

Aims & Scope (Economics)

Article

A DESCRIPTIVE INVESTIGATION ON ALTERNATIVE INVESTMENTS IN FINANCIAL SYSTEM FOR SMALL INVESTORS IN ALBANIA

Lorena Bezo (Balili),

Ph.D., Faculty of Economy,

University of Tirana, Albania

<https://orcid.org/0009-0000-8574-0427>

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Abstract. This study seeks to investigate possible investment alternatives by small investors in Albania. The analysis is mainly descriptive and analytical of the main factors that have influenced the existence of a limited number of investment alternatives. Furthermore, a comparison was made of the shares that each of the investment alternatives occupies within the financial system, interpreting the data in the study qualitatively. The descriptive data are from the last 5 years, reflecting the dynamics of current post-Covid pandemic event and the war in Ukraine.

It is concluded that the spread of mutual investment funds serves as a competitive alternative to bank deposits since this form of investment requires a small amount for investment and is liquid, therefore preferable for the investor. The only limitation lies in the level of risk, which is higher than other forms of investment in bank deposits and government securities. This risk is perceived to be even higher, especially in the current situation of the war in Ukraine, which has led to increased global inflation and an upward trend in interest rates, which puts the value of investment portfolios in fixed income securities at risk.

Keywords: Treasure Bills, Investment Fund, Interest Rate, Central Bank, Investment.

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Introduction

Apart from the positive developments realized in the framework of the legal and regulatory basis of the financial markets in the last two years, the Albanian financial market is again limited in its alternatives offered to the investing public. The 2022 Progress Report of the European Commission especially evaluates the modernization that the new acts in the legal and sub-legal framework have provided for the financial markets by aligning with the European Directives. (Authority, 2021)

The advantages conveyed in this framework affect the establishment of European standards in the organization and activity of entities that provide investment services. The harmonization of Albanian legislation with that of the European Union for financial markets increases the opportunities for diversification by expanding the presence of internationals in the financial markets, improving supervision and increasing market standards.

Investing money in distinct investment alternatives is a difficult task and involves a deep understanding of risk-return analysis (Bhaskaran & Andavan, 2012). In every economy, both developed and less developed, the main levers for stimulating economic growth are focused on entrepreneurship. The two most important indicators of economic growth and development are considered human capital and entrepreneurial behavior. It is considered of high importance that the investment is made in an intelligent way because only in this way it would enable the increase of wealth. Investment initiatives do not necessarily lead to "all or nothing". This also depends on the attitude that each of the investors has towards investment risk.

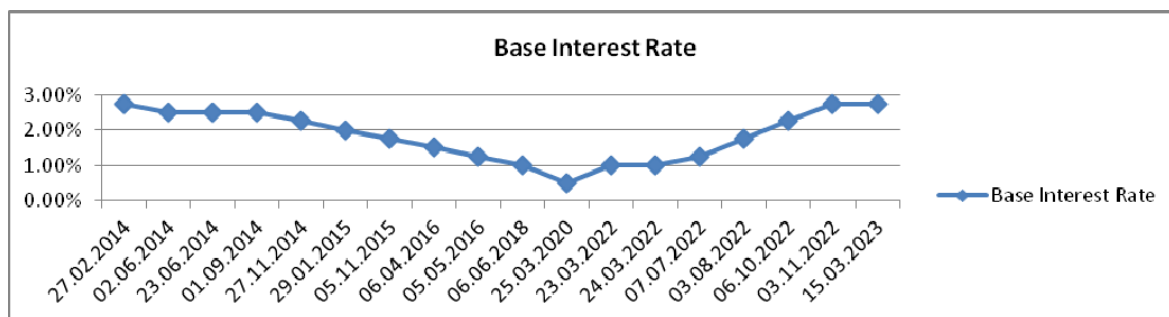


Figure 1. Progress of the basic interest rate

Source: (Interest rate statistics) Bank of Albania

Financial markets around the world, from the end of 2021 onwards, have been faced with a rapid change in interest rates. After a long period of low interest rates, even touching historical minimums (March 2020 at 0.5%), the Ukraine-Russia war brought inflationary pressures around the world, animating interest rates as well. Most of the Central Banks have increased the reference rates and this has been reflected in the interest rates of financial products. As in Albania, an increasing tendency of the basic interest rate is also proven, resulting in a rate of 2.75% nowadays.

