

BUCHAREST AND SOFIA ON THE EUROPEAN STOCK MARKET LANDSCAPE

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Abstract: *The paper points out the main issues on the integration of the Romanian and the Bulgarian capital market in the European financial services market and the position that these two emergent markets can reach near future.*

Keywords: *capital market, Romania, Bulgaria, market capitalization, European integration.*

The Romanian Stock Exchange has a long institutional history. The first, French inspired, law regarding the Romanian capital market appeared in 1881, and was modified in 1929, when the so-called "Madgearu Law" was enacted. The years between 1934 and 1945 saw some intense activity, with 56 listed companies, some of which were also traded on other, renowned, European exchanges (Paris, Anvers, Frankfurt, Amsterdam, Basel and Zurich).

Unfortunately, the communist regime caused the exchange's shut down. It did not resume activity until 1995, operating under Law 52/1994. In April 1995, 24 brokerage firms decided to reopen the Bucharest Stock Exchange, which was to supply efficient and transparent trading mechanisms for shares issued by local and international companies, investment funds, the government and local authorities.

What has driven the Romanian stock market's development? Firstly, there was the Romanian government's mass privatization program, in the early 1990s, which created thousands of private companies and shareholders. Unfortunately, just a few (8 or 9) companies were listed in '95-'96, due in my opinion to their managers' lack of interest in the stock exchange mechanisms, and weak corporate governance. Later, though the listed companies number increased, with a high mark of 130 in '98-'99, market transparency was still an issue. Consequently, the Bucharest Stock Exchange decided in 2000 to raise transparency and corporate governance standards among listed companies, with the aim of achieving a qualitative transformation of the stock market, and gaining a competitive advantage over the open-market exchange, the RASDAQ.

Another interesting feature is the rapid increase in the number of brokers, from 28 in 1995 to 173 in 1998. Their ranks were gradually diminished, though, due mainly to decreasing traded securities, as the Asian and Russian crises of 1998 made many investors wary of the emergent markets.

A quick review of the Romanian stock market's past shows a sinuous evolution, with significant variations both in the number of listed companies, and in the volume and value of traded shares. Yet, in spite of the difficult last 12 years, the Romanian stock market has grown step by step. An important milestone was the introduction in 1998 of the BET index, covering the 10 most liquid shares. Also of importance was the enactment in August 2001 of the Corporate Governance Code, drafted in accordance with the principles of OECD, which has had an effective contribution to a more transparent stock market in Romania. Another contribution to the market's development was the issuing, at the end of 2001, of the first municipal bonds (for Mangalia and Predeal), and the launch in the same year of the electronic platform for fixed income shares.

The year of 2003 was a turning point for the Romanian stock market, as the brokers' community adopted a new strategy for market development. Thus the framework was in place for achieving a climate improvement for investments.

The main objectives of this strategy were:

- National stock market growth through attracting new issuers to the market;
- Strengthened integrity and liquidity of the BSE;
- The introduction of new financial instruments;
- The adoption of the Corporate Governance Code by more issuers;

- The BSE's alignment to European stock market trends, etc.

The BSE's legal status underwent an important change in January 2005, as it went from a public institution to a profit-oriented public company, with 67 former exchange members as shareholders.

Concerning market capitalization, I find the following chart very relevant, as it shows its growth from a near-insignificant level in 1996, to almost 25 billion Euros in 2007.

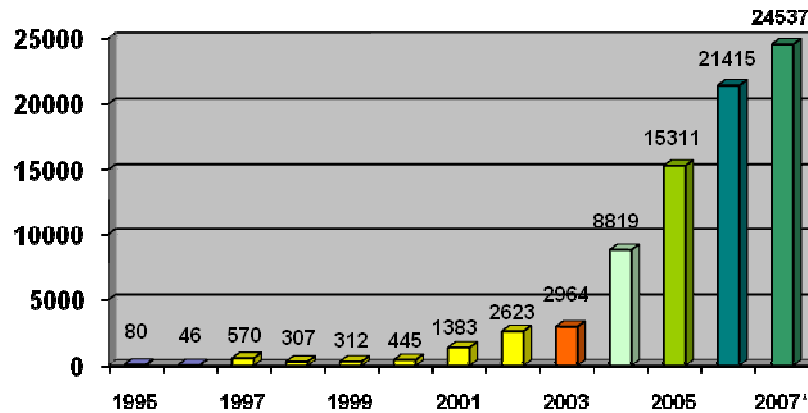


Figure nr.1 The evolution of the market capitalization in billion euros

The daily traded value average also increased significantly, to almost 10 million Euros, while we observed the exchange management's desire to maintain the image of a secure, transparent and efficient market, and increase investor trust in the stock exchange mechanisms.

