

Importance of Non-banking Financial Institutions and of the Capital Markets in the Economy. The Case of Romania

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***Abstract.** Deep and broad financial markets facilitate savings mobilization, by offering both individuals and insitutional savers and investors additional instruments and channels for placement of their funds at more attractive returns than are available on bank deposits. Bank and non-bank financial intermediation are both key elements of a sound and stable financial system. Both sectors need to be developed as they offer important synergies, meant to foster economical growth. While banks dominate the financial systems in most countries, business, households, and the public sector rely on the availability of a wide range of financial products to meet their financial needs. Such products are not provided only by banks, but also by insurance, leasing, factoring, and venture capital companies as well as mutual funds or pension funds.*

Key words: financial intermediation; capital market; economical growth.

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JEL Codes: G21, G32.

REL Codes: 8E, 11B, 11E.

1. The development of the financial system and the economical growth

The financial system unifies the capital demand and offer through banks, capital markets, and other financial intermediaries like mutual funds, pension funds, leasing companies or factoring companies. An efficient and well-functioning financial system mobilizes collects the saving realized by the entities that, after they satisfy their own objectives of investment and consumption, have a financing capacity for channeling it towards those units that, for realizing their investing objectives, need financing. In the same time, the financial system offers an efficient payment and clearing system, in this way facilitating the financial transactions. One of those economists who have opted for this kind of thought is Ross Levine who assures the fact that “a theoretical as well as an empirical constant work volume tends to make even the most skeptical to believe that the development of the financial system is a determinant of the economical growth, and not only a passive answer to this growth.” Levine and the others that share his opinion believe that there are inherent relations between financial intermediate and productivity and, as the amelioration of the productivity level produces on a long-term benefic effects on the level of economic development, it can be said that also the financial intermediate generates economical growth. Moreover, Levine suggests that the development of the financial system has an important positive effect over the economical growth saying that “it can be eliminated a third of the already existent

inequality between the countries with an important growth and those with a slow growth through the development of the financial intermediation for the latter ones until they reach a developing level comparable with the one of the countries with a quick development”. The positive association between the degree of development of the financial system and economical growth was at large analyzed also by Demirgüç-Kunt (2006), as well as Beck, Demirgüç-Kunt, Levine and Maksimovic (2000, pp. 2-12). Moreover, they prove that regarding a country with a developing financial system the degree of financial development is correlated not only with the current growth, but also with the future economical growth.

Access to finance is crucial for the creation and maintaining a certain position on the market, as well as sustaining the private sector of an economy. The lack of alternatives in reaching adequate finance resources make it almost impossible to develop in well conditions the current activities of a firm and, most of all, to realize those investments required for developing its activity. A survey realized by World Bank in 2000⁽¹⁾ upon 80 firms from developed and developing countries reached the conclusion that, after taxes, financing represents the secondly most important obstacle in initiating and developing the normal activities of a firm. Having a wider range of financial products, the firms have an increased growth. Starting from this survey, recent research

has proven the fact that financing is the main constraint in reaching economical growth (Ayyagari, Demirgüç-Kunt, Maksimovic, 2002, pp. 2-10). More precisely, they mention that developing the financial system leads to an increased productivity of the firm, increased competition and innovation and lower costs of transactions. These, further, lead to economical growth. According to some recent studies, increasing the percent of the banking assets, respectively the percent of the market capitalization of a country in its GDP, has been positively correlated with increasing the GDP per capita. This thing is easy to understand taking into consideration the fact that a significant growth and a well-functioning financial system is essential for the economical growth and prosperity of a nation⁽²⁾.

For the maintaining of a healthy and stable financial system, both banks and non-banking financial intermediaries have to be well-developed and offer a varied range of financial products. The necessity of further developing the activity of the non-banking institutions is essential for any developing economy, including the Romanian economy. Through providing alternative and varied financial services, they assure the medium and long-term financing, which represents most of the times a challenge for the bank-based economies. In the same time, they increase the competition, competing with the banks for attracting those medium and long-term funds, sustaining in this way the development of capital market, leasing, factoring and others. Those institutions that collect the savings permit a better diversification and allocation of the risks for those willing to bear it,

reducing systemic risk and offering advanced techniques of portfolio management.

2. Recent evolutions of the non-banking financial intermediaries and of the capital market in Romania

As far as concerns the Romanian financial system, this one suffered, in the last decades, a series of reforms meant to create a more and more competitive environment, for the benefits of the users of this system, and this also led to the development of the economy. With one year of entering the European Union, Romania is making progress in developing the financial non-banking intermediaries and the capital market in the economy, in order to reach the level of economical development and financial development of the other EU member states. One of the main objectives is the one of having a similar mature financial market, capable of offering modern financial services.

