

BUCHAREST STOCK EXCHANGE POSITION WITHIN THE CENTRAL AND EASTERN EUROPEAN REGION

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ABSTRACT. At the end of November 2010 Bucharest Stock Exchange celebrated 15 years of contemporary/ modern history since its re-opening for activity in November 20th 1995, after it has been closed in 1948 due to the nationalization process imposed by the communist regime.

After a slow start, Bucharest Stock Exchange registered and important growth between January 2003 and June 2007, and yielded spectacular results for its investors. Thus, when compared with neighboring countries, Romanian capital market ranks at the same level with Slovenia, one of the smallest country in the region. Furthermore, Romania and its capital market are included in the category of *frontier markets* by well known international companies like Standard & Poors's and MSCI-Barra.

Romania, along with other small countries from European Union, must face the question regarding the development direction, consolidation and integration of its capital market and should take into consideration the fact that this capital market might not necessarily be relevant in European Union context.

The present paper will present Bucharest Stock Exchange evolution, asses its current position inside the country and at regional level and will try to identify its future evolution perspective, taking into account its present standing.

Key words: national stock exchange, frontier market, investor base, exchange cooperation, Bucharest Stock Exchange.

JEL classification: G10, G15, O16

Introduction

Romania, as a European Union (EU) member country can benefit from the adaptive response of this regional grouping of states to the changes and challenges of the global economy. Romania, along with the other 11 countries that joined EU in 2004 and, respectively, in 2007, must face the important question about the direction of development, consolidation and integration of its domestic capital market, a market which might not be a relevant one in the EU context, as Iorgova & Ong (2008) highlighted in their study regarding other domestic capital markets from Central and Eastern Europe region.

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Romania's position as EU member state brought, along with various advantages, an increased competition for Romanian capital market. Romanian authorities in charge with domestic capital market development must deal with at least two important aspects highlighted by various studies:

- given the growing integration process of financial markets within Europe and the rest of the world, the long-term sustainability of the national capital markets might be in doubt, as highlighted by Berglof & Boltan (2002). The problem is common for all the domestic (relatively small) capital markets in the geographical area of Central, Eastern and South-Eastern Europe.
- the advent of Markets in Financial Instruments Directive (MiFID) under the Financial Services Action Plan (FSAP) of European Commission is likely to raise the critical size needed for exchanges to attract and to retain liquidity and to generate revenues necessary to invest in the needed technology (Haas 2007).

The enforcement of MiFID starting with Nov.1st 2007 is expected to generate an increased competition pressure, mainly on relatively small exchanges (Skinner 2007), like the exchanges functioning in Romania. The MiFID influence will be felt mainly due to the following facts:

- the directive eliminates the 'concentration-rule' and this situation enhance the competition among the existing exchanges;
- alternative trading venues – defined as Multilateral Trading Facilities (MTFs) will become more heavily regulated and will become important competitors for the existing exchanges;
- another category of competitors, which will have a direct impact on the existing exchanges' market share are the Systematic Internalisers (the investment banks/ financial institutions that internalize client orders and cross these against their own books) as potential providers of trading venues.

It will be reasonable to assume that some of the Europe's smallest exchanges will suffer significant reduction in trading volume and revenue. Under the strain of fierce competition, the future of small national capital markets is under question.

Several arguments are in favor of further development and improvements of domestic capital markets; among them, the following were considered relevant:

- national capital markets are important for the respective economies because they offer a place for domestic companies and government institutions to raise capital mainly from domestic, smaller investors that cannot afford to be present in multiple markets (Andritzky 2007; Stultz 2009). National capital markets will perform better if the local companies and government institutions can finance themselves at a lower cost than elsewhere. This argument is supported by the fact that investment continue to show substantial home bias: investor continue to channel an important proportion of their

available resources toward securities issued and traded in their own home country. Investment appears to follow the ‘gravity model’ which shows that investors hold securities in geographically closed companies; this phenomenon has been shown to hold across countries (Li, Yan and Faruqee 2004) and confirmed by the recent studies of Rey (2008) and Kho, Slutz and Warnok (2009).

- maintaining and deepening a national capital market might generate several advantages for smaller companies; given the relative high cost of foreign listing and other administrative and cultural factors, a better access to domestic equity finance can help local companies to develop and grow (Andritzky 2007). O’Hara (2001) suggests that national capital markets should focus mainly on these smaller domestic companies.
- for most countries, stock and derivative exchanges are a source of national pride (O’Hara 2001) and economic development. An important number of studies support either the idea that national capital markets lead to faster economic growth or a two-way causality. Economic growth leads to and increased demand for financial services and also attracts further investment. Among the most recent studies in this field, supporting the relationship between economic growth and the development of capital markets are Black & Levine (2004) and Ang (2008).

The aspects mentioned above trigger the following questions:

- ✓ is there a future for small domestic stock exchanges in the region of Central and Eastern European countries, which are also EU member states?
- ✓ which will be the future for Bucharest Stock Exchange (abbreviated BVB² from now on) taking into account its inclusion in the category of *frontier markets*?

Review of literature

A vast body of academic literature focus on various aspects of emerging capital markets, but only a relative small number of studies take into consideration the determinant factors of capital/ stock markets development and evolution in emerging economies, while even fewer have as main subject the domestic capital markets.

Most of the studies which take into consideration capital or stock markets development and evolution in emerging economies are under the form of surveys and include a large number of emerging countries. Among these: Claessens et al.(2001) presenting the level of development and the economic determinants for stock markets in transition economies; Mathieson & Roldos (2004) are highlighting the problems of

² The BVB abbreviation comes from the Romanian name of the exchange: Bursa de Valori Bucuresti and it is preferred by the authors in order to avoid any confusion with similar possible abbreviation for Bucharest Stock Exchange, which are Budapest Stock Exchange, Bratislava Stock Exchange, and Bulgarian Stock Exchange.

local securities and derivative markets in emerging economies; Ramswamy (2004) analyzing emerging equity markets as alternative investments for foreign investors and as alternative sources for domestic funding; O'Hara (2001) study investigates the market microstructure and how this should guide the design of equity markets in developing countries. Most recently, Jaramillo (2010) analyzed the determinants of investment grade status in emerging markets.

Another category of studies concentrate on the same topics mentioned above, but at regional level. Chosen to be mentioned, in relation with the topic of the present paper, are the following: Lemierre (2002) presenting the regional developments in securities markets; Bonin & Watchel (2003) showing the level of capital market development in transition countries at the end of the 1990s; Silagy et al. (2004) presenting the perspective on the emerging European financial markets; Dvorak & Podpiera (2005) trying to assess the impact of European Union (EU) enlargement on the evolution of stock exchanges in the accessing countries; Irving (2005) assessing the expected results of the regional cooperation and integration in Eastern and South Africa, Fonteyne (2007) presenting the advantages of integrating the domestic financial markets in a single financial market at European level; Yartey (2008) presenting the institutional and macroeconomic determinants in stock markets development using a panel of 42 emerging economies for 1990-2004 and applying the results on African countries; Iorgova & Ong (2008) overviewing the trends in the European region for the local capital markets and presenting the factors that have contributed to their growth and effectiveness; Huseynov (2010) reviews the market structure of major stock exchanges in eight members of Countries of Independent States group.

The Romanian capital market was included in the category of frontier markets by three of the most important financial information providers: FTSE – The Index Company, Standard & Poors's, and MSCI-Barra Company. As a consequence, a trial was made in order to identify the academic literature concerning this topic of frontier markets. Only several studies could be found: Speidell & Krone (2007) and Speidell (2008 and 2009) analyzing the frontier markets as diversification opportunities for international investors and their behavior when frontier markets are concerned; another small group of studies are focused on risk and return inside frontier markets – Girard and Sinha (2008), Groot et al.(2010a and 2010b).

The studies concentrating on domestic/ local capital markets identified and consulted are: Szalkai (2001) concentrating on Hungarian financial markets; Marone (2003) presenting the case of Lusaka Stock Exchange and its low impact on Zambian economy; Billmeier & Massa (2007) focusing on Egyptian Stock Market, Andritzky (2007) assessing, through the case of Slovenia, the capacity of small emerging economies to develop thriving capital markets.

The body of literature covering various subjects regarding BVB and in connection with BVB was growing slowly but steadily for the past 5 years. The following studies are approaching various aspects of BVB evolution: Kaznovsky

(1999), Pop & Dumbrava (2006), Skully & Brown (2006), Obreja-Brasoveanu et al. (2008), Matei (2008), Pop, Curutiu and Dumbrava (2009). Only two studies – which are continued by the present study – tried to assess the BVB position among the stock exchanges in the region: Pop and Delaney (2010a and 2010b).

The structure of the present paper

The present paper is a survey of BVB evolution over the past 15 years and is based on data available in public reports. The paper presents Romanian capital market landscape, BVB position among the other Romanian exchanges, BVB evolution during the past 15 years, the Romanian investor base and the position of BVB compared with Central and Eastern European exchanges.

