

CORPORATE GOVERNANCE IN ROMANIA



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PREFACE

The issue of corporate governance has risen in prominence over the last decade, as the role of the private sector has increased around the world. In OECD countries, there has been substantial reform to improve the corporate governance framework. Financial crises in emerging markets, and a long transition process in many countries from plan to market, have made clear the relevance of good corporate governance as a key structural and institutional feature of a functioning market economy. This has been true in Romania, which had no private corporations at the beginning of the last decade, but now has a large corporate sector producing over sixty percent of Romanian's GDP and employing the majority of its workers.

Good corporate governance ensures that companies use their resources more efficiently and leads to better relations with workers, creditors, and other stakeholders. Most importantly for a transition economy like Romania, good corporate governance enhances the confidence of domestic and foreign investors. It is an initial prerequisite for attracting international investment, especially the patient capital needed for sustained long-term economic growth.

The Organization for Economic Co-operation and Development (OECD) pioneered the development of policy standards for corporate governance. In 1998, at the recommendation of the OECD Council, the OECD established an Ad-Hoc Task Force on Corporate Governance to develop a set of corporate governance principles. Adopted in 1999, the *OECD Principles of Corporate Governance*¹ have become the global benchmark for corporate governance reform. Admitting that no one model of corporate governance can work for all countries and for all companies, the OECD Principles identify standards that can apply across a broad range of legal, political and economic environments. The Principles are intended to assist governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries. They also provide guidance for stock exchanges, investors, corporations and other parties that have a role in the process of developing good corporate governance.

As part of a broad co-operation agreement between the OECD and the World Bank to assist in the improvement of corporate governance worldwide by using the principles as a standard, regional Roundtables on corporate governance have been established in Russia, Latin America, Asia and Eurasia. A similar Roundtable has also been established in South East Europe (SEE) in conjunction with the Stability Pact in 2001. In this context, the OECD, with the support of USAID, developed a specific program to improve corporate governance in Romania. The objectives of the OECD/USAID Romanian corporate governance effort were to:

- Evaluate corporate governance in Romania;
- Offer a set of key recommendations for improving corporate governance in Romania and bring it closer to the international standard of the OECD Principles
- Identify needed technical assistance in the area of corporate governance;
- Improve the understanding of present corporate governance practices in Romania, informing the international community about progressive national reform initiatives;
- Facilitate full Romanian access to the ongoing international dialogue on corporate governance.

These objectives are the key drivers of the present *Report on Corporate Governance in Romania*. A draft version of this Report was discussed at a high-level policy meeting on Corporate Governance in Romania held September 18-19, 2001 in Bucharest. The meeting was co-hosted by the Bucharest

¹ The Principles as well as other documents related to corporate governance may be found at www.oecd.org

Stock Exchange and the National Securities Commission. It brought together the leadership of the Stock Exchange and the Securities Commission with prominent members of Romania's business and financial communities and academia, trade union representatives, and senior experts on corporate governance from Romania and OECD member countries, as well as government officials. Immediately following the meeting, September 20-21, the SEE regional corporate governance roundtable was also launched in Bucharest with the participation of private and public sector experts from a number of countries in the region.

The Report has been finalized on the basis of comments and presentations offered at the meeting, as well as written comments. The meeting provided a crucial forum to discuss Corporate Governance in Romania, and has had a great impact on the final report.

The key Recommendations of the report constitute a comprehensive agenda for reform. The Recommendations not only emphasize legislative changes, but also underline the importance of reform in the areas of enforcement, institution building and private behaviour/capacity building that are necessary for improved corporate governance in Romania.

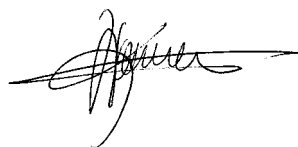
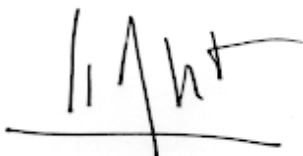
Part One of the Report gives a comprehensive picture of the current situation of the corporate sector in Romania, and the process of transition that created it. Part Two examines the main aspects of the regulatory environment for corporate governance. In each case, the legal provisions are compared with current practice in order to assess the institutional framework's effectiveness and identify shortcomings that should be dealt with. The *OECD Principles of Corporate Governance* are the benchmark against which regulations and current practice are evaluated.

We would like to extend our sincere appreciation to the Bucharest Stock Exchange and the National Securities Commission, our co-hosts for the meeting on Corporate Governance in Romania in Bucharest, whose help was critical for the successful outcome of the meeting and hence this Report. We would also like to thank the Government of Romania for agreeing to co-host the final presentation of this important Report in December 2001.

This report was produced by the Corporate Affairs Division of the OECD and is a part of the program of work of the OECD Center for Cooperation with Nonmember Economies. Aurelian Dochia was the principal Romanian consultant.

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RECOMMENDATIONS

Overall Reform Priorities

As recognized in this report, during the complex process of transition Romania has taken several important steps to improve the legal and regulatory underpinnings of corporate governance. These efforts have made extensive use of both national and international expertise and have resulted in broad familiarity with the issues involved. A company law, which was introduced in 1990 and to a large extent meets internationally accepted standards, and a similarly solid securities regulation which was issued in 1994, are two examples. Over the last few years, the desire to improve corporate governance in Romania has also increased considerably; an ambition that was clearly seen during the consultation and drafting phases of this report. One example is the listing requirements for the newly created Transparency Tier of the Bucharest Stock Exchange (BSE), which include higher standards of corporate governance.

In assessing the strengths and weaknesses of Romanian corporate governance today, **it is recommended that top priority be given to reforms that will improve effective implementation and enforcement of existing laws and regulations.** As recommended below, priority should be given to ensure that the National Securities Commission has sufficient independence and resources to carry out its mandate. It is also urgent to increase the capacity of the judicial system to deal with commercial disputes, and to ensure the integrity of Romanian accounting and auditing practices. Progress in the area of implementation and enforcement will depend on a mix of measures, such as training and capacity building on the one hand, and institution building on the other. As results may take time to emerge, it is important that changes are initiated immediately if Romania is to catch up with international developments.

Top priority should also be given to facilitating the emergence of a strong private sector in Romania with an effective ownership and control structure. This will not only increase corporate productivity but also create sound domestic and international demand for good corporate governance. Concretely, this calls for immediate measures to intensify privatisation efforts and to facilitate de-listing of many of the small- and medium-sized companies presently listed on the Romanian exchanges.

The third area of priority is prevention of expropriation by controlling shareholders and/or managers. As noted in the more detailed recommendations below, this should include effective enforcement of shareholder rights with respect to changes in share capital and the introduction of control mechanisms to prevent abusive related party transactions. The Stock Exchange should participate in these efforts and, building on the newly created Transparency Tier, immediately initiate the development of a voluntary code, which should be tied to listing requirements.

1. Ownership Structure

1.1. Privatisation efforts should be intensified and include a program to improve corporate governance in the National Companies.

In spite of numerous reforms, the management of the National Companies remains politicized and inefficient. Privatisation is therefore the best solution to improve their overall performance. However, a poor corporate governance record has sometimes made it more difficult to find buyers for these companies. It is reasonable to assume that improved corporate governance practices will facilitate placement, and ensure a higher valuation and better access to capital for these firms.

OECD member governments have made great efforts in reforming their state-owned firms in the process of privatisation. Their experiences could provide Romania with some guidance regarding the reform of the national companies. Some important steps include the transfer of

control from the ministries to professional boards with commercial objectives and the institution of performance-enhancing compensation combined with high standards for management (see recommendation 6.2). It is also important that public policy priorities are clearly defined in legislation and exercised via regulation rather than ownership. This would allow for a substantial reduction in the number of enterprises that require some sort of state ownership.

1.2. Ownership in most of the small and medium-sized listed companies should be consolidated, and the companies delisted.

Mass privatisation resulted in more than 5,000 public companies listed on the Romanian over-the-counter trading system (RASDAQ). Currently, a vast number of these companies are de facto insolvent, with no prospects of their shares being traded. Consequently, ownership should be consolidated and these companies delisted. However, Romanian creditors face extreme delays when attempting to restructure or liquidate insolvent companies. Bankruptcy procedures must therefore be streamlined, accelerated and conducted with less bias for corporate incumbents. Where a company can be restructured its creditors should be allowed to agree on restructuring as quickly as possible without undue administrative, or other, obstacles.

The privatisation process also led to extremely dispersed ownership in individual companies, with ten million Romanians becoming shareholders. While the RASDAQ has facilitated some concentration for those companies that are effectively solvent, many of them still have very large numbers of shareholders. This ownership structure makes it almost impossible to monitor management or controlling interests, resulting in very poor treatment for minority shareholders. These companies also face large administrative burdens for being publicly listed, burdens that will almost certainly increase as the standards for shareholder treatment and transparency and disclosure are raised. Regulating and monitoring such a large number of companies imposes a burden on the National Securities commission that exceeds any potential benefit.

In order to facilitate ownership consolidation and delisting, regulation should provide for incentives for the controlling interests in listed companies to buy out dispersed shareholders through a fair and equitable system of tender offers. This could include the development of a 'squeeze out' procedure, to be initiated by the company or shareholders, when the fraction of shares held by minority investors falls below a certain threshold. This would be a mandatory buy out of minority shareholders at a price set through a fair and independent appraisal of the share's value. The independence of the assessment should be confirmed either by shareholder agreement/consensus or by an independent authority. This process may also include the establishment of an independent authority to assist in consolidating claims.

2. Enforcement and Implementation

2.1. The capacity of the judicial system to effectively deal with commercial disputes must be strengthened.

The judiciary has had great difficulty in dealing with the very rapid growth of commercial litigation that has occurred since the end of central planning. Politicization, insufficient training, lack of experience and precedent and a shortage of resources have all plagued the system, leading to long delays and sometimes questionable judgments. Strengthening the judicial system should be an essential element in Romanian corporate governance reform, given that it underpins many of the recommendations listed in this report.

Successful reform of the judiciary will require a number of steps. Priority should be given to the following: (a) The training of lawyers and judges in commercial law and procedures,

especially with respect to bankruptcy and company law. Multilateral and bilateral assistance could play an important role in achieving this. (b) The compensation of judges and other court personnel should be increased to ensure the education, experience and integrity required for the position. (c) Greater specialization of the judiciary should be encouraged. (d.) Court written opinions and decisions should be made public to increase public awareness, facilitate interpretation of the law and enhance the accountability of the legal system. (e.) An effective mechanism to counter corruption in the judiciary should be put in place.

2.2. The public and private redress mechanisms for shareholders must be improved and include the use of professional arbitration and collective shareholder action.

Due to an overburdened and inefficient judicial system shareholders that seek legal redress experience delays and costs that in the vast majority of cases exceed the value of their shares. This discourages shareholders from seeking redress when their rights are abused.

As a remedy, it might prove useful if the stock exchanges provide for professional arbitration mechanisms to settle disputes between companies and shareholders. Improving the legal redress mechanisms for shareholders could also include allowing low cost collective action through shareholders' associations or other collective institutions, and allowing the Securities Commission to file lawsuits on behalf of shareholders, provided that sufficient resources are made available for this function.

2.3. Parliament should ensure that the National Securities Commission has the independence and resources necessary to fulfil its mandate, including the supervision of the self-regulatory organizations.

The National Securities Commission is headed by five commissioners appointed by the parliament, which also approves its budget on an annual basis. As a consequence of a long and expanding list of responsibilities, the resources of the National Securities Commission are generally strained. Part of these responsibilities includes the supervision of the self-regulatory organizations (SRO), which have often failed to assume their responsibilities, adding to the work load of the Commission. In addition, the division of responsibility between the National Securities Commission and other authorities is not always clear and the commission is sometimes seen to be subject to political influence.

Effective enforcement on the part of the National Securities Commission requires budgetary stability, regular staff training, including exchange of expertise with similar institutions regionally and worldwide, competitive salaries and adequate facilities. Commissioners should be appointed and carry out their functions on the basis of professional merit and their respectability in financial markets. The commission must demand the highest ethical and professional standards of the SROs. In particular, the National Association of Securities Dealers must be provided with incentives to improve its performance and credibility sufficiently to allow it to qualify again for SRO status. Technical assistance programs could be initiated in order to identify the weaknesses and needs of the SROs

2.4. Listing requirements should stipulate disclosure of compliance with a Voluntary Corporate Governance Code

A Voluntary Code of Corporate Governance is an important part of successful corporate governance reform, having the advantage that it can be developed and implemented independently of the legislative process. Building on earlier efforts in Romania, such as the recently established requirements for listing on the Transparency Tier, it is recommended that the BSE initiate the development of such a code in close cooperation with investors and issuers and all other relevant parties.

Disclosure of compliance with a Voluntary Code should ultimately be required for listing on certain tiers of the BSE. Disclosure of compliance should also be required by the RASDAQ when and if it develops a 'top tier'. Those institutional investors backed by international development agencies -- including the EBRD, IFC, and USAID -- as well as the Financial Investment Companies (SIF), could also take into account compliance with the code when making investment decisions. The Code should require high standards with respect to transparency and disclosure, and should be consistent with the *OECD Principles of Corporate Governance*. It should focus primarily on the duties of directors and what they can do to improve corporate governance, including the recommendations of this report.

3. The Rights and Equitable Treatment of Shareholders

3.1. Changes in share capital must be approved by shareholders, respect preemptive rights, and be priced in a manner consistent with a fair and independent assessment of the company's value.

Abusive capital increases are all too common in Romania, and the rights of shareholders to approve such changes and to exercise their preemptive rights have frequently been circumvented. Dubious means have sometimes been used to price new shares for certain buyers, with the effect of diluting existing shareholders. The most common and severe abuses include the use of nominal book value in a hyperinflationary environment, and in-kind contributions where the value of the contribution was grossly inflated.

Good corporate governance requires that a general shareholder's meeting must approve any change in the capital structure. The meeting must follow all the stipulated procedures, including requirements for notification and attendance required for general shareholder meetings. In announcing the general meeting, it must also be made clear that the meeting will consider a change in share capital, and the terms of that change. Once a change has been approved, the pre-emptive rights of shareholders must be honored. If they are not, the new issue should be null and void. 'In-kind' contributions for share capital should not be allowed and joint stock companies should not use nominal book value as a basis for pricing new shares in the context of a capital increase. Since the stock market value of Romanian companies is often an ineffective means for valuation, it is important to develop and increase the use of independent assessments of a company's share value.

3.2. Control mechanisms must be put in place to monitor and prevent abusive related party transactions.

Controlling interests, such as majority shareholders and management, have repeatedly used abusive transactions to extract value from the company at the expense of minority shareholders. Such practices fundamentally violate the principle of equitable treatment of shareholders.

To inhibit such practices, major transactions that involve a substantial part of the company's assets should always be approved by the general shareholders meeting. In all other transactions, regardless of size, managers and board members should be obliged to disclose any potential conflicts of interest before the decision is made. In the case of a conflict of interest, the manager or director should not participate in the decision. Conflicts of interest may arise in transactions with a party who is affiliated with a member of the board, management, and their relatives or close associates. Conflicts of interest are also likely to occur when elected officials or cabinet members serve on the boards of business corporations. All major transactions, and all transactions that include conflicts of interest, should be disclosed to shareholders.

3.3. Shareholders, including institutional investors, should be encouraged to increase their participation in the corporate governance process.

The great majority of shareholders play no role in the corporate governance process of the companies they own. This reflects both the very small stakes that most shareholders possess, as well as an underdeveloped equity culture. Raising the awareness of the shareholding public is therefore an important condition for improved corporate governance. It is recommended that educational and public awareness programs be initiated in order to allow for a better understanding of corporate governance issues. International institutions could play an important role by supporting such programs that should also include active participation from journalists and media representatives. Initiative could also include assisting companies and investors in organizing proxy voting.

Institutional investors play a much smaller role in Romania's capital market than in other transition economies that have experienced voucher based mass privatisation. In order to contribute to an improved corporate governance culture in Romania, institutional investors, including foreign investors, should be encouraged to formulate and make public their ownership policies, especially with regard to voting in the general shareholder meeting. Institutional investors must also strive to improve their own corporate governance practices, especially with regard to transparency.

3.4. Techniques designed to prevent shareholder participation in the general meeting must not be allowed, the notification period for the meeting should be extended and the decisions of the meeting should be implemented.

The general shareholders meeting is the company's ultimate decision making body, vested with the authority to decide on fundamental issues including the composition of the board of directors and the use of corporate profits. In order to facilitate the proper running of the general meeting, it is recommended that a Best Practices Guide be developed for use as a reference manual for listed corporations and shareholders.

Some Romanian companies have established onerous identification requirements, and complicated 'share registration' schemes in order to restrict shareholder participation in the general meeting. It is imperative that all practices that limit the legal right of shareholders to participate in any meeting be abolished.

Though the rights of shareholders to be notified of, and informed about, the general meeting are generally respected, the short notification period makes it difficult for shareholders to be fully informed and prepared for the meeting. To allow shareholders to be properly informed and prepared, the currently required 15-day notification period should be extended to at least 30 days.

Non-payment, or delayed payment, of agreed dividends is a frequent abuse, which is aggravated by Romania's recent history of high inflation. Dividends should be paid promptly, within 60 days. More generally, shareholders should be able to force the implementation of the decisions of general meetings through accelerated court procedures, such as interim measures.

4. The Role of Stakeholders in Corporate Governance

4.1. Romanian companies should put in place governance mechanisms that ensure familiarity and compliance with outstanding legislation related to the rights of stakeholders.

While the censors are formally charged with monitoring compliance with Romanian law, it is not clear whether they have been successful in fulfilling this role. The division of responsibility for the company's external obligations needs to be well-defined, with clearly assigned responsibilities amongst company organs. It should be the ultimate responsibility of the board to assure that such a structure is put in place. From a stakeholder perspective, examples may include company officials dedicated to following developments in areas such as shareholder rights, creditors rights, labor law, or environmental law.

Also, in areas where stakeholder interests are not legislated, companies may find it useful to explicitly address stakeholder issues of concern to international investors. The environmental record and labor relations of companies are two areas that may be of particular concern.

4.2. Greater protection must be given to employees and others that reveal illegal or abusive practices of a company's board and management.

Lacking other means to communicate their concerns, employees in Romanian companies have sometimes felt the need to make internal corporate practices public in order to protect the rights of themselves and others. Currently, such 'whistle-blowers' may find themselves unemployed and in some cases in physical danger. Not only is this a serious violation of civil rights, but better protection of those that point out severe corporate misconduct would provide an important check on bad corporate governance.

4.3. Creditors' rights must be honored, especially with regard to bankruptcy procedures.

In spite of some improvements in recent years, protection of creditors' rights is not satisfactory in Romania. Bankruptcy procedures are especially problematic with delays and a general bias in favor of existing management, making it extremely difficult for creditors to exercise their rights with respect to insolvent companies. Bankruptcy procedures should be expedited, and conducted without bias.

4.4. Effective consultation and communication with employees must be established.

Employees have the legal right to be informed of, and consult the board regarding, labor-related issues. Not only is such consultation required by law, it also provides the board with a potentially useful source of information regarding labor relations and other company matters.

