

FINANCIAL CRISIS IMPACT ON THE DEVELOPMENT OF THE ROMANIAN CAPITAL MARKET

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Abstract:

The recent years have been characterized by important challenges in all areas of the society, mainly in the financial one. The financial markets crisis had a high impact on the stock exchange, affecting mostly the emergent markets, such as Romania, which experienced a severe consequences of the crisis. The main spot market of the stock exchanges was characterized by high volatility in the years following the subprime crisis, especially in 2008. These effects lead to a massive fall in the market value of most of the listed companies, at the same time with the decrease of the market cap and the average of the traded value. The decrease of the traded volume was not only generated by the foreign investors` reluctance to invest in the Romanian capital market, but also by the severe decrease of the prices of the listed companies.

The financial crisis altered the consolidation of the internal capital market, strongly emphasising the leading factors that generated the severe contraction of this domain (especially, the cvasidependence on the foreign capitals and the lack of some strong local institutionals, given by – for example - the very late inception of the public pension sector reform).

In the Romanian capital market, the subprime crisis altered most of the listed companies and resulted in extreme volatility, that lead to the increase of the investors` risk aversion. Therefore, it is necessary to identify remedies for the present state of the capital market, that will allow the stock exchange to regain its role as an alternative channel for financing the companies.

Keywords: financial crisis, capital market, market cap, traded volume, foreign investment

Clasificare JEL: G22

This study looks at the developments of the internal capital market, in the framework of the international economic crisis and identifies the main causes that lead to the major contraction of the operations in the stock exchange field. To this purpose we need to present the basic structure of the Romanian capital market, the legal framework regulating the operations, the changes of the investors' structure and the causes of this state of facts. We conclude this article by presenting some possible solutions for the revival of the internal capital market.

Romanian capital market

The first entities related to the capital market in Romania resulted as consequences of the implementation of the Law of the stock exchanges, intermediaries of change and intermediaries of commodities, the first stock exchange being incorporated in 1881, using a French model, and the operations began in 1882 (*when, in the Official Journal of Romania, were published the quotes for listed companies*).

The Romanian capital market was influenced by periods of institutional consolidation and legal consolidation, such as the changes operated in 1904 and especially 1929, when it was voted the "Madgearu Law", unifying the laws regulating the stock exchanges.

The recovery years that followed the 1929-1933 economic crisis were characterized by the increase of the importance of the trading activity using the mechanisms of the „Bucharest exchange” (*former name of the Bucharest Stock Exchange*), that lead to a maximum in traded volume in 1939 (*on the Bucharest stock market were being traded 56 listed companies, mainly from the banking, insurance or transportation sectors*).

After the communist regime ended, the internal economic environment has been invaded by a large number of companies pretending to be „stock exchange”, but now, only two companies still operate on the capital market and are authorised as market operators (in the spirit of the European directives that matters in the stock exchanges field, the most important being *2004/39/EC Directive – Markets in Financial Instruments - Mifid*), namely Bucharest Stock Exchange and Sibex-Sibiu Stock Exchange din Sibiu.

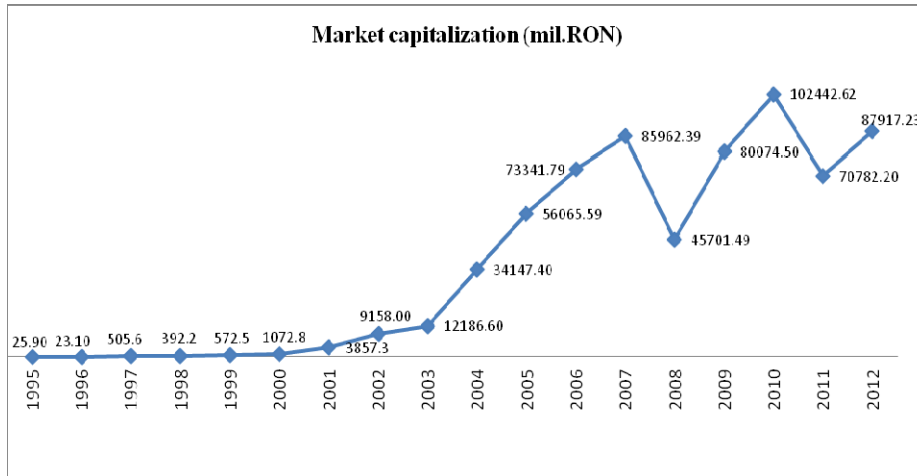
Bucharest Stock Exchange was reestablished in 1995, following a decision issued by the National Securities Commission, based on the provisions of Law no.52/1994 on securities and stock exchanges. Although it was established on April 1st, 1995 and officialy launched its operations on June 23rd, 1995, the first trades