Romanian capital market landscape during the 1990s and the first decade of 2000s

The privatization process in Romania had a very slow start and several years were necessary to make it work. Only between 1994 and 1995 the first wave of privatization was registered – having as root the free distribution of 30% of State owned shares in an important number of Romanian companies³. By June 1995, the number of companies privatized using the certificates distributed to Romanian population, along with selling of State owned shares toward associations formed by companies' employees, generated the critical mass of outstanding shares that could trigger the need for a secondary market where the respective equities could be exchanged.

Bucharest Stock Exchange (BVB)

Bucharest Stock Exchange (BVB) was re-established⁴ and started trading (with only 8 listed companies) November 20th 1995. Between November 1995 and December 2005, BVB had the status of an institution of public interest and was under the administration of BVB association of (Romanian) brokerage companies; the membership regime was an open one. BVB demutualized in January 2006 and during May 2010 BVB announced it received the approval to list its own shares. BVB always was a regulated market and it is under the supervision of Romanian National Securities Commission.

³ The free distribution of 30% of state owned shares took the form of privatization certificates – of a fixed value of 1,000,000 ROL - which were distributed during 1992, 1993 and 1994 to all the Romanian population having at least 18 years old. Those certificates could be subscribed at any of the companies that the Romanian government announced to be under privatization process. While it seemed simple, the process became complicated by the lack of proper management in the collection and registration of the options expressed by Romanian people, and due to lack of proper information regarding the complete list of companies under privatization and all the available alternatives.

⁴ Bucharest Stock Exchange was first opened for trading December 1st 1892. It was closed in 1948 due to the nationalization process that started during that year under the imposed communist regime.

Since the re-start of its activity in November 1995, one of BVB's goals was to list and trade only good quality companies and imposed listing requirements regarding the capital level, profitability, and a minimal free float for accepted companies, along with an imposed level of transparency. The number of BVB listed companies grew steadily, reaching by the end of 1999 the level of 127. Despite the important growth in number from 8 to 127 in the space of 4 years, BVB's listing conditions kept an important number of privatized companies away from its trading venue.

RASDAQ

In order to allow the listing of a higher number of Romanian companies, a second exchange was established and started trading during November 1996. The second trading venue's name was RASDAQ and had as main model the American NASDAQ, as it functioned during the early 1990s. RASDAQ was considered to be an OTC market; had a very permissive listing requirements and the level of supervision was more relaxed. RASDAQ managed to absorb for listing the majority of the privatized companies. However, the low quality level of listed companies and/ or the limited interest their field of activity generated among investors, represented problems difficult to overcome and the following table 1, showing parallel evolution of BVB and RASDAQ enhance the low profile of the second trading venue.

Table 1.
The number of listed companies and the market capitalization at BVB and Rasdaq
(as December of every year)

	No of listed companies at BVB	No of listed companies on RASDAQ	BVB market capitalization (mil.EUR)	RASDAQ market capitalization (mil.EUR)
1995	9	-	77.61	-
1996	17	1,561	48.35	n/a
1997	76	5,367	706.1	1,670.9
1998	126	5,496	402.1	894.7
1999	127	5,516	336.6	1,058.6
2000	114	5,382	450.5	872.7
2001	65	5,084	1,361.1	1,188.5
2002	65	4,823	2,646.5	1,764.9
2003	62	4,442	2,991.0	1,943.7
2004	60	3,998	8,818.8	2,064.3
2005	64	3,683	15,311.4	2,241.3
2006	58	2,420	21,414.9	3,126.4
2007	59	2,019	24,600.8	6,985.7
2008	58	1,753	11,629.8	3,079.1
2009	69	1,561	19,052.7	2,937.7
2010	74	1,309	23,892.2	2,526.5

Source: BVB data (<http://www.bvb.ro/TradingAndStatistics/DailyMarketReport.aspx>)

Between 1997 and 2001, BVB and RASDAQ considered being in competition. Though, RASDAQ's low level of transparency, the difficulties faced by investors to find information regarding the listed companies, the occurrence of periodic speculative bubbles involving a small number of companies, and the rumors regarding frauds and stolen shares being trades on this market, transformed the OTC market in a minor player of Romanian capital market. The poor quality of an important number of listed companies was another factor that left its mark on RASDAQ trading activity.

RASDAQ market officials tried to diversify the offer between 1998 and 2000 by launching the possibility of trading in Romanian bank deposit certificates. The attempt failed: the fixed-income instruments were not popular in Romania at that time, the yield curve was almost impossible to be traced due to lack of information (except the information offered by the Romanian National Bank for interbank monetary market), no rating was available and the number of issued certificates was very small.

However, the fact that RASDAQ played a role in the process of shareholders concentration, in spite the fact that it allowed this concentration to happen through highly speculative and questionable trading, can not be denied.

In a trial to enhance its position and image, RASDAQ officials decided that it should become a fully regulated market in 2003, when it also changed its name in: Electronic Exchange RASDAQ. The situation improved slightly, but not at the expected level. During 2004 discussions began with BVB for a future merger. The merger became effective starting with January 2006. Since then, RASDAQ is part of BVB, still having separate daily reports and its data are considered separately from BVB data.

Due to its relative minor role and importance at Romanian capital market level, RASDAQ will not be analyzed inside the present paper.

Sibiu Stock Exchange – SIBEX (former BMFM Sibiu)

July 1997 marked a diversification of Romanian capital market landscape through the emergence of Monetary, Financial and Commodity Exchange Sibiu (Bursa Monetar Financiara si de Marfuri Sibiu or BMFM Sibiu)⁵ considered being the first Romanian derivative exchange. However, the first years of activity at Sibiu were under the influence of lack of clear regulations regarding the derivative exchanges in Romania, the absence of a supervising body and no clear regulations regarding the clearing house. The situation changed for the better after new regulations

⁵ BMFM Sibiu was formerly known as Bursa de Marfuri Sibiu (Sibiu Commodity Exchange) and first started spot trading on various commodities at the beginning of 1995. The opportunity to develop inside the derivative products niches was considered during 1996 and by mid 1997 the first futures and options contracts were launched, while the Sibiu exchange changed its name to reflect the new trading profile.

were issued during 2000; the supervising body was stated to be the same as in the case of BVB and RASDAQ, the Romanian National Securities Commission and a clearing house was established.

BMFM Sibiu changed its name again in SIBEX sometimes between 2006 and 2008⁶; as a consequence the new name will be used from now on.

During 2006, BVB and SIBEX representatives negotiated a merger between the two exchanges, but the idea was abandoned due to divergent opinions.

During 2007, Warsaw Stock Exchange acquired a small stake of 1.81% of SIBEX shares; however, this position enabled a close co-operation between the two exchanges. In order to diversify its activity and as a response to the launch of futures contracts trading at BVB, SIBEX announced during 2008-2009 that it will launch its own platform for trading Romanian shares. SIBEX share trading platform became operational at the beginning of 2010; starting with January 2010 SIBEX is listing its own shares under SBX symbol and by September 2010 a second Romanian company chose to list its shares at SIBEX. SIBEX also announces that double listing at Warsaw Stock Exchange is available for all the companies that chose SIBEX as a trading venue for their shares. However, the share trading is almost negligible compared with SIBEX main activity: trading futures and options on futures.

During February 2011, BVB announced its intentions to reopen the merger negotiations with SIBEX. A merger between the two exchanges would be a logical solution for a stronger and better diversified capital market at Romania's level and by joining forces, a combined Romanian exchange could gain more visibility and a better position within Central and Eastern European region, and at EU27 level.

Table 2 below presents the evolution of derivative contracts at SIBEX and the futures contracts at BVB. As it can be seen, a decade dedicated to derivative trading put SIBEX in a clear advantage when compared with futures trading at BVB.

Table 2.

Volume of futures and option contracts at SIBEX and volume of futures contracts at BVB⁷

	SIBEX			BVB
	Futures and options volume	Futures (%)	Options (%)	Futures volume
1997	77,877	n/a	n/a	-
1998	193,336	n/a	n/a	-
1999	175,142	n/a	n/a	-
2000	205,288	n/a	n/a	-
2001	188,973	n/a	n/a	-
2002	292,369	n/a	n/a	-
2003	187,914	n/a	n/a	-

⁶ A data for this name change could not be established using the official reports published by the exchange.

⁷ An attempt was made to compare the trading value registered by the two exchanges for the listed derivative contracts, but SIBEX does not offer complete information and data are discontinued for 2008 and 2009 when annual and monthly reports were used as information source.

BUCHAREST STOCK EXCHANGE POSITION WITHIN THE CENTRAL AND EASTERN EUROPEAN REGION

	SIBEX			BVB
	Futures and options volume	Futures (%)	Options (%)	Futures volume
2004	75,174	n/a	n/a	-
2005	707,738	98.35	1.65	-
2006	4,268,710	99.14	0.86	-
2007	3,490,923	99.00	1.00	64
2008	3,618,766	98.89	1.11	18,018
2009	2,483,287	97.89	2.11	15,613
2010	1,637,794	98.92	1.08	25,099

Sources: http://www.sibex.ro/docs/despre/raport_de_activitate_2010.pdf, other SIBEX reports available at: <http://www.sibex.ro/index.php?p=despre&lang=ro&s=6&su=1&d=1> and <http://www.bvb.ro/TradingAndStatistics/GeneralStatistics.aspx?tab=5&m=0>

From the brief presentation made within this paragraph, BVB can be considered the main Romanian market for equity trading, while SIBEX is the main trading venue for derivatives. A brief visit of the dedicated BVB and SIBEX website will give an important advantage to BVB due to a better structure and more detailed information available.

