

# **ISSUERS, SHAREHOLDERS AND INVESTORS**

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This book contains brief information on types of securities in the Republic of Armenia, features of open and closed joint-stock companies, forms of their reorganization, ratios used to calculate stock price, features of the procedure for registration and listing of securities at the Armenian Stock Exchange.

Some of the information contained herein would be useful for the issuers, shareholders and investors who entered the market as a result of privatisation of state ownership.

The book is for stock issuers, shareholders and investors, it would also be of interest to a much larger audience.

## Issuers, Shareholders and Investors

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## **INTRODUCTION**

Issue of new stocks for sale and resale at the stock-exchange to attract additional capital still has rather an insignificant part to play, despite that this is quite an efficient mechanism for increasing of profits and redistribution of capital. Under these circumstances, any talk of the liquidity of stock market in Armenia would just be inappropriate. First steps are made towards openness and accessibility of information on JSC-s, without which it would be nearly impossible to estimate the value of their stocks. Securities market in RA is just getting its role in market economy, changes in stock prices do not fit any financial model and mathematical logic, which means that until now system analysis of securities market has not taken its deserved place within the investment decision making process. Many rules and standards are developed for professional participants of the market and stock issuers to implement effective control over quality and transparency of the information presented by JSC in view of the existing accounting principles and economic factors. This has been done taking the account of the modern accounting principles and economic standards.

However, much is still to be done to ensure efficient activities of the market, including developing of standards for the behaviour of market participants: stock issuers, shareholders, and investors.

## **Chapter 1.**

### **Securities Market**

#### **1.1. Securities market in Armenia and its features.**

In early nineties of the past century, following the collapse of the USSR, Armenia gave up the command-administrative economy and adopted strategy aimed at development of new economic relations, which had never existed in the country before. Armenia's transition to market economy is the outcome of the objective changes, which took place within the new framework of economic relations. One of the most important market economy features is the securities market. Introduction of the securities market, establishment of stock-exchanges and initiation of stock-exchange trade is the logical conclusion of state ownership privatisation process.

It is widely recognised that the public system of economic relations forms the financial market, which consists of the capital market, as well as foreign exchange and money markets. Securities market is one of the elements and the connecting link of the financial market.

Securities market is a mechanism to bring together buyers and sellers of securities. The most important function of the securities market is its constant dynamic movement, which results in the economic development. Below are the special functions of the securities market:

- formation and distribution of financial resources necessary to expand production and ensure technical progress.
- transfer of ownership rights to third parties in the form of securities and, first of all, stocks.

Owing to introduction of various kinds of securities in financial and economic circulation, the opportunities and flexibility of distribution and redistribution of financial resources increases and the directions of the investment flow diverse significantly not increasing general money supply. Issue and allocation of securities is one of the most efficient way to accumulate capital for rehabilitation of the industrial sector and establishment of new enterprises.

Under market economy securities market acts as the re-distribu-

tor of money savings, which results in free, although sustainable, capital flow to the most effective sectors of economy.

It has to be pointed out that securities market existed in Armenia during the Soviet period, at NEP times, in the form of commercial credit. However, the securities market was rather restricted at that time and only existed for Treasury bonds and minor private stocks. It was a mechanism for distribution rather than mobilization of funds, since no stock-exchange and no market where securities would be subject to buying and selling existed. Stocks were allocated to various organizations, enterprise and bank owners, which resulted in reduction of the securities market functions, and, eventually, the economy lost another tool to attract funds. Unfortunately, plenty of examples where the Government failed to duly pay against its debts can be stated from the history of borrowing at the local market during Soviet times.

Securities market trades its own specific goods - securities. Securities is a document certifying property rights where established forms and obligatory requisites are observed. Realization and delegation of the rights are only possible upon presentation of the securities, which is allowed to be in circulation in the securities market. By transferring securities to other entity all its certified rights are delegated. Securities give the owner property rights, serve as a source of income and are subject to sale and purchase. Securities include stocks, bonds, bills and other types of long-term and short-term financial obligations. Classification and description of securities are given in the subsequent section of this chapter.

Any securities market includes the following components: participants of the market, stock-exchange and off-exchange markets, state regulation authorities, self-regulatory organizations and market infrastructure (legal, information, depository-clearing and registration networks).

Securities market is the regulator of many spontaneous processes in market economy, such as process of capital investment. The migration of capital provides its inflow to required places of application and its simultaneous outflow from sectors where it is in excess. The mechanism of migration works as follows: demand for certain goods or services increases, prices for them increase, profits from production of such goods, or rendering of such services, also increase, as a result,

the adsorbed capital is directed to this industry leaving non-profitable sectors. This leads to an effective distribution of capital within market economy mainly in socially necessary industries. As a result, optimum structure of public production corresponding to public demand develops. This is the main advantage of the market economy.

This mechanism works effectively under advanced market relations and becomes especially important for countries in transition to market economy. The making of market relations brings to civilized development of economy and society, which, in turn, predefines and increases the level of civilization of various society groups.

Under transition economies, enterprises face numerous problems connected with change in management, need for new production methods, marketing and sales development. However, no sources, and shortage, of funds is probably the most significant problem. The requirements of enterprises as regard additional capital can relate to various reasons: one of the most important reasons is the necessity to create new and modernize the existing fixed assets and replenish current assets, which directly relates to changing market conditions. Therefore, to ensure normal activities and an appropriate level of competitiveness, enterprises should receive additional financing required all the time while favourable market conditions exist. In countries with developed market economy additional capital is obtained at the securities market, which is the most accessible source of financing.

Like any other market, securities market is a complicated organisational and economic system containing high level of integrity and completeness of technological cycles.

Securities market is a specific market, which differs from the market of real values where both material resources and assets circulate, and the credit market where loans for certain period of time, against certain fee and subject to repayment are granted. The securities market covers the relations of joint ownership for real assets and credit relations through issue of securities subject to free sale, purchase and redemption.

Another important feature of the securities market is its liquidity. A developed securities market allows the issuers to receive long-term funds required for the investments, and the investors to make

investments as short-term as possible. This is explained by the fact that the investor has an opportunity to sell securities throughout their validity, while the enterprises as the debtors can make use of the funds throughout the investment term, on conditions established. The other important feature of the securities market is the redistribution of risks (hedging) by means of sale and purchase of fictitious capital through "reverse" deals, where parties to the deal assume the risk by turns, as well as "the function of attraction of venture capital", which gives the participants of the market an opportunity to risk their own capital to gain higher profits, and the venture companies the opportunity to receive financing. Venture enterprises are the enterprises mainly involved in the development of computer systems and software, telecommunications, biotechnological research etc. It has been discovered that enterprises paying high dividend contain higher level of latent risk; more than half of them go bankrupt and wind up. It has to be mentioned, in the meantime, that some of them may appear very perspective and profitable.

Securities markets consist of primary and secondary markets.

The primary market consists of all stages of new securities issues and their primary allocation. At the secondary market, securities initially allocated at the primary market circulate. Secondary market, in turn, consists of organised and non-organised markets. Let's consider the primary securities market. The securities issued by the issuers first enter the primary securities market, where they are allocated, i.e. transferred by the issuer to their first owners (shareholders) or investors. Therefore, it is at the primary market that the issuers receive funds from the investors. The basic participants of the primary market are the stock issuers who need funds for investments into fixed and current capital, as well as the investors seeking profitable industry to use their capital in. The primary market ensures mobilization of freely available funds for issuers. However, it not only mobilizes the funds, but also allocate them by sectors of economy. Note has to be made of the fact that the funds are invested in sectors of economy, which are able to ensure maximum income, with effective and proportionate structure of national economy formed.

In the Armenian securities market, open joint-stock companies, as well as the Government act as the issuers. It has to be noted that

the Government is getting more and more prevailing role at the securities market from one year to another. Volume of the Treasury bond market exceeds the corporate securities market significantly: in the year 2000, it stood for 95.56 per cent of the entire market. The buyers of securities are both private and institutional investors.

From legal point of view, the primary securities market is described as the relations related to the stock issue, or between the parties who assume obligations on securities (shareholders or primary investors, professional participants). Hence, primary market represents the market of primary and repeated securities issues, where initial allocation thereof to investors takes place. The basic feature of the primary market is the full disclosure of information to the investors, which allows to reasonably choose securities for investments. The issuer's activities at the primary market, i.e. issue of prospectus, registration thereof, confirmation by the authorised Government body of the integrity and validity of the information presented, prospectus publication, announcement of subscription results, are aimed at disclosure of information. There are two forms of securities allocation at the primary market:

- private allocation (limited subscription);
- public offer (open subscription).

Private allocation includes sale of securities to a limited number of originally chosen investors with no public offer and sales made.

Public offer represents the allocation of securities on primary issue by means of public announcement and sales to unlimited number of investors.

Like in other CIS countries, in Armenia, the securities market is in the making. Privatization carried out in 90s, as well as majority of state owned enterprises having gone public resulted in establishment of numerous joint-stock companies, who are in desperate need of investment funds to purchase new fixed assets and update the old ones, replenish current assets, implement new technologies, improve competitiveness level.

The primary market is interconnected with the secondary market, where securities issued and once purchased at the primary market are being resold to other investors. The main role of the secondary market is to ensure the liquidity of securities market, which allows

to support the interests of the investors. In this case the investor has the opportunity to sell the securities he owns at market value, which helps maintain the investors' trust in the securities market as the tool to allocate temporarily available free funds. Another purpose of the securities market is to increase the quoted value of the securities - "promotion" of the issuer's securities. This is done by the dealers by purchasing the shares at the primary market and then by means of speculating for a rise selling them at a higher price. At the secondary market, circulation (buying and selling) of securities, continuing change in owners takes place, whereas the owners of the securities, and not the issuers get the proceeds from sales. The most important feature of the secondary market is the liquidity thereof, i.e. the ability to allocate major volume of securities within short period of time under insignificant price fluctuations and low sales expense.

The secondary market consists of stock-exchange (organized) and off-stock-exchange (non-organized) markets. The features of these markets will be discussed in the next section.

Stock-exchange represents an organized market for high quality financial instrument (securities) trading. Deals at such market are carried out by professional participants of the securities market.

Stock-exchange is extremely important for the transformation of the capital seeking short-term investments. Stock-exchanges allow to collect financial resources with no intervention by the Government and allocate them in profitable sectors of economy. Giving up stock-exchange services under the market conditions would lead to enterprises having to manage with own funds and savings. Majority of enterprises have got limited opportunities of obtaining bank loans because of high rates of interest payable and the requirement to provide high quality security. There are in total about 150 stock-exchanges worldwide, of which New-York, London, Tokyo, Frankfurt, Zurich, Paris and Hong-Kong stock-exchanges are the largest ones.

The participants of securities market can act as both stock issuers and investors. The main participant of securities market of Armenia is the Government. Government securities are liquid, and the market is always prepared to accept them in large quantities. Treasury bonds are highly reliable and contain low risk, with stable yield ensured.

Owing to their reliability those who don't wish to risk prefer to invest funds in securities. Government represented by various Ministries is also a major shareholder of a number of open joint-stock companies, which will go public in the nearest future.

The other market participants worldwide are institutional and private investors (individuals). Institutional investors include financial and credit institutions entering into transactions regarding securities, such as commercial banks, insurance companies, pension funds etc. Private investors are individuals who invest in securities. In Armenia, significant investments in corporate securities are made by individual investors. Finally, the other important group of participants of the securities market are professional participants - brokers and dealers.

In Armenia, the process of formation of market economy and market relations has got an irreversible character. Some stages of economic reforms are left behind as a result of which appropriate economic structures have appeared. One of the results of economic transformations is the securities market along with its components. The dynamical development of the latter requires further expansion of economic transformations by means of accumulation of financial resources. This can be achieved by applying capital market mechanisms and attracting direct investments, which promote production growth. Financing received on the basis of agreements with international institutions should be used for investment purposes by creating favourable conditions to promote investing by international financial institutions in the share capital of the enterprises comprising the real sector of Armenian economy.

It is unquestionable that the market should be based on legislatively approved legal base. Laws and other legal acts should provide legality of the concluded contracts. Such an approach can be a guarantee for investors, especially foreign investors, for them to be sure that a fair decision would be made on any disputable question. Thus, the role of the state in economic relations will remain decisive for rather a long time in the countries with transition economy, especially in such an area as the securities market, since being extended and risky this market would only be able to operate in a civilized and safe way provided that the state support is in place. The features of the regulation of the Armenian securities market will be discussed below.

Nowadays, the main trend of the Armenian securities market is the prevalence of the primary market over the secondary market. Primary market formed as a result of a privatization, foundation of new joint-stock companies and financing the state debt by issue of Treasury bonds. As for the secondary market, it is still in the making. According to the provisions of the Law of the Republic of Armenia "On regulation of the securities market", securities market infrastructure, including Stock exchange and Central Depository has been established. At present, two such organizations operate in Armenia: the Armenian Stock-Exchange and the Central Depository of Armenia.

In general, only the first steps have been undertaken towards the development of securities market in Armenia, and there are numerous problems, resolving of which would require implementation of aggressive state policies aimed at the formation of the national market integrated into international capital markets and protecting national interests. At this stage of economic development, most of the joint-stock companies are in desperate need of funds. If favourable investment environment is created in Armenia, it would become possible for the enterprises to have a direct access to the securities market for the purposes of attraction of investment funds. Such policy would also establish conditions promoting attraction of foreign investments through additional stock issues. During the past few years, a part of the Armenian population who had free funds available began to invest in Treasury bills. It is obvious that in countries with transition economy the basic precondition for formation of the securities market has always been the privatization. In Armenia, as a result of a mass privatization of state enterprises new economic-legal relations, as well as the following institutional structure were formed:

- Corporate sector of economy;
- Stock-exchange and off-stock-exchange corporate securities markets;
- Major and minor proprietors.

However, the main participant of the securities market, namely the average sized proprietors (investors), has not appeared. It has to be noted that one of the disadvantages of the Armenian securities market is the fact that there are neither institutional investors, nor sta-

ble mechanisms to protect the rights and interests of the investors.

Let us present in brief the situation at the Armenian securities market.

Stocks issued as a result of privatization of state enterprises (common registered stock), as well as Treasury bonds issued on behalf of the Armenian Government make the significant part of securities in circulation. At present, short-, middle- and long-term Treasury bonds are in free circulation at the market. The Treasury bonds were first issued in August 1995; since then the Ministry of Finance has continued to issue T-Bonds on behalf of the Government on a regular basis. The allocation of T-bonds is carried out by the Central Bank of Armenia, which was appointed as the financial agent of the Government. Besides, at the T-bond market the Central Bank of Armenia carries out registration of ownership rights over the bonds, setting off mutual obligations on transactions with bonds, checking and accounting of obligations at delivery of bonds. It means, that at the T-bond market the Central Bank actually carries out functions of depository and clearing bank. The bonds are allocated at price below nominal value, with discount, and circulate in non-cash form.

As to the issue and circulation of corporate bonds, it has to be noted that this industry is actually not functioning.

In Armenia, the following basic types of stocks can circulate:

- Bearer or registered stocks;
- Stocks in free circulation and those in limited circulation;
- Common or preferred stocks

Mainly registered stocks are currently in circulation at the securities market, whereas most of them have been issued as a result of a privatisation of state owned enterprises.

Activity, which is subject to licensing according to the Law of RA "On Regulation of Securities Market", is considered as professional activity at the securities market. For carrying out of any professional activity at the securities market, a license is granted, validity of which is not limited. The licensing and regulation of the professional participants of the securities market is carried out by the authorized governmental body, namely: Securities Commission of the Republic of Armenia. It has to be noted, however, that despite there is rather large a number of experienced participants at the market,

they do not possess sufficient professional knowledge, nor the range of services offered by such participants is diverse enough. Unlike other countries with transition economy, in Armenia, investment funds do not have a significant role to play during the ongoing privatisation. As to other institutional investors, note has to be made of the fact that state owned pension fund and private insurance companies operate in the republic, however, they are not active players of the securities market. At present, one stock exchange operates in Armenia - the Armenian Stock Exchange (ARMEX), which has been established as self-regulatory organization. ARMEX is regulated by the legislation in force, as well as the stock exchange rules. ARMEX carries out the examination and listing of securities. "RTS Plaza" electronic trade system has been installed at the Armenian Stock Exchange, which meets international standards. "RTS Plaza" includes up-to-date software and databases and allows to conclude deals and effect set offs via computer network on-line in real time, i.e. immediately once such deals are entered into, which helps reduce the amount of work required to conclude and register the deals, increase the efficiency of the whole process, minimize the occurrence of system risks. The system ensures the efficiency of the distribution of information, in particular, that one about trade sessions, volumes and prices of individual deals.

In Armenia, circulation of securities at the off-stock secondary market takes place with no examination, and is, therefore, risky. Upon transition to market economy, Armenia became an open part of the world financial market. This has ensured pre-conditions for the significant inflow of foreign investments. Investments through purchase of securities depend directly on the development of the national stock market, and especially on the efficient activities of the depository and clearing systems. Given the features of the stock market development in Armenia and taking the account of the recommendations issued by the international organizations, as well as the experience of other countries, centralized model of depository system was created in Armenia.

Central Depository of Armenia is a self-regulatory organization. The Stock-exchange, professional participants of the stock market, banks, inclusively of the Central Bank of Armenia, can be members



of the Central Depository. Central Depository is engaged in the following kinds of economic activities:

- provides securities depository services, runs deposit accounts for securities converting them into intangible form;
- acts as the centralized register, runs the register of owners of securities;
- carries out set offs of obligations under the deals, converts securities into depo-accounts based on the results of the trading thus carrying out final settlements.

Real (beneficiary) stock owners, nominal stock owners, i.e. professional participants of the market who have got licence on carrying out depository activities and concluded relevant agreement with the Central Depository, as well as stock issuers can be the customers of the Central Depository. For each stock owner, individual personal account is opened, which is operated as both register account and depo-account. If the real stock owner is also the nominal owner, then two personal accounts would be opened. Using the account of the nominal stock owner, professional participants of the market effect deals for their customers.

The state regulation of one of the securities market, one of the most important sectors of the financial market, is one of the basic mechanisms to ensure smooth functioning of the economy.

In developed countries, control and regulation of the securities market is carried out jointly by the state and self-regulatory organizations. At present, two self-regulatory organizations exist and successfully operate in Armenia.

Self-regulatory organizations are established by professional participants of securities market to ensure appropriate conditions for their activities, compliance with the standards of professional ethics, protection of interests of securities owners, establishment of rules and standards for carrying out of transactions with securities. Ensuring maximum possible protection of investors and integrity of the Armenian securities market by implementing consistent, fair and efficient self-regulation is the goal of ARMEX. Self-regulation ensures that all members of ARMEX participate in the management of stock exchange on equal terms. Self-regulation is carried out according to "one member - one vote" principle. This means that each ARMEX member company, has one vote in managing the activities of the

stock exchange irrespectively of the trading volume, financial assets, and other conditions.

In securities market of Armenia the self-regulatory organizations assume ever more important role, as only professionals can understand difficult conditions of securities market. Where control above securities market is only in hands of the state, it is insufficiently effective and is almost always late in making of decisions.

Securities Commission of RA is the state body regulating securities market of Armenia. The regulating body carries out functions on improvement of legislative field regulating securities market, regulation of stock exchanges and non-stock trade, licensing of the professionals of the market, preventing of manipulations, application of sanctions, establishment of kinds and forms of reporting, creation of perfect information field.

According to the Law of RA "On regulation of securities market" the purposes of regulation are the following:

- to protect the investors' rights
- to ensure the transparency of the activities carried out by the participants of the securities market
- to promote the improvement and the development of the efficiency of the securities market activities
- to implement settlement and clearing transactions on the deals entered into as regard securities
- to develop and maintain fair mechanism for securities pricing
- to secure using the securities and cash aimed at concluding deals with securities.

As the experience gained worldwide proved, the securities market can exist with no regulation at all, however, in this case it would not be able to function effectively, since it would become obvious for the investors that the deception and manipulations are an integral part of practices used by such market. It is widely known that investments tend to flow towards markets with the most attractive ratio between risk involved and profits expected. One of the basic objectives of the market regulation is creation of such conditions at the market that would promote the effective and fair execution of the deals with securities. Those markets that do not provide information sufficient to evaluate the risk involved in the investment can not attract capital flows.

To create an effectively regulated market, the Armenian National

Assembly has approved Law "On regulation of the securities market", which was of utmost importance and ensured the legislative environment required for further development of the securities market.

The Law envisages that: regulation of those companies who carry out professional activities at the securities market should be in place, the transparency of the securities market should be ensured by means of providing of the participants of the market with full and accurate information in a timely manner, the procedure for issue and public allocation of the securities, as well as procedures (guidelines) of activities of the on Securities Commission of the Republic of Armenia should be approved. One of the basic objectives of the Law is to establish favourable environment for private investments.

## **1.2. Stock-exchange and off-exchange trade.**

### **ARMENIAN STOCK EXCHANGE**

In this paragraph we will describe the secondary securities market, namely: the stock-exchange and off-stock-exchange markets, we shall also discuss their special features, advantages and disadvantages, mainly advantages provided by the stock-exchange ; the importance of the secondary market for mobilization of the capital and allocation thereof to various sectors of economy to ensure as revival of such sectors, as successful activities of the securities market.

As it is widely known, the securities market is divided to the primary and the secondary markets. The importance of the primary market, i.e. the market where the initial allocation of the newly issued securities is carried out, was described in the previous paragraph. It should be noted that the primary and the secondary markets are closely connected and it is not possible for the one of them to exist without the other in place.

Circulation of the shares already issued is ensured at the secondary market. Here, broker companies are operating, whose main objective is to protect the investors' rights by complying with their instructions at the securities market. Dealer companies act on their own behalf, at their own expense, their main objective is to buy for less

and to sell for more. The market price over the securities depends on the changes in supply and demand; as a result the real market value of the securities is formed. The secondary market does not affect the volume of investments and savings, but just promote redistribution of the ownership.

Another equally important role of the secondary market is to ensure the liquidity of the securities, i.e. ensure that the securities can at any time be converted into cash at an acceptable rate. The opportunity of selling the securities is one of the most significant factors, which the investors consider while buying at the primary and secondary markets.

The securities are considered liquid if there is an opportunity to convert it quickly and in full in cash. At the secondary market, the supply and demand for securities are generated, which helps establish its quoted rate.

The secondary market promotes conditions necessary to ensure that the securities market is balanced and liquid; ensures market efficiency, therefore also strengthening of the economy.

There are two organizational types of secondary securities markets: organized and non-organized market, each of them has features of its own. The organized securities market represents circulation of securities among the licensed professional participants of the market in accordance with strict set of rules and by the instruction of the other market participants. Non-organized market is the circulation of securities with no unified rules set for all of the participants of the market. Based on the method of trade, there are stock-exchange and off-stock-exchange (off-exchange trade) exist. Stock-exchange market represent securities trade at the stock-exchanges. In Armenia, off-exchange market is extremely unorganised. The off-stock-exchange market of securities is discussed forth.

The non-organized, spontaneous or off-exchange market is the simplest stock trade form. Whether the deal will be concluded would depend on how adequately will the chance bring the potential buyer and seller together. The terms and conditions of the deals may vary even where such deals are concluded at the same time. No unified quote rate for securities, or any information on the market in place is typical of the non-organized market. In off-exchange circulation,

there is no one physical centre for concluding of the deals; buying and selling is effected at broker offices by entering into sales and purchase contracts. Prices are negotiable.

This is how the off-exchange circulation of securities takes place. It has to be noted that the majority of deals with securities is still effected off-exchange, and not at the stock-exchange.

Despite that the above mentioned features are typical of the off-stock-exchange markets of many countries, there are a number of differences between such markets and that of Armenia. In particular, in Armenia, rules exist that regulate the off-exchange circulation of securities, although such rules are less severe than those for stock-exchange trade.

In Armenia, all licensed broker offices automatically become members of the Armenian Stock Exchange, however, having the full right to effect deals through the stock-exchange they still prefer to do so at the off-stock-exchange market. The reason for this is the fact that the investors who intend to sell or buy securities of a company do know each other. As one may be aware, the Law of the Republic of Armenia "On Regulation of the Securities market" allows to effect such transactions off-stock-exchange.

As it was discussed earlier, another organizational form for the secondary market is the stock-exchange.

Establishment of joint-stock companies, issue of shares and Treasury bonds, using funds for effecting investments into the economy and financing of the Government projects result in formation of the swiftly growing securities market and cause the need for it to be regulated by the Government. As a result, a special institute is created, namely the stock-exchange, the basic objectives of which are the arrangement of the trade sessions, as well as supervision and regulation of the circulation of securities. At present, the only stock-exchange registered in Armenia is the Armenian Stock Exchange, which is a self-regulatory organization and a non-commercial legal entity. The Armenian Stock Exchange is a voluntary association of broker (dealer) companies, which carries out its activities pursuant to the Civil Code of the Republic of Armenia, the Law of the Republic of Armenia "On Regulation of Securities Market" and its charter. Armenian Stock Exchange is the first self-regulatory organization reg-

istered in Armenia. The self-regulation principle provides each member company with equal right to participate in the management of the stock-exchange.

