

## Analyses of foreign portfolio investment at Bucharest Stock Exchange in Global Financial Crisis

Daniela Enăchescu, Petroleum and Gas University of Ploiesti, Romania, [denachescu22@yahoo.com](mailto:denachescu22@yahoo.com)  
 Mirela Matei, Petroleum and Gas University of Ploiesti, Romania, [mirematei@yahoo.com](mailto:mirematei@yahoo.com)  
 Dorel Dumănescu, Petroleum and Gas University of Ploiesti, Romania, [doreld@upg-ploiesti.ro](mailto:doreld@upg-ploiesti.ro)

### Abstract

*The globalisation of financial markets, facilitated by new technology, under which a shock in one region is rapidly transmitted to other centres all over the globe, had ensured that, in less than a year, the USA financial crisis has spread across the continents, including countries that are not so very linked regarding financial markets.*

*The capital market in Romania is a market of shares, bonds market being in a process of development, a phenomenon specific to the countries of Central and Eastern Europe. Unfortunately, the weak integration of our stock exchange on international and European financial market and a poor transparency of the transaction at BSE established a masive turmoil of the BSE activity.*

*In this paper the authors will try to analyse the impact of the USA financial crisis in Romanian Stock Exchange markets, especially the foreign portfolio investment in BSE.*

**Keywords:** financial crisis, BSE, foreign portfolio investment

### 1. Introduction

As economic turmoil spreads around the world, Romania, as an emerging market and country, is not protected. The development of IT&C, microtechnology, especially in the field of communications, the Internet and global networks, have served as a vehicle for globalisation, especially for financial markets. Facilitated by new technology, globalisation is increasing finance-schock wave.

The globalisation of financial markets, under which a shock in one region is rapidly transmitted to other centres all over the globe, had ensured that, in less than a year, the USA financial crisis has spread across the continents, including countries that are not so very linked regarding financial markets.

In this paper the authors will try to analyse the impact of the USA financial crisis in Romanian Stock Exchange markets, especially the foreign portfolio investment in BSE.

### 2. The set up and evolution of Bucharest Stock Exchange

The Bucharest Stock Exchange was established later compared with other countries from Central and Eastern Europe. The first regulations regarding securities have existed since 1990, when Law no.

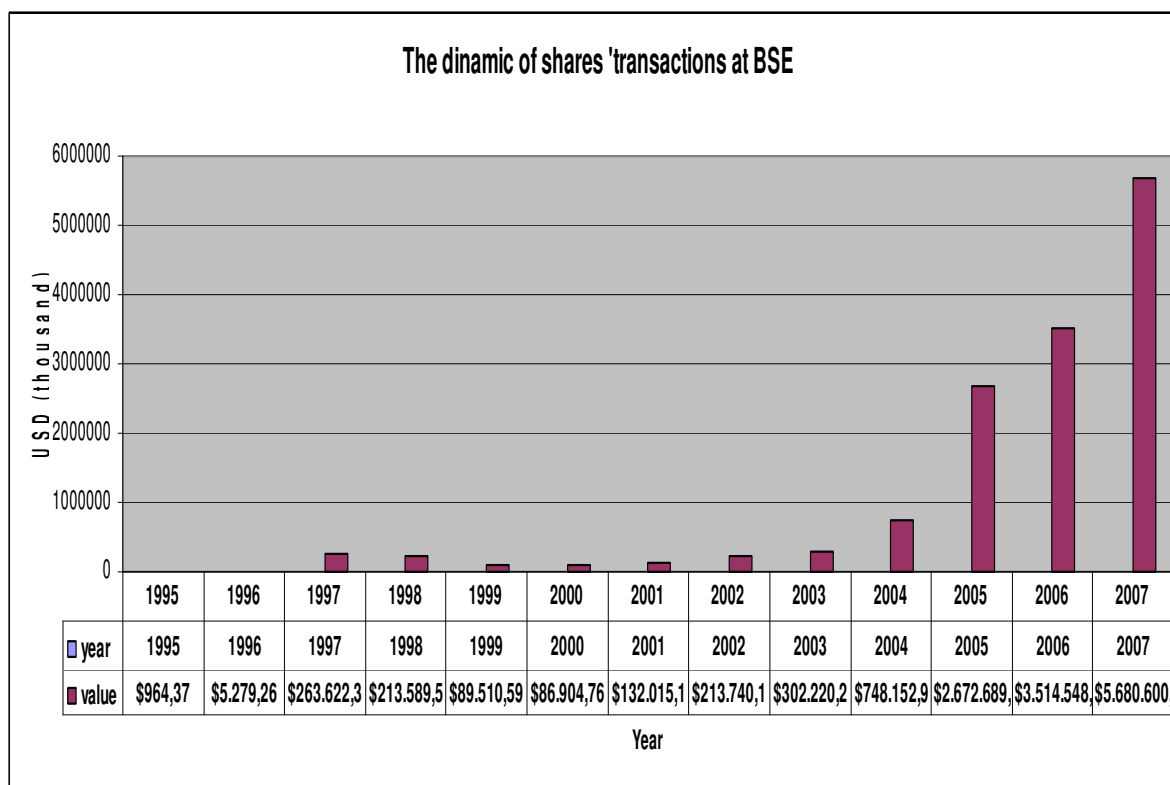
15/1990 on the processing units of state in companies and Law no. 31/1990 on companies, came into force. The Law no 31/1990 is governing the issue of shares and bonds by Romanian companies. Given the economic and political context, the emergence and development of the capital market in Romania was due to the initiation and conduct of the privatization process. Thus, Law no. 58/1991 regarding the privatization of state owned companies imposed the emergence of capital market and related legislation to allow trade, in an organized manner, of the vouchers shared to the population in the Process of Mass Privatization. Although the deadline imposed by this law, for adopting the law of securities and stock exchanges was 6 months; the law (no. 52/1994) was introduced in time for the Government, but it was approved by Parliament until after two and a half years, in 1994. [1]