The relative low level of Romanian investor sophistication tends to give preference to equity trading and during the past 5 years BVB diversified the listed products (as it can be seen from the following paragraph), in a trial to keep its dominant position within the Romanian capital market landscape.

BVB evolutions over the past 15 years

The following table 3 tries to present a synthesis of the main developments BVB undergone between November 1995 and December 2010, covering a period of 15 years.

Table 3.

Main developments at BVB between Nov.1995 and Dec.2010

Main date	Market segment	Further development date	Developments within the segment
1995, Nov. 20 th	Equity market was launched and trading started with 8 listed companies		
		1997, Jan. 28 th	First category (tier) was created to enhance the status of Romanian blue chip companies
		1997, Sept. 22 nd	BET (Bucharest Exchange Traded Index) was launched; portfolio including top 10 most liquid shares
		1998, Apr. 21 st	BET-C (BET-Composite) was launched – including all listed shares

CORNELIA POP

Main date	Market segment	Further development date	Developments within the segment
		1999, Nov.1 st	The 5 Romanian closed-end funds generated by the privatization process, called SIFs ⁸ , start listing at BVB first category
		2000, Nov.1 st	BET-Fi (BET-Financial) index was launched; portfolio included only the 5 SIFs (SIFs were not included neither in BET nor in BET-C portfolios)
		2005, January	First rights were traded
		2005, March	ROTX index was launched in collaboration with Vienna Stock Exchange; it is an underlying asset for derivative contracts in Vienna
		2007, Nov.19 th	3 rd category was introduced in order to rank better the quality of listed shares
		2008, Feb.14 th	Erste Bank start parallel listing at BVB within the International category under the symbol ESB ⁹
		2008, Jul.1 st	Two new indices are launched: BET-XT with a portfolio of 25 blue chips, including SIFs, and BET-NG, a sector index for companies in energy sector or related to it
2001, Nov.	Bond market segment started its activity – trading the first two municipal bond issues		
		2003, May	Romanian corporate bonds started trading
		2006, Sept.	International bonds ¹⁰ issued for the Romanian market became available for trading
		2008, Aug.	Romanian government bonds (T-bonds) were introduced for trading

⁸ The 5 Romanian Financial Investment Companies – called in Romanian Societati de Investitii Financiare, from where the abbreviation SIFs (used also in the present paper) – started their existence November 1st, 1996 under the Law no.133/ 1996. The mentioned law stated the transformation of the former 5 Private Property Funds (or PPFs) in SIFs. Due to the fact that they became public limited companies which have under their management important portfolios of assets (mainly Romanian shares) to which subscribed an important number of Romanian citizens, SIFs can be considered closed-end funds.

⁹ Erste Group Bank, Austria, is the majority shareholder of Romanian Comercial Bank (Banca Comerciala Romana), one of the most important Romanian Banks, controlling between 25% and 30% of Romanian retail banking market.

¹⁰ The international bonds were issued successively by the International Bank for Reconstruction and Development, the European Bank for Investment and by the European Bank for Reconstruction and Development. All issues were dedicated for Romanian market and were denominated in Romanian currency (Romanian new leu or RON).

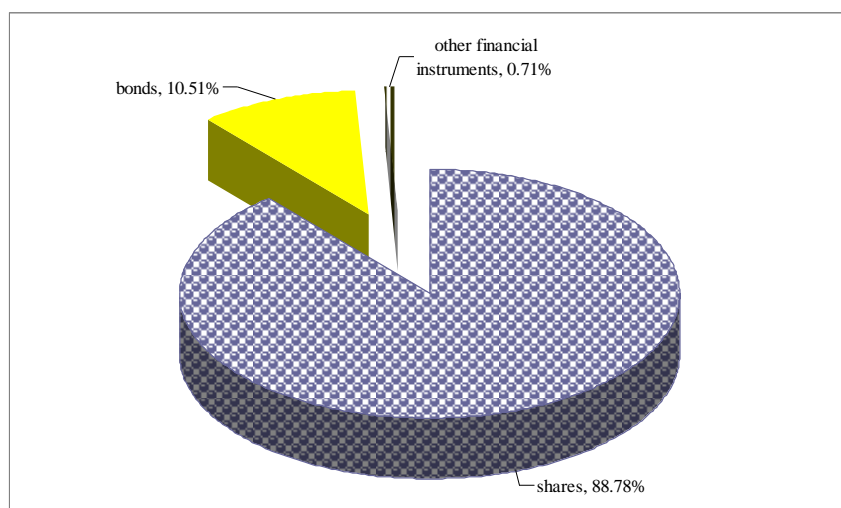
BUCHAREST STOCK EXCHANGE POSITION WITHIN THE CENTRAL AND EASTERN EUROPEAN REGION

Main date	Market segment	Further development date	Developments within the segment
2007, Sept.	Futures contracts were launched for trading within their dedicated sector		By the end of 2010, 42 futures contracts were available for trading
2008, Sept.	The market segment dedicated to exchange traded funds (ETFs) was launched		By the end of 2010, 5 ETFs were available for trading
2010, Jul.8th	The segment for structured products was launched		Only structured notes (translated in Romanian as 'certificate) were admitted for trading. Those structured notes were issued by Erste Group Bank and Raiffeisen Centrobank. By the end of 2010 a number of 24 structured notes were available for trading

Source: author's compilations based on information available at www.bvb.ro

The structure of BVB main market, where the above mentioned developments took place, is presented in the following graph 1. It is constructed based on the turnover (trading value) registered by each market segment between November 2001 (when bond trading started) and December 2010. The category 'other financial instruments' includes: rights, futures contracts, ETFs and structured products.

As it can be seen, shares are the dominant traded instruments on BVB main market. The contribution of bonds is growing slowly, while the other financial instruments can be considered still 'new' – like the ETFs and the structured products and only the years to come will establish their position within the BVB main market.



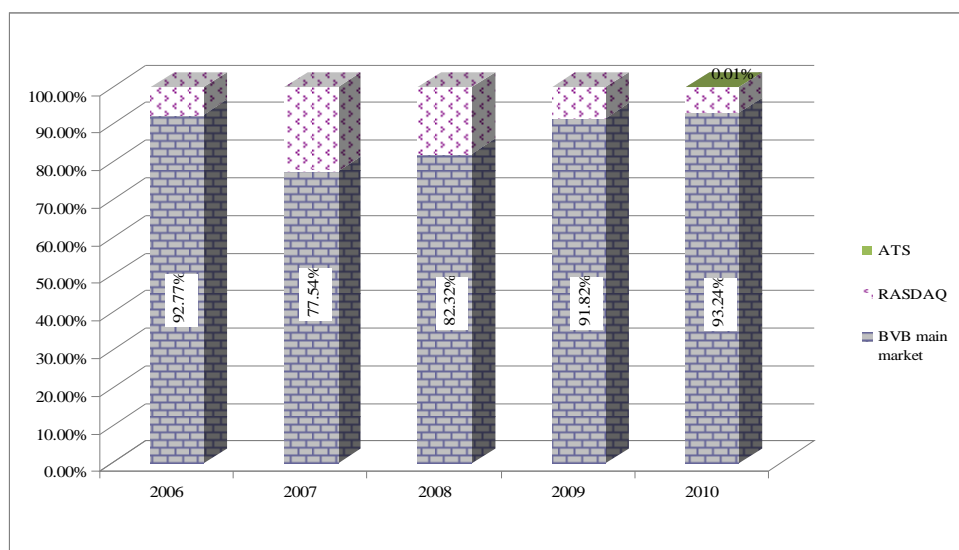
Graph 1. BVB main market structure between Nov.2001 and Dec.2010 (average %)

Source: author's calculation based on data available at www.bvb.ro

As presented above, BVB merged with RASDAQ market, by absorbing it. RASDAQ remained a distinct market, with different trading rules, different listing requirements and for which separate reports were issued for the past 5 years, since January 2006 when the merger became effective. On RASDAQ market, only shares and rights were traded. Between January 2006 and December 2010, a number of 2200 companies were delisted from RASDAQ; some companies (a very small number) were transferred for listing at BVB, while the others were eliminated due various reasons, mainly the lack of attractiveness in the eyes of investors.

However, in time, the RASDAQ market is supposed to disappear and to be replaced by the newly launched, during Nov.2010, Alternative Trading System (ATS) which, currently, has listed only one international company, Daimler AG (trading symbol: DAI).

Graph 2 presents the importance of each market hosted by BVB, based on turnover.



