Development Perspectives of Investment Funds in Republic of Macedonia

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***Abstract* – This paper will discuss the importance of investment funds for the expansion of investment alternatives in the capital market in the Republic of Macedonia, as well as their role in collecting funds from small investors who often do not possess sufficient knowledge and financial resources to achieve satisfactory degree of diversification of their individual portfolio. It will also give a review of perspectives, measures and recommendations to encourage the development of these financial institutions in our country.**

Keywords: **investment funds, capital markets, small investors**

1. Introduction on investment funds

Investment companies are financial intermediaries that collect funds from individual investors and in turn sell shares or certificates of participation in the financial assets of the fund. [1] [6] Income obtained in this way, investment companies invest in various types of financial instruments in the domestic or international financial markets, while achieving diversification of the portfolio. Investment companies incurred as a result of the rapid development of the capital market in industrialized countries, because the existing banking system was a barrier to the further development of the financial markets and overall market relations [2], [5].

The number of investment companies started to increase rapidly in the late 19th and early 20th century. The Great Depression (1929 - 1933) stopped the development of investment funds. This crisis particularly affected those funds that had a lot of debts, through the issuance of bonds and preferred shares, which were issued to further increase the yield of ordinary shares. A real boom, investment companies experienced in '80 and '90 of the 19th century in the USA, UK and in France, Germany, Japan and other countries. Today, however, investment companies represent some of the most important financial institutions in the financial markets [8], [9].

2. Types of investment funds

There are several criteria that are could be used to classify investment companies. Specifically, by way of how investments in them are made and how funds are withdrawn, they can be divided into open-end investment funds (mutual funds) and closed -end investment funds (closed - end funds) [3].

The first closed-end investment fund was established in 1893 in Belgium. The main feature of closed-end funds is that they have emissions with a fixed number of shares and are not required to buy the shares from its investors [4]. Closed-end investment funds may not perform an additional issue of shares to increase their capital and therefore the value of their portfolio is relatively limited.

Investors can buy shares of closed-end investment funds, based on the initial public issue of shares, which is organized by an investment bank, or on the secondary market. Assets invested in investment funds, investors can withdraw only through direct sale to another investor in the stock market or with operations outside the stock market. The price of the shares of closed-end investment funds is established in the secondary market under the supply/demand influence and thus there is no guarantee that the sale price will match the net asset value per share of the fund – NAV [13]. The shares can be sold at a price higher than NAV, but in that case the shares are sold at a premium. If, however, the price at which a share is sold is under NAV, then it is said that the share is sold with a discount. The management team of the Fund may take certain measures to reduce the discount, mainly through reports and communication with the public. Closed-end funds may attempt to increase demand of their shares through the presentation of the plan for reinvestment of dividends, or through programs for purchase of shares on the open market. Some funds may periodically perform their conversion to open-ended funds, and that allows its shareholders to return their shares at NAV price. Each of the measures stated above must be approved by the board and be in accordance with the interests of the fund.

There are two basic types of closed-end investment funds, including: stock funds and bond funds. They can hold portfolio with domestic or foreign securities [10].

According to legislation in several countries, closed-end investment funds may not be advertised and make additional issue of shares, but on the other hand can borrow funds through the issuance of bonds and preferred shares and to perform aggressive speculative trade in derivative financial instruments, like futures and options.

At present, closed-end investment funds are increasingly leaving the main spot to the open-end investment funds [14].

The first open-end(mutual) investment fund Massachusetts investors trusts, was formed in 1924 in Boston, and it still exists today and carries on its business in the U.S. Open-ended investment funds are obliged constantly to sell shares to interested investors and upon their request, be redeemed by the net asset value per share of the fund. Investment funds put a lot of money in advertising, because the increase in the number of shares sold leads to increased revenue for the whole fund. As for limitations, it can be said that legislation in many countries prohibits open-end investment funds to carry out the issue of debt securities and the payment of more than 8.5 % sales commission of the revenue from the sale of shares.

There are several basic types of open-end investment funds, including [11], [17]:

- Funds in stocks ;
- Funds in bonds ;
- Hybrid funds ;
- Funds in the money market (funds in short-term securities).

According to the Investment Company Institute, the most common stocks funds are: capital appreciation funds, total return funds and world equity funds.