On the basis of Law no. 52/1994, the National Securities Commission, the Bucharest Stock Exchange and RASDAQ were created. With the emergence of capital market, companies are able to mobilize the funds available in the economy and may be financed through issues of shares and bonds, which become effective such alternative funding compared to bank credit. In addition, stock markets provide efficient allocation of funds, financial investors punishing companies characterized by lack of efficiency or reduced profitability. Thus, the economic situation of companies is reflected in the market price of shares listed on stock exchange and is influencing investors' interest not only for existing securities, but for shares and bonds subject to public primary offers. Some offers of bonds issued by private companies were not successful due to the high degree of indebtedness of the issuing companies. These examples illustrate the exigent operation in capital market and rational attitude of investors. In addition, stock-market indexes, calculated by the capital market institutions or brokerage firms, are important tools used by investors in evaluating the performance of securities and management of portfolios of financial securities.

Since the set up, Bucharest Stock Exchange and RASDAQ - the two fundamental institutions of capital market in Romania - have gone several steps to adapt to market requirements and international standards. As a result of progress in the field of information and communication technology (ICT), capital market activity in Romania has been computerized since the beginning of its establishment. Thus, although BSE has made initial transactions in classical system by brokers meeting in

the pit, in present, transactions are conducted with electronic systems.

launched (futures contracts, options, preference rights), that are in dramatic extension.



*Fig.1. Dynamic of share's transactions at BSE*

*Source: www.bvb.ro*

RASDAQ market, since its establishment, was an electronic market. Therefore, using the "tools" offered by information technology and communications has allowed the "burning" of some development's stages of stock exchange activity in our country and the alignment with the practices of major European and American stock exchanges.

Submitting to the trend recorded worldwide in the financial field - consolidation through mergers and acquisitions - in 2005, Bucharest Stock Exchange and RASDAQ have merged. Instead, the merger between BSE and Financial and Commodities from Sibiu has not occurred, the two exchanges trying to start some process of development on their own and collaboration with other foreign exchanges. In this respect, we mention the collaboration between BSE and the Vienna Stock Exchange, with the result of the launch ROTX index that is calculated based on six blue-chips listed on BSE. In this way, data from Romanian stock exchange market become accessible to Austrian and European investors.

The development of the Romanian capital market is influenced both by improving legislation in this area, which was aligned to the European Union standards and the diversification of securities

In this respect, we mention the legislative changes and the Bucharest Stock Exchange's concern for stability of capital market, resulting in reducing the number of listed companies, being withdrawn the companies that have not complied the exchange regulations.

