Market force of institutional investors on the Romanian capital market

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MARKET FORCE OF INSTITUTIONAL INVESTORS ON THE ROMANIAN CAPITAL MARKET

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ABSTRACT: *The role of institutional investors*[1] *in developing domestic capital markets and not only is well known in the economy. They support the financing process of different economical entities with deficits within the economy, providing long-term capital resources to the capital market. Therefore, they play a crucial role in the development of the country's private sector. In this paper, the authors analyse the current situation of the institutional investors on the Romanian capital market and show their contribution to the economical development of a country from a theoretical point of view. The offered statistical information complete the general analysis made about the current position of institutional investors on the market.*

KEY WORDS: *institutional investors, capital market, pension funds, investment companies*

1. INTRODUCTION

Once with the development of the domestic capital market, we can state that the role of the instituional investors in the economy has even more increased, contributing to the economical growth and supporting the real economy. Many initial public offerings (IPOs) are subsribed by such kind of investors, permiting in this way to the companies to develop in adequate conditions their production and investment projects. The short and long-term bond market is also supported by th existence of the institutional investors, that look for this long-term placements, and find the corporate, county and state bonds very attractive. Therefeore, the influence of instituional investors upon the development of the local capital market is obvious and canot be denied.

As in the case of small investors, the behaviour of institutional investors is a subjective one. It is based on previous analysis and forecasts, and on the fact that they have a better knowledge upon the market, lot of information, abilities, previous experience in managing their funds and securities on the market. For this reason, they are considered „the clever investors" from the market. Sophisticated and well informed, the institutional investors are the ones that establish the trends of the capital markets all over the world. We are talking about the market force of institutional investors in the current situation of Romania because of their strong growth over the time and of the fact that their presence started to be visible on the local capital market.

2. THE CURRENT SITUATION OF INSTITUTIONAL INVESTORS ON THE ROMANIAN FINANCIAL MARKET

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[1] Through institutional investors we understand the persons entitled to manage the portfolio of insurance companies, pension funds, mutual funds, financial investment companies, credit institutions. They are professional investors, their job being that of increasing the value of liquidities they manage.

2.1 Private pension funds

First of all, the role of pension funds increased a lot, the effects being likely to be seen in the next period, taking into consideration the reform of the pension system. It supposed the introduction of two more pension pillars, along to the state pension, of fostering the private pension funds activity in their attempt of reaching a significant volume of compulsory and optional private pensions. The more and more intensive activity of private pensions funds is becoming more visible, considering the fact that the percent from the monthly revenue of each employee dedicated to private pension will increase gradually to 6% till 2016. This fact has a deep influence upon the domestic capital market. The experience of other countries that have implemneted such reforms in their countries show the potential big impact upon the capital market. The existence of the suplimentary two pillars represents a premise for the developing the activity of these pension funds, that will further look for investitional products in order to place their funds. Ineluctable, that will lead to a wider range of financial instruments on the capital market, an increase growth of the market liquidity and not at least, a deepening of financial market in general. In our opinion, the effects generated from the private pension funds are not yet significant for the domestic capital market for two reasons. First of all, the uncertainty climate and major capital losses registered on the capital market more recently, have released a certain reserve from the part of the persons in charged with the investment decisions, being more cautious in their approach to choosing investment instruments and assume risk. Therefore, they'd rather invest in bank deposits or state bonds. On the other hand, these alternatives are preferred also because there is this politics at the level of the pension fund, that, in the first years, the majority of their assets (> 70 %) must be placed in low risk financial instruments (short and long term state bonds, bank deposits, fixed income securities), for prudential reasons and for covering the provisions and guarantees required by the law. On contrary, in the following years, managers of such funds choose high risk financial instruments, as equities listed on the domestic capital market that can offer higher yields[2].