The Armenian Stock Exchange sets down rules regulating professional activities of its members and standards for conclusion of deals with securities, which are mandatory for all of its members, as well as supervises compliance with such rules and standards. The Armenian Stock Exchange is entitled to check the activities of its members and obtain information required, supervise compliance with professional and securities dealing standards and rules approved by Armex, develop training programs for existing and potential professional participants of the securities market.

Since Armenian Stock Exchange is a non-commercial organization it is not a profit oriented company, and any income gained is used by Armex exclusively to achieve its statutory objectives and is not to be distributed among its members.

Armenian Stock Exchange is a financial intermediary with a regulated working regime where trade deals between the buyers and sellers of securities are effected according to the official rules of the stock-exchange through stock-exchange intermediaries, the broker companies.

According to the Law of the Republic of Armenia "On regulation of the securities market", the number of companies-members of the stock-exchange should not be less than ten. As at the 1st March, over 20 broker companies operating in Yerevan, Gyumry and Vanadzor were members of Armex.

The trade process at the stock-exchange is arranged according to the rules of the stock-exchange. The stock-exchange is also to provide technical and logistical basis for the implementation of the deals at the stock-exchange.

The most important goal of the stock-exchange is the establishment of the real market value of the share as a result of the trade sessions. At the stock-exchange, the correlation between the current supply and current demand is established and the market price is defined, which reflects the balance, albeit temporary and relative, sufficient for carrying out of a deal. In fact, the concentration of supply and demand, large number of deals concluded eliminate any influence by

non-market factors over the price of securities, meaning, bring it close enough to the real level of supply and demand. As a result, based on the stock-exchange prices, which appear to be the market prices, forecasts as regard prices are made on a daily basis. It has to be pointed out, however, that Armex is not an actively operating stock-exchange yet, mainly due to the limited number of deals and volumes traded. The majority of deals is carried out off-stock-exchange.

Stock-exchange guarantees that the deals entered into will be executed. This is achieved owing to the clearing and settlement systems used by the stock-exchange. For this purposes, settlement system, as well as mechanisms for effecting set offs of mutual obligations of the participants of the market are used, and execution of the deals is arranged. The procedure of settlements applied by Armex is detailed in the rules of trade of the Armenian Stock Exchange.

It is recognised that one of the functions of the stock-exchange is its informational function. Armenian Stock Exchange undertakes all steps necessary to ensure transparency of the deals concluded at the stock-exchange and fair securities pricing. The results of the stock-exchange trade are open to general public, i.e. the stock-exchange publishes information on prices, volumes of trade and number of deals, as well as companies trading at the stock-exchange and market conditions, in media. To ensure normal course of business and transparency of the securities market, Armex provides its members with information on the date and place of execution of the deals, securities listed, value and price thereof, results of trade sessions and other data required. Disclosure of information is made pursuant to the procedure for disclosure of information approved by the Armenian Stock-Exchange.

One of the features typical of the stock-exchange is that it is subject to regulation by the state. In Armenia, Securities Commission of the Republic of Armenia is the competent state authority to regulate the activities of the stock-exchange. By approving legislative and other legal documents, the Commission establishes rules, according to which the stock-exchange should operate. The regulation of the stock-exchange market is carried out for the following purposes:

- to promote the free and open stock-exchange pricing process based on the concentration of supply and demand;
- to establish an efficient market, which always has incentives

for entrepreneurship to offer and where any risk assumed is adequately remunerated;

- to ensure the order and lawfulness at the stock-exchange market, as well as conditions to ensure normal course of business of the participants of the market;
- to prevent any potential unfairness, fraud and manipulation by professional participants of the market;
- to create and support stock-exchange institutes.

Securities entering the stock-exchange have to pass through listing, which is rather a severe procedure designated to define the most reliable and profitable instruments. The listing is carried out for the purposes, as follows:

- to promote favourable conditions for the formation of the organized securities market;
- to increase the awareness of the investors on the condition of the securities market;
- to protect the interests of the investors and promote the confidence in securities in circulation at the stock-exchange.

At Armex, this goals are achieved by disclosing of a detailed information on activities, financial position etc. of the issuer company. Such information is made available to any interested party upon first demand. Securities, which have been listed, get the access to trade sessions, whilst information on the issuers is posted on the Internet. Data on the listed securities and issuers thereof are then entered into electronic database and become accessible to all participants of the market. The listing checkups of the issuers and their securities are then repeated on a regular basis, which significantly reduces the risk of the stock-exchange transactions.

The advantages and benefits of the listing both to the issuers and the investors, as well as the registration and listing of the Armenian issuer companies at the Armenian Stock Exchange follow.

The stock-exchange is not only trade, but also research and information centre of the securities markets: it publishes information on the events and processes occurred at the securities market on a regular basis. Since Armex is still in the making, and the Armenian securities market passes through the initial stages of development, Armex does not carry out this function yet.

Armenian Stock Exchange has a well-equipped trade hall under

its disposal, which offers an appropriate number of broker workplaces. Software for trade sessions is rather improved, as well, which includes equipment of the trade hall, workplaces for the participants, software to handle all trade processes at the stock-exchange etc. The main advantage provided by Armex is the electronic trade system " RTS Plaza " - up-to-date software and databases, which include technical, technological and organizational instruments and allow to conclude deals, reconcile the parameters thereof, as well as effect settlements on-line in real time, which helps reduce the amount of work required to conclude and register the deals, in the meantime increasing the efficiency, improve confidence and minimize the occurrence of any system risks.

Therefore, one can conclude that the Armenian Stock Exchange has all the pre-conditions to create organized stock-exchange market and carry out its supervision according to the rules of Armex in place. It ensures conditions necessary to ensure establishment and further development of an efficient, balanced and transparent securities market in Armenia, attract domestic and foreign capital by disclosing of full and reliable information on the Armenian issuer companies and ensuring the fairness and publicity of the dealings. The mission of the Armenian Stock Exchange is to make the Armenian securities market a civilized market, as well as strengthen the confidence of the local and foreign investors.

### 1.3. Types of Securities.

It is widely known that securities are documents, which are compiled in compliance with the format established and with mandatory details included. Securities certify property rights, which can only be exercised or transferred upon presentation of the document. Securities represent financial documents, which certify property rights in the form of the ownership title, or property rights as a relationship as regard borrowing between the owner of the document and the issuer. Securities certify investment of funds and are the supreme form of investments. One of the important features of securities is the fact that they are income bearing. Securities are a sort of capital, which differs from real capital.

Ceteris paribus, income from real capital depends on the value of

capital within production. The value of capital invested in securities does not predefine the size of income to expect, but rather depends on such income. A kind of split in capital occurs. On the one hand, there is real capital, on the other - it is reflected in securities. The real capital works within production, while securities start to circulate in the market independently. The owner of, let's say, shares is able to sell them at the market and receive its cash capital back.

In the Law of the Republic of Armenia "On Regulation of the Securities Market", it is specified that securities are any investment, payment or title documents envisaged by the Civil Code of the Republic of Armenia and other laws on securities, as well as agreement on profit allocation, being a party to such agreement, or any document certifying being a party thereto, option, futures and any other derivative, pre-emptive right as regard securities, deposit certificate or receipt, irrespectively of form thereof (documentary, or non-documentary), as well as any investment agreement, which has the features of securities detailed above, or a part thereof, any other document used to attract capital, irrespectively of form thereof (documentary, or non-documentary), as well as the right to own securities or certificate confirming such right, or joint ownership over securities, irrespectively of the form, if exercising or transfer of the rights certified by such documents is only possible upon presentation thereof, or making appropriate records in special registries (documentary or computer-based). Any documents, irrespectively of their form, can also be considered as securities if they have been recognised as such by the business circles.

Securities has a number of features, without which documents can not be considered as securities, namely:

***Being liquid.*** Securities can be converted into cash through sale at the market.

***Being able to circulate.*** Securities represent either objects for buying and selling (shares, bonds), or payment instruments, which are used to ensure circulation of other goods (cheques, bills of exchange, bills of lading) at the market.

***Being of market nature.*** Securities have market of their own, which has organizational and procedural features. At the market, securities are subject to buying and selling using pricing mechanisms,

which is also why they are different from ordinary commodities. Securities have nominal value, which serves as a basis while calculating dividends payable, initial allocation price, as well as market price at which they circulate at the secondary market.

**Being standardized and serial.** Securities are issued in series, homogeneous groups. Securities of one type should have standard contents. Being standardized makes securities widely-accessible uniform commodity.

**Being in civil circulation.** Securities are not only the objects of buying and selling, but also objects of other property relations (collateral, safekeeping, grant, commission, borrowing, inheritance deals etc.).

**Being regulable.** The rights certified by securities, mandatory details of securities, requirements to format thereof, procedure for issue and circulation are subject to regulation by the legislation, which is aimed at protecting of the investors' interest and providing them with equal rights while dealing at the securities market.

**Being risky** represents the probability that the income from securities will not be received, or the funds invested will not be repaid. In addition to financial risks, there are a number of other risks, such as: interest rate, investment, political etc.

**Being documentary.** The rights certified by securities can be presented in both documentary and non-documentary form. The party who is to establish the rights in non-documentary form must at request of the owner of such rights issue the latter with a document confirming such rights. Securities in both documentary and non-documentary form must contain all details envisaged by the legislation. If any of such details is not included, or is recorded in an incorrect manner, the document will be deemed invalid. According to the Law of the Republic of Armenia "On regulation of the securities market", securities jointly owned may be registered exclusively in non-documentary form. According to the Law of the Republic of Armenia "On Joint-Stock Companies", extract from the register should contain the following mandatory details:

- confirmation of the registration by the competent state authority, official full name and registered address;
- authorized capital, number of shares of each type in issue and cumulative nominal value thereof;
- state registration number for each type of shares, if such

registration is envisaged by the Law of the Republic of Armenia "On regulation of securities market";

- number of shares, nominal value of a share, as well as cumulative nominal value of the shares;
- date extract issued;
- full name of the shareholder, nominal owner (in case of individuals, name and first name);
- signatures (or facsimile) of the Chairman of the Board and the Chief Accountant, or Financial Director, as well as - in case register is kept by a competent authority - signature (or facsimile) of the relevant official, as well as information on registration, full name and registered address of the authority;
- sample of the seal of the joint-stock company, as well as - in case register is kept by a competent authority - sample of the seal of such authority;
- other information as set out in the application of the party requesting the extract.

It has to be pointed out, however, that extracts from the register are not considered as securities.

Securities have very important role to play in the economy. On the one hand, these are flexible instrument to use while investing funds of the individuals and corporate entities available. On the other, allocation of securities is an efficient method to mobilize resources for further investment in various sectors of economy and production development.

At the stock market, securities are quoted, and the quotations reflect any political and economic changes in the country. During crisis and unfavourable conjuncture, quotations go down rapidly, whilst at booms, they go up. The contradiction between the trend towards the increasing expansion of the enterprises and the limitedness of private capitals impedes the development of the production. Introduction of new enterprises, or the expansion of the existing ones, requires relevant capital investments, however, the capital of an individual proprietor, as well as borrowings that he is able to attract, are usually insufficient. Therefore, the need arises for joining of the individual capitals to form one associated capital, which is achieved by establishing joint-stock companies.

Shares and corporate bonds appeared as a result of the objective

requirements of the production, since they are the most important instrument for the concentration of the real capital.

The operating stock market consists of two basic sectors: corporate securities sector and Government securities sector.

**Corporate securities** are securities issued by commercial and non-commercial entities.

Corporate securities include debt instruments, shares and derivatives.

**Debt instruments** are used within credit relationship. Cash issued for use for a term established is subject to repayment along with interest for use of funds accrued. The use of debt instruments is based on the relations as regard loans. Bonds, bills, deposit and savings certificates of the banks are all examples of such securities.

**Shares** provide their owners with the right to own a part of the property of joint-stock companies. The owner of the shares becomes the co-owner, shareholder of the enterprise. According to the Law of the Republic of Armenia "On Regulation of Securities Market", shares include stocks, or any other securities, which provide its owner with either the right to own a part of the property, or membership, or participation in share capital, as well as any securities that may be converted into such securities. Shares can only be registered (nominal) securities. Corporate securities of this type are issued at the establishment of the joint-stock company and allocation of shares among the founders, or in case of increasing of the authorized capital stock of the company.

**Derivatives** are securities, which certify the right, or a duly binding obligation, to exercise rights or obligations within a specified period of time, or at some time in the future. Options, warrants, futures contracts are all derivatives.

Let's discuss the main securities types.

**Stocks** are securities with no circulation term defined, which certify the right of its holder as regard a part of the ownership of a joint-stock company, as well as provides its holder with a number of rights, advantages and powers. Stocks exist all the time while the joint-stock company, which is the issuer thereof, exist. However, during the course of this period, the holder of stocks may change several times. Stocks can be issued with an indication of its nominal value, which in fact represents value of the authorized capital per stock. The nom-

inal value of the stock, however, does not guarantee that it is of a real value. The latter is defined at the market, where based on the supply and demand the market price for the stock is established. The nominal value is just a basis, which helps define the issue and the market price for the stock, as well as value of dividend payable.

Against the capital, i.e. temporarily free funds available, which the investor transfers to the joint-stock company he gets certain powers. First of all, he gets the right to participate in the distribution of profits gained by the company, i.e. the right to receive annual and quarterly dividend, which is part of the profit of the company after taxes distributed to the stockholders. Dividends may be paid in cash, or by other assets, in form of stocks, or by combining various methods of payment.

In many countries, the legislation envisages that the joint-stock companies should present the stockholders with information on the financial position of the company on a regular basis, entitle the shareholders to carry out audits of documentation and financial statements. The joint-stock company must in a timely manner inform the stockholders on any significant changes in its activities. The Armenian legislation also provides for the right of the stockholders to receive any information on the activities of the company, inclusively of the financial statements, as envisaged by the charter, except for the confidential documentation.

Common stocks provide the holders with the right to attend the general meetings of shareholders, which are normally held once a year (if there are issues to be dealt with urgently, the meetings can be convened more often), as well as the right to vote on all issues (within the authority of the general meeting of shareholders) related to the activities of the company. In addition to the rights mentioned above, the stockholder also has the pre-emptive right to purchase newly issued shares of the company. In fact, stockholder is able to purchase the newly issued stocks before they are released to the market, whereas the subscription price for the newly issued stocks is normally lower than the market price for those previously issued and allocated. The stockholder is entitled to purchase newly issued stocks pro rata to his holding in the authorized capital stock of the company.

And finally, the holder of the stock is entitled to get a part of the

property of the company in case of liquidation. Note has to be made of the fact that if the company fails and suffers losses, the stockholder also bears the risk of failure of the joint-stock company, within the value of stocks held.

There are common and preferred stocks, features of which will be discussed later.

Another type of securities, which allows the company to obtain capital for financing of its activities at the stock market, is bonds. Bonds of the joint-stock company represent an instrument for the mobilization of the long-term capital. The bond issuer undertakes to repay the holder of the bond, who is in fact the creditor of the company, the amount received under allocation of the bond, as well as pay the holder interest over the nominal value of the bond on a regular basis. The owner of the bond neither has the right to vote, nor attends the general meeting of shareholders, nor participates in the management of the company; in the meantime he has rights that a stockholder doesn't have. To be specific, the issuer of bonds undertakes to pay interest over bonds, whereas it should be paid before the issue on whether to pay dividends is considered. Under liquidation of the company, the holders of bonds have preferential right to receive a part of the property of the company as compared to the stockholders.

Capital mobilized by issue and allocation of bonds does not become share capital. These funds are used to deal with current and perspective goals of the development of the company.

**Promissory note (bill)** is an abstract financial instrument, which contains an unconditional financial obligation (debt). It is called abstract instrument since on the face of the document no references to the bases for its issue, or reasons why the obligation arose, are allowed. Because of this feature the promissory note is a universal instrument. Obligation, which is assumed under the promissory note can only be a cash obligation. One of the features of the promissory notes is their ability to circulate.

Several types of promissory notes exist. Let's discuss the features of the promissory notes and bills of exchange (drafts), which are transferable promissory notes. The promissory note contains an unconditional obligation of the issuer to pay the holder an indicated amount on a date in the future. The draft contains a written order of

the drawer to the drawee to pay the amount indicated to the holder of the draft. Once the drawee accepts the draft, i.e. agrees to pay the amount required, he is held responsible for the payment on the draft.

All securities discussed above are primary securities. Based on this securities (mainly stocks) secondary securities, or derivatives, are issued. In Armenia, derivatives market has not developed yet, which can be explained by the underdeveloped corporate securities market, first of all, stocks.

Let's consider the most widespread types of derivatives.

**The pre-emptive rights to purchase newly issued securities** are securities related to stocks, which give the owner the pre-emptive right to purchase newly issued common stocks of the given company at a price lower than the market price. The term of validity of such right is fixed and normally makes between 30 to 60 days, during which period the owner can exercise the right or sell it, except for such called unassignable rights.

**Warrants** are securities, which give the holder the right to buy a certain number of common stocks at a fixed price during a long period of time. They are normally valid for 10 to 20 years. The warrant owner is able to sell it only after such called "pending period", which lasts nearly a year.

Any financial transaction involves a degree of risk. As security against risks (hedging) certain types of securities are used, main function of which is the redistribution of risks. Owing to these instruments, risks can be minimized, or even eliminated. On the other hand, such instruments themselves are the most risky assets since those who buy them are prepared to assume high degree of risk if larger profits may be received. These are option and futures contracts.

**Options** are securities, which provide the buyer with the right to buy or sell a certain number of securities at a fixed price on or before a fixed date. The seller of the option is obliged to sell or buy these securities should the buyer decide to exercise the option. Against the right provided, the buyer of the option pays the seller the option price, which is called "the premium". Therefore, the right to demand execution of the contract arises as a result of the payment of the premium.

As the stock market develops, transactions with securities become more complicated, which requires standardization of the deals. As a



result, *futures contracts* appeared at the market, which suggest delivery of securities at some time in the future at the price agreed at the conclusion of the deal. Under futures deals, the two participants undertake opposite obligations on buying and selling of securities after a certain period. Once such period has expired, actual delivery of stock values may take place under the futures contract, which, in fact, happens very rarely. Internationally, only 2 to 5 % of all futures contracts end up with actual delivery. As a rule, futures contracts suggest that one party to the deal will compensate the other for the difference between the contract and the stock-exchange price, which may occur as at the date of the actual execution of the contract.

In Armenia, various types of securities exist, circulation of which is regulated by a number of laws and legislative documents, in particular, the Civil Code of the Republic of Armenia, laws of the Republic of Armenia "On Regulation of Securities Market", "On Joint-Stock Companies" etc. According to the Civil Code of the Republic of Armenia, the following are also classified as securities: bonds, cheques, bills of exchanges, drafts, stocks, bills of lading, bank certificates (bank certificate, chequebooks), dual warehouse receipt, ordinary warehouse receipt and other securities, which are recognized as such by the legislation related to securities. As mentioned above, there are three basic types of securities. Bonds and stocks are investment securities; cheques, bills of exchange and drafts are payment instruments, whilst bills of lading, dual warehouse receipt and ordinary warehouse receipt are title securities.

Below securities specified by the Civil Code of the Republic of Armenia are described.

**Bonds** are debt securities, which certify a borrowing relationship between the holder and the issuer. On the date indicated, the owner (creditor) is entitled to demand repayment of the bond, i.e. repayment of the nominal value of the bond, or the nominal value along with any interest accrued. A bond has a nominal value. The total nominal value of all secured bonds issued by a company should not exceed the amount of the authorized capital stock of the company, or the amount of the security. According to the legislation in force in the Republic of Armenia, a joint-stock company is allowed to issue bonds suggesting a full redemption date, or bonds suggesting repayments on a regular basis,

i.e. coupon payments. Redemption of bonds may be effected in cash and in property form. Bearer's and nominal bonds exist. The joint-stock companies operating in Armenia are allowed to issue:

- bonds secured with the property of the company;
- bonds secured with the guarantee of bonds issue provided by third parties;
- obligations with no security.

**Stocks** are securities, which certify the right of the owner (stockholder) to receive a part of the profit of the joint-stock company in the form of dividend, participate in the management of the company and receive a part of the property of the company in case of liquidation thereof. According to the Law of the Republic of Armenia "On Joint-Stock companies", joint-stock companies are allowed to issue common and preferred stocks. The majority of the corporate securities issued in Armenia are stocks. Total volume of other corporate securities issued, in particular, bonds, bills and other securities, is far smaller. Majority of stocks were issued during the privatisation process, i.e. while the state-owned property (stocks owned by the Government) was being sold. The main methods for privatisation were the free allocation of stocks and the auctions.

More than half (51%) of all open joint-stock companies operating in Armenia have over 50 stockholders, whilst the major shareholding is mainly owned by a limited number of parties. Such allocation occurred as a result of the privatisation process, as well as further resale of stocks.

**Cheques** are payment instruments, which contain an unconditional written request of the cheque issuer to the bank (the payer) to pay the amount indicated on the face of the cheque to the cheque holder.

**Promissory notes** are securities, which represent an unconditional financial obligation of one party (the drawer) to the other party (the holder of the bill) compiled in a strict compliance with the format envisaged by the legislation, which certifies the unconditional obligation of the party issuing the bill (promissory note), or any other payer indicated on the face of the document (draft), to pay a certain amount to the owner of the bill after the specified time period expires.

**Bank certificates (deposit books, bank certificates)** are securities, which certify the amount of the deposit and the right of the deposi-

tor to receive the amount of the deposit together with any interest accrued back upon expiry of the term of the deposit at the premises of the bank, which issued the certificate, or any branch thereof.

**Bills of lading** are securities (transport document) certifying the right of the holder to receive from the carrier cargo mentioned in the bill of lading after transportation. The bill of lading may be bearer's, issued to the order of someone, or nominal.

**Warehouse Receipt** certifies that the commodities have been accepted by the warehouse. Unlike ordinary warehouse receipt, dual warehouse receipts are order securities. Dual warehouse receipt consists of two parts: the warehouse receipt and the pawn receipt (mortgage), which are separate securities.

Limited liability companies issue **shares**, which certify the amount of the investment of the participant in the authorized share capital of the company.

Securities of each type have their own features, based on which they are divided into classes. Securities class consists of all securities having the same nature and providing their owners with the same rights and advantages.

Government securities have huge role to play at the Armenian securities market. Today, Government securities significantly influence the economy and are irreplaceable for the purposes of the regulation of the money circulation. Nowadays, using Government securities the Government implements its monetary policy to regulate the macroeconomic situation. The Central Bank of Armenia who acts as the agent of the Government, buys and sells Government securities at the securities market (transactions of the open market) in order to carry out the regulation of the money supply in circulation. Monetary policy is implemented to control money supply in order to increase the level of production and employment, as well as prevent the inflation. Issuing of Government securities is the most civilized market method to form the Government debt. They help cover difference between income and expenses of the state budget, which occur as a result of the time gaps between receiving of the tax payments to, and making expenses from, the state budget.

As in any other developed country, or a country with economy in the making, in Armenia, the sector of Government securities is one of the most important parts of the stock market. In countries with

highly developed industry, Government securities normally stand for the major part of the market volume (up to 60%), notwithstanding, corporate financial instruments also have rather a significant share. In Armenia, Government securities account for approximately 95% of the market. Since the repayment of the principal debt and interest accrued is guaranteed by the state, these securities are highly reliable and liquid. The Government (state) is considered as the most reliable guarantor, therefore, Government securities in Armenia are the most reliable instrument of the stock market, and purchasing of Government securities is considered as the most efficient investment.

The Government securities market provides the state with a non-inflationary mechanism to manage the deficit of the state budget, and the investors with a profitable method for the investment of capital. In many countries, deficit of the state budget can be covered, or reduced, at the expense of the loans received from the central banks, which are owned by the state. If it is impossible to obtain such loans, or these would not be sufficient, the money emission is carried out, which, however, can not be considered as effective methods to raise funds, since they usually result in inflation, or debt obligations.

In the case of the Armenian budget, expenses normally exceed income, i.e. there is deficit of the budget. In 2000, deficit of the Armenian state budget made AMD 31.2 billion (3% of the GDP). To compare, let's note that in 1999 the deficit made AMD 40.7 billion (4.1% of the GDP), and in 1998 - AMD 15.3 billion (1.6% of the GDP). In Armenia, deficit of the state budget is financed at the expense of the external and internal sources. The issue of Government securities is one of the sources of financing of the state budget deficit.

The internal state debt of Armenia represents issues of Government securities on behalf of the Government of the Republic of Armenia. There are short-term (up to 1 year) and medium term (1 to 5 years) debt obligations of the Government of Armenia. At present, short-term Government securities with maturities between 1 and 52 weeks are issued on a regular basis, which are discount bonds, as well as Government medium term coupon bonds suggesting partial repayments with maturities from 15 months to 5 years. The issue, circulation and the redemption of the Government securities is regulated by the following legislative documents:

1. "Procedure for issue, circulation and redemption of the Government (Treasury) short-term bonds of the Republic of Armenia".

2. "Procedure for issue, circulation and redemption of the Government (Treasury) coupon bonds of the Republic of Armenia with partial redemption".

Central Bank of Armenia services the internal state debt by carrying out the allocation, redemption and payment of interest over the bonds.

The repayment of the internal state (Government) debt is effected at the expense of the state budget. Such repayment suggests redemption of the borrowings at maturity, as well as payment of interest (including payments using coupons) and the discount value.