If we take into consideration the above statements and if we analyze at the level of the current Romanian financial system (Figure 1), we can notice that the activity of the banking system, as well as the one of the Romanian capital market had an upward trend which is correlated with the economic growth of Romania from the last few years. But for having a stable and healthy financial system the non-banking intermediaries as well as the banking ones have to develop for realizing important synergies at a national level. While in Romania the banks are dominant over the financial system, the traded companies, individuals, and the

public sector as entities with financing needs have to have a variety of financial instruments in order to reach their financial objectives. Unfortunately, the degree of choosing other financing sources except the traditional ones is very small.

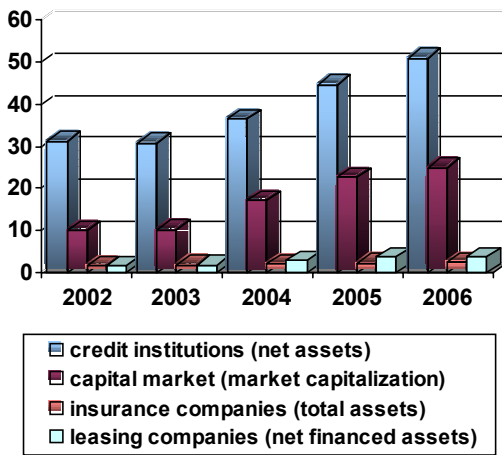


Figure 1. Principal components of the financial system (% in GDP)

The capital market is the only that started to be attractive for those with surplus capital and this is, lately, a growing tendency favorable to the Romanian economy. In our opinion, this thing was due to the favorable modifications in the local economic environment, to the growth of the incomes of the population and to some rearrangements in the investors' structure. But for encouraging this fact it is necessary the growth of the stock market's transparency, sustaining the principles of corporative government, providing a wide and adequate offer of financial instruments on the stock market and the adoption of adequate costs structure. All of these could lead the domestic capital market to a more and more important place in the European stock markets. A more liquid and efficient stock market will allow the Bucharest Stock

Exchange to increase its presence between the international financial organizations and to maintain more and more tight contacts with the other European stock markets.

With a pretty devious evolution, the joint-stock market seems to have got to a certain maturity which can lead to future quantitative, but especially qualitative growth. Regarding the bond market, Romanian capital market is characterized by an insufficient development of the bond primary market and secondary market. In April 2008, at The Stock Exchange Bucharest there were only 26 bonds quoted, of which only 4 corporate bonds, the other 20 municipal bonds and 2 international bonds. Moreover, analyzing the value of the transactions that took place in the first four months of 2008, we can see that only 2% of this is due to the bonds, the listed actions at BVB having a contribution of 98%⁽³⁾. It is obvious the fact that the bonds transactions are not as far as attractive as the stock ones, thing that determines a reduced liquidity for the investors of this kind of securities.

Another positive fact associated with the Romanian capital market noticed by the statistics is the fact that in the last period took place a growth in the number of companies relevant for the issuers from the regulative market: reducing the concentration of the capitalization of the market. The concentration of the market capitalization is one of the characteristics to the emergent capital markets, category where there are also included the capital markets from Central and Eastern Europe. The year 2006 followed a tendency imprinted two years before. If in 2004 the first five listed companies cumulated over

83% from the total of the market capitalization, and in 2005 these cumulated only 80%, at the end of the last year exchange capitalization of the most important five companies from BVB got under 75% from the total of the market⁽⁴⁾. With the access on the market of many Romanian companies, there are premises of a higher reduction than these percentages.

The economical growth of Romania⁽⁵⁾, remarkable for the emergent countries, had as a consequence the growth of the market capitalization. After this indicator and the one of the volume of transactions (Euro), the Romanian capital market gets the fourth place in a ranking made with the capital markets of the countries from Central and Eastern Europe⁽⁶⁾. The growth potential of the Romanian capital market is extremely high, due to the new companies expected to move from Rasdaq to BVB, but also to the increase in the level of economical and financial performances of the current issuers. On the other hand, the recent trends in the financing patterns of the European economies show that prove that the role of financing the economy by the capital market began to increase significantly in the last years and suggest a transformation of the bank-based economies in market-based ones. Although the current financial structure of the EU-27 is based mainly on banks, the growth pace of the capital market overtakes the growth pace of the banking sector⁽⁷⁾. The banking assets had a positive trend, but this trend is decreasing, indicating a continuous and more visible process of financial disintermediation.