The legal right of employee representatives to consult the board and receive certain information regarding company policies affecting the work force should be respected and enforced. During the privatisation process, for example, authorities should assure that labor and other interested parties are consulted. It is important that the parties involved in these consultations use them as a constructive tool in the process of corporate restructuring and privatisation.

5. Transparency and Disclosure

5.1. In order to ensure the integrity of accounting and auditing, institutional and organizational structure in Romania needs to be strengthened.

Transparency and disclosure is one of the weakest areas of corporate governance in Romania. Investors and the public often do not trust the information that companies provide. To increase credibility, systemic changes between companies, accountants, auditors and their professional bodies, and the government must be instituted.

It is the responsibility of the government to license auditors and regulate the audit process. It is imperative that this is done in a fair, efficient and independent manner, with the interest of protecting the public. Certain responsibilities should be delegated to the audit association provided they follow International Standards of Auditing (ISA) as promulgated by the International Federation of Accountants (IFAC).

While the government has the duty to watch over the accounting and audit profession, the profession and its self-regulatory bodies must also provide support in the form of an infrastructure that assures: (a) the quality and availability of relevant training; (b) appropriate testing and certification of accountants and auditors, and; (c) an internationally recognized Code of Ethics for the profession. Based on international criteria, the profession should also establish a process of quality control and review of Auditors and Audit firms and pursue close cooperation with international accounting bodies such as IFAC and The Fédération des Experts Comptables Européens (FEE) and participate in relevant international fora, including the South East Europe Program for Accountancy Development (SEEPAD).

5.2. Romanian accounting standards must be improved and continue their transition to International Financial Reporting Standards (IFRS).

Romanian law currently requires large companies to transfer their accounts to IFRS by 2005. This transition is critical both to the overall improvement of standards of transparency and disclosure, as well as attracting the interest of foreign investors. Simplified accounting standards for small- and medium-sized companies should also be IFRS based.

Currently, financial and other important information is often reported with significant delays and in a opaque manner. Accounting practices must be improved with respect to content and timeliness. For example, financial statement notes should include schedules of accounts and loans receivable, and accounts and loans payable, indicating how past due they are. The likelihood of collection in the case of accounts and loans receivable should also be indicated. Consistent with recommendation 3.2, related party transactions should be fully disclosed in the financial statements. In the event there are no related party transactions, management and auditor should make an affirmative note of such. Consolidated accounts for business groups should be improved

5.3. Companies should improve the disclosure of their ownership and control structures.

Holding companies and offshore corporations are increasingly being used to conceal the controlling parties in companies and transactions. Such arrangements are often used in conjunction with abusive related party transactions. Both domestic and offshore beneficial owners, or combination thereof, holding over 5% of the shares should be disclosed to the National Securities Commission and the public through the annual report. Sanctions and penalties should be imposed for violations.

5.4. Listed companies must disseminate accurate financial and non-financial information in a timely manner to appropriate agencies, shareholders, and the public at large.

Company information is currently being disseminated in a limited and opaque fashion. The weakness of internal financial controls in Romanian companies raises questions about the quality of information that is disseminated. This impacts not only shareholders and other interested parties, but also raises doubts about the credibility of the corporate sector in general.

To provide accurate information for both internal and external use, internal audits should be conducted by an internal auditor and/or audit department under the direct authority of the audit committee, consistent with recommendation 6.4. Current and complete financial information should be posted on the Web and made available to the public at the same time as information is provided to the Securities Commission. The Annual Company Report should include all relevant corporate governance financial and non-financial information

5.5. The potential liability of outside auditors should be increased and enforced to ensure their independence and integrity.

Auditors in Romania are sometimes seen as pawns of the companies they audit. This reduces the credibility of the whole profession, and raises doubts about the veracity of information provided by companies.

Auditor's liability should be defined more clearly, increased and enforced. The audit association should establish monitoring and enforcement committees that will investigate misconduct and impose sanctions for member violations. The existence of such committees however, does not remove the right to involve the judicial system in disputes. The government needs to retain authority and actively prosecute businesses and auditors for criminal and civil violations.

6. The Responsibilities of the Board

6.1. Legislation should clearly stipulate that the Boards' duty is to serve in the interest of all shareholders.

For the board to function properly, board members must act in the interest of *all* shareholders, not the controlling shareholder or some group of shareholders. The directors' duty of loyalty to all shareholders should be well-defined and specifically sanctioned in the Company Law.

Effective evaluation and monitoring of the Board's work requires that their collective and individual liabilities are clearly defined. While current Romanian law seems strong in this respect, its complex nature provides for numerous exceptions which prevent board members from being held liable by shareholders. For example, a shareholder cannot take action against a board member until it has been determined that the shareholder's general meeting *will not* collectively take action against the board member. Improved corporate governance requires that the collective and individual liability of board members in Romania must be clarified in such a way as to allow effective redress by shareholders.

6.2. Board members should be enabled to carryout their duties in a professional and informed manner.

For board members to properly fulfil their responsibilities, and not merely act as a tool of the majority shareholder and/or management, they must have adequate qualifications and information on the company. It should be clearly stated that management is obliged to provide all relevant information to board members.

Given the limited number of qualified and experienced board members in Romania, a Director's Institute could be established in order to enhance board professionalism. Business schools in Romania and abroad, as well as donor-supported technical assistance, could play an important role in developing the Institute. In addition, the present legal restriction that limits board members from serving on no more than three boards could be relaxed in the interest of using the limited number of capable and experienced board members more efficiently.

Given the many potential areas of conflict, companies should refrain from having on their boards directors who simultaneously hold elected offices or are members of the cabinet. Such practices are not compatible with board professionalism. In the longer term, civil servants should also be precluded from serving as directors. The state should appoint independent professional outsiders to look after its ownership interests. In any event, remuneration for sitting on the board of state-owned firms should be very limited in order to avoid disincentives regarding the privatisation and proper governance of state-owned enterprises.

6.3. Companies should have a sufficient number of independent directors

Independent directors -- i.e. non-executives who are not related to the company or the controlling shareholders -- are rarely found on Romanian boards, and are not currently required by law or listing requirements. This is partly due to the general lack of experienced board members, and is still a serious problem, since independent judgement is a critical factor for the quality of board decisions. Therefore, listing requirements should require a minimum number of independent directors.

6.4. The effectiveness of the Board should be strengthened through the use of specialized committees, including an audit committee, to replace the Censors.

Specialized board committees are rarely used in Romania. This tends to diminish both the role and the competence of the board, and increases their dependence on management. Such specialized Committees should be established, especially an Audit Committee and a Remuneration Committee. These committees should have a majority of independent directors who are not members of the Directors Committee if the latter exists.

The Censors Committee, which is supposed to provide certain auditing and compliance monitoring functions, has been largely ineffective, and has further weakened the board by creating confusion regarding the relative responsibilities of the two bodies. In conjunction with the creation of an Audit Committee, the role of the censors must, therefore, be clarified. Eliminating the Censors Committee and replacing it by the Audit Committee is a possible solution, consistent with recent international best practice.

6.5. The board and board members should operate in a fashion that is transparent, and consistent with the intentions of the general meeting. This includes the nomination and remuneration of directors.

While Romanian law has provisions requiring that shareholders be informed and involved in the nomination and remuneration of board members, as well as having the right to see minutes of board meetings and other rights to information, in practice crucial information regarding board behavior is not provided and the intentions of the general meeting are sometimes subverted. For example, while a board member's compensation must be approved by the general meeting, the approved amount can be augmented by 'bonuses' and adjustments that are not approved by shareholders. The process by which board members are nominated is also generally opaque, and shareholders are rarely given information about the nominees before the general meeting. This effectively transfers of the nominating process from shareholders to management.

All shareholders should, in a timely manner, be adequately and effectively informed about board nominees and their qualifications. Procedures for nomination should be included in legislation. To prohibit undue deviations, the remuneration of board members as decided by the general meeting should be verified by external auditors and disclosed in the financial statements of the company. The right of shareholders to have access to board meeting transcripts and other relevant information should be effectively protected.

What is Corporate Governance?

Throughout the report, “**corporate governance**” is given the sense proposed in the OECD Principles, i.e.

- a set of relationships between a company’s management, its board, its shareholders and other stakeholders;
- the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are provided;
- the system of incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and to facilitate monitoring, thereby encouraging firms to use resources more efficiently.

Corporate governance standards and practices are instruments devised to address the specific problems that result from separation of ownership and control. Hence the report focuses on publicly traded companies, although occasionally reference is made to state-owned or privately held companies. “Publicly traded” companies are what the Romanian legislation defines as “open” companies.

How Does Romania Rank in Terms Of Corporate Governance?

According to the “Standards of Corporate Governance”, a study published in February 2000 by SG Emerging Markets Equity Research, Romania ranked 7th in the ten emerging market economies surveyed for their corporate governance practices (see Table A). A breakdown by main elements of corporate governance reveals Romania’s strong and weak points, compared with its peers in the Central and Eastern Europe (Table B). **The most problematic area is clearly enforcement.** The role of the board, and poor information for shareholders are also problem areas. It should be noted that the scores are based on best practices, i.e. the behaviour of blue chip companies, but standards vary widely for lesser grade companies.

Table A: Regional Rankings of Corporate Governance based on overall scores

Ranking	Overall score (out of 36)
Greece	32.5
Israel	32.5
Hungary	31.4
Turkey	28.2
Poland	26.0
Egypt	22.8
Romania	20.6
Czech Republic	18.4
Morocco	18.4
Russia	14.1

Table B: Breakdown of Corporate Governance results for the CEE Region

	Average	Poland	Russia	Romania	Czech	Hungary
■ Fair conduct of shareholders meetings	2	2	2	2	2	2
■ Insider trading effectively prohibited	0.8	2	-1	1	0	2
■ Directors’ dealings published	1.4	3	-1	2	0	3
■ All capital changes announced with due warning and opportunity to participate	2.6	3	2	3	2	3
■ Extraordinary transactions carried out at transparent prices	1.8	1	1	2	2	3
■ Publication of results – regular and consistent quality	2.2	2	2	2	2	3
■ Independent audits	2.8	3	3	2	3	3
■ Equal access to information to all shareholders	1.8	2	1	1	2	3
■ Information on shareholding structure freely available	2.4	3	1	3	2	3
■ Role of the boards of directors	0.8	1	1	1	0	1
■ Effective enforcement of shareholders’ rights in courts, etc.	-0.2	0	0	-1	0	0
■ Quality of access on visits	2	2	2	1	2	3
Overall (country average) score	1.7	2.0	1.1	1.6	1.4	2.4
Total score	22.1	26.0	14.1	20.6	18.4	31.4

Note: Scores range from –1, where is evidence of consistent, willful abuse, and 3, the best score.

Source: SG Research

PART I: THE CORPORATE GOVERNANCE ENVIRONMENT IN ROMANIA

The corporate governance environment in Romania is very much a product of the transition from central planning to a market economy. This includes the direct impact of that transition, through new laws, the development of new institutions, the creation of new firms and, very importantly, the privatisation process. It also includes the indirect impact in the sense that corporate governance reform was never the central focus of the remaking of the macroeconomic landscape, rather it has been a critical by-product of that process. Part I of the report discusses the main characteristics of corporate governance that have emerged in Romania over the last decade. Chapter 1.1 provides the macroeconomic background. Chapter 1.2 provides an overview of the corporate and financial sectors, and 1.3 discusses in more detail the economic transition of the last ten years. Chapter 1.4. presents some conclusions on corporate behavior and motivation and their implications for corporate governance.

1.1. THE GENERAL ECONOMIC CONTEXT

In 2001, eleven years after the collapse of the communist regime, Romanian GDP is still at around 75% of its 1989 level. At 41% in 2000, inflation is the highest among the Central and Eastern European countries. Due to lax policies and a chronic inability to collect revenues, the resulting fiscal deficit has led to a public debt which, although not high as a proportion of GDP, is very difficult to finance -- in 2001, one-third of the budget had to be dedicated to servicing the public debt. Unemployment, currently at 10.5%, is relatively low² and the fact that it never reached 12% in the last decade indicates that structural change has been slow. Consumption and standards of living have declined in general – the average wage is among the lowest in Europe.

In six out of the last ten years, GDP declined, in most cases by more than 5%. While the first “transformational recession”³ of 1990-1992 was the result of the “institutional interregnum” prevailing in the first years after the December 1989 Revolution, as well as a consequence of the collapse of COMECON markets externally, the second recession of 1997-1999 was due mainly to a “policy shock”⁴. In 1993, several key policy decisions (rise in the nominal interest rates, remonetization of the economy, unification of the foreign exchange market, and stricter control of base money) prompted a recovery peaking at 7.1% growth in 1995. Growth resumed in 2000, mostly on the back of record exports of over USD 10bn.

The trend in industrial output has generally mirrored GDP, with sharp declines (over 20%) in 1990-1992 and 1997-1999. With the exception of 1990, 1992, 1997 and 2000 (when climatic conditions should be taken into account), agricultural output has been fairly stable, despite land atomization resulting from the dismantling of the large cooperative farms, as well as the lack of a clear strategy in terms of government support. Final consumption rose during 1993-1996 but fell over 4% during 1997-1999.

² It should be noted that early retirement was extensively used as an alternative solution to unemployment. As a result, Romania has now more pensioners than employees, a serious strain on the social security budget.

³ The term was proposed by Janos Kornai.

⁴ See Daianu, *Structure, Strain and Macroeconomic Dynamic in Romania*, in *Economic Transition in Romania – Past, Present and Future*, Proceedings of the Conference: Romania 2000. 10 Years of Transition, edited by Christof Ruhl and Daniel Daianu, published by the World Bank and the Romanian Center for Economic Policies, 2000..

Table 1 – Romania - Macroeconomic indicators

Indicators	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP, annual change, %	-5.6	-12.9	-8.8	1.5	3.9	7.1	3.9	-6.6	-5.3	-2.3	1.6
GDP structure, %											
- Industry	40.5	37.9	38.3	33.8	36.2	32.9	33.2	35.5	27.5	27.1	27.6
- Agriculture and forestry	21.8	18.9	19.0	21.0	19.9	19.8	19.2	18.1	14.6	13.4	11.4
- Construction	5.4	4.4	4.8	5.2	6.5	6.6	6.5	5.3	5.3	4.9	4.8
- Services	26.5	34.8	40.6	37.0	33.7	36.1	36.7	33.1	43.0	43.6	45.4
Exports as % of GDP	16.7	17.6	27.8	23.0	24.9	27.6	28.1	29.5	25.7	23.3	27
Current account surplus/deficit, mil. USD	-3,337	-1,012	-1,564	-1,174	-428	-1,774	-2,571	-2,137	-2,968	-1,288	-1,400
Private sector contribution to GDP, %	16.4	23.6	26.4	34.8	38.9	45.3	54.9	58.1	58.4	61.5	n.a.
The overall state budget surplus/deficit as % of the GDP	1.0	3.2	-4.6	-0.4	-1.9	-2.6	-3.8	-3.6	-3.3	-3.8	-2.7
GDP per capita at Purchasing Power Parity, USD	3,414	-	-	3,643	3,790	4,070	4,244	3,964	3,679		
Inflation, Dec./Dec. %	37.7	222.8	199.2	295.5	61.7	27.8	56.9	151.4	40.6	54.8	40.7
Unemployment rate, end of period	-	3.0	8.2	10.4	10.9	9.5	6.6	8.8	10.3	11.8	10.5
Net average monthly wage, USD	154	98	65	78	86	104	104	88	117	101	100
External debt, US mil.	230	1,143	2,479	3,357	4,546	5,482	7,209	8,504	9,308	8,709	9,555

Source: The National Commission for Statistics; National Bank of Romania

At the macroeconomic level, some structural changes are obvious. Industry and agriculture, which used to contribute more than 50% to GDP, now represent less than 40% of national production. The service sector has taken the lead, its contribution to GDP being over 45% in 2000 – a twenty percentage point jump since 1990.

On closer inspection however, the structural changes are less convincing. Inside the industrial sector few changes took place – most of the fixed assets in the economy remain captive and under-utilized in the large state enterprises that did little to restructure themselves. Agriculture, plagued by land ownership and land consolidation problems, is slow in finding efficient forms of production. As for the services sector, its larger share of GDP was due primarily to price increases: service prices were the only ones to rise more than the average rate of inflation throughout the decade.

With a quite active trade union movement, strong in the state-owned companies, the Romanian authorities feared radical restructuring measures and programs. Unemployment was relatively low and real wages sometimes increased without any relation to productivity. Unemployment peaked at 12% in 1993-1994, declined to 7% in 1996 (election year) and since then increased to around 11-11.5%. Still, most of the state-owned companies are overstaffed and more radical cuts will be needed in the process of corporate restructuring. But, as always, restructuring is more difficult during recession.

The principal structural change in the Romanian economy is the development of the private sector. In fact, the statistics on the contribution of the private sector to GDP are among the few indicators having a steady pattern of growth -- from 16.4% in 1990 to 61.5% in 1999 -- although in the period 1997-1999, progress was slower due to the impact of recession⁵. The private sector clearly dominates agriculture (over 90% of the value added), retail sales (over 90%) and commercial services to the population (around 70%), as well as construction and some forms of transport. The figure is much lower for industry as a whole (around 30% of value added), due in large part to the dragging privatisation process. With prices repressed through administrative controls before 1990, "corrective inflation" is regarded as an inevitable consequence of liberalization in all transition economies. However, in Romania's case, inflation turned into a chronic ill for more than a decade. The reduction in inflation from annual triple-digit rates in 1991-1993 to less than 33% in 1995 was the main achievement of the stabilization program of 1993-1994. However, the expansionary macro-economic policy pursued in 1995 led to a resurgence of inflationary pressures in the middle of 1996, which resulted in year-end inflation of 56.9% in 1996. In the first half of 1997, energy prices (kept artificially low since 1994) were adjusted to international levels which, coupled with the liberalization of the foreign exchange rate, prompted a new inflationary burst. Restrictive monetary and fiscal measures brought inflation down to 41% in 1998, 46% in 1999 and again 41% in 2000. The intricate cross subsidies system that made it difficult to estimate the social impact of price liberalization may be an excuse for the initial hesitations in adopting "shock therapy". However, inflation has persisted in large part thanks to the unwillingness to confront, and difficulty in financing, the loss-making state companies.

Currency devaluation is another major problem in Romania, closely related to that of inflation. Throughout the decade (with the exception of 1995 and 1999-2000), the National Bank of Romania (NBR) preferred a policy of real appreciation of the currency, supposedly to help control inflation. But such a policy had a perverse effect, as it discourages exports and deteriorates the external balance. Moreover, with relatively thin foreign exchange reserves, whose primary role was to provide credibility for debt servicing and foreign borrowings, the NBR has a limited capacity to intervene in the markets under the floating current exchange rate regime. This was painfully confirmed in 1998 when the NBR spent approx. USD 800mn. on a failed attempt to prompt the domestic currency.

