

BANKING'S IMPLICATIONS ON ROMANIAN'S BUSINESS ENVIRONMENT IN CONTEXT OF GLOBAL FINANCIAL CRISIS

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1. Introduction

The economic crisis which has begun in 2007 has brought to surface most of the problems from the Romanian economy. While the highly industrialized countries have engaged heavily in anti crisis measures, Romania preferred to let this phenomenon go away. The problem with the economic crisis is that you cannot wait the end of it and then start acting as if nothing has ever happened.

To make things even more complicated, current economic crisis has raised many questions on economic theory and in particular, how the governments interact with the financial banking system. To all the governments' and central banks' questions and concerns from the highly industrialized countries, Romania responded with a sort of indifference, emphasized in the fact that the years 2008 and 2009 were election years. The lack of action against the economic crisis manifested by the Romanian state, made the economy to solve these problems under stress, slowly and without force. The principle of action of the Romanian Government has always been the need to wait the re-launch of the economic growth worldwide, and therefore, the Romanian economy will develop together with the other industrialized countries.

To sketch trends for the Romanian banking system is necessary to see where we are right now.

2. The Romanian banking system in 2009

Domestic macroeconomic evolutions have an important impact on the health of the financial system. A new vulnerability is the economic contraction, materialized in 2009, which equates with the worsening of the financial position of the companies and with the increasing of unemployment, with negative repercussions on the financial system, especially on the banks.

Another new challenge for financial stability is the banking system itself; reducing the access to internal financing, generates serious constraints in reimbursement business debts.

The banking sector continues to show financial health indicators in positive figures; it is well capitalized and still with considerable financial turnover.

Analysis for testing stress showed us a good capacity for absorption of moderate shocks. Two vulnerabilities manifest themselves strongly, influenced by global economic and financial crisis:

- credit risk;
- liquidity risk.

Starting with the last period of 2008, it is recorded the sharpest deterioration in quality credit portfolio, mainly reflecting contraction of economic activity and depreciation of the domestic currency rate. The deterioration is not uniform, the largest bank noting higher levels of outstanding and doubtful loans. Despite rapid debasement of the loan portfolio in the last period of time, overall

portfolio quality fits favorable in the European context. Also the coverage with provisions regarding bad loans from Romanian credit institutions balance sheets is higher than the one reported by several EU countries.

Capital adequacy is good both at aggregate and individual level. Persistence effects of global financial and economic crisis bring to the surface the need to strengthen banks to cope with potential high shocks.

Therefore, the Romanian National Bank has decided as a prudential measure, that the banks will provide and maintain, at least for the period 2009-2010, a minimum solvency level of 10% (this measure was recommended by the IMF). Also, to assess the need for additional capital in order to achieve the adequate solvency threshold established in terms of a possible worsening of the economic environment, the NBR has agreed with the IMF to run stress test scenarios for the banks. The results of these scenarios indicate the level of own funds by applying a set of shocks and, by default, the necessary funds to achieve a solvency ratio of 10%. This exercise stress test, based on stress terms identified in the government's economic program was applied to all banks. In terms of the main frame scenario used for testing result that bank's own funds fall with about 21% and in order to achieve solvency threshold, the banks will require an additional capital contribution of around one billion euros. Banks found in position of a need for additional funds acted in accordance with the regulation of a minimum solvency requirement of 10% for 2009-2010.

Central banks from the countries of origin of the Romanian banking capital have financed with significant amounts their financial systems, in order to reload lending and money market function. These financings had different impacts on the financial resources of Romanian subsidiaries: some have registered

increases of own funds and foreign liabilities, while for others the situation was exactly the opposite. Under these circumstances, the role of local liabilities raised tends to become increasingly important.

Economic and financial crisis is expected to generate significant losses worldwide. IMF forecasts show that losses could be counted at approximately 4,000 billion, of which two thirds could be located in banks. Decrease of global economic activity and concrete losses will generate by contagion, implications for the local banking sector and real economy from Romania.