Romania's intent to join the EU has also influenced its stock market. Given the serious commitment to the membership race, especially since after 2004 this was a realistic target for 2007, adopting the European stock market regulations became a necessity. Thus, a new Exchange Code was introduced in 2006, bringing clarifications to many issues essential for an efficient stock market. Among these new measures were:

- Clear delisting mechanisms on the regulated market;
- Shorter suspensions for issuers following an event in the company;
- Regulations for margin trading and short selling;
- More flexible price limits (+-15%) per trading session

Another important step was the development of the BSE's electronic trading platforms, and the introduction of the Arena trading system. This allowed for faster operational trading, and a significant improvement of the back-up system.

The Bucharest Stock Exchange was actively involved in the implementation of regulations for the Central Depository. Thus, the clearing activities were outsourced to the Central Depository, connected in real time. This is expected to increase the stock market's transparency, as required for alignment with the European regulations.

The BSE's future depends on how the Romanian stock market will be able to integrate with the European stock market. Investor perception of the BSE is as one of the region's major markets. This is confirmed by the listing in 2006 and 2007 of the first bonds issued by international financial institutions, the World Bank and the European Investment Bank. These bond issues contributed to the stock market's strength, and its image as a mature market, a requirement for international recognition.

2006 was a relatively good year for investment on the Romanian stock market. The BET index, which follows the average movement of the listed shares' prices, went up 22% in 2006. This represents a solid performance compared with the interest on bank deposits, which is almost three times smaller.

The value of shares traded on the BSE increased with 27% in 2006, from 223% in 2005, and 140% in 2004.

The index's evolution (and in fact the Romanian stock market's) was correlated in a large measure with that of indexes of other important markets in the region (Px –Czech Republic, WIG – Poland, BUX – Hungary). This correlation will obviously grow stronger, as the Romanian stock market matures.

2006 also brought other important events for the stock market. The merger between the BSE and RASDAQ was finalized. According to the new stock market legislation, and a new exchange code issued by the NSC, today the BSE operates a regulated market with three categories for shares and three for bonds (the practical equivalent of the old BSE) and will operate shortly an alternative trading system currently undergoing authorization by the NSC (RASDAQ's 'heir'). This involves definitively shutting down the electronic trading system used by RASDAQ, and migrating all issuers to the BSE's Arena system. The two markets' merger was one of the most important events on the Romanian stock market, and this consolidation improved its visibility regionally and internationally.

Unfortunately, this consolidation trend did not continue. The merger of the BSE and the SMFCE, under consideration for a long time, was rejected in 2006 by the BSE shareholders. In consequence, the BSE announced the launch of its own derivatives trading platform in the near future, which will use the SNCDD as a clearing house. On the other hand, the SMFCE announced also announced a trading platform. While this market fragmentation is not necessarily considered positive by experts, the two institutions will definitely present new platforms and financial instruments.

In the field of operations and new instruments, it was now possible for brokerage firms to offer margin trading to their clients. This became operational in the fourth trimester of 2006, but this kind of transactions is still under development. Under legal requirements, the guarantee deposited by the client, in form of cash or securities, must be at least 50% of the market value of the securities to be bought through margin trading.

By the end of 2006, 58 companies were listed on the BSE, with 2.8 bill. Euros in traded shares.

Corporate bonds had a good year in 2006. In September, the World Bank launched in Romania a 525 mil. RON public bond issue, the first issue of an international financial institution in our country, and the biggest one to that date. The issue was successful, with 635,948 shares subscribed, from 525,000 issued and allotted.

The EU membership is certainly an important step for the BSE. We expect a stronger and improved institutional framework, due to intensified cooperation among key institutions on the stock market, increased contact with the business community, and the support for institutions with a potentially positive effect on the quality of stock exchange activities: the Institute for Corporate Governance and the Brokers' Association. We can also assume an increase in market capitalization, probably to 40 billion Euros.

In the first two years from accession, market capitalization in the Czech Republic, Hungary and Poland grew with a 48% average rate per year, and the traded value with 77%. While these effects will not be immediate, they will certainly, given the increased visibility and trust, also manifest in Romania.

With the BSE's future relatively bright, and Bucharest increasingly a point of interest on the European stock market landscape, an analysis of the stock exchange in Bulgaria, neighbor country and simultaneous new EU member, is not without interest.