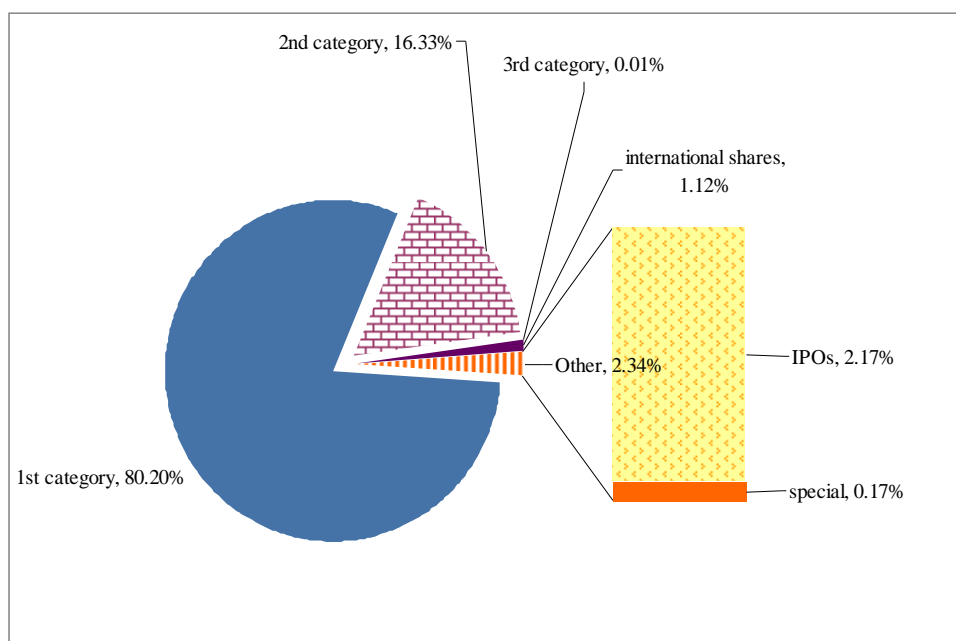
Graph 2. BVB main market position within BVB trading platform

Source: author's calculation based on data available at www.bvb.ro

BVB equity market segment

This is the oldest and the most important market segment at BVB. It is structured by three trading categories (tiers), the first category including the blue chip shares.

The trading structure for the equity market (presented in graph 3), based on turnover, highlights the investor interest directed mainly toward the companies listed inside the first category (within which SIFs are concentrating 49.18% of turnover – average figure for the period Nov.1999-Dec2010).



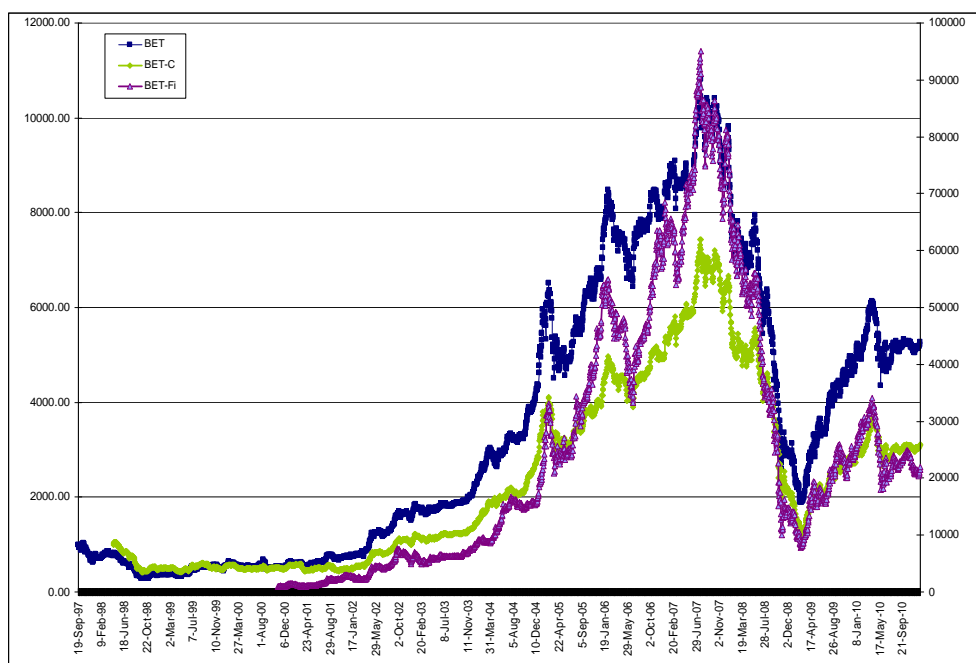
Graph 3. Equity market structure between Jan.1997 and Dec.2010

Source: author's calculation based on data available at www.bvb.ro

Note: 'special' is an old category of transactions which occurred up until 2000; they were replaced by the 'deal' trades that are now registered when they occur for each listed shares.

The evolution of BVB equity market segment is reflected by the three oldest indices, BET, BET-C and BET-Fi, in graph 4. As it can be observed, 2002 and 2004 were two important moments for BVB's growth: by the mid of 2002 the announcement that Romania will become a NATO member state boosted domestic and foreign investors interest alike; 2004 was marked by a surge of investments in the 10 new EU member states and extended to Romania also. The annual returns of the above mentioned indices are presented in table 4, compared against Romanian inflation rate. As table 4 below shows, starting with 2002, BVB returns became attractive for investors, the only exception being represented by the year 2008, when the 2007-2009 financial crisis reached its climax.

CORNELIA POP



Graph 4. BVB oldest indices evolution between Sept.1997 and Dec.2010

Source: based on BVB data available at www.bvb.ro

Table 4.
BVB's oldest indices annual returns compared against Romanian annual inflation rate

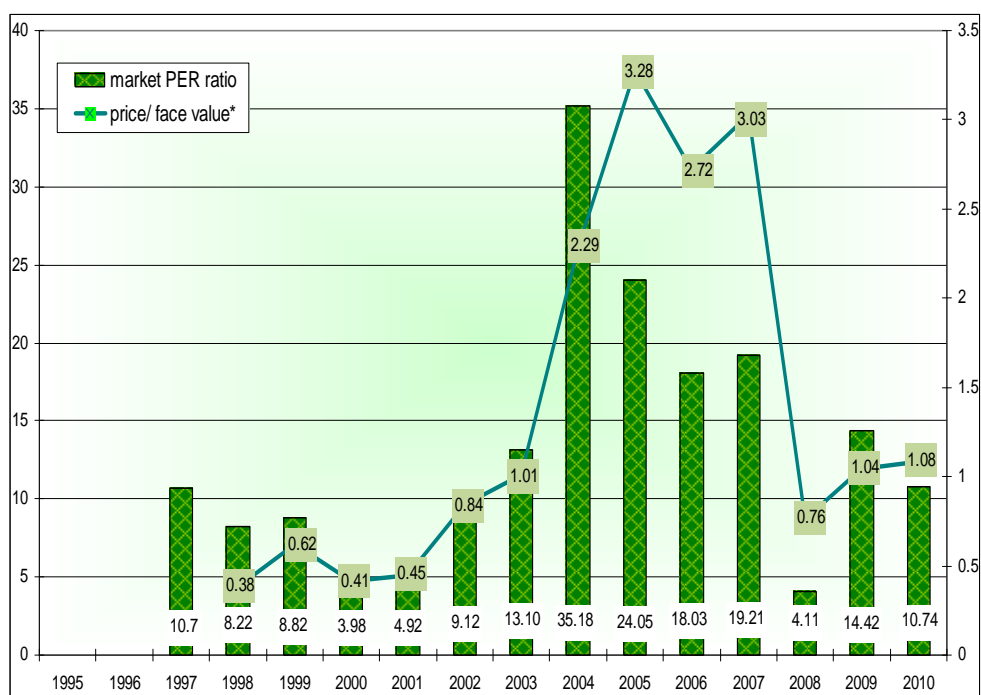
	BET return (%)	BET-C return (%)	BET-Fi return (%)	Inflation rate
1998	-49.40	-	-	59.10
1999	15.21	-4.99	-	45.80
2000	18.25	7.39	-	45.70
2001	35.71	-6.47	109.92	34.50
2002	117.52	124.02	113.14	22.50
2003	27.13	22.62	24.72	15.30
2004	93.15	98.29	106.94	11.90
2005	42.47	31.63	151.32	9.00
2006	18.09	25.07	24.66	6.56
2007	16.29	26.27	14.95	4.84
2008	-69.68	-69.68	-83.62	7.85
2009	57.21	34.62	83.33	5.59
2010	10.89	13.49	-10.09	6.09

Source: author's calculation based on data available at www.bvb.ro and at <http://www.bnro.ro/Publicatii-periodice-204.aspx>

The following graphs, 5 and 6, present PER and market/ book value ratio, and respectively the dividend yield compared against the inflation rate and average bank deposit rates offered by banks operating in Romania.