Thus, economic contraction in the countries of origin of the Romanian banking capital will increase the difficulties of the debtors from these countries to honor debt service. Mother bank solvency will be affected and the problems created will be added to the liquidity matters. Therefore, the need for capital of the mother banks will reduce the resources which could be directed to subsidiaries from abroad.

In the structure of liabilities of the Romanian banking system could be noted the dominance of domestic component, the main component is represented by the non-banking sector deposits, which represents almost half of the volume of non-bank liabilities.

Deposits from companies and individuals have increased over the year by about 6% to a level of 46% at December 31, 2009. This increase is due on one hand to the interest rates and on the other to the uncertainty from the future. In case of overnight deposits for individuals, the decline occurred both in the dynamics of investment in local currency, and in foreign currencies, while in case of companies, it was felt only for the overnight foreign currency deposits. The increase for interest rates on term deposits in November, as well as non-taxation of the income on term deposits and saving instruments, had led to the

migration of customers from overnight deposits to term deposits.

3. Romanian Banking system trends in 2010

In order to sketch an evolution tendency of the banking system in 2010 we have to observe the trend in the entire national economy. From this point of view there are two options, the first one, is the possibility to have economical growth for 2010 no matter of its size and for the second possibility we could expect a second wave of recession.

The first variant is supported by the National Bank of Romania Governor's advisor L. Croitoru¹, who considered a certainty return of the global economy growth if will be maintained the principle of caution for the actions of national authorities. In the view of Romanian adviser are required only the actions of growing investors confidence and stability in the act of governance. These issues can be debated more coherently if the Romanian Government made the adjustments necessary for a crisis period.

The second view isn't taken into account by the Romanian authorities. In this regard it should be noted that the issues that have generated the global crisis have not been restructured in order to prevent similar future events. Moreover, regarding the Romanian economy it appears that the government doesn't show any signs that they want to change the pattern of development for Romania under the circumstances in which the current model proved to be unsustainable for long term. Both the Romanian Government and the Romanian National Bank want to encourage lending as the main developing engine for the economy. Lending activity in Romania led to an economic growth with a high degree of

sensitivity to the influences coming from the foreign markets. Another issue often mentioned even by Governor Mugur Isarescu was the use of lending for consumption and not for investments. From this point of view even if will be a growth in 2010, this is not a healthy growth for the Romanian economy, but a return to the situation before the onset of the crisis. Taking into account that international financial banking markets aren't reformed until the present moment (there are only plans for a deep reform of the banking financial level by the American Administration) it can be assumed even only as a simulation under stress a return of the global crisis. In this hypothetical situation the preventive measures of the Romanian state are nowhere.

Forecasts for 2010 made² by HSBC economists say that the developing countries will register an economic growth of 6.2%, compared to the developed countries which will grow by only 1.9%. The reason why countries like China, Brazil, India will register a record growth, in a period of time characterized by depression, is the promotion of industrial development as the core of the national economy. During 2009, the countries that have a competitive advantage in terms of competitive industrial production without having a sophisticated banking system have passed more easily over the world crisis. The conclusion is that not the lending activity is what makes the economy vulnerable cycle crisis but how it is used for consumption or for investments in income-generating activities on long term. This was noticed also by the Romanian Government through the voice of Prime Minister Emil Boc³, who pointed out the necessity to promote a national economy capable to fulfill the needs of domestic demand. The Prime Minister also focused in his

¹ L. Croitoru- A serious effect of a wrong idea: wealth tax would affect mostly the poor, Business Standard, 19.01.2010

² HSBC Emerging Markets Index Q4 2009

³ Emil Boc, Financial Newspaper, Sibiu Conference, 03.02.2010

conference on the problem of avoiding high consumption on credit, without a response from domestic producers. However the Romanian Government has not presented until now a clear long term strategy for stimulating local companies to produce goods and services.