A first look at the Sofia Stock Exchange reveals a stock market split into official and unofficial operations. Shares from the A and B segment are traded on both market sectors, but some differences exist in the types of bonds traded. While government, corporate and municipal bonds are traded on the official market, the unofficial one deals in privatization cheques and other bond types. In April 2007 17 companies were traded on the official market, with a 2.8 bill. Euros market capitalization, compared with 339 companies and 7 bil. Euros on the unofficial market. The 9.8 bill. total capitalization is significantly smaller than the BSE's (approx. 25 bil. Euros). In 2006, there were 29 newly listed companies, 2 IPOs, 19 mutual funds and 28 bond issues. The beginning of 2007 brought 7 new IPOs, 10 bond issues and 6 new companies.

The Sofia Stock Exchange top 20 listed companies, aggregated by type of activity, contains:

- 43% financial brokers;
- 30% transportation, warehousing and communication companies;
- 20% production companies;
- 4% retailers and whole sellers;
- 3% tourism and food companies.

Active since 2000, the Sofia Stock Exchange enjoyed constant growth, evident both from the doubled daily average in the last few years and the SOFIX index' evolution (up 1300% from 2000 to 2007), and from the low capitalization level in 2007 (37% of the GDP, from 5% in 2000).

Trends and expectations for the Bulgarian stock market's near future include the concern for alignment with European requirements, by introducing legislation and the unique European passport. Also, the Sofia Exchange, like the BSE, is considering alliances with other European stock markets (7 of which have expressed interest), and multiple listing using a single issue prospectus.

What about investment opportunities on the Bulgarian stock market?

The Sofia Stock Exchange intends to encourage companies to be active on the stock market, and to increase the role of stock exchange mechanisms in attracting new financing. More precisely, this concerns raising capital through share issues.

Simultaneously, securitization is encouraged in key economic sectors: energy, electricity, central heating, banking, etc. Real estate is to be an important domain for the stock market. Also, small and medium companies are expected to be more actively involved in the stock market to fund new projects, occasionally even riskier ones.

Like Romania, Bulgaria is concerned with better corporate governance standards (aligned with the same OECD principles), and is drafting a special code, which I find very similar with the one in place in Romania.

The Bulgarian stock market shares the introduction of IT solutions as a priority, and technological innovations will be deployed rapidly, mainly in the existent systems – COBOS (Client-Order-Book-Online-System) and EX3 (automated single-point information disclosure system developed by the BSE, FSC and CSD).

Of course, as with the BSE, the Sofia Stock Exchange's management is aware of the limitations: a market still small, reduced liquidity, few IPOs, limited range of financial instruments, but there are great expectations. Introducing new legislation and finding important partners are the next period's main goals. Much is expected of the collaborations with the Deutsche Burse, OMX, Wiener Bourse, Hellenic Exchange, the Italian Exchange, the Warsaw Stock Exchange.

EU membership will for both Romania and Bulgaria, along with increased foreign funds' investments, more investment from domestic institutional investors.

Pension funds and insurance companies are stock market segments with great potential, and expected to become much more active in the future.

Thus, positive effects will surely manifest on both Romanian and Bulgarian stock markets, especially quantitatively, potentially making 2008 a more interesting year than 2007. At least in Romania, the listings of important companies like "Fondul Proprietatea" or Romtelecom will have an essential impact on both market size and attracting interest from potential investors.

The introduction of regulations following EU accession will mark a difference between 2007 and 2008, for both the BSE and the Sofia Stock Exchange. Of interest will be the increased competition as international operators enter the market, and the results (undoubtedly benefic) of this added competition for investors.

The financial instruments will certainly become more diverse. The BSE is developing a new derivatives platform, the introduction of which will be a major market event. The platform will start by supporting futures contracts in the first stage, so share options could be introduced in 2008. Margin trading could also significantly bolster traded values.

Bonds will continue to be an important market segment for Bucharest and Sofia. As many banks express interest for the stock market, corporate bonds will be a growing segment, and municipal bonds will also continue to consolidate. Investment firms in both countries are candidates for continued good performance, and we can confidently expect that IPOs will play an essential role.

Bulgaria must be seen as a serious, fast-approaching competitor, which cannot be treated with indifference. Consequently, finding strategic partnerships is most important in the future, as is the consolidation of the domestic market, and increased prestige on the international market. Speed is of extreme importance while introducing reforms and leading the competition in the region.

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