Capital appreciation funds make rapid capital appreciation (increase in stock prices) and are not very preoccupied with paying the dividend. Many of these funds are relatively risky because managers tend to choose companies with rapid growth. For example, most of these funds invested in high tech in the '90s. years of the 20th century .

Total return funds try to combine long-term capital growth with steady income from dividends. These funds do fulfill that goal by investing mostly in common stocks of established companies with potential for capital growth and achieving mandatory dividends.

World equity funds invest primarily in stocks of foreign companies and allow investors easy access to international diversification. Many analysts recommend investors to keep at least a small part of their investment in foreign stocks.

Besides these three basic types, there are a number of other funds in stocks that differ among themselves according to their goals [15], [17].

Funds in bonds comprise 16% of the total assets that are managed by the open-ended investment companies. The most common are funds that invest in corporate and government bonds.

Hybrid funds invest in stocks and bonds, with what they conduct diversification of the portfolio. Only about 5% of the total assets of open-ended investment funds are accounted to hybrid funds.

Funds in the money market emerged in the '70 of the 20th century and they are open-ended investment funds that invest in short-term securities issued by the state, corporations and local government units. Given that the instruments that are traded by these funds have maturity period shorter than 13 months (bank acceptances, commercial securities, deposit certificates and short-term government securities) and are characterized by low risk, there are small fluctuations in the value of the fund's portfolio. They comprise 40% of the total assets that are managed by the open-ended investment companies.

Investment trust is an investment company that buys and maintains a fixed portfolio of securities (typically, bonds). The number of issued shares is fixed. Investors who buy shares get part of the main value of the company and dividends (or interest). Investment trusts differ from open-ended and closed funds under several aspects, including [12]:

1. There is not an active trade with bonds in the trust portfolio. Once the trust is established by a sponsor (usually a brokers firm) and it is given to the person who will take care of it, then that person holds all bonds until they are redeemed by the issuer. Usually, the only case when the person responsible may sell is if there is a dramatic decline in the credit quality of the issuer. This means that the trust operation costs will be significantly lower than the costs incurred by the open and closed-end investment fund;
2. Unlike investors in open and closed-end investment funds, the investor in the trust knows that his portfolio includes a specific set of bonds and there is no concern that the responsible person will change the portfolio.

Sales commissions, charged by investment trusts, typically range from 3.5 % to 5.5 % [18].

Depending on whether investment funds charge fees for the sale of their shares or not, there are load funds and no-load funds. Load funds charge entry fee, which can amount to up to 8.5 % of the value of the investment. In addition to this fee, however, there is also an exit fee, brought by investment funds when they want to discourage trade in shares of the fund. Some of the no-load funds impose special exit fee, which is collected at short-term purchases of shares of the fund. There are funds with low load, whose commission is within 3 % - 3.5 % of the value of the investment [16].

Investment companies allow their investors to gain profit in three ways, namely:

1. Based on dividends and interest received from the securities within the portfolio. The return (yield) is income per share paid to shareholders and it is a percentage of the purchase price of the shares of the fund;

2. Based on the positive difference between the higher sales and lower purchase price of certain securities or capital gains which, as a rule, are paid to the investor.

3. Based on the growth in value of financial instruments within the portfolio, leading to an increase in net asset value per share of the fund.

So, the total return to investors includes dividends, interest, profits realized through the sale of securities and the growth in net asset value per share of the fund.

3. Advantages and disadvantages from investment funds

Every investment has advantages and disadvantages. The dynamic development of investment companies and their huge popularity among small investors is due to their advantages that can be summarized in the following [7]:

- Investment companies provide a high degree of liquidity. Open-ended investment companies are ready at any time to purchase their shares from investors at NAV (net asset value per share of the fund), possibly increased by an entry fee. So, if an investor gives an order, then the investment company shall, not later than seven days from the given order, send check in the amount of NAV on the date of issuance of the order. Liquidity in closed-end investment companies is very similar to the liquidity of shares of businesses and it depends on their size, efficiency and investment objectives;
- Investment companies are diversifying the portfolio by investing resources in different types of shares in the domestic and international financial markets and thus allow reducing the risk and increasing the rate of return;
- Investment companies realize the transactions with lower transactions costs compared to individual investors. The large volume of transactions allows investment companies to take advantage of lower brokerage fees and low transaction costs. Low transaction costs can lead to an increase in investment performance;
- Professional management allows investment companies to make efficient and effective placement of funds entrusted by investors. The fact that the management of the fund is entrusted to professional portfolio managers significantly reduces the risk of making the wrong investment decisions and increases the attractiveness of buying shares by the population;
- The operation of investment funds enriches the institutional structure of the banking - financial sector, by increasing the competitiveness, promoting the development of the capital market and providing a contemporary approach in carrying out market transactions;
- Investment companies play a particularly important role in the field of financial services. In fact, they are a means of saving for achieving individual sources of primary or additional income that can be used for pensions, funding education of children, buying housing, health care and many other needs. Because investment companies offer higher yield of stocks and bonds compared to savings and by providing and relative safety and high degree of liquidity, they become the most efficient means for long-term savings and take traditional markets of other financial institutions such as banks, insurance companies and pension funds.

Apart from the advantages there are Potential Risks and Disadvantages of Investment Funds that can be summarized in the following:

1. Funds invest in various financial markets, so they are exposed to the corresponding price fluctuations and currency risks.
2. A decline in overall performance on one or more stock markets can result in a fall in the price of units (general market risk).
3. Investor risk increases in tandem with the degree of specialization. Funds that focus on investment themes have a more pronounced risk profile than funds with a broad diversification.

4. Investment decisions are delegated to the fund management and investors have no influence on them.
5. Prices are only calculated once per day (net asset value).

4. Investment funds in Macedonia

In Macedonia, the establishment and operation of investment funds is regulated by the Law on Investment Funds. First Equity Act was enacted in 2000 and it regulates the conditions for the establishment of investment funds, the way of their operation, terms of choice of depository bank, as well as control over their operations. However, despite the many years of the existence of a legal framework, the first investment fund in the Republic of Macedonia was established in November 2007.

There are several reasons that influenced on slow growth in the number of investment funds of which the most significant are the following:

- Strict procedures for foreign operations that have slowed and increased the price of operations for foreigners who want to establish an investment fund in the country ;
- High amount of the basic capital required for establishing an investment fund ;
- The law for investment funds did not allow funds to invest in securities that are traded on foreign markets or in real estate. It prevented greater diversification of the fund's portfolio. The founder of the fund had to invest in stocks or bonds on the Stock Exchange, which significantly reduces the possibilities to optimize the structure of the fund's portfolio.

In 2009, in Republic of Macedonia there were 9 open-end investment funds, managed by six companies for fund management. For example, Ilirika Fund Management manages SEE Ilirika and Ilirika Global Emerging Markets, Innovo Status - with Innovo Status Stocks, KD Funds with KD Brick and KD South Balkan, My Fund - with My Fund , Sava Invest - the Sava Invest growth Fund shares and Sava Invest balancing Fund and KB Publicum Invest - the KB Publicum balanced . Also, the Commission has registered 14 private investment funds managed by 9 companies.

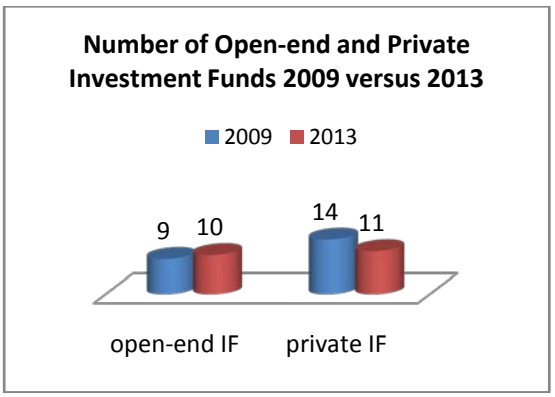

Figure 1. Number of Open-end and Private Invesment Funds

The global financial crisis has adversely affected the functioning of investment funds in the country. The significant decrease was observed in the rates of return and value of shares of open-end investment funds [19]. At the end of 2008 the rate of return on the open-end investment funds, on average, was 57 %. In the case of shares, it also showed a significant downward trend. Compared with the initial value of the participation of 100 denars per share at the end of 2008, the value of the share at most of the open-end investment funds accounted for , on average , 40 denars. The effects of the global financial crisis were felt on Macedonian Stock Exchange and caused decrease in stock prices, which negatively affected the performance of the investment funds, primarily as a result of their investments in securities.