Without a clear strategy of an important domain which should be promoted in Romania, to restart the lending activity would generate a new "bubble" in the field of unsustainable consumption on long term. In this direction, only a coordinated strategy, implemented by governmental measures would lead to a real national economic recovery based on investments which will generate further consumption and not like in the near past, a consumption based on future earnings.

From the Romanian point of view there is an advantage in the development of the banking system compared with the situation from the western countries, a competitive advantage determined by the growth potential. It can be easily noticed that the Romanian banking system has the possibility to increase significantly, similar to the Western European level. Thus, the level of banking intermediation is currently 52%, compared to 70-80% in Central European countries. Also, lending activity can increase considerably in the small company sector. This development is conditioned by many facts, such as: real anti crisis measures taken by the Romanian authorities, restart lending by commercial banks and not at least the reduction of the level of credits in categories "doubtful" or "loss". In the month of November 2009, 3.4%⁴ of total loans were recorded as outstanding.

The full maturity of the Romanian banking sector is one of the expected things for the next period. This maturity involves reaching critical waist, specialization in customer's needs and, especially, increased activities of

customer knowledge and loyalty. Thus, many steps have been made and development will continue up to the level of the Western banks.

Local banks increased their capital by 225 million from March to September 2009. Also, several banks were forced to increase capital in order to improve solvency during the year.

At the end of December 2009, the average solvency indicator for Romania was 14.3%, compared with 11.9% the level from September 2008. Banks had own funds of 6.6 billion euros in mid-2009. This level is 0.4% lower in real terms, compared to September 2008. During this period of time banks increased their total capital of 468 million euros.

In the spring of 2009, NBR has conducted a series of stress tests according to the agreement with the IMF; from these resulted that the banks need at least 1 billion euros in order to maintain solvency above the level agreed of 10%. In the autumn of 2009, the central bank has developed a new set of tests, asking banks more data than in the spring.

It was debated the problem of reducing exposure on Romania, with almost 2%, different from the level of March 2009. The drop had a level of 0.7 billion euros in figures. Some banks have even a bigger exposure as they receive more money. Some of them made casual operations with mother banks. There was a reversible flow, "sent money and bring them back". Banks have motivated this actions by the lack of opportunities to invest liquidity.

NBR officials have shown that the bank requirement for the implementation of provision according to the format of international financial reporting standards (IFRS), instead of the local system, can not be made without a complete accounting change. Bankers have asked the NBR to allow them to make provisions according to IFRS, under the circumstances that local

⁴ NBR, Inflation Report, April 2010

standards (RAS) are more severe and this will generate additional costs. However, banks have asked for derogation from the full adoption of IFRS accounting principles, especially in terms of regular adjustment of the value of assets at market prices (mark to market).

Banks intend to continue talks with NBR at least to amend the provisions level for restructured loans. Currently, the regulations establish that a credit which is restructured or rescheduled goes to "lost" class without any opportunity to be reanalyzed and moved into a higher class, even if no problems arise. It is hoped that in short term this problem will be solved.

Retail banking market has already reached stability in terms of number of actors and entry rules on the market. Banks should continue to focus on getting new customers and retain the existing clients in order to obtain sustainable growth. A large number of bank's customers use their services to a minimum level. In order to increase population education towards banking, banks should develop increasingly the customers' loyalty. For this, credit institutions will have to promote with much more emphasis their services, to ease the relationship between bank and customer, such as a internet-banking and CRM (Customer Relationship Management).

The middle class appeared and they need relevant instruments for saving and investment, small companies are expanding and seeking innovative financing offers. To all of these, are added the compliance for new European directive on SEPA (Single Euro Payments Area) and the policies against money laundering, which have a major impact on EU banking. Romanian banks prepare themselves to become viable competitors throughout Europe. Also, the crisis raised some more important strategic priorities. Among these are:

- finding liquid resources in Romania and not from the mother bank;

- finding the appropriate formulas to resume lending process for individuals and businesses after a fair negotiation with NBR;

- finding internal resources to reduce interest for customer at a fair value.