The unsatisfactorily situation revealed by the Romanian non-banking financial

intermediaries activity is also presented in the following figure, meant to be a comparative illustration with the main EU-15 non-banking financial intermediaries situation. We notice that in 2004 they had a much more important weight in GDP than the one this sector realizes in Romania (Figure 2).

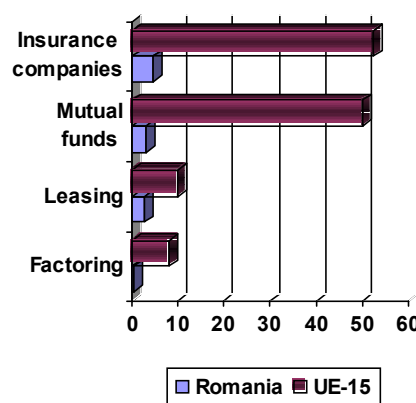


Figure 2. Principal categories of non-banking financial intermediaries and the percent of their assets in GDP- comparative analysis Romania-UE-15 (2004)

The situation of the non-banking intermediaries is considerably improving at a national level. The economical growth experienced by Romania in the last years is the main factor that influenced this improvement and it led to a growth of the incomes.

On the leasing market there is a significant development which confirms the statute of the leasing as financial product complementary and competitive to other banking products and capable of sustaining the development of the various sectors of the national economy. Therefore we can say that leasing has become a mean financing source capable to sustain the development of the different sectors of the national economy to competitive financial costs.

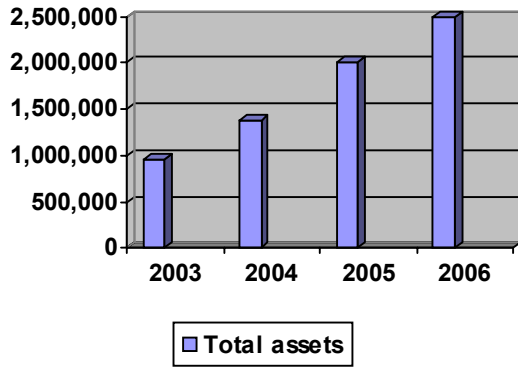


Figure 3. Evolution of leasing market in Romania between 2003-2006

The factoring is present in the Romanian legislation from 2002 and it is extremely useful especially in import-export operations where the need of liquidities and the recovery in short time of the invested funds are in equilibrium. Through factoring, the companies that make trade transactions also benefit by the fact that they can concentrate on the development of the activity, while the agent follows up the cashing and the evidence of the invoices of the factoring. The Romanian companies started to cope with this kind of market in 2001 because there was a lack of the banking offer and the macro-economic conditions were not so good. But the present tendency is of an accentuated growth and the local factoring market is split between BRD (27%), BCR (23%), Rieffeisen (23%), Unicredit (19%), and ABN Amro (12%)⁽⁸⁾.

The pension system reform implied the extension of the bases of the pension system through adding another two pension pillars, along the public pension, stimulating the development of the activity of the private pension funds in their try to achieve a higher volume of compulsory and optional private pensions. In 2016 is predicted that the percentage from the monthly income of any employee for the private pension will

increase with 6%. This thing influences also the local capital market. The experience of the other countries shows that the social security system reform has a significant potential influence over the capital market. The existence of the two pillars is a premise of the intensification of the institutional investors' activity embodied in the private pension funds in their try to find adequate investment instruments. This thing inevitably leads to the creation of some diversified instruments on the capital market, the increase of the liquidity on the market, and a deepening of the financial market as well.

Regarding the local market of the mutual funds, it has a high potential although it is on a reduced level in comparison with other countries in the region. With the decrease of the bank interest rates, the mutual funds start to possess a stronger position on the market. Presently, on the Romanian market there are four categories of mutual funds (monetary, bonds-based, diverse, and stock-based), and the efficiency they offer is in high competition with the one offered through bank deposits. The below table (Table 1) illustrates the predicted growth of the financial assets of the mutual funds between 2006 and 2008, from which we can easily notice that they have the highest growth level predicted for this period.

Annual average growth rate of the financial assets in the period 2006-2008

Table 1

| | Annual average growth rate (%) |
|-----------------|--------------------------------|
| Cash | 15 |
| Bank deposits | 17 |
| Stocks | 17 |
| Mutual funds | 44 |
| Insurance funds | 29 |
| Pension funds | 0 |

3. Conclusions

In conclusion, Romania would gain from the development of the non-banking financial intermediaries, from developing its domestic capital market, and the financial system in general. The reforms from the Romanian financial system have to go on for developing an efficient financial intermediation which is necessary for a sustainable economical growth.