In financial markets such as Albania, which lacks an active stock exchange and where international investment alternatives are still limited, the drop in interest rates leads to the removal of interest to keep savings invested in traditional financial instruments. The rising growth of interest rates makes the financial market more attractive in absorbing savings towards investment alternatives mainly for small individual investors.

In order to start the analysis of the investment alternatives that prevail in Albania for small savings, it is necessary to study the structure of the weight of the segments of the financial system. Figure 2 reflects the dominant weight of the banking system of 90% to the total financial system. The important role of the banking system is attributed to the level of economic development, the lack of development of the capital markets and the support that this market segment offers to all market participants. It is also noted that the second important segment of the market is occupied by investment funds which have had an upward trend since 2012 until today, clearly competing with other market segments and being positioned second after the banking sector.

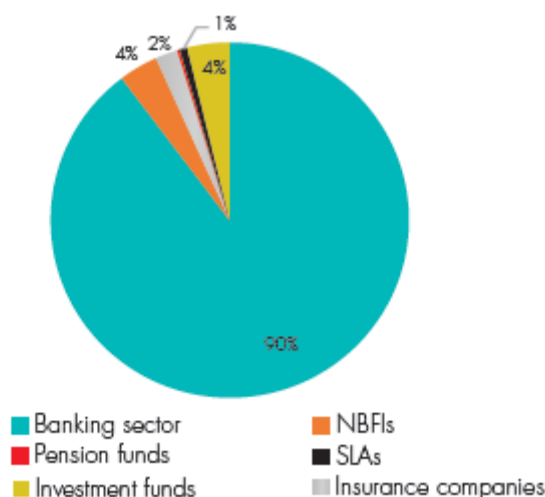


Figure 2. Share of financial system segments / total assets of financial system

Source: (Financial Stability Report, June 2022)

The overview of shares of the segments of the Albanian financial system provides information on how savings are oriented within the system. Being a developing economy, the study analyzed small investors as they represent the majority of accumulated savings in a limited investment reality like in Albania. More specifically, the analysis will focus on the alternatives such as: investment funds, bank deposits and public securities.

Literature Review

From the review of past studies, it is found that a large number of researches have been conducted in different countries to analyze the most important factors that influence the behavior of investors in their investment decisions. Across different countries, researchers have evaluated the investor's behavior and tried to grow our insights of how investors be able to do their investment management in diversification (Kaur & Kaushik, 2016). Investment involves the engagement of money funds and assets with the investment objective of making and receiving regular income or capital appreciation and sometimes both (Bishnoi, 2014). Many researchers and academics have evidenced that most investors avoid investing in options, shares and portfolios built on such theoretical assumptions. (Mamun, Syeed, & Yasmeen, 2015). Instead, there are numerous factors, namely, perception, interest, attitudes, pattern, awareness, and so on, that persuaded the financial decision making of individual investors (Hemalatha, 2019).

(Huberman, Gur, Iyenga, & Jiang, 2007) show that the availability of an employer match increases participation and contributions, especially among low-income employees. Individuals with below average financial knowledge become “overwhelmed” by making investment decisions (Agnew, Julie, & Szykman, 2005).

(Karlsson, Massa, & Simonov, 2006) find evidence that investors choose assets as a function of the way they are represented in the menu available to them. Meanwhile, according to (Benartzi, Shlomo, & Thaler, 2001), employees who follow a "naïve diversification strategy," allocate their income in shares indirectly through an investment fund.

Methods

Secondary data from supervisory financial institutions and mutual investment funds were used in the analysis of this study. The information is collected from the official bulletin of the Bank of Albania, Albanian Financial Supervisory Authority, Raiffeisen Prestigj Fund. In the study, statistical data, analysis, trend and comparative analysis are used. The descriptive data are from the last 5 years, reflecting the dynamics of current post-Covid pandemic event and the war in Ukraine.

Descriptive data analysis seeks to provide a critical and interpretive judgment of the real situation. The most important data are interest rates on repos, treasury bills (3,6,12 months) and government bonds (2Y, 3Y, 5Y, 7Y, 10Y and 15Y). In order to analyze the market of investment funds, data was obtained on the participants in this market, the structure of the assets of the investment portfolio of the investment funds and the annual return of the Raiffeisen Prestige Fund.