According to Governor Mugur Isărescu⁵, massive capital inflows generate economic crisis. This point of view is substantiated by research and generates the next question. Why no central bank could predict the nowadays economic crisis? Moreover, after the crisis manifested worldwide the analysts from National Bank of Romania haven't done anything to prepare the Romanian economy for recession. The simplest answer is that all over the world banking supervision systems are "asleep". After triggering crisis, the representatives of central banks have tried various explanations for the lack of vision in the short, medium and long term. All these explanations could be synthesized by the words of Mr. Greenspan⁶ "a bubble cannot be identified until it brokes"

At present, the main question related to the economic crisis has changed. It is now when this negative phenomenon will pass over. If the central bank advisors noticed that this crisis in Romania was predicted by massive capital inflows, then we logically assumed that this theory will apply up to the end, namely, that countries that have entered the crisis enjoying massive capital inputs will bypass the crisis harder than other countries. Even if the theory can be different from the practical image of this crisis, the above mentioned option should not be neglected by the National Bank of Romania. If the Romanian authorities denied the crisis at the beginning, right now we can draw the conclusion that they deceived

⁵ Mugur Isărescu, External deficit financing and macroeconomic adjustment during the financial crisis - the case of Romania, 11.2009

⁶ Florin Aftalion, How to discipline central banks, 19.01.2010

themselves as we have passed the recession.

Since we don't estimate correctly the reality, it is very likely that this reality will affect us in the near future. The lack of consistency and vision in the measures of the Romanian authorities, may determine us to think that the crisis will continue throughout 2010. Even though, Romanian banking system is much better organized than other fields, we cannot extract it from the Romanian economic context. If the Romanian economy will remain in crisis, the banking system will suffer, too. The trend this year in terms of prediction can not look favorable as the last two years were elective ones and we haven't overcome the structural reforms, necessary to go through the crisis. From the moment when we shall adopt effective measures we can expect to a painful resetting and after that to a healthy economic growth.

4. Financial crisis affecting business environment in Romania

The overwhelming majority of small and medium enterprises on the domestic market are severely or very severely affected by problems in the economy. There are also companies which haven't difficulties due the economic crisis. Their percentage is extremely small (only 2% of firms do not feel the crisis).

That only two of 100 firms say that profit remained on an upward trend in crisis conditions is a very serious matter. In these circumstances, employers expect a large number of bankruptcies, lower turnover and the loss of many companies changing. We believe that saving many SMEs could come from state aid. But here is a paradox. Although 70% of companies feel they require a large and very large measure of government support, only 4% received this support in the first quarter of 2010. One explanation for this difference is that

now, in times of crisis, such instruments are very little promotion. More than half of companies do not know any conditions, nor after that procedure can access aids. We borrowed from F.M.I. or other institutions, instead of doing what is easier - not reinvested profits tax, to subsidize bank interest, to give guarantees. Rapid change is necessary for granting aid procedures state that simplify and increase maximum amount.

In a study by the Religion Market Research for the National Council for SMEs, 35% of respondents said that business declined because of mistakes made by the state, 25% said that disputes in the political class have played an important role in the current economy, while 22% are responsible banks and 18% of entrepreneurs have raised the global crisis. For some, reliance on financial crisis proves a good excuse to justify restructuring or rethinking the business, caused, in fact, hasty decisions, or overly optimistic assessments of market realities were not taken into account (and we mean real estate construction, where developers have not taken into account solvent demand, or the car market where imports have led to lower sales of used importers). Their crisis has created problems for businesses already vulnerable and in turn caused a chain reaction across, such as the impact on manufacturers of building materials. For other business, the financial crisis has led cutting funding sources. All companies are thinking but to lower costs, especially the fixed, regardless of reasons. Many have decided to defer all investments blank, not related to work safety and without an immediate reduction in costs.

