The Importance of European Capital Markets Union for the Romanian Companies

Miţac Mirela Claudia
„Ovidius" University of Constanta, Faculty of Economics Sciences
mirela_mitac2002@yahoo.com

Abstract

This paper analyzes the possible impact of European Capital Market Union on the development of Romanian economy. It discusses also the actual size of Romanian capital market, the evolution of it between 2014 and 2016 and the harmonisation of Romanian legislation to European Community aquis regarding the capital market. Another topic is the access of Romanian companies to different sources of financing such as: internal funds, from banks and non-bank financial institutions and from Romanian capital market in period 2014 - 2016. Romania is a country with an undeveloped capital market and Romanian companies will benefit from cross-border financing from European Capital Markets Union if the implementation of this union will succeed in European Union.

Key words: Capital Markets Union; European Union; economy; financing
J.E.L. Classification: F33, F36, G15

1. Introduction

The Capital Markets Union (CMU) is a plan adopted on 30th September 2015 by the European Commission with the purpose to mobilize capital in Europe. It will channel it to all companies, including small and medium-sized enterprises (SMEs), and infrastructure projects that need it to expand and create jobs. By linking savings with growth, it will offer new opportunities for savers and investors.

The Capital Markets Union is a new frontier of Europe's single market the completion of which is due to extended from 2015 to 2019.

Deeper and more integrated capital markets will lower the cost of funding and make the financial system more resilient. All 28 Member States of the European Union (EU) will benefit from building a true single market for capital.

The free flow of capital was one of the fundamental principles on which the European Union was built. Despite the progress that has been made over the past 50 years, Europe's capital markets are still relatively underdeveloped and fragmented. The European economy is as big as the American one, but Europe's equity markets are less than half the size, its debt markets less than a third. The gap between Member States is even bigger than that between Europe and the US. More integrated capital markets will lead to efficiency gains and support Europe's ability to fund growth.

The European Commission presented in paper *Action Plan on Building a Capital Markets Union* the importance of Capital Markets Union. In this case stronger capital markets will complement Europe's strong tradition of bank financing, and will:

- **Unlock more investment from the EU and the rest of the world:** Capital Markets Union will help to mobilise capital in Europe and channel it to all companies, infrastructure and long term sustainable projects that need it to expand and create jobs. It will provide households with better options to meet their retirement goals.
- **Better connect financing to investment projects across the EU:** Member States with small markets and high growth potential have a lot to gain from a better channelling of capital and investment into their projects. Member States with more developed capital markets will benefit

from greater cross-border investment and saving opportunities.

- **Make the financial system more stable:** integrated financial and capital markets can help Member States share the impact of shocks. By opening up a wider range of funding sources, it will help to share financial risks and mean that EU citizens and companies are less vulnerable to banking contractions. Furthermore, more developed equity markets, as opposed to increased indebtedness, allow for more investment over the long term.
- **Deepen financial integration and increase competition:** more cross-border risk-sharing, deeper and more liquid markets and diversified sources of funding will deepen financial integration, lower costs and increase European competitiveness.
- **Enhancing the capacity of banks to lend.** As lenders to a significant proportion of the economy and intermediaries in capital markets, banks will play a central role in the Capital Markets Union. Banks have strong local relationships and knowledge: bank lending will continue to be the main source of funding for many businesses alongside capital markets.

In this sense, the Commission will:

- Revitalise simple, transparent and standardised European securitisations to free up capacity on banks' balance sheets and provide access to investment opportunities for long term investors;
- Explore the possibility for all Member States to benefit from local credit unions to operate outside the scope of the EU's capital requirements rules for banks;
- Assess whether and how to build a pan-European covered bond framework, building on national regimes that work well, and explore the feasibility of similar funding tools for SME loans.

Put simply, Capital Markets Union will strengthen the link between savings and growth. It will provide more options and better returns for savers and investors. It will offer businesses more choices of funding at different stages of their development.