In 1990, as a reaction to decades-long frustration accumulated under the communist regime and in an attempt to immediately improve standards of living, the Romanian authorities allowed for a 10% increase in imports, while exports were cut to 55% of their 1989 level. The COMECON trading block was dismantled in 1991, contributing to a further decline in Romanian exports. After 1990, Romania's trade deficit was constantly around USD 1bn., with both imports and exports increasing slightly each year. In 1994, Romania finally experienced a major upturn in exports. The restoration of the Most Favored Nation trading status by the USA, the European Union (EU) and CEFTA trade concessions, economic recovery in the West, as well as the discontinuation of the embargo against Yugoslavia all contributed to a great extent to the recovery in Romanian exports.

After 1996, as result of the removal of most import control quotas, imports soared to over USD 10bn., broadening the trade deficit to USD 2.5bn. in 1996 and 3.5bn. in 1998. The removal of import controls

⁵ For detailed statistics and comments on the particular features of the development of the private sector in Romania, see Dochia *New Private Firms Contribution to Structural Change in the Romanian Economy*, in *Economic Transition in Romania – Past, Present and Future*, Proceedings of the Conference: Romania 2000. 10 Years of Transition, edited by Christof Ruhl and Daniel Daianu, published by the World Bank and the Romanian Center for Economic Policies, 2000.

increasingly exposed domestic producers to Western quality goods and products and it was only in 2000 that Romanian manufacturers succeeded in breaking the USD 10bn. exports threshold. Over two-thirds of foreign trade is now carried out with the European Union -- Romania became an associated member in 1993, and since 1997, it has become a full member of the Central European Free Trade Association (CEFTA). Export growth has been concentrated on items in which Romania can be expected to be competitive in the long run, such as textiles, clothing, shoes and furniture, followed by iron and steel, fuels and mineral oils, electrical equipment and appliances.

With the current account constantly running a deficit, Romania was in permanent need of foreign financing. The international financial institutions, primarily the International Monetary Fund and the World Bank, were the first providers of funds. Several agreements were concluded after 1990, and though none of them were carried out, they were nevertheless extremely important as they provided the outline for economic reform. At the same time, the IMF agreements paved the way to the international capital markets. In May 1996, Romania won its first credit rating from major international agencies (BB-minus by Standard and Poor's, and Ba3 from Moody's Investors Service) and was able to start raising funds on the external capital markets through several bond issues. The external debt went up steadily, from USD 0.2bn. in 1990 to USD 9.5bn. in 2000.

Considering the adverse macroeconomic conditions, the NBR was fairly successful in building up the foreign exchange reserve. After the drastic drain on the NBR's reserves caused in 1999 by large foreign debt servicing obligations (USD 3.25bn.), the reserve was brought to USD 1.5bn at the end of 1999 and increased to USD 2.5bn in 2000. After an initial period of accelerated devaluation in 1999, which restored the competitiveness of Romanian exports, devaluation followed inflation, with the gap between the two narrowing. According to the government's medium-term economic strategy, the national currency will continue to appreciate in real terms against the USD by 2-3% in the next 2-3 years.

In 1992, and 1994-1996, the budget deficit was over 4% of GDP. Inability to collect taxes from loss-making state-owned companies as well as a chronic inability to reduce public expenditure were the main reasons for consistently high budget deficits. After 1997, the situation improved slightly and slowly, with 1999 closing with a deficit of only 2.6% of GDP. Better control over state companies and restructuring measures in some sectors, such as mining, stabilized losses and reduced the need for subsidies. In 2000, an election year, the deficit "inflated" again to 3.7% of the GDP. As in the past, the deficit and the inflation figures are the government's constantly unmet targets and the center of negotiation hurdles with the IMF.

Moreover, quasi-fiscal operations also had a negative effect on the budget deficit. When the small private banks, DACIA FELIX and CREDIT BANK, failed, the government decided on rescue measures to prevent a systemic crisis which could spread to the two large state banks. The total cost of the operation is estimated to have been 8% of GDP. BANCOREX and BANCA AGRICOLA accounted for, respectively, 25% and 20% of the assets in the banking system and concentrated, respectively, USD 1.7bn and 0.75bn in terms of non-performing loans.. The rescue of the two state banks rendered NBR's sterilization efforts very expensive and difficult. The other banks in the system had to pay part of the price: the minimum reserve for banks increased up to 30%. As BANCOREX held 47% of the hard currency denominated loans in the banking system, its disappearance created significant pressure on the foreign exchange and money markets, and both interest rates and the exchange rate exploded in March 1997.

1.2. THE STRUCTURE OF THE CORPORATE SECTOR AND THE FINANCIAL SECTOR IN ROMANIA

1.2.1. THE CORPORATE SECTOR

As of 31 December 2000, 849,497 economic agents were listed with the Romanian Trade Register, out of which 812,381 were active from a legal point of view. The majority of these are either self-employed or family businesses, or closely-held small companies. Out of the 682,263 entities incorporated as firms, only 3% were organized as joint-stock companies (table 2.).

Table 2: Distribution of economic entities registered at 31 December 2000, by legal form of organization

Type of business	Number of entities
Total, of which:	812,381
Individual entrepreneurs (non-corporate)	130,118
General partnerships	29,806
Limited partnerships	1,
Limited partnerships by shares	4
Limited liability company	623,330
Joint-stock companies	23,016
Autonomous bodies (regies autonomes)	466
Cooperatives	4,273

Source: *Sinteza statistica, no. 109, edited by the Chamber of Commerce and Industries and the Trade Register*

It should be noted however that many companies are economically inactive: the National Statistical Commission records only 330,276 companies as being economically active in 1998⁶. The vast majority of these companies are small – 295,028 have less than 9 employees and only 2,588 have more than 250 employees. There are 12,422 active joint-stock companies.

Table 3: Distribution of active companies by size and sector of activity in 1998:

	Total	size, according to number of employees			
		0-9	10-49	50-249	>250
Companies, of which	330,276	295,028	25,626	7,034	2,588
Agricultural holdings	11,059	8,215	1,857	832	155
Industry, construction, trade and other services	318,376	286,265	23,565	3,140	2,406
Financial and insurance sector	841	548	204	62	27

Source: *The National Commission for Statistics, Romanian Statistical Yearbook, 1999, p. 400*

61% of the large (over 250 employees) active companies in industry, construction and trade are concentrated in the manufacturing sector, while small and medium firms are concentrated in trade and services. Around 10,000 small and medium sized companies are organized as joint-stock companies.

The private sector, which currently contributes more than 62% of GDP, is dominant in terms of numbers: 311,167 companies are private and in another 1,990 the state has less than 50% of the capital. The state sector, with most of the large enterprises, controls the largest portion of the share

⁶ The National Commission for Statistics, *Romanian Statistical Yearbook, 1999*.

capital in the country (Table 4). Indeed, private firms control only 30% of the share capital in the country and make

Table 4: Main economic indicators by company* size and ownership in 1998

	Number of companies	Share capital (ROL bn.)	Turnover (ROL bn.)	Gross investment (ROL bn.)	Gross Result (ROL bn.)
Total, of which	318,376	208,301	594,973	140,643	338
- dominantly private	313,157	61,820	405,508	50,035	8,680
Large (over 250 employees), companies, of which	2,406	173,307	285,694	110,510	-5,436
- private		37,079	106,377	23,136	2,335

Source: The National Commission for Statistics, Romanian Statistical Yearbook, 1999

* *Companies in industry, construction, trade and services*

35% of the gross investments. In spite of their limited resources, the private sector has achieved 68% of turnover. Moreover, the private sector offset the losses (-5436 ROL bn.) produced by the large state companies.

A first provisional conclusion that may be derived from the statistics is that only a small proportion of the approximately 12,000 business entities registered as joint-stock companies are potentially part of the “corporate universe” in terms of size, ownership patterns and organizational model.

In fact, one of the most striking features of the companies in Romania is that a majority even among the largest are closely held, i.e. owned by one or a few investors. The highest ranking by turnover are the state-owned energy and utility companies: PETROM SA (the integrated oil company); CONEL SA (e power production); TERMOELECTRICA SA (producer of thermal energy); SNTFM “CFR MARFA” and SNTFC “CFR CALATORI” SA (railway transport); ROMGAZ SA (gas production and distribution)⁷. Only one of the top ten companies (Automobile DACIA SA) is listed on the Bucharest Stock Exchange (BSE).

The situation is not much different when considering a larger pool. Although the 500 largest companies in Romania (by turnover) are now primarily private entities⁸, closely held ownership is also common for many of the most successful private businesses. Approximately half of the largest 100 private companies are “closely held” and only 13 of the top 200 are listed on the stock exchange. Closely held ownership structures are clearly preferred by foreign capital – many of the largest companies are 100% owned by a single foreign investor or jointly between a foreign and a local investor. It is also important to observe that greenfield investments, domestic or foreign, are more likely to have a closely held ownership structure, while companies with a more diversified ownership are almost always those resulting from the privatisation of state enterprises.

⁷ The TOP TEN according to the National Commission for Statistics, *Economic activity units 1998*, published 2000. Some of the largest companies have been reorganized in the meantime but they are still under the state control.

⁸ 1998 was the first year when the private companies in the turnover based top 500 outnumbered the state-owned entities.

In the end, it looks like neither company size nor the legal form of organization are determinant factors in shaping the corporate sector in Romania. Basically, the “corporate universe” is mainly composed of the 6000 or so small-, medium- and large-sized companies that went through the privatisation process and, as a result, have a diversified ownership. The largest companies in the country are still closely held, either by the state or by domestic or foreign investors.

1.2.2. THE STRUCTURE OF THE FINANCIAL SECTOR

The three segments of the Romanian financial sector -- banking, insurance and capital market -- are not very integrated because of differences in their historical developments and regulatory frameworks. While banking and insurance activities maintained a presence in the economy throughout the years of the communist regime, the market for securities was abolished for almost fifty years and had to be rebuilt from scratch in the 1990s. In 1990, reform of the banking system was perceived as a priority, while securities-related activities seemed to concern a relatively distant future. Three distinct regulatory bodies were created at different moments in time: the National Bank of Romania in 1991 for the banking system, the Insurance and Reinsurance Supervisory Office in 1991, and the National Securities Commission in 1994⁹. The system of three distinct regulatory bodies was well-adapted to the fragmented nature of the financial markets prevailing in the early 1990s; it was also in line with European practice¹⁰. Recently, under the influence of the reforms achieved or envisaged in other countries, Romanian officials launched the idea of creating a single regulatory body for the whole financial sector, on the British model. For the time being though, the initiative has not advanced beyond controversies in the press.

The reform of the **BANKING SYSTEM** was the first to be initiated in 1990, when a two-tier banking system was implemented. The National Bank of Romania (NBR) was created as an independent central bank, with the Governor and the Board of Administrators appointed by the Parliament for a seven year term. Its main objective stated in the law is to ensure the stability of the domestic currency in order to contribute to price stability. Apart from elaborating and implementing monetary, foreign exchange and credit policies, the NBR also has the role of licensing and supervising the banking system.

At the end of 2000 thirty-three banks were licensed to operate in Romania, in addition to seven branches of foreign banks. Twenty-one of the thirty-three banks have foreign capital, one bank is fully state-owned and another four have a majority of their capital in the state's hands. In spite of the rapid increase in the number of privately held banks, state owned banks are still the most important players in the system, with 43% of the capital base and 47% of the assets. The share in both capital and assets of the Romanian private banks has drastically fallen, while foreign capital banks spectacularly augmented their share from 15% of the assets and 27.5% of the capital in 1998 to 49.55% of the assets and 47.47% of the capital in 2000. The total assets held by the banking system are of more than USD 8.6bn.

The drastic structural changes that took place between 1998 and 2000 reflect two major events: the crisis and eventual collapse of several state-owned and private banks and the privatisation drive. Both resulted in a cleaner and much more solid banking system.

DACIA FELIX and CREDIT BANK, two of the largest private banks, were the first to signal the problems in the system in 1995. The reaction of the National Bank was hesitant and slow, but in the end it took measures to isolate the two ailing banks from the rest of the system. Bankruptcy procedures proved to be long and the intervention instruments controlled by the National Bank inadequate. As a

⁹ The corresponding legislation includes Law no 33/1991 on banking, Law 34/1991 on the Statute of the central bank, Law 47/1991 on insurance activities and Law 52/1994 on securities and stock exchanges. The initial legislation was amended for banking and insurance, but remained unchanged for securities and stock exchanges.

¹⁰ An overview of the current European financial regulation situation and reform, in *The Economist* 3 March 2001.

result, confusion persists even now regarding the resolution of the situation for these two banks. The following year the private COLUMNNA BANK followed the same scenario.

The crisis of the banking system reached its peak in 1999. In April, BANCA ALBINA was declared insolvent, followed shortly afterwards by news that BANKCOOP was unable to meet its obligations. In spite of these problems, their impact on the system was limited because all these banks were relatively small. The shock came when problems surfaced in two of the largest state-owned banks, BANCOREX and BANCA AGRICOLA, which accounted for, respectively, 25% and 20% of the assets of the banking system. While smaller private banks failed because of large-scale fraud and embezzlement, the failure of the state banks resulted from a chronic misallocation of resources and poor performance in the real economy. BANCOREX and BANCA AGRICOLA held USD 1.7bn and 0.75bn, respectively, in terms of non-performing loans. Fear that the collapse of the two banks might have systemic consequences prompted the authorities to decide on a rescue plan. USD 1.5bn of BANCOREX's bad loans were transferred to the public debt, USD 0.6bn were spent on an eventually unsuccessful recapitalization and USD 0.3bn was guaranteed for problem loans issued by the state. When BANCOREX merged with the Romanian Commercial Bank, BANCA AGRICOLA's restructuring was more successful. The first recapitalization occurred in 1997, when some ROL 2,700bn worth of non-performing loans were transferred to the Assets Resolution Agency (AVAB), to clean the bank's balance sheet. In the end, the Austrian REIFFEISEN BANK acquired a majority stake in a smaller but clean BACA AGRICOLA.

Although 1999 was the worst year for the banking system, 2000 also had its problems. BANCA TURCO ROMANA-BTR was the most promising and fastest growing bank and one of the blue chips on the Romanian stock exchange. After rapid expansion in 1998 and 1999, mostly in terms of balance sheet items (assets, loans, placements in T-bills and interbank deposits as well as source-deposits), the bank was confronted with massive deposit withdrawals starting in October 2000. Investment in IT and network expansion that led to low net profits both in 1998 and 1999 only partially explained the bank's problems. Rumors about illegal operations in favor of the main shareholder and finally the Turkish crisis in 2001 contributed to the aggravation of the situation. The National Bank is expected to take a decision soon on BTR's future.

Another potential problem for the financial system is the credit cooperatives. They hold deposits of around ROL 4,000bn (USD 186mn) and previously did not fall under the supervision of the central bank (NBR) or other regulatory bodies and were not covered by the Deposit Guarantee Fund (DGF). In 2000, after the collapse of the largest credit cooperatives, and panic surrounding most of the others, the NBR decided to introduce stricter regulations, which forced these institutions to clarify their situation and to continue their activities as non-banking institutions under the supervision of the NBR, to apply for a banking license or be liquidated. According to NBR, from the 925 cooperatives in existence at the end of December 2000, 820 have submitted files to NBR to become credit houses grouped into 10 networks. None of them has submitted applications to become a commercial bank.

The successive failures of banks and the strain on the whole financial system prompted the Romanian authorities to be more diligent in privatizing some banks. The French group SOCIETE GENERALE acquired a controlling stake in the ROMANIAN BANK FOR DEVELOPMENT The State Ownership Fund sold 45% of BANC POST to a consortium composed of GE Capital (35%) and BANCO PORTUGUES DE INVESTIMENTO (10%) The banking system is in much better shape now. As result of stricter banking regulation and supervision procedures adopted by the National Bank, the solvency ratio for all the banks improved from 10.25% in 1998 to 22.13% in September 2000. The proportion of non-performing loans decreased from 14.5% in 1998 to 0.7% in 2000 (excluding provisioned loans). Higher provisions, however, led to reduced profits with a ROA at the end of 2000 of 1.46%, while ROE declined from 21% in March 2000 to 13.2% in December 2000.

The INSURANCE industry had relatively smooth and continuous development since 1991, when the first legislation was passed, providing for the de-monopolization of insurance activities. The single state insurance company, ADAS, was split into two companies, ASIROM and ASTRA, and the door was

opened for new entrants. In spite of the soft regulatory stance prevailing in the initial phase, the insurance sector had fewer and less spectacular failures than the banking sector. At the end of 1999, 72 insurance companies have been licensed, with a share capital of ROL 1,011bn. (USD 55mn.) and assets of more than ROL 6,077bn. (over USD 330mn.).

The CAPITAL MARKETS, which are reviewed in detail in the annex, were the only segment of the financial sector that started from scratch. Basic notions like capital, shares, and stock exchanges, had to be reinvented. Everybody had a lesson to learn -- the authorities, the companies, the investors and entrepreneurs – and sometimes they did it the hard way. No crisis has spared the capital markets. The first Ponzi scheme (called CARITAS) inflated until becoming a USD 200mn. mass phenomenon. When it broke up in 1993 the shock-wave menaced the financial system and had the political system shivering. The development of the mutual funds industry outran the legislative framework. When, in 1996, the newly created Securities Commission imposed prudential regulations in calculating the net asset value for investment funds, the largest fund, SAFI/FMOA, suffered a severe correction. Confronted with massive withdrawals it eventually collapsed, smashing investors' confidence in the burgeoning capital market. After several years spent regaining investors' confidence, the industry was again hit by a new scandal: the collapse of FNI (the National Investment Fund) in April 2000. For the first time, the National Securities Commission was held responsible and commissioners, including the president of the Commission, were arrested.

Securities and Stock Exchanges legislation was adopted relatively late, in 1994, and the newly created National Securities Commission gradually assumed a regulatory and supervisory role. In a very short period of time, the whole infrastructure for securities trading was put in place, including both the Bucharest Stock Exchange and the over-the-counter RASDAQ trading system. Designed with a substantial contribution from Western advisors, the Romanian capital markets infrastructure is well adapted to its task under its basic aspects and even, under its technical aspects, is very advanced. From a regulatory perspective, the system evolved mainly through the norms issued by the Securities Commission; Law 52/1994 has remained basically the same since its adoption.

On 20 November 1995 the BUCHAREST STOCK EXCHANGE resumed operations¹¹ as a self-regulated body under the supervision of the Securities Commission. The Bucharest Stock Exchange has all the traditional departments of similar institutions: trading, listing and membership. In addition, the BSE has departments dedicated to auxiliary services including clearing, registration and settlement. A company is listed on the BSE upon request, provided that it meets certain criteria. Two sets of listing criteria have been established: for high-grade companies, listed on the first tier of the Stock Exchange and for lower-grade companies, listed on the second tier of the exchange. There is also an 'unlisted' tier. The first tier companies can be considered the 'blue chips' of Romania¹².