How companies will adjust their spending budgets and decide which areas to cut costs depend on the impact of the crisis. Theory says that you can not control turnover, because you know how evolves, especially in difficult moments, must therefore assess all

costs which means invested. In general, those postpone investment projects may be delayed and cut costs in any area that has no direct impact on company performance. Ultimately, it reevaluates human performance. A list of "tips and tricks" for managers in times of crisis must include renegotiating the terms of contracts, since suppliers are more sensitive. This decision implies the dropping of certain suppliers, generally for those products not bring you a comfortable margin, and contracts with unfavorable terms too close or be renegotiated. Another important issue is customer loyalty. An old customer always costs you less than a new one. Human resource is the latest to be subjected to cost-efficient process, but may represent an important source of savings, if the restructuring is subject.

One of the most common mistakes, especially in retail, is to cut prices to increase sales. Do not actually increasing sales simply raise costs and losses associated with a higher turnover. The merger of companies or divisions of activities can be an important source of cost reduction, alas, in Romania, so something is not quite practical. According to experts, the fastest recovery can be achieved by optimizing the external procurement costs (Strategic Sourcing). Also, outsourcing repetitive operations, settlement, one alternative could be explored. Finally, many companies in Romania which have expanded aggressively in recent years - sometimes without prior analysis of very deep - you should not only revise their growth plans, but the existing network to see whether it is justified and sustainable. Other specific measures can be adopted sector, for example, optimizing production, strengthening back-office sites in financial institutions, retail shops efficiency (optimization hours, standardize and store operations personnel to optimize the allocation depending on traffic, etc.).. What will be impact on the economy, to

reduce costs by companies? Even larger firms that are not necessarily insolvent, faced with the opening of insolvency proceedings by a creditor. Failure of one of the customers generate liquidity problems, the company can not be affected and, in turn, to pay its own suppliers on time (such cases were encountered mainly in construction).

5. Conclusions

The full effects of the crisis were felt by Romanian companies last year, and the phenomenon will continue this year if nothing is done as soon as measures to support Romanian entrepreneurs. Unlike domestic capitalists, foreign firms have been less affected by it, so now they have less local competition than ever before, which favors further position on the Romanian market.

In general, Romanian companies are SMEs and they were the most affected by the crisis. In addition, they have had to deal with measures taken by the Government, which has further aggravated the situation. Meanwhile, these firms were not adapted to new conditions and many have lost both internal markets and external. Also, unlike the Romanian companies, foreign firms have felt differently crisis, the latter passing over it and easier due to the fact that they could receive additional funds. This is one serious, but companies will be able to withstand the crisis will be long and strong, which will create new development opportunities for the next period.

2010 is an extremely difficult year for employers, given that it will experience further absence of measures that could lead, at least, to stabilize the situation. Romania. In general, the central bank took a series of measures that have been effective default and the business environment. BNR reference interest rate fell to 6.25% level, which should have a positive effect on Romanian

entrepreneurs, so that with the resumption of lending will resume and the business cycle. Exit from recession in 2011 will be possible only with external markets and possible monetary support from the NBR. With regard to interest commercial banks, they will start to future, but that it cause many investors to try to block as best interest at current levels longer term rather than waiting to drop interest more in the future.

Furthermore, we believe that National Bank has no interest in leaving a lion too strong. One solution is leaving Romania in recession including boosting

decline only when they have enough comfort for business and it will be a gradual process that will be felt rather from the end of the third quarter, early fourth quarter th 2010. Makes monetary policy relaxation expectations of interest to indicate a decrease in their exports and to stimulate exports during their must remain relatively favorable, so the lion should not be considered. To summarize, we say that the main problems facing companies in our country are: late payments from clients or partners in demand, depreciation of the leu, company liquidity, cash and inflation.

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