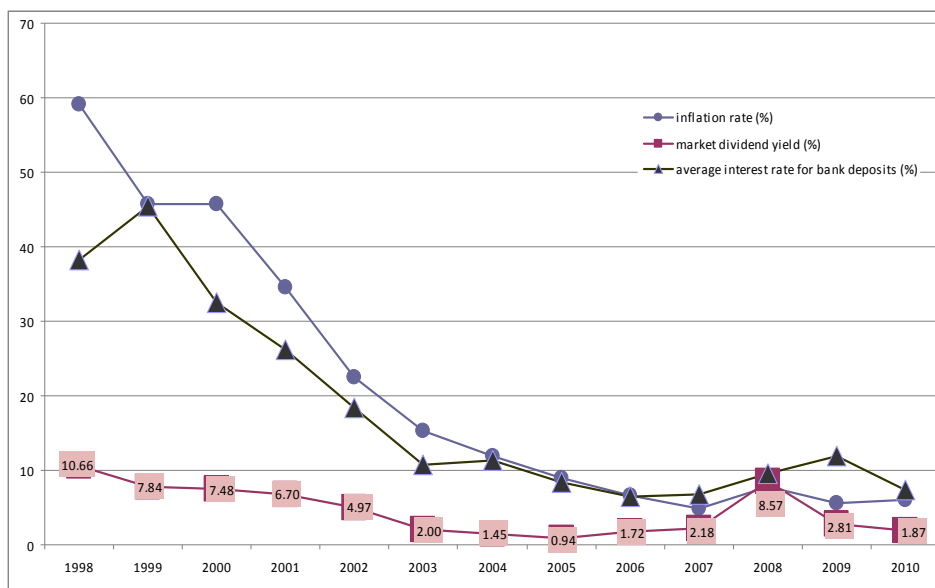
As it can be seen, PER followed BVB indices' evolution and reached its pick by the end of 2004, and the lowest value by the end of 2008 under the influence of the financial crisis.

The level of dividend yield (DIVY) for BVB equity market is very modest; it reached a pick by the end of 2008 due to the sharp decrease in prices as a direct effect of the financial crisis. The low DIVY can be explain by the fact that BVB listed companies rarely pay attention to their dividend policy. This fact is supported by the constantly decreasing number of paying dividend companies: from 54 in 2000 to 21 in 2009 (<http://www.bvb.ro/ListedCompanies/StatusDivid.aspx>).



Graph 5. - PER and Market/ Book value ratio at BVB

Source: based on BVB data available at www.bvb.ro



Graph 6. DIVY at BVB compared against inflation rate and average bank deposit interest rates

Source: based on data available at www.bvb.ro and at <http://www.bnro.ro/Publicatii-periodice-204.aspx>

On what liquidity is concerned, using the number of trades, the volume and the turnover at daily level, 3 sub periods have been observed at BVB:

1. between 1995 and 1996 (the beginning period) the average number of daily transactions was 150, with an average volume of around 11.000 shares and an average daily turnover of 0.12 million ECU.
2. between 1997 and 2004, the average number of daily transactions increased to about 2145, with a volume of about 14 million shares and an average daily turnover of 0.82 million EUR.
3. between 2005 and 2009, the average number of daily transactions grew further to about 5400, with a volume of around 57 million shares and an average daily turnover of 9.74 million EUR.

While the general picture shows an improvement in BVB's liquidity, there are still problems with a number of companies due to relative low free float and/ or lack of trading frequency.

Two more details regarding BVB equity market segment should be added:

- it is dominated by the 16 companies listed inside the first category/ tier, including the 5 SIFs; between 1997 and 2009, the first category companies concentrated 74.83% of all BVB transactions, 63.61% of BVB volume and 80.09% of BVB turnover;

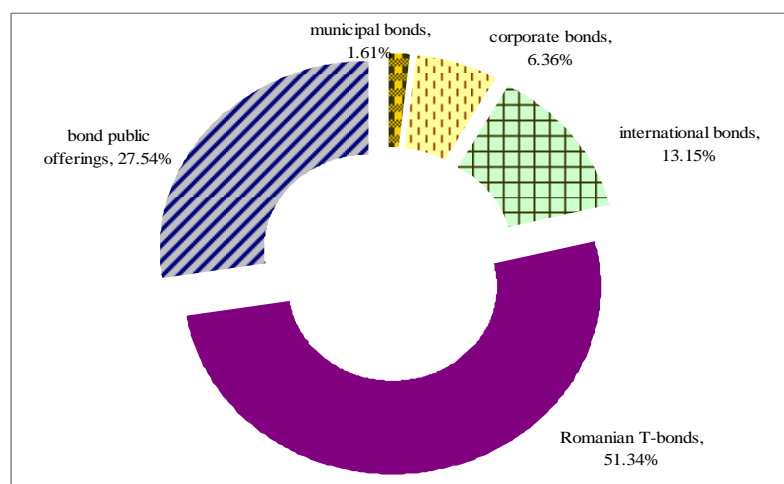
- the 5 SIFs play an important role inside BVB concentrating (since November 1999 until December 2010) 49.66% of all BVB transactions, 29.17% of BVB volume and 40.14% of BVB turnover; a recent study (Pop et al.2009 and Pop, Vamos, Craciun 2010) also revealed that mainly between 2005 and 2008 BET-Fi (which includes only the 5 SIFs) explains around 58% of BET variability and further investigations showed that BET-Fi returns Granger-cause BET returns – with probabilities ranging between 96% and 100% (for 44 days), while BET returns do not Granger-cause BET-Fi returns. This direct influence of SIFs over BVB should be taken into consideration by any investor interested in Romanian main stock exchange.

BVB bond market segment

The secondary market for Romanian bonds was launched at BVB at the end of November 2001 with only two bond issues of the small municipalities of Predeal and Mangalia¹¹.

The number of listed bond issues grew from 2 by the end of 2001 to 55 by the end of 2010. While the highest trading volume was reached by the end of 2007, the year 2010 was the one with the highest turnover within the bond market, as the information available at <http://www.bvb.ro/TradingAndStatistics/GeneralStatistics.aspx?tab=1&m=0> shows.

The structure of bond market segment, based on turnover, is reflected by graph 7.



Graph 7. BVB bond market segment structure for the period Nov.2001 - Dec.2010

Source: author's calculation based on data available at www.bvb.ro

¹¹ Both municipalities are popular tourist destination, one on the mountain region of Prahova Valley (Predeal), respectively a resort at a Black Seaside (Mangalia).

The dominant position of government bonds does not represent a surprise; their listing at BVB was expected since 1998 and they represent an important investment alternative mainly for Romanian private pension funds, but also for Romanian bond oriented mutual funds. Being listed starting with August 2008, the T-bonds represented a safe alternative investment during the financial crisis climax.

The other types of bonds have a relative low profile, mainly the municipal bonds, which are the most numerous (35 listed issues at the end of 2010). Another problem is represented by the absence of listed corporate bonds since January 2010, when the last of the previous listed issues matured. It seems that there is no interest from Romanian company to finance their needs through bond offerings and list them at BVB.

BVB bond market segment relative low importance compared with the equity segment has various causes; several of them are mentioned below:

- the low volume per offer; the highest number of offered bonds did not overpass 3,000,000 bonds (the case of bond offering launched by European Investment Bank in 2007 for the Romanian market);
- the small number of investors that subscribe to the bond offerings; this cause is connected with the previous one: due to the low volume/ offer (combined with the fact that bonds offer an alternative in very high demand for portfolio diversification on Romanian market) every bond offering launched on the market is subscribed in a very short period of time mainly by domestic institutional investors; the dominance of institutional investors in subscribing bonds and the high speed with which they are subscribing municipal bond offerings were highlighted by Sain (2004, 2005a, 2006), and Ciobanu (2007a, 2008b);
- the tendency of the bond subscribers to keep the bonds in their portfolio long periods of time or up to their maturity as highlighted by Sain (2005b), Ungureanu (2006), Ciobanu (2007b, 2008a, 2010);
- the absence of a yield curve announced and periodically published by the Romanian Ministry of Finance for the period 2001 – 2006, this situation was similar with other neighboring countries, where benchmark yield curves are incomplete or unreliable (Iorgova & Ong, 2008); the relative difficulty in accessing the present information regarding the yield curve published starting with the second quarter of 2007 due to its hidden pages in the complicated website of Romanian Ministry of Finance;
- the absence of rating for Romanian listed bonds; this cause is not uncommon in the Central and East European countries due to the absence of a culture oriented toward using ratings, as highlighted by Szilagy et al. (2004); in the case of Romanian municipality, the need for a rating is not felt since in the market the demand unsatisfied by the offer; however for some Romanian investors the absence of rating becomes increasingly disturbing in the past 3-4 years, as stressed by Ciobanu (2009).

Currently, BVB officials launched a series of discussions with various potential corporate bond issuers in order to re-introduce those type of bonds for listing. Several other projects were also announced for promoting bond market segment among investors.

BVB other market segments (rights, futures contracts, ETFs and structured products)

As graph 1, above, showed, the other financial instruments listed at BVB have a low importance (less than 1%) within the total turnover of BVB main market. Most of these market segments were launched during the past 3 years and can be considered as ‘new’ in the eyes of Romanian investors. The influence of financial crisis should also be considered as an important factor that kept investor interest at relative low levels when stock exchange investments were concerned.