Results

In order to internally analyze the investment alternatives for investors in the Albanian financial market, table 1 presents the main characteristics of the investment funds market in Albania. What is noticed is the dominance of individual participants inside investment funds with about 99% compared to legal entities. It is proven that these funds serve as a valuable alternative for investing in small amount. Currently, 14 investment funds are operating, a trend which has been increasing from year to year. The first fund established is Raiffeisen Prestigj in 2012 with an investment portfolio in the domestic currency Lek.

Table 1
Characteristics of Investment Funds Market

<i>Key characteristics of IFs' Market</i>			
<i>Specification</i>	<i>Membership</i>		<i>Change (in %)</i>
<i>Period</i>	31.12.2021	31.12.2022	31.12.'21-31.12.'22
<i>Membership</i>			
<i>IFs' members</i>	40,054	28,953	(27.72)
<i>Of which:</i>			
<i>Individuals</i>	40,028	28,929	(27.73)
<i>Legal entities</i>	30	24	(20.00)
<i>Number of investment funds management companies</i>	5	5	-
<i>Number of investment funds</i>	13	14	7.69

Source: (Statistical Report of Albanian Financial Supervisory Authority, 2022)

The presence of the Raiffeisen Prestigj fund is the earliest among mutual investment funds in the capital market in Albania. Its elite position is also observed in Figure 3, holding a dominant market position of 75.42%. For this reason, this fund will serve in our analysis as a reference fund to compare it with other investment alternatives.

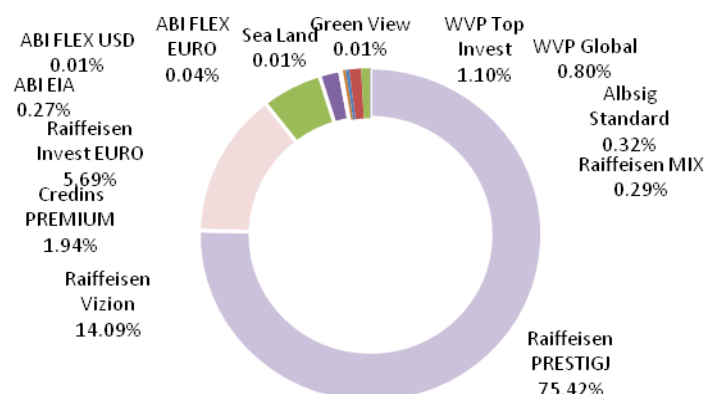


Figure 3. Investment Funds members in %

Source: (Statistical Report of Albanian Financial Supervisory Authority, 2022)

In any investment plan, it is very important that the investor's attitude towards the risk and the generated return. Based on the view that small investors mainly prefer non-risky alternatives, we first analyze the asset structure of investment funds in Albania. According to the latest published statistics, can be observed the dominance of Government Bonds (66.52%) and Treasury Bills (9.42%).

This investment attitude seeks to meet the main demand of local investors against risk, but on the other hand, it is conditioned by the lack of development of the capital market in Albania. The secondary retail market of public securities is organized in the form of the Over-the-Counter Market and includes only trades between licensed brokerage firms (mainly banks) and individual investors or investors-legal entities.

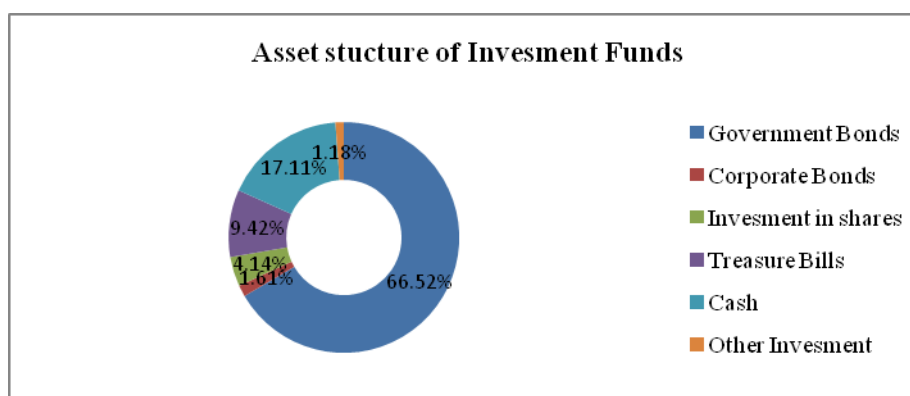


Figure 4. Asset structure of investment funds (21.12.'22)

Source: (Statistical Report of Albanian Financial Supervisory Authority, 2022)

The measures taken by the Central Bank of Albania to maintain unchanged the basic interest rate at 2.75% has given its first effects in recent months, resulting in a decrease in inflation in recent months. In February 2023, the inflation rate fell to 7.1%, which was also reflected in a decrease in the interest rates of bonds and treasury bonds during the beginning of this year. The evidence of this decline is also reflected in Figure 5 and 6.