#### **1.4. Common and Preferred Stocks.**

Stocks are the securities of joint-stock companies. By type of allocation, these are emission securities, i.e. securities allocated by issues. Stocks of an issue represent equal rights and obligations, regardless of the time of purchase. Stocks with different nominal values, different rights provided to owners and restrictions as regard circulation can not be issued under one issue. All stocks of the same issue should bear the same state registration number. There exist common and preferred stocks.

Issue of preferred stocks is a step, which is undertaken when:

- fast increase in own capital is required for further implementation of a major project;
- they are not willing to increase the number of parties having the right to participate in management and not to diversify the major shareholding;
- they are not willing to increase the amount of the debt by issuing bonds.

According to the Law of the Republic of Armenia "On Regulation of Securities market", all stocks of the joint-stock companies should be nominal. Information on the owners of the stocks is recorded in the stockholders' register, where data on each owner, number and

types (categories) of stocks owned, as well as date of purchase are stored.

Where the stocks of the joint-stock company are subject to registration according to the Law of the Republic of Armenia "On regulation of the securities market", the register of the owners of securities of this joint-stock company is kept by a competent organization, namely: the Central Depository of Armenia. Such companies are joint-stock companies and limited liability companies with over 50 stockholders and net assets exceeding the limit set down by the Securities Commission of the Republic of Armenia.

A common stock provides the owner with the right to attend the general meeting of shareholders, vote on all issues falling under the authority of the latter, receive dividends, as well as a part of the assets of the company in case of liquidation thereof. The holder of a common stock is entitled to put forward proposals at the stockholders' meetings. Within 30 days after the end of the financial year (unless otherwise is envisaged by the charter of the company), any stockholder who owns no less than 2% of total voting stocks have the right to put forward no more than two proposals on the Agenda of the annual general meeting of shareholders, as well as propose candidates to be elected to the Supervisory Board and the supervisory committee of the company.

Holders of common stocks have the right to receive dividend, which is paid while the company operates successfully.

Under the below mentioned conditions, the joint-stock company is not entitled to take a decision on (announce) paying dividends on stocks allocated:

- if the authorized capital stock of the company has not been fully paid-up;
- if the company has not purchased all those stocks owned by the stockholder that should have been purchased (redeemed) according to the Law of the Republic of Armenia on Joint-Stock companies";
- if as at the date of taking of the decision on paying dividends, there are symptoms of insolvency (bankruptcy) in the financial position of the company, or such symptoms may occur as a result of the payment of dividends;
- if the net assets value of the company is less than the

authorized capital stock, or may become less as a result of payment of dividends.

In international practices, special common stocks exists, which are regarded as preferred when paying dividends. Owners of such stocks receive fixed income on a regular basis; besides that, at the year-end, based on the results of the year, they also receive additional dividend (extra dividend).

Joint-stock companies can issue and allocate preferred stocks, and the total nominal value of the preferred stocks of all issues should not exceed 25% of the authorized capital stock. Preferred stocks provide their owners with certain advantages as compared to the holders of common stocks. Dividends on common stocks are only paid after the distribution of the profit among the owners of corporate bonds and preferred stocks has been completed. In case of liquidation of the company, owners of preferred stocks have the preferential right to receive a part of the liquidation assets of the company. Such advantages may be considered as kind of compensation for the fact that such stocks do not provide the holders with the right to vote. The owners of preferred stocks are only allowed to vote on the issues related to the reorganization and the liquidation of the company. Owners of some of the preferred stock types, rate of dividends payable against which is determined by the charter of the company, except for the owners of cumulative preferred stocks, have the right to attend the general meetings of shareholders and vote on all issues under the authority of the latter, if such meeting immediately follows the annual general meeting where decision that dividend on such type of stocks would not be paid, or would not be paid in full. However, once dividend payments have been effected, the owners of such stocks are no more entitled to vote.

The company is only allowed to issue one or several types of preferred stocks with certain advantages envisaged by the charter of the company provided by each type. The rate of dividend payable and the liquid value of each of the allocated and declared preferred stock types should be indicated in the charter. Dividends and the liquid value are indicated in cash terms, or as a percentage of nominal value of the stocks. Dividends are paid out of the net profit; on some of the types of preferred stocks, dividends may be paid out of special funds formed for this purpose. This helps protect the owners of such shares

from unexpected losses, however, at the same time, does not give them an opportunity to receive additional income, like the owners of common stocks do.

The other advantage lies in the fact that in case of the termination of the activities of the issuer company, the claims on preferred stocks would be treated as a priority.

According to the Law of the Republic of Armenia "On Joint-Stock companies", the companies are allowed to allocate preferred stocks of the following types: cumulative, convertible, with fixed or variable dividend, as well as other types of preferred stocks, as envisaged by the charter of the company.

Cumulative preferred stocks are the most widely used type of preferred stocks. The envisaged by the charter dividends unpaid, or not paid in full, on such stocks will be accumulated and paid in the future. The term, during which dividends on cumulative preferred stocks are not paid must not exceed three years. Owners of some of the types of cumulative preferred stocks can vote at the general meetings, if such meeting immediately follows the annual general meeting where decision that dividend on such type of stocks would not be paid, or would not be paid in full. The right of the owners of such stocks will cease once payment of all dividends accumulated has been made in full.

Convertible preferred stocks are stocks, which can be exchanged for common stocks of the company, or preferred stocks of other types. The opportunities and the terms and conditions of conversion may be stipulated by the Charter of the company. In case of conversion of the preferred stocks into common stocks, the company must repay all debts to the holders of the convertible preferred stocks, or by their consent, assume the obligation of repaying of such debts using another method.

The rates of payments on preferred stocks with variable dividends usually depend on the financial position of the joint-stock company.

## **Chapter 2. Investments.**

### **2.1. The importance of investments to the economy.**

The ongoing integral processes at the interstate level and the international cooperation of the companies, the objective process of globalization of economic relations ensure that real opportunities are in place for more intensive capital flow for the purpose of achieving the highest quality and efficiency of production, as well as for efficient implementation of financial and social policy of the Government. Economic processes towards the making of market relations in Armenia have caused a need for qualitative comprehension of the new economic and social phenomena. Fundamental transformations of legal organizational forms of management have predetermined the freedom of entrepreneurship and independence in using own financial resources. New financial tools and levers appeared, transforming the organizational structure for investment activities, which existed in the past.

The term "investments" derives from Latin word <invest>, which means "to put in". Investments reflect property and intellectual values, which are put in the objects of entrepreneurship, as a result of which profit is formed, or other (social, ecological etc.) useful effect is achieved.

The specificity of the securities market under transition economy should serve achievement of the following goals

- Creation of pre-conditions for economic growth
- Financing of the internal state debt
- Development of integral processes
- Promotion of investment flows into the real sector of economy
- Protection of investors' rights

At present, the position of the Armenian economy is determined by severe deficit in financial resources and the investors (internal and external) reluctant to invest in real sector of economy, first of all, the industrial production. The main reason for this is the high level of investment risks - political, market, legislative etc.

In the meantime, the accounting system representing the main

source of information undergoes a period of transition to international standards of accounting and reporting; also, many of the previously existed conceptual methods of financial analysis are reviewed. Process of reforming of economic knowledge is rather a long-term process; besides, many issues of theory and practice haven't been duly developed to date, while some provisions haven't even been formulated precisely.

The institutional reforms carried out during the past years can to a certain degree promote the making of the financial sector capable to mobilize, and provide the economy under reformation with, investment funds.

Given the magnitude of the goal, in the nearest future, the economy of Armenia cannot rely on the budget system and the banking sector in what relates to financial re-structuring of the economy. Hence, securities market have an extremely important role to play.

The actual need to resolve issues of importance to the Armenian economy is determined by the strategic role of the investments in the social-economic development of as the country in general, as the individual enterprises. To almost all Armenian enterprises, the updating and replacement of obsolescent fixed assets with more productive and resource-saving ones, as well as modernization of the technology has become an urgent task, which if resolved can ensure normal course of activities of the enterprises under conditions existing.

Appearance of various specific factors and changes occurred in the mechanism of investment activities have discovered that the previously accumulated by the majority of owners knowledge is insufficient.

The newly established market relations should become an incentive to acquire further knowledge and organizational skills acquisition at microeconomic level, which unfortunately doesn't exist in our society. In Armenia, majority of new owners who hold 50 and more percent of shares of a company in issue, are unable to understand the axiom of the market economy, that is: successful development of a company of any legal form under competition depends much on how active it is in carrying out investment activities. Only attracting investments (less often than own funds) companies can survive, receive income to update and grow economic potential in a specific area of business.

Investment activity is the strategically directed investment of economic resources, for the purposes of receiving competitive advantages or certain benefits, i.e. the possibilities and willingness of the investors to influence the economic processes by initiating financial relations and offer temporarily free cash available to companies who are in need of them. Cash accumulated by private individuals (e.g. savings) and enterprises (e.g. retained profit) results in, on the one hand, availability of temporarily free resources, and on the other - demand thereon. Need for a mechanism to regulate supply and demand on investments arises. In other words, the degree of investment activity depends on the accessibility of the sources of financing. And what can be considered as the most important tool to regulate the degree of activity of the investors? It's, no doubt, the interest rate on loans.

Low interest rate results in increase of investments, hence, also production expansion, and, vice versa, high interest rate constrains investments into real sector of economy. This connection is defined by the objective laws of the market economy. For example, in Russia, when the rate of refinancing increases by one interest point, investments in fixed assets decrease by nearly 0.3 points. As to Armenia, in our opinion, such decrease would make between 0.4 and 0.5 points. The founder of the monetaristic approach in the theory of economics, J. Keynes in his book "The General Theory of Employment, Interest and Money" wrote, that the investment decisions should be oriented towards maximum efficiency of capital equal to such discount rate that would equalize current value of various income expected during serviceability of capital assets with the price of its supply. To ensure stable growth of the flow of investments into real sector of economy of Armenia at a rate of at least 5-6 percent per annum (which is very low for Armenia), not only the approval of a set of legislative acts to protect the investors' rights; efficient tax reform; political stability; reasonable protectionism of local manufacturer, low rate of inflation are necessary, but also retaining the refinancing rate at no higher than 20-25 per cent per annum.

While examining incentives for investments one has to mention the motivation of the parties interested in this rather a complicated economic process. The subjects of investment activities, which are the

pre-condition for the ongoing development under the existing conditions are: commercial organizations; business owners (proprietors); creditors; the Government and the society.

**Commercial organizations** are interested in achieving the highest standards of production and financial activities. Major goals, on which the efforts of the company management should be concentrated are the maximization of profit and expansion of market share for goods (services). The prospect of further successful development of as existing as newly established enterprises depends on the implementation of the strategically directed investments, which ensure getting and maintaining of competitive advantages.

**Business Owners (proprietors)** are interested in assuming lower risk and receiving high enough stable income, not in the future but immediately. So, the shareholders' direct interest lies in accumulation, not consumption. At the first sight, this may seem a contradiction. An active and successful investment activity, will promote the increase in stock price by increasing the attractiveness of the company for investments, even if initially such activity leads to reduction in net profit used to pay dividends.

Besides, profit expected from implementation of investment projects will positively reflect the value and frequency of dividend income.

**Creditors** pursue nearly the same objectives as the business owners (proprietors), however, the main criteria here would be the safety and maturity of investments.

**The Government** is interested in carrying out regulation of the branches and sectors of the Armenian economy by using various financial methods and levers (grants, tax privileges etc.). Investments are the major element of the Government policy aimed at strengthening of economic security (collection of taxes, increasing competitiveness of enterprises at the internal and external markets) and revival of the Armenian economy.

**Society** as the ultimate user of the benefits of civilization is the subject extremely interested in intensification of investment processes, as innovation influences the quality of industrial goods, products and services in an extremely positive way.

Within the framework of practical approach, investments are aimed at receiving profits and income, which are considered as the major criteria of activity of any company.

While discussing this issue, we have to disengage ourselves from macroeconomic role of investments, since the latter takes the account of the general goals of economy rather than interests of individual businesses, whereas in this case, investments should be made to increase the capital available in Armenia at large, while purchase of assets (fixed assets) used in the past is not considered as an investment, but just "transfer of assets from one account to another"

In our view, the maximisation of the market price of the company's stocks has to be considered in here as the ultimate objective of investment activities.

This goal takes the account of the interests of owners - holders of common stocks.

By investment objectives, investors can be classified into two groups, namely: strategic and portfolio investors. The main objective of the strategic investors is the general management of the company, which requires acquisition of the controlling interest, or major shareholding, in a company. They are also inclined to carry out acquisitions of, and mergers with other companies.

Portfolio investors who normally follow the diversification principle, invest their capital into various financial instruments to receive large current income, or increase the capital. In this case it has to be estimated objectively whether it is necessary, appropriate and secure to make investments; define the directions of the development of the company and priority areas; reveal the factors (objective and subjective, internal and external) involved, justify the optimal investment schemes.

At present the Armenian stock market is still in an undeveloped condition, however, the steps undertaken today will definitely result in formation and development of the securities market, therefore each investor should have a knowledge of the basic rules of theory, even if sometimes they do not correspond to the actual conditions of the Armenian stock market.

## 2.2. Investments and trading

Is it possible to grow rich by speculating on a stock exchange? It's absolutely possible, e.g. in USA, the stock price of "Intel" increased 6 times between January 1996 and February 1997 (i.e. for a year). Millions of people worldwide are involved in stock exchange game, which is promoted further owing to the opportunities given by modern computer technologies.

Investment is a long-term input of capital into stocks, while short-term speculation for a rise or a fall is trading. Trading is measured by months, weeks, days or even hours. The processes of choosing stocks for investment and those for trading differ.

Under the first option, main attention should be paid to the reliability and profitability of the companies, taking the account of dividends payable; under the second option the main criterion should be how much other traders are interested in the given stock.

Trading is mostly carried out by professionals. Profit of 2-5 percent over stocks of one company is considered as sufficient and can be a signal to sell one stock and purchase another. For a professional trader, annual profit of about 70-100 % is considered a norm, although many earn much more. One should bear in mind, however, that stock exchange trading is great deal of a risk.

Once a fairy tale was being told in American financial circles. There lived a banker, and he had three sons. On Christmas Eve the father called all of his sons and said: "My sons! You are learned big boys already. I am giving a thousand dollars to each of you. Try to multiply them. So that after my death the fortune made in sin isn't stale on a wind, I shall leave it to the one of you who will make best use of the father's money. So go wherever your eyes look then come back in 30 years and report". And the sons followed different financial roads. Being the children of the twentieth century they knew well that money should be put in securities.

The eldest son, who has been praised for being cautious since he was a little boy used his one thousand to buy Treasury bonds. Faultless family man, he lived for 30 years on the salary of office clerk, and used the 50 dollars he was getting as interest on bonds to make Christmas gifts to his wife and children. 30 years later, as it

was agreed, he came back to his aged father. He gave his father the bonds and said with a pride that exactly the same bonds cost 1,220 dollars at the stock exchange.

"That's true," the banker agreed, "only don't forget the inflation. Today, with 1,220 dollars you can buy as much goods, as you were able to buy with 700 dollars 30 years ago. You haven't saved your father's money, son."

At the same moment, the second son came into the room and with saying nothing put a batch of stocks in front of his father. He was a cautious man, too, but with a greater power of imagination than his elder brother. 30 years ago, with his thousand of dollars he bought stocks of the 30 then most powerful American corporations. Now, these stocks were valued at 9,100 dollars and despite the inflation the father's capital has increased over 5 times. The old man was about to praise the middle son when a scratch of brakes was heard out the windows. Through the window, the banker was able to see his smiling youngest son driving a magnificent "Cadillac", while an armoured van filled with money was following his car.

Years ago, the youngest son also bought stocks, however, he then waited for the moment when the prices jumped up, sold the stocks and purchased others, which were cheaper. And he did so continuously.

A tale is a tale, but it is absolutely true that buying and selling of securities can yield large profits. That is why the history of securities market is that of speculation.

By involving professional participants of the securities market today's stock exchanges serve a huge number of investors. For many investors, if not most of them, the basic reason for buying and selling securities is to receive profits from the difference in quotations, i.e. the speculation. Here is where the spirit of initiative is expressed. Speculation, which also promotes favourable investment environment, is one of the key factors of stock market development. While for common goods, trade is only one of the stages leading to consumer, securities can remain in circulation for decades by changing hands.

It is widely known that an average American family puts in stock about 30 percents of its earnings, preferring buying stocks over pur-

chasing real estate, gold, jewellery or antiquities. For the investor, investments in stocks is a more preferable form of savings, because it provides higher income in spite of the fluctuations and shocks that are an inevitable part of the stock markets.

Prices for stocks are defined by three objective factors: condition of the stock market as a whole, condition of the sector which the given company operates within, and the financial position of the company. Based on the research carried out by the Investor's Business Daily newspaper, the significance of the mentioned factors can be estimated as 31%, 49%, and 20%, accordingly. For a long time now (years and decades), the behavior of any company's stock is defined by its profits. But such ups and downs of the stock price are strongly influenced by significant fluctuations lasting for days, weeks and months. Such fluctuations are basically caused by fluctuations of all stocks of the given sector and market as a whole. Choosing appropriate moments to purchase and sell stocks can many times increase profits from investments.

Analysis of stock market of USA for period between 1964 and 1975 has shown that for this period the average profit of the investor from dividend payments and increases of stock price at the New-York stock exchange (NYSE) has only made 55%. If the investor managed to sell the stocks before the three maximum falls of the market had occurred and buy the same stocks in the beginning of the market growth, then the profit would go up to 800 %. If in addition to that, dealing for a fall was carried out during when the market was falling, the profit could make 2,400%. Finally, if the investor managed to catch all fluctuations of the market exceeding 5%, his profit would grow up to a level of 400,000%.

It is certainly impossible to foresee all the movements of the market. Even an experienced stock exchange trader can hardly guess the moments when the market changes its trends. However, there is a number of laws and rules being aware of which can considerably improve results of stock exchange dealings. Guessing of the moment when dealing for a rise switches to dealing for a fall, even with a minor delay enables to improve the results. The main thing that the investor and the trader should ask themselves is whether the market



is rising or falling at the moment. It is not as easy to answer correctly as it may seem.

Let's assume that market prices for most of the stocks have been falling for a week. One can not, however, state positively that it has been a falling market. It could be falling locally - yes, but within a larger period of time (let's say a month) it can be a rising market. The market never rises or falls by a straight line. Even at growth there are local minimums, and at fall there are local maximums.

The market is considered rising if each local maximum is higher than the previous one and each local minimum is also higher than the previous one. Obviously, the market is considered as falling if each local maximum is lower than the previous one and each local minimum is also lower than the previous one. Even if the economic and political situation is stable the market still fluctuates.

If the volume of stock trade during the market growth exceeds that one during a fall, this means that the number of optimists trusting in further rise of the market (who are called "bulls" speaking stock-exchange language) prevails over the number of pessimists ("bears") who expect that the market will go down further. In this case local minimum occurs above the previous one, and the market is considered as rising. Therefore, daily volume of stock sales is regarded as a very important factor. A rising market continues rising owing to constant inflow of investments. pumps up ever more money. Prices over the stocks of successful companies go too high, and no more correspond to the actual earnings of such companies. While fluctuating, stock price goes down with its local minimums and maximums to go up again in a while. The good news inspires the "bulls", and the market begins to rise, while the bad news is for the "bears", and the market falls.

While speaking about trading, the concept of short-term trading should not be forgotten. Short-term trading is a dealing for a rise or a fall, which lasts several hours, less often days.

The basic indicators of the companies move off to background, and the main method for selection of the candidates becomes the technical analysis (although many analysts consider this as "telling fortune by coffee grounds"). Daily fluctuations of stock prices, difference between purchase and sale price, volume of stock trade, cur-

rent news, rates of commission fees, as well as how soon information can be accessed and how quickly deals are carried out become the key factors.

The behavior of a stock on short time mainly depends on the crowd psychology. If euphoric attitudes occur towards any stock at the market, the trader would buy such stock and hold it as long as the euphoria lasts. When the slightest symptoms of withering of interest to the stock, the trader immediately sells it and begins speculating for a fall. The art of the trader lies in guessing the moment when the inflow of new buyers would stop. Sellers are nearly always there, therefore once interest in a stock drops, the stock price begins to drop, as well.

The choice of stocks for trading somewhat differs from that one for investment. Here, the attitude to the given stock shown by other traders i.e. the subjective factor, comes to foreground.

The first factor at choice is the average daily trade volume, i.e. the number of stocks of the given company changing hands in a day at stock exchange.

The second important factor is the difference in purchase and sales prices, as one has to be happy with rather small a difference often enough.

The third one is the amplitude of stock price fluctuations, i.e. it is necessary to estimate average amplitude between the minimum and the maximum price of the stock for one day of trade. The amplitude of stock price fluctuations is quite an important characteristic. The larger it is, the higher is the potential profit, but also the higher is the risk assumed.

Trading requires constant control over the market, and trader should feel the market. Trading is extremely fascinating, but it is time-consuming and requires major input of energy.

Irrespectively of whether the exchange player is professional or amateur, success at stock exchange is defined by the following:

- Understanding of the economic laws
- Knowledge of market psychology
- Trader's self-control

These are the three whales, which support the success of the exchange player.

While taking a decision on investing a part of the capital in stocks, one has to first of all define optimum value thereof. Let's assume you have a stable job and you are self-confident enough. In this case you are able to put some of your money aside for living, and invest the remaining part in securities market. A number of rules exist that help define an optimum share of capital for investment in stocks. According to one of them, share of capital invested in stocks (percentage) should be equal to  $100 - x$ , where  $x$  is your age. If you are 40, then you can invest 60 per cent of your capital in stocks.

Investment capital should be divided into two parts. One part should be put in shares of stable companies, which you should keep for months and years with paying no attention to fluctuations of the market. The other part can be used for trading. You can determine the ratio by yourself.

Trading at stock exchange involves great deal of risk, and you can lose significant sums of money. Besides, frequent sales and purchases require that a continuous analysis of the market is carried out. Initially, money intended for trading should be regarded as money for entertainment (for example, the widespread in our republic lotto). Even if you lose all of it, should not upset you much.

Another thing - you shouldn't play at the stock exchange with money belonging to other persons, or with borrowed money.

It is not recommended to speculate at stock exchange to earn money for special purposes, such as purchase of an apartment, car etc.

When and what to buy and sell, how to secure capital invested - here are the questions that the professionals are concerned about.

The three basic reasons for large losses on investment and trading are:

- Purchase of stocks with no preliminary analysis carried out,
- No action plan for any possible fall of stock prices in place,
- Investment of capital in stocks of one company.

If the results of your activities at the stock exchange don't meet your expectations, and the failures follow one another, don't grieve over this too much. You would have to review the strategy of the play, or just your attitude towards securities market.

## 2.3. Investment Portfolio.

Investment portfolio means the whole complex of all securities comprising such portfolio, inclusively of corporate securities, Treasury bonds etc. At present, feature typical of the structure of the Armenian securities market is the existing disproportion, since buying and selling of Government securities stands for the major part of the trade (over 90%). This sector of the securities market is the most advanced one owing to the level of regulation in place.

The main goal of the portfolio investments theory is to help the investor make the right choice while dealing at the securities market.

The objective of the portfolio management is to ensure that the investment strategy is implemented in an efficient manner, whereas the following principles should be observed:

1. Analysis of the economic growth rate of the joint-stock company;
2. Investment projects should be developed, and time period sufficient for their implementation should be ensured. In the meantime, the following should be taken into account:

- financial position of the company;
- technical improvement level of the production, and whether any unfinished construction and equipment pending installation is available.
- whether the company has own funds under its disposal, as well as any opportunities to attract loans and borrowings.
- financial conditions for making investments at the capital market;
- advantages provided to the investors by the Government;
- commercial efficiency of the projects intended for implementation;

As the investment climate in the republic is improved, the following factors will also assume quite a significant role:

- the opportunities of obtaining equipment for lease;
- ensuring minimization of the risks, conditions for insurance and getting financial guarantees for financial risks;
- ensuring maximisation of profits.

The choice of management policies also depends on the type of

the portfolio. Large expense on effective portfolio management could hardly be justified if the activities are aimed at getting high yield.

Portfolio management is carried out in two basic ways:

- the management is carried out by the portfolio holder;
- portfolio management responsibilities are transferred to another party on a trust basis.

Under the first option, it is the portfolio holder who carries out the management, whereas both individuals and legal entities can be such holders.

Under the second option, the portfolio holder transfers the rights as regard portfolio management to a professional participant of the market (licensed by the Securities Commission of the Republic of Armenia), on a trust basis by entering into a Trust management agreement. It has to be noted in this respect that for major investors, the second option would be more preferable.

Portfolio may contain securities of one type, as well as change its structure as a result of replacement of one type of securities with another.

The investment portfolio is formed bearing in mind a certain balance between risk and profitability.

The general features of the types of securities comprising the portfolio determine the type of the portfolio.

In practice, portfolios can be classified as those of growth, income, risky capital, balanced, special and short-term securities.

By level of balance between risk and income, there are:

- **Portfolios of aggressive investors.** Objective: receiving high income under high degree of risk assumed.
- **Portfolios of moderate investors.** Objective: receiving reasonable income under reasonable degree of risk undertaken.
- **Portfolios of conservative investors.** Objective: assuming lowest risk possible using reliable securities, quotation price for which, however, goes up slowly.