The fact that the Romanian financial market is more and more mature and the trust in its different sectors is constantly growing is also noticeable from the point of view of the reorganization of the assets held by the population. This change has already started and

we can notice that the portfolio of the population has a higher and higher weight towards the acquisition of stocks, bonds, and investment funds titles. This changing was influenced especially by the decreasing tendency of the interest rates. Restructuring the population's assets' portfolio is accompanied by risks and pleads for the need for initiating actions by the authorities for increasing the degree of financial education of the population. The economical entities that function in the economy have started to become aware of the other financing alternatives than the classical ones offered by the banking system and they concentrate more and more on the non-banking financial intermediaries and the capital market.

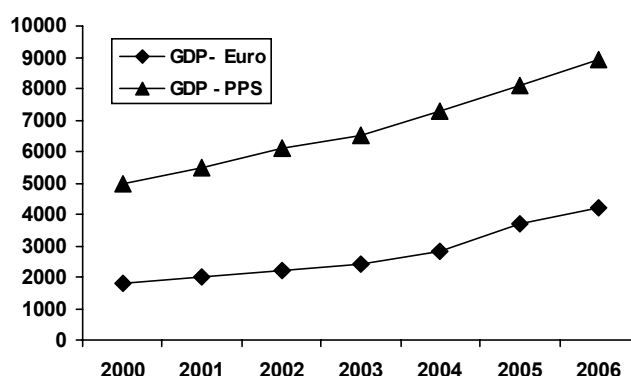
Notes

- (1) World Business Environment Survey, 2000.
 (2) The relationship between financing and growth has been deeply analyzed by Honahan (2001).
 (3) Authors' calculations based on data from BSE (Bucharest Stock Exchange).
 (4) 2006 Annual report of BVB.
 (5) Appendix 1.
 (6) Appendix 2.
 (7) Appendix 3.
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GDP/capita evolution in the period 2000-2006



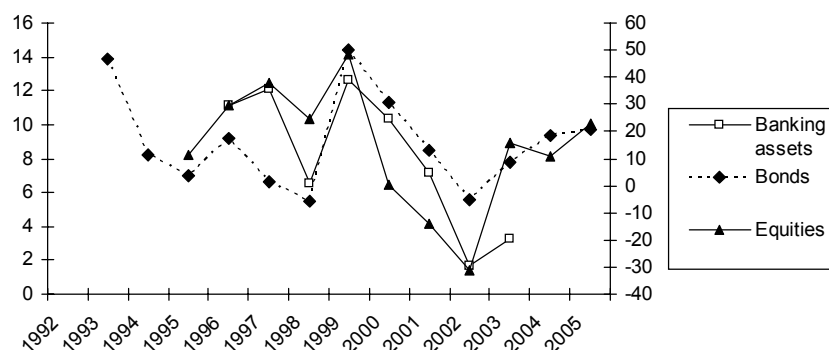
Source: NBR (National Bank of Romania).

The current state of the Romanian capital market in comparison with the other countries from Central and Eastern Europe, members of the European Union

| Country | GDP 2006 (bl. Euro) | Market capitalization (bl. Euro) | Market capitalization/GDP (%) | Volume of transactions 2006 (bl. Euro) | Volume of transactions/Market capitalization 2006 (%) |
|----------------|---------------------|----------------------------------|-------------------------------|--|---|
| Cyprus | 14.5 | 12.3 | 84.5 | 3.343.3 | 27.3 |
| Czech Republic | 112.6 | 34.7 | 30.8 | 30.015.4 | 86.5 |
| Estonia | 12.8 | 4.6 | 35.7 | 766.5 | 16.8 |
| Hungary | 89.2 | 31.7 | 35.5 | 24.625.5 | 77.7 |
| Latvia | 15.5 | 2.0 | 13.1 | 87.7 | 4.3 |
| Lithuania | 23.3 | 7.7 | 33.1 | 1.606.7 | 20.8 |
| Malta | 4.8 | 3.4 | 70.9 | 205.1 | 6.0 |
| Poland | 267.4 | 112.8 | 42.2 | 43.235.2 | 38.3 |
| Slovakia | 43.9 | 4.2 | 9.6 | 70.1 | 1.7 |
| Slovenia | 29.4 | 11.5 | 39.1 | 1.451.5 | 12.6 |
| Bulgary | 24.3 | 7.8 | 32.2 | 1.176.0 | 15.0 |
| Romania | 96.9 | 22.9 | 23.7 | 2.801.7 | 12.2 |

Source: Annual report 2006 BVB.

Growth in bank assets, bond markets and equity markets (%)



Source: Author calculations on dates provided by BIS, OECD, FESE, EC.