Also, in some cases, major shareholders have wanted a change in society's regime, moving from an open society (listed on the exchange) in a closed society, especially in the situation of companies with foreign capital. However, the volume of transactions are conducted on an upward trend (figure 1) between 1995-2007, although there have been years in which value of transactions fell down compared to previous years. In this context, years 1998 and 1999 are remarked because, the decrease of GDP, influenced by weak economic situation, put the fingerprint on stock activity (compared with 1997, the volume of transactions with shares in 1998 decreased by 5% and in 1999 with nearly 30%).

Table 1: The main indicators for period 1995-2007, Source: www.bvb.ro

Year	Value of transactions RON(thousands)	No. of companies listed	No. of brokerage companies	No. of shares trades	No. of transactions
1995	964374.58	9	28	42761	379
1996	5279262.90	17	62	1141648	17768
1997	263622324.01	76	133	593893605	609651
1998	213589535.14	126	173	986804827	512705
1999	89510594.07	127	150	1057558616	415045
2000	86904761.06	114	120	1806587265	496887
2001	132015138.58	65	110	2277454017	357577
2002	213740130.54	65	75	4085123289	689184
2003	302220205.87	62	73	4106381895	440084
2004	748152938.28	60	67	13007587776	644839
2005	2672689146.44	64	70	16934865957	1159060
2006	3514548785.99	58	73	13677505261	1444398
2007	5680600844.13	59	73	14234962355	1544891

Despite oscillations extended on short term, we notice the boom of stock exchange's activity since 2000, the annual growth rate are impressive, especially as, during this period, the inflation cut down, and consequently the registered increase is real.

In the first phase, 1995-2001, due to permissive legislation and to the desire to win immediately, the number of brokerage companies was relatively high in relation to market requirements and criteria for their effectiveness. Subsequently, the National Securities Commission and the Bucharest Stock Exchange, in order to improve the quality of capital market, have resorted to reducing the number of brokerage companies operating in this market, excluding the non-efficient companies from the point of view of financial capital and intermediate transactions. This measure has ensured the access to the most important component of the capital market, only the big brokerage firms, which having financial resources and qualified personnel, help to strengthen the market. Scandal of shares' theft, offence committed by some employees of brokerage firms that have abused the lack of information to individuals who have obtained the shares through the Mass Privatization Program, was another factor that has contributed to the disappearance of many brokerage companies.

Decrease in the number of intermediaries has led to an increase in the volume of transactions concluded by a brokerage company.

According to data presented in table 1, it is observed not only increasing the number of shares traded, but also increase the average volume of transactions and the average value of a transaction intermediated by a brokerage company.

The development of capital market and the increased investors' interest for Romanian securities are reflected in the intensification of activity in the stock exchange and in increase of the volume of transactions especially after 2000. Thus, only in the period 2000 -2006 we are registering a growth of 32.5 times of the total value traded on the Bucharest Stock Exchange (listed and unlisted shares and bonds), from 93.24 million Euro to 3030.37 million Euros; the main part of these transactions are done with shares of companies listed. Intensification of transactions has increased securities' prices, a fact highlighted by increase of the indicators' value like PER (price earning ratio), market price/nominal value and by decrease of dividend yield, as a result of the table 2.

Table 2: Evolution of some indicators in period 2000-2007, Source: [www.bvb.ro](http://www.bvb.ro)

Year	PER	Market price / nominal value	Dividend yield
2000	3,98	0,41	7,48
2001	4,92	0,45	6,70
2002	9,12	0,84	4,97
2003	13,10	1,01	2,00
2004	35,18	2,29	1,45
2005	24,05	3,28	0,92
2006	18,03	2,72	1,72
2007	19,37	3,05	2,16

### 3. The impact of financial crises on BSE's activity

The financial turmoil began in 2007 and has encompassed securities market and banking sectors from developed and developing countries. The financial crises start in USA after the collapse of subprime mortgage market. The consequences were bankruptcies, forced mergers and interventions of

public authorities. Short-term variation of foreign investments in BSE is a transmission instrument of financial crises. Because foreign direct investments is long term investments, theirs volatility degree is low. Foreign direct investors set up companies and they are interested in the development on long term. Portfolio investments have a great grade of volatility and they are soon affected by financial crises. Despite dramatic actions taken by authorities from developed countries to prevent the systemic risk and to help banks with liquid assets, financial market risks remain acute [2]. Emerging economies are more vulnerable to turbulence on financial markets and depends on factors like the development of capital market and monetary market, the access to foreign funds, the importance of foreign direct investment and the power of monetary authorities.