The BSE is responsible for monitoring all market activities in order to ensure compliance with the law and regulations, minimize market volatility and protect investors. To enforce discipline and ensure investors' protection, the BSE can downgrade and delist companies, and suspend brokers from trading. Until recently, the Stock Exchange was hesitant in imposing sanctions and many violations of the rules and regulations were disregarded. However, after serious frauds were discovered, the Executive Committee of the BSE has taken a firmer stance.

In December 2000, the market capitalization of the Bucharest Stock Exchange (BSE) stood at 2.9% of GDP, among the lowest market capitalization in Central and Eastern European countries. Bulgaria, with a capitalization of 1.2% of GDP, is the only country in the region comparable to Romania. Since its inception, the BSE has progressed in terms of volume of activity: the number of companies listed increased from the initial 6 to 127 at the end of 1999 and the number of shares traded in 2000 was

¹¹ The first Stock Exchange in Romania was established in 1882, but it was closed in 1948.

¹² Recently a Transparency Tier has been created for companies that meet higher corporate governance standards.

1,500 times higher than the shares traded in 1996. The total turnover remains low, however, at USD 86mn. in 2000¹³. The valuation of shares on The Bucharest Stock Exchange also seems low compared with other markets

Since its inception, the exchange has been predominantly a trading place, not a capital-raising instrument. The BSE has also played a role in the privatisation process since the State Ownership Fund, the privatisation authority, has used the stock exchange for placing some of the residual blocks of shares it holds.

In the first half of 2001, 114 companies were listed on the Bucharest Stock Exchange, 23 on the first tier (blue chips) and 91 on the second tier, with an average market capitalization of USD 7.5mn per company¹⁴. However, the market is very concentrated, the largest 10 companies accounting for 80% of market capitalization.

The financial sector is clearly dominant on the stock exchange. Two banks and the five FINANCIAL INVESTMENT COMPANIES (SIFs) are among the largest and most traded companies on the stock exchange.

The SIFs are the result of the Romanian mass privatisation program, which provided for a free distribution of 30% of the share capital in state-owned companies to all adult citizens¹⁵. At the end of 2000, each of the five SIFs had over 9 million shareholders. At the same time, each SIF has assets including listed and non-listed companies, as well as financial placements (bank deposits etc.) (see Table 5).

One of the distinguishing features of the SIFs is that they regularly pay dividends. Non-payment of dividends is one of the most frequent complains of investors. Apart from cases of abuse, companies are frequently victims of the Romanian accounting system, which creates illusory profits.

¹³ In 2001 turnover increased to USD 120mn.

¹⁴ During 2001, a number of companies were delisted. Currently 76 are listed, 19 in the first tier and 51 on the second tier, plus the SIFs.

¹⁵ For details, see chapter 1.3.2. below.

Table 5: The Financial Investment Companies' holdings

Indicator	SIF 1	SIF 2	SIF 3	SIF 4	SIF 5
Market capitalization, ROL bn.	373	247	415	369	342
Assets, book value, (ROL bn. 31.12.2000), of which	2,184	3,308	3,233	2,664	2,927
- – shares	2,469	2,950	2,833	2,237	2,505

Source: BSE and annual reports.

In any case, the low level of dividends and payment problems both contribute to making investment in BSE securities unattractive. Analysts¹⁶ have calculated that, with just a few exceptions, the return on investments in BSE listed securities is inferior to the return on a bank deposit.

By 1996, the Romanian Mass Privatisation Program (MPP) created a huge number of shareholders in all state-owned companies. Millions of these shareholders were locked into many obscure companies. Selling stock was difficult and inefficient, as only local, non-transparent and fragmented markets were available. Thanks to substantial financial and technical support the National Association of Securities Dealers (NASD) succeeded in rapidly putting in place an over-the-counter transaction system called the RASDAQ (the Romanian Association of Securities Dealers Automated Quotation) -- the "exchange of the MPP". A company may decide to list its shares on the RASDAQ without any prior conditions or requirements to be fulfilled. There are no disclosure requirements. Most companies have been actually listed on the RASDAQ because of a legal provision imposing listing of all companies included in the mass privatisation program.

There are 5,427 companies listed on the RASDAQ OTC market, however the vast majority of the companies listed on the RASDAQ market are sporadically traded. Only around 15 companies are traded regularly, that is more than half of the time, and 1,500 have never been traded since listing.

Because the RASDAQ was essentially a trading platform for the companies included in the mass privatisation program, the number of companies listed did not significantly change, while the sectoral structure of the companies listed on RASDAQ closely mirrors the structure of the economy in general. However, trades are concentrated in industry, which has made up over 70% of the total volume of trades since the beginning of the OTC market.

As the RASDAQ is based on loose regulation, there are not many sanctions provided. Failed trades are therefore relatively frequent and fraudulent transactions are a serious problem of the RASDAQ market. A growing number of problems led the National Securities Commission to temporarily recall NASD's statute of Self-Regulated Organization. A sense of "crisis" prevails¹⁷ and NASD members seem incapable of agreeing on solutions. Eight restructuring proposals were presented in NASD's General Meeting in April 2001, but no decision was taken¹⁸. Merging the Bucharest Stock Exchange

¹⁶ Carol Popa, *Doar o treime din societatile listate la bursa platesc dividende (Only one-third of the companies listed on the BSE pay dividends)*, published in the weekly Capital, no. 16, 19 April 2001.(in Romanian)

¹⁷ RASDAQ is "short of time, ideas and money" as a journalist depicts the situation – see Laurentiu Ispir, *Piata RASDAQ isi cauta perlele ingropate (The RASDAQ market is looking for its buried pearls)*, in Ziarul Financiar of 3 April 2001

¹⁸ Laurentiu Gheorghe, *Reformarea RASDAQ este doar în faza de intentie (The RASDAQ reform is only at the intention stage)*, in Capital no. 16/2001

and the RASDAQ or splitting the market into several tiers, where the best companies would be admitted to listing on the first tier, have been among the suggested solutions.

Under the circumstances it is not surprising that the Romanian capital markets are fragile and vulnerable. On the other hand, when considering the starting point, the short period of time elapsed and the fact that some of the components of the system incorporate very advanced technical solutions, one has to admit that progress has been remarkable. Romania now has the basic infrastructure for a modern, robust and effective capital market.

Like the capital market of other transition economies, the Romanian market was created as an instrument for **promoting reform** and **facilitating the privatisation process**. While in other transition economies foreign investment was quick to take advantage of the existence of the domestic capital markets to carry on a diversified array of transactions, in Romania scarce foreign capital had a very limited impact on the market.

The Romanian capital market never succeeded in taking the lead in what represents one of its main functions -- raising capital for companies. Privatisation and post-privatisation transactions provide both the Bucharest Stock Exchange and the RASDAQ over-the-counter market the substance for their day-to-day existence. In many respects, the Bucharest Stock Exchange and the RASDAQ over-the-counter market have integrated very advanced technical solutions -- logistics and regulations -- inspired by highly evolved markets and best practices. But the best technical solutions cannot provide deals, the essential ingredient necessary for the prosperity of any capital market. This situation has several important consequences for all parties involved in the capital market:

- **Companies** do not perceive real advantages in being listed. The mass privatisation program forced thousands of companies to get listed on the RASDAQ, but most managers complied grudgingly. For them, listing is an extra bother without any rewards. The situation is somewhat better on the BSE because listing was voluntary (although in the beginning it took a lot of persuasion from BSE officials to convince managers!) and provides a certain prestige and visibility that many companies and managers appreciate. However, as long as the companies do not regularly use the capital markets for raising capital, they have no strong incentive in being listed.
- The **regulatory bodies**, from the National Securities Commission to the self-regulated organizations, have been shy in imposing discipline and improving standards. They are in a difficult position as long as de-listing, the ultimate sanction in their hands, is not a real threat for the issuers – many companies on the RASDAQ had repeatedly attempted to get de-listed.
- The **brokerage houses** were initially the most enthusiast and progressive promoters of the capital market. But soon they realized their dreams about buoyant markets, with diversified products and sophisticated transactions, had to be abandoned, or at least postponed, to the indefinite future. In order to survive, some “cut corners” and took advantage of the weakness of regulatory authorities.
- **Investors** are, for the time being, the most obvious beneficiaries of the existence of organized capital markets. The capital markets provided a means of reshaping ownership patterns from the dispersed ones that resulted from the privatisation process to more concentrated ones; both the BSE and the RASDAQ are predominantly **post-privatisation markets, whose function is the concentration and transfer of ownership from privatisation beneficiaries to investors**. Some of the investors on the capital market are sophisticated institutional investors, who can contribute to imposing higher standards.

Although, in the near future the post-privatisation function of the capital market will continue to be dominant, a different combination of factors and actors will play a role in shaping the institutional framework, the type, volume and diversity of operations:

- Changes in the regulatory framework will have less influence than in the past few years, when it was the main shaping force of the capital market, although improvements in the legislation are still necessary.
- The changing attitude of the regulatory bodies, visible in the second half of 2000, may contribute to improving the discipline and the transparency of the markets.
- The privatisation process will continue to use the capital markets and to provide new blue chip listings, but will not have the same influence as in the past, when the mass privatisation program produced long-lasting effects on the stock exchanges.
- The brokers' community seems quite weak and incapable of coordinating efforts in order to have an influence in the near future. However, if consolidation takes place in the industry and the securities dealers' associations become more organized and better focused, they could play a role in setting and enforcing professional standards.
- The capital markets will be increasingly influenced by foreign investors and by sophisticated domestic institutional investors, who understand the problems, have expertise to identify solutions and have resources to lobby for their implementation. Several investors' associations were actively involved in the debates last year around proposed amendments to the legislation.
- New actors, like private pension funds, may become one of the main driving forces of the capital markets.

However, many things will depend on the evolution of the Romanian economy, which is the most important single factor affecting the market . A strong recovery and macrostabilisation is the best remedy for Romania's ailing stock exchanges.

1.2.3. PATTERNS OF CORPORATE OWNERSHIP

Apart from the companies that are still controlled by the state, there are two types of corporate structures in Romania today: **Greenfield private companies** and **privatised companies**.

Greenfield private companies are the product of the last ten years of economic liberalization. Although many of these companies have rapidly evolved from small- and medium-sized businesses into some of the largest corporations in the country, they are still closed, non-public companies, controlled by their founders. Around half of the largest companies in Romania fall under this category. In many cases, these companies are controlled by international corporations: METRO CASH AND CARRY ROMANIA; MOBIFON, MOBIL ROM, SHELL ROMANIA, BRITISH AMERICAN TOBACCO, LUKOIL ROMANIA, LAFARGE ROMCIM, PROCTER AND GAMBLE, PHILIP MORRIS, COCA-COLA, UNILEVER, ABB ALSTOM POWER, AGIP ROMANIA, HENKEL ROMANIA etc. Romanian interests control some other large corporations: TRANSILVANIA GENERAL IMPORT EXPORT, TOTAL DISTRIBUTION GROUP ROMANIA, TOFAN GROUP, INTERAGRO, TONICAL TRADING, COMPANIA DE DISTRIBUTIE NATIONAL, EUROPEAN DRINKS, RIENI DRINKS, TOPWAY INDUSTRIES, etc. In all cases, the owners/founders of these companies prefer to keep a close control on their operations and avoid raising equity capital on the stock exchange.

However, sooner or later, many of these companies will eventually grow to the point where it becomes desirable to raise capital from public sources. Three companies now listed on the stock exchange have origins in the private sector: BANCA TRANSILVANIA, IMPACT Bucuresti and BANCA TURCO-ROMANA (now suspended). Recently, M.J.MAILIS Romania, a private company controlled by foreign investors, have successfully raised capital on the stock exchange and was subsequently listed on the BSE.

It is primarily the privatised companies that are “public” (or “open” according to Romanian definition), which provide the bread and butter of the stock exchange. In current ownership patterns one can easily distinguish the marks of the privatisation process – less evident in the companies listed on the BSE and more explicit in the companies listed on the RASDAQ.

In 60 of the companies listed on the Bucharest Stock Exchange, ownership is concentrated in the sense that a shareholder has more than 50% of the shares; many of the others are controlled by shareholders having stakes of less than 50%. Only around 12 companies have a dispersed ownership structure, with no evident controlling group; six of them are financial institutions (the five FINANCIAL INVESTMENT COMPANIES – SIFs - and TRANSILVANIA BANK).

There are several **categories of majority shareholders** that control the companies listed on the BSE:

- **Strategic investors** are usually corporations active in the same industry which take a position in a company with a view to long-term strategic considerations like complementarity in industrial activities, potential for cutting costs, expansion on certain markets, getting ahead of competition etc. There are 15 strategic investors in the companies listed on the BSE, most of them foreign investors who acquired shares from the State Ownership Fund in the privatisation process: SOCIETE GENERALE (the Romanian Bank for Development), RENAULT (Dacia Pitesti) SAMSUNG DEUTSCSHLAND (Otelinox Targoviste) AKER (Tulcea Shipyard), TRINITY INDUSTRY (Astra Vagoane Arad), etc. The perspective adopted by strategic investors sometimes conflicts with the interest of other investors. Many strategic investors have adopted strategies of increasing their participation (through public offerings or increases of capital), sometimes diluting other shareholders, and in some cases have expressed their will to de-list the companies and turn them into closed organizations.
- **The employees associations (PAS)** which acquired shares under the special conditions granted to them in the privatisation process. Under certain aspects, the employees that have a controlling stake in their company may also be regarded as “strategic investors” but their objectives are frequently different, emphasizing stability and protecting jobs more than profitability and long term development. There are 17 companies listed on the BSE where employees have a majority stake. It is expected many of these associations will cease to exist when shares are integrally paid and many employees choose to sell their shares.
- **Institutional investors** are either specialized financial institutions like mutual or venture capital funds, or holding structures. Although the financial institutions do not usually take majority positions, in four of the companies listed on the BSE different foreign investment funds have stakes of more than 50%. Another nine companies are controlled by holding groups.
- **The state – currently represented by the Authority for Privatisation and Administration of State Property (APAPS)** is still present with more than 50% of the shares in 16 of the companies listed on the BSE, but the situation is changing every month.
- Finally, there are a few cases where **natural persons** hold a majority position in a company listed on the BSE.

The same categories of investors are found as **minority shareholders**, but in different proportions. The **institutional investors** and the **employees associations** frequently have a significant position and in many cases hold a controlling stake. The SIFs are present in 33 of the companies listed on the BSE while other investment funds like BROADHURST, LINDSELL ENTERPRISES, SOCIETE GENERALE ROMANIA FUND, ROMANIAN-AMERICAN FUND, ROMANIAN INVESTMENT FUND, are regularly listed among the significant investors. **Natural persons** make for a special category of minority investors. They are, in general, beneficiaries of the mass privatisation program and they have been the main providers of liquid shares on the stock exchange. When ownership is concentrated in the hands of strategic and institutional investors, liquidity falls dramatically.

The ownership pattern of the companies listed on the RASDAQ is quite similar to the BSE if the most traded companies are considered. The same trend towards concentration of ownership in the hands of strategic and institutional investors can be observed – the RASDAQ is well-known as a market for takeovers. More than half of the top 100 companies on the RASDAQ have a majority shareholder, either strategic or institutional. Frequently, the same institutional investors identified on the BSE are equally active on the RASDAQ.

But the situation changes as we leave the group of the 300 most traded stocks on the RASDAQ and investigate the pattern of ownership of the companies rarely or never traded. Here, the ownership structure petrified at the post-privatisation stage, with companies controlled by employees associations or by the state and with tens of thousands of voiceless minority shareholders who received their shares under the voucher privatisation.

The schemes for indirect company control are just emerging and are not very sophisticated. The most common is the **holding group** by which a private investor takes positions in and eventually controls several other public companies. Cross-shareholdings are occasionally used. It is not easy, and sometimes it is impossible, to track the “ultimate owner” when companies registered abroad are used as vehicles for taking participation, and eventually a controlling stake, in a company.

Holding Companies in Romania

TOFAN Group is a privately held company controlled by its founder, Gelu TOFAN. After an initial period when it was dealing in trade with tyres, it created a fully owned subsidiary specialized in re-threading. After 1996, TOFAN Group acquired successively controlling stakes in several tire companies offered for sale in the privatisation process – DANUBIANA BUCURESTI, VICTORIA FLORESTI, SILVANIA ZALAU, and ROTRAS – all of them listed on the RASDAQ. NOMURA PLC. became a partner in TOFAN Group through a capital injection of USD 100mn. The group spread out towards other areas – communication, media, bakery and retail trade – based on the same complex holding structure that gives founders a possibility to control a variety of businesses. In 2001, Tofan sold most of its tire business to Michelin.

INTERAGRO is a private company controlled by its founder, Ioan NICOLAE. It grew into one of the largest holdings in Romania by taking controlling stakes in 15 different companies, among which one oil refinery, two fertilizer producers, the largest insurance company ASIROM and many other agriculture and food industry related companies – all of them listed on the RASDAQ. INTERAGRO has devised a scheme for controlling the BSE listed ASTRA ROMANA oil refinery through cross shareholding: it holds 26% of the shares directly and another 32% through ASIROM, in which InterAgro holds a controlling 33% position.

1.2.4. INSTITUTIONAL INVESTORS

We have seen that the institutional investors play a very important role in the ownership structure of the companies listed on both the BSE and the RASDAQ. There are three categories of institutional investors who are relevant for the Romanian market: the five Financial Investment Companies, the venture capital funds and the mutual funds.

Other institutional investors like banks and insurance companies do not play a significant role, one reason being the poor performance of the investment in shares compared with other alternative placements like treasury bonds, bank deposits or real estate. In any case, the insurance industry, although rapidly growing, is relatively small (total assets of less than USD 500mn.). Pension funds, some of the most important institutional investors in other countries, are in a very incipient stage in Romania – the legislation concerning the “universal pension funds” has been just adopted in 2000 (Emergency Ordinance 230/2000). No fund has been licensed until now and it will take a few years until pension funds generate a steady demand for securities.

With total assets of around USD 550mn., of which more than 90% in shares, the five FINANCIAL INVESTMENT COMPANIES are, for the time being, the largest institutional investors in Romania. In spite of their similarities, the five SIFs each have an individual profile determined by the initial structure of their holdings and by the specific policies implemented over the years. All SIFs have reduced the number of

Table 6: The Financial Investment Companies’ holdings – end of 2000

Indicator	SIF 1	SIF 2	SIF 3	SIF 4	SIF 5
Market capitalization, ROL bn.	373	247	415	369	342
Assets, book value, (ROL bn. 31.12.2000)	2,184	3,308	3,233	2,664	2,927
The structure of the portfolio of shares (end of January 2001):					
- Total number of companies , of which:	724	529	467	407	301
- BSE listed	29	13	10	36	27
- RASDAQ listed	458	304	293	182	181
- Closed (non-public)	216	209	150	139	57
- Unlisted, traded on BSE	2	3	1	4	
- Open but unlisted	19		13	46	13
- Companies under liquidation					23
Breakdown of portfolio by size of participation					
- nominal value of participation, ROL bn., of which:	2,469	2,950	2,833	2,237	2,505
- less than 5%	6.2	0.9	4.8	4.8	12.5
- 5 – 33%	75.9	75.6	54.5	59.9	61.6
- 33 – 50%	6.5	18.5	20.2	3.0	15.4
- over 50%	11.4	5.0	20.5	32.4	10.5
Global risk index	3.58	4.37	3.8	4.05	3.70

Note: The risk index is calculated according to instructions set by the Securities Commission. Its range of values is from “0”, low risk, to 5, high risk. Source: BSE and annual reports.

companies in which they hold shares, but to a different degree. In 1993, each fund was allocated shares in 1,100 to 1,300 companies. SIF1 (Banat-Crisana) has cut the number to 724, and SIF 5 (Oltenia) has reduced its holdings to 301. SIF 4 (Muntenia) has over 32% of its portfolio in companies where it holds a majority (over 50%) position, while SIF 2 (Moldova) prefers to remain a significant

shareholder, without taking majority positions (only 5% of its portfolio is placed in companies where it holds more than 50%). There is also a certain differentiation by industrial sectors – SIF 1 is dominant in sectors like wood, furniture, pulp and paper, SIF 2 in textiles, SIF 3 in machine building, transports and tourism, SIF 4 in building materials and petrochemicals, SIF 5 in electronics and electrical equipment.