were concluded later on, on November 20th, 1995. This fact repeats former experience proving an inertia of the Romanian business environment to the implementation in local economic system of mechanisms that used to work in western countries for a long time and proved their usefulness and importance.

Year	Trading sessions	Number of Trades	Trading volume	Number of listed companies	Number of new listings	Number of delisted companies
1995	5	379	42.761	9	9	0
1996	84	17.768	1.141.648	17	8	0
1997	207	609.651	593.893.605	76	59	0
1998	255	512.705	986.804.827	126	50	0
1999	253	415.045	1.057.558.616	127	15	14
2000	251	496.887	1.806.587.265	114	1	14
2001	247	357.577	2.277.454.017	65	3	52
2002	247	689.184	4.085.123.289	65	1	1
2003	241	440.084	4.106.381.895	62	0	3
2004	253	644.839	13.007.587.776	60	3	5
2005	247	1.159.060	16.934.865.957	64	5	1
2006	248	1.444.398	13.677.505.261	58	2	8
2007	250	1.544.891	14.234.962.355	59	3	2
2008	250	1.341.297	12.847.992.164	68	10	1
2009	250	1.314.526	14.431.359.301	69	3	2
2010	255	889.486	13.339.282.639	74	5	0
2011	255	900.114	16.623.747.907	79	6	1
2012	58	214.396	3.446.077.238	79	0	0

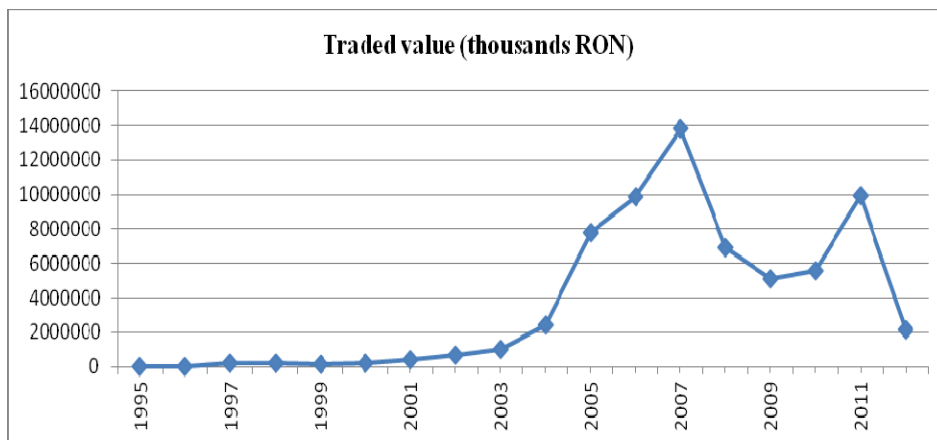
Source: www.bvb.ro

The approval of a new legal framework regulating the privatisation process facilitated improved visibility and importance of the internal capital market in the national economy, especially following the establishment of the RASDAQ market (*using the know-how and consultancy provided by American specialists, that replicated the NASDAQ model on the Romanian capital market*), that was intended to be a mechanism that allows more than 8 million citizens to sell the shares received from the Romanian authorities.