A beginner investor with rather a small capital can be given with an advice to exclude obvious outsiders while choosing companies for portfolio investments.

One of the methods for such exclusion should be the analysis of dividends paid.

If the company has paid out dividends for many years uninterruptedly, then the chances are high that such company is stable enough. If the company is able to pay the holders of shares, then it must have reserves to expand the production, create new production capacities and carry out research and development. Many investors do not even consider companies which do not pay dividends as potential investment objects.

In the meantime, difficulties may arise while analysing the history of dividend payments since the latter vary from one sector of economy to another. For example, dividends paid by Company A, which belongs to the electronic industry, made 0.2% of stock per annum, whereas those paid by Company B involved in car construction made 4.6%. Does that mean stocks of Company B are better than those of Company A? Besides, for the same period of time stocks of Company A went up by 30%, whereas stock of Company B just by 9%.

This was quite an illustrative example to state that while choosing stocks for investment only companies of one sector should be compared.

A recommendation can be given to a beginner investor that while selecting companies to include in the investment portfolio, history of profits should be considered, as well, since profit is the key factor describing the activities of a company. Profitability record of the companies, which are attractive for investment, should be analysed.

The basic parameter for evaluating stock price is the ratio of stock price to earning per stock for the recent year: P/E.

This ratio actually shows in how many years will the company repay the investors.

A value of between 10 and 20 is considered as normal, in fact, the lower is the P/E value, the better. However, there is the golden rule of market: "Avoid companies with low P/E ratio."

Like dividends, P/E ratio depends much on the individual sectors of economy, which means each sector has its own profit norms and rates of growth thereof. Let's note one more thing: "The company is attractive for the investor if the growth rate of profits exceeds that of sales."

### **Chapter 3.**

## **Corporate management**

### **3.1 General description of a joint-stock company**

Joint-stock company (JSC) is one of the forms of business companies envisaged by the civil legislation of RA.

JSC is a commercial organization, authorized capital stock of which is comprised of a number of stocks certifying the obligatory rights of participants of the company (shareholders) to the company. The main objective of JSCs is receiving profit.

Shareholders invest money or other property rights, which may be evaluated in cash terms, in the authorized capital stock. JSC gets the right of ownership for the investments made by of the shareholders, whilst the shareholders get the securities - stocks, by which the rights of shareholders as regard the JSC are formalized. Shareholders get the rights envisaged by the Civil Code of the Republic of Armenia and the Laws of the Republic of Armenia "On Regulation of Securities Market" and "On Joint-Stock Companies". As a legal entity, JSC represents a detached property unit, which is liable for its obligations. Thus, the shareholders are not liable for the Company's obligations and bear the risk of losses within the limits of the value of their shareholding, whilst the Company is not liable for the shareholders' obligations.

JSC is considered established once it has been registered by the competent Government authority.

### **3.2 Types of Joint-stock companies and their distinction**

JSC can be open or closed, which is stated in its charter and the company's official name. The type of JSC is established at its foundation. The registered JSC can be transformed: closed into open, or into limited liability company (Ltd.), or commercial co-operative. In open JSC (OJSC) shareholders can without the consent of other shareholders sell or otherwise transfer their stocks, carry out open and closed subscription for newly issued stocks. The number of shareholders in OJSC is not restricted. Features of open and closed JSC are presented below (see table 3.1).

**Table 3.1**

**Comparative analysis of the features of OJSCs and CJSCs**

Feature	OJSC	CJSC
Number of shareholders	Not limited	Not to exceed 49
Authorized capital stock	Not less than thousandfold minimum wages established	Not less than hundredfold minimum wages established
Subscription for securities	Open (free sale) and closed unless otherwise is stipulated by the charter	Closed. Only for shareholders or a range of persons determined beforehand authorized by the majority of shareholders' votes regarding the number of applications, and in quantity proportionate to percent of stock already owned by persons interested
Securities registration	By Securities Commission of RA or at ASE	Not mandatory
Shareholders Register	At the Central Depository of Armenia	At the company or the Central Depository of Armenia
Alienation (sale) of stocks	With no restrictions - free sale	Pre-emptive rights of shareholders of the company, the company, then free sale within 60 days since the offer was made
Supervisory Board	Mandatory if the company has no less than 50 shareholders	Not mandatory
Disclosure of information	Obligatory publication of the annual report, accounting balance-sheet, profit and loss account, the prospectus, if and when envisaged by Law and the charter; list entities affiliated with an indication of quantity and types of stocks held	Not mandatory in case of common stocks; mandatory in case of bonds (as in OJSC)
Annual audit	Mandatory	Not mandatory if bonds or other securities were not issued

Reorganization of the JSC is carried out by the decision of the general meeting of shareholders, with appropriate amendments inserted into the charter of company, or drafting new version thereof, and registration of either by the competent authority according to the procedure set down. It has to be noted in this respect that that at reorganization of company the shareholders are authorized to require redemption of their stock if they voted against reorganization, or did not participate in voting on this issue.

Stocks of CJSC are allocated among entities determined in advance. The shareholders of the CJSC and the company itself have pre-emptive right to purchase stocks sold by other shareholders.

Pre-emptive right to purchase stocks of other shareholders in CJSC should be envisaged by the charter of the Company, where procedure and terms of purchase should be defined, which is established within the limits of no less than 30 and no more than 60 days since the day of the offer.

Regardless of the form of share participation, the shareholder of the company should only expect getting of stock value when leaving CJSC, i.e. investing into the authorized capital stock means actual loss of right on the investment for shareholder.

JSCs can be established in two ways: by creation of a new company and reorganization of the existing legal entity (merger, division, allotment, transformation).

Foundation of a new company is implemented by the decision of the founders at the general meeting, and in case of establishment of a company by one entity, the decision is approved solely by this entity. Statutory meeting of JSC is to be called within three months after the shares have been allocated and payment for them was received. Founders sign a written contract on foundation of company, in which the following is reflected: information about founders, procedure for carrying out of joint activities, size of authorized capital stock, categories, types of stocks to allocate, quantity of stocks of each founder and procedure for payment, rights and duties of founders, information on authorized person representing founders until statutory meeting takes place. Besides, terms conditions of share participation of the founders on obligations assumed during foundation of company and the procedure for return of assets invested are stipulated in the contract.

Contract on creation of the company is not a constituent document of the company and is invalid from the moment of the state registration of the company.

The decision approved by the statutory meeting includes the following : approval of the results of stock allocation, making decision on establishment of the company, approval of the size of authorized capital stock, approval of the charter of company, election of the governing bodies including Supervisory Board, supervisory committee and executive bodies, report of the person authorized by the company's founders.

The results of stock allocation, size of authorized capital stock and report of the person authorized by the company's founders are approved by founders with three-fourths of votes. Foundation of the company and approval of company's charter must be approved unanimously. Decisions on other issues are made by simple majority of votes.

The only constituent document of JSC is its charter and the requirements specified therein are obligatory for all bodies of the company and its shareholders. The charter of the company should contain the following information: complete and short name of the company, location, type (open or closed), quantity, nominal value, categories and types of stocks distributed by the Company, rights and duties of shareholders by categories and types of stocks, size of the authorized capital stock, structure and competence of the management bodies of Company and decision making procedure, procedure for preparation and holding of general meetings of shareholders with list of issues, decision on which is made by management bodies of Company by simple majority of votes or unanimously, information on divisions, representative offices, subsidiaries and affiliated companies, as well as other information and regulations stipulated by Law. By the Company's charter, restrictions can be set as regard quantity of stocks owned by one shareholder and their total nominal value, as well as maximum number of votes given to one shareholder.

### 3.3 Forms of reorganization of JSC

As mentioned above, the establishment of JSC is possible by voluntary reorganization of the existing legal entity (merger, affiliation, division, allotment, transformation). Let's consider all forms of reorganization of the Company one by one.

**Merger** is establishment of a new company by transferring to it all rights and duties of two or several companies with termination of their activity that means establishment of a new legal entity with transfer of both rights and duties of company. Mergers assume the following stages.

1. Companies participating in merger, on behalf of their management bodies, conclude merger contract, which defines the procedure for, and conditions of, the merger, procedure for conversion of stocks of each company into stocks of the new company.

2. Supervisory Boards of each company submit issues pertaining to the merger reorganization, on which the general meeting of shareholders should make decisions with approval of the merger contract and the transfer certificate where rights and duties of members of each company are transferred to the newly created company.

3. General meeting of each Company is called where the decision of its Supervisory Board is approved.

4. No later than in 30 days after the approval of the decision the company notifies the creditors on reorganization in writing. The creditors have right to require compensation of losses or fulfilment of other obligations in writing within 30 days from the date of sending of the notification.

5. General meeting of JSC is called where results of stock allocation, decision on establishment of company, its charter and authorized capital stock are approved, elections to Supervisory Board and Supervisory Committee are held.

6. The new company is registered at the competent state authorities, as well as issues related to the termination of the activities of the merging companies are resolved.

**Affiliation of companies** is the termination of activities of one or several companies with transfer of all its rights and obligations to other company. It includes the following actions.

1. The company's managing bodies conclude the contract on affiliation where the procedure for, and conditions of, affiliation, the

procedure for conversion of stocks and the procedure for voting at the joint general meeting are defined.

2. Supervisory Boards of each company submit issues pertaining to the reorganization in form of affiliation, on which the general meeting of shareholders should make decisions, with approval of the contract on affiliation, transfer certificate, conditions and procedure for affiliation, procedure for conversion of stocks.

3. General meeting of each Company is called where the decision of its Supervisory Board is approved.

4. No later than in 30 days after the approval of the decision, the company notifies the creditors on reorganization in writing. The creditors have the right to require compensation of losses or fulfilment of other obligations in writing within 30 days from the date of sending of such notification.

5. The joint general meeting of shareholders of the companies is convened where decision on inserting of amendments and addenda into the charter of JSC is made and elections to Supervisory Board and supervisory committee are held.

6. By affiliation of one company to another, all rights and duties of the former are transferred to the latter according to the transfer certificate with subsequent registration in competent state authorities with termination of activities of affiliating companies.

**Division of company** is the termination of activity of the given company with transfer of all its rights and duties to the newly created companies. This process goes through the following stages.

1. Company's Supervisory Board holds a meeting and submits the following issues to the general meeting: reorganization, the procedure for, and conditions of, the reorganization, form of division, creation of new companies, the procedure for conversion of stocks, and preparation of division balance sheet.

2. The general meeting of shareholders is held to discuss agenda put forward, and the division balance sheet is approved.

3. No later than in 30 days after the approval of the decision, the company notifies the creditors on reorganization in writing. The creditors have right to require compensation of losses or fulfilment of other obligations in writing, within 60 days from the date of sending of such notification.

4. Statutory meetings of the shareholders of each newly created company are held, at which results of stock distribution, decisions on

establishment of the companies, authorized capital stock and charters of the companies are approved, and Supervisory Boards, supervisory committees are elected.

5. Newly established companies are registered in competent state authorities, as well as issues pertaining to termination of the activities of the reorganized company are resolved.

**Allotment** of company is foundation of one or several companies with transfer to them of part of rights and obligations of the reorganized company without termination of the latter. This process is carried out as follows.

1. Supervisory Board of the company holds a meeting and discusses the following issues: reorganization, the procedure for, and conditions of, the reorganization in the form of allotment, foundation of the new companies, the possibility and procedure for, conversion of stocks, preparation of division balance sheet and transfer of a part of rights and duties to the new company.

2. The general meeting of shareholders is held on the Agenda put forward, and division balance sheet is approved.

3. No later than in 30 days after approval of the decision, the company notifies the creditors on reorganization in writing. The creditors have the right to require compensation of losses or fulfilment of other obligations in writing, within 60 days from the date of sending of notification.

4. Statutory meetings of shareholders of the newly created companies are held, at which results of stock allocation, decisions on establishment of companies, authorized capital stock and charters of the newly created companies are approved, and Supervisory Boards, supervisory committees are elected.

5. Newly created companies are registered in competent state authorities, as well as issues pertaining to the termination of activities of the reorganized company are resolved.

**Transformation** of the company is its reformation into another legal form. Company can be reorganized into a limited liability company (Ltd.) or commercial cooperative. The procedure is as follows:

1. A meeting of the Supervisory Board of the Company is held to put the following issues on the Agenda of the General Meeting of Shareholders: transformation, the procedure and terms and conditions of reorganization by means of transformation, the procedure for conversion of company's stocks into shares or stocks and transfer certificates.

2. General meeting of shareholders is held with Agenda approved, where resolutions on transformation of the company, procedure and terms and conditions of reorganization by means of transformation, procedure for conversion of company's stocks into shares or stocks are taken and the transfer certificate is approved.

3. Not later than within 30 days after the resolution has been taken the company notifies its creditors on reorganization in writing. Within 30 days after delivery of such notice, the creditors of the company have right to require compensation for losses or fulfilment of other obligations in writing.

4. At the statutory meeting, the members of the newly established as a result of the transformation legal entity approve the statutory documents thereof, the transfer of rights and obligations to the newly established legal entity pursuant to the transfer certificate, as well as elect (assign) the management bodies.

5. Amendments and addenda made to the charter of the transformed company are registered at the governmental authorities.

It has to be noted that in case of reorganization of the company, the right of shareholders who did not participate in the voting, or voted against the decision on redemption of their stock, occurs the procedure and terms for which are described in detail in the Article 58 of "Joint-Stock Companies" Law.

**We strongly recommend that in case of reorganization licensed professional participants of securities market are applied to for advice.**

The forms of reorganization of JSC discussed have their features, one of which is the procedure for allocation of securities under reorganization of JSC. Allocation of shares and bonds under reorganization of JSC is carried out through conversion, exchange and purchase.

The shares of the reorganized JSC, on which redemption has been required and which are to be redeemed, are not converted. If there is no such requirement placed during a period set down, these shares are considered convertible at the end of such period.

Securities of commercial organizations reorganized through merger, consolidation, division, allotment and transformation, are cancelled at conversion.

JSC can be liquidated voluntarily or by Court decision.

JSC can be liquidated voluntarily as per the procedure established by Civil Code of RA, in view of the provisions of the Law of the Republic of Armenia "On Regulation of Securities Market" and Charter of the JSC under liquidation. Voluntary liquidation of JSC means liquidation in accordance with decision of the general meeting of shareholders. The basis for voluntary liquidation is the expiry of the term of validity of JSC, and (or) the achievement of the goal for which it was established.

Court decision on liquidation of a JSC can be taken if :

- a. JSC carried out its activities without permission (license) required;
- b. JSC carried out activities prohibited by Law
- c. numerous and flagrant breaches of Law, or other legal acts, were committed by the JSC
- d. registration of JSC was quashed by Court because of the infringements of Law, or other legal acts, committed during the foundation of the company, which can not be eliminated.
- e. adjudication of bankruptcy of the company on its financial obligations.

The liquidation of JSC entails termination of its activities without transfer of its rights and obligations to other parties according to legal succession procedure.

The procedure for liquidation of JSC is as follows:

1. The Supervisory Board of the company put the issues on liquidation of the company and appointment of the liquidation committee on the Agenda of the General Meeting of Shareholders.

2. General Meeting of Shareholders is held to discuss the following:

- liquidation of the joint-stock company
- appointment of the liquidation committee

2.1. Prior to making a decision on appointment of the liquidation committee, the general meeting of shareholders approves the final balance sheet and draft resolution on liquidation of the JSC. The draft resolution includes: the final balance sheet, terms and procedure for

liquidation committee has been appointed, it assumes the full powers as regard management of JSC up to appearing at Court on behalf of the JSC. Representatives of governmental or local authorities, as well as, if so shall be required by them, the representatives of state register and tax inspection, should be included in the liquidation committee. Shareholders having more than 10% of the shares of the company, or their representatives, have right to be included, as well. The structure of liquidating committee is registered by the state register. Based on the relevant resolution of the general meeting, the members of liquidation committee can be remunerated.

2.2. The liquidation committee announces the liquidation of the JSC in , as well as the procedure and terms and conditions for presentation of claims by the creditors (usually 2 to 6 months from the date of announcement) in mass media. The shareholders and creditors are entitled to get acquainted with all documents, including the interim and final balance sheets.

2.3 The liquidation committee develops an action plan on revealing accounts payable and receivable, and notifies the creditors on liquidation of JSC in writing.

2.4. Within a month after the liquidation committee has prepared the interim liquidation balance sheet, which should contain information on the structure of property of JSC, list of claims submitted , as well as the results of discussion of such claims.

2.5. The interim liquidation balance sheet is presented by liquidation committee for approval to the general meeting of shareholders and is to be agreed with the authority that has carried out state registration of the JSC under liquidation. If no debts have been recorded, upon approval of the interim balance sheet the property of the JSC is distributed among the shareholders.

2.6. If there is no sufficient cash available, the liquidation committee, arranges for, and carries out, the public sale of property of JSC to satisfy the creditors' claims.

2.7. Payments to creditors are made as per the interim balance sheet approved, in sequence as follows:

- claims of creditors on obligations secured with the collateral of property owned by the JSC under liquidation are effected;



- claims of citizens whom the JSC under liquidation is liable to for any harm caused to their health and life with payment effected by capitalization of relevant time wages;
- salary payments to persons employed by employment contracts, as well as payments on temporary employment and unemployment benefits are made;
- debts on obligatory payments to the state budget and to off-budget funds are covered;
- mandatory payments to other creditors are made.

Distribution of the property is carried out in accordance with the following principle: each may only get its share after the claims of the previous one have been fully satisfied.

In case liquidation committee does not observe claims of a creditor, the latter has the right to apply to judicial bodies before the liquidation balance sheet will have been approved.

The property of the JSC under liquidation is distributed among the shareholders, as follows:

- Payments on shares, which should be bought out by JSC at the shareholder's request;
- Payment of dividends accrued but not paid on preference shares, as well as payment of liquidation value of the preference share as stipulated by the Charter.
- Distribution of the property of the JSC under liquidation among the holders of ordinary shares.

2.8. The liquidation committee draws up the liquidation balance sheet. General meeting of shareholders is held, where the liquidation balance agreed with the authority that has carried out state registration of the JSC under liquidation is approved.

2.9. The liquidation of the JSC is considered completed, and JSC is considered ceased once appropriate records have been made in the state register of legal entities by the state registration authorities.

The liquidation of JSC can only be appealed against by bringing an action to Court within six months after relevant records have been made in the state register of legal entities by the state registration authorities.

### 3.5. Bankruptcy of JSC

Bankruptcy of JSC pursues two goals:

- recovery of Company i.e. ensuring its solvency and financial stability
- liquidation of JSC

Liquidation of JSC enables to terminate its activity, sell its property on the most favourable conditions, distribute the proceeds among the creditors of the JSC. Both JSC and its creditors can initiate the bankruptcy procedure. Bankruptcy of banks operating in Armenia including those established as joint-stock companies is regulated by the Law of the Republic of Armenia "On Bankruptcy of Banks" and will not be discussed here. The bankruptcy procedure is advantageous for both JSC and its creditors, because it:

- protects the interests of the creditors
- allows JSC to make structural changes
- allows to ensure the solvency and financial stability of JSC

The rights of the creditors, judicial bodies and other parties involved throughout the bankruptcy procedure are protected by Civil Code of RA, Laws of the Republic of Armenia "On Joint-Stock Companies" and bankruptcy. cy Law of RA. According to the legislation of Armenia the judicial bodies can declare the JSC bankrupt if the obligations of JSC exceed 1,000,000 Armenian Drams and they are overdue for more than 30 calendar days.

In case the bankruptcy procedure was initiated by the JSC voluntarily, the enterprise holds up the increase of the indebtedness to creditors and takes the opportunity to begin improving its financial position. In most cases JSC gets an opportunity to effect structural changes in the meantime changing the field and profile of activity, pay debts to creditors and to revise its activities changing the main management. JSC submits to the judicial bodies a set of documents, including:

- announcement on the company's intention to improve its financial position;
- most recent financial statements;
- current accounting records;
- list of assets, including investments, fixed and current assets, tangible and intangible assets.
- list of the creditors with their addresses

The compulsory bankruptcy of JSC by the creditors of the enterprise begins with submitting reasonable claims to judicial bodies. Upon receipt of such claims, Court is obliged to register the claim and notify the JSC accordingly. JSC has the right to appeal against the claim to initiate the compulsory bankruptcy procedure. Prior to accepting the claim, Court has the right to request that creditors a bank account is established for the purposes of covering legal costs, however, for no more than 500,000 Armenian Drams. Upon bringing up of a decision in favour of the joint-stock company, relevant judicial body must repay the applicant the amount remaining after its costs have been deducted. Upon receipt of the claim, Court makes a decision on filing a suit on bankruptcy advising the JSC, creditors, and governmental authorities (state register, real estate cadastre and tax authorities) accordingly. In case the creditor's claims have been met, a manager shall be appointed by Court within two days who within 28 days after the decision has been made holds the first meeting of shareholders. The manager's duties include:

- carrying out of inventory check of the JSC's property;
- preservation of property of JSC safe and sound;
- holding of, and presiding over, the meetings of shareholders;
- checking the accuracy of the information given by JSC;
- checking the legality of shareholders' claims;
- accepting and rejecting of claims, return of the property collateralized, sale of property, agreeing with Court and issuing guarantees.

Shareholders of the JSC are entitled to appeal against the actions of the manager at judicial bodies only, however, the actions of the manager aren't suppressed.

Distribution of the assets of JSC under bankruptcy is carried out in the following sequence:

1. Secured claims;
2. Court costs and manager's salary;
3. Expenses of the manager regarding ensuring of the safety of property, managerial expenses;
4. Unsecured claims, including any costs occurred in connection with the bankruptcy;
5. Accounts payable;
6. Unsecured claims of the creditors including payments to state and local budgets, except for obligations to governing authorities;

7. Obligations to governing authorities occurred after the claim was brought to judicial bodies, including claims on bonds with maturity 10 years and over, preference shares, donative and inherited obligations;

8. Obligations to owners, founders, shareholders.

### 3.6. Authorized capital stock of JSC

Authorized capital stock is capital consisting of the investments made by the shareholders at the establishment of JSC. Authorized capital stock consists of all stocks allocated to the founders at nominal value.

Authorized capital stock of JSC determines the minimum size of the property of JSC, which ensures the protection of the interests of its creditors.

According to the accounting standards, the authorized capital and the amount of the founders' actual indebtedness on the contributions to the authorized capital are reflected separately in the balance sheet: authorized capital opens the liabilities part and the indebtedness to the authorized capital stock is reflected under assets. Not only the degree of the shareholders' influence on JSC, but also their status can depend on the size of shareholding. To get a better idea of the procedure of increase and decrease of the authorized capital stock, one have to understand the meaning of allocated, declared and other categories of shares first.

Allocated shares are shares purchased by the shareholders, quantity and nominal value of which are determined by the charter of the JSC.

Declared shares is the shares, quantity and nominal value of which are determined by the charter of JSC and which JSC is entitled to distribute in addition to shares already allocated.

The allocated shares, in fact, define the authorized capital stock, whereas the declared shares represent some conventional value, which is secured with nothing when it is recorded in the charter, therefore declared shares can not be reflected within the authorized capital stock. Decisions on shares allocated and declared are made by the general meeting of JSC and are reflected in the charter. The evalu-

ation of the property offered as payment against shares is made by agreement between founder parties. The share doesn't give the right to vote until it is fully paid-up. In case full payment against shares is not effected on or before an agreed (specified) deadline, then the share will fall under the disposal of the JSC, which is reflected in the register of JSC. Cash and other property entered as payment for the shares after deadline established aren't returned. Shares under disposal of the JSC doesn't give the right to vote and are not taken into while accruing dividends. Such shares must be sold within a year after the JSC got them under its disposal. Otherwise, the general meeting of shareholders will have to make a decision on reduction of authorized capital stock by redeeming the mentioned shares.

In the charter of JSC, there is a provision on reserve fund, size of which has to be envisaged by the Charter of the JSC, however, can not be less than 15% of the authorized capital stock. It is formed by obligatory annual deductions at the rate of no less than 5% of the net profit. The reserve fund is intended for covering the losses of JSC, as well as redeeming the bonds and shares of JSC if no other means are available. It cannot be used for any other purposes. JSC supervises the ratio of authorized capital to net assets at certain times, including completion of the financial year (at the general meeting of shareholders), as well as based on the findings of audit. If upon completion of the second and each of the following years, the value of the net assets of the company as per the annual balance sheet presented to the shareholders of JSC for approval, or according to the findings of audit, is less than the value of the authorized capital or less than thousandfold minimum wages established for OJSCs and hundredfold minimum wages for CJSCs, then JSC has to have its authorized capital reduced to the value not exceeding the value of net assets, or make a decision on liquidation of the company.

If neither of the decisions is taken, then the shareholders or creditors, relevant governmental authorities shall be entitled to require that the JSC should be liquidated through Court.

