

Stock Exchange Development and Growth – Report on the lessons from the capital market conference of the Budapest Stock Exchange (BSE) and the Association of Hungarian Economists (AHE)*

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The stock exchange conference, organised jointly by the Budapest Stock Exchange and the Association of Hungarian Economists, took place on 26 May 2016 in the ballroom of the Váci street headquarters of Magyar Külkereskedelmi Bank. In the morning session of the conference, the presentation of the representative of the Ministry for National Economy was followed by a discussion by the heads of the Zagreb, Belgrade and Bucharest stock exchanges on the development trends, successes and challenges of the regional stock exchanges. In the second part of the conference, the various dimensions of boosting the Budapest floor were discussed by *Márton Nagy*, Chairman of BSE and the Financial Section of AHE, and a panel comprising of the Chief Executive Officer of BSE and actors in the industry.

The participants were welcomed by *Richárd Végh*, Chief Executive Officer of BSE and *Benedek Sándor*, Deputy Chief Executive Officer of MKB, designating the discussion of the regional and domestic stock exchange development trends as the key objective of the event. *Ágnes Hornung*, State Secretary at the Ministry for National Economy in charge of finances, highlighted the stock exchange's significant role in the national economy and the latest supporting measures of the Government. The upgrade of Hungary by Fitch on 20 May 2016, the administrative easing implemented within the framework of the recently adopted modification of the Capital Market Act, as well as the regulations facilitating the development of new capital market structures all clearly reflected the Government's commitment to developing the stock exchange. *Hornung* also assured the audience that there were ongoing consultations with stakeholders to ensure further measures in the 2016 autumn legislative session.

Ivana Gažić, CEO of the Zagreb Stock Exchange, provided a very thorough summary of the factors influencing the path of the Zagreb stock exchange so far and the future

* The views expressed in this paper are those of the author(s) and do not necessarily reflect the official view of the Magyar Nemzeti Bank.

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prospects, with special regard to the initiative related to the regional stock exchange association. As she noted, the development of the Croatian markets was hindered by several internal and external factors: the poor macroeconomic environment and high external vulnerability, the low willingness to privatise, the financing model with the banks in focus, the low free float, and the underdeveloped institutional investors all contributed to the stagnation of the Zagreb stock exchange. This was further exacerbated by an economies of scale problem, as the international regulation and the increasing requirements for technological investments gave preference to larger stock exchange operators. *Gažić* was of the opinion that other stock exchanges in the region struggled with similar problems, which gave rise to the initiative known as SEE Link. The SEE Link association was established by the stock exchanges of Bulgaria, Croatia and Macedonia, and was soon joined by another five national stock exchanges in the region. The products of the other stock exchanges became visible and accessible for the member stock exchanges participating in the association and for their partners free of charge, which facilitated the realisation of the orders between the various stock exchange systems and intermediaries by setting up a shared protocol. In the medium run, the integration of new stock exchanges may support strengthening of the SEE Link initiative, while in the longer run the trend of the development may be represented by deeper harmonisation of the trading, post-trading and other stock exchange rules and systems.

Siniša Krneta, CEO of the Belgrade Stock Exchange, started his presentation by drawing a distinction between the European and Asian processes. Over the last ten years, the liquidity of the European stock exchanges, with the exception of the Warsaw Stock Exchange, had declined significantly, while turnover on the Asian stock exchanges had multiplied in the same period. *Krneta* highlighted that this development was only partially linked to the different impacts of the financial and economic crisis in the two continents; the differences between the approach to the role of the stock exchange may have been equally important. The European model was more focused on trading, and the regulation was very favourable for the emergence of the alternative markets, while the Asian model gave preference to the financing function and paid special attention to the regulated markets. *Krneta* encouraged the strengthening of the financing channel in Europe as well, which may be realised by new issuances generated by the strengthening of the connection between the stock exchange and the real economy. The Belgrade stock exchange will also be joining the SEE Link initiative, in addition to listing state-owned companies and developing an adequate regulatory environment, in order to lay the foundation for higher liquidity, which was essential for the development of the stock exchange.

Ludwik Sobolewski, CEO of the Bucharest Stock Exchange, highlighted the fact that not much time was left to boost the development of the capital markets. In his view, the transformation phase of the economic and social systems in the

countries of the region was approaching its end, and hence the maximum time left for defining the role of the national stock exchanges at a new, higher level may be 3–5 years. According to his regional experiences, the presence of foreign investors had had a positive impact both on pricing and financial literacy; on the other hand, their participation had also depended on the broadness of the issuer base, as well as on the flexibility of the capital market infrastructure and regulatory environment. In addition to encouraging stock exchange privatisation, the Bucharest Stock Exchange had also established the Aero market for SME-sized enterprises. He believed that there were no supply problems in Romania, while on the demand side it was necessary to enhance the financial awareness of private investors and to manage the liquidity risk. As regards the future, *Sobolewski* hoped that the latest regulatory initiative would not undermine the functioning of the capital market and believed that the arguments for the stock exchange consolidation clearly pointed to integration in the longer run.

Márton Nagy, Chairman of BSE and the Financial Section of AHE, reported on recent research that dealt with the features of the companies eligible for listing and may serve as a basis for BSE's issuer acquisition activity. As a starting point, he stated that the financing opportunities of companies were substantially influenced by the fact that the inflow of the EU funds would decelerate significantly in the coming years and the central bank loan programmes would also run out in the foreseeable future. Thus, the companies would change over to "normal" market-based financing by 2020, whereby BSE must play an important role. However, for this it was necessary to define the criteria that determined the range of companies eligible for listing and along with this to identify those companies with which BSE should initiate further cooperation. The specialist literature measured companies' eligibility for listing on a quantitative scale, based on which the most important factors for being successful on the stock exchange included age, export capacity, size, growth and capital structure. The backbone of the qualitative scale was comprised of the market share, other industry features, the ownership structure and the corporate governance system. SME-sized companies best satisfying these criteria typically had higher ROIC-based return and export activity, and lower leverage, and usually paid higher wages to their employee than the entire SME universe. 44 per cent of the headquarters of the SMEs eligible for listing were located in the Central Hungary region and they mostly operated in the manufacturing sector.

