THE ROLE OF THE FOREIGN INVESTMENTS AND THE CAPITAL MARKET IN THE RESTRUCTURING OF THE ROMANIAN FINANCIAL SYSTEM

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Abstract: *One of the most visible and most important effects for the stability of the financial system is the restructuring and the consolidation of the banking system, as main component, so that the credit institutions to meet the requirements of some functional banking markets, in full globalization process. Then, we can't talk about a qualitative development of the Romanian economy and especially of the financial system, without the development of the capital market. The banking system must truthfully reflect the development and decentralizing level within the economy, representing not only a result of the reform, restructuring and privatization process, but also a very active and mobilizing factor of this process.*

Key words*: privatization, banking system, restructuring, foreign direct investments.*

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1. The development of the Romanian financial system

In the new EU accession countries, Bulgaria and Romania, foreign banks have moved rapidly to take dominant positions. In Bulgaria 83% of the banks are controlled by foreign owners. In Romania, Austrian banks are leading (23%), followed by Greek banks (10%) and Italian banks (7%). Romania may offer the best prospects for FDI by foreign banks since, although it is the second largest market in Central and Eastern Europe, it has the least developed banking system.

In Romania, the banking field has been and it is one of the most dynamic and active segments within the economy, registering important growths from year to year, both regarding capital, number of employees, investments, and the credit level of the economic activity. Nevertheless, there had been some deficiencies materialized in some aspects of banking system leanness, non performing credits, important losses or even bribery.

The banking system must truthfully reflect the development and decentralizing level within the economy, representing not only a result of the reform, restructuring and privatization process, but also a very active and mobilizing factor of this process.

It is very important to underline that the current Romanian banking system is „a creation and a major success of the passing process from market economy which happened after 1989"335. Recognizing this reality calls for a specific approach, distinct of this field of activity, at least under the following points of view:

- represents achieving an objective which, by structure and functional finalities, constitute a fundamental premise in edifying a real market economy;
- it's the conjugated result of the Romanian society, after 1989, as part of practicing a strategy whose finality is found in the consent of the entire national political spectrum;
- the respective system covers the entire national area, constituting a lever and perhaps the most coherent way of implementing and achieving major mutations in the other fields of activity.

The restructuring process, as fundamental guiding mark of the transition to market economy, mandatory also includes the banking system, mentioning that it must keep into account, on one side, of the above mentioned, and on the other side, of the necessity of a real capital input within the system. One can add aspects which are to be taken into account of elaborating any national development strategy, with direct influences upon some defining elements of national interest.

335 Constantin Bencheci, "Banking restructuring techniques", Financial Market no. 10 / 1997, p. 8.

As a result, the number of bank investments included in this process, and also the implication percentage of private capital, internal or external, become the expression of a will with a double motivation: economical and political.
The tendency registered in Romania, of growth of the presence of foreign banks, is available in the entire Central and Eastern Europe. The growth of roles of the foreign banks on emergent markets is due, originally, to financial segment globalization, which led to an intensification of competition from non banking lending sources and financial services – partially from the capital market, with inference over the registered profits. This fact determined a reduction of traditional banking activities capacity, banks choosing for regional diversification and achieving other banking activities. The expansion of the foreign banks and gaining new market shares had been favoured also by more permissive regulations and technical progress.
The presence of foreign banks leads to a growth of stability and efficiency of the banking system of the host country. In this way is registered a direct and indirect improvement (as a result of competition) of the quality, prices and banking services availability. In addition, it is considered that foreign banks have a more efficient assignment of credits due to the fact that they have more sophisticated systems for risk evaluation. Also, it is appreciated that foreign banks can better estimate the risks associated to different financial products due to their experience on international financial markets.
Moreover, unlike local banks having state capital which can be submitted to some political pressures for granting some of the credits or neutralizing the economic levers for recovering the credits, foreign banks are more intransigent, thus contributing to strengthen business discipline.
„Thus, in a country in which residual payments are a constant of economic life after 1989, due to non restructuring the state sector and changing the behaviour of profitable economic agents, foreign banks had adopted a determined solution: bankruptcy"336. Thus, Romanian Bank for Development – Societe Generale demanded in the court the bankruptcy of the company Rulmentul Slatina. The Bank had granted in 1997 a credit line for the production activity, with reimbursement term at the end of the year. The term had been extended until the half of 1998, and in the beginning of the next year, the bank had granted another additional credit. The debtor company had not been able to return the loan contracted, reason for which the bank requested the bankruptcy. The act made by BRD – GSG drains the economy and, certainly, it shall be pursued by other private banks, considering the reduction of the number of state capital banks, which, for many years, had good relations with the state companies.
Local banks confront with a series of disadvantages, compared to the foreign banks: limited access to capital, lack of geographical diversification, lack of experience on several markets, delays in implementing new services and products, limited capacity to achieve investments in information and communications technology.
The entrance of foreign banks on the local market means the import of some more strict prudent regulations, at least for a part of the banking system. Moreover, in times of crisis of the banking system, the branch offices of the international banks can contribute to stabilizing the situation, the depositors going to such banks than the ones outside the country. Foreign banks are considered to be more stabile sources for granting credits, which make the banking system of the host country to be more robust to shocks. Thus, the subsidiaries and branches of the foreign banks have access to additional funds from the mother companies. The banks having international activity have a better access to international financial markets, benefit from the diversification of the portfolio and have larger incomes, which are less correlated with the local shocks. The Asian crisis in 1997 revealed another policy of the foreign banks, and namely one of cut and run.