Apart from reducing the number of participating firms to more manageable numbers, the SIFs' policy has also aimed at improving the quality of their portfolios and lowering their risk. However, the SIFs still hold very heterogeneous portfolios, which include a large number of unlisted companies. The SIFs' are also known to take controlling, or even majority positions, and to behave like strategic investors.

While SIFs have a focus on former state companies, some foreign VENTURE CAPITAL FUNDS have made a policy of investing in private (not listed) companies that have a great potential for growth over the next few years. The listed companies rarely offer the 30% return (in dollar terms) that the venture capital funds take as a minimum when considering opportunities that should match Romanian risk. It is estimated that approximately USD 500mn. are invested by the venture-capital funds, most of it in private projects. There are 15 venture capital funds, all of them foreign-owned (table 9).

Table 7: The venture capital funds active in Romania

Name of the fund	Main investments
■ Global Finance	■ Delta România, Neoset, Germanos Telecom, Titan/Moara Loulis, Chipita Romania, Sicomed
■ AIG New Europe Fund	■ MobilRom, Luxten, Astral Telecom
■ Societe Generale Investment Fund	■ Luxten, Arctic Gaesti , MobilRom
■ Baring Private Equity	■ Topway Industries
■ Advent International	■ Euromedia, Monopoly, Europlakat
■ Oresa Ventures	■ Flanco, Medicover
■ Enterprise Investor	■ MobilRom
■ CCP Overseas Equity Partners	■ Mobifon
■ Fondul Romano-American Romania Post Privatisation Fund	■ Banca Agricola, Policolor
■ Foreign & Colonial Romania Investment	■ Compa, Sanex, Stirom
■ Romanian Investment Fund Limited	■ Policolor , TEC, ComtelRom, CMC Magnetics Corp.
■ Romania Fund Limited	■ Luxten, Conterra, Policolor
■ Romanian Growth Fund PLC	■ Romcim, Oltchim

Note: Public companies (listed) are evidenced in bold letters.

Source: *Capital* no. 18, 3 May 2001

Not all funds are dedicated to Romania. The Danube Fund, promoted by the Greek Alpha Bank, has USD 30mn. Of capital invested not only in Romania, but in Moldova, Bulgaria, the former Yugoslav Republic of Macedonia, and Albania. On Western markets the Société Générale Romania Fund has raised USD 50mn. for investments in Romania; EBRD and the IFC have contributed to the capital of Global Finance; the Romanian American Enterprise Fund is sponsored by the US government and by private investors. The Romanian Investment Fund has raised USD 65mn. from European and American investors.

Exit is not always easy for the funds. The stock exchange is depressed and does not pay the returns fund managers are seeking. Therefore, funds prefer selling to strategic investors ready to pay the premium for taking control.

Since the first Romanian MUTUAL FUNDS were created in 1993, crisis and scandal have plagued the industry. Today, the Romanian mutual funds industry is small, and dominated by money market funds. [See the box on the next page.]

Hence, along with the “strategic investors”, the SIFs are currently the most important corporate governance agents, followed by the foreign venture capital funds. No other institutional investor is likely to become in the near future a significant presence in corporate governance.

Mutual Funds in Romania: A Turbulent History

The first mutual funds were created in 1993-1994, when no specific regulation regarding the investments industry existed. All of them were “open ended funds” with a diversified portfolio of investments, part of it risky, venture capital type of businesses . With no regulations and no supervision, the funds were able to post consistently high increases in the net asset value of their portfolio, attracting a large number of investors.

In March 1996, the newly created National Securities Commission issued instruction no.6 regarding the calculation of the net asset value for the investment funds. Most funds had to drastically correct the value of their assets. An outburst of panic prompted investors to immediately redeem their titles, leading to the collapse of the largest fund of the time, FMOA (USD 200mn.). Confidence in the funds was undermined and it took years until the number of investors reached pre-crisis levels. Although confronted with difficulties, the industry progressed significantly in terms of organization and regulations. The UNOPC (the National Union of Collective Placement Organizations) was created as a Self Regulated body, under the supervision of the National Securities Commission. Weekly reporting requirements were imposed and, since 2000, funds must report the detailed structure of their assets. Related to the structure of their placements, a risk evaluation index was established and each fund is compelled to notify the public about its risk profile.

By the end of 1999, the funds looked again like a promising industry -- the number of investors was over 230,000 and the net asset value of their portfolio reached USD 150mn. In April 2000, a new scandal erupted when the FNI, the largest and most dynamic fund, lacked liquidity and subsequently collapsed, generating protests and demonstrations. An investigation was initiated, several persons arrested – among them the president of the Securities Commission – and a court case was initiated by the tens of thousands of victims. Fraud and negligence contributed to the denouement of the FNI case and the experience was once again devastating for the market. The number of investors and capital placed through the mutual funds fell ten-fold compared to the pre-FNI scandal levels. In March 2001, there were less than 50,000 investors and the net assets value less than USD 10mn. Another consequence of the FNI collapse was the change in the asset structure of the funds. In order to lower their risk index, funds reduced placements in listed and unlisted shares to only 8% of total assets.

Table 8: The mutual funds’ industry evolution

	Apr. 96	Dec. 1998	Dec. 1999	Dec. 2000	Mar. 2001
Number of funds	10	10	15	17	20
Number of investors	77,723	116,286	239,382	46,736	44,720
Net Assets Value, ROL thou.	190610	664,424	2,880,603	197,062	276,464
Assets’ Structure, %					
cash		21,2	39,9	1,20	1,1%
T-bills		0,5	3,7	71,70	60,4%
bonds		-		15,80	31,3%
bank deposits		5,7	0,7	0,30	0,0%
listed		8,3	9,1	0,40	0,6%
unlisted		50,9	37,2	0,30	0,2%
other assets		13,3	9,3	11,30	6,5%
Average risk index		3,007	2,23	0,759	0,67

Source: UNOPC reports

1.2.5. SHAREHOLDER ACTIVISM

Only a few years ago, “shareholder” was a word very few people in Romania had heard. Suddenly, through the mass privatisation program, virtually every Romanian adult citizen became a “shareholder”. The extremely dispersed ownership structure that resulted from the mass privatisation program was a recipe for lack of involvement.

Why are Shareholders so Passive?

- most shareholders are not familiar with their rights as shareholders and do not fully understand the corporate governance system in their companies;
- it is practically impossible for shareholders to organize themselves because of the large number and variety of persons involved;
- the free distribution of shares may have fostered a passive attitude among shareholders that tend to be grateful or indifferent, not incisive and demanding as people tend to be when they invest their own resources;
- in many companies the state was still a dominant stakeholder, having an intimidating effect on the activism of other shareholders;
- but above all, **the lack of shareholder activism is a perfectly rational decision from a cost-benefit point of view**: the costs for small individual shareholders to get involved in corporate governance is much higher than the benefits they would eventually derive from their activism.

The companies privatised through MEBO (Management and Employees Buy Out) were the first to experience some form of shareholder activism. Employee shareholders quickly learned that they could influence the boards’ decisions and could eventually change the boards. The power held by the employee shareholders was not always good for the companies and many tough decisions related to restructuring and cost reduction tended to be postponed and overall financial performance subordinated to the benefit of job security. Frequently, insiders’ interests proved to be in conflict with outsider shareholders’ interests.

In 1999, and especially 2000, shareholders’ activism evolved towards an organized, institutional form. Shareholders’ activism tended to be organized mainly around the protection of minority shareholders, in large part in reaction to a number of high profile cases of abuse, some of which are discussed in Section 2.2.2.. The year 2000 was also the debut of involvement of professional and non-government organizations in corporate governance affairs.

The Corporate Governance Initiative for Economic Democracy in Romania was the first large-scale systematic effort to bring corporate governance issues into public debate. The project was conducted by the International Center for Entrepreneurial Studies (CISA) in collaboration with the Strategic Alliance of the Business Associations (ASAA)¹⁹ and it was sponsored by the Center for International Private Enterprise (CIPE), an affiliate of the US Chamber of Commerce. Through conferences, debates and studies prepared by high-caliber Romanian professionals, the Corporate Governance Initiative had a significant impact on the business community. In January and February 2000, workshops were organized in different cities, where board members from local companies,

¹⁹ The Association includes a number of 37 entities – chambers of commerce and industry, business centers, professional associations and employers’ organisations.

executive directors, researchers and public administration officials all shared their experience and expressed views on practical aspects of corporate governance topics. In the end, a **Code of Corporate Governance** was elaborated²⁰.

The Code is a collection of best practice recommendations and is aimed at setting standards for corporate governance applicable to “any commercial company, but principally to the companies listed on the stock exchange or traded on the RASDAQ”, no matter where their capital originates from, state or private sources. The 6 chapters and 27 articles of the Code cover the main issues typically related to corporate governance:

- Structure of the board – the Code recommends boards composed of executive and non-executive directors or, if shareholders so decide, only non-executive boards (art. 4). The Code specifies (art.9) that the board should include two non-executive and three executive directors. For large companies, the number of directors may be increased to seven, while in small companies a board structure is not needed.
- The Code specifies professional and moral standards for selecting members of the boards. The Code is also more restrictive than the existing Romanian legislation on appointing board members – a person should not be appointed to more than 2 boards (against the 3 admitted by law 31/1990) and officials (members of the parliament, ministers and other high rank officials) and their relatives should not be eligible for positions on the boards. A more curious provision of the Code is the preference given to directors that are not shareholders in the company. Another innovation is the recommendation to appoint creditors’ representatives to the board (art. 10.1).
- According to current practice, directors exercise their power in virtue of a legal mandate; the Code proposes to also have contracts concluded between shareholders’ representatives and board members.
- Stakeholders are given proper consideration by the Code: shareholders (especially institutional investors), clients, suppliers or employees representatives are to be invited to certain meetings of the board, while creditors and institutional investors may be given a “permanent invitee” statute.
- Every board should adopt a Code of ethics, setting rules of conduct for all employees of the company (art. 15.3).
- The Code promotes higher standards of transparency. For example, according to the Code, directors have to make public all elements of their remuneration – fees, bonuses, other benefits; managers are obliged to disclose transactions with shares of the company. Special and detailed provisions refer to the reports directors must present to shareholders.
- The Code suggests some minimal financial controls directors should consider in order to insure prudential management of the company.

The Corporate Governance Code was to be promoted through the business associations, especially the network of the Chambers of Commerce, and voluntarily adopted by the companies. We have no information on whether the principles of the Code have been used by a significant number of companies. In any case, both the Corporate Governance Initiative and the Code of Corporate Governance were well received by the media and by the business community.

In 2000, the activism shareholders increased with the creation of the “Romanian Shareholders’ Association” (AARO) initiated by the five SIFs plus one individual. The AARO mission statement specifies: “Our aim is to introduce and enforce the principles of corporate governance issued by the

²⁰ Dr. Ion Anton, Valentin M. Ionescu and Despina Pascal finalised the “Code” adopted by the business associations on 24 March 2000, including the workshops’ conclusions.

OECD within the Romanian economic environment.” The minority shareholders’ case was well presented and well covered in the media.

Another remarkable development is the increased activism of SIFs’ shareholders. By definition, the shareholders in the SIFs are small and very dispersed (one single shareholder cannot have more than 0.1% of the shares). However, shareholders succeeded in imposing a change of the board of SIF Oltenia in October 2000, before the expiration of the mandate of the board. In 2001, one shareholder of SIF Transilvania initiated a campaign in the press against decisions of the board that he deemed to be illegal. His position was supported by court decisions.

Court disputes are the most obvious manifestation of shareholders’ activism. Probably every company has had at least one court case involving shareholders. Although the process is slow, experience is growing.

1.3 CORPORATE GOVERNANCE AND THE PROCESS OF TRANSITION

In Romania, as in other transition economies, changes in the corporate governance landscape occurred not so much as a result of dedicated reform efforts, but rather as a by-product of the broader reforms aimed at re-shaping the whole economic system. Only recently has corporate governance emerged as a distinct policy issue. **Enterprise reform**, prompted by the collapse of the administrative controls prevailing under the communist regime, laid the basis for the creation of private enterprise. **Capital markets reform** allowed for trade in equity for the first time in several decades. **Privatisation** not only transferred state assets to the private sector, but led to the creation of thousands of publicly listed shareholder-owned companies. These reforms are the only reason that the phrase 'corporate governance' has any meaning in Romania.

1.3.1. ECONOMIC REFORM AND THE TRANSITION TO A MARKET ECONOMY

Over the past decade, Romania's political, economic and social life have been subordinated to one major objective: the transition from the pre-1990 centrally-planned economic system to a market economy. Though based on practically the same set of measures used in all reforming countries in Eastern Europe, the Romanian transition to a market economy distinguished itself through the pace and sequencing of these measures. The resulting reform profile reflects not only decisions of the moment but also, to a large extent, the constraints imposed by the initial conditions. Indeed, prior to 1990, Romania was one of the most tightly controlled centrally-planned economies. Unlike other Eastern European countries, it did not experience some form of "mild reforms". The violence of the December 1989 revolution forced a sudden collapse of basic institutions and undermined traditional sources of authority. Instead of enjoying a "consensus building" preliminary period, Romania's reforming authorities were confronted from the beginning with a tense, distrustful and sometimes hostile environment, to which they had to reply with hasty decisions and measures.

From an economic point of view, Romania was confronted with serious macroeconomic imbalances, mainly large excess demand, price distortions and reduced competitiveness due to forced compression of basic imported inputs in the 1980s, when huge efforts to repay the external debt were made. These imbalances were aggravated in 1990 by the collapse in output combined with the policy of boosting real incomes to improve living conditions in compensation for the suffering of previous years.

Institutional fragility and serious **imbalances in the economic system** greatly complicated the task of the Romanian authorities and has had a long-lasting effect on the course of economic reform. Although the programs of economic reform have evolved through time, influenced by internal and external factors as well as by experience and better understanding accumulated in the process, they were constantly struggling with the same two issues, institutional fragility and macroeconomic imbalances.

INSTITUTIONAL REFORM

The reconstruction of the whole legal infrastructure was the main instrument used to re-build the institutional system. Two stages may be distinguished in institution building: the 1990 – 1996 period, during which the fundamental institutions were put in place, and the period after 1997, when attention was focused on expanding, amending and fine-tuning the existing institutions.

A **new Constitution** was adopted through a referendum in December 1991, which set the groundwork for a democratic political system. A bicameral Parliament (the Chamber of Deputies and the Senate) is the supreme legislative power; members of the parliament are elected for a four-year term through direct universal vote. The President is also elected through direct vote. The President designates a candidate to the office of Prime Minister after consultation with the political party which has obtained a majority in the Parliament. Within ten days after being designated, the candidate seeks a vote of confidence of the Parliament on his government's program and cabinet. The Government is in charge of implementing domestic and foreign policy in accordance with the program accepted by the Parliament, and with managing the public administration system.

The Constitution explicitly asserts that “Romania’s economy is a free market economy” (art. 134). However, in order for this proclamation to become a reality, comprehensive reforms had to be implemented. Hundreds of laws and thousands of other pieces of legislation completely changed the institutional framework of the economy .

The Romanian legal system resumes a pre-war continental tradition: apart from the old Romanian Commercial Code (a piece of legislation drawn itself from the French and Italian codes, which was never officially abrogated) the new laws took inspiration mainly from the regulations of EEC member countries.

A natural sequencing was imposed by the priorities of the moment:

Enterprise reform was among the first radical changes to be enacted. After the December 1990 collapse of the old regime, the whole system of economic relations based on planning and administrative enforcement disintegrated. The “socialist enterprise” had become a fictitious entity, with no legal status. The answer to this situation was **Law no.15/1990, On the Reorganization of State Enterprises**, a cornerstone of the economic reform passed in July 1990, which changed the legal status of state "socialist enterprises". Two types of economic entities were created: the "**autonomous organizations**", state-owned organizations on the French model of the “regies autonomes", dedicated to activities in "strategic sectors" (defense, energy, mining, railway etc.) and the "**commercial companies**", most of them joint stock companies having the state as unique shareholder. Commercial companies were granted great freedom to take decisions, but their legal status was still equivocal, as very few specialists were familiar with notions such as stocks and shareholders.

Consequently, **Law no.31/1990, The Commercial Companies Law**, instituted the general rules for creating and running different types of commercial companies, and granting non-discriminatory entry rights to all entrepreneurs and equal treatment for all entities, private or state-owned. One of the very basic requirements for the existence of competitive markets had thus been fulfilled. New institutions were established in order to create an adequate environment for private, independent economic entities, such as the **Trade Register**, instituted by **Law 26/1991**; the **Chambers of Commerce and Industry**, instituted by **Decree-Law 139/90**; and **Administrative Disputed Claims Office**, established by **Law 29/90**. The Commercial Companies Law was amended in 1997.

Privatisation was the logical extension of the enterprise reform which started with Law 15/1990,. The ideas presented there were fully developed in **Privatisation Law no.58/1991**, adopted in August 1991. The privatisation legislation was amended several times, the most important changes being in 1995 and 1997. In 1997, most of the “regies autonomes” were transformed into commercial companies or “national companies” falling under the provisions of the Privatisation legislation.

The reform of **agricultural enterprises** deserves a special mention in this context. Reform in agriculture was triggered by the adoption of **Land Law no.18/1991**, which provided for the restitution of lands held by cooperative farms to former owners or heirs. There was a transfer of 80% of the arable land in the country to 5 million private owners and cooperatives were dismantled. State farms, reorganized as joint-stock commercial companies and holding about 16% of the land, were supposed to be privatised under the general provisions of the privatisation law.

Market reform evolved independently for different markets. The markets for goods and services were the first to be liberalized in 1990, but it was only in 1996 when **Law 21 -- the Competition Law --** was adopted that the market institutional framework was achieved. The most important markets liberalization measure was the **liberalization of prices**, which was gradual and hesitant. The large discrepancy between the money in circulation and the goods available on the market (estimated at 10 to 1) prompted fears that untenable price rises might occur if prices were suddenly liberalized. For many consumer goods, prices were liberalized in October 1990 but different controls and subsidies were maintained for a relatively large number of products. it was only in 1997 that price controls and price subsidies were completely

removed for all food items. Price liberalization for energy and some intermediary products took even longer.