It is predicted that this decline will continue throughout the first 6 months of 2023 and further a stabilization until the end of the year. The yield of 3- and 6-month Treasury Bonds decreased by 0.27% and 1.12%, respectively, compared to the previous auctions. The 12-month Treasury Bond yield was 3.984%, falling by 0.88% compared to the January auction.

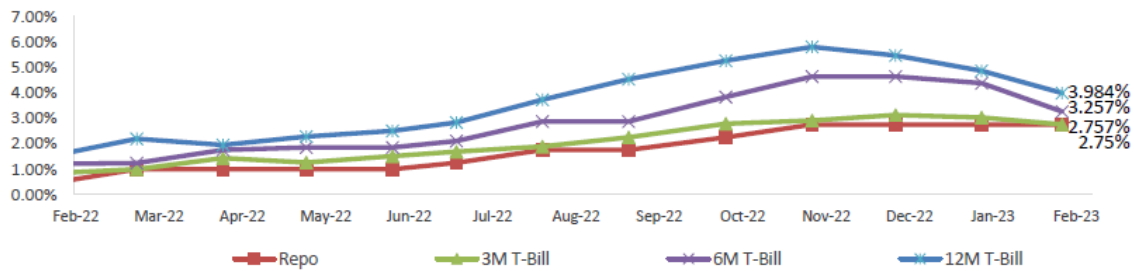


Figure 5. Progress of interest rates of the Treasury Bills of Albanian Government
 Source: (Raiffeisen Prestige Monthly Report , February 2023)

Regarding bonds, chart 6, the yield of the 2-year bond was 5.35%, falling by 0.45% compared to the yield in the previous auction. The reference 3-year bond was 4.984%, falling by 1.30%, the 7-year bond resulted in 6.00%, falling by 1.98% and the 15-year bond resulted in 6.80%, falling by 2.15% compared to the previous auction.

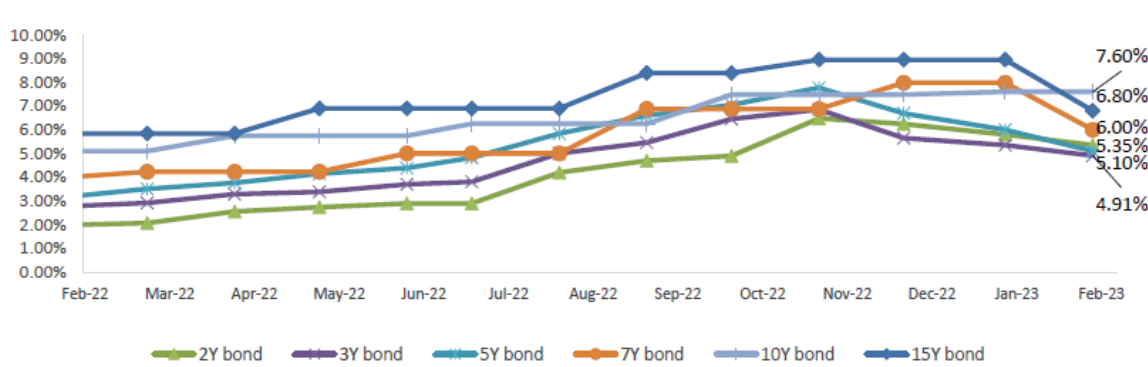


Figure 6. Progress of the interest rates of the Treasury Bonds of the Albanian Government
 Source: (Raiffeisen Prestige Monthly Report , February 2023)

Since the investment funds are oriented towards investments in public securities within the country, the representative case of Raiffeisen Invest, the performance of the interest rates of these securities affects the performance of these funds. Considering that the rate of return varies depending on market conditions, the continuous increase in interest rates during 2022, dictated by the increase in inflation, caused a negative impact on the annual rate of return of this fund (-4.07%) and reflected in Figure 7.