In 2012 investment funds still had little importance within the Macedonian financial system. [20] Despite the relatively rapid growth, their share in the total assets of the financial institutions accounted for only 0.1 %. Inflows of funds from the sale of share documents in 2012 increased, but at the same time there was an increase in the outflows of funds from investment funds based on the purchase of share documents. However, net inflows contributed to the increase on property of the open-end investment funds.

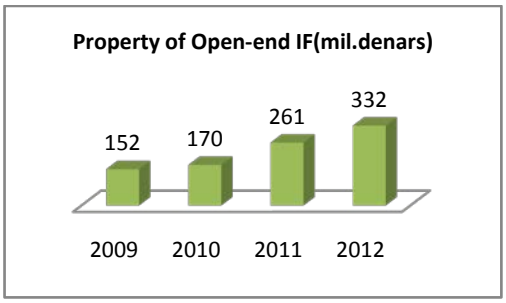

Figure 2: Property of Open-end IF in Macedonia

Moreover, due to favorable movements of the financial markets in which investment funds have invested in the latest quarter of 2012, the nominal annual return of investment funds received positive values . However, companies that manage investment funds continue to operate with negative financial result.

5. Scope, goals and framework of the research

The scope of the research can be defined as the identification of the specifics of the environment of the many relevant indicators that determine investment funds as an alternative way of investing the free funds in the country.

Objectives of the study : Based on the specifics of the investment opportunities for the free financial investment funds in the country , the purpose of this paper will be to define relevant indicators and factors that influence and determine the selection of investment funds as a way of investing free financial resources in the country. This would result in further development and better management of free financial resources in the country. Based on the main objective, through this work the following sub-goals will be carried out:

- Based on critical analysis of the current situation and the treatment of investment funds to identify the real needs of investment funds as an alternative way of investment of the free financial assets
- To receive quality information on scientific and technical basis that will contribute to better understanding of the need for investment of free resources in investment funds .
- To suggest measures for promotion and development of investment funds as an alternative way for investment of the free financial assets.

Defining the theoretical framework of the research:

- Collecting relevant data on how to invest free financial resources with special emphasis on investment funds in the country.
- Definition of hypotheses.
- Creating the content of the questionnaire.
- Designing the plans of the sample.
- Distribution of the questionnaire in paper and electronic form to the previously defined representative and random sample.
- Realization of empirical research.
- Creating a database of survey questionnaires and data processing with appropriate software support. (SPSS, StatCalc).
- Realization of statistical analysis and statistical data concluding for the created data obtained through empirical research, as a basis for discovering relevant factors and indicators for investment funds in Macedonia.

In order to achieve the goal of the project a questionnaire was prepared and it contained 10 questions. The survey covered 219 respondents from larger cities of the Pelagonija statistical area in the country. The questionnaire was designed in a way to be attractive and easy to fill. The structure of the questionnaire is as follows: The first five questions concern on the respondent characteristics (gender, age, education level, employment status and monthly family income). The remaining five questions relate to the status, opportunities and prospects of investment funds as a way to invest free financial resources.

In the conducting process of the survey the basic principles of representativeness, objectivity were respected, and a mandatory safety assessment of results is given (risk of 5% or threshold or reliability of 0.95 as standard in statistical research) and a completed overall documentation for the choice and measurement. All that, including processing and presentation of the data will be realized with appropriate software support.

- In the survey this types of excerpts were used: random excerpt without recurrence, and all the grades in an adequate way are generalized for the target population and are fair and unbiased.
- For the testing of the statistical hypotheses the non- parameter test is applied (χ^2).

Summarized implementation of the research:

• Identification of relevant factors that define investment funds as a way to invest free financial resources in the country.

• Quantitative and qualitative analysis of the research results, conclusions and recommendations

Expected effects of the research:

This research is oriented towards the detection of the current situation and the increasing awareness of opportunities for investment funds as a way of investing of the free financial assets.

6. Descriptive statistics of the sample used for the research

In the following part of the paper a summarized descriptive statistics of the sample will be given in order to have a better understanding of the results.