The capital market in Romania is a market of shares, bonds market being in a process of development, a phenomenon specific to the countries of Central and Eastern Europe. Although the legal provisions regarding bonds have been issued since 1990 (Law no. 31/1990 on companies), the first bonds issue was occurred quite late and the interest on the bonds has intensified since 2001.

The development of this market is sustained by international financial institutions like International Bank for Reconstructions and Development and European Bank for Investment. The bonds market has small dimensions and data of non-residential investors are not available from Bucharest Stock Exchange. Because of that, we analyze only the investments in shares at BSE.

The macroeconomic stability, the new legal framework for financial services available from 2004 and listing of companies with foreign capital, have a dramatic influence in the value of total transactions and on transactions made by foreign investors. After 2004, we have notice the increase of transactions made by non-residential investors. These investors have been involved in purchases and sales of shares, and the trend is a positive sold of transactions made. For the period 2000-2007 (for which we have data), only in 2001 a negative sold of 2,7 million USD was recorded.

The most attractive companies for portfolio investments could be grouped in five categories:

- the five Financial Investments Companies (established as a result of privatization programme that are in fact investments funds): SIF Muntenia, SIF Oltenia, SIF Transilvania, SIF Moldova, SIFBanat Crisana;
- foreign companies: like ErsteBank;
- companies holded by local investors like Carpatia Bank and Transilvania Bank;
- companies with foreign shareholders: Romanian Commercial Banks (that has a major shareholder Erstebank), Romanian Development Bank (where Societe Generale has the majority shares), Petrom (the former state owned company bought by OMV), Alro (company sold in privatization program to Marco Industries), Policolor (held by foreign investments funds), Mechel, Zentiva etc.
- state owned companies like Antibiotice, Translectrica or Transgaz.

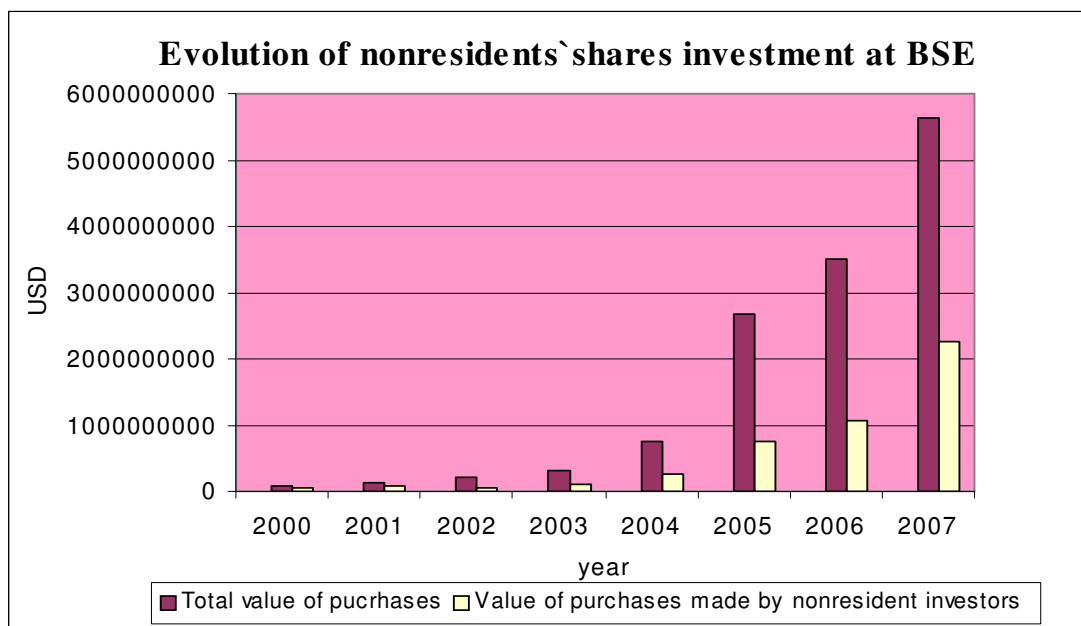


Fig. 2. Evolution of nonresident`s shares investment at BSE

The evolution of nonresidents' shares sales was increasing between 2000-2007, as we see in figure 3, because Romania had a great potential for business and development. Unfortunately, the global financial crisis almost stops the foreign investments, and the emergent countries were the first.

