medium sized enterprises surpassing 30 per cent and for the large corporations 19 per cent. On the other hand, companies that were solidly capitalised fared much better through recession.

Although the CEE region is not big, there are significant differences in terms of capital market development and levels of cross border investments. Several decades after their (re)opening, there is relatively big variation between regional stock markets in terms of trading volume and listed shares. Originally, at the beginning of transition, stock exchanges and public listings were a venue where recently privatized state owned companies listed their shares in order to facilitate trading for new owners. Nowadays, we see relatively livelier trading on some of the exchanges (i.e. Warsaw stock exchange, Bucharest stock exchange). On the other hand, many other CEE exchanges have firms with significant market capitalization listed while trading is less dynamic. Some exchanges seem to settle in an equilibrium with low turnover and only few listed companies. Finally, international integration of the regional stock exchanges also varies, where exchanges with more turnover attract more international investments.

Capital markets union is an important part of the single market that should be further promoted in the future. At the same time, regional markets are still very important in the CEE countries. Plans to further develop capital markets union should take this in to account. Many companies that are listed on regional exchanges will not list on the big EU exchanges due to various reasons (i.e. listing requirements, costs, dual reporting, etc.). On the other hand, some companies that surpass the ability of the local market to service them, will graduate towards dual listings on bigger EU exchanges. However, in order to save the ability of such companies to fund on capital market and preserve ecosystem of financial intermediaries, we must implement sensible policies. Decreasing regulatory requirements for financial intermediaries that operate on a small scale while increasing capital market integration should provide relief and incite the development of regional capital markets not only in CEE but throughout European Union. By doing so, we are increasing options for consumers with supply of more readily available products from intermediaries throughout EU, while at the same time giving chance to regional markets and intermediaries to operate with the regulation level that is suitable to their size and risk profile. ●