The gradualism in the liberalization of the prices had two major negative consequences: it created persistent inflationary expectations and induced distortions for the business sector. Many state-owned companies went practically bankrupt as prices for their inputs were liberalized, while prices for their final products were kept fixed.

The labor market was deregulated through Law 13 (on collective labor contracts),¹⁴ (on wages and salaries) and Law 15 (on labor conflicts settlement) all adopted in early 1991. Restrictions on hiring and laying off were removed, and salaries and wages in all commercial companies were to be settled through individual or collective negotiations, subject to a national minimum wage. However, in state-owned companies rules for setting wages were introduced. The Unemployment Law no.1/1991 supplemented the legislative framework of the labor markets with a hitherto missing piece of the social safety net.

Financial markets. The reform of the banking system resulted in the creation of a two-tier system in 1991 and the de-monopolization of banking activities. Under Law 33/1991 concerning banking, commercial banks are granted permission to operate as universal banks under the supervision of the National Bank of Romania. Conditions for setting up new banks were established by law and the National Bank was given responsibility to check compliance and grant licenses. The legislation concerning the banking system was augmented and amended with Law 66/1996 (by which CEC, the traditional savings house, was given the status of a bank) and Law 58/1998 which amended Law 33/1991. The insurance sector was also de-monopolized in 1991, when Law 47/1991 on insurance companies was adopted. The capital market was completely recreated with Law 52/1994 concerning securities and stock exchanges.

Opening the economy was a natural complement of the liberalization of the markets. In February 1990, **foreign trade** was liberalized. The monopoly of the fifty or so foreign trade dedicated organizations on import and export operations was abolished. Any company, state-owned or private, was given the right to carry out transactions with foreign partners, subject to a licensing system. A new customs tariff became effective in 1992. However, the licensing system and the customs tariffs were significant barriers to trade, especially in “sensitive” products like energy or agricultural products. It was only in 1997 that most of these barriers were removed. After 1992 the foreign trade regime was increasingly influenced by agreements concluded with the European Union and CEFTA.

Positive discrimination was the dominant policy with respect to **foreign investment**. A company controlled by foreign capital enjoys the same rights and obligations as a Romanian company. For a good part of the 1990s, foreign companies were extended different fiscal incentives such as profit tax holidays, import duty exemptions for machinery and raw materials etc.. Investors were granted the right to repatriate net profits (dividends) and capital invested. After 1996, the regime of fiscal facilities for foreign investments was modified, then suspended, becoming quite unpredictable.

In November 1991, **internal convertibility** of the national currency, leu (pl. lei), was declared and a two-tier exchange rate system was initiated. An inter-bank auction system controlled by the National Bank established an “official” exchange rate, while an increasing volume of transactions took place at the much higher “market” exchange rate. It was only after 1997 that the auction system was completely liberalized and the market for foreign currencies started to work smoothly.

In 1991, the construction of a completely new system of **economic management** was initiated, based on two pillars: the National Bank of Romania, in charge of monetary policy, and the Ministry of Finance, in charge of fiscal policy.

The National Bank uses credit controls and the refinancing rate as the main instruments of its **monetary policy** aimed at “ensuring the stability of the domestic currency in order to contribute to price stability”, as stated in the Statute of the National Bank adopted through law 34/1991 (amended in 1998). A floating

exchange rate regime was finally adopted, given the high rates of inflation and small foreign reserves of the National Bank.

Law no. 10/91, On Public Finances was the initial attempt to rebuild the fiscal system in line with the independent status of economic agents and with the new role of the state. The state and social security budgets are approved yearly by the Parliament. Taxes on profits, salaries and wages (complemented by the global income tax, which began in 2000) and the value added tax are the main sources of public revenue. They can only be modified by law. Public finance was an area of permanent change during the last decade. The frequent modifications of the existing legislation, the introduction of new taxes and the increasing number of regulations created a system difficult to administer and prone to abuses. Hence, it is not surprising that it is constantly mentioned as among the first obstacles to business in all surveys.

Reconstruction of **public administration** and of the **social safety net** were other areas of institutional reform initiated in the early 1990s, and are still evolving. The reform of the pensions system is the latest major reform measure, enacted in 2000, which may have a significant impact on the capital market as pension funds become investors.

ECONOMIC POLICY

Decisions regarding economic policies in Romania were difficult as no model nor established path for transition existed and conditions are very specific for each country. Some errors were probably inevitable, but many analysts think that policy blunders aggravated the situation and hindered Romania's progress towards a stable and business-friendly economic environment. The most obvious economic policy deficiencies noted are²¹:

- A “pathological gradualism”²², meaning not only that “shock therapy” was constantly rejected by Romanian policy-makers, but that the gradualist approach was generalized into becoming the standard approach to all reform measures. The best illustration is offered by the succession of price liberalization measures. The attempt to keep some prices under control for the sake of “social protection” proved to be disastrous -- the amount of subsidies required ballooned to unsustainable levels and structural distortions were aggravated. Price liberalization, in the absence of interest rate liberalization, caused the decapitalization of the banking system. Though a bonanza for the industrial companies that could obtain cheap credit, the interest rate controls of the first half of the 1990s led to bank failures. The bill was paid in 1997-2000 when about 8% of GDP had to be spent on cleaning up the banking system. The attempt to avoid the consequences of full liberalization of the exchange rate through a “multiple exchange rates” regime that prevailed until 1997 resulted in the depletion of the National Bank's foreign reserves.
- The “mirage of the industrial model” is related to the prevailing (although usually implicit) assumption that Romania's industrial infrastructure is an asset that has to be preserved at any cost. All macroeconomic stabilization efforts stumbled at the gates of the large industrial enterprises that continued to produce losses and to absorb, in one way or another, public money. Policy-makers failed to understand, and/or to accept, that the state did not have the resources to restructure and modernize the entire industrial system and that the market is the ultimate force in picking winners and re-shaping industries.

²¹ After Ilie Serbanescu, *Can the vicious circle be broken?* in *Economic Transition in Romania – Past, Present and Future*, Proceedings of the Conference: Romania 2000. 10 Years of Transition, edited by Christof Ruhl and Daniel Daianu, published by the World Bank and the Romanian Center for Economic Policies, 2000.

²² The term was coined by Costea Munteanu in a paper produced in 1995.

Four periods may be distinguished in Romania's reforming policies²³:

“The first transformational recession” of the early years (1990 – 1993) was characterized by a severe decline in economic activity (more than a 26% drop in GDP) and extremely high inflation (300% in 1993). Incoherence in economic policies, with the first signs of “pathological gradualism”, as well as the “institutional interregnum” situation, contributed to creating a fuzzy and volatile economic environment. The economy was deteriorating rapidly when a stabilization plan supported by the International Monetary Fund was adopted in 1991. But the gradualistic approach of the program failed to stop inflation and to restore macroeconomic equilibrium.

“The interest rate shock” (1993 – 1994). Rising inflation forced a reconsideration of policies; by the end of 1993, the National Bank increased the refinancing rate more than two times, pushing interest rates in the economy to positive levels for the first time. The effects appeared promptly: the flight from the currency was stopped, which permitted a substantial devaluation of the “official” exchange rate to levels close to the market rate. In 1994, inflation was down to 62% and the trade deficit reduced substantially.

“Fragile growth and relapse into inflation” (1995-1996). With inflation of only 28% and economic growth of 7.1%, 1995 looked like the best year of the decade. But clouds were already accumulating on the horizon: the current account deficit increased three-fold and the quasi-fiscal deficit was increasing rapidly because of growing subsidies to agriculture and loss-making *regies autonome*. Approximately USD 400mn. were injected into two ailing banks (CREDIT BANK and DACIA FELIX). By the end of 1996, the monthly inflation rate was again in the double-digit zone, the current account deficit was rising and, in spite of borrowing on the international capital markets (USD 1.5bn.) the National Bank's foreign exchange reserves were running low.

“The second transformational recession” (1997-1999). As result of the liberalization of the foreign exchange market and of other prices (food, energy -- whose prices were, in fact, administratively adjusted towards market-clearing levels) initiated by the new government after the 1996 elections, inflation in 1997 bounced back to 151%. The corrections had some immediate positive consequences -- the budget deficit was reduced, as well as the current account deficit, while the National Bank's foreign exchange reserves soared to about USD 2.6bn. However, GDP fell by 6.6% in 1997 and continued its slippage until 2000. As monetary policy was prematurely relaxed towards the end of 1997, and the restructuring in the real sector was slow and inadequate, prospects for 1998 were not good. Although the budget deficit remained low and inflation continued to decline, the foreign trade deficit was higher than ever and the National Bank's reserves were declining again. This seriously increased the risk of external payment default in 1999, when more than USD 2.9bn. was due, especially considering that, after the Asian and Russian crises, the attitude of international capital markets towards Romania was very severe.

Romanian authorities were left with very little room for maneuver but, after avoiding payment default in 1999, things started to improve in 2000. Exports soared to the highest levels of the decade, the National Bank reserves were restored and, above all, a moderate 1.6% output growth was achieved – in spite of a very bad agricultural year. Inflation was still high, at over 40%, but the budget deficit was under 3.5%.

Romania had a mixed record in achieving the targets agreed upon in the accords concluded with the international financial institutions, the IMF and the World Bank. Although, technically none of the agreements concluded during the decade were finalized, they were of extreme importance for the country, providing several important benefits:

²³ After Daniel Daianu, *Structure, Strain and Macroeconomic Dynamic in Romania*, in *Economic Transition in Romania – Past, Present and Future*, Proceedings of the Conference: Romania 2000. 10 Years of Transition, edited by Christof Ruhl and Daniel Daianu, published by the World Bank and the Romanian Center for Economic Policies, 2000.

- money, in times when no other external financing sources would have been available;
- technical expertise in the field of macroeconomic policy and instruments which were not familiar to Romanian experts;
- increased credibility on the international capital markets;
- a firm stance on macroeconomic policy decisions which helped to keep on track some stabilization and structural adjustment programs.

After 1999, when Romania was officially invited to start negotiations for accession, the EU's influence over economic policy matters has been growing. A "Strategy for the Integration in the European Union" was elaborated in 2000, providing a detailed blueprint for action. All political parties endorsed the strategy, proving that the European idea is one of the strongest consensus-building political objectives of the moment.

1.3.2 THE PRIVATISATION PROCESS

In the year 2000, over 60% of Romanian GDP was produced by the private sector. Although agriculture, construction and services generate, respectively, 90%, 71% and 72% per cent of value added, industry is still dominated by state-owned companies which produce 55% of value added. The expansion of the private sector was achieved through two major avenues: the creation of new economic entities and the transfer to private ownership of state assets through privatisation.

In Romania, the importance of privatisation was recognized very soon in the debates on economic reform. The "Outline of a Strategy for Transition to a Market Economy in Romania", the first blueprint for reform published by the provisional authorities in May 1990, mentioned not only the need for privatisation, but also drew up an ambitious calendar. While privatisation was generally accepted, passionate disputes were engaged over the "best" privatisation method. Law 15/1990 on the reorganization of state enterprises into commercial companies and "regies autonomes" touched the issue and outlined the idea of a privatisation scheme combining a free-distribution program with a more conventional sale of assets and stocks.

The preparation of Privatisation Law no. 58/1991 took another year and was adopted by the Parliament in June 1991, after fierce controversies and contestation. In the meantime, some collateral privatisation was already initiated:

- the sale of housing stock was not regarded as a "privatisation" measure, but more like social protection/compensation – approved early in 1990 and extended in 1992 to houses owned by state companies;
- the restitution of agricultural land (Law 18/1991) which resulted in the collapse of the collective farm system. Over 80% of the arable land was returned to former owners or heirs.

The **privatisation of state enterprises** was, however the centerpiece of the privatisation program. Although, over time the initial privatisation scheme was altered, it remains essential for understanding the results and current configuration of the capital markets.

THE INITIAL PRIVATISATION SCHEME

In essence, the Romanian privatisation program proposed by Law 58/1991 was a combination of two basic schemes: a **free-distribution scheme**, aimed at speeding up the process and satisfying political objectives and a more conventional **sale of assets and stock scheme**, aimed at providing effective control over productive assets. The **National Agency for Privatisation** had been already set up by Law 15/1990 to prepare, coordinate and control the privatisation program.

The privatisation law was applicable to the approximately 6,300 commercial companies that resulted from the reorganization of socialist enterprises following Law 15/90. It was estimated that these companies were holding approximately 55% of the productive assets in the economy, the rest being held by the "regies autonomes" and excluded from the privatisation process.

Most commercial companies subject to the privatisation law were organized as joint-stock ventures with the state as the initial single shareholder. The privatisation law stipulated that the stock in each of these companies was to be transferred to two types of newly created legal entities: the State Ownership Fund, which was allotted 70% of the stock in each commercial company, and five Private Ownership Funds which received the other 30% .

The State Ownership Fund (SOF) was created as a "public institution acting on commercial grounds". It was subordinated directly to Parliament and controlled by a 17-member Board of Administrators appointed by the government, by the two chambers of Parliament and by the President. The SOF's main task was to reduce its portfolio through selling shares at a planned rate of 10% a year: in seven years it was to sell off its initial 70% stock in every company and disappear. A Privatisation Program was to be presented to the Parliament every year, with concrete measures proposed in order to secure that the 10% target be met.

The SOF had an independent budget and it could use the proceeds from sales for preparing new companies for privatization. In that context, the SOF also had responsibilities for restructuring the commercial companies.

The five Private Ownership Funds (POFs) were created as commercial companies of a "financial nature", which for the first five years of their existence were to be regulated under the special provisions of Law 58/91; after that, they would become common "mutual funds"²⁴. Each POF was governed by a 7 member Board of Administrators, appointed by Parliament for the first five years.

Each POF was endowed with 30% of the shares in companies allocated to it (around 1,200 companies per POF). At the same time, each POF had to issue **Certificates of Ownership (COs)** to be distributed free of charge to qualified Romanian citizens. Thus each Romanian citizen over 18 years old received five COs at the end of 1990 -- one for each of the five POFs -- and became a shareholder in the POFs.

The CO holders had several choices: to sell their COs to other Romanian citizens (foreigners were denied the right to possess COs); to buy, in exchange of their COs, shares in commercial companies put up for sale by the appropriate POF; to convert their remaining COs into common shares of the POFs when they transformed into regular mutual funds. As any stock, the CO gives the right to receive dividends from the POFs as well as the (theoretical) right to control the actions of the Board.

The POFs were allocated companies in certain industrial sectors and the original industrial profile is still discernible in the portfolio of their descendents, the five Financial Investment Companies (SIF):

- POF I – now SIF1 Banat-Crisana: companies in wood processing; non-ferrous metals;
- POF II – now SIF2 Moldova: textile and clothing;
- POF III – now SIF3 Transilvania: naval transport; fishing; tourism and catering;
- POF IV – now SIF4 Muntenia: glass and ceramics; construction materials; cosmetics; pharmaceuticals;

²⁴ They were in fact renamed "Societati de Investitii Financiare" (Financial Investment Companies) – better known under their Stock Exchange symbol SIF.

- POF V – now SIF5 Oltenia: electronics and electrotechnics; footwear and leather;

The "critical industries" (those in a difficult economic situation and in need of global restructuring -- metallurgy, machine building, petrochemicals and chemicals; and those enjoying monopoly or vital positions -- banks and insurance) were distributed among the five Funds in order to spread the risk, improve prospects for restructuring and avoid dominance of one POF over the others. Finally, other industries were assigned according to regional criteria (trade, construction and agriculture).

According to the law, the stock held by the State Ownership Fund, and by the Private Ownership Funds, was subject to sale to Romanian or foreign legal entities or natural persons, through one or several methods specified by the law: public offer for sale; sale of shares through open cry auction or auction with pre-selected bidders; sale of shares through direct negotiation.

THE EVOLUTION OF THE PRIVATISATION PROCESS²⁵

The experience of the "pilot privatisations" carried out by the National Agency for Privatisation in 1992 and 1993, as well as the first sales concluded by the State Ownership Fund, showed that serious difficulties confronted the process, which advanced much slower than expected. Only one privatisation method was an unexpected success: the sale to managers and employees. Initially devised as a standard procedure applicable only to small companies, MEBO became the dominant method of privatisation when a special law (no. 77/1994) granted substantial facilities to the employees who wanted to buy shares. This explains the relatively large number of PAS (employees associations) that are listed among the significant shareholders in companies on the Stock Exchange and especially on the RASDAQ.

²⁵ A detailed presentation, including many comments and critical observations, in Dragos Negrescu, *A decade of Privatisation in Romania*, in *Economic Transition in Romania – Past, Present and Future*, Proceedings of the Conference: Romania 2000. 10 Years of Transition, edited by Christof Ruhl and Daniel Daianu, published by the World Bank and the Romanian Center for Economic Policies, 2000.

Table 9: Evolution of the privatisation process

	1993	1994	1995	1996	1997	1998	1999	2000
No. of companies in SOF portfolio, beginning of the year	5,937	6,291	7,602	9,010		5,554	4,330	3,149
No. of companies privatised during the year, of which	265	604	648	1,388	1,304	1,267	1,772	1,341
■ MEBO	261	519	43	14				
■ Direct negotiations	4	85	605	1,006	1,064	244		
■ Auctions				455	231	991		
■ Sales on the capital market					9	32	64	108
Companies sold to foreign investors	1	1	5	4	44	96	83	38
Proceeds from sale to foreign investors – USD mn.	2.0	3.9	15.0	15.5	403.8	608.1	57.1	7.0

Note: The number of companies in SOF's portfolio was increasing mainly as result of reorganizations – some companies were split into several smaller units. Several privatisation methods may be used concurrently so numbers do not necessarily add up.

Source: *The State Ownership Fund*

Growing criticism (coming not only from domestic political opponents but also from the international financial institutions) prompted the government to try to instill new life into the privatisation program. In 1995 a new law (no. 55/1995) for “accelerating privatisation” was adopted. The new law in fact modified some of the provisions of Law 58/1991 and, thereby, set in motion the Mass Privatisation Program. Basically, new vouchers (named “privatisation coupons”) were distributed which, along with the old Certificates of Ownership, gave Romanian citizens an option to subscribe their vouchers either for one of approximately 4,000 companies targeted by the program, or to subscribe to one of the five POFs. Although, globally the 30% stake to be distributed freely was maintained, in individual companies up to 60% of the shares were put up for exchange against “coupons”. Although a logistical nightmare, the program was eventually finalized, and resulted in a dramatic shift in ownership structure characterized by an extremely dispersed ownership, with some companies having hundreds of thousands of small shareholders. The mass privatisation program created the ownership pattern that can be easily recognized on Romanian stock exchanges today.