The beginning of the year known a massive going out of foreign capital, but the good evolution of Romanian economy has brought foreign investors, but the amount of the capital was small.

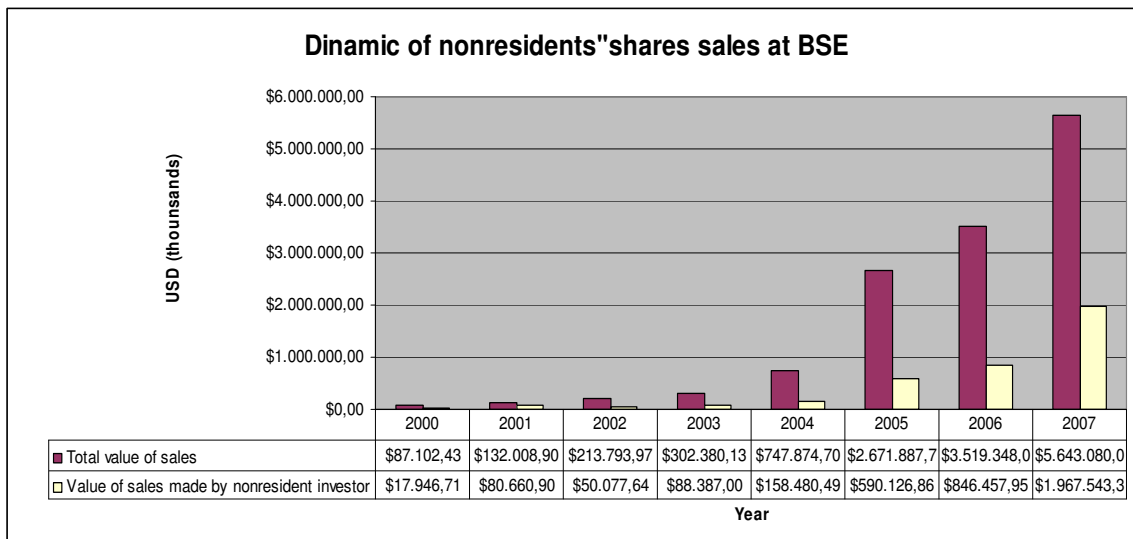


Fig. 3. Dynamics of non-resident's shares sales at BSE, Source: www.bvb.ro

The years 2007-2008 bring spectacular changes for foreign investments' trend at Bucharest Stock Exchange. The impact of financial crisis was shocking and turmoil the BSE activity, especially in foreign investments, as we see in figure 4. The massif withdraw of the foreign capital from the BSE started in July 2007 and continued the whole year and in the first month of the next year.

The analysis of available data for 2008 shows a decrease of foreign investors interest because the month values for purchase and sale cut down and the sold diminished, as in figure 5. The impact of financial crises on Romanian local market is strong. Despite the good financial results of the companies listed at BSE, the turmoil of the foreign markets, especially USA markets, determine the strong decrease of the shares' value.

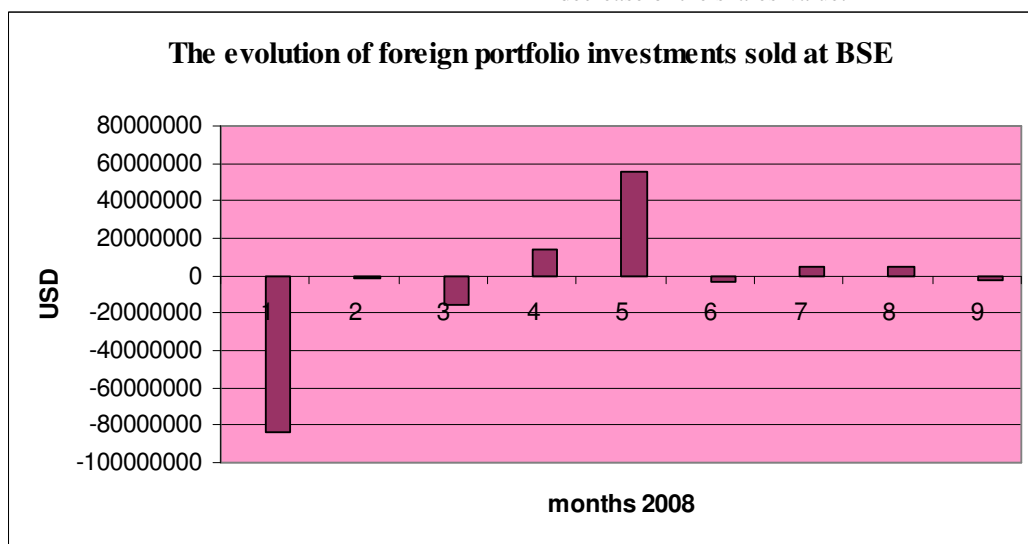


Fig. 4. The evolution of foreign portfolio investments sold at BSE, Source: www.bvb.ro

