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*Abstract: Having in consideration that the entire world has changed itself in a globalized economy, characterized by a more and more integrated and connected financial system, it becomes pretty difficult that a financial crisis from a certain economy not to be spread in others through the contagion effect, with more important effects upon the emergent countries, like Romania. In this paper, first of all, we have proposed analysing the impact of financial crisis upon the financing potential of the capital market in this difficult period. Moreover, there are considered some measures of relaunching the Romanian capital market for the further period.*

*Key words: capital market, financial crisis, financing alternatives*

## **1. Introduction**

Theoretically, the creation of a global, competition and functional capital market, must foster the efficiency of the financial system, allowing a reduction in the cost of capital and a better allocation of the capital between different countries and different sectors of activity, from which it can result a more rapidly growth of the global economy. After decades of changes and moves of managed capital, was being thought that a solution has been found: removal of the administrative barriers on the markets and of the impediments that brake the free competition among entities that operate on the market, owners of financial resources and those with need of financial resources meeting easier in this way and with reduced cost ( through deregulation); developing more and more the direct financing rather than the indirect one (through desintermediation); creation of connections and common departments between money markets and capital markets. This triple revolution has allowed companies worldwide to finance better their investment projects.

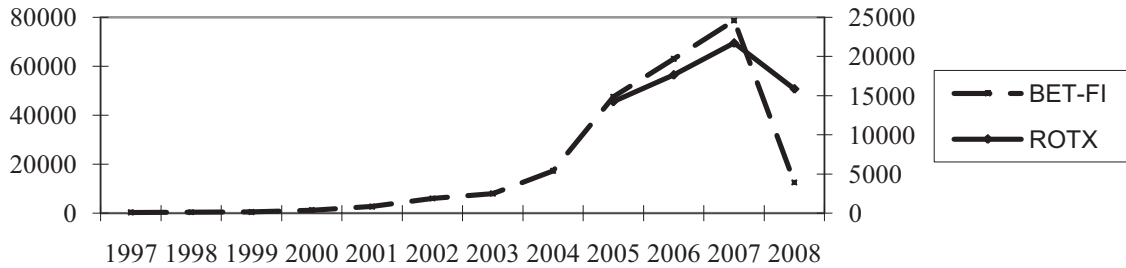
Globalization has not brought though just positive effects upon the financial system and upon the economy. Unfortunately, it has made also possible the rapidly transmission of volatility on European and global level, given the tight connection between different international financial centres, realized through multiple electronic methods of transport of information in real time, as well as by the previous mentioned defragmenting of the international financial market, through the contagion effect.

An adequate example for the contagion of the financial markets, in the context of the current financial crisis is represented by the collapse of the emergent capital markets, like Bucharest Stock Exchange (BSE), that doesn't make an exemption. The most important effects of the financial crisis upon BSE could be easily noticed in 2008 and are described in detail in the following paragraph.

## **2. Effects of financial crisis upon the Romanian capital market**

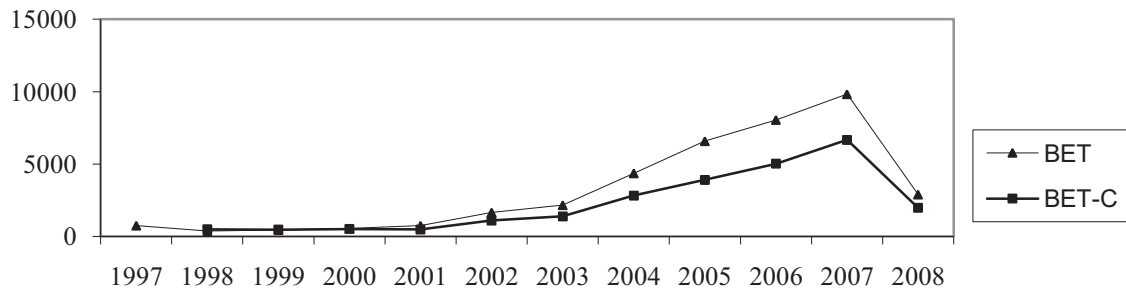
The year 2008 has represented for BSE and for all the participants on the Romanian capital market the most complicated year in its entire history of development. As we can see in the figures below (Figure 1, Figure 2), after a decade in which the main indexes of BSE have described an upward trend, the trend has been reversed for the first time, and the liquidity has fallen dramatically on the capital market. BET-FI index was the most exposed one to the

corrections registered on the capital market in 2008, dropping with 84,05 % at the end of the year 2008.