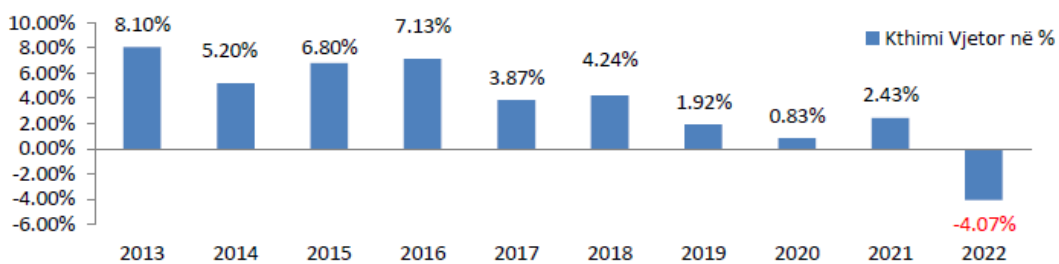


Figure 7. Historical annual return of Raiffeisen Prestige Fund
 Source: (Raiffeisen Prestige Monthly Report , February 2023)

Throughout 2023, the drop in interest rates has had a positive impact on the investment portfolio. In addition to the performance of market factors, it is suggested that investors in mutual investment funds have a longer investment horizon, mainly in the medium and long term to recover the negative effects created in the short term.

The traditional alternative of investing small savings for risk-averse investors is through bank deposits. The form of investment is considered safe and liquid, but the guaranteed return compared to investing in investment funds or treasury bonds is again a little lower. This result is

also evidenced in Figure 8, in which the 12-month interest curve for treasury bills is historically above the 12-month deposit return curve.

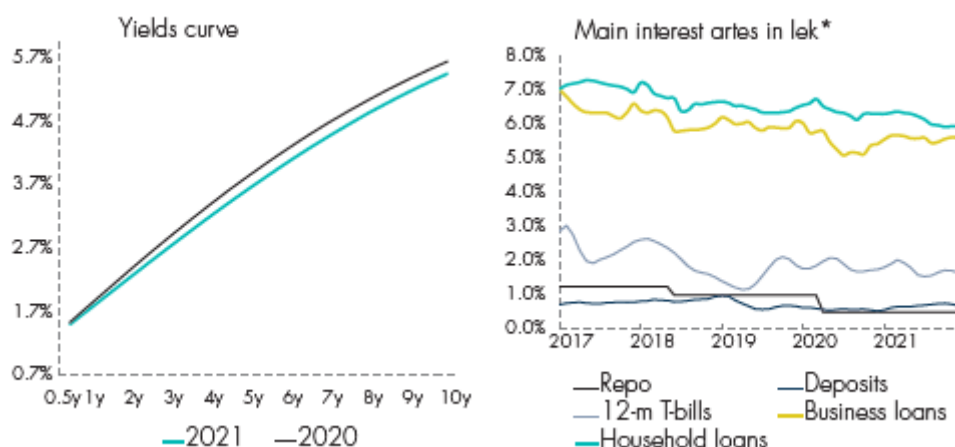


Figure 8. Performance of yields in primary market and interest rates in ALL

Source: (Stability Report of Bank of Albania , 2022)

In the risk-return ratio, the return of deposits should dominate, but the way trading is organized and the absorption of public securities in the Albanian financial market brings such a result. A significant weight of public securities is absorbed by commercial banks by imposing such behavior of interest rates of public securities on bank deposit rates.

Conclusion

This study seeks to investigate possible investment alternatives by small investors in Albania. The analysis is mainly descriptive and analytical of the main factors that have influenced the existence of a limited number of investment alternatives.

During the study, it is evident that the Albanian financial system is limited in the number of segments of its representative markets. According to the data analysis, it was proven that the banking system occupies an important role (90%) of the entire system. The important role of the banking system is attributed to the level of economic development, the lack of development of the capital markets and the support that this market segment offers to all market participants. It is also noted that the second important segment of the market is occupied by investment funds which have had an upward trend since 2012 until today, clearly competing with other market segments and being positioned second after the banking sector.

After a decline in returns experienced during 2022 as a result of rising interest rates, throughout 2023, the drop in interest rates has had a positive impact on the investment portfolio of investment funds. In addition to the performance of market factors, it is suggested that investors in mutual investment funds have a longer investment horizon, mainly in the medium and long term to recover the negative effects created in the short term.

It is suggested that; regulatory authorities to stimulate more public information on direct investment of investors in bonds and treasury bonds in auctions carried out by the Central Bank, caution of investors in investing in mutual funds mainly in short-term periods as the risk is higher and the development of alternatives new ones which would enable the diversification of the investment portfolio of investors in Albania.

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