The local investments were weak and volumes small. A reason is the weak integration of our stock exchange on international and European financial market and a poor transparency of the transaction at BSE.

the region. Thus, in May 2004, Wiener Börse bought 14% of share of Budapest Stock Exchange, the actual percentage being of 12,5 %, after technical capital operation. Wiener Börse is interested to purchase a stock of shares that belongs to Sofia Stock Exchange.

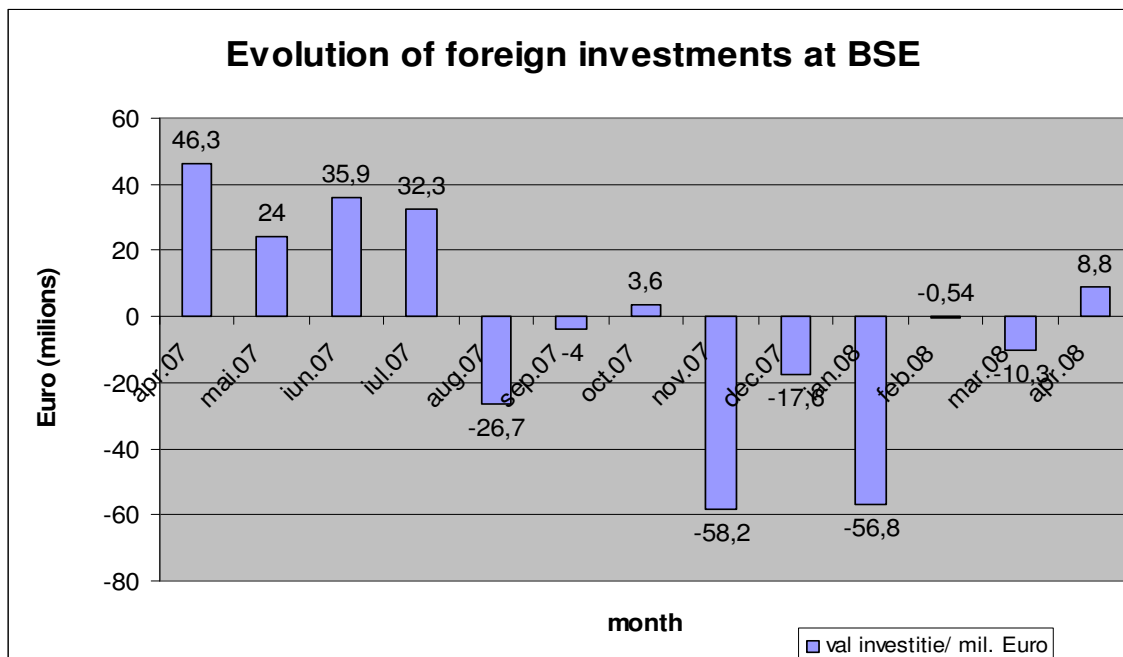


Fig. 5. Evolution of foreign investments at BSE

At international level, the financial integration of exchanges has been accelerated and mergers and acquisitions took place even between American and European exchanges. The result is the set up of financial groups like NYSE Euronext Group or CME Group. In Central and Eastern Europe, the echoes of financial integration are weak. The European authorities' initiatives in order to create an integrated financial market are in the first stage.

In order to meet this goal, the collaboration between exchanges is very important. In Central and Eastern Europe, the leader is Wiener Börse, an exchange with tradition that has many collaborations and gives assistance to exchanges from Bucharest, Zagreb, Budapest, Belgrade, Sofia, Sarajevo, Montenegro and Macedonia. In addition, in order to meet the investors' interest regarding the companies from Central and Eastern Europe, this exchange has launched and calculated 14 indexes for companies from Czech Republic, Romania, Hungary, Poland and Russia. Besides these regional indexes, Wiener Börse calculates partial indexes for fields like telecommunications, gas, oil, banks and health and composite indexes like CECE and SETX that comprises the shares traded on a specific national exchange. Next to this initiative, we notice the interest of Wiener Börse for acquisition of shares issued by exchanges from

The strong bond of the Wiener Börse with Central and Eastern Europe is based not only on the above mentioned collaboration but also on results of Austrian companies that have a strong presence in this part of Europe.