Secondly, the effects are not so visible due to the fact that the third pillar, the optional pension market, has only celebrated its first year of functioning at the middle of the year 2008, so the real growth will come up in some years from now. We can state the same thing about private administrated compulsory pensions. The assets accumulated so far are not so significant, taking into consideration the fact that people have only started to allocate a percent of their income in this direction. A more visible effect will be seen starting with 2009, of course, if the capital market recovers from the current situation. The future impact of

[2] According to the Surveillance Commision of Private Pension Funds System (CSSPP), a pension fund privately administrated can choose from the following financial instruments: a) money market instruments, inclusive lei bank accounts and deposits at a Romanian bank or a foreign bank licenced to function in Romania and that is not under a special surveillance or a special treatment because of the lack of licence (<=20 % of total amount of assets); b) state bonds issued by Ministry of Economy and Finance from Romania or belonging to the European Union member states or the European Economical Space (<=70 % of total amount of assets); c) bonds and other securities issued by local public administration authority or by the member states of European Union or belonging to the European Economical Space (<=30 % of total value of the assets); d) securities traded on regulated capital markets of Romania, member states of European Union or belonging to the European Economical Space (<=50 % of total amount of assets); e) state bonds or other securities, issued by third-party states (<=15 % of total amount of assets); f) bonds and other securities, traded on regulated capital markets from third-party states, issued by their local public administration (<=10 % of total amount of assets); g) bonds and other securities issued by nonguvernmental foreign organisms, if these instruments are quoted on approved capital markets and if they can accomplish the rating conditions (<=5 % of total amount of assets); h) titles of participation in mutual funds, issued by collective investment companies from Romania or other countries (<=5 % of total amount of assets); i) other type of investment instruments according to the Commision.

private pension funds on the capital market will be an important one, fostering the companies to finance themeselves from the capital market and encouraging the appearance of new financial instruments on the domestic capital market, that could help managers of pension funds to diversify their portfolio. Practically, the private pension funds are an important part of the demand of financial instruments on the market. On the other hand, they contribute to the quality of the securities listed on the capital market, considering tha fact that they introduce the mechansims of corporate governance in the managament of listed companies , duet o the fact that they have a strong interest in making these companies as transparent as possible.

2.2 Insurance companies

In the category of insitutional investors, the insurance companies have an important part. Thier importance will grow even more in the future, emphasizing their potential role on the capital market. Their growth will be determined by: per capita growing of income, better financial education of the people, process of aging (increasing in this respect the demand for life insurance policies, alongside with private pensions), as well as developing the mortgage market (through the creation of suplimentary demand for estate insurance). There is a close connection between insurance companies and capital market. On one hand, according to the current legislation, the insurance companies can invest their assets in state bonds, current bank accounts and deposits, tiltles of participation in investment companies, securities (equity, bonds, others) or even real estate, all of these combined in a manner that the insurance company does not suffer from any paying incapacity. According to one order of Insurance Surveillance Commision (CSA), the aquired financial instruments made by insurance companies on the capital market can be considered their liquid assets. The equities aquired by insurance companies will serve as a mean to cover the technical reserves of companies that practice general insurance. In other words, insurance companies could sell from the owned equity, obtaining realatively quick the necessary cash they need. In the same time, as a natural consequence of the financial innovation, as the financial market is becoming more and more mature, the insurance companies can begin to assure other specicif events on the capital market, like for example, to take over the risks associated to issuing equity or bonds by companies or the risks associated to interruption of the transactional system of the capital market. As a recognition sign of this integrating evolution of capital market and insurance market, the legislative and administrative authority, respectively Romanian National Securities Commision (CNVM) and the Insurance Surveillance Commision (CSA) have concluded a common protocol that has as purpose the financial market surveillance.

2.3 Investment companies

Investment companies is used as a generic term for defining the two types of investment companies that coexist on the Romanian financial market (closed and open investment companies). They have reached an important growth over the time, and their importance seem to rise even more. As far as concerns the closed investment companies, we have five financial investment companies (SIF) listed on the regulated capital market. They have been created as a consequence of the Mass Privatization programme, further listed on the capital market. Their growth can be justified by the the fact that the placements made in such companies were proved to have high yields, a sum invested in 1999 in this kind of equity woulf have raised 40 times till present.