By the end of 1996 a special law (no. 133/1996) was adopted for the transformation of the five Private Investment Funds into “regular mutual funds”, as recommended by the initial privatisation law. The most complicated and convoluted technical solutions were adopted. For example, not only did approximately 500,000 citizens who subscribed their “coupons” with each POF become shareholders,

but also over 10 million individuals were entitled to receive dividends from previous years. It took more than two years until different “compensations” and “regularization” were achieved and each Financial Investment Company (SIF) had a complete list of all its 10mn. shareholders!

At the conclusion of the Mass Privatisation Program and the “regularization” exercise, the State Ownership Fund was still in control of most of the companies in its portfolio. After the 1996 general elections, a new approach to the privatisation process was promoted through several changes in the legislation. Although the new legislation was intended to simplify, render more transparent and accelerate the process, for a period of 25 months (from May 1997 to June 1999) no less than 15 additional reshuffles of the legislative framework were adopted. Of course, the volatility in legislation had negative consequences on the capacity to effectively finalize the deals. However, the new approach to privatisation during the period 1997-2000 produced some remarkable results:

- The scope of the privatisation process was substantially enlarged with the reorganization of the non-privatizable “regies autonomes” into “national companies”. The corporatisation of the large utilities opened new opportunities for privatisation. In 1998, 35% of ROMTELECOM -- the national telephone company – was acquired by the Greek operator OTE. The gas and electricity monopolies were split into several operational units and regulated markets started to be organized as a step towards the utilities’ privatisation.
- Other previously “taboo” sectors were addressed: the ROMANIAN BANK FOR DEVELOPMENT was sold to the French SOCIETE GENERALE, and another retail bank, BANKPOST, was sold to a consortium formed by GE CAPITAL and BANCO PORTUGESE. Sales of large state farms were also initiated in 1999.
- The number of large companies that were privatised increased.
- Many of the large sales involved foreign investors – the number of contracts concluded with foreign investors and the hard currency proceeds increased several times as compared to the previous period.
- As a consequence, the percentage of total equity divested was more than double of that achieved in the previous years.
- The privatisation methods were diversified, including also sales on the capital markets. However, capital markets were used mainly for sales of the “residual” participations the SOF was left with in a number of companies after the Mass Privatisation Program.
- The SOF was no longer the only institution in charge with the privatisation – most “national companies” fell under the ministries’ responsibility.

At the beginning of 2001, the State Ownership Fund (transformed into the Authority for Privatisation and Administration of State Property) still had 1,135 companies in its portfolio and several projects underway. A group of 64 companies was selected for privatisation with investment banks under the World Bank PSAL agreement:

- Four large individual companies: TAROM (airlines), SIDEX (steel), ALRO/ALPROM (aluminum).
- Five medium sized companies, among which the most important is the pharmaceutical company ANTIBIOTICE.
- Fifty small- and medium-sized companies pooled into 5 groups of 10.

In spite of some delays incurred in 2000, the program now looks poised to take off. Negotiations for SIDEX, the largest company in Romania and a very difficult transaction, are quite advanced, with the international group ISPAT as the only bidder²⁶. The privatisation of BANCA AGRICOLA, which had been dragging on for more than one year, was concluded in April 2001. If the momentum is maintained, privatisation in the classical sense of the original Law 58/1991 should be concluded in 2001 – not too far off from the initial target! Privatisation of some large “national companies” like the oil company PETROM SA, the tobacco company SNTR, the airlines TAROM (all of them unsuccessfully offered for sale in 2000) as well as the utilities (electricity and gas) may take longer²⁷.

1.3.3. THE ROLE OF FOREIGN INVESTMENT

At USD 6.4bn, the stock of foreign investment in Romania is low compared to Poland, which attracted more than USD 30 bn. in foreign investment, or with the smaller Hungary and the Czech Republic, which have each around USD 20 bn. of foreign investments.

Greenfield foreign direct investment contributed 80% to the total stock of foreign capital in Romania (table 7); the proceeds from privatisation make for another 17%, while the quite volatile portfolio investments on the capital markets are currently over USD 200mn. It should be noted that privatisation’s contribution to attracting foreign investment became relevant only after 1997, while in other CEE countries it was the driving force for structural changes in the economy.

Table 10: Evolution of foreign direct investment

	No. of companies foreign participation	with Capital subscribed in hard currency, USD mn.
1991	5,526	376.6
1992	10,827	280.7
1993	9,858	343.5
1994	10,717	840.1
1995	4,249	213.5
1996	4,449	493.3
1997	5,864	347.1
1998	8,978	547.0
1999	7,776	602.0
2000	9,090	958.0
Total	77,334	5,001.9

Source: Chamber of Commerce and Industry, Foreign Investments in Romania, bulletin no. 35,

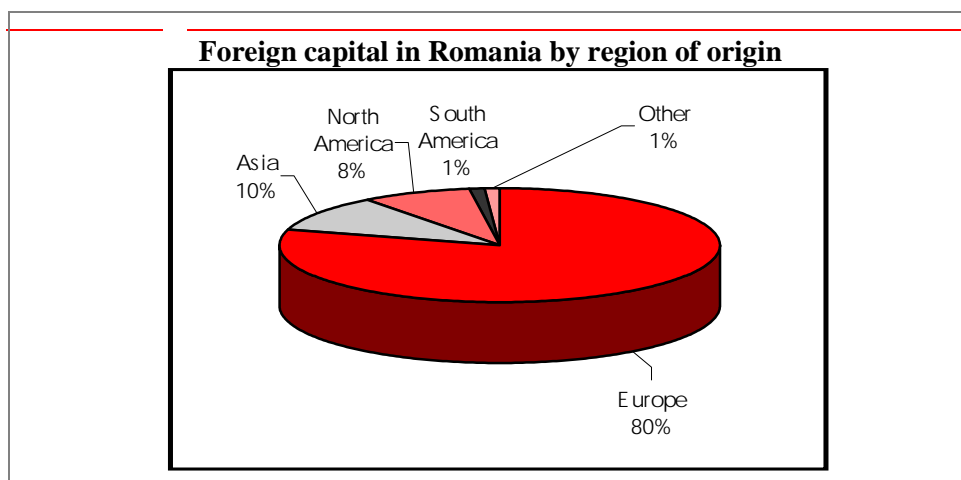
²⁶ The privatisation of Sidex has now been finalized.

²⁷ Petrom was listed in September 2001 when 4% of the company was sold to the public. Technically, the listing nearly doubled the capitalization of the market, including the shares still held by the state.

Lagging reforms and poor macroeconomic performance, a volatile and frustrating legislative framework especially in the area of taxes, a bloated bureaucracy and delays in privatisation are the main factors that have deterred foreign investors.

Moreover, statistics show that:

- Only 7.7% of foreign investors are legal persons, but
- 81.1% of the foreign capital invested in companies with foreign participation belongs to legal persons;
- 1% of the companies with foreign participation own over 80% of the invested capital, while the last 95% own only 12%.



Source: Trade registry

The analysis of FDI indicates two distinct periods:

1990-1996. Privatisation was confined to small- and medium-sized companies; foreign investors, consisting mainly of small companies or individuals, brought in around USD 35mn. The only large FDI investments during this period were in infrastructure projects (energy-ABB, telecommunications-Siemens), or driven by the size of the market in the consumer goods industry (Coca Cola, Colgate Palmolive) or the special incentives offered to some large investors (Daewoo, Unilever, Kraft Jacobs Suchard).

1997-2000. The recession, as well as the sense of political and legislative instability inspired by the continuous tensions within the ruling coalition of the time, were discouraging factors for foreign investors. On the other hand, the privatisation of large companies increased considerably and several significant transactions were concluded:

- **Romanian Bank for Development.** Initially SOF sold a 42.1% stake to Societe Generale for USD 135mn or USD 20.15/share. This was followed by a 20% share capital increase bringing SG's stake to 51% at a total cost of USD 200mn. 8.33% was acquired by the bank's employees and management and 4.99% was sold to the EBRD. A 9.86% stake was subject to a public offering, of which 25.7% was taken up and followed by listing on the BSE (as of 15 January 2000).
- **Bank Post.** The value of the 45% stake was USD 42.7mn, to which USD 50mn were added as direct investments. An additional 8% were sold to the employees and management and the bank is

under negotiations for the conditions of a debt equity swap for its two subordinated loans from the EBRD and the IFC. The remaining shares are to be sold via a private placement and followed by a listing on the BSE.

- **Dacia.** On 2 July 1999 a privatisation agreement for USD 269.7mn was signed, of which USD 50mn represented the price of the 50.96% stake (USD 0.14/share), USD 68.4mn share capital increase (Renault's obligation) and USD 151.3mn investment to be made by Renault over the next five years.

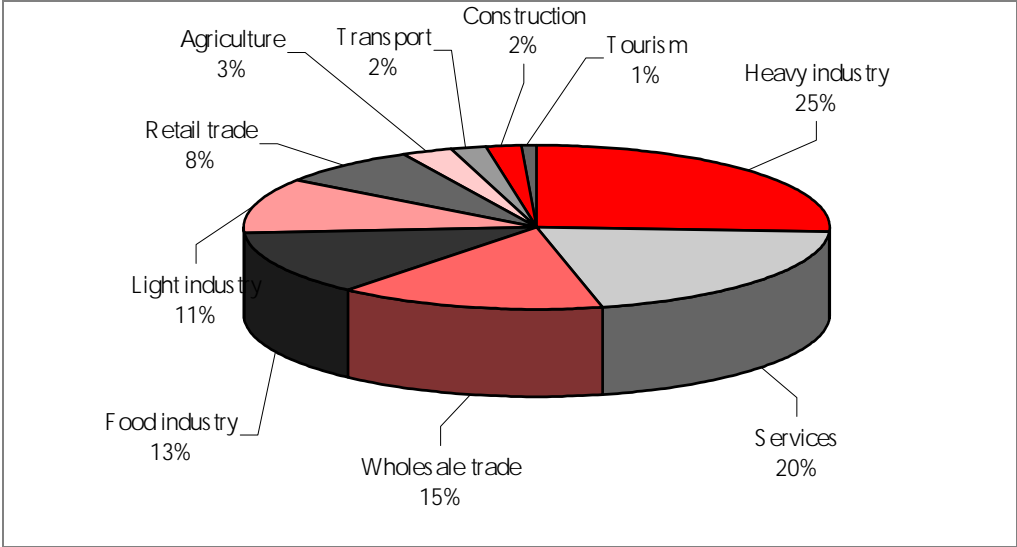
Table 11: Some major foreign investments via privatisation

Company name	Investor	Stake (%)	Amount (USD mn)
Automobile Craiova	Daewoo	51%	150
Romanian Bank for Development	Societe Generale	51%	200
Bank Post	General Electric	35%	92.7
	Banco Portuguese de Investimento	10%	
Dacia	Renault	51%	269.7
Astra Vagoane Arad	Trinity Industries	81.9%	50
Galati Shipyard	Group of four investors	40.9%	25
Silcotub Zalau	Tubman International Ltd	71.96%	6.8
Artrom Slatina	Staro Stahl- Und Rohrenhandel Gmbh	57.82%	6.2
Banca Agricola	Reiffeisen Bank	90%	15+37
	Romanian American Investment Fund		

Note: The amount of investments includes also the investment commitment.

Source: SOF.

FDI breakdown by sector as at October 2000

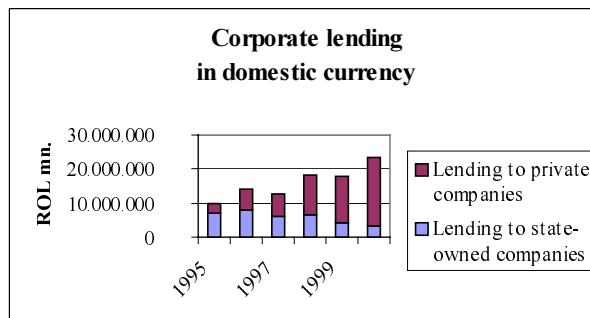
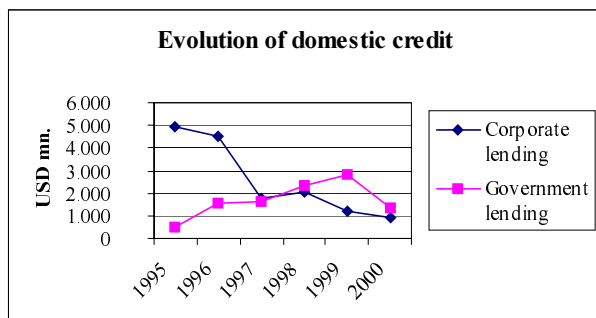


Source: Invest Romania

1.4. CONCLUSION: CORPORATE BEHAVIOUR, FINANCE AND RESTRUCTURING

According to the national accounts statistics²⁸, in 1997 the Romanian corporate sector had an operating surplus of 54% of the gross added value. 37.9% of the gross operating surplus was directed towards savings; the self-financing ratio (gross savings/gross fixed capital formation) was, therefore, 58.4% or, if net capital transfers and changes in inventories are included, 64.6%. This shows that Romanian companies used external sources for financing 35-40% of their capital needs. The net lending of the corporate sector in 1997 was ROL 15,663.5bn.

Lending in Romania



Although shrinking substantially in real terms, domestic credit remains the most important source of external finance: in 1997, bank lending to companies in domestic currency was ROL

12,479.1bn., that is 80% of the net lending (financing needs) of the corporate sector. While in 1995, 72% of bank lending was directed towards state-owned companies, in 2000 the state-owned companies were absorbing only 13% of the lending in domestic currency²⁹. In spite of the deteriorating macroeconomic conditions prevailing after 1996, every year the corporate sector has absorbed important funds – almost USD 1bn in 2000 (down from USD 6bn. in 1995). Romanian companies make very little use of the stock market as a source of new capital.

The very partial, anecdotal information available³⁰ suggests that companies' economic behaviour is correlated with the ownership structure that prevails in individual firms. Several situations may be distinguished from a corporate governance perspective:

- Because of the multiple and inevitably conflicting objectives the state has as owner of commercial companies (profit maximization, maintaining jobs, increasing tax revenues, serving political interests etc.), **state-owned firms** are rarely focused on economic performance. The interests of directors and managers of state firms are poorly aligned with shareholders' interests. The agency problem in state firms is aggravated by the limited capacity of the state institutions to effectively monitor managerial performance and behaviour³¹ and sometimes by conflicts between different

²⁸ National Commission for Statistics/National Bank of Romania, *National Accounts 1996 – 1997*, issued August 2000,

²⁹ According to data included in the National Bank of Romania *Monthly Bulletin no. 12/2000*.

³⁰ Studies based on surveys at a microeconomic level aimed at identifying patterns of managerial behaviour and corporate governance practice are missing. Opinions expressed occasionally by different authors on corporate governance are based on personal observation and on cases brought up by the media.

³¹ The agency problem was chronic for the Romanian State Ownership Fund since its inception in 1992. The legislation was modified several times with an aim to improving state representation in the general shareholders' assemblies and boards of directors (see 2.2 and 2.3 below), but with little success. The task is of daunting dimensions – the SOF had to appoint and monitor the activity of tens of thousands of representatives in the over 9000 companies it was holding in its portfolio at one time! The selection of state representatives was largely influenced by political motivations – each ruling party's specialists were better qualified for the job than their predecessors! Very frequently the state representatives – supposed to monitor the performance of the companies' managers – were, in fact, colluding with managers for different personal benefits.

institutions trying to impose their own bureaucratic objectives³². As a result, different forms of company assets stripping are frequent in state firms. Restructuring is slow in state companies as managers hesitate in taking responsibility for unpleasant tasks. When initiated, restructuring tends to be merely cosmetic³³ and driven from the outside (ministries and government agencies, different forms of financing granted in the event that restructuring programs are adopted etc.). Rent seeking through political lobbying is a much more rewarding managerial policy than cost cutting. Running a high volume of arrears, especially to the state budget, is also regarded as good managerial policy.

- **New private firms** are, in general, closely held by their founders, who are also involved in the current management of the company. The agency problem is therefore reduced. Instead, conflicts between associates are quite frequent, also resulting in court cases and split-offs. As companies grow and professional management is hired, agency may become an issue, but in general it is less severe than in the case of state-owned firms. Although economic rationality prevails in decision making, performance is not necessarily related to profit maximization but rather to company expansion. As a result, diversified and poorly structured business empires have appeared. Marred by financial problems, many of these empires tend to adopt the financing tactics of state-owned companies, such as building up arrears to the state budget. Restructuring eventually occurs but is rather slow.
- **Privatised companies** provide the widest variety of situations, with, at one extreme, firms having an extremely dispersed ownership or, at the other extreme, companies having a strong controlling ownership. The main corporate governance problem here is the conflict between insiders (controlling owners) and outsiders, minority shareholders. Because the minority shareholders usually resulted from the mass privatisation program, the controlling owners rarely think of them as investors and useful partners that could eventually contribute funds in the future. Although foreign investors³⁴ bring in better organizational and incentive systems that can improve corporate governance, their attitude towards minority shareholders is not much different. Many large strategic investors tried, and sometimes succeeded, in buying out minority shareholders' interests and delisting their companies from the stock exchange. The situation is very much improved in cases where minority shareholders are genuine investors who provide funds directly to the company. Most venture capital funds succeeded in building good relations with their controlling partners. Restructuring is slow in companies controlled by employees and most effective in companies controlled by foreign strategic investors.

In conclusion, the behaviour of companies is very much influenced by their ownership structure and privatisation is the main factor determining change in corporate behaviour. Although closely held private companies have their own specific corporate governance problems, these are most obvious in privatised and state-owned companies. Because stock exchanges have themselves been set up through political decision, as a complement and fulfillment of the privatisation process, they play a very limited role in financing the economy. As a result, companies have little incentive to get listed and to rigorously comply with all listing requirements. For the same reason, controlling owners are not motivated to keep minority shareholders satisfied, and conflicting relations tend to develop.

³² The most evident are the conflicts between the branch ministries (Ministry of Industries, Ministry of Agriculture etc.) which propose restructuring and development strategies for industrial sectors and the State Ownership Fund which is the nominal "owner" of the companies, having its own restructuring programmes.

³³ For many managers, restructuring is equivalent with and limited to staff reductions.

³⁴ A good analysis of the economic performance of foreign firms compared with domestic ones (state owned and private), in Voicu Boscaiu, Costea Munteanu, Daniela Liusnea, Lucia Puscoi, *Impact of the FDI on Productivity in Romanian Manufacturing Industry*, at www.cerpe.ro

PART II: THE REGULATORY FRAMEWORK AND THE ROLE OF POLICY

Laws and other regulations provide the foundation for any corporate governance system. In practice however, corporate governance standards depend not only on the provisions of the laws but also on their effective application, which is related to the functioning of the institutions aimed at monitoring compliance and enforcing the law. Part II of the report is dedicated to presenting the main provisions of the Romanian legislation relevant to corporate governance and provides some discussion of actual practice. Chapter 2.1 introduces the main laws and institutions, while 2.2. through 2.5 examine in detail the regulations, practices and policies covering all essential elements of corporate governance, following the structure of the OECD Principles.