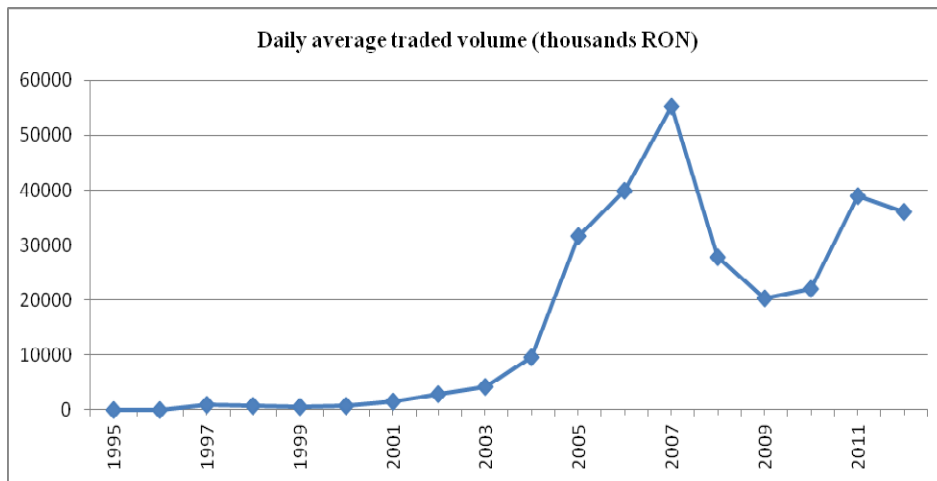


Source: www.bvb.ro

As a result, the market ca grew exponentially in the years of 1996-1999, from 23,1 million RON in 1996 to more than 572,5 million RON in 1999, mainly determined by the 59 new listings in 1997, 50 new listings in 1998 and 15 listings in 1999. The Romanian business environment interest toward capital market, as well as its poor financial education, were emphasized by the entrance on this market of a very large number of investors that established intermediaries (*in accordance with the provisions of the Law no.52/1994*). In this context, the number of intermediaries increased by 517% in only 3 years (*from 28 in 1995 to more than 173 in 1998, the highest value ever in the recent history of the Romanian capital market*).



Despite these developments, the international economic environment (characterized by high volatility, caused by the Russian crisis, as an example) and the internal one (severe economic crisis, along with significant depreciation of the local currency, financial scandals and bankruptcy of some commercial banks) lead to a stable annual traded value, at low levels (in the range of 138 -184 million RON) and a severe fall in the daily average of traded value, from 940 thousands RON (in 1997) to 547 thousands RON (in 1999), as a result of the increase in the number of shares traded (from more than 593 million in 1997 to more than 1.05 billion in 1999).



Years 2000-2004 are characterized by the listing of some important issuers (even today they are still significant on the market), events used to calculate some indexes of the Bucharest Stock Exchange (like *BET* or *BET-FI*). At this stage, a significant increase of the market cap, from 1.072 billion RON to 34.147 billion RON was registered. The consolidation process is also revealed at the intermediaries' level, their number reducing by more than half in these years (from 120 intermediaries in 2000, to 67 in 2004).

Despite the above mentioned facts, the main notable element on the Romanian capital market was the very extensive program of delistings that resulted, only in year 2001, in 52 companies leaving the Bucharest Stock Exchange.

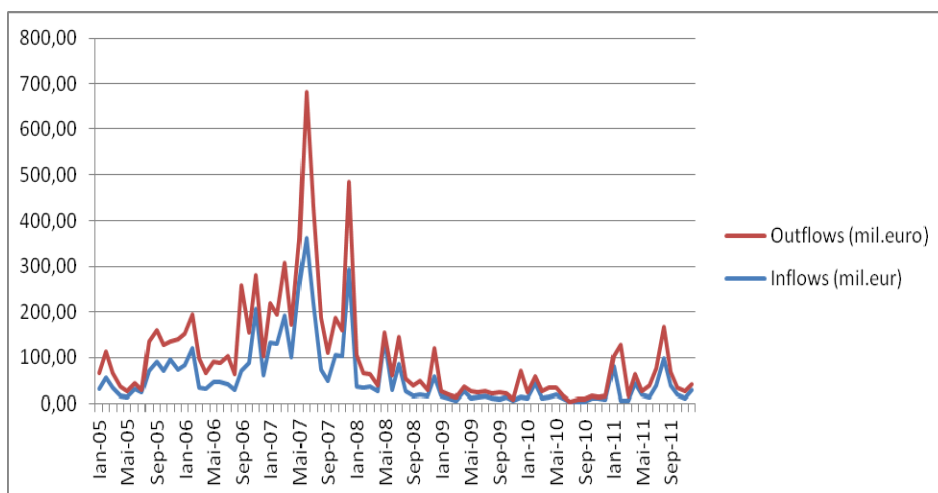
Internal capital market development has been pushed by the approval of the Law no.297/2004 of capital market, that integrated in the internal legal framework the main provisions of the *acquis communautaire* applicable at that time, as part of

