

THE FINANCING OF INVESTMENT PROJECTS BY ISSUING BONDS

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The stock exchange is one of the most important institutions of the market economy, a segment of the financial market, an organized, transparent and supervised secondary market where agents conclude transactions with securities, their derivatives, and money.

The importance of the stock exchanges for the national economies has grown enormously in time. If, initially, the number of the stock exchange participants was limited to mainly individuals with a high income, today, millions of private investors place a large part of their savings directly on the market or through the mutual funds.

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1. General aspects on bonds

Throughout the evolution of the financial market, different institutions (trading companies, local public administrations, investment funds and banks), and elements of the equation MONEY – GOODS – MONEY have been looking for efficient solutions to draw in money in order to use it for financing different investment projects. The financing methods have evolved during the “money rush” so that we can speak today about two major categories of financial products:

- Financial products that participate in the financing process and generate ownership rights on the issuer – shares, and
- Financial products that participate in the financing process and generate debt rights on the issuer – bonds.

It is important to point out a third category – the bonds that can be converted into shares, thus transforming the debt rights to ownership rights on the issuer.

We are all familiar with the financing method by obtaining a bank credit, still, in time, this method has proven to generate high costs, the crediting conditions are rather rigid, the guarantees are quite big and the reimbursement terms are short. This is why the economic agents are always looking for *an alternative to bank credits* so that the issuer could finance himself having lower costs on longer terms, the investments could be guaranteed by the business itself, addressing several potential investors or all those who have bigger or smaller savings. Last but not least, another important aspect is to protect the issuer from the risk related to the growing interest rates during the periods of rising inflation, periods in which the cost of the credit was rising.

The investors have been always looking for financial products that bring a certain secure productivity, if possible, superior to the rates offered by the banks and lacking the risks specific to investments in shares on one side, allowing them to transform their investment into cash before the date of payment, on the other.

The instruments or financial products that comply with the above mentioned requirements are the BONDS.

From the point of view of the issuer, the main advantages of this financing method are the following:

- The low cost of the credit, the interest rates for the issued bonds are lower than the ones involved in bank credits and a little higher than the interest rates for the bank deposits.
- Due to the clause of redemption specific to the issuing process, the issuer has the right to redeem his bonds before the date of payment.

From the point of view of the investor, the main advantages of investing in bonds are the following:

- The low level of investment risk due to the right of being the first to be reimbursed in case the issuer bankrupts (before the shareholders).
- The obtaining of a certain profit equal to the interest rate for the issued bonds, the latter being higher than the interest paid for bank deposits or for the government bonds.
- By listing the bonds on a secondary market (the Stock Exchange or Rasdaq), the investors can transform their investment into cash at any time before its date of payment at a correctly and transparently established price.

On the international market, the bonds hold an important part of the primary and secondary capital markets. There are several types of bonds sorted according to their characteristics; the classification used most often is the one according to the type of the issuer. The bonds issued by the trading companies are called **corporate bonds**, while the one issued by the public authorities are called **municipal bonds**.

Bonds were issued for the first time in Romania in 1906 by the city of Craiova, the obtained funds following to be used to finance the works related to drinking water supply.

After the revival of the capital market in Romania, bonds started to be issued. In 1997 Siderca Călărași issued a number of 350.000 corporate bonds reaching their maturity in 2000. Starting from the year 2000, the number of bonds that are issued, both corporate (three issues), and municipal bonds (nine issues) is continuously growing. A constantly increasing number of local public administrations use this practical method of financing objects of interest for the community they are administrating, as an alternative to the modest funds they receive from different financial institutions (World Bank, Phare Funds, Sapard etc.), from the state or the local budget.

It is important to mention that all the municipal bonds issued so far in Romania were concluded successfully and were subscribed entirely.

Here are a few examples of objectives financed using the money obtained by issuing bonds:

PREDEAL:

a) The first issue of municipal bonds after 1989:

- The expanding of the skiing zones of the city.
- The new ski track from Creasta Cocosului.
- Obtained funds: 5 billion lei.

b) The second issue of bonds:

- Machinery for artificial snow-drifting of the tracks, modernizing and lighting the ski tracks.
- Obtained funds: 7.5 billion lei.

MANGALIA:

- The arrangement of the promenade near the sea-front in the south part of the city.
- Starting the construction of the sports center at Callatis Highschool.
- Obtained funds: 10 billion lei.

ALBA IULIA:

- The rehabilitation of the sewerage system of the city.
- Obtained funds: 16 billion lei.