2.1. THE LEGAL AND REGULATORY FRAMEWORK

The current system of corporate law in Romania is rooted in the Continental European tradition of civil law. The centerpiece of corporate legislation is the **Commercial Companies' Law** no. 31/1990, amended in 1997 by government ordinance no.32. Law 31/1990 draws on the Romanian Commercial Code of 1938, which, while never enacted, was an attempt to modernize and update the old 1887 Commercial Code. The Code was heavily inspired by the French legal tradition – although the 1938 Commercial Code also draws on the Italian Commercial Code, considered at the time the most advanced piece of legislation.

The second pillar of corporate legislation is more specific: the **Securities and Stock Exchanges Law** no.52/1994. This law contains special provisions for “public companies” (“open companies” in Romanian legal parlance), which are in general more constraining than the standards imposed by law 31/1990. The Securities and Exchanges Law is a modern piece of legislation, inspired not only by European tradition but also by Canadian and American experience.

As a candidate for EU membership, Romania is engaged in a comprehensive process of legal harmonization. One of the major objectives of the 1997 amendments to the Law 31/1990 was to bring Romanian legislation in line with EU regulations. Specialists consider corporate regulations to now be harmonized with respect to: the publicity of commercial companies; the validity of social commitments; the voidability of the incorporated company, protection of associates and third parties, mergers and divisions of commercial companies. Romanian legislation still differs on the minimum level of share capital (EUROS 25,000)³⁵.

However, analysts have observed that “fulfilling EU membership requirements will not do much to improve corporate governance regulatory standards because EU directives on company law are generally vague, reflecting the varying standards and practices of existing member states. EU directives are almost entirely for public companies, but do not distinguish between listed companies and offer little consistency with regard to takeovers.”³⁶ Although some EU rules do have great relevance on specific issues -- like accounting and auditing, transfer pricing, insider dealing, protection of creditors and other stakeholders, etc. -- assimilation of the EU regulations cannot be expected to induce major changes in the corporate regulatory framework.

2.1.1. THE COMPANY LAW

The Company Law is a comprehensive piece of legislation, drafted to produce a self-sufficient corpus of regulations governing the creation, organization, functioning, modification and liquidation of all types of commercial companies. Although for some interpretations of the law's provisions, reference should be made to the Commercial Code, the 287 articles of Law 31/1990 are the ultimate source for

³⁵ Elena Cârcei, *Societatile comerciale pe actiuni (The Joint-Stock Companies)*, ALL BECK Publishing House, 1999.

³⁶ SG Emerging Markets Equity Research – *Standards of Corporate Governance*, London, February 2000, p.2.

corporate legislation in Romania. Special provisions may apply to companies dedicated to specific commercial activities (banks, insurance companies, investment funds, etc.) or to companies in special conditions (companies listed on the stock exchange, companies in liquidation, etc.) but these provisions are always complementary to the Company Law. On the other hand, Law 31/1990 does not cover individual or collective businesses that are not organized into a distinct legal entity – a company. Here we will succinctly present the main provisions of the law, focusing on aspects that are relevant to “corporate governance”. Specific issues, such as the role and functioning of the board, shareholders’ rights and protections, accounting and disclosure requirements etc. are treated in the following chapters.

FORMS OF COMPANIES

Under the Romanian Company Law (art.2 and 3) five forms of corporate business organization are defined, each of them representing a specific mix of capital and persons, and differentiated by the extent the associates assume, in subsidiary, the company’s liabilities:

- general partnership (societate în nume colectiv – SNC) is the most “personal” type of organization, where partners are jointly and severally liable for their company’s obligations (each of them is liable for any claim against the company with all his possessions);
- limited partnership (societate în comandita simpla - SCS) – a first step towards a more depersonalized organization: there are simple contributing partners, liable up to the extent of their contribution, and committed partners that are jointly and severally liable for the company’s obligations;
- limited partnership by shares (societate în comandita pe actiuni – SCA), where the entire capital is divided into shares and the simple partners are liable only with their shares, while committed partners are jointly and severally liable;
- joint-stock companies (societate pe actiuni – SA), a completely depersonalized organization, where shareholders are only liable to the extent of their shares;
- limited liability companies (societate cu raspundere limitata – SRL), where partners are liable only to the extent of their contribution to the capital.

As a rule, at least two partners are required to set up a company (art.4). A minimum of five partners is required to set up a joint-stock company. Sole partnerships are admitted as an exception for limited liability companies, which cannot have more than fifty partners. Both natural and/or legal persons may become partners in a commercial company.

For some forms of companies, a minimum level of share capital is required (art. 10 and 11); currently, the limit is ROL 2mn. for limited liability companies and ROL 25mn. (approx. USD 800) for joint stock companies and limited partnerships by shares. Contributions in cash and contributions in kind to the share capital are accepted, but at least some contribution in cash is required.

The limited liability company is the most common form of organization for business entities in Romania. However, the joint stock company is the most complex organization and the one which is relevant for large corporate entities, where ownership and management are usually separated. Apart from general provisions, applicable to all forms of business entities, the Company Law treats extensively the special situations with which joint stock companies are confronted.

INCORPORATION

The incorporation of a company is a four-step process: (a) preparation of the association documents (contract of association and by-laws, which can be unified into a single document called a

“constitutive act”); (b) a hearing before a judge delegated by the Court to the Trade Registry; (c) the matriculation with the Trade Registry; (d.) public notification of the incorporation in the Official Gazette. For some businesses (banking, insurance, brokerage, etc.) a prior approval from the competent regulatory authority is required.

The Trade Registry is the key institution for the incorporation process. Organized on the basis of Law 26/1990, the Trade Registry is affiliated with the Chamber of Commerce and Industry. Its role is to keep public records on all businesses. The information recorded by the Trade Registry is quite extensive and mirrors the information required to be specified in the constitutive act³⁷: identification data on all associates or founders; information on the company (name, headquarters’ address, subsidiaries or branches, legal form of organization, object of business); information on the capital (share capital, associates’ contribution, in-kind capital, nominal value of shares and shares’ distribution among associates, types of shares); information on the administrators/directors and censors; the conditions required for the validity of general shareholders meetings; the commitments assumed by the founders; clauses on the dissolution and liquidation of the company. Changes in any of these elements during the lifetime of a company also have to be recorded with the Trade Registry. Records are publicly available – for a fee, anyone can obtain information on a given company.

CREATION OF A JOINT-STOCK COMPANY

There are two ways to set up a joint-stock company as specified in article 9 of the Company Law: by integral and concomitant subscription by the founders or by public subscription. Public subscription, which implies raising money from third parties, is regulated in detail by the law. As public subscription is equivalent to a public offer as defined by the Securities and Stock Exchanges Law (no. 52/1994), the provisions of the company law are supplemented with the relevant provisions of Law 52/1994. The public subscription is based on a prospectus approved by the National Securities Commission and then presented to a judge delegated by the Trade Registry. The prospectus includes the information required for the “constitutive act”. Fifteen days after the closing of the public subscription, the founders have to call for the “constitutive meeting”, which checks whether the subscribed capital was effectively paid in, validates the report presented by the experts designated to evaluate the in-kind contributions (as the case may be), approves the operations previously carried out by the founders, adopts the constitutive act and appoints the directors and censors. The incorporation process is then continued by the persons designated.

SHARES AND SOCIAL PARTS

The capital of a Romanian corporate vehicle is divided into "shares" (for a joint-stock company or a limited partnership by shares) or "social parts" (for limited liability companies). Basically, both shares and social parts give their holders the same rights, including, but not limited to, the right to dividends and voting rights. However, some differences do apply.

All shares are of equal (nominal) value and grant equal rights to their holders. In particular, every share gives one vote – multiple voting shares are not allowed under Romanian legislation. However, the associates may decide, through the constitutive act, to issue *non-voting shares* (which give preferential dividends).

Two forms of shares may be issued by a company: *bearer shares* and/or *nominal shares*. The general shareholders meeting may decide to convert one form into the other. However, shares that are not paid up can only be nominal.

While ownership over bearer shares can be transferred through simple trading of the (paper) note (Art.99 of the law), the ownership transfer for nominal shares has to be recorded in the shareholders’ registry kept either by the company, or by an independent specialized registry. Although nominal

³⁷ The information requirements are slightly different for different types of companies.

shares can have a material (paper) form like the bearer shares, they usually take a *dematerialized form*, being represented only by a record in the shareholders' registry. Only securities having a dematerialized form can be listed on a stock exchange.

As a result of the 1997 amendment to Law 31/1990, companies were granted the right to redeem their shares if there was agreement among shareholders assembled in a general meeting. The operation is limited to 10% of the paid-up capital, subject to certain restrictions.

Social parts in SRLs are not negotiable instruments (art.11). As a matter of law, social parts should not be transferred to third parties unless agreed to by associates holding at least three-quarters of the capital. The existing holders have preemption rights over the social parts. The assignment of social parts has to be registered not only in the company's books but also with the Trade Registry.

THE FUNCTIONING OF THE COMPANY

The functioning of a company is based on three bodies that have specific roles and powers defined by the law and by the constitutive act: the general shareholders meeting, a collective body that expresses the volition of the shareholders; the directors – administrators in Romanian legal parlance³⁸ – which form a body mandated with implementing the decisions of the shareholders and overseeing management; and the censors, a body dedicated to the financial supervision of the company. For small companies (i.e. limited liability) the three bodies are not necessarily distinct.

THE GENERAL SHAREHOLDERS MEETING

The general shareholders meeting is the supreme decision-making body in a company and all companies are supposed to hold general meetings on a regular basis. However the law gives special attention to the joint stock companies. There are four categories of general meetings:

- the constitutive general meeting – which adopts the constitutive act that initiate the incorporation process; unlike all the other general meetings, where every share gives one vote, in the constitutive meeting every person has one vote.
- the ordinary general meeting – which, in essence, sanctions the operations of the company and adopts decisions that do not modify the constitutive act;
- the extraordinary meeting – which, in principle, is the only meeting authorized to make changes in the constitutive act;
- special shareholders meetings – addressed to some shareholders, for example non-voting preferential shareholders.

The general shareholders meeting is normally convened by the directors (administrators), but in certain situations may be called: (a) by the administrators at the request of shareholders representing 10% of the share capital; (b) by the censors, if they deem well-founded and urgent a request by shareholders representing 25% of the share capital to verify certain facts; (c) by the liquidators that assume the administrators' functions during liquidation.

General shareholders meetings are called whenever necessary. An ordinary general meeting has to be organized at least once a year, within three months of the conclusion of the fiscal year. Notification of the meeting is to be published in the Official Gazette and in one local newspaper, at least 15 days before the meeting. The notification of the meeting has to specify: (a) the date and the place the meeting is held (the place must be where the company is headquartered); (b) the agenda of the

³⁸ "Director" designates, in Romanian, strictly an executive position; members of the board are called "administrators" and the board itself is called "administrators' council" – on the French model "conseil d'administration".

meeting; (c) the full text of proposed amendments to the constitutive act, when such an issue is included on the agenda; (d) when shares that certify a person is a shareholder are to be presented.

All issues on the agenda have to be explicitly stated in the notification. After publication, the agenda becomes mandatory for all shareholders and no other topics may be brought into discussion during the meeting – with one exception. According to art. 150 of the Commercial Companies Law, the decision to take action against administrators, censors or executives of the company may be discussed in the general shareholders meeting even if it was not on the agenda.

Shareholders can be represented in the general meetings by proxies. Only another shareholder can represent a shareholder in the general meeting, unless the constitutive act provides otherwise. The quorum for the validity of a general meeting and the majority required to adopt decisions in a general meeting differ for various types of meetings.

- for an ordinary meeting the quorum required in accordance with art. 112 of the law is shareholders representing at least half the share capital. If the quorum is not met, a second meeting is convened – this time the law does not impose any quorum. Decisions are adopted by absolute majority in the first meeting and by simple majority in the second meeting that takes place when the quorum was not met the first time.
- for extraordinary meetings, the quorum required by the law (art. 115) for the first meeting is three-fourths of the capital, while for the second meeting convoked, in case the first one did not meet the quorum, half of the capital is required. The majority required for adopting decisions is at least half the share capital in the first meeting and at least one-third of the share capital in the second meeting.

By law, the **ordinary general meeting** has as core competencies:

- to discuss, adopt or modify the annual financial statements, after hearing the directors/administrators and the censors report, and to decide on the distribution of profits and on dividends;
- to elect administrators and censors;
- to establish the remuneration for the administrators and censors, if it was not established in the constitutive act;
- to ratify directors' activity;
- to establish the income and expenses budget and the program of activity for the next fiscal year;
- to decide on mortgaging, leasing or dissolving one or several units of the company.

Other competencies of the ordinary meeting may be set by the constitutive act.

The **extraordinary general meeting** has as core competencies:

- change of the legal form of the company;
- moving the headquarters of the company;
- change of the statutory object of business;
- extension of the duration of the company;
- increase of the share capital;

- reduction of the share capital or to make up for incomplete capital by issue of new shares;
- mergers with other companies or division of the company into several entities;
- anticipated dissolution of the company;
- conversion of shares from one category into another;
- issue of bonds;
- any other change in the constitutive act.

Some of the competencies of the general shareholders meeting can be transferred to the administrators (change of headquarters' address, change of the object of business, increase or reduction of the share capital and conversion of the shares from one class to another).

As a rule (art. 129 of the Law 31/1990), the vote is open, but secret ballot is required for the selection and repeal of the directors/administrators. Conventions among shareholders to vote in a certain way are prohibited.

The decisions of the general meeting become valid only after having been submitted to the Trade Registry in order to be recorded and published in the Official Gazette. The decisions can be contested in court by shareholders that have voted against a certain decision (and their opposition mentioned in the minutes of the meeting) or by shareholders who were not present at the general meeting, within 15 days of publication. Creditors can also oppose decisions involving changes in the constitutive act.

DEBT INSTRUMENTS

Only joint-stock companies can issue debentures -- corporate bonds -- up to 75% of paid share capital. Limited liability companies cannot issue debt instruments.

Bonds are in many respects similar to shares. They may be issued in *nominal* or *bearer* form. Trades of nominal bonds have to be recorded in the company's bond register, while trades of bearer bonds are simply transfers of the title deeds. All bonds in an issue have the same characteristics. *Convertible bonds* have to be issued at a face value equal to the value of the shares.

Bonds issued through a public offer are also subject to the provisions of Law 52/1994: a public offer prospectus has to be approved by the Securities Commission prior to its publication.

According to art. 166 of the Company Law, bondholders may gather themselves "in a general meeting, in order to deliberate on their interests." The meeting is convened by bondholders representing a quarter of the securities or by bondholders' representatives -- if they have been appointed. The organization of bondholders' general meeting is very similar to a general shareholders meeting (publication of the meeting's notice, period, voting etc.). The company has the obligation to bear the costs entailed by the organization of the meeting.

The main competencies of the general meeting are:

- to appoint a representative of the bondholders and one or several substitutes, and to establish their remuneration. The bondholders' representative has the right to participate in the general shareholders meeting and to represent bondholders in relation with the company and in court.
- to carry out all activities aimed at monitoring and defending bondholders' rights;
- to establish a fund designated to cover expenses incurred by activities aimed at monitoring and defending bondholders' rights;

- to oppose modifications in the company's by-laws or in the terms of the loan which would be harmful for bondholders;
- to accept or to reject proposals on issuing new bonds.

MODIFICATION OF A COMPANY

Any change in one of the basic elements that define a company is similar to a re-creation of the company, involving an intervention in the constitutive act. In principle, any such change is subject to the same formal requirements imposed by the law for the creation of the company – approval of the general shareholders meeting, hearing before a judge, registration with the Trade Registry and public notification in the Official Gazette. While some changes are trivial (the address of a company's headquarters) others seriously affect the company and the interests of its owners, creditors or stakeholders. Changes in the share capital, mergers and divisions are the most important modifications.

An **increase of capital** can only be decided by the shareholders' extraordinary meeting if the previously issued shares have been fully paid in. The decision for increasing capital is taken by the shareholders based on a report presented by the directors/administrators, which motivates the operation and justifies the proposed value of the shares. There are two ways to increase capital: from internal sources or from external sources.

- An increase of capital from internal sources supposes capitalization of reserves, differences resulted from revaluation of assets or profits/dividends. This is mainly an accounting operation and takes place by either increasing the face value of the existing shares or by issuing new shares allocated proportionally to all shareholders.
- An increase from external sources brings in new capital from either the existing shareholders or through a public subscription. An increase of capital based exclusively on the contribution of the existing shareholders can only be decided by a unanimous decision of the extraordinary shareholders meeting -- which makes it a quite rare solution. If a public subscription takes place, the existing shareholders have preemption rights which allow them to subscribe new shares proportional to the number of shares they actually hold. The preemption right is negotiable -- a shareholder may buy or sell preemption rights. The preemption right does not apply when the increase of capital is achieved through an in-kind contribution (art.213 of Law 31/1990)³⁹. The general meeting may vote for giving up the preemption rights in favor of a third party.

The law provides for a third way of increasing the capital of a company that represents a combination of the internal/external sources: increase of capital by conversion of debt to equity. Although it is an accounting operation, the conversion changes the exiting shareholders' structure so that former creditors become shareholders⁴⁰.

A **reduction in the capital** of a company is required by law if: a) some shareholders have not fully paid in their contribution; b) when the company had losses representing half the share capital (or less, if the constitutive act so provides); c) some shareholders that voted against certain decisions in the general shareholders meeting decide to withdraw from the company under provisions of art. 133 of the law. In this case, the company has to redeem their shares and to reduce the capital. Apart from that, shareholders may decide to reduce capital for business considerations.

³⁹ This is frequently a source of abuse and litigation because many majority shareholders used in-kind contributions to increase the capital and dilute other shareholders.

⁴⁰ The Ministry of Finance has extensively used the conversion for recovering bad debts.

In practice, a reduction is operated by either lowering the face value of the shares or by reducing the number of shares. The shareholders' decision to reduce capital has to be published in the Official Gazette and the reduction is effectively operated only two months after publication. During that period, creditors have the right to file opposition with the court to the reduction of the capital.

With the 1997 amendments to the Company Law, **mergers and divisions** received special attention, being treated in a dedicated chapter – articles 233 – 245. The new provisions on mergers are in line with EU directives no. III and VI.

Two types of mergers are defined: a) absorption, by which a company integrates another company that ceases to exist; b) unification, by which two or several companies put together their resources in order to create a new company – the initial companies all cease to exist. Similarly, division may consist in: a) splitting part of a company to create a new company (the initial company continues to exist) or b) separating one company into two or several new entities (the initial company ceases to exist). It is important to note that the liabilities of companies involved in merger or division operations are transferred to the successors and creditors may claim settlement from any of the successors, unless merger/division documents have specified which successor assumes a specific claim.

The merger or division has to be approved by each of the involved companies' shareholders meeting. The directors/administrators are mandated to prepare a merger (or division) proposal that is presented to the Trade Register and, after approval by the delegate judge, is published in the Official Gazette. Creditors have the right to file opposition to the proposal with the court within 30 days of publication. After that period elapses, the shareholders in each of the companies involved take the final decision on the operation in an extraordinary meeting. Shareholders have the right