### Conclusions

With all combined efforts of state institutions, brokerage firms and companies, the Romanian capital market and its main component - BSE are among the last in European top and has small annual increase comparative with Bulgarian or Belgrade Stock Exchange (table 3).

Regarding the activity of Bucharest Stock Exchange, we can draw some conclusions:

- even if the companies reported raising profits, in period 2007-2008, the price of shares have decreased dramatically; as an emerging market has followed a similar downward trajectory as mature credit market [3] and have demonstrates the herd behaviour [4];
- Romanian authorities made efforts to improve the transparency of our capital market, but the foreign investors are sensible to external facts like American crises even if the local listed companies have as major

shareholders Romanian or European investors;

- the breakdown of Romanian exchanges should not affect our economy because only 5% of our companies are listed on Bucharest Stock Exchange;
- foreign investors leaved our market before the start of international financial crises because they have lack of confidence in Romanian exchange;
- the transmission of financial crises in a rapid process because of globalization and informatisation of exchanges` activity;
- in the period of American election, the results reported on media have influenced the evolution of official index – BET (Bucharest Exchange Trading);
- the process of financial innovation at Bucharest Stock Exchange is modest, the futures contracts on shares, indexes and currencies have been launched in 2007; so, foreign investors do not have many possibilities to operate on Romanian financial market and they rapidly leaved our market.

Stock Exchange and RASDAQ), modest use of capital market in the privatization process of state owned companies; compromise of investment funds after scandals of SAFI and FNI; delay reform of the pension system, the withdrawal of major companies such as Dacia Pitesti, Arctic Găiești or Terapia Cluj Napoca from stock exchange and companies are mainly based on bank credit as financing method. In conclusion, BSE is in the process of development, providing effective alternatives for financing local companies and attractive investment opportunities for Romanian and foreign investors. However, versus other European stock exchanges, BSE`s offer is modest in terms of quality and quantity of products.

Potential development of Bucharest Stock Exchange consists in introducing options contracts on indices, stock and bonds and by the launch of structured products such as warrants or exchange traded funds (ETF). Products offer has to meet the requirements of local and foreign investors who are already accustomed to derivatives launched by the Financial and Commodities Exchange from Sibiu.

In addition, BSE should inspire from major European and American exchanges that runs large financial processes of innovation and launched contracts on weather, volatility indices, price indices for real estate market etc.

Table 3: European exchange`s top (millions USD)

Exchange	Domestic market capitalization 2007	Domestic market capitalization 2006
Athens Exchange	264,960.8	208,256.1
Bucharest Stock Exchange	30,642.0	25,235.0
Bratislava Stock Exchange	6,911.3	5,831.4
Budapest Stock Exchange	46,195.6	41,934.5
Bulgarian Stock Exchange	21,667.7	10,325.0
Cyprus Stock Exchange	29,474.3	16,157.8
Euronext	4,222,679.8	3,712,680.8
Istanbul Stock Exchange	286,571.7	162,398.9
Ljubliana Stock Exchange	28,794.0	15,180.7
London Stock Exchange	3,851,705.9	3,794,310.3
Prague Stock Exchange	68,913.2	44,372.1
Warsaw Exchange	211,620.2	151,809.0
Wiener Borse	236,448.4	199,121.0

The causes of slow development of capital market are numerous and consist of: late establishment of the two parts of the capital market (Bucharest

Another possibility is to create an integrated financial group with exchanges from neighbours` countries. Economical theory and practice suggest that financial



integration and consolidation in European Union will increase the investment opportunities, will generate new business, will reduce the transactions costs and will allocate more efficiently money because some obstacles will disappear. Important modifications are observed on compartmental plan, because institutional and individual investors are more interested in foreign markets than local markets. In spite of this trend, we must draw the attention about the risks of the integration process. The competition will be affected, because some service suppliers could abuse of their position on the market and the risk of contagion among integrated markets could be materialized.

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