CLUJ NAPOCA:

- The modernization of some streets.
- The modernization of the bridge over the Lombului stream.
- The modernization of “Mihai Viteazu“ public marketplace.
- Obtained funds: 25 billion lei.

SEBEȘ:

- The expanding and the rehabilitation of the water supply and sewerage systems of the town of Sebeş and the Petreşti village.

- Obtained funds: 10 billion lei.

BACĂU:

- The consolidation, modernization and arrangement of the “Bucovina” theatre.

- Obtained funds: 35 billion lei.

TÂRGU MUREŞ:

- The modernization of the street Gheorghe Doja.

- Obtained funds: 20 billion lei.

2. The risk factors

Before subscribing to the Public Offer, it is recommended for the potential investors to take into account the following risk factors that have to be analyzed together with the information about the issuer. The main risks involved in the process of investing in securities in Romania are as follows:

1. The price risk

This type of risk is relevant for the investors who do not intend to keep their bonds up to their maturity. The price variations are limited by the quarterly recalculation of the interest rate and its connection to the average of the BUBID and BUBOR rates.

2. The economic risk

This kind of risk is generated by the possibility of being dependent upon an economic agent or any important changes in the demographic structure of the populations throughout the existence of the bonds, including the emigration and the immigration.

Romania is in a stage of transition towards the market economy and the macroeconomic environment is still unstable because of the low performance of the national economy, this being associated to such phenomena as hyperinflation, unemployment, budget deficit, balance of payments deficit capable to influence the performance of the budget exercise of the Issuer.

3. The risk related to legal instability

The transition period of Romania is also described by instability and a certain legal incoherence that have effects on the economy. The legislation on the setting up and the activity of the trading companies and the one referring to the capital market is constantly changing.

4. The risk related to national currency convertibility

The bonds are indicated in the Romanian currency. Consequently, the value of the investment will depend on the exchange rate of the Romanian leu as compared to any convertible currency. One should keep in mind that the Romanian currency has gone through a very big depreciation, but there are certain signals that due to the stabilization of the inflation at the present values, the coming period of time might bring a controlled depreciation with no significant jumps.

Conclusions

According to their efficiency, the bonds are situated between the investments on the monetary market (government bonds, bank deposits) and the investments on the capital market (in stock shares); the efficiency of the municipal bonds in Romania is generally the highest efficiency that can be obtained from fixed income instruments available to common public.

Annual interest rate index in 2005
Municipal bonds 18,98 - 21,00%
Bills for population (issued for 6 months) 15,00%

Government bonds with an interest rate (for 3 years) 12,89%
Government bonds with an interest rate (for 2 years) 13,95%
BCR bank deposits interest rate (1 year, payment on the due date) 15,00%
BRD bank deposits interest rate (1 year, payment on the due date) 14,75%

The financing of local budgets in our country poses great problems for the state budget because the budget income for this sector decreases every year. This aspect had important consequences for the **Baia Mare municipality** in the last few years.

In the case of the town of Baia Mare, the **municipal bonds** are profitable instruments both for the **investor**, and for the **issuer**. Consequently, using this type of financing method for own projects by the local municipal administrations means to obtain lower costs as compared to the bank credits, a better monitoring of the obtained funds (regular reports on the payment of the interests, the capital and the use of the obtained funds) which increases the trust of the investors in this type of instruments.

The issue of these bonds for the investment project “The modernization of the water supply network, stage II” for Baia Mare brings a series of benefits both for the investors, and the issuer. This project will provide all the inhabitants of Baia Mare with water supply according to pressure areas in all distribution networks. By its whole fiscal and tax power, the **municipality of Baia Mare** guarantees the payment of the interest and the capital on the due dates for the bonds.

Another big advantage – from the point of view of the **issuer** – is the very short period of time, taking into account that the works are planned to be finished in maximum one year with lower costs. The results of a previous analysis concerning applying for bank credits entailed higher costs and a period of 5 years.

The main advantages for the **investor** are as following:

- This is a secure investment method guaranteed by the state.
- The rate of interest for the bonds is higher than the one for the bank units.
- The profit obtained after these investments is not subject to state taxes.
- The commission imposed by the bank on subscribing cash bonds by the clients is paid by the Issuer.

In the near future one could expect a rise of the number of issuers of municipal bonds, still having a lower rate than the rise of issue, taking into account that some municipalities have reconsidered this financing method, going through two or even three bond issues.

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