### **3.7 Reduction and Increase of the authorized capital of the JSC**

#### **3.7.1 Reduction of authorized capital.**

The reduction of authorized capital of JSC is possible by reduction of nominal value of the share, as well as decrease of their total number, including purchase and redemption of a part of the shares. Such decision falls under the authority of the general meeting and must be taken by not less than 75% of votes of the shareholders of JSC attending the meeting, but at least 2/3 of the owners of the voting shares. The reduction of the authorized capital of JSC by means of purchase and redemption of a part of the shares is allowed provided that such opportunity is envisaged by the charter of JSC. JSC doesn't have the right to reduce the authorized capital if as a result of such reduction its value becomes less than the minimum authorized capital stock required by Law as at the date of registration of the relevant amendments to the charter of JSC. No later than within 30 days after the decision on reduction of the authorized capital JSC was made, the JSC has to notify its creditors in writing accordingly. No later than within 30 days after such notice on the reduction of the authorized capital was sent, the creditors have the right to request the JSC to terminate fulfilment of its obligations prematurely and compensate any losses caused for this reason. Registration of the amendment to the charter of JSC occurred as a result of the reduction of the authorized capital is allowed within 60 days after the decision was taken.

#### **3.7.2. Increase of the authorized capital.**

Increasing of the authorized capital stock of JSC is possible through increasing of the nominal value of the shares, as well as allocation of additional shares, provided that all shares previously issued have been fully paid up. The decision on the increase of the nominal value of the shares inserting relevant amendments in the charter of JSC is to be approved by the general meeting of shareholders or the Supervisory Board of the JSC if in accordance with the charter of the JSC, or the decision of general meeting of shareholders, the Supervisory Board has the authority to approve such decision.

Increase of the authorized capital through increasing the nominal value of the shares can not exceed the value of the net assets of JSC as per the most recent annual balance sheet approved by general meeting of shareholders, or the findings of the latest audit. Increase of the authorized capital of the JSC by increasing the nominal value of stock is only possible at the expense of:

- the retained profit of JSC;
- transfer to the authorized capital of property (net assets) exceeding the total amount of the authorized capital and capital reserves, as well as the difference between the liquidation and nominal value of the preference shares, or part thereof.

Additional shares can be allocated by JSC only within the number of shares declared, as per the charter of JSC. In the resolution on increase of the authorized capital of the JSC through allocation of additional shares, the following has to be defined:

- number of additional shares to be allocated, as well as number of every type of preference shares within the number of shares of each of such types declared.
- terms and conditions of their allocation, including the price of allocation for shareholders who have the pre-emptive right to purchase shares under allocation.

### **3.8. General Meeting of Shareholders, Board of Directors (Supervisory Board), Executive Board, Executive Director and Supervisory Committee**

#### **3.8.1. The general meeting of shareholders**

1. The general meeting of Company's shareholders is the supreme body of Company's management. The Company is obliged to convene general meeting of shareholders on an annual basis; such meeting is called the annual general meeting of shareholders. The statutory meeting of Company's shareholders is its first annual meeting. The first annual general meeting of Company's shareholders is convened after the end of the first financial year. The annual general meeting of shareholders is held within 6 months after the end of each

financial year. All general meetings of Company's shareholders held during the course of the year other than the annual general meeting, are considered extraordinary. Extraordinary general meetings of Company are convened to discuss urgent issues. Extraordinary general meetings of Company are convened by the decision of the Board of Directors (the Supervisory Board) of Company: on its own initiative, by the requirement of supervisory committee (controller), official auditors or shareholders who own not less than 10% of voting shares.

2. The following issues fall under the authority of the general meeting of Company's shareholders:

2.1. Approval of the charter of company, changes and additions thereto, approval of the new version of the charter of the Company.

2.2. Reorganization of company.

2.3. Liquidation of company,

2.4. Approval of the interim, final and liquidation balance sheets and appointment of liquidation committee.

2.5. Approval of the number of members on the Company's Board of Directors (Supervisory Board), election of its members and premature termination of their authorities.

2.6. Setting up of the maximum number of the declared shares.

2.7. Increase of the Company's authorized capital through increase of the nominal value of the shares or allocation of additional shares.

2.8. Reduction of the Company's authorized capital through decrease of the nominal value or their total number, including by redemption of shares partially paid-up, as well as by redemption of shares bought out or purchased by the Company.

2.9. Appointment of the executive body of the Company, premature termination of its powers, if otherwise is not stipulated by the Charter.

2.10. Election of Company's supervisory committee (controller) and premature termination of its powers.

2.11. Approval of company's auditor.

2.12. Approval of company's annual accounts, balance sheets, profit and loss accounts, profit and loss allocation report, taking of decisions on payment of annual dividend and approval of the rate of annual dividends.

2.13. Taking of decision that the pre-emptive rights of shareholders as regard purchase of shares or converted shares of company shall not apply.

2.14. Division and consolidation of shares.

2.15. Concluding of deals in case the counterparty is an interest-ed party.

2.16. Concluding of major transactions on alienation or acquisition of property by the Company, if such property exceeds 50% of the Company's assets.

2.17. Purchase and redemption of securities allocated.

2.18. Establishment of subsidiaries and affiliated companies including shareholding therein.

2.19. Approval of the administrative structure of company etc. according to Law "On Joint-Stock Companies"

The general meeting of Company's shareholders is authorized to make decisions on any issue, which falls under the authority thereof according to Law and company's charter.

3. Taking decisions on issues specified in all sub-points of point 2 is the exclusive authority of general meeting of Company's shareholders and cannot be delegated to company's Director except for the sub-point 2.18, where this relates to shareholding. Taking decisions on issues under the exclusive authority of general meeting of company's shareholders can't be delegated to the Board of Directors (Supervisory Board) of the Company, except for the cases stipulated in sub-points 2.7, 2.9, 2.17 and 2.18.

4. Shareholders who own common shares have the right of vote at the general meetings of shareholders.

5. Decisions on issues stipulated in sub-points 2.3, 2.8 are made by the general meeting of the Company's shareholders by 2/3 of total votes of shareholders attending the meeting and holding voting shares, but not less than 2/3 of total shares.

6. In cases stipulated in sub-points 2.2, 2.13, 2.14-2.17 decisions by general meeting of shareholders are made on submission of the issues by the Board of Directors (Supervisory Board).

7. Decisions on issues stipulated in sub-points 2.1, 2.2, 2.4, 2.6, 2.16 are made by general meeting of the company's shareholders by 3/4 of the votes of shareholders attending the meeting and holding voting shares.

8. Company's shareholders should be informed about the decisions taken by general meeting of the Company's shareholders, as well as the results of voting within 45 days after the decision was taken.

9. Shareholder has the right to appeal against the decision made by the general meeting of the Company's shareholders at Court, if such decisions infringe the provisions of the Law, other legal acts and the charter of company, if he did not attend the meeting, or voted against such decisions, and his lawful interests and rights have been affected by such decisions. Court has the right to leave the decision of the general meeting of company's shareholders in force, if participation of the shareholder who brought in the claim in the voting could not affect the results of voting, breaches committed are insignificant and/or the decision didn't cause loss to the shareholder.

10. Decisions of the general meeting of the Company's shareholders (except for the decisions on issues stipulated in sub-point 2.12) can be accepted without convening general meeting - by means of postal voting (circularisation). Decision of general meeting of the Company's shareholders approved by postal voting is valid if shareholders who participated in the voting own in total more than half of voting shares of the company. Postal voting is carried out using ballot-papers, which should be delivered to shareholders at least 30 days prior to the date of acceptance of ballot-papers.

11. Entities mentioned below have the right to attend the general meeting of the Company's shareholders:

- shareholders holding allocated common shares of the company with number of votes corresponding to the number and nominal value of common shares fully paid-up by them;
- shareholders holding allocated preference shares of the Company with number of votes corresponding to the number and nominal value of preference shares fully paid-up by them;
- members of the Board of Directors (Supervisory Board) and members of Executive Board of the Company who are not the Company's shareholders can also attend the general meeting with deliberative vote;
- members of the Supervisory Committee (controller);
- official auditors of the Company, if their report is included in the set of documentation to be discussed at the meeting.

List of shareholders having the right to participate in the general meeting of the Company's shareholders is made up as at the date established by the Board of Directors (Supervisory Board) of the Company according to the shareholders register. Such date can not be set down prior to approving the decision on convocation of the general meeting of shareholders, or later than 60 days before the date of the meeting.

### **3.8.2. Board of Directors (Supervisory Board) of the Company.**

Members of the Board of Directors (Supervisory Board) of the Company are elected at the general meeting of the Company's shareholders, or if the powers of the members of the Supervisory Board were terminated prematurely at the extraordinary general meeting.

The number of members on the Supervisory Board must be approved exclusively at the annual general meeting of shareholders. Once new members of the Supervisory Board have been elected, powers of the previous members are considered as terminated. The members of the Supervisory Board are approved by simple majority of votes. If the Company has more than 500 shareholders (owner of voting shares), then the elections of the Supervisory Board must be held according to the procedure set down by the law "On Joint-Stock Companies". The shareholders who as at the date of drawing up the list of shareholders who are entitled to attend the general meeting of shareholders own at least 10 per cent of the allocated voting shares of the Company, have the right to be automatically included in the complement of the Supervisory Board, or appoint authorized representatives thereto. Such right can also be exercised by the nominal holders of the shares. Persons who are not shareholders of the Company can be members of the Supervisory Board. A shareholder can only have one seat on the Supervisory Board. Board of Directors (Supervisory Board) of the Company carries out the general management of the Company. Members of the Supervisory Board are elected at the general meeting of shareholders for an unlimited period of time. Elections of the Company's Board of Directors (Supervisory Board) can be held by both simple and cumulative voting.

The following issues fall under the exclusive authority of the Company's Board of Directors (Supervisory Board):

- Setting up of the main directions of the Company's activity.
  - Convocation of annual and extraordinary general meetings of the Company's shareholders, except for the cases stipulated by Law.
  - Approval of the agenda of general meeting of the Company's shareholders
  - approval of the date for drawing up of the list of shareholders who are entitled to participate in the general meeting of shareholders, as well as other issues pertaining to the general meeting;
  - increase of the authorized capital of the Company, inclusive-ly of such through additional share issue;
  - acquisition of shares, bonds and other securities of the Company allocated;
  - Determination of the market price of the property.
  - allocation of bonds and other securities;
  - appointment of the executive body (administration, executive board) of the Company, premature termination of its powers, procedure and conditions for remunerating the executive director, members of the administration and executive board, as well as compensating them for expenses incurred.
  - Setting up of the Company's auditor's remuneration rate.
  - Drafting proposals on the rate of, and procedure for, annual dividend payments for further presentation to the general meeting of the Company's shareholders.
  - Definition of the rate of, and procedure for, interim (quarterly or semiannual) dividend payments on the Company's shares .
  - Use of Company's reserve fund.
  - Approval of the internal documents of the Company regulating the activities of the Company's managing bodies.
  - Taking of decisions on entering into major deals as and when stipulated by Law.
  - Approval of the Company's administrative and organizational structure
  - Approval of the manning table and the annual budget of expenses etc. according to the law "On Joint-Stock Companies"
- Taking decisions on the issues falling under the exclusive authority of the Supervisory Board can not be delegated to the executive

body of the Company. Total duration of the powers of the Supervisory Board members is not limited.

According to the "Law on Joint-Stock Companies", the meetings must be held according to procedure as follows:

- the Supervisory Board meetings are convened by the Chairman of the Supervisory Board: at his own initiative, at request of the member of the Supervisory Board, Supervisory Committee (controller) of the Company, the official auditor, the sole executive body of the Company, as well as at request of any other parties, as envisaged by the Charter of the Company.
- quorum for the Supervisory Board of the Company is defined by the Charter of the Company, however, it shall not be less than half of the members of the Supervisory Board members;
- decisions are taken by the Supervisory Board by simple majority of votes of the members attending the meeting, except for where otherwise envisaged by the legislation or the Charter of the Company;
- the Supervisory Board is entitled to take decisions by means of postal voting.

If the number of members of the Supervisory Board defined by the general meeting of shareholders have decreased by more than half, then the Supervisory Board has to make a decision on convocation of the extraordinary general meeting of shareholders to replenish the number of Supervisory Board members. Minutes of the Supervisory Board meeting are drawn up within 5 days after the meeting, whereas the following must be mentioned in the Minutes:

- date, time and place of the meeting;
- persons attending the meeting;
- agenda of the meeting;
- issues put to voting and results of voting;
- resolutions taken at the meeting.

Minutes of the Supervisory Board meetings are to be signed by all the members who have attended the meeting, whereas they are held liable for the trustworthiness of the information included in the Minutes.

### **3.8.3. Chairman of the Board of Directors.**

Positions of the Chairman of the Board of Directors (Supervisory Board) and the Director of the Company can be combined if the Company has less than 500 shareholders (owners of voting shares). Except for where envisaged by this point, the Chairman of the Board of Directors doesn't have the right to occupy other paid positions within the Company.

The Chairman of the Board of Directors (Supervisory Board) of the Company is elected by the Board of Directors (Supervisory Board) by majority of total votes of the members of the Board of Directors (Supervisory Board). If at the voting the votes are distributed equally, the Chairman has casting vote.

The Chairman of the Board of Directors (Supervisory Board):

- Organizes the activities of the Company's Board of Directors (Supervisory Board)
- Convenes, and presides over, the meetings of the Company's Board of Directors (Supervisory Board);
- Arranges for drawing up of the minutes of the meeting;
- Presides over the general meetings of the Company's shareholders

### **3.8.4. The management of the current activities of the Company is carried out by the General (Executive) Director of the Company.**

The Executive Director of the Company deals with all issues, except for those under the exclusive authority of the general meeting of the Company's shareholders and the Company's Board of Directors (Supervisory Board). The Executive Director arranges for the implementation of the decisions of the general meeting of the Company's shareholders and the Company's Board of Directors (Supervisory Board), reports to them, and doesn't have the right to make decisions binding upon the general meeting of the Company's shareholders or the Company's Board of Directors (Supervisory Board).

The Executive Director should act in a conscientious manner and bona fide, for the benefit of the Company. If so demanded by the founders (shareholders), he is obliged to cover any losses caused by him to the Company, unless otherwise stipulated by the Law or

contract. The contract with the Director is signed by the Chairman of the Supervisory Board. If the positions of the Chairman of the Supervisory Board and Director are combined, then by the decision of the Supervisory Board the contract with the Director is concluded by one of its members. Within the authorities given to him by the Charter of the Company and the provisions of the contract concluded with the Chairman of the Supervisory Board, the Director shall:

- Administer the assets of the Company, inclusively of cash assets, sign deals on behalf of the Company.
- Represent the Company in the Republic of Armenia and abroad.
- Act without Power of Attorney.
- Issue Powers of Attorney.
- Sign agreements, inclusively of employment contracts according to procedure applicable.
- Open current and other accounts (inclusively of those denominated in foreign currency) with banks in the name of the Company.
- Submit to the Board for approval the regulations of the Company, divisions and departments thereof, as well as the organizational structure of the Company.
- Issue orders, instructions and duly binding guidelines within his authority, and supervise implementation thereof.
- Hire and dismiss employees of the Company pursuant to procedures applicable.
- Apply motivational and punitive measures to the employees of the Company.

### **3.8.5 Supervision over the Company's financial and economic activities**

For the purposes of carrying out supervision over the Company's financial and economic activities the general meeting of the Company's shareholders elects Company's supervisory committee (controller). The powers of the Supervisory Committee (controller) and the procedure for carrying out the audit are established by the Civil Code of the Republic of Armenia, Law "On Joint-Stock Companies", as well as the Charter of the Company.

The Supervisory Committee supervises the implementation of the decisions of the Company's governing bodies, checks the compliance of the Company's documents to the provisions of Law, other legal acts and the Company's charter. The Supervisory Committee carries out the audit of the annual results of the Company's financial and economic activity, as well as the audit of the Company's financial and economic activity on its own initiative and by decision of general meeting of Company's shareholders or Board of Directors (Supervisory Board), as well as if so required by the shareholder(s) who own(s) at least 10 per cent of the voting shares of the Company. The Supervisory Committee has the right to require convocation of the extraordinary general meeting of shareholders, as envisaged by the Law. If so requested by the Supervisory Committee, it must be provided with any documentation, information and explanations as regard the financial-economic activities of the Company, its branches and representative offices, institutions.

Members of the Supervisory Committee are elected exclusively at the annual General Meetings of Shareholders. The issue on election of the Supervisory Committee can only be discussed at the extraordinary general meeting of shareholders if an extraordinary general meeting has taken a decision on premature termination of powers of the Supervisory Committee or some of its members.

Members of supervisory committee are elected for 3-year period by the general meeting of shareholders of Company.

The Supervisory Committee reports to the general meeting of the Company's shareholders.

Conditions and rates of remuneration or compensation payable to the members of the supervisory committee (controller) or are defined by the decision of general meeting of the Company's shareholders. Individuals who are not members of the governing bodies of the Company and are authorized by a shareholder or founder can be members of Supervisory Committee. The number of members on the Supervisory Committee is approved by the general meeting, however, can not be less than three. The Chairman of the Supervisory Committee is elected from among its members, by simple majority of votes.

Based on the audit of the financial-economic activities of the Company the Supervisory Committee draws up a report. Such report



and the balance sheet is presented by the Supervisory Committee (controller) to the annual general meeting. With no report of the Supervisory Committee available the annual balance sheet of the company can not be approved by the general meeting.

Voting shares owned by the members of the Supervisory Board and the General (Executive) Director are not taken into account while calculating the results of voting at the elections of the Supervisory Committee (controller) members if the Company has over 50 shareholders (owners of voting shares).

For checking the reliability of company's annual financial statements the Supervisory Committee has to involve a competent supervisor (individual or legal entity) - the auditor (external audit) who hasn't got any interest in the Company or its members.

General meeting of shareholders approves the Company's auditor. The contract with the Company's auditor is signed by the Company's Board of Directors (Supervisory Board) who determines the rate of remuneration payable to the auditor. If so requested by the shareholders who jointly own 10 per cent or more of the authorized capital stock, audit of the Company's activities must be carried out immediately. Audit of the annual financial statements of the Company can also be carried out at request of any of the shareholders of the Company. In this case the audit is carried out at the expense of the shareholder who requested such audit.

### **3.9. Dividend policy of the JSC**

JSC always has serious intentions to invest at the expense of its own funds, and since paying dividends to shareholders reduces the amount of refinancing, it is obvious that the decision on payment of dividends becomes an urgent issue for both shareholders and the JSC itself.

The basic objective of the management of the JSC is the increase of the share capital, which entails the need to take strategic decisions as regard management of investments, finance and dividends. Let's discuss some dividend policy issues, in particular, the effect of the rate of dividends over the value of the JSC and the optimisation of the value of the payments. Dividend policy includes taking of the following decisions:

- To pay or not to pay dividends
- Whether to keep the funds as retained profit
- The amount of dividends to be paid.

The optimisation of dividend policy includes balancing the model of evaluation of common stocks taking the account of a number of factors such as stock price, income growth rate, amount of the retained profit. Dividend policy of JSC is implemented with consideration of the influence of two major factors: the financial position of the JSC including the effect of market forces and Governmental policies, and the preferences of the investors and shareholders. While taking decision on sources of financing the JSC has to choose from debt and stocks. If JSC obtains a bank loan, the loan agreement would stipulate that dividends can only be paid to shareholders if certain ratios showing the rate of repayment of loans and interest accrued are complied with. Besides, the protection of creditors' interests is ensured by setting down a requirement as regard the size of the retained profit, which must exceed the amount of total dividend payments. Issue and allocation of stocks by the JSC result in costs of allocation, which are rather high for small JSCs. In this case it is cheaper to finance the projects at the expense of retained profit rather than issue of common stock. If the costs on attraction of borrowings are low enough, the JSC can decide to maintain a constant level of dividend payments and borrowings.

Usually, as the dividends over shares increase, price for shares rise and, vice versa, the reduction in dividends is followed by fall of share price. The increase in dividends is a kind of a signal to the investors that the management of JSC expects a period of prosperity and the reduction in dividends warns about financial problems. The management of the JSC should be aware of the fact that it is necessary to support a constant ratio of dividends to profit and it is not purposeful to reduce dividends payable.

Based on the special features of privatization in Armenia one can state that the number of the retired employees in JSC will increase in view of the time factor. Hence, many shareholders will prefer current income over future one, as the dividends will be important source of income for them. Other shareholders can be not in need of cash and will prefer to reinvest the dividends. Dividend policy of JSC should take into account the interests and needs of all shareholders.

This is a vivid example of the influence the shareholders can have over the activity of the JSC. Given the reality existing nowadays in Armenia, with rare exception the dividends are not paid, and the low income available to the JSCs are invested in production, which alone even does not have any influence over their economic position. Therefore to support the stock prices it is necessary to pay dividends to shareholders in cash even quarterly, if possible, and that in turn will eventually effect positively the reputation and investment policy of the JSC. end. The value of dividends paid quarterly shouldn't exceed their annual value. The date of payment of quarterly dividend is established by the Supervisory Board of the JSC, but it should be paid no earlier than in 30 days after the decision has been made.

Payment of dividends must be effected according to a certain procedure. If dividends are paid quarterly, list of shareholders registered at the depository is drawn up, and shareholders registered during the 10 days preceding the date of making of the decision get the right to receive dividends, and if dividends are paid on an annual basis, such right is given to shareholders registered as at the date of drawing up of the list of shareholders who are entitled to participate in the general meeting. Everything is defined at the annual meeting of shareholders where decision on payment of dividends is made and the rate of dividend per share is determined, as well as the date of registration of shareholders and the date for initiating payments of dividends are established. All shareholders who are included in the lists of shareholders by the day of registration of shareholders will get the right to receive dividends and maintain such right even if they sell the share before the cash is actually paid.

JSC does not have a right to make a decision on payment of dividends if:

- Authorized capital stock is not fully paid up,
- The total amount of the net assets and reserve fund of the JSC is less than the authorized capital stock, or would become less if dividends are paid.
- the economic position of the JSC shows symptoms of bankruptcy, or such symptoms may appear if dividends are paid;
- JSC declared redemption (repurchase) of shares from shareholders, but has not yet completed the process.

The redemption of the shares of JSC at the secondary market is

one of the methods of allocation of the excessive own equity of JSC. The redemption of shares pursues the following purposes: obtaining of shares option, absorption of other JSCs and reorganization of state owned JSC-s into private companies. In any case, the shares are redeemed to withdraw them from circulation, and this process is considered as one of the components of the dividend policy.

There are two methods of redemption. Under the first one, the JSC makes an official offer to shareholders to purchase their shares at the existing market price, and the shareholders can choose whether to sell the shares or not. This process usually takes 45 days, whereas the JSC can decide on whether the shares should be redeemed partially or in full. Under this method, the redemption costs for the JSC are higher than under the second one - purchase of shares at the secondary market. When the second method is used, the commission fee payable to brokers is not fixed and is subject to further negotiation. In this case JSC needs a lot of time to complete collection of the shareholdings.

The use of the special fund of the JSC to purchase the shares of the Company at the secondary market has its advantages for as the governing body of the JSC, as the shareholders. Redeemed shares are kept within the JSC and can be allocated either among the management, or to the employees, up to 25% of authorized capital stock, or among shareholders against cash payments. After the employment contract with the employee is terminated, except the case of their retirement, the Company has the pre-emptive right to buy the shares out at market price, however, at no less than the nominal value.

In order to protect the shareholders from hostile processes, e.g. absorption of the Company, the management can make use of their own funds, or borrow for the purposes of buying the shares out, from unhappy or minor shareholders. The purchase of shares from shareholders by the JSC is not an investment in its own shares as no increase in assets takes place, and the bringing of this operation to its logical end would mean return of the capital to shareholders and liquidation of the JSC. Only where surplus cash is available, the decision on redemption of shares can be considered as an element of the dividend policy of the JSC. By redeeming its own shares, the JSC is able to increase the profit per share, but in the meantime it also increases the leverage efficiency, which depends as on the initial

leverage effect, as on how much it has increased as a result of the redemption of shares.

When redeeming the shares of the JSC, side effects appear, e.g. a signal is given by the JSC that the share is underestimated at the securities market, which is a positive signal for the market prompting it to revalue the share of this JSC.

The relationship between the inflation and the dividend is of a great interest. With acceleration of the inflation the JSC should make a re-calculation of at least the depreciation charges for the replenishment of the fixed assets value. But even after the adjustment of the income value, it is difficult to define the rate of dividends payable. As a result of the inflation, the taxes payable by the JSC will increase, which leads to a decrease in free cash. The rate of dividends in this case is defined by the amount of intakes, and it's important not to overestimate the allowable value of dividends. The inflation will reduce the ability of the JSC to pay dividends and sometimes it will be necessary to abstain from making dividend payments. The inflation undermines the ability of JSC to pay dividends, first of all, because of the increase in costs, which is not always compensated by the increase in prices for finished goods. The slower the turnover of the finished production and the larger the stock are, the lower is the net profit because of the growth of taxes payable in respect of the illusive increase in value of the stock of the finished goods. The definition of the rate of dividend payments is a complicated process, and JSC should follow logic below:

- Financial claims should be estimated by capital investments
- It's necessary to maximize the use of own assets
- The optimal investment decision should be chosen
- Dividends should be paid from net profit

In accordance with the theory of dividend payments, shareholders will be interested that the investments are made at the expense of the own funds of the JSC, provided that such investments would result in larger profit than the profit shareholders would get using their portion of dividends. Thus the value of dividends becomes changeable, which contradicts the main logic of the actions of the management of the JSC aimed at the stabilization of the value of dividends.