An incentive for the growth of the five financial investment companies was due to the increase in the level of ownership threshold, from 0,1 % to 1 & in 2005. This fact has generated a growth of the five financial investment companies. Their cummulated net assets continue to grow, in the last two years registering even a 100 % growth. This can be easily noticed from the table below:

Table 1

The current state of the financial investment companies on the capital market

Financial investment company	**Net Asset (mill.RON)**		**Number of issued equities**	**Unit value of net asset**	**Nr. companies included in the portfolio**
	2007	**Growth 2005 (%)**	**2007**	**2007**	**2007**
SIF Banat-Crişana	2.024	106 %	548.849.268	3,6892	368
SIF Moldova	1.789	108 %	519.089.588	3,4468	265
SIF Transilvania[3]	2.764	162 %	1.092.143.332	2,5309	303
SIF Muntenia	2.166	146 %	807.036.515	2,6843	241
SIF Oltenia	2.756	112 %	580.165.714	4,7518	191

(*Source*: computed by author on dates provided by www.unopc.ro)

Alongside financial investment companies, in the closed investment companies also figure venture capital funds. Many local companies have been restructured and developed with the help of these kind of investment companies. Venture capital investment is generally made as cash in exchange for shares in the invested company, with the purpose of developing the business and gain a return over a period of time through an eventual realization event such as an IPO or trade sale of the company. The value of the investments realized by these companies has raised from one year to another in Eastern and Central Europe, reaching in 2006 a three times bigger volume than in the previous year and in the same time a record of value. The volume of investments have increased especially in countries like Hungary, Czech Republic, Poland and Romania. More precisely, the volume of investments made by venture capital funds in Romania registered in 2006 a value of 110 millions Euro, a growth with approximately 58 % since the previous year, reaching the fourth position in the general ranking of the countries of Central and Eastern Europe, considering the total volume of investments.

Mutual funds**,** in their quality of open investment companies, have as main objective the growth in value of the managed total assets. The required financial performance has as purpose a superior yield, usually considering a benchmark (stock market index, for example). Depending on the type of mutual fund (monetary fund, bond orientated fund, equity orientated fund), it is established the specific strategy of investment, the range of financial instruments had in consideration and of course, the assumed risk. Despite the fact that Romanian mutual funds have developed lately (at the end of 2007, they had 265 millions Euro in net assets), in comparison with the other mutual funds from Central and Eastern Europe, their net assets are very low, as we can see in the figure below:

[3] In the year 2007, SIF Trasilvania doubled its capital by incorporating rserves and distributing free equities.

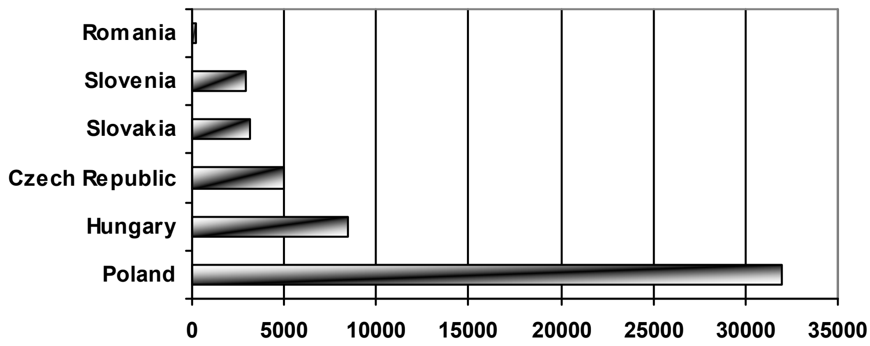

Figure 1 – Net assets of mutual funds from countries belonging to Central and Eastern Europe in 2007 (mill.Euro)

3. CONCLUSIONS

An important element for developing the domestic bond market and capital market in general is the presence of **powerful institutional investors**, with a long-term investment horizon (pension funds, insurance companies, investment companies). Studying more carefully in this article, the current situation of these investors, we can state that they have known a significant growth over the time and they should have a "market force" when talking about the capital market. Of course, the difficult period that the domestic capital market is passing through nowadays is influencing negatively upon these investors, just in a period when their presence on the capital market should have been felt in a serious way.

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