(European Commission, 2015, p.3)

2. The evolution of the Romania's capital market between 2014 and 2016

The Romanian capital market, which is one of the smallest market in European Union compared to the country's size, was characterized in period 2014 - 2016 by a low volatility, excepting the period between January and February 2016, due to the turbulence of the financial markets from China, and in June 2016 when was expected the result of Great Britain' referendum. (Financial Stability Authority, 2016).

The total amount of transactions carried on by the Bucharest Stock Exchange (BVB) and Alternative Trading System (ATS), which is a part of BVB recorded a decreasing from year to year between 2014 and 2016, from 14.424.168 mil ron in 2014 to 12.156.263 mil ron in 2015 and to 11.250.787 mil ron in 2016. (see Table no. 1 and Figure no. 1)

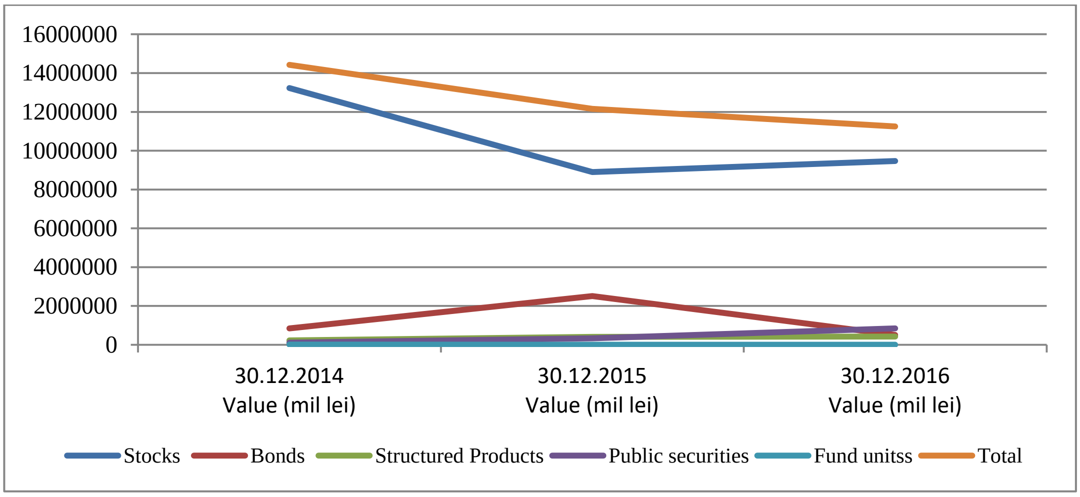
At the same time the number of transactions diminished from a year to another in analyzed period. (see Table no. 1 and Figure no. 2)

Table no. 1 The structure of the Bucharest Stock Exchange and of the Alternative Trading System transactions between 2014 and 2016, upon the value of each instrument component

Instrument	30.12.2014			30.12.2015			30.12.2016		
	Number of transactions	Value (mil lei)	%	Number of transactions	Value (mil lei)	%	Number of transactions	Value (mil lei)	%
Stocks	860.333	13.229.475	91,7%	716.902	8.897.383	73,19%	706.508	9.465.811	84,13%
Bonds	245	842.102	5,8%	535	2.509.441	20,64%	783	506.068	4,50%
Structured Products	197.177	227.807	1,6%	299.750	406.304	3,32%	247.613	427.910	3,80%
Public securities	148	113.608	0,8%	1.535	338.373	2,78%	23.107	846.873	7,53%
Fund units	3.572	11.176	0,1%	2.320	7.762	0,06%	2.364	4.125	0,04%
Total	**1.061.475**	**14.424.168**	**100,0%**	**1.021.042**	**12.156.263**	**100,00%**	**980.375**	**11.250.787**	**100%**