There is almost a balanced age structure of the respondents which is quite significant for statistical research. The survey covered about 10 % more female than male respondents.

Most of the respondents or 45% are at the age 19-24. The least of the respondents or only 5% are over 64 years old. Three out of four respondents are younger than 40 years. The average age of the respondents was 33.84 years, or half of the respondents have the age to 27.66 years and the other half over 27.66.

More than half of the respondents have a high level of education (or 53% of respondents). In terms of level of education of the respondents 7% have primary education, and 8% have a master's degree or PhD).

According to the employment status 37% of respondents are employed and the remaining 63% are unemployed , students and pensioners.

Nearly 60% of respondents belong to families with monthly income of 10 000 to 30 000 denars. Every 7th respondent belongs to a family that has a monthly income below 10 000 denars. The average monthly income of families where the respondents belong was 25 228 denars, or half of the respondents belong to families with monthly income of up to 22,461 denars and the rest of respondents belong to families that have an average monthly income over 22,461 denars. Both modalities of average monthly income of families are above the average salary in Macedonia.

Most or 60%, invest free funds in banks and significant 32% of respondents did not invest free cash or they keep them at home. Only 4 % of respondents invest their free funds in a private pension fund or investment fund.

70% of respondents invest or keep their free funds due to security. 18% of respondents, invest their free money in institutions because of their awareness of the opportunities they offer and only 12% of respondents, invest their free funds to achieve higher yields.

A significant number of respondents or 61% were not informed about opportunities to invest in investment funds in Macedonia.

Significantly large number of respondents or 93% want to be informed about the possibility of investing in investment funds in Macedonia.

30% of respondents want to be informed about the possibility of investing in investment funds in Macedonia through lectures by experts, 26% want to be informed by e- mail, 23% want to realize communication by attending seminars and the remaining 22% of respondents want to be informed about the possibility of investing in investment funds through printed media (newspapers, magazines).

7. Statistical processing of data obtained with the research

Apart from the descriptive statistics, a statistical testing was carried out in order to define some possible factors that influence the investment activity of Macedonian residents.

Considering the subject, goals, motives and objectives of the research in this paper, as a basic assumption is the following general hypothesis: the different characteristics of the respondents (population) affect the choice of institution where they are investing their free funds. Based on the general hypothesis defined above we can differentiate the following individual hypotheses:

Hypothesis 1: The choice where to invest the free funds in the variety of institutions does not depend on the gender of the respondents.

Table 1. Empirical (theoretical) Frequency of variables: gender of the respondents (rows) and institutions where free funds are invested (columns)

	Bank	Private pension fund	Investment fund	Do not invest (keep at home)
Male	65 (58,710)	3 (3,61)	3 (4,06)	27(31,61)
Female	65 (71,290)	5(4,387)	6(4,935)	43(38,38)

Results of χ^2 - test

Chi square 3.1540
Df 3
P< 0.3680
Cases(n) 217

The calculated value of the test is $\chi^2_{pr} = 3{,}1540$

For an error risk of 0.05% and the number of degrees of freedom $r = (m-1)(n-1) = (2-1)(3-1) = 3$ the theoretical (critical) value of the test is $\chi^2_{(0,05;3)} = 7{,}8147$

Since the calculated value of the test ($\chi^2_{pr} = 3{,}1540$) is less than the theoretical value ($\chi^2_{(0,05;3)} = 7{,}8147$) we accept our hypothesis and we can conclude that the choice where to invest the free funds does not depend on the gender of the respondents. This is confirmed by the fact that the defined risk of error is $1-\alpha$, or p = 0,05 is less than the value of the realized level of risk of error, which is p = 0,3680.

Hypothesis 2: The choice where to invest the available funds in the various institutions does not depend on the age structure of the population.