Table 5 presents the volume and turnover for the other market segments at BVB and it shows for various segments either low traded volume (in the case of futures contracts), or low turnover (in the case of rights), and in the case of ETFs both.

Table 5.

BVB other market segments volume and turnover as reported at the end of every year

		2005	2006	2007	2008	2009	2010
Rights	Volume (000)	231,482.06	393,246.10	12,974.09	2,939.20	0	161,790.00
	Turnover (mil.EUR)	0.74	0.16	24.71	12.98	0	1.11
Futures contracts	Volume (000)	-	-	0.06	18.02	15.61	25.10
	Turnover (mil.EUR)	-	-	0.16	5.24	15.81	25.42
ETFs	Volume (000)	-	-	-	141.48	159.98	223.11
	Turnover (mil.EUR)	-	-	-	7.08	4.84	5.38
Structured products	Volume (000)	-	-	-	-	-	1,213.31
	Turnover (mil.EUR)	-	-	-	-	-	10.86

Source: <http://www.bvb.ro/TradingAndStatistics/GeneralStatistics.aspx?tab=3&m=0>

Note: the exchange rate used to express the turnover in million euros are those available for Romania at <http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&language=en&pcode=tec00033&plugin=1>

The investor base in Romania

The home bias phenomenon briefly mentioned in Introduction is one of the factors in favor of maintaining the domestic capital markets. Therefore, a national investment base is important for the sustainability and the further growth of a capital market like the one of Romania.

At the end of 2010, Romania had an active population of about 4.8 million persons, of which 0.6 millions were unemployed. From this sketched statistic, despite the high unemployment rate caused by the 2007-2009 financial crisis, the potential of attracting domestic individual investors toward BVB seems important.

However, the official data (available only since 2006 when the Romanian Investor Compensation Fund was established in accordance with EU regulations regarding the capital markets) show very modest figures (see table 6).

Table 6.

Investors at BVB (end of every year)

	2006	2007	2008	2009	2010
Total investors	65,304	87,664	92,864	94,545	86,703*

Source: Annual Reports of Investor Compensation Fund (www.fond-fci.ro)

Note 1: The figure is estimated based on data provided by the Investor Compensation Fund to Romanian daily papers, but is not announced officially on the Compensation Fund website.

Note 2: Based on data presented inside the reports of 2006 and 2007, which now are discontinued, in average, 95.5% are estimated to be individual investors.

The causes for these modest number of individual investors at BVB are several and range from the relative low average net income/ person¹², to the preference given to bank deposits as main saving alternative, combined with the spending patterns of average Romanians, a relative lack of education in the field of individual investments, and with the mistrust generated by two successive crisis within Romanian mutual fund sectors during the second half of the 1990s. All these causes need further and extensive investigations and will not be further developed inside this paper.

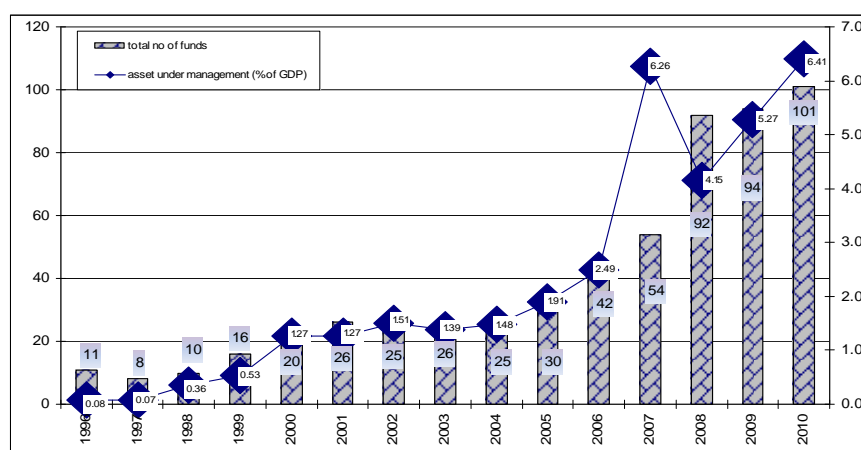
Romanian institutional investors' base is also a thin one. A number of 101 investment funds (registered in Romania) were identified by the end of 2010 – including open-end, closed-end, ETFs and pension funds from 2nd and 3rd pillar. The increase in number of investment funds and in asset under their management from 2008 was mainly due to the launch on the market of 23 pension funds, which started their activity January 1st the respective year. Graph 8 presents the evolution of those Romanian institutional investors.

¹² The level of average net income/ person is about 350 EUR/ month between 2006 and 2010 (source: own calculations based on data provided by the Romanian National Institute for Statistics; previously to this period the same income was even lower.

The picture should be considered incomplete; from this evolution Romanian insurance companies were eliminated for the following reasons:

- only an estimated number of 7 insurance companies (of a total of 24) have majority Romanian capital;
- while it was supposed that these 7 companies might choose to invest at BVB, they have very low profile segments of life insurance, if any;
- the available data regarding the assets under their management are not continuous, thus no proper analysis could be made.

It must be mentioned that this investor base is dominated by the 5 SIFs mentioned above, which for the period 2000 – 2006 concentrated over 90% of the assets under management. During 2007 a new peculiar investment fund, Fondul Proprietatea¹³, was launched and in combination with SIFs the 6 closed-end funds concentrated about 83% of the assets under management for the period 2007-2010. These 6 closed-end funds have a peculiar position within Romanian investor base due to the fact that the SIFs emerged from the privatization process and Fondul Proprietatea was created for a special purpose. In all the cases, Romanian state had an important initial contribution to these funds assets by transferring in their favor stakes from its ownership in various companies.



Graph 8. The number of Romanian investment funds and the assets under management.

Source: author's estimation based on data offered by Asociatia Administratorilor de Fonduri din Romania (www.aaf.ro), Romanian National Bank (www.bnro.ro) and by Romanian Private Pension System Supervisory Commission (<http://www.csspp.ro/rapoarte>)

¹³ Fondul Proprietatea (FP) was established in order to grant compensations to those persons abusively deprived of their properties by the former communist regime and for who was no longer possible to be compensated in kind. Initially, the sole shareholder of FP was the Romanian state (represented by the Ministry of Finance). The persons entitled to compensations (established through some stages determined by regulations) received shares at FP, transferred by the Romanian state. Currently, the Romanian state stake diminished at less than 40%. The shares of FP became freely transferable since March 2008 and were traded OTC until January 25 2011, when FP was listed at BVB first tier. Source: www.fondulproprietatea.ro/index.php/pages/en/71/FAQ.html

This thin investor base might be expected to increase in the years to come, but the growth might be too slow for BVB, if the institution wants to remain independent, as it stated in its 2008 Annual Report.

In order to increase its visibility, BVB organized 'road shows' in various Romanian towns. These events were canceled during the second half of 2007 and were resumed starting with the beginning of 2011. Due to the financial crisis, the previous road shows' effects on attracting new investors could not be assessed.

Another way to increase BVB visibility is following NYSE model: various personalities are invited to open trading sessions.

However, the potential Romanian individual investor inertia is probably the most important obstacle to be overcome. In order to do this, several extensive studies regarding the profile of Romanian potential investors should be made and used accordingly.

BVB position compared with other Central and Eastern European exchanges

Romania, and therefore its capital market, was included in the category of **frontier market** by the three main companies offering international indices: FTSE Index Company, Standard and Poor's, and MSCI Barra include Romania.

While no commonly accepted definition exists for this concept, a 'frontier market' is a lesser developed market even by emerging market standards (Standard and Poor's) and it fulfills only 5 of the 21 criteria considered by FTSE Index Company for developed markets. These indices are relatively recent, launched between 2006 and 2007.

Other countries from EU27 that are considered, along with Romania, as being frontier markets are presented in the table below. As it can be observed, Romanian capital market is included in a group of EU member states with a lower economic power and potential of development than Romania. This inclusion is showing the relative low level of sophistication and the relative low capitalization of BVB, as will be presented further in this paragraph.

Table 7.

EU27 countries considered 'frontier markets'

FTSE Frontier 50 Index (a total of 23 countries)	S&P/IFC Global Frontier Markets (a total of 24 countries)	MSCI Frontier Market Index (a total of 25 countries)	IMF World Economic Outlook Database for 2009 GDP (PPP) \$M and rank out of 180 countries	IMF World Economic Outlook Database for 2010 GDP (PPP) \$M and rank out of 181 countries
Bulgaria	Bulgaria	Bulgaria	93,569 (rank 66)	44,843 (rank 75)
Cyprus			22,703 (rank 103)	22,752 (rank 91)
	Latvia		38,764 (rank 92)	23,385 (rank 90)
Estonia	Estonia	Estonia	27,207 (rank 104)	19,920 (rank 98)
Lithuania	Lithuania	Lithuania	63,625 (rank 80)	35,734 (rank 82)
Romania	Romania	Romania	270,330 (rank 39)	158,383 (rank 49)
Slovak Republic	Slovak Republic		119,268 (rank 58)	86,262 (rank 60)
Slovenia	Slovenia	Slovenia	59,316 (rank 82)	46,442 (rank 74)

Sources: www.ftse.com/indices/FTSE_Frontier_Indices/index.jsp; www.standardandpoors.com; www.msibarra.com/products/indices; <http://www.imf.org/external/pubs/ft/weo/2010/02/weodata/weorept.aspx?>

For the current study, however, Romanian main capital market (BVB) will be compared against the neighboring EU member countries in the Central and Eastern European region: Bulgaria, Czech Republic, Hungary, Poland, Slovak Republic and Slovenia. Cyprus and the Baltic countries were not considered due to their geographic distance and due to the fact that Romania is more often compared with the countries in its near vicinity.