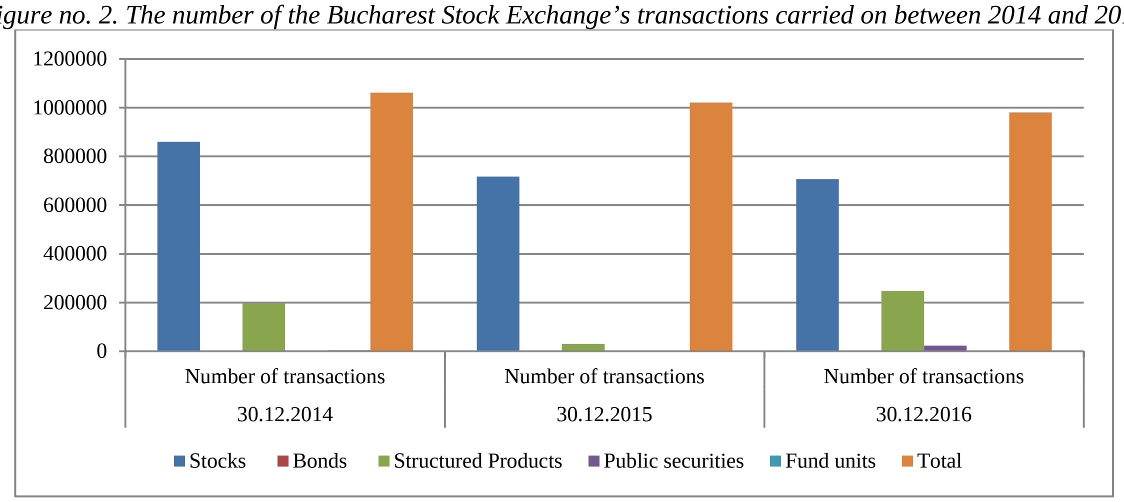
Source: Financial Stability Authority (2015, 2016)

Figure no. 1.The evolution of the volume of the Bucharest Stock Exchange's transactions between 2014 and 2016



Source: Financial Stability Authority (2015, 2016)

Figure no. 2. The number of the Bucharest Stock Exchange's transactions carried on between 2014 and 2016



Source: Financial Stability Authority (2015, 2016)

In structure, the evolution of the volume of different types of instruments carried on the BVB in period 2014 – 2016 are presented in Table no.1 and in Figure no.3.

The transactions with stocks, which had held in all years the important percentage in total transactions with more than 73%, recorded a variation between 2014 and 2016, decreasing from the value of 13.229.475 mil ron (91,7% in total transactions) registered in 2014 to 8.897.383 mil ron in 2015 (73,19% in total transactions), then in 2016 grew to 9.465.811 mil ron (84,13% of total transactions).

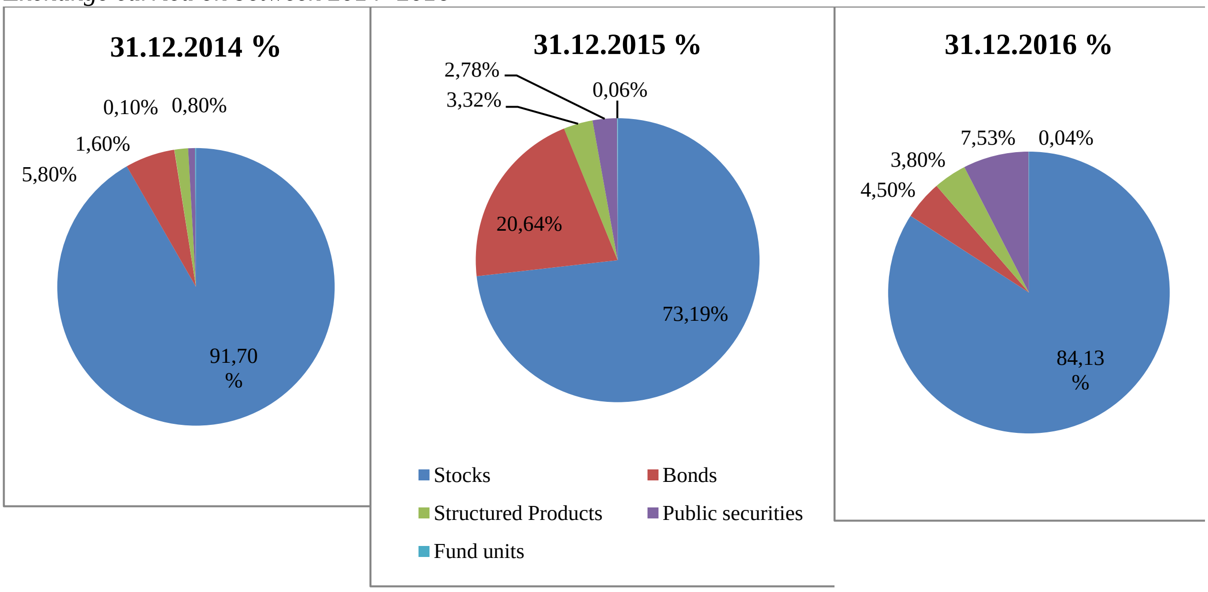
The transactions with bonds recorded a fluctuation trend, increasing from 842.102 mil lei (5,8% of total transactions) in 2014 to 2.509.441 mil ron in 2015 (20,64% of total transactions) and finally decreasing with more than 80% at 506.068 mil lei (4,50% of total transactions) in 2016.