**Figure 1 – Dynamics of BET-FI and ROTX indexes (points)**  
Source: realized by authors on the dates supplied by BSE

The year 2008 has influenced in a negative way also the values of BET and BET-C indexes, these fallen as much as 70,47 % and 70,34 % respectively.



**Figure 2 – Dynamics of BET and BET-C indexes (points)**  
Source: realized by authors on the dates supplied by BSE

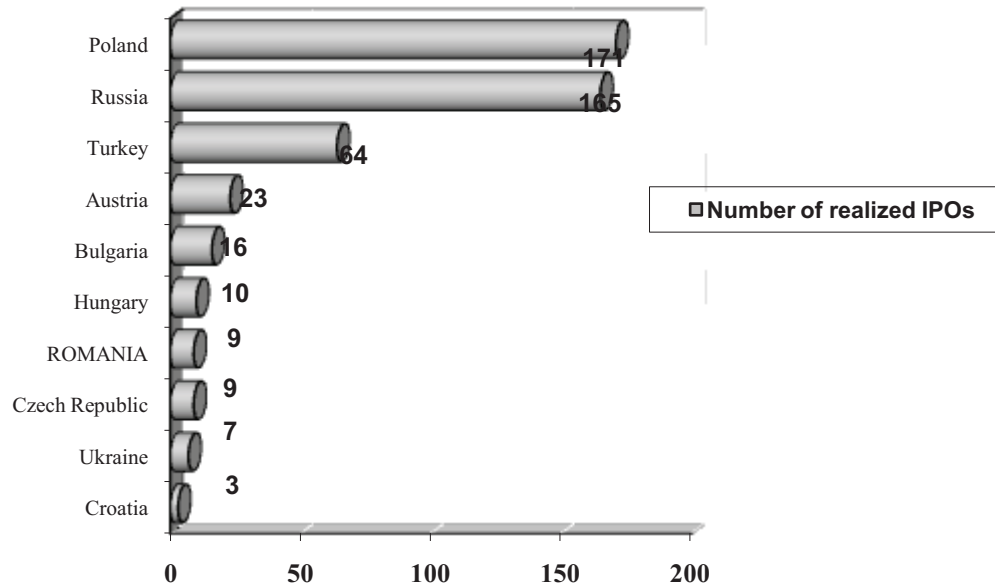
The same phenomena of correlation with the developed capital markets, of sensitivity at external factors that has grown during the last years made the local capital market to be strongly influenced by the existing international turbulences, the current financial crisis roused important changes in the perception of the investors upon the market dynamics and upon the perspectives of the real economy and financial system. With the background of a reduced liquidity of the local capital market, unable to be compared with the one registered on developed capital markets (European, American or Asian), the contagion effect has affected in such a measure the correlation between the BSE indexes and the ones of international capital markets, that this correlation caused further an extreme volatility on the market. Moreover, the excessive volatility had lead to unrevealing the buying orders in the range +/-15% in some trade sessions from the 3rd trimester of the year 2008, that forced the managing authorities to close the trade sessions for the first time in the BSE history. The indexes have experienced one of the highest corrections on the European capital markets, of about 70 % (Figure 3).



**Figure 3 – Dynamics of the main indexes in 2008**  
 Source: taken over kmarket.ro

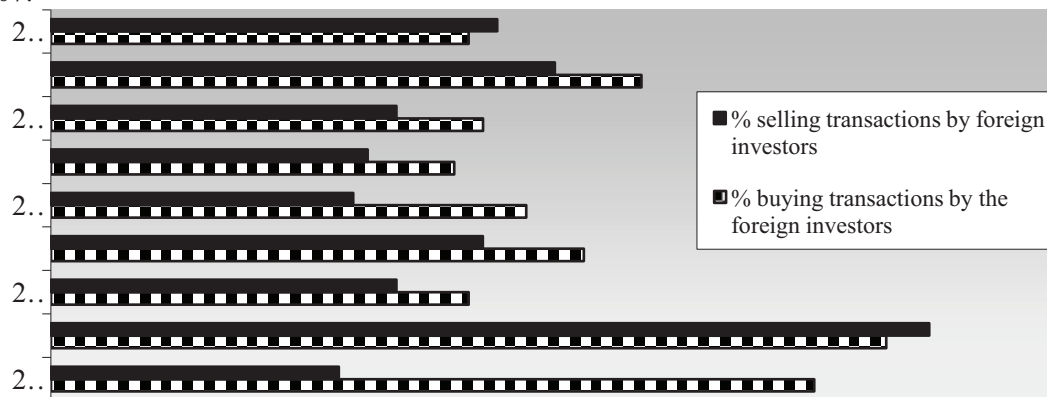
The financing potential of the capital market in the context of the current financial crisis it is strongly affected. The external financing alternatives for the companies, such as issuing initial public offers on the market or secondary issuing by the already listed companies represents a difficult process, given the fact that on a downward trend of the stock market, the buying price of the shares by the investors has an increased risk of getting under the market price in a short period of time. Nevertheless, neither before the financial crisis occur, the initial public offers were not numerous. But the years 2008 and 2009 were being announced as the first years when the process of financing the companies through the capital market could finally get the international recognized importance.