As regards the BSE's objectives, it was an important aspect that if the 50 most eligible SMEs entered the stock exchange, it would increase market capitalisation only by 5 per cent. Hence, BSE also deemed important to involve the large corporate sectors, but this worked through a different channel. Nevertheless, it was still worth making efforts to support the capital market entry of the SME sector, which the BSE intended to facilitate by providing support and consultation services

during companies' preparation process. The framework of this would be the BSE Anteroom, which would help eligible companies that were just about to enter the stock exchange with training and consulting programmes focused on corporate finance. Another anticipated initiative was the designated consultant system based on foreign best practices, which in part supported the preparatory process and in part also fulfilled an investor protection role. In addition, it was important to note that the actors in charge of regulation also recognised the need for this, which was reflected in the modification of the Capital Market Act. Hopefully a capital fund, supported by EU resources, would also be established, which would support both the supply and demand sides of SME transactions by capital market exit and the subscription of capital market issuances.

The panel discussion was attended by *Róbert Cselovszki*, CEO of ERSTE Befektetési Zrt., *Ádám Hegyi*, Director of KBC Securities, *Róbert Barlai*, Executive Director of OTP Treasury, *György Jaksity*, Chairman of Concorde Értékpapír Zrt., and *Benedek Sándor*, Deputy CEO of MKB Bank, with *Richárd Végh*, CEO of BSE, acting as moderator.

The participants first commented on the analysis presented by *Márton Nagy*, the purpose, approach and methodology of which was essentially welcomed and regarded as suitable for identifying and approaching potential issuers. On the other hand, *György Jaksity* and *Róbert Cselovszki* expressed their doubts about the way to access a substantial range of investors and achieve liquidity for the shares of SME-sized companies, which may have a fundamental influence on acquisition activity. In recent years, the stock exchange performance of smaller companies had been marked by unfavourable experiences and due to this at present there was no investor interest in the smaller shares. On the other hand, the participants agreed that in the present low yield environment and by introducing additional incentives it could be possible to find a way to boost investor interest again and resolve the credibility problems of stock exchange investments.

Richárd Végh mentioned some methods to reach the SME-sized issuers and encourage their presence on the stock exchange. *Benedek Sándor* was of the opinion that successful enterprises had increasing reserves and may be able to implement their investments even without external finance. *György Jaksity* proposed to capitalise on the succession problem – he believed that the stock exchange may be a real alternative for owners which had already fostered somewhat independent management in the governance of their company, and hence the governance structure of their enterprise may be more suitable for the stock exchange. On the other hand, strategic investors may be competitors in this case as well. *Ádám Hegyi* mentioned in general that their SME clients typically searched for other alternatives after having fully utilised the solutions of credit nature, but this connection was not inevitable. He believed that substantial demand for stock exchange financing may arise only when it provided a solution not only for the financing problem, but was

also advantageous in other respects as well, such as – for example – the absence of the requested tangible collaterals. *Róbert Cselovszki* mentioned the unfavourable nature of the present regulation in respect of the issuance transactions as an obstacle, while *Richárd Végh* believed – as was noted in the presentation by *Ágnes Hornung* – some progress had already been made in this respect.

Richárd Végh raised the question to what extent the designated consultant structure may be viable at BSE. The participants essentially found the model, which has already applied in a number of markets in the EU, to be viable in Hungary as well, but at the same time they repeatedly called attention to the importance of fiscal incentives in this area as well. In addition, *Ádám Hegyi* also mentioned that in the issuances of recent years institutional investors were not present in the range of investors, which would have been reassuring for small investors as well in terms of pricing and the safety of their investment.

Reacting to the presentations during the morning session, *Végh* asked the participants about the opportunities they saw in the SEE Link initiative and to what extent it might be advisable for the BSE to join the association. *Róbert Barlai* stated that the Xetra integration of BSE had not achieved the expected positive impacts, and thus the disadvantages of the integration should also be clear. *Róbert Cselovszki* and *György Jaksity* also mentioned that the integration would result in the equalisation of the participants' trading and other costs, which may be definitely advantageous for investors and the actors of the industry.

Finally, the focus was on the future of the national stock exchanges. *Róbert Cselovszki* and *György Jaksity* called attention to the process of turning the stock exchange and investment services activity into a “public utility”, accompanied by increasing competition and disruptive structure (MTF markets); thus the prospects were negative at present. On the other hand, national stock exchanges play a unique role, and hence the participants did not see the need for and the sustainability of these exchanges as being in question.

Richárd Végh thanked the lecturers and attendees of the conference for their participation. In his summary, he mentioned that *Ágnes Hornung* had informed the participants about the latest regulatory developments and based on this the participants may hopefully expect measures supporting the further development of the stock exchange. The managers of the regional stock exchanges discussed a number of topics containing significant lessons for BSE and the participants thereof, and the stock exchange association also provided an important view on the cooperation opportunities. The presentation of *Márton Nagy* and the panel discussions mainly focused on national considerations, but these related to the key challenges faced by BSE and hopefully strengthened the belief in the development of the stock exchange.