336 Mirela Matei, "Foreign Direct Investments. Functions and evolutions. 1990 – 2000, Expert Publishing House, Bucharest, 2004, p. 207.

Some specialists consider that the foreign banks adopt a focus policy over the companies with a stabile financial situation ("cherry pick"), letting to the local banks the clients with problems, thus contributing to the growth of the autochthonous banks risks. Moreover, as a result of competition development, local banks having a weaker position shall develop more risky, with the purpose of improving their position, the final result being the bankruptcy.
Besides the defiance which the foreign banks address to the monetary authorities within the host country, a stronger focus of the banking segment can create a monopoly situation, with immediate effects over the local banking system efficiency.

2. The restructuring of the Romanian financial system

According to a survey made by the National Bank of Romania, the privatization had been and it is still a factor with a special influence over the banking system.
The changing environment in which banks function, generates new business opportunities, but at the same time it assumes more complex and different risks, which are a challenge for the traditional approaches of the banking management, which the bank must administrate more properly in order to survive the competition and in order to sustain the economic growth induced within the private sector.
The Romanian financial system includes different entities, but the most representatives are: credit institutions, non-banking financial institutions, credit co-operatives, financial investment services companies, investment funds, insurance, leasing and financial investments companies. The dimension of the financial fluxes estimates the range of the economic fluxes and they are directly proportional. Of all the sectors of the financial system, the most remarking are: banking industry, insurances, financial investments companies and – more and more significantly within the past years – the financial investments services companies. On the first place within the banking system there is the banking industry, the first financial sector restructured 4 years long, process started since 1998.
In essence, the property structure in case of the banking system is a quality indicator, reflecting the intensity degree of the banking reform and restructuring, being directly proportional to the property structure within the economy.
In the years while the banking restructuring process had lasted and then as a result of the banking consolidation process, the banks assets had been restructured in a manner underlined in the following configuration[337]:
1) the downturn of the major state capital bank assets from 71,02% of the total of the banking system assets in 1998 to 6% in 2005. The rate had been significantly influenced by the liquidation of Bancorex and BCR privatization;
2) the emphatic reduction of the assets of autochthonous major private capital Romanian banks, as an unpleasant consequence of bankruptcy of most Romanian major private capital (from 13 banks in 1998, to 6 banks in 2001, 4 banks in 2002, so that barely in 2004, the number to grow to 7, being in 2005 at the same level also), fact reflected in the decrease of their market share from 9,03% in 1998 to 3,2% at the end of 2002. Except for some banking frauds, the bankruptcy of some private banks was due to the alternation of the phases of the economic course, of the restrictive monetary policies, combined with very large real positive interests, which had marked up the interest of the credit over the profitability limit of the economic agents and had created for many of them an insolvency risk translated into credit risk (or sources immobilization) for the banks which had bankrupted. Subsequently, by the BCR privatization, the share of the Romanian private major capital banks majored to 31,08% in 2005;
3) the assets of the foreign major private capital (including the branches of the foreign banks) had grown in a progressive rhythm from 14,25% to 62,2% at the end of 2005. 2002 was the year in

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which the foreign capital managed to take over the control of the Romanian banking market, the market share of the commercial banks having foreign major capital (calculated as assets share in total system assets) was of 56,4%, exceeding the market share of the commercial banks having state major capital, respectively 40,4% of the banking total assets. This had not been possible without a quantitative development (the number of foreign major capital had grown from 13 in 1998, to 23 in 2004, even if the number of the branches of foreign banks in Romania had dropped from 9 to 7), but also by a qualitative extension in the banking products and services range, fact confirmed by the growth of public confidence in foreign capital banks. The process had been favoured also by the liquidation of Bancorex, fact proved by the growth with 26,22% of the market share of foreign major capital in a single year (1998 – 1999) from 14,26% to 40,48%, even though the number of foreign capital bank operators had grown only with 3 units, while the number of foreign banks branches had reduced with 2 units;

4) the assets of the foreign banks branches had slowly grown from 5,69% in 1998 to 8,5% in 2004, so that in 2005 to be reduced at 7,5%.