As far as concerns the number of IPOs realized at the level of Central and Eastern Europe, Romania did not rank itself in a very favourable position. As we can see in the figure below, the Romanian capital market ranked 7 out of 10, with the same number of IPOs as the Czech Republic and being get ahead by Bulgaria, Russia and Poland, among others:



**Figure 4 – Number of IPOs registered in the period 2003-2007**  
 Source: Raiffeisen Investment, Mergers and Acquisition Market

Unfortunately, the international financial crisis has caused at the level of the Romanian capital market, still an emergent market, massive withdrawals of capital by investors, potential bidders for IPOs. For the first time in a long period (2002-2008), the percent of the selling transactions was higher than the buying transactions one, inevitable consequence of foreign investors withdrawal out of emergent markets in the context of international financial crisis. More precisely, the buying transactions from foreign investors represented only 29% out of the total in 2008 (less the aggregated accounts), to 41% in 2007, while the selling transactions realized by foreign investors were 31% out of the total in 2008 (less the aggregated accounts), to 35% in 2007.



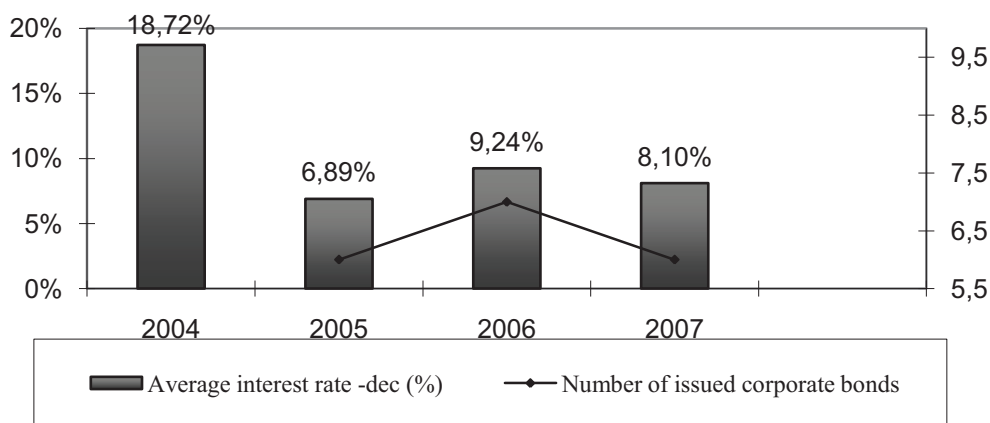
**Figure 5 – Percent of buying and selling transactions realized by foreign investors in total transactions realized on BSE in the period 2000-2008 (%)**  
 Source: realized by authors by dates supplied by Annual Reports of BSE

As far as concerns the other alternative of financing through the means of capital market, financing through bond issuing, at least on a theoretical level, we can state that its role should

increase in difficult periods, like the current crisis, given the reorientation of investors towards fixed income financial instruments, with lower risks. In the same time, the more difficult access to bank loans for companies in this period and the increased cost of bank capital can be considered a reason more for fostering the corporate bond market. On a developed capital market, the fixed income instruments play a significant role in the individual and institutional investors' portfolio. This method of financing presents numerous advantages for the issuers, among them the most important ones being a faster access to financing and an increased elasticity for their global indebted.

Unfortunately, the domestic capital market is characterized by a low level of development of this market. There is a low diversity of these instruments (there is a lack of asset backed securities and also mortgage bonds) and also a reduced liquidity on the market and a lack of initiative from the nonfinancial companies for choosing this type of financing. Thus, these facts leave the potential of development of the domestic bond market just on a theoretical level.

Through the BSE system, there were being traded at the end of the year 2007 six corporate bond issuings, (in comparison with seven at the end of the year 2005), and the average interest rate reached in the year 2007 a value of 8,10 %, an yield superior to the bonification for the existing deposits on the money market at the level of the year 2007.



**Figure 6 – Yield of corporate bonds and the number of transacted corporate bonds in the period 2004-2007**

Source: realized by authors by dates supplied by Annual Reports of BSE

There can be easily noticed from the above figure that using the bond issuing for financing the companies' activity is a rare measure taken by the Romanian entities, mainly because of the low diversity of instruments on this market and because of the specificity of the domestic capital market that is not focused on fixed income instruments, with low risk.