Of the group of country considered for this study, 3 countries are in the same category as Romania: frontier markets (Bulgaria, Slovak Republic and Slovenia). In the same time, Hungarian and Poland are included, by FTSE Index Company, in the category of ‘advanced emerging’ and Czech Republic in ‘secondary emerging’. This situation is consistent with what Iorgova & Ong (2008) mention in their study: that in the region of Central and Eastern Europe, Poland, Hungary and Czech Republic have the most developed stock, bond and derivative markets in terms of size, liquidity and instruments.

Romania and the Romanian financial market’s position among the countries of the Central and Eastern European region is well presented by the Global Competitiveness Reports published by World Economic Forum. Using these sources of information for the period 2007 – 2011, presented in table 8, it can be seen that the Romanian financial market is ranked relatively low, usually in the second half of the general rank; within the group of neighboring countries, Romania usually rank sixth, at best ranking on the fourth place. This position is in concordance with the relative lack of capital market sophistication which included Romania among **frontier markets**.

Table 8.

Romania’s financial market position among neighboring countries

2007-2008 131 countries ranked	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovak Republic	Slovenia
Country rank	74	31	38	45	73	37	40
Financial market sophistication/ development (8 th pillar)	74	53	51	64	78	33	47
Financing through local equity market (8.03, former 8.02 component)	105	71	76	66	83	103	70
Regulation of security exchanges (8.08 component)	100	56	n/a	52	91	73	64
2008-2009 134 countries ranked	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovak Republic	Slovenia

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2007-2008 131 countries ranked	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovak Republic	Slovenia
Country rank	76	33	62	53	68	46	42
Financial market sophistication/ development (8 th pillar)	74	47	61	68	60	31	46
Financing through local equity market (8.03, former 8.02 component)	90	71	95	59	83	101	76
Regulation of security exchanges (8.08 component)	104	59	58	63	91	76	70
2009-2010 133 countries ranked	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovak Republic	Slovenia
Country rank	76	31	58	46	64	47	37
Financial market sophistication/ development (8 th pillar)	76	42	69	44	56	28	48
Financing through local equity market (8.03, former 8.02 component)	85	37	100	61	78	93	72
Regulation of security exchanges (8.08 component)	108	38	54	39	88	84	60
2010-2011 139 countries ranked	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovak Republic	Slovenia
Country rank	71	36	52	39	67	60	45
Financial market sophistication/ development (8 th pillar)	91	48	68	32	81	37	77
Financing through local equity market (8.03, former 8.02 component)	90	39	111	64	89	110	84
Regulation of security exchanges (8.08 component)	109	47	52	31	97	89	66

Sources: Global Competitiveness Report 2007-2008, 2008-2009, 2009-2010, 2010-2011 – as they were available for download on www.weforum.org

For further comparisons market capitalization and the percentage of market capitalization in GDP were used. Table 9 presents the evolution of market capitalization for the exchanges under scrutiny, while graph 9 shows the importance of market capitalization respective to GDP.

Table 9.

Market capitalization (million EUR)

	Warsaw Stock Exchange (Poland)	Budapest Stock Exchange (Hungary)	Prague Stock Exchange (Czech R)	Ljubljana Stock Exchange (Slovenia)	Bratislava Stock Exchange (SlovakR)	Bucharest Stock Exchange (Romania)	Bulgarian Stock Exchange
2000	33,760.8	12,810.1	n/a	3,335.0	3,523.2	450.5	n/a
2001	28,845.8	11,564.8	8,999.1	3,838.9	3,919.6	1,361.1	n/a
2002	27,055.4	12,493.3	9,796.3	5,355.1	2,528.6	2,646.5	n/a
2003	29,349.8	13,227.9	12,287.9	5,660.1	2,203.7	2,991.0	n/a
2004	51,888.3	21,039.5	21,720.0	7,115.2	3,239.4	8,818.8	2,062.1
2005	79,353.5	27,586.4	31,059.5	6,696.6	3,729.3	13,535.4	4,312.2
2006	112,825.6	31,687.1	34,693.4	11,513.1	4,213.8	18,857.9	7,829.9
2007	144,198.2	31,502.6	47,998.6	19740.12	4,554.9	21,508.5	14,820.8
2008	65,177.6	13,325.6	29,615.1	8,468.4	3,907.3	6,474.1	6,371.0
2009	105,157.2	20,887.9	31,265.4	8,462.2	3,614.4	8,402.5	6,030.9
2010	141,918.4	20,624.4	31,922.2	6,994.4	3,379.5	9,776.3	5,498.5

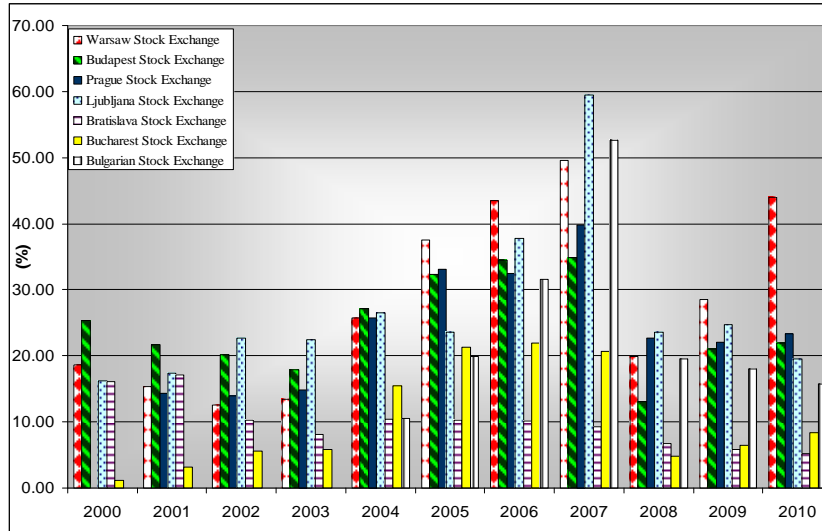
Source: FESE (<http://www.fese.be/en/?inc=art&id=4>) and Stock Exchanges websites where information was not available on FESE website

As table 9 shows, BVB (Bucharest Stock Exchange) was the only exchange which experienced capitalization growth rates of over or near 200% for 2001 (growth rate of 202.12%) and 2004 (194.84%), while for 2003 the same growth rate was near 95%. This situation was due to the important undervaluation of Romanian traded shares, combined with favorable conjuncture either political (2002 was the year when NATO accepted Romania as a member state) or economic and political (2004 was the year when EU was enlarged with 10 new member states, 5 of them being Romania's neighboring countries and included in the present study).

Only two other exchanges experienced important growth in their capitalization: Bulgarian Stock Exchange for 2005, 2006 and 2007 and Bratislava Stock Exchange for 2006 and 2007, but neither in the vicinity of 200%.

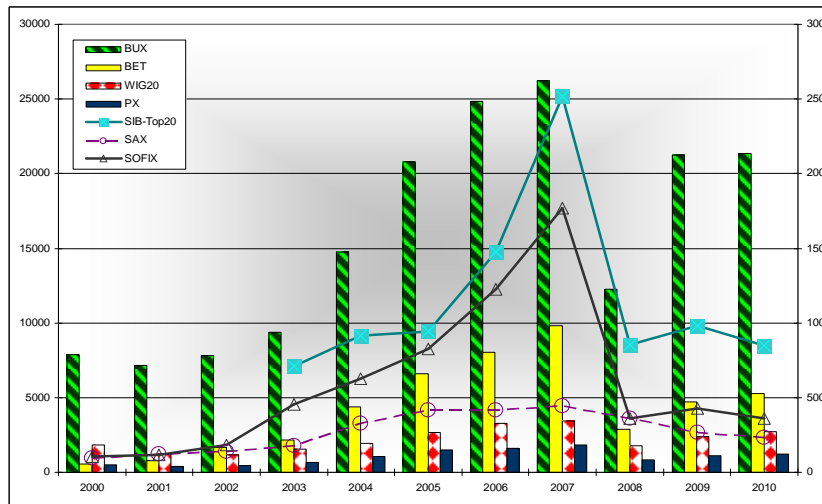
Despite BVB's important growth capitalization rate, the capitalization did not reach the levels of Warsaw, Budapest or Prague stock exchanges and the absolute figures are placing BVB at best on the 4th place (of 7), as it was the case previously when the financial market sophistication/ development was considered.

Graph 9 presents a similar position (at best ranking 4th of 7) for BVB when the importance of marker capitalization in GDP is considered, enhancing the rank given to Romanian financial market by World Economic Forum Global Competitiveness Reports.