If the banks had doubled the assets of the financial system, about the capital market one can say that they had registered in 2004 a growth of 1.6 times compared to 2002, but anyway the share of the net assets of the SSIF's within the financial system and of these assets reported to the GDP had stayed the same. The development of the market had been noticed also from the growth of the stock exchange capitalization as a share in the GDP, from 10,6% in 2003 to 17,6% in 2004, against a superior growth rhythm (109,6% in 2004, superior to the one of 48,1% in 2003). On another side, it had also been noticed a very high dynamics of the capital market in 2005, where the capitalization had grown from 10% of the GDP in 2002 to over 22% at the end of 2005. Parallel with this, there had been a consolidation of the SSIF's on base of fusions and withdrawing authorizations of some financial investments services companies followed then by a growth of the number of financial investments services companies, currently being 72 such companies. The relative boom of the capital market determined the purchase of some financial investments services companies by domestic credit institutions, process which probably shall continue under the empire of the new capital market law and under the requirements of regulation imposed by the C.N.M.V. The process shall be stimulated also by the appetite of the banks for the diversification of the incomes gained in the conditions of an effectiveness superior to the banking market, but also by the lack of Human Resources specialized in market operations (brokers) within the banking personnel structures, which makes more attractive the purchase of a financial investments services companies than creating a direction: The capital market within a bank.

The significant development of the capital market had been favoured by the continuous reduction between 2002 and 2004 of the nominal level of the bank interests for clients' deposits, which had enhanced a special perception upon stock exchange registered effectiveness. This development of the capital market had not yet tale place by a proper widening of the choosing possibilities between the listed titles. The great unbalance between banking assets and those of other financial institutions equally suggest the long absence of some pro-active policies for developing alternative markets and the reduced volume of the local financial resources in search of investment.

Along with the slow – down of the decrease rhythm of the interests, this perception shall disappear, and the growth of the effectiveness could be favoured by the listing of new issuers to the stock exchange, including the private banks within Romania, even the ones owned by foreign capital. The restructured and consolidated banks can represent underwriters, drawing the public investor. That is why the banks can propel the capital market on an ascending trend in a near future.

One of the most visible and most important effects for the stability of the financial system is the restructuring and the consolidation of the banking system, as main component, so that the credit institutions to meet the requirements of some functional banking markets, in full globalization process. Then, we can't talk about a qualitative development of the Romanian economy and especially of the financial system, without the development of the capital market. In economy manuals, the stock exchange is presented as the economy barometer. Beyond this plastic expression, a financial system can't demand to be a developed system without a healthy capital market, solid, as it began to be the banking market within the last years. Another aspect which had been suggested in the financial press and literature within the last years is the one of competition between the capital market and the banking market. Outwardly, correctly, profoundly, all wrong. The great financial groups own brokerage houses, they also administrate important stock exchange placements investments, so that the margins lost when the interest decreases (when it is assumed that money are moved to the stock exchange) to be recovered and maybe even more of that from ratings acquired on the capital market. Turning the reasoning, what does the capital market lose when the banking market evolutes on a growth waive? Especially in the conditions in which the three listed banks have a capitalization which is 27% of the total capitalization of the stock exchange (information from august 2006), which are added indirect relations to (the SIF's own important participations to banks). The two markets don't compete or if they do, they both gain. It is only up to us to understand this thing and act in order to achieve it.

3. Conclusions

In the beginning of the 21st century, one of the main tendencies of the world economy is the globalization. Adhering step by step to a sole economic complex, regulated by the same game rules, the national economies get new modernization and economic growth possibilities.

Currently, without direct foreign investments, the fast overflow of economic crisis and staying behind of the countries in course of development is very difficult to achieve, sometimes even impossible. More than ever, the development of a healthy economy based on the principles of the competitive market can't be achieved beyond its connection to the world economy, as well as economic progress and growth can't be achieved without investments, including those direct foreign.

In the conditions of the Romanian society being in transition process to a market economy, the need of capital and investments, which are up to a level way over the economic possibilities, imposes as an objective condition to turn to foreign capital as drawing direct foreign investments.