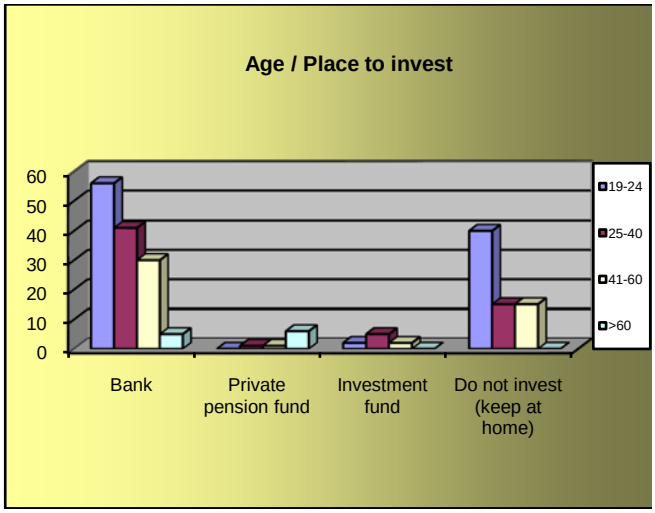

Figure 3: Empirical frequency of variables: age of the respondents and institutions where free funds are invested.

Results of χ^2 - test

Chi square 94.4850
Df 9
P< 0.0001
Cases(n) 219

The calculated value of the test is $\chi^2_{pr} = 94{,}4850$.

For an error risk of 0.05% and the number of degrees of freedom $r = (m-1)(n-1) = (4-1)(4-1) = 9$ the theoretical (critical) value of the test is $\chi^2_{(0,05;9)} = 16{,}9190$

Since the calculated value of the test ($\chi^2_{pr} = 94{,}4850$) is bigger than the theoretical value ($\chi^2_{(0,05;9)} = 16{,}9190$) we reject our hypothesis and we can conclude that the choice where to invest the free funds depends on the age structure of the respondents. This is confirmed by the fact that the defined risk of error is $1-\alpha$, or p = 0,05 is bigger than the value of the realized level of risk of error, which is p = 0,0001.

Hypothesis 3: The choice where to invest the available funds in the various institutions does not depend on the level of education of the population.

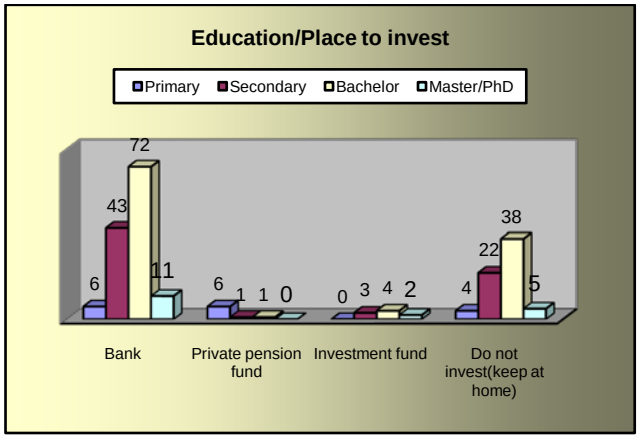

Figure 4: Empirical frequency of variables: Education level of respondents and institutions where free funds are invested.

Results of χ^2 - test

Chi square 58.7580
Df 9
P< 0.0001
Cases(n) 218

The calculated value of the test is $\chi^2_{pr} = 58{,}7580$.
For an error risk of 0.05% and the number of degrees of freedom $r = (m-1)(n-1) = (4-1)(4-1) = 9$ the theoretical (critical) value of the test is $\chi^2_{(0,05;9)} = 16{,}9190$

Because the calculated value of the test ($\chi^2_{pr} = 58{,}7580$) is bigger than the theoretical value ($\chi^2_{(0,05;9)} = 16{,}9190$) we reject our hypothesis and we can conclude that the choice where to invest the free funds depends on the level of education of the respondents. This is confirmed by the fact that the defined risk of error is $1-\alpha$, or p = 0,05 is bigger than the value of the realized level of risk of error, which is p = 0,0001.

Hypothesis 4: The choice where to invest the available funds in the various institutions does not depend on the employment status of the population.

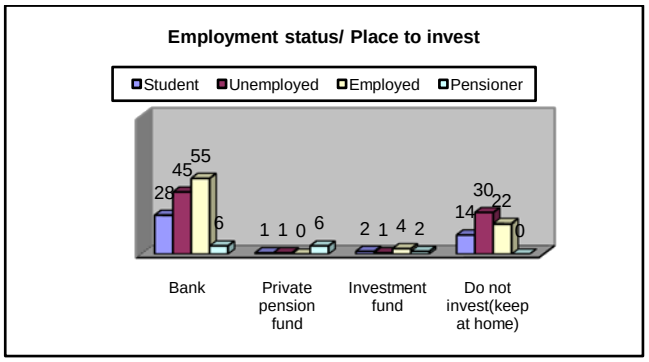

Figure 5: Empirical frequency of variables: Employment status of respondents and institutions where free funds are invested.