The structured products scored an upward path from a year to another upturning from 222.807 mil lei (1,6% of total transactions) in 2014 to 406.304 mil ron in 2015 (3,32% of total transactions), almost doubling the value and the share in total deals and in 2016 increasing just with 5% at 427.910 mil lei (3,80% of total transactions).

The transactions with public securities registered a pick up trend, doubling their value, from a year to another, from 113.608 mil ron (0,8% of total transactions) in 2014 to 338.373 mil ron (2,78% of total transactions) in 2015 and finally to 846.873 mil ron (7,53% of total transactions) in 2016.

The fund units recorded a downward path from a year to another and had a percentage of under 0,1% of total transactions in all years (their value decresing from 11.176 mil ron in 2014 (0,1% of total transactions), to 7.762 mil ron in 2015 (0,06% of total transactions) and to 4.125 mil ron in 2016 (0,04% of total transactions).

Figure no. 3. The evolution of the weight of each instrument in total transactions of Bucharest Stock Exchange carried on between 2014- 2016



Source: Financial Stability Authority (2015, 2016)

In order to implement the harmonization of legal regulations regarding the capital markets union the important reforms on the capital market taken by Romanian's policy makers were as follows:

- in 2014 was initiated the STEAM (Set of actions Towards Establishing and Acknowledgment of the emerging Market status) project which is based on a programme with a set of objectives that aim to eliminate the shortcomings that still keep Romania in the frontier markets area. Financial Stability Authority's main lines of action to reach STEAM objectives are structured on 5 great pillars, with achievements listed below:
  - PILLAR 1: Revision of primary and secondary legislation
  - PILLAR II: Consolidation and modernization of capital market infrastructure
  - PILLAR III: Development of bonds market
  - PILLAR IV: Increasing the number of issuers and capital market liquidity
  - PILLAR V: Development of retail market and financial education
- a series of structural reforms meant to improve its functioning, such as clarification of the status of the RASDAQ (Romanian Association of Securities Dealers Automated Quotation) market, implementing the European directives on the collective investment undertakings and the managers of alternative investment funds, thus stimulating market development, dismantling barriers identified through the STEAM project and increasing the competitiveness of the capital market. The activity of the RASDAQ market and of the unlisted securities market ceased rightfully on October 27th 2015.
- Law no.74/2015 on the managers of alternative investment funds was enacted, transposing into the national legislation the provisions of the AIFM Directive (Directive on Alternative Investment Fund Managers). To implement this law and in order to clarify some of the provisions of the Delegated Regulation of the EU no. 231/2013 on implementing AIFMD, FSA issued the Regulation no.10/205 on managing alternative investment funds.
- 2015 was also the year for adopting the law that amend the Emergency Order no.32/2012 aiming to transpose the (EU) Directive no.91/2014 as regards depositary functions, remuneration policies and sanctions applicable to undertakings for collective investment in transferable securities (UCITS V).