The role of foreign capital derives both from the necessity of supplementing the financial resources of the country, and from the structural status to the economic reform process. The foreign capital is more than a flux of exterior resources, it's the main support for making inevitable structural adjustments by which the Romanian economy can get out of the tighten inherited structure, of inefficient assignment of the resources which currently stop it and by which to enter into the structural economic reform process.

Thus, the impact of foreign capital over our economy is double. First, as financial flux, the foreign capital plays a complementary role in the transition context, because it supplements the limited financial resources of the country in the effort of reversing the tendency which had been exercised in the first years of reform, that of continuous deterioration of the economy condition.

A massive foreign capital flux as direct investments can represent a support for the governmental policy, aiming the stabilization of the domestic financial - monetary system against the completion of the price liberalization process.

Secondly, as investment flux, the foreign capital plays a structural role. In the conditions in which the pitching of the functional biased errors and of the chronicle inefficiency can be overflowed only by an influx of modern technology, management expertise and economic administration, the structural role of the foreign capital being determinant, because it can generate and maintain, in the current conditions, such an influx.

Direct foreign investments stimulates the development of all sectors of the economy, determines the growth of the production and of the number of work places, the improvement of working conditions, the growth of labour productivity, of the economic efficiency and of the living level of the population, and the main advantage of them is that they don't create exterior debts.

If the investment input is materialized in equipments, gears, know how, etc., the investments can become real reception and framing channels within the world economy of some exterior impulses of technology, management and marketing experience.

Transnational companies, which are the main promoters of foreign investments and, implicit, of the globalization process, are the ones which should try to create stronger connections to the host countries, in the conditions in which this type of relations had not always had the best results. Currently, when the role of self image became so important, it can be positively influenced not only by economic and financial performances, but also by the ones achieved regarding the social security granted especially to the states in development, as it's the case of Romania. Thus, transnational companies must involve more in forming and reconverting the work force in the countries in which they make branches, make scientific research centers and attempt to make a permanent connection between them.

Foreign capital investments can bring an important input for the development of the domestic market and, step by step, to the activation of the exports, having their own distribution networks.

Drawing direct foreign and portfolio investments contribute to the rebalancing of the balance of payments by foreign capital inserted into the economy, which can reduce from the pressures over the rate of exchange generated by an adverse trade balance.

The state can directly interfere through many levelers and mechanisms for the balance of the exterior balance of payments, but the foreign investments are considered the most benefic because they have a synergic effect much larger over the domestic resources.

Despite the continuous opening of the exterior trade and of the significant performance of the export, these are not yet enough diversified, matter due to the fact that few companies have innovating or research activities in developing their products and services. In addition, most of the Romanian exports are traditional sectors.

That is why, Romania's strategic priority must be the competitive advantages, the development of capacity and competence of the exporting sectors, drawing direct foreign investments, and creating an economy which would be able to develop in the free trade conditions in a more and more globalized market.

Considering that the DFI are a source of capital, know how, technology and management aptitudes, and that they stimulate the economic growth, Romania must become a better pretender for the immersion of direct foreign investments, especially those oriented to the export. The main matters which require solutions are regarding the creation of an attractive environment for the foreign investors, them being interested in: diminishing the domestic market, the existence of important natural resources, cheap work force, the possibility to access exterior outlets, the liberalization of the economic domestic policies, the technical progress level and the quality of the human resources, the elimination of bribery and bureaucracy, etc.

Near the impact the DFI have over the exterior trade and over the competitive advantage of the host country, we must also mention the DFI catalyst role in the restructuring process of the national economy and of the local companies, both directly, in case of those having connections with the transnational companies, and indirectly, by enhancing the competition between the local companies and foreign branches.

Due to the negotiations and requirements of the European Union, in order to receive the functional market economy statute, Romania had to accelerate the privatization process. Thus, the banking sector had been strengthened by the privatizations of the state banks in the previous years, the most important in the likeness of value until now being the privatization of the

Romanian Commercial Bank with the Austrian partner Erste Bank, but also by the opening of the foreign banking and non-banking capital input.
The banking activity in Romania is not yet, at least, not currently, situated according to the requirements and standards of the European banking industry. The local banks have some disadvantages, comparing to the foreign banks: limited access to capital; the lack of a geographical diversification; the lack of experience on more markets; delay in implementing new services and products; limited capacity to make investments in information and communication technology.
The real challenge for our country shall begin once with the completion of the privatization process, thus not contributing to the growth of the direct foreign investments flux.

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