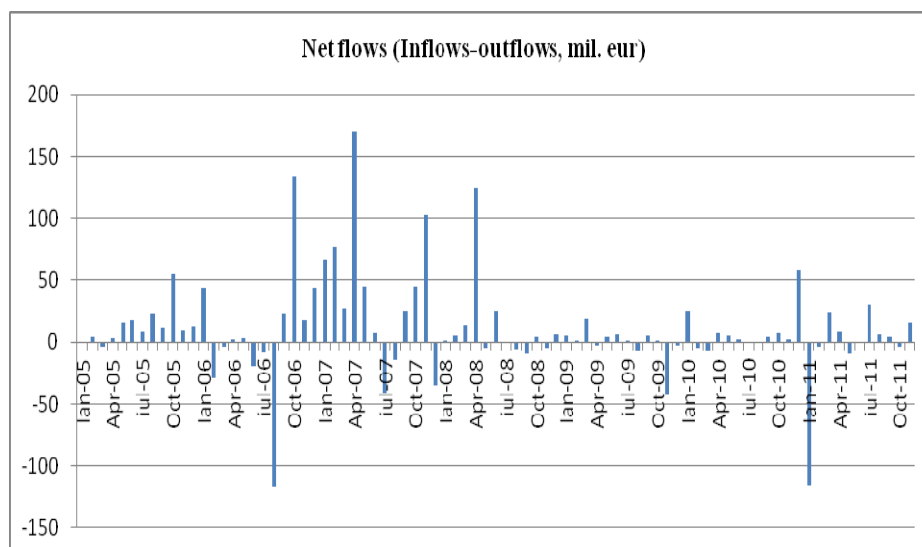
the Romanian authorities efforts to fulfill the accession criteria to the European Union (*criteria that were included in the third chapter of negotiations, - Free move of services*).

Implementation of this Law created ground for reshaping the the internal capital market and for the consolidation of the two market operators authorized by the National Securities Commission that operate in different areas of trading – spot market (*managed by the Bucharest Stock Exchange, where there are mainly traded shares and bonds, and more recently rights and structured products*) and term market (*managed by the Sibex- Sibiu Stock Exchange, where there are mainly traded futures contracts on companies listed on Bucharest Stock Exchange, indexes or commodities*).

The improvements in the internal macroeconomic framework and the accession to the European Union lead to the augmentation of the visibility of the Bucharest stock market, that favoured the increase of the market cap up to 85 billion RON (*in 2007*), alongside the increase with more than 110 times of the daily average of the traded volume (*from 734 thousands RON to more than 55.2 million RON*).

The occurrence of the first signs of turbulences on the international financial markets was ignored by the investors on the Bucharest Stock Exchange, given the historical highs of the most of the listed companies (*especially during the fourth quarter of 2007, when the first signs of subprime crisis in the US were visible*).





Source: www.bvb.ro, own computation

The ascendent trend of the Romanian capital market (*spot market being represented, until 2010, only by the Bucharest Stock Exchange, afterwards also by Sibex- Sibiu Stock Exchange*) was fuelled by the irrational exuberance present on the mature capital markets, investment vehicles of various financial entities – searching for higher margins compared with the markets where they are incorporated – opening positions, starting 2005, in the local stock exchange field.