There are a number of reasons that cause undesirable reduction

in dividends. The first one relates to the existence of many shareholders who expect that their investments should yield large profits. The second reason lies in the fact that shareholders can come to a conclusion that the company experiences serious financial problems, which will result in fall of price for shares. As a rule, any change in the level of dividend payments results in an immediate reaction from the shareholders' part and can be perceived by them unambiguously. In USA, large JSCs have a serious attitude towards the stability of dividends paid, and for that even give up financing at the expense of own funds.

Dividends paid to the shareholders (individual) are tax exempt in Armenia. In conclusion, we would like to note that there is no universal rule that suits every situation. However, what we should state is that any decision on dividend payments should be adequate to the specific situation.

### **3.10. Stock price and its basic parameters. Ratios used while calculating stock price**

Below methodical guidance is offered, which can be used by the shareholders of the JSC to carry out elementary financial analysis of the accounting reports to calculate the stock price. It is obvious, that a more comprehensive and professional analysis for developing strategy of behaviour at the stock market, i.e. investment in securities, should be left to the specialists who while dealing with indefinitely large number of variables eventually take an intuitive decision on investments. The professionals' analytical abilities essentially expand the possibility to make timely and reasonable decision. In this case the professional's intuition is his latent ability to analyse data, which can not be calculated using mathematical formulas, in a fast and comprehensive manner. Analysis of the financial statements of the JSC is carried out using various ratios. Such ratios can be grouped by information attributes, as well as ensure comparability of data in time for different JSCs and the industrial sector as a whole.

### 3.10.1. Ratios for per stock calculations

Common stock is characterized by three basic parameters: profit per stock, value of dividends per stock and stock price. The stock price is usually defined at the stock exchange, and is based on market value. To get the complete information on a common stock, the following additional parameters are used: volume of sale, cash flow (profit plus amortization), book value etc. per stock.

The per stock parameters have essential deficiencies:

- Distract the investor from the analysis of activity of the JSC as a whole, namely: studying the volume of sale, profits, invested capital and aggregate market valuation of the JSC
- Much attention is paid to one stock, without considering features of income calculation.

Formulas to calculate the most frequently used parameters per stock are given below. It is necessary to pay attention to parameters describing results as at the end of the year and on a certain date. In the first case, the average weighted number of allocated common stock, and in the other, the number of the allocated stock on the balance sheet closing date is indicated in denominator.

#### 3.10.1.1. Profit per stock

While calculating profit per stock it should be correlated to the reported net profit. The expenses or repayment of credit should be excluded from the calculation of net profit, with relevant calculation of charges or credits per stock. The stock price is not a constant value, as it changes depending on the share (percentage) of participation in the property of JSC, i.e. the stock price for this year is not equal to that one of the previous or the next year.

$$\text{Profit per stock} = \frac{\text{Profit on all common stocks}}{\text{Average weighted number of allocated common stocks}} .$$

#### 3.10.1.2. Dividends per stock

Dividends per stock for the reported period is a stable parameter. It is nearly never calculated since it is usually declared.

$$\text{Dividend per stock} = \frac{\text{Total annual dividends on common stock}}{\text{Average weighted number of allocated common stocks}} .$$

#### 3.10.1.3. Volume of sale per stock

No explanations are required.

$$\text{Volume of sale per stock} = \frac{\text{Volume of sale}}{\text{Average weighted number of allocated common stocks}} .$$

#### 3.10.1.4. Cash flow per stock

This parameter describes the ability of the JSC to develop at the expense of its own equity, convert calculated profit into cash and take the advantages of financial flexibility. The cash flow doesn't become the ownership of the shareholders. It is used to service the debt or other obligations.

$$\text{Cash flow per stock} = \frac{\text{Income after tax}}{\text{Average weighted number of allocated common stocks}} .$$

### 3.10.1.5. Book value of net assets per stock

Describes the position as at the closing of the balance sheet.

$$\text{Book value of net assets per stock} = \frac{\text{Book value of net assets - Goodwill - Majority of other intangible assets}}{\text{Number of allocated stocks at the closing of the balance sheet}}.$$

### 3.10.1.6. Current assets per stock

Describes the position at the closing of the balance sheet.

$$\text{Current assets per stock} = \frac{\text{Current assets- All claims on common stocks}}{\text{Number of allocated stocks at the closing of the balance sheet}}.$$

### 3.10.1.7. Instant assets per stock

Describes the position at the closing of the balance sheet.

$$\text{Instant assets per stock} = \frac{\text{Cash + Accounts receivable - All claims on common stocks}}{\text{Number of allocated stocks at the closing of the balance sheet}}.$$

### 3.10.1.8. Cash assets per stock

Describes the position at the date of closing of the balance sheet.

$$\text{Cash assets per stock} = \frac{\text{Cash assets - All claims on common stocks}}{\text{Number of stocks allocated at the closing of the balance sheet}}.$$

### 3.10.2. Price ratios

Price ratios make it possible to make investment decisions taking the account of with the existing market, calculated or forecasted prices. Price ratios are compared to profit, dividends, value of assets and sales and are calculated based on the results of the annual balance sheet. As the annual profit varies from year to year it's necessary to indicate the period of calculation and whether the parameter is actual or calculated. Let's consider these parameters.

#### 3.10.2.1. Ratio of stock covered by profit.

The ratio is calculated not only for evaluation of the guaranteed dividend, but also for the purposes of comparison with the current market stock price. Besides, it is necessary to specify the period of calculation. This ratio is calculated in diverse and changeable forms, and even its current values are unstable.

$$\text{Ratio of stock covered by profit} = \frac{\text{Stock price}}{\text{Profit per stock}}.$$

The price/profit factor is usually used as an indicator of the relative value of the common stock. The factors influencing the price/profit ratio can be tangible and intangible. The tangible factors include:

- growth of profit and sales
- profitability, the income level
- stability
- level and dynamics of dividends
- financial position

The intangible factors are:

- Quality of management
- The nature and development perspectives of the given sector
- Competitive status of the JSC and the development perspectives

The intangible factors influence the indicators of the JSC as they are indirectly reflected in the reports, i.e. the reported indicators give a clear and full view over the level of competence of the governing bodies. Exceptions are the situations occurred in quickly developing branches where the expected profit is not in any way related to the profit received in the past.

#### 3.10.2.2. Stock Profitability.

The basic characteristics for the majority of common stocks are the stock price and profit per stock, which give the investors and shareholders an idea of their quality and growth. This ratio reflects the stability of the profit in the past.

$$\text{Stock profitability} = \frac{\text{Profit per stock}}{\text{Stock price}} .$$

#### 3.10.2.3. Ratio of dividends per stock to stock price.

This ratio reflects the level and dynamics of dividends over a certain period of time.

$$\text{Ratio of dividends per stock to stock price} = \frac{\text{Dividends per stock}}{\text{Stock price}} .$$

#### 3.10.2.4. Ratio of stock covered by balance sheet assets.

Ratio shows to what extent stocks are covered with balance sheet assets.

$$\text{Ratio of stock covered by balance sheet assets} = \frac{\text{Stock price}}{\text{Balance sheet assets per stock}} .$$

### 3.10.3. Profitability Ratios

Profitability ratios show the ability of the management of the JSC to use capital to get maximum profit. The basic profitability indicator is the ratio of the net profit to capital. Net profit is a component of income and reflects all kinds of profits. The advantage of the indicator of return on invested capital is that it measures the general efficiency of business to total assets. Profitability ratios reflect the contents of the JSC and the information on cumulative capital, capital, long-term investments and own equity. To ensure comparability of various JSCs it is necessary to reduce the interest costs in numerator by the relevant tax rate.

#### 3.10.3.1. Profitability of capital.

The profitability of capital is calculated using formula or by multiplying capital turnover ratio by the net profit ratio.

$$\text{Profitability of capital} = \frac{\text{Net profit} + \text{Income from participation in other organizations} + \text{Interest income adjusted by tax rate}}{\text{Tangible assets- Accumulated short-term accounts payable}} .$$

#### 3.10.3.2 Ratio of capital turnover.

Capital turnover is an indicator of economic activities of the JSC. Shareholders need it to carry out comparative analysis with other enterprises of the same sector. Capital turnover ratio is calculated through dividing sales volumes by the relevant indicators of turnover of assets, inventory stock, own capital, fixed assets, accounts receivable and current assets.

$$\text{Capital turnover ratio} = \frac{\text{Sales volume}}{\text{Tangible assets- Accumulated short-term accounts payable}} .$$

### 3.10.3.3. Net profitability ratio.

Net profitability ratio differs from the one used in accounting.

$$\text{Net profitability ratio} = \frac{\text{Net profit} + \text{Income from participation in other organizations} + \text{Interest income adjusted by tax rate}}{\text{Sales volume}} .$$

### 3.10.3.4. Profitability of capital before depreciation charges.

Net profitability and capital turnover ratios reflect changes in profitability of the capital and promote a more detailed analysis of the reasons for changes. Taking into account the depreciation charges is necessary while comparing the results of several JSCs of one sector.

$$\text{Profitability of capital before depreciation charges} = \frac{\text{Net profit} + \text{Income from participation in other organizations} + \text{Interest income adjusted by tax rate} + \text{Depreciation charges}}{\text{Tangible assets - Accumulated short-term accounts payable}} .$$

### 3.10.3.5. Profitability of own equity.

Another significant factor of profitability is profitability of own equity describing how efficient the own equity of the JSC is used by the management of the Company and the latter's ability to increase the profitability of the own capital by using the debt. The increase in variability of the profit per common stock is the undesirable side effect of the financial leverage. The study of the relationship between the growth of profits and the growth of variability of profit is used to estimate the optimum debt size.

$$\text{Profitability of own equity} = \frac{\text{Net profit} - \text{Obligations on privileged stocks}}{\text{Own equity} - \text{Goodwill} + \text{Deferred taxes}} .$$

Goodwill is intangible assets (employee qualifications, flexible transport schemes used to get access to sales markets, know-how, etc.), which are not taken into account while evaluating the balance sheet of an enterprise. They form the reserve of "goodwill" which represents the positive difference between the actual value of the enterprise and the final price of its sale.

### 3.10.4. Growth ratios

Growth rates of JSC are expressed by sales volume, general profitability and profit per stock. The following growth rates factors are used rarely: cash flow (profit plus depreciation charges), dividends, balance value, fixed assets value, natural factors (volume of production or capacity), ratio of retained profit to own capital. To determine growth rate ratios it is necessary to compare the trends and general characteristics for rather long periods of time, approximately 10 years. However, taking into account the special features of JSCs in RA, reliable information is only available for the past 3 years, since 1998-1999. In the meantime, while calculating it is necessary to take into account the inflationary growth, and not to consider the inflationary growth of the indicators as a source of growth. Regressive ratios can be used while comparing trends in various industrial sectors, as well as while carrying out over the dynamic analysis of the data of one sector.

#### 3.10.4.1. Sales Growth.

$$\text{Sales Growth} = \frac{\text{Sales volume for a given period}}{\text{Sales volume for the basic period}} .$$

#### 3.10.4.2. Total profit growth

$$\text{Total profit growth} = \frac{\text{Net profit from capital for a given period}}{\text{Net profit from capital for the basic period}} .$$

### 3.10.4.3. Profit per stock growth

$$\text{Profit per stock growth} = \frac{\text{Profit per stock for a given period}}{\text{Profit per stock for the basic period}} .$$

### 3.10.5. Stability

Ratio of stability of profit is necessary to define the quality of bonds and preferred stocks. The indicator of minimum dividend rate per common stock for a long period of time estimation of internal stability of JSC is of use to all JSCs. Therefore, the ratios specified below are recommended for the JSCs of RA; it is necessary to distinguish and to choose correctly the periods of stability of JSC. It is necessary to make a precise distinction between the periods of high profitability from the period of decrease in demand for products. Dealing with short periods of time, stability can be defined using the formula of mean square deviation or statistical methods.

#### 3.10.5.1. Percent of reduction in the profitability of the capital

$$\text{Percent of reduction in profitability of the capital} = \frac{\text{Profitability of capital in the worst year}}{\text{Average profitability of capital for the three previous years}} .$$

### 3.10.6. Share of dividends

#### 3.10.6.1. Share of dividends in the profit.

The share of the net profit paid out as dividends against common stocks is the most important factor while evaluating the market value.

$$\text{The share of dividends in the profit} = \frac{\text{Dividend per common stock}}{\text{Net profit, from which the dividends are paid}} .$$

### 3.10.6.2. Share of dividends in cash flow.

The percent of total profit paid out as dividends is more stable factor, than the percent of net profit.

$$\text{Share of dividends in cash flow} = \frac{\text{Dividend per common stock}}{\text{Profit after tax plus depreciation charges}} .$$

### 3.10.7. Credit ratios.

Credit ratios include mixed indicators, reflecting liquidity, financial flexibility, capital structure, ability to serve a debt and etc. While making decision on buying or selling of shares, an attentive shareholder will pay attention to the balance sheet to make sure that cash is available, as well as will take the account of the relationship between current assets and current liabilities and availability of urgent cash obligations.

*3.10.7.1. Liquidity ratio.* Liquidity ratio in combination with other parameters allows predicting financial difficulties and bankruptcies with high level of accuracy. When the value of liquidity ratio falls below average (normative ratio - 2), the shareholder should consider the conditions of purchase of stock.

$$\text{Liquidity ratio} = \frac{\text{Current assets}}{\text{Current liabilities}} .$$

*3.10.7.2. Instant liquidity ratio.* If factor of instant liquidity does not meet the normative criteria (normative ratio - 1), this affects the market price of common and preferred stocks.

$$\text{Instant liquidity ratio} = \frac{\text{Current assets} - \text{Inventory}}{\text{Current liabilities}} .$$



**3.10.7.3. Cash liquidity ratio.** If cash liquidity ratio does not meet the normative criteria, this affects the market price of common and preferred stocks.

$$\text{Cash liquidity ratio} = \frac{\text{Cash assets}}{\text{Current liabilities}} .$$

**3.10.7.4. Ratio of book value of common stocks covered with assets.** This parameter gives a concept about surplus of assets compared to obligations on senior securities. It is identical with parameters of credit burden over own capital and total capital.

$$\text{Ratio of book value of common stocks covered with assets} = \frac{\text{Common stock at book value}}{\text{Tangible assets - Accumulated accounts payable}} .$$

**3.10.7.5. Ratio of balance sheet market price of common stock covered with assets.** This parameter reflects the evaluation of the JSC by the market. If the market price of stocks allocated exceeds their book value, then JSC can allocated additional stocks at the market.

$$\text{Ratio of balance sheet market price of common stock covered with assets} = \frac{\text{Common stock at market value}}{\text{Tangible assets - Accumulated accounts payable}} .$$

**3.10.7.6. Ratio of coverage of senior obligations by before-tax profit.** Senior obligations are interest charges, which include interests on short-term and long-term debts, including investment lease, interest charges plus interest component on operational lease, interest charges on short-term and long-term debt, including rent component on investment and operational lease, sum of the obligations on bonds, preferred stock and rent payments.

$$\text{Ratio of coverage of senior obligations by before-tax profit} = \frac{\text{Income before tax}}{\text{Obligations on senior securities}} .$$

**3.10.7.7. Ratio of coverage of senior obligations by total after-tax profit.** No special explanations required.

$$\text{Ratio of coverage of senior obligations by total after-tax profit} = \frac{\text{Profit after tax + depreciation + senior obligations}}{\text{Senior obligations}} .$$

**3.10.7.8. Ratio of total income on net assets.** This ratio reflects the speed of the capital renewal. It is similar to the ratio of economic activity, and the higher is its value, the better.

$$\text{Ratio of total income on net assets} = \frac{\text{After-tax income + depreciation charges + interest income adjusted by tax rate}}{\text{Tangible assets - Accumulated accounts payable}} .$$

**3.10.7.9. Ratio of coverage of expenses on total debt service.** This ratio is necessary to calculate how the total profit covers all liabilities.

$$\text{Ratio of coverage of expenses on total debt service} = \frac{\text{After-tax income + depreciation charges + lease income + interest income adjusted by tax rate}}{\text{Interest charges + lease payment + current debt + Deductions to the fund of long-term debt repayment fund}} .$$

**3.10.7.10. Ratio of protection period (days).** The ratio shows to what extent production costs can be covered with assets. This ratio helps evaluate production opportunities if cash inflow stopped and the cash reserves and similar funds remain the only source of payment.

$$\text{Ratio of protection period} = \frac{(\text{Cash} + \text{accounts receivable}) \times 365}{\text{Total production costs} - \text{depreciation charges} - \text{other non-cash obligations}} .$$

### 3.10.8. Other ratios

Ratios mentioned below are of use while presenting general information on the JSC.

*3.10.8.1. Ratio of depreciation charges to sales.* This ratio is used for comparison within the same industry, for JSCs having identical structure of fixed production assets.

$$\text{Ratio of depreciation charges to sales} = \frac{\text{Depreciation charges}}{\text{Volume of sales}} .$$

*3.10.8.2. Ratio of depreciation charges to original value of the buildings, constructions and equipment.* The ratio is used for comparison within the same industry, for JSCs having identical structure of fixed production assets.

$$\text{Ratio of depreciation charges to original value of buildings, constructions and equipment} = \frac{\text{Depreciation charges}}{\text{Original value of buildings, constructions and equipment}} .$$

*3.10.8.3. Ratio of turnover of stock.* The turnover of production stock shows how many times a stock unit is sold and compensated for. The degree of stock supply requirements at the expense of existing funds is determined by multiplication of this ratio by the amount of days in a year.

$$\text{Ratio of turnover of stock} = \frac{\text{Cost the production sold}}{\text{Cost of stock, including LIFO reserves}} .$$

*3.10.8.4. Ratio of turnover of accounts receivable.* The ratio helps the governing bodies of the JSC reveal problems connected with accounts payable and receivable.

$$\text{Ratio of turnover of accounts receivable} = \frac{\text{Sales}}{\text{Accounts receivable}} .$$

*3.10.8.5. Ratio of turnover of accounts receivable in days.* As a rule, this ratio is expressed in days.

$$\text{Ratio of turnover of accounts receivable in days} = \frac{365 \text{ days}}{\text{Ratio of turnover of accounts receivable}} .$$

### **3.11. JSC's opportunities pertaining to issue of securities.**

#### **3.11.1. Development prospects of the stock market in RA.**

The analysis of the stock market in RA shows that since 1995, national economy sector, which is essentially new to Armenia, began to form gradually. Normative base and legislative regulation of this sector have been created now, and the elements of infrastructure are in place. Range of companies engaged in professional activity in this market is determined, the requirements to the experts' qualifications and ethical norms of behaviour have increased, and the most important is that RA government and private individuals have changed their attitude to this economic subsystem. If in 1994 the concept of stock market was generally associated with financial pyramids, or street trade of privatisation certificates, the perception of this concept by as experts, as private people has changed now with a prevailing opinion that the stock market is one of the most important attributes of market economy and the main mechanism for the management of the property and the financial flows. The basic features of the Armenian stock market are:

- Being speculative and subject to conjuncture, which means that the quotations, trade volumes and other securities parameters highly depends on the influence of political, but not financial-economic factors.
- Strong dependence of changes on the behaviour of foreign and local investors.

Like in any other post-soviet republic, the stock market in Armenia becomes very active during parliamentary and presidential elections, i.e. the level of activity does not depend on any extraordinary events happening in the world, to which stock markets of the developed countries sensitively react.

The main competitors of the corporate securities are the Government securities, foreign currency, as well as private deposits in banks. The situation existing at present is rather extraordinary, because neither Government securities, nor bank accounts are attractive to population due to the low interest rates and limited prof-

itability of these instruments. To date, people consider buying foreign currency as the only and the most reliable investment.

Today, making the use of all levers and mechanisms of the stock market available, steps have to be undertaken to change the situation for the benefit of corporate securities. Such methods may include: issue of corporate bonds by JSC making appropriate amendments in laws as regard profit tax and income tax, developing of mechanisms to ensure investors' risks, establishment of private pension and investment funds, promotion of favourable conditions for changing of the issue policies applied by the stock issuers, namely: adoption of the method of increasing of the authorized capital stock by means of allocating new shares issues for the development of production. The importance of such trend is that stock market would get additional instruments, and stock issuers would get an opportunity to resolve problems by means of having share issues.

#### **3.11.2. Stages of securities issue**

The process of issue and allocation of corporate securities consists of four stages: preliminary, making of decision, allocation, preparation and registration of the report. The most important one here is the preliminary stage, when the strategy is developed and the appropriateness of having the issue is defined, categories and type of securities to be issued, procedure for their allocation, the volume of issue and other parameters of issue are chosen. The next three stages are consecutive and regulated, their contents are established by the procedures and rules of the issue.

The second stage, which is making of the decision, is divided into following basic substages:

- Making of the decision on allocation of securities by JSC;
- Preparation of the issue prospectus;
- State registration of the prospectus and the issue of securities;
- Disclosing of the information contained in the prospectus;
- Allocation of securities by distributing them among the shareholders;
- Registration of the report on the results of securities issue;

- Disclosing of the information contained in the report on the results of issue;
- Making of appropriate amendments in the charter of the stock issuer and state registration thereof;

According to the rules of issue and the charter of the issuer, the governing body of the JSC makes a decision for the allocation of securities. This issue falls under the competence of the general meeting of shareholders, and, if bonds are to be issued - the Supervisory Board.

Resolution on issuing of securities should contain information necessary for establishing of the volume of rights certified by securities. The form and contents of the securities are subject to strict regulation by the issue standard. This document should necessarily contain information on kinds and forms of issued securities, their nominal value and number of securities in issue, procedure for allocation, date when the allocation begins and terminates, the method and price of allocation, procedure for, and terms and condition of, the payment. It should also specify the rights of the owner of each security newly issued; and, if conversion is to be carried out, the category (type) of stocks and (or) series of bonds, into which the previously issued securities are converted, the number of stocks or bonds into which each previously issued security is converted, procedure for, and conditions of conversion (total number of stocks of the same category already allocated by the stock issuer). Decision for the issue of stocks is approved by the Supervisory Board (Board of Directors) of the stock issuer, and the decision on issue of bonds is approved according to the charter of the stock issuer. Decision on having of stock issue is approved at the general meeting of shareholders.

It is recommended that in their charters, the stock issuers specify the maximum possible number of declared stocks of various categories and their nominal value. In the meantime, one should remember that total nominal value of announced preferred stocks should not exceed 25 % of the total nominal value of the allocated and announced stocks of all categories. By the preliminary announcement of stocks, the issuer facilitates the process of making of the decision on the issue and subsequent amendment of the charter. Amendments in the charter of the stock issuer and registration

are carried out based on the results of stock allocation, pursuant to the decision of general meeting of the stock issuer.

After the decision on the issue of securities is made, the stage of preparation of the prospectus for further registration at securities commission follows.

This document should necessarily contain general information on the stock issuer, the stock issuer's management structure, as well as information on persons participating in the management of the stock issuer, information on shareholders holding more than 10 % and 20% of the stocks in issue and previous issues of securities, data on the financial position of the stock issuer, information on the current and forecasted activities of the stock issuer, and the securities under allocation. Besides, set of documents including copies of statutory documents of the stock issuer, extracts from the minutes of the meetings of the managing bodies of the stock issuer who made the relevant decision, as well as various items of information envisaged by the standards of issue should be attached to the prospectus.

Once the issue and the prospectus have been registered, the allocation stage begins. Actual term of the allocation of the issue can appear to be shorter than it was envisaged by the resolution on issue or the prospectus.

Once the allocation stage has been completed, the stock issuer registers the report on results of the issue at the securities commission.

The report is to be submitted within a deadline of 15 days. According to the legislation in force, the allocation of the newly issued securities is allowed no earlier than in 15 days after making of the information on the issue available to all potential buyers. The information on prices for securities under allocation can be announced only on the day allocation begins.

While defining the date for securities allocation in case of an open subscription, one has to take into account that the shareholders holding voting shares have the pre-emptive right to purchase securities under open subscription. The contents of the pre-emptive right is that the shareholders holding voting stocks should be notified on the allocation of the new stock issue 30 days before the allocation begins. Besides, they can get the rights on the newly issued securities pro rata to the number of common stocks owned by them, before selling of

the securities to outside investors begins. In some cases, at the meetings of shareholders decision can be made to refuse exercising of the pre-emptive rights by the shareholders holding voting stocks. In this case some changes in the structure of the share capital are possible.

### 3.11.3 Objectives of the secondary issue.

The only objective of the primary securities issue is the completion of the JSC establishment process. As the Armenian stock market is at the earliest stage of formation, and the volume of trade at the ASE isn't too large, an appropriate question occurs: whether the securities issue is worth discussing? The attention of the stock issuers should, however, be drawn to the two essential factors, which are typical of the most of the Armenian enterprises.

1. The process of preparation of securities issues is rather long. The preparation and making of the decision on securities issue in RA will take long enough to get the full understanding of the process. However, by that time, the objective and subjective reasons that are considered by the stock issuer while making decision on entering market relations and the intention to avoid the affect of the negative factors of the transitional period may change. Besides, the imminence of integration in world economy will force the governing bodies of JSC to recognise the stock market as the instrument for financial improvement of enterprises. The preparation for the implementation of this mission is the imminent problem of our times.

2. There are a number of problems, which are resolved by having securities issue, including:

- Replenishment of current assets for further implementation of the investment projects .