The financial crisis period is disadvantaging for sure the domestic capital market, putting more barriers to equity issuing or bond issuing and given a certain incentive to private equity funds to take actions. These funds select unlisted companies, acquiring the majority of the share package, or a certain volume of shares, making sure that they will be involved in the management of those companies, and that they could sell what they have bought at an increased price in the future (this period varies among 3 and 5 years). In the context of adversity that exist currently on the capital markets, and of limitation of bank loans, these being very expensive, the private equity funds represent an attractive alternative for the companies.

### 3. Proposed measures for relaunching the domestic capital market

In our opinion, the financial and economical context will remain a complicated one during the next period of time, influencing upon the Romanian capital market's activity. This period of steep

decreasing on the market will continue for a while, and afterwards it is possible to be followed by a period with an unclear trend, with higher or lower increases, on the background of a very reduced liquidity. This period can take from few months to several years. *On this whole period, there will be a lot of fake signals coming from the market: on one hand, positive signals, that will give hope to the investors, but that will prove to be just breaks of the downward trend, and on the other hand, negative signals, descending periods, that will create confusion among investors. Finally, will start again the upward trend, once with the restructuring of the economy and fully maturization of the domestic capital market.*

We must understand though that the upward trend is possible to come again only if some conditions are met. These conditions refer to some measures that must be taken in order to relaunch the local capital market. Maybe the most important one, having in consideration the restricted access to bank loans, is related to promoting the bond market. The secondary market of fixed income instruments on BSE shows an increasing interest for this type of financial instruments and the offer must suit the demand. For supporting this initiative, in its essence favorable to the development of capital market, there must be found some measures to reduce in a significant way the costs related to issuing such instruments, so that local companies could be attracted to issue bonds.

The problem of *reducing the operational costs* on the capital market is the first measure that can be taken in consideration, with the aim of gradually increasing the volume of trade on the capital market. For the year 2009, it was planned by BSE a reduction with 10% of the transactional tariffs, in order to align to the other tariffs practiced on other regional capital markets. It is important though that the small tariff practice remains an objective for the following years, having in consideration an even more important reduction, in order for BSE to become the most attractive capital market from the region, from this point of view.

Other important measures can be of *fiscal nature*. The state has approved already the suspension of the computation and dole of the tax on the income achieved by trading on the capital market in 2009 (the programme was completed by CNVM through the suspension of the fee collected by Commission from the trade realized on BSE in the period october/december 2008). This measure could be completed in the future not by totally suspension of the income from trading on BSE, but by applying a reduced tax, of 1 % for example, for a longer period of time, of 2/3 years, or even more, until the domestic capital market becomes more mature.

**Not less important is *creating an adequate legal background*, through the elaboration of some clear, transparent and fair rules and norms for mobilizing, attracting and allocating in an efficient way the financial resources. There must be taken a series of legislative measures that must ensure the growing of protection of minority shareholders, the clarification of delisting procedures as well as the obligations of majority shareholders.** Extremely important is as well creating *an adequate operational background*, that allow the creation of a virtual platform meant to connect foreign investors and BSE and the Romanian investors with the other international capital markets.

One of the major problems to which the local capital market is confronting every day is the one of reduced liquidity, in comparison with the other developed capital markets from the region. Therefore, the objective of development of local capital market can only be achieved by taking *some measures meant to foster the market liquidity*. Such measures can have as goal finalizing the process of privatization of the private domain of the state through the means of capital market, supporting the most representative local companies to get listed on the capital market for getting non-inflationary resources. Not at least, listing on BSE at least 10 % of the main 100 state companies and selling at least 20 % of their shares through public selling offer on BSE would certainly increase the liquidity.

Finally, the BSE must continue and intensify the series of free trainings and classes, meant to increase the competences and skills about capital markets among investors and potential issuers.

Only by resorting to this package of complex measures, the Romanian capital market will have the opportunity of reaching in the shortest period of time an upward trend.

#### **4. Conclusions**

To conclude with, we consider that the financing potential of the capital market, pretty limited before 2008, is very limited nowadays due to the current financial crisis. There can be taken though a series of measures for supporting the domestic capital market, limiting the effects of the financial crisis, especially in what concerns the bond market, some of these measures being proposed in this paper. These measures can be carried out by reducing the operational costs on the domestic capital market, fiscal incentives for the investors, creating a legal and more operational background necessary for the development of the capital market, as well as some measures meant to make aware the investors and potential issuers of the benefits of financing through the capital market.

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