Graph 9. Market Capitalization in GDP (%)
Source: FESE and stock exchanges' websites

Graph 10 and table 10 below present the evolution of the oldest indices for the stock exchanges under scrutiny; the choice of indices was made taking into consideration their type; 5 of the indices have blue-chip portfolios and only two are return indices (for Bratislava and Bulgaria).



Graph 10. Indices evolution
Source: FESE and stock exchanges' websites

Table 10.

Index annual returns (%) for Central and Eastern European exchanges

	WIG 20 (Warsaw)	BUX (Budapest)	PX (Prague)	SIB-Top20 (Ljubljana)	SAX (Bratislava)	BET (Bucharest)	SOFIX (Bulgarian)
2001	-33.47	-9.15	-17.53	n/a	31.41	38.58	11.15
2002	-2.71	9.36	16.75	n/a	15.90	119.79	54.33
2003	33.89	20.28	43.06	n/a	26.24	30.91	148.16
2004	24.56	57.17	56.58	29.30	84.85	100.96	37.63
2005	35.42	40.99	42.99	2.80	26.54	50.90	32.02
2006	23.75	19.53	7.67	56.57	0.56	22.23	48.27
2007	5.19	5.60	14.24	70.97	7.23	22.05	44.43
2008	-48.21	-53.34	-52.72	-66.09	-19.40	-70.47	-79.71
2009	33.47	73.40	30.19	15.03	-25.67	61.68	19.13
2010	14.88	0.47	9.62	-13.47	-13.71	12.32	-15.19

Source: FESE (<http://www.fese.be/en/?inc=art&id=4>) and Stock Exchanges websites where information was not available on FESE website

As table 10 shows, BET and SOFIX indices registered extreme values: their highest annual returns were over 100%, but these indices also registered the largest negative returns for 2008 when the financial crisis reached its climax.

The information presented above are all consistent indicating a relative low profile rank for BVB among the Central and Eastern European countries, despite overall good market performances as shown in table 10.

In spite BVB's good individual evolution between 2001 and 2007, completed by an important diversification of traded financial instruments, mainly between 2008 and 2010, Romanian main capital market could not overpass the more dynamic and better perceived markets in the region: Poland, Czech and Hungarian. One important reason is the thin base of domestic investors, either institutional or individual. The reasons those domestic investors have to avoid or be very cautious in approaching BVB (apart the relative low average monthly income) need further investigations. Another reason is the low power of BVB to attract foreign investors; this reason is partly explain by the sovereign ratings¹⁴ Romania receives and received in the past, the highest being BBB offered by Fitch for the period September 2006 – November 2008 and BBB- offered by Standard & Poor's for the period October 2005 – October 2008. Since November 2008, both rating agencies rated Romania at BB+, while for 2011 the perspectives are considered to be stable.

¹⁴ Data offered by the Romanian Ministry of Public finance at the following website address: <http://www.mfinante.ro/ratingul.html?pagina=domenii>

The alliances between European exchanges: where does Romania stand?

The competitive challenges that European integration brought for the small national exchanges represented and represent incentives for market operators to consolidate and/ or intensify collaboration. Relatively small markets may need to move toward linking their trading systems or merging with global markets (Claessens, Klingebiel and Schmukler 2002).

Within the EU the process of stock and derivative exchange integration started during 2000 when Euronext was created through the merger of Amsterdam, Brussels and Paris stock exchanges. Euronext includes today also Lisbon and LIFFE. It merged with NYSE Group during 2007 creating one important international exchange: NYSE-Euronext. It must be mentioned that Warsaw Stock Exchange has cross-membership and cross-access agreements with Euronext for cash and derivative products. Euronext alliance between four relatively small national exchanges represents a model to be followed during 2000s in Europe.

OM AG, latter OMX, created the Nordic Market virtual platform reuniting Stockholm, Copenhagen, Helsinki and Iceland exchanges and the Baltic Market where it joined Riga, Tallinn and Vilnius exchanges. The merger process for the Baltic Market started in 2003 and ended in 2006.

London Stock Exchange Group was created and is active since October 2007 joining under the same umbrella the London Stock Exchange and the Italian Stock Exchange.

Deutsche Boerse formed partnerships with Wiener Boerse, Irish Stock Exchange, Helsinki Exchange and Bulgarian Stock Exchange regarding the use of its Xetra trading platform.

September 17, 2009 is the date that marks the creation of the latest exchange group: Central and Eastern European Stock Exchange Group or CEE Stock Exchange Group, having as members: Wiener Boerse, Budapest Stock Exchange, Ljubljana Stock Exchange and Prague Stock Exchange.

All the groups mentioned above considered that through the merger of their forces through common trading platforms and increased transparency, they will gain exposure to a larger investor base (at least cross-national, but also international), while offering a wider variety of products and diversification under the same name and in the same virtual location.

BVB has just one important co-operation agreement with Wiener Boerse for its ROTX index, since 2004. Other 7 bilateral agreements are mentioned in BVB annual report of 2008 (pp 54): with Athena, Tokyo, and London Stock Exchanges – signed between 1997 and 2000; with Italian Stock Exchange, and Salonic Stock Exchange, signed in 2002 and 2003; and in 2006 with the exchange from South Korea and Republic of Moldova. None of these 7 agreements yielded any close co-operation or the perspective of an integrated alliance that can offer BVB an enhancement of its position.

Concluding remarks

The answer to the first question asked above:

✓ is there a future for small domestic stock exchanges in the region of Central and Eastern European countries, which are also EU member states? can is given by the Euronext model and CEE Stock Exchange Group that followed the respective model. Through these kind of alliances, the identity of a small stock exchange is preserved, while the common trading platform allows an increased visibility when the international investors are concerned. As part of an alliance, a small stock exchange can fulfill its functions for the domestic companies and domestic government agencies looking for financing alternatives, and it also is opened toward an increased range of investment products that can be offered to domestic and foreign investors alike.

The answer to the second question:

✓ which will be the future for Bucharest Stock Exchange (abbreviated BVB¹⁵ from now on) taking into account its inclusion in the category of *frontier markets*? contains more nuances and is given in the paragraphs below:

In a challenging environment which put under question mark the existence of national stock exchanges, BVB remained isolated and small from capitalization point of view. Liquidity is also relatively low and despite the diversification of its activity through the bond and derivative market segments, the number of domestic investor accessing the market remain very low, with poor perspective to grow at a rapid pace in a short to medium-term horizon of time. The growth of Romanian institutional investors is also expected to be slow. The thin base of domestic investors calls for a strategy that will offer BVB an international exposure, and that could no more be realized individually.

BVB's position among the exchanges in the Central and South-Eastern European region is, at best, an average one. If BVB will not take into consideration the possibility to become part of one of the existing group of exchanges at the European level, its future can be put under question mark.

While difficult to asses, the barrier that BVB have to cross in order to join or to be taken over by an European group of exchanges are rather cultural than technical. To this it must be added the fact that BVB can be considered 'a source of national pride' which might raise further debates regarding its independence or appartenance to a group of stock exchanges.

The most logical solution for BVB is to try to join CEE Stock Exchange Group, but the German cultural influence over this group is too strong for a Latin country like Romania.

¹⁵ The BVB abbreviation comes from the Romanian name of the exchange: Bursa de Valori Bucuresti and it is preferred by the authors in order to avoid any confusion with similar possible abbreviation for Bucharest Stock Exchange, which are Budapest Stock Exchange, Bratislava Stock Exchange, and Bulgarian Stock Exchange.

Other alternatives are:

- an alliance with other small exchanges in the region, which are not (at last for now) independent, like: Bratislava Stock Exchange, Bulgarian Stock Exchange, Malta Stock Exchange and Cyprus Stock Exchange; however, such an alliance is difficult to be established due to important differences in the market structures, but also in the cultural background;
- an alliance with the important stock exchanges in Europe, which are still independent, like: Madrid Stock Exchange, Athens Stock Exchange or Warsaw Stock Exchange; however, compared with any of these exchanges, BVB is almost invisible and the proposal is likely to come from the other parties, rather than be made by BVB.

If BVB will not enter any alliance during the next 2-5 years its profile in the region will remain very modest and far from the stated objective in BVB's 2008 Annual Report of 'becoming a leader in the region'.

However, a right alliance has the potential to enhance BVB's profile and to insure, at least up to a point, its independence.

During the month of June 2010 the BVB's shares will start listing on its trading platform. This situation will allow interested groups to make mergers or takeover offers. It remains to be seen if such an interest exists, and when and by whom it might be expressed.

The year 2011 might mark an important step forward if BVB position in Romania will be consolidated if the planned merger with SIBEX will be agreed upon and will take place.

Some rumors inside the Romanian financial sector (currently not confirmed) seems to indicate that the most probable alliance BVB will (be invited to) make is the one with Warsaw Stock Exchange.

The future evolutions will show if BVB chooses to join its forces with other exchanges in order to upgrade its profile for foreign investors, mainly, or will follow a slow (and relative risky) development path on its own in a fast moving, challenging and globalized financial environment.

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