Normally, enterprises lack own resources while implementing long-term investment projects. The Armenian banks don't have under their disposal funds and opportunities sufficient for the potential borrowers, namely companies. In addition to that, companies don't have appropriate property to place as collateral. Budget investments are also not available because of the chronic deficit of budget at all levels. Obtaining of targeted financing, assistance from the international organizations and various donations is currently an extremely dif-

ficult task for the majority of issuers. Under such conditions, the only real source of additional funds for the improvement of the financial position of enterprises is the issue of own securities, which represent the optimal way to attract investors' funds for the stock issuer. Expenses the issuer bears as regard preparation of the prospectus and remuneration of the underwriters nowadays make between 1-5 % of stock issuer's income from securities allocation. It is extremely difficult to allocate newly issued securities at the stock market, therefore relevant preliminary works should be carried out by the issuer. This includes development of the strategic concept of the issue policy and everyday work on gaining high rating at the stock market, with attraction of professional participants of the market for carrying out transactions at the exchange and the off-exchange markets for the purpose of increasing of the market price for securities.

- Increase of the own equity of the stock issuer

It is rather surprising that the governing bodies of the JSC almost ignore the size of company's own equity. Very much so, because while providing any financial support to the company regardless of the objectives of the investment any creditor defines the minimum size of property to secure its interests. Therefore, the issue of common or preferred stocks is the only way to increase authorized capital of the JSC, while it absolutely doesn't matter , at the expense of which sources and funds such increase occurs: outside investments, remainder of the retained profit, revaluation of fixed assets or any other. The most important thing here is to increase the authorized capital stock with minimum expense born and for as much as possible.

- Overcoming the negative trends of the stock capital structure

One of the realities of the Armenian stock market is the purchase by group of entities or an entity of stocks from small investors to get major (50-75%) holding. Issue of common stock with the pre-emptive right to purchase the securities by shareholders not exercised is the most effective way to overcome the fast purchase of stocks and the reduction of stock issuer's share in the authorized capital stock. Here, an opportunity to participate in subscription is given to numerous individuals and legal entities, which eventually increase the attractiveness of the Armenian enterprises for foreign investors. One have to also take into account the opportunity to make use of the

secondary issue as a means for getting control over the share capital of the stock issuer. Indeed, to get the major shareholding, it would only be needed to allocate to a few parties voting stocks for a total nominal value equal to the size of the authorized capital stock of the stock issuer at the moment of registration of the new stock issue. Given that the authorized capital stocks of the privatised enterprises are rather small, the investors' expenses on purchasing major holding in such enterprises by means of secondary issue will only make some tens thousands US dollars.

- Repayment of accounts payable by granting a part of the stocks issued to creditors, including state institutes

Unfortunately, in Armenia there is no legislation regulating securities issues for the purposes of effecting repayment of debts of enterprises, and such deal hasn't become a widespread practice. What would be the benefit of the method of repayment of the debt by issue of securities for JSC and the Government? Such option would give an opportunity to repay the principal debt evenly, according to schedule within 2-5 years; to postpone payment of penalties and fines, which in case of some organizations several times exceed the principal debt; to terminate accruing of penalties over the principal debt by tax authorities from the moment of issue. In the meantime, it's necessary to define appropriateness of the specific method of issue for each of the above mentioned purposes, as the ability of the company to carry out current payments to the state budget and the ability to comply with the established schedule of debt repayment differ and depend on the financial position of the company.

- Increasing of the investors' income from buying and selling of the issuer's securities at the secondary market. This one doesn't require any further explanations.

## **Chapter 4.** **Securities Registration and Listing**

### **4.1. Securities Registration and listing**

From the moment when the stock issuer, i.e. the company issued share securities is considered accountable stock issuer, the registration of the specified securities becomes obligatory requirement stipulated by the legislation. According to the Law of the Republic of Armenia "On Regulation of Securities Market", securities can be registered either at the Securities Commission of RA, or the stock exchange.

If the stock issuer suggests that listing of the securities should be done in the future, (advantages of which will be discussed later) it is appropriate to register the securities at the stock exchange immediately, as it will allow avoiding:

1. Going through the same process in various bodies;
2. Spending of extra money and time for repeated registration.

To be convinced in validity of the second statement, one has to just compare the rates established for registration of securities in Commission on securities of the RA and the stock exchange, as well as take into account that more time and efforts are required for passing through the same process in two different bodies.

Thus, the registration of securities at the stock exchange gives an opportunity for its further listing and all advantages resulting from this, therefore this would be a more efficient process, which has attractive prospects for the future.

### **4.2. Registration securities at the stock exchange**

As the only stock exchange registered in Armenia is the Armenian Stock Exchange, we shall present the procedure for securities registration based on the requirements determined by "Rules of listing and delisting of securities" of this organization.

For the purpose of registration, the stock issuer submits to stock exchange application on registration of securities in duplicate, simultaneously attaching a copy of the application to Securities Commission of RA. Within 20 working days from the moment of presentation of the application, Armenian Stock Exchange is obliged

to consider the application and make a decision for the registration of, or refusal in to register, the securities. In case during this term addenda to this application are presented to stock exchange, the decision is made within 40 working days from the day of the presentation of application. The decision on registration and the written notice on acceptance of the decision are sent to Securities Commission of RA. The decision on registration of securities only enters into force if the Securities Commission does not object to the decision made by the stock exchange within 10 working days from the moment of the receipt of the specified notice.

As it was mentioned above, the registration of securities is an obligatory requirement of Law. However, in fact, the application is a history of creation and development of company, a brief description of establishment of economic communications with the partners, present and future activities, assortment of goods, financial position of company at acquaintance with which the potential investor forms an opinion on the given company. The signatures of the majority of members of the company's Supervisory Board (Board of Directors), the executive director (all members of the executive Board) and chief accountant, who bear responsibility for representation of unfair data, certify that the information submitted is true and reliable. The application, based on which registration and listing of securities is carried out, is a kind of advertisement brochure, which creates real conditions for the attraction of capital by the company and the implementation of its strategic programs, as well as exceptional opportunities for financial improvement and the development of the company.

#### **4.3. Purpose of the application for the registration of securities.**

The structure and contents of the application submitted to the stock exchange for registration of securities, as well as the procedure for the presentation of information are determined by rules approved by the Commission on securities on September 28, 2001 and published on November 30 of the same year in "Manual of the departmental normative acts of RA" #21.

We shall try to give as detailed description of each rule, sub-rule, point, sub-point, as possible paying special attention to those items, where at presentation of information greatest number of errors and omissions were observed. In particular, list of the required information with necessary explanations and examples with description of deficiencies most frequently occurred, precise definition of terms, list of required documents etc. will be presented.

This is done for the purposes of rendering assistance to stock issuers and companies providing advisory services, i.e. for:

- The accessibility of requirements envisaged by rules;
- Excluding of an opportunity of any misinterpretation of any requirement of rules;
- Minimizing of expenditures of money and time for drawing up of the application on registration of securities, thereby ensuring of high efficiency of securities registration process.

#### **4.4. The required format and contents of the application for securities registration and documents attached.**

First of all, the requirements to the application on registration of securities submitted to the Armenian Stock Exchange and documents attached thereto should be presented. The application on registration of securities is submitted in triplicate and includes the title page, required information and other attachments.

The title page of the application should include the name of the stock issuer, organizational-legal form, number and date of state registration, class (type) of securities, type and number, nominal value (if available), type of allocation (public or closed subscription), main activities of the issuer, name of the competent body, which has made the decision on the issue and date the decision was made, location of the stock issuer, its mail address and communications available.

The title page should include the following three statements:

- "Offers to register and list, according to the rules of the self-regulatory organization Armenian Stock Exchange";

- "We assure that the information contained in the given application is accurate and we fully realize that any inaccurate statement as regard any significant fact, or its omission, can result in refusal in registration of the application and (or) in liability established by the legislation of RA", as well as the names, surnames, positions of the persons signing the application, their signatures and date of signing by each;
- "By the following the stock issuer undertakes the responsibility to observe requirements to securities listing and preservation of listing established by Armenian Stock Exchange self-regulating organization and defined by rules registered at the Securities Commission of RA from the moment of securities listing up to its delisting", as well as name, surname, position, signature, date of the signing by the person certifying signatures.

The application should be signed by the majority of the members of the Supervisory Board (Board of Directors) (or other body with the same authorities) of the stock issuer, by general director, chief accountant (also by all members of the executive board or other executive body, if such is available within the structure of the stock issuer). The signatures should be witnessed by the representative of the Supervisory Board (Board of Directors) or by the executive director of the stock issuer, or by any other person having the same authorities. The certification of the signatures should be confirmed by the seal of the stock issuer.

Copies of the following documents are part of the application on registration and should be necessarily attached thereto:

1. Decisions, contracts concerning the issue of the given securities, other necessary documents which are valid for no more than 3 years, namely:

- a) Charter of the stock issuer,
- b) Certificate on state registration of the stock issuer,
- c) Minutes of the decision on securities issue,
- d) Guarantee from the person certifying the obligations, or part thereof, stipulated by securities of the stock issuer (where applicable),
- e) Contracts entered into with the person (where applicable), car-

rying out distribution of securities,

- f) Auditors' report,
- g) Special permissions /licenses/ (if necessary) to carry out the stock issuer's activity,
- h) Those contracts (orders, decisions), according to which these persons are persons participating in the management, members of the Board of Directors (Supervisory Board), members of the executive and supervisory bodies, chief accountant or person having similar duty, as well as any other person involved in the activities of the stock issuer and managing any project, program, branch or representation related thereto;
- i) Those contracts concluded between the stock issuer and specialized entity acting at the securities market, including Central Depository;

2. Written approval of the related entities who are not accountable stock issuers, on disclosure of the information related to themselves to the Commission on securities of RA;

3. Budget of expenses on issue and allocation of securities (for securities under issue);

4. Professional opinion used in the application or obtained with this purpose, signed by any person (accountant, evaluator, consultant or other expert) and written approval to use it;

5. An explanatory note properly proving the absence of information included in the application (including confidential information), consent or signature, if nothing else is stipulated by rules;

6. Information about individuals, which are specified in the application according to the requirements approved for legal entities, according to their eligibility and applicability principle (e.g. individuals should specify their names, surnames instead of official names of the legal entities), if nothing else is stipulated by rules.

The application and all documents attached should meet the following requirements:

- The application should be readable, written in literary Armenian and typed;
- At least two copies of the application should be stapled and certified by seal of the stock issuer;



- Pages of the application should be numbered;
- If the presentation of any document included in the application is not possible according to the specified requirements (e.g. any document is represented not in printed form), it is necessary to include in the application its typed version marked with the note: "Corresponds to the original" and copy of this document.

#### **4.5. Information to be contained in the application for securities registration**

Information in the application on registration of securities should be presented in certain sequence.

Information included in the application is presented under the following sections:

Section 1 - "Information on organizational issues and the activities of the stock issuer",

Section 2 - "Information on organizational issued and activities of the entities related to the stock issuer";

Section 3 - "Information on organizational issues and activities of the entities who guaranteed the execution of obligations stipulated by securities of stock issuer, or part thereof";

Section 4 - "Information on securities previously issued by the stock issuer";

Section 5 - "Information on securities issue";

Section 6 - "Information on entities participating in the management of stock issuer, underwriters, owners of significant shares of share securities";

Section 7 - "Information on entities, for which stock issuer establishes annual payment exceeding minimum ten thousandfold wages";

Section 8 - "Information on bonus payments, established by the stock issuer and agreements on distribution of profit",

Section 9 - "Information on contracts entered into by the stock issuer, value of which exceed minimal ten thousandfold wages";

Section 10 - "Information on options concluded concerning securities issued by stock issuer";

Section 11 - "Information on financial position of the stock issuer".

#### **4.5.1. Section "Information on organizational issues and activities of the stock issuer" includes the following information:**

General information about stock issuer

a. The firm name of the stock issuer specified in its charter, including an abbreviation or short name and variants in other languages (if appropriate). If the firm name of the stock issuer is similar to the name of other organization, necessary explanations should be given in order to prevent possible confusion (for example: OJSC "Yerevan jewellery factory" and OJSC "Yerevan jewellery factory-1", or OJSC "Yerevan machine-tool plant" and OJSC "Charentsavan machine-tool plant ");

b. Organizational-legal form (e.g. OJSC) and date of creation of stock issuer (e.g. date decision of RA government on creation of OJSC was made). If during the activity of the stock issuer its name has changed, or stock issuer has reorganized, its names, organizational-legal forms, reasons for such changes (e.g. the process of privatisation), as well as date of these changes should be specified;

c. Date of first and current (if applicable) state registration of the stock issuer and registration number (instead of the number of the registration certificate) under certificate or other document certifying state registration of the stock issuer (when presenting information on items 2 and 3 it is necessary to be especially attentive marking the date of registration of the document (e.g. the inlay of the certificate on state registration, where relevant amendment is recorded );

d. Information on special permission (license) to carry out the activities of the by stock issuer, validity of which has not expired yet, with indication of the relevant activity types , the number of the special permission (licenses) and date of their issuance, terms of their validity, as well as name of the body issuing the license;

e. Taxpayer's identification number given to the stock issuer by the tax authorities;

f. Names of the banks, where the stock issuer's settlement and other accounts are opened;

g. The names of all branches and representations of the stock issuer, date of their establishment, location and mail addresses as specified in their charters, surnames and names of the managing persons of all branches and representations of the stock issuer, as well as duration of powers issued by the stock issuer;

h. If the stock issuer is significant or major owner of share securities, which means it owns more than ten or twenty percent of share securities issued by other entity, such entity's company name, its organizational-legal form, location and mail address, number share securities, owned by the stock issuer, and size of its participation;

i. Names (names, surnames), locations, mail addresses and contact details of the entities who during the last three years:

- carried out the audit of the company;
- were hired by the company as experts and consultants of the stock issuer

(to be indicated in chronological order);

j. Names and locations of industrial, banking, financial groups, holdings, concerns and unions, in which the stock issuer participates, its basic rights and duties in these organizations;

k. Total number of the employees of the stock issuer with indication of number of managers and number of employees on forced holiday;

l. Size of the authorized (cumulative) capital stock of the stock issuer (specified in the charter), percentage of the fulfilment of obligations on payment of the share securities by participants;

m. Number of the owners of share securities of the stock issuer by types and categories of securities owned;

n. Description of company's property, where the following should be specified: the area of buildings, constructions, number of floors, duration of exploitation, depreciation, ground area, remoteness from populated areas, technical parameters (capacity, frequency) of machines, the most important equipment, vehicles, duration of their exploitation, depreciation, degree of validity, as well as location of the above-stated property. If any of the property does not belong to the company by ownership right or the ownership right is limited, , the nature of these restrictions is briefly stated (e.g. the property is rented, pledged, rights over the property is limited by court resolution etc.);

o. If the stock issuer is engaged in production or processing of natural resources it is necessary to present types of natural resources, forecasted size of stocks, their location, as well as validity of the right on their use and brief description of conditions of production or processing,

Information on stock issuer's activity:

a) Description of the stock issuer's activity:

- The complete description of stock issuer's activity with brief indication of the current conditions of the sectors of the most important activities of the stock issuer and general trends of their development (e.g. the stock issuer operates in various sectors of economy, and at the same time the most important sector of its activity is the one that provides small portion of income), and also comparative data reflecting the position, occupied by stock issuer in the given scope of activity;
- General description of sales markets (market for services, works) of stock issuer, current trends of their development, ratio of imported and local production at the domestic market, basic export markets, general description of basic consumers and competitors, as well as other information, which in opinion of the stock issuer is essential while describing the markets of its activity.
- Analysis of the possibility of the stock issuer's participation in new possible sales markets for production (market for services, works rendered), study of the implementation of new products (services, works) and designing of modern models, general characteristic of their markets,
- those types of products (services, works) and volumes of their sales (in cash terms), which during every 3 financial years preceding the moment of presentation of securities for registration provided more than 10 percents of stock issuer's income. It is necessary to present all kinds of exported production (services, works) and volumes of their sales in chronological order, kinds of seasonal activity of stock issuer and share of the income received from them in total revenue, kinds of activity having dominant or priority importance for stock issuer should be pointed out. If the basic part of the stock issuer's income received from its activity was formed as a result of those kinds of activity of the stock issuer, which are of secondary importance, the reasons for this should also be specified;

- The basic methods and ways of sales of the stock issuer's production (contractual, wholesale trade, retailing, trade sessions etc.), intermediary organizations (if applicable) and their share in total amount of realization, basic transport (communication) schemes of production (services, works) export (if applicable);
  - Basic characteristics of consumers of production (services, works) of stock issuer (in case of individuals indication of the social group, age category they belong to, annual revenues, consumer preferences and other information should be included). Names of those consumers, whose share in total annual revenue of stock issuer from realization is more than 10 percents and trends of change of this parameter for last 3 years are specified;
  - Names of basic competitors of the stock issuer, their share in market at separate kinds of activity (if the information is available), basic competitive methods (price, service, warranty, quality etc.), used by the stock issuer and its competitors are described;
  - Names of those basic suppliers of the stock issuer, whose share in deliveries of inventory values (in cash terms) is more than 10 percents, as well as their share in total volumes of deliveries. It should be also indicated, which part of deliveries to the stock issuer makes the import, forecast for the accessibility of these sources in the future should be given;
  - The kind of activity on which the state can have essential influence (conclusion of contracts, amendment, cancellation thereof, change of credit policy etc.) is described;
  - Total sum paid (calculated) by stock issuer under tax obligations for the last 3 financial years preceding the moment of presentation of application of securities for registration, with indication of the share of each kind of tax (income tax, VAT, property tax, tax on land etc.);
  - Tax privileges envisaged by Law and (or) by other legal acts, which are established especially for the stock issuer, or which the stock issuer make use of, are also briefly described (e.g. "Jewellery factory" OJSC by: is exempt from paying VAT);
- b) For the last three years preceding the moment of presentation

of securities for registration, information on about the punishment (administrative, civil, material, criminal) measures applied to stock issuer by court, state authorities. Date of application of certain preventive punishment, body who called to responsibility, bases (reasons), kind and size of attraction of the stock issuer to responsibility, and also degree of execution on the date of representation of securities to registration is indicated. Participation of the stock issuer in proceedings, including bases (reasons) for its participation in those proceeding trials and its possible obligations, arising in result of that, which can affect activity of the stock issuer (e.g.: The size of penalty stipulated by contract concluded between the stock issuer and other entity, which the stock issuer undertakes to pay in case of pronouncing appropriate judgement by court) for last three years preceding the moment of representation of securities are also specified. If the stock issuer has received the order from Securities Commission of RA, contents of the order (with precise indication of the Law), and also degree of execution of the order should be given;

c) Information on problems connected with pollution of environment, and also on influence of observance of norms for capital investments of the stock issuer established by Law, on profit received and its competitiveness are presented (e.g.: installation and use of filters for air purification at a chemical factory can affect capital investments, received profit and the competitiveness of Company);

d) The description of those deals according to which purchase or sale of assets was carried out or is planned to realization is given in cases when one of the parties is:

- person participating in management, or member of his family,
- significant owner of share securities,
- person related to the stock issuer;

e) Description of each deal, which should be carried out within no less than a year after presentation of the application, if the amount of such deal exceeds 10 percent of the value of assets of the stock issuer;

f) Volumes of those orders of the stock issuer, which can not be executed during minimum one year after presentation of securities for registration, with an indication of the reasons;

Information on the future activity of the stock issuer:

a) Program of the future activity of the stock issuer includes

description of the plans of the future activity of the stock issuer, e.g. organization of new production, expansion or reduction of production, development of new kinds of production, use of new types of raw materials, use of such modern methods of organization of manufacture and technologies that will promote the increase in production efficiency, modernization of basic assets, reorganization, purchase of new equipment, programs connected with the change of orientation of activity (Information can be taken from business programs, if such are available ). Possible negative factors are specified which can affect the activity (services, works) of the stock issuer, e.g. worsening of political situation, blockade, termination of relationship with countries - partners;

b) The description of obligations of the stock issuer that may arise in the future, which can negatively affect its activity (e.g. in the following period non-payment of the salary to personnel is planned);

c) The competitive conditions of the stock issuer's activity are described, the markets to which the stock issuer's activity is directed, or is going to be directed, and also prospective competitors of the stock issuer are specified;

d) Planned research and experimental development - works connected with improvement of production methods and technics with involvement of new kinds of production, services and technologies complying with up-to-date requirements are described (presentation of the mentioned information is obligatory in particular for those companies, within structure of which there is a division stipulated for implementation of similar works).

4.5.2. Information included in section **"Information on organizational issues and activities of entities related to the stock issuer"** can be presented in tables.

A) Any individual or legal entity is considered as related to the stock issuer, if one of them owns 20 or more percent of voting share securities of another with the right of direct or indirect voting.

In this case the following information about related entity is presented:

a) In case of an individual:

**Table 4.1**

N/N	Name, surname	Residence	Series, number of passport	Positions held in managing bodies of Company for last 3 years (in chronological order with indication of sphere of activity)	Positions held pluralistically for last 3 years (in chronological order with indication of sphere of activity)	Quantity of share securities of the stock issuer owned by him
1	2	3	4	5	6	7

b) In case of a legal entity the name of the legal entity related to the stock issuer, its location, number of state registration and also the following information about those members of the executive (collegial) body and Board of directors (Supervisory Board) of the given legal entity, who held (hold) positions in managing bodies of the stock issuer or participated (participate) in share securities of the stock issuer during the last 3 years are represented:

**Table 4.2**

N/N	Name, surname	Positions held during last 3 years (in chronological order)	Quantity of share securities of the stock issuer owned by him	Quantity of share securities of the given legal entity owned by him
1	2	3	4	5
1				

- B) Any entity is considered related to the stock issuer, if:
- more than half of members of the Board of Directors of one of them are also members of the Board of Directors of another, or
  - director or other official equal to him by legal authority of one of them is also a member of the Board of Directors, or director or other official equal to him by legal authority of another.

In this case the name of the legal entity related to the stock issuer, its location, number of state registration and also information specified in table 4.2 about those members of the executive (collegial) body and Board of Directors (Supervisory Board) of the given legal entity, who held (hold) positions in managing bodies of the stock issuer or participated (participate) in its share securities during last 3 years are presented.

C) Any entity is considered related to the stock issuer, if any of them has the opportunity, actual or fixed by contract, to influence the decisions of another, any of them has the opportunity to predetermine the decisions of another owing to its dominant participation in its authorized capital stock or to the contract, concluded between them, or a certain third entity has an opportunity to predetermine their decisions owing to its dominant participation in their authorized capitals stock or to the contracts, concluded with them.

D) Any entity is considered related to the stock issuer, if they are members of the same family or in this case acted in coordination proceeding from their common economic interests.

In last two cases, information in format specified in table 4.1 is presented on individuals, and information in format specified in table 4.2 is presented on legal entities. Also, the actual opportunities of predetermination of decisions of the stock issuer by the above-stated related entities, provisions of the contract giving such opportunity, or the character of common economic interests according to which the given entity acts are described.

**4.5.3. In section "Information on organizational issues and kinds of activity of entities charged for execution of obligations stipulated by securities of stock issuer, or a part thereof" the following information about entities charged for execution of the obligations stipulated by securities of the stock issuer or their part are presented;**

In case of individuals - see Table 4.1

In case of legal entities - see Table 4.2.

The actual opportunities of the entity who guaranteed for the fulfilment of obligations envisaged by the securities of the stock issuer or their part by predetermination of decisions of the stock issuer, provisions of the contract giving the opportunity of predetermination of such decisions or those common economic interests according to which the given entity acts are described.

**4.5.4. The section "Information on securities previously issued by stock issuer" includes the following information:**

A) Type or category (e.g. simple nominal stock) and kind (documentary or not documentary) of securities;

B) Registration number (e.g. 00140) of securities of each kind, type (category), distinctive code (at presence e.g. AMVELGS10AR3) and date of its delivery, thus at indication of distinctive code it is necessary to take into account that common index specified in registration certificate of securities is not the distinctive code;

C) Name of the body who has carried out the registration of securities of each issue (name of the body giving out the certificate on registration);

D) Date of beginning and end of each distribution of securities (e.g. in case of distribution of securities by open subscription distribution begins in 10 days after publication of securities emission prospectus and can proceed up to 35 days),

E) Terms of repayment (if appropriate);

F) Total amount (quantity of securities specified in securities emission prospectus or in minutes on results of allocation) of each issue of securities on sale;

G) Quantity of allocated (actually sold) securities of each issue;

- H) Nominal value of one stock (if appropriate);
- I) Basic rights and duties of the owners of securities of the given type (category) and kind (as it is specified in the charter);

If the Company issued ordinary (common) stock, their owners according to "Joint-stock companies" Law of RA and the charter of Company have the right:

- a) to participate in general meetings of Company's shareholders with the right to vote on all issues under its authority;
- b) to participate in management of Company,
- c) to get dividends from profits from Company's activity,
- d) to purchase stocks allocated by the Company based on pre-emptive rights, if nothing else is stipulated by "Joint-stock companies" Law of RA and the charter of Company,
- e) to get any information concerning Company's activity except for confidential documents, including: get acquainted with balance sheets, reports, industrial and economic activity of Company as stipulated by the charter,
- f) to authorize third parties to represent his own rights at the meetings,
- g) to put forward proposals at the general meetings of Company's shareholders,
- h) to vote at general meetings of Company's shareholders with number of votes given by their stock,
- i) to apply to court to appeal against the decisions made by general meeting of Company' shareholders and contradicting Law and other legal acts,
- j) to receive a part of Company's property due at the liquidation of the Company;
- k) to exercise other rights stipulated by Company's charter.

The owners of common (ordinary) stocks of Company are obliged not to disclose the confidential information concerning Company's activity;

- J) Conditions (e.g. the payment of dividends is carried out in commodity form - integrated products of Company) and sizes of payments of incomes (dividends), received from registered securities of each class (kind) within last finished three financial years, and when this term is less than three years, for each financial year from the

moment of creation. Those cases when the payments on securities were limited (e.g. because of absence of the profit) or can be limited (forecast of profits on the basis of results of present activity) are described in details. It is also necessary to specify cases of non-payment of incomes (dividends) at presence of the profit and reason of non-payment (for example: under the decision of general meeting of shareholders of company the incomes are directed on expansion of manufacture, development of new kinds of production and etc.), and also size of the intermediate incomes, if stock issuer carried out intermediate payments in the current year;

K) Market information on securities:

a) If securities of the stock issuer are sold at the stock exchange, the highest and the lowest prices of their sale for last two financial years known to the stock issuer are specified,

b) If securities are not sold in stock exchange, the highest and the lowest prices of off-exchange sale of securities known to the stock issuer (for accounting year and last quarter) are specified,

L) Brief description of cases and reasons, terms of converting, distribution, concentration, purchase, payment and (or) repayment of issued securities, and also results of these activities.

4.5.5. **"Information on securities issues"** includes the following information:

A) On issue (allocation) of securities:

- a) Type (category) and form of securities,
- b) Order of accounting of securities storage,
- c) Total volume of issue (supply),
- d) Number of allocated (sold) securities,
- e) Nominal value of securities (is appropriate),
- f) The rights, fixed by securities, which are defined by the charter of the stock issuer and (or) decision on release, other stipulated rights, necessary explanations about the order of realization of the rights,
- g) In case of allocation of convertible securities those securities into which issued securities should be converted and the rights of their owners as well as order and conditions of converting are specified,

h) Terms, conditions and order of repayment of securities (for securities subject to repayment),

i) Data on issue of securities (if appropriate):

- Date of taking a decision on distribution of securities and date of taking a decision on issue of securities,
- The name of the body that takes the decision on issue of securities, and in case when the decision on distribution of securities takes other body of the stock issuer the name of that body is also included,
- Those restrictions on securities issue which are determined by the charter of the stock issuer or decision on securities issue and also restrictions imposed on investors investing into securities;

j) Legal-organizational forms of organizations which keep the record of and (or) carry out registration of rights and obligations concerning securities, their firm names, location, post addresses and communication facilities;

k) Beginning of allocation of securities or the procedure for determination thereof;

l) Completion of distribution of securities or the procedure for definition thereof;

m) means for ensuring fulfillment of obligations (if appropriate) envisaged by securities (e.g. the terms and conditions of agreement on support by mortgage or by other means are specified, and if the support is defined by third entity the name (name, surname), location (residence) and post address of this entity are also specified;

n) Information on the following cost and rated conditions for securities:

- Price (prices) of allocation of securities on categories of securities or general conditions of their definition,
- At allocation by open subscription with money payment of share securities giving voting authority (including stock) and securities, convertible into them, the price by which they are distributed among the entities owning voting securities (including stock) which has primary or priority right on their purchase is also specified (only if general meeting of shareholders has not accepted the decision on non-exercising of this right),
- Conditions, order of payment of securities (including size and

periodicity of payment, form of payment and calculations, accounts and name of bank where means which are put in as payment of securities should be transferred and (or) should be accumulated). If the payment of securities is provided not in monetary form the order, conditions of estimation of property and the place of reception of property are also specified;

o) Information about entities participating in securities distribution and degree of their participation:

- Quantity of securities sold by the stock issuer, price and other essential conditions;
- Legal-organizational forms of underwriters of securities of the stock issuers working on the basis of an agreement (power of attorney), their firm name (name, surname), location (residence), post addresses and contact numbers, ways of distribution, essential conditions of the agreement signed between the stock issuer and these entities and conditions of their compensation, and also quantity and price of securities offered by these entities;
- Quantity of securities on which the owners of share or voting securities have subscribed (including the owners of options or other rights), price of gained securities and other essential conditions which can affect the price of offered securities;

p) Information about those essential owners of share securities of the stock issuer, related entities and entities participating in management who are going to purchase or sale securities of the stock issuer by use of the given prospectus. It's also necessary to specify the following:

- Name (name, surname)
- Quantity of share securities owned by this entity, the degree of its participation in authorized capital stock of the stock issuer at the moment of presentation of the application on registration of securities
- Quantity of purchased or sold securities stipulated by them
- The degree of possible participation of this entity in authorized capital stock of the stock issuer after termination of distribution and quantity of securities

q) Size of income received from allocation of securities deducting size of charges connected with securities issue, purposes on which the proceeds received as a result of the allocation of securities are

supposed to be used, with specific amounts suggested for every purpose;

r) The size of income from securities paid to the owners of securities or the order of their definition and conditions of payment (e.g. size of fixed dividends per preferred stock, all kinds of incomes per bonds (interests, discount), their size and periodicity of payment, and also the places and names of organizations where the owners of securities can receive incomes due to them and repay securities also by reception of property equivalent etc.);

s) Complete and thorough description of the order of taxation of incomes received from allocated securities;

t) Complete and thorough description of restrictions on turnover of securities in secondary market of securities;

u) procedure of transfer of rights on possession of securities;

v) Features of transactions with given securities and their consequences for foreign investors;

4.5.6. For presentation of information stipulated in the section **"Information on entities participating in management of stock issuer, underwriters, significant owners of share securities"** it is necessary to specify the meaning of expressions "body of management", "entity participating in management", "significant but not major owner of securities" and "underwriter".

Bodies of management of the stock issuer are the bodies elected or nominated in the order established by the legislation or charter of the stock issuer (Board of Directors, executive body, supervisory committee etc.).

The entity participating in management of the stock issuer is one involved into bodies of management of the stock issuer, chief accountant or entity that carries out similar function, and also any other entity involved into the activity of the stock issuer and managing any project, program, subsidiary or representation concerning its activity.

Significant but not large owner of securities is the entity owning not less than 10% but not more than 20 % of share securities of any organization.

Underwriter is the entity that purchases securities from the stock issuer with the purpose of distribution, offers, sells them or participates in agreement or contract about organization or realization of similar activities.

4.5.6.1. Information concerning entities participating in management is the following:

A) Complete description of structure of managing bodies is given according to the charter of the stock issuer, i.e. information, specified in the charter about general meeting of Company's shareholders, about Board of directors, executive body, supervisory committee with indication of issues under their competence are presented (it's necessary to be attentive here and not to use the expression "this charter").

B) Name (name, surname) of each entity participating in management, location (residence), post address, series and number of passport (number of state registration), year of birth (creation), citizenship (name of country of registration), profession (sphere of activity), positions held during last 3 years including pluralistically in chronological order with indication of the name of organization in which this entity took (takes) position, payments of the stock issuer to this entity for last 3 financial years preceding the moment of presentation of the application on registration are specified. Thus the year, sum and basis (e.g. register, order, contract) for payment of quantity of securities of the stock issuer belonging to this entity by stock issuer, significant participation of this entity in other share securities (for not residents - in securities of stock issuers registered or acting in RA) with indication of categories of securities, names of the stock issuers and quantity of securities are specified separately. All contracts, agreements or decisions by which this entity is entity participating in management of the stock issuer (with indication of the date of protocol of decision of general meeting of Company's shareholders or decision of the Supervisory Board, order, and also parties of the contract, its basic statements etc.), validity of its activity are briefly described.

The information can be presented by the following table.



Table 4.3

N	Name, surname	Residence	Post address	Series, number of passport	Date of birth	Date of birth	Citizenship	Positions held during last three years	
								In OJSC "..." (stock issuer)	If combined: "name of the organization" position
1								1998 - position	
								1999 - position	
2								2000 - position	

N	Stock issuer's payment		Quantity of securities of OJSC "..." (stock issuer)	Positions held during last three years		
	Sum	Basis for payment		Category, type of securities	Name of the organization	Quantity of securities
1	1999-dr.					
	2000-dr.					
	2001-dr.					
2						

Description of those contracts (agreements) or decisions according to which this entity is the entity participating in management of the stock issuer can have the following structure.

- Members of Board of directors are elected by the decision of general meeting of Company's shareholders (day, month, year) for one-year term.
- Members of supervisory committee are elected by the decision

of general meeting of Company's shareholders (day, month, year) for three-year term.

- Executive director is nominated according to employment contract concluded between a member of Company's Council (name, surname) and a citizen (name, surname) for ...-year term.
- Chief accountant is nominated according to the order N... (day, month, year) of executive director perpetually.

C) Bases (reasons) and consequences of petitions presented in last three years on acknowledgement of the entity participating in management (or organization in which it was an entity participating in management for the specified term) a bankrupt (insolvent) or of presentation of similar petitions by this entity and also application of preventive punishment concerning this entity (or organization in which it was an entity participating in management for the specified term) by court decision or by any state body are indicated;

D) The character of relative attitudes between entities participating in management (members of the same family, their spouse, father, mother, sister, brother of this entity or their spouse) are specified;

E) If there are employees having essential influence on the present or future activity of the stock issuer, but not involved in its managing bodies (e.g. production manager, employee engaged in research-engineering works, bookkeeper etc.) information specified in table 4.3 is presented;

4.5.6.2. Information about significant but not major owners of share securities of the stock issuer includes:

- A) In case of individuals - see Table 4.1;  
B) In case of legal entity - see Table 4.2.

4.5.6.3 Information on underwriters includes organizational-legal form of the underwriters allocating securities of the stock issuer based on an agreement, or power of attorney, their firm names (names, surnames), location (residence), mail addresses and contact details, their functions, methods of allocation, essential terms and conditions of the contract entered into by the stock issuer and these entities, rate of remuneration payable to them, as well as quantity and price of securities offered by them.

4.5.7 Section **"Information about entities for which stock issuer establishes annual payment exceeding minimal ten thousandfold wages"** includes information on entities for which annual payment established by stock issuer for the last three completed financial years preceding the moment of presentation of application exceeds ten thousandfold minimum wages. The following information: names, surnames (names), positions of these entities, size of salary, bonus, other payments (the amount of specific payments is indicated separately), and their total amount are specified.

**Table 4.4.**

Year	Name, surname	Position	Salary	Bonus payment	Other payments	Total amount

4.5.8 Section **"Information on agreements on distribution of profit and bonus payments established by stock issuer"** includes information on agreements on distribution of profit and bonus payments established by stock issuer for last three completed financial years preceding the moment of presentation of application. Names, surnames (names of those entities with which such agreements were concluded, sizes of distribution of bonus payments and profit (with separate indication of the size of the sum assigned for certain payment) and total amount envisaged by these agreements) are specified.

Information may be presented using a table, as follows:

**Table 4.5.**

Year	Name, surname	Bonus	Distributed profit	Total amount

4.5.9 Section **"Information on contracts made by stock issuer, prices of which exceed minimum ten thousandfold wages"** includes information on contracts existing and those, which were concluded by the stock issuer during the last three completed financial years preceding the moment of presentation of application, the value of which exceeds ten thousandfold minimum wages. Name (name, surname) of those entities with which the contracts were concluded, subject of the contract, validity are specified.

The information can be presented by the following table.

**Table 4.6.**

Name (name, surname)	Subject of the contract	Value of the contract	Validity

4.5.10. Section **"Information on options made concerning securities issued by stock issuer"** includes information on options concerning securities released by stock issuer. Names (name, surname) of the parties of the contract, date of conclusion of the contract, date of cancellation, subject (category), price of the option.

The information can be presented by the following table.

**Table 4.7.**

Parties of the option	Date of conclusion	Date of cancellation	Subject of the option	Price of the option

4.5.11. Section **"Information on the financial position of the stock issuer"** includes the following financial parameters of the stock issuer: quarterly accounting balance-sheets for last three financial years (with attachment of the conclusion of independent auditor) and for year of registration (with attachments thereto), as well as information stated below.

4.5.11.1. Analysis of the financial position and results of activity of the stock issuer made by at least two persons participating in management of the stock issuer, and including the following information.

A) Results of financial year with presentation of information on liquidity of the stock issuer's assets, capital expenses and results of activity, whereas:

a) Brief description of the structure of capital assets and current assets of the stock issuer (including accounts payable), basis for their occurrence and their unit weight in the structure of total assets as well as any difference between the balance and market value occurred based on supply and demand are presented.

b) Liquidity of current assets is specified, including: any trends, events, reasons and arrangement, which could be the reasons for the increase or reduction in current assets. If there is a reason for significant reduction, it is necessary to present the activities of the stock issuer, which he has undertaken, or suggests to undertake, to prevent the reduction in assets. It is also necessary to state whether the liquid assets are owned or borrowed,

c) Brief description of the structure of obligations of the stock issuer (including accounts payable), basis for their occurrence, their share within the structure of total accounts payable and the possibility of repayment thereof are presented.

d) Capital expenses suggested by the stock issuer as at the end of the last financial year are presented. It is also necessary to state the general goal and financial sources of these expenses. Well-known and essential trends towards increase or reduction in own funds are also specified. In this connection, one should take into account the changes, which have taken place or will take place in own funds and obligations,

e) Results of activities with description of those extraordinary

events, deals, important economic changes, which have had essential influence on presented (received) income,

f) If financial reports show essential growth or reduction in incomes it should be stated, to what an extent is such growth explained by rise or fall in prices, volume or quantity of goods sold, or services, granting of new services or sale of new goods;

g) The influence, which the inflation has had and change in prices on proceeds and income for the last three years of activities or a shorter period, if the stock issuer functions for less than three years is specified.

h) If the stock issuer presents interim financial reports, the analysis of financial position and results of activity should include data on significant changes in the above-stated information, except for the data on inflation and changes in prices.

4.5.11.2. Changes and discrepancies in accounting and the results on disclosing of financial information connected with auditors are presented in case:

a) The refusal of an auditor, him not participating in re-elections, or dismissal from audit with indication of the relevant date,

b) Presence and essence of an unfavourable opinion, refusal or some uncertainty, opinions on insufficient comprehensiveness of the audit, or breaches of accounting principles in the auditor's conclusion made on financial report for last two financial years,

c) Name of the body representing and approving the decision on replacement of the auditor (e.g. by any auditor, stock issuer's auditing commission or Council of Company),

d) Presence of discrepancy of auditor on breaches of principles of bookkeeping, disclosing of financial reports or comprehensiveness of audit, or processes for last two reporting years preceding the decision on refusal of auditor, his dismissal or not participation in re-election and in the following intermediate period of time, as well as essence of such dispute.

#### 4.6. Securities listing at the Armenian Stock Exchange

Stock exchange is considered the most organized system of securities trade, and one of its advantages is that the stock exchange gives an opportunity of securities listing. Circulation of securities at the stock exchange is only allowed after it has successfully passed through the listing procedure.

By its nature, listing of securities means the permission to participate in trade sessions held at the stock exchange; it also gives a number of indisputable advantages. All over the world, exchange trade becomes a beneficial and attractive process, therefore the majority of Companies aim at presenting securities for listing to one or even several various stock exchanges.

Let's describe the advantages and privileges of the listing to both the investor and the stock issuer.

First, it's worth noting, that the process of circulation of securities is carried out under the direct control and regulation by the stock exchange, which provides high availability of securities to realization in the market, its high liquidity, and also relative stability of its market price.

Investor who has purchased listed securities can be sure that he will periodically receive authentic and up-to-date information on the financial and economic position of the stock issuer and the market rate of its securities. Thus, he gets an opportunity to estimate outlooks of the economic development of the stock issuer and the quality of its securities.

If investor (owner of securities) makes a decision to collateralize securities owned, listed securities are considered as more preferable collateral than securities, which haven't passed through this procedure.

However, it has to be noted, that the stock exchange does not guarantee stable profitability of the listed securities.

Securities listing also gives a number of advantages to stock issuer companies. First, the attraction of local and foreign capital. The above-stated advantages given to the investor create favourable conditions for the increase in number of deals on sales and purchase of securities, acceleration of securities' circulation, which is an indefeasible advantage for the stock issuer, as in similar way rather high and

stable market price of given securities is formed at the market (the rate of capitalization of the company increases). Besides, stable price of securities and its high rating creates favourable conditions for the effective and successful distribution of the new issues of this securities carried out in the future, or issue of new securities and attraction of local and foreign investments for this purpose.

Through the listing of securities, the company gets popularity and authority among financial institutions involved in investments. Banks, financial institutions and brokers will hardly agree to distribute new issues of existing securities, or securities newly issued, if the stock issuer turns down the proposal to make listing of securities on stock exchange in the future. By listing of its securities Company informs everyone that it is open for general public and, therefore, gets general trust. Banks and financial institutions show more confidence and readiness in granting credits, loans and grants to those companies whose securities have passed through listing at the stock exchange.

Listing of securities on stock exchange allows the Company to take a stable position at the market. Stock exchange is a system of preservation of market value of securities at affiliation, merge or sale of Company the estimation of assets is based on market value of securities, and not on the basis of balance value of Company, which is usually lower.

Let's also note that though this is not practiced in our country, in some countries listing of securities is a basis for granting tax privileges.

The most important advantage of securities' listing is the high liquidity of securities, that is the given securities become more liquid and get relatively stable market price, as circulation of securities is carried out under constant control of stock exchange, that allows stock issuers to avoid price abuses.

At the world stock exchanges various levels of listing are established depending on quality of securities. For listing at any level, securities should meet certain requirements and criteria, which differ by levels of severeness. The higher is the level of listing, the more severe are the requirements on listing, and hence, the higher is the quality of securities passing through listing at the given level. The international experience have shown that the requirements on listing worldwide are becoming more severe. Many stock exchanges establish requirements even for the lowest level of listing. However, taking into

account the existing level of economy and securities market in RA, Armenian Stock Exchange has tried to establish such requirements on listing, which would stimulate process of listing, instead of impeding it. Armenian Stock Exchange has established two levels of securities listing: lower and upper. For the above-stated reason the minimum criteria and the requirements are not established for the lower level of listing, which enables all stock issuers to list their securities. The only and obligatory requirement for securities listing at the lower level is the registration of securities at the stock exchange. For the upper level of listing, the following minimum requirements and criteria are established:

Minimum size of equity of the stock issuer	AMD 50 million
Minimum term of activity carried out by the stock issuer	3 years
Minimum number of securities owners of the given type issue by the stock issuer	200 proprietors
Minimum number of issued securities of the given type	5000
Result of the last financial year	Profit

Stock exchanges, including Armenian Stock Exchange, carry out listing by stages:

- 1) Examination
- 2) Agreement for listing
- 3) Listing support

The sense of examination lies in the fact is that stock exchange should examine thoroughly the documents presented by stock issuer before acceptance of the decision on securities listing, so that the decision on listing of securities is justified and accurate. According to Rules of Armenian Stock Exchange on listing and delisting of securities it is necessary to present the following documents for listing:

1) Application for listing in established form: if the title list of the application for the registration is filled in according to the form established, the title list of application for registration is considered to be the application.

- 2) Copy of the document certifying payment of the fee estab-

lished for securities listing;

The application for listing is considered satisfied only when the decision on registration of securities takes effect. At the moment of securities' listing the stock issuer assumes obligation to undertake certain steps on support of the securities listing. Thus, the stock issuer undertakes to:

- pay listing fees in established order and terms ;
- present reports on its activities, as well as annual and quarterly financial reports (with conclusion of independent auditor enclosed);
- keep a register of owners of securities of the same type through the Central Depository;
- notify the stock exchange that the securities which have passed listing at the upper level do not satisfy the criteria established for the upper level of listing;
- comply with other requirements set down for the accountable stock issuers;

For any breach of the established requirements and criteria, the stock exchange applies temporary delisting of given securities as a sanction, which gives an opportunity to stock issuer to eliminate breaches discovered, and reason for such breaches within a term established. Otherwise, securities will be delisted. Delisting of securities is a basis for suspension of the registration of the given securities.

#### 4.7. Prospectus of issue.

As an invitation to initiate buying and selling of securities through prospectus, or any other public offer, the issuer of the securities should submit to the Commission on Securities of the Republic of Armenia a duly filled in application for the registration of securities, including the prospectus of issue. The structure and contents of the application for registration of securities, which includes prospectus, as well as formats for presentation of information are set down by the Law "On Regulation of securities market" approved by the "Manual on departmental legislative documents" # 21.

The application should contain certain items of information, as well as title page, prospectus (information required by the application) and other documents attached.

Once the decision on issue of the new securities has been made, the issuer shall present to the Securities commission an application for the registration of the securities, including the prospectus of issue. A securities sales offer can be made once it has been registered, as during the registration process. However, under the second option, the title page must contain the following provision: "Application for registration of securities, including the prospectus, has not been registered at the Securities Commission and an offer to sell the securities on prospectus can only be accepted upon registration of such securities in due course and making the prospectus available to the buyer." Upon registration, such provision should be removed. The title page of the application should also contain a provision that the Securities Commission shall not be held liable for the fairness of the information contained in the application, and the registration shall not be considered as security against the investment.

The information contained in the prospectus is presented by sections. Section named "Brief description of the information" gives an opportunity to get an idea of the stock issuer, its activities, financial position, as well as purposes of publishing of the prospectus. Section "Risk Factors" presents the main factors, which in case of acceptance of the proposal contained in the application, can have negative consequences, factors that may give rise to such consequences, as well as the probability of such risks. Also, information on the stock issuer, its governing bodies and persons participating in the management, significant, but not major shareholders, the financial position, current and future activities and securities to be issued should be submitted. The information mentioned should be presented under relevant sections of the application for the registration at the stock-exchange.

#### **4.8. Liability for breaches of the procedure for issue and registration of securities.**

In case of breaches committed during the issue and the registration of the securities, measures of civil liability are applied. As mentioned above, the securities issue process is regulated by the Law of the Republic of Armenia "On Regulation of Securities Market" and other legislative documents approved. In this legislative acts, civil liability measures are described, which are applied for the breaches of the requirements to the prospectus, application for the registration of the securities including the prospectus, as well as bases for not holding a party liable for such breaches. As to the criminal liability, in the securities sphere (Criminal Code of the Republic of Armenia, article 82) liability relates to the making and sales of false banknotes or securities, however criminal liability measures for the breaches of the issue and the registration procedure are not envisaged.

It has to be noted that, e.g. in the Russian legislation, criminal liability is applied as regard fraudulent activities while issuing of securities: this is envisaged by the Article 185 of the Criminal Code of the Russian Federation, which was enforced in 1996. By that time, such activities was not subject to criminal liability. During the making of the market economy in Russia, concentration of large capital was effected, in particular, by some joint-stock companies, e.g. through issue by "MMM" company" of unsecured shares, the reason for the large volume of sales of which was the false information on reliability and profitability of the shares, which caused significant losses to the investors. Criminal liability shall be applied in those cases where relations within the society ensuring the issue of the securities according to the legislation and the interests of the securities owners, were harmed.

Let's present in brief the measures on civil liability for the breaches of the requirements to the prospectus and the application for registration of the securities, including the prospectus, as envisaged by

the Law of the Republic of Armenia "On Regulation of the Securities Market".

A mandatory pre-condition for selling of the securities by prospectus, or otherwise, is the fact that the application for the registration of securities should be registered pursuant to the procedure envisaged by the Law "On Regulation of Securities Market". The prospectus has to comply with the requirements established by the Law, and a copy thereof should be made available to the buyer. In case such requirements are not complied with, then the sale of the securities will be deemed invalid. If the copy of the prospectus is made available to the buyer 24 hours prior to the conclusion of the deal, or after the deal, then on the buyer's demand, such deal may be deemed invalid.

If the sale deal was concluded under the influence of a confusion, which have had essential significance, and the buyer was not aware of this, then such deal may be deemed invalid. However, if the seller manages to prove that he was not aware, and could not be aware, of such confusion, the deal will not be deemed invalid. Application for the registration of securities, including the prospectus, should be signed by majority of the members of the Supervisory Board (or any other body with the same authority), the Executive Director, Chief Accountant (if within the structure of the stock issuer there is an executive board or any other executive body, then all of its members). Each of the persons mentioned will be responsible for the accuracy and completeness of the information disclosed in the application and documents attached. If at the time of registration, any essential fact is missed or reflected erroneously in any section of the application, the buyer of the securities can through Court demand compensation for losses by the stock issuer, or any other party, which:

- a) signed the application for registration;
- b) is the accountant, evaluator, or any other expert hired by the stock issuer, therefore is responsible only for the opinion, announcement, report, or a conclusion, or part thereof, which was drawn up by him;

c) according to the agreement (contract) concluded with the stock issuer, is the underwriter for such securities.

The amount of losses to be compensated though Court shall be defined according to the Article 15 of the Law of the Republic of Armenia "On Regulation of the Securities Market".

If the buyer purchased securities after publication of the financial statements, at least 12 months before the registration of the application, or after they have been made available by the owner of the securities, and he is able to prove that the purchase was made based on the application for registration, and he was not aware of such confusion, then the losses he suffered are to be compensated, while all the above mentioned persons are considered to be jointly responsible to the buyer.