Results of χ^2 - test

Chi square 75.6530
Df 9
P< 0.0001
Cases(n) 217

The calculated value of the test is $\chi^2_{pr} = 75{,}6530$.
For an error risk of 0.05% and the number of degrees of freedom $r = (m-1)(n-1) = (4-1)(4-1) = 9$ the theoretical (critical) value of the test is $\chi^2_{(0,05;9)} = 16{,}9190$

Because the calculated value of the test ($\chi^2_{pr} = 75{,}6530$) is bigger than the theoretical value ($\chi^2_{(0,05;9)} = 16{,}9190$) we reject our hypothesis and we can conclude that the choice where to invest the free funds depends on employment status of the respondents. This is confirmed by the fact that the defined risk of error is $1-\alpha$, or p = 0,05 is bigger than the value of the realized level of risk of error, which is p = 0,0001.

Hypothesis 5: The choice where to invest the available funds in the various institutions does not depend on the monthly income of the families of the population.

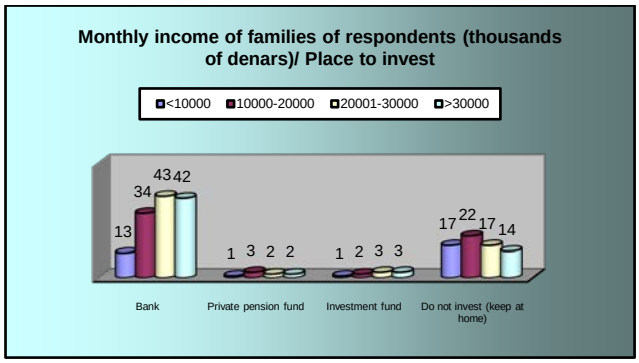

Figure 5: Empirical frequency of variables: Monthly income of families of respondents and institutions where free funds are invested.

Results of χ^2 - test

Chi square 11.1060
Df 9
P< 0.2690
Cases(n) 219

The calculated value of the test is $\chi^2_{pr} = 11{,}1060$

For an error risk of 0.05% and the number of degrees of freedom $r = (m-1)(n-1) = (4-1)(4-1) = 9$ the theoretical (critical) value of the test is $\chi^2_{(0,05;9)} = 16{,}9190$

Because the calculated value of the test ($\chi^2_{pr} = 11{,}1060$) is less than the theoretical value (

$\chi^2_{(0,05;9)} = 16,9190$) we accept our hypothesis and we can conclude that the choice where to invest the free funds does not depend on the monthly income of the families of the respondents. This is confirmed by the fact that the defined risk of error is $1-\alpha$, or p = 0,05 is less than the value of the realized level of risk of error, which is p = 0,2690.

8. Conclusion

Based on the theoretical background on investment funds and their presence in the world and in Macedonia and based on the results obtained through the research these conclusions can be drawn:

The research shows that our population knows very little about these funds. The largest number of respondents, because of their ignorance and lack of information, lack of knowledge about the functioning of investment funds and the benefits of investing, give preference to investing in banking institutions. But the results also show readiness of the respondents to get proper education for this investment option.

Based on the statistical testing the choice where to invest the free funds depends on the age, education level and employment status of respondents and that should be used in order to perform an effective marketing and education campaign that will increase the use of investment funds as an alternative way of investing the free funds in Macedonia. That should give the required boost to the development of investment funds in the country and the free funds will be invested in a more productive way for the investors.

Additionally, the development of investment funds in Macedonia depends on the development of the Macedonian Stock Exchange and the offer of more attractive financial instruments that will enable investment funds to achieve an optimization of their portfolio. If these financial instruments are available, investment funds can become more attractive for potential investors especially small investors.

Further research should provide an answer for the dilemma whether bigger growth dynamics of the Macedonian Stock Exchange will automatically enable growth of investment funds as an alternative way of investment in the Macedonian market.

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