Financial Stability Authority supported the initiation, drafting and enactment of the Government Order with the purpose to eliminate the following barriers that currently prevent Romania from classifying to emerging capital markets status and which is a real obstacle to diversifying financing sources through the capital market:

- the lengthy and complicated process for foreign investors to open a trading account in Romania;
- difficult processes for investors to exercise their fundamental rights (e.g.: the right to receive dividends, the right to vote in the General Shareholders Meeting);
- certain thresholds applied to holding shares issued by the market operators which make it impossible to take strategic decisions, thus hindering the functioning of these entities and negatively impacting the local capital market;
- provisions on the public offers of securities and admiting securities for trading on regulated markets which can be modernized and rendered efficient according to European best practices. (Financial Stability Authority, 2015, p. 15)

3. The evolution of Romanians companies access to financing in period 2014-2016

The results of the Surveys on the access to finance of non-financial corporations in Romania and their capacity to withstand adverse financial conditions conducted by the National Bank of Romania between 2014 and 2016, twice a year, are the following:

- most companies in the sample (around 80 percent) responded that they had not applied for financing from financial institutions;
- nearly 20 percent of companies indicated that access to finance is a pressing problem. Also, the main difficulties faced in accessing financing from banks and non-bank financial institutions were the overly high level of interest rates and commissions, the requirements regarding the value or type of collateral, and bureaucracy.
- companies continued to rely mainly on internal funds, for financing their activity, for investment or other financing needs, with more than 64 percent of respondents turning to retained earnings/sale of assets or to loans from shareholders or capital increases as a financing source. The bank financing was one of the less-tapped sources, approximate 20 percent of companies preferring this means of financing. The use of European funds was insignificant, with more than 98 percent of firms responding they had not resorted to such funds. At the same time Equity and debt securities issuance used as a source of finance by companies recorded an insignificant percentage, below 0,5 percent of total firms.

4. Conclusions

The Capital Markets Union' main goal is to develop non-banking financing on the economy in a context in which bank lending flows are diminish their level. Also, the bank lending will continue to be the main source of funding for many businesses alongside capital markets in European Union.

The Capital Markets Union will try to make less costly for businesses to raise funds publicly, review regulatory barriers to small firms listing on equity and debt markets and support the listing activities of small firms through European advisory structures.

The other objectives of Capital Markets Union, presented in the European Commission' paper - *Action Plan on Building a Capital Markets Union* are:

- to support venture capital and equity financing in the EU, including catalysing private investment using EU resources through pan-European funds-of-funds, regulatory reform, and the promotion of best practice on tax incentives;
- to promote innovative forms of business financing such as crowd-funding, private placement, and loan-orginating funds whilst safeguarding investor protection and financial stability; and
- to explore ways to build a pan-European approach to better connect SMEs with a range of funding sources.

Taking into account the fact that between 2014 and 2016 the Romanian companies:

- had relied mainly on internal funds, for financing their activity, for investment or other financing needs (approximate 65 percent of total companies);
- had used the financing from banks and non-bank financial institutions into a small number, in ratio just nearly 20 percent of companies;
- had funded from Romanian capital market (using equity financing and debt securities issuance) into an insignificant proportion of only 0,5 percent of total firms included in Surveys on the access to finance of non-financial corporations in Romania and their capacity to withstand adverse financial conditions conducted by the National Bank of Romania in period 2014 – 2016

and that the access to finance represented a major problem for Romanian enterprises, mainly due to the overly high level of interest rates and commissions, the requirements regarding the value or type of collateral, and bureaucracy, in my opinion, the integration of the Romanian capital market into the European capital markets union will have a possible positive effects, regarding the development of Romanians companies and the growing of Romanian economy because:

- will complement the banking financing with the financing from developed capital markets and also will increase the financing period for long terms;
- will provide more funding choices for Romania's enterprises at different stages of their businesses development and of different markets, not only on the national market, firms could seeking funding in another European Union member state and
- the companies costs of access to financing products will converge across the European Union, diminishing their level in Romania.

The increasing and diversification of the financing sources of Romanian's firms could lead to a development of their activity, could fund their expansion (hire more workers - have the potential to grow into future large employers) and finally could determine a general development of Romanian society (generating a turover growth an also an employment growth) and an growth path of Romanian economy.

5. References

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