As a result, the major inflows occurred in the second semester of 2006 and continued in the first part of 2007, being influenced, mainly, by the Romanian accession to the European Union and the consolidation of the internal economy, along with the positive outlook over the whole macroeconomic level. These inflows in the internal capital market were also generated by the majority shareholder's requirement to initiate and realize mandatory takeover public offers in order to delist the companies. Furthermore, the inflows were also derived from the investors' interest related to the secondary public offers initiated by the Romanian government through which some stakes were sold on Bucharest Stock Exchange (*as an example, the secondary public offer related to TRANSGAZ, concluded in 2007, was oversubscribed by more than 40 times, the cumulated value of the bid was over 1.8 billion EUR, when the Romanian government sold the stake for 65 million EUR*).

The strong bull stock market at the end of 2007 covered the premature signs of the systemic risks associated to the turbulences present on the mature capital markets and lead to significant shifts in the foreign capital (especially, as they were leaving the Bucharest Stock Exchange). Considering the low depth of the market and the quasidependence of the foreign capitals, these movements resulted in extreme phenomena on the Bucharest Stock Exchange, that peaked with the suspension of the trading session on October 8th, 2008 (*in order to prevent the spread of the irrational panic, especially on the level of local investors*).

Furthermore, the excessive volatility that characterized year 2008 was influenced by the insufficient sophistication of the local investors, especially the institutional ones, that could have counterbalanced the big supply of shares provided by the foreign hedge funds operating in Bucharest spot market (*the main institutional investors that could enter the market and make investments mainly with countercyclical effects, the private pension funds, had only a short life, as the reform of the public pension sector – that lead to the establishment of the second pillar – really started in September 2007, their investments being done starting the second quarter of 2008, especially in money market instruments*).

So, 2008 was the year of premieres on the Bucharest Stock Exchange spot market, such as the biggest loss in the market cap in the recent history, from more than 85 billion RON (*in 2007*) to 45.7 billion RON (*in 2008*), caused by the fall with more than 50% in the price of most of the listed companies and the decrease of just 10% in the number of shares traded (*from 14.2 billion in 2007 to 12.8 billion in 2008*).

The massive fall in 2008 was partially recovered in 2009-2011, as it is shown by the increase of the market cap (*from 45 billion RON in 2008 to 70 billion RON in 2011*), trend that continues in the first quarter of 2012 (*when the market cap is over 87 billion RON*).

The apparent out of line situation, of increased market cap in 2009 and 2010, is determined by the strong positive trend of the main listed companies on the Bucharest Stock Exchange encountered starting the second quarter of 2009 (*increase of 61.68% for BET index, 66.55% for BET-XT index, 37.31% for BET-C index and 90.33% for BET-FI index*) and the inclusion of ERSTE BANK AG (*the only foreign company listed on the International section of the Bucharest Stock Exchange*) in the computation of the market cap.

Although the beginning of 2012 reveals an increase in the foreign and local investors' interest toward the Romanian capital market (*enhanced by the changes in the limits imposed for the holding and voting rights in the 5 investment companies, shareholder coagulation in the case of some important issuers etc.*), the local stock exchange is still underdeveloped compared with the optimal potential

and the place it should play on the Romanian economy. This fact is determined, mainly, by the lack of a defined strategy needed for the consolidation of the Romanian capital market, at the level of the supervisor and every participant (*institutional investors, intermediaries etc.*)

In order to facilitate the consolidation of the Romanian capital market, possible remedies could be considered:

- Improvement of the institutional capacity of the supervision authority, that should elaborate and implement its own strategy for the development of the capital market, especially by solving the issues that should regain the confidence of the investor on the Romanian stock exchange sector;
- Involvement of the two market operators' shareholders and management in starting coherent programs of operational development, fully valuing all the competitive advantages of the operators (*Bucharest Stock Exchange being specialized in spot market, Sibex-Sibiu Stock Exchange in derivatives market*);
- Actions conducted by every intermediary in order to list on the stock exchanges companies active on some very performant and competitive fields, that are not represented today on the Romanian stock market (companies from the IT sector, research and development etc.);
- Increasing capital market visibility by means of educational programs addressing large audiences on the advantages and risks associated to investments on capital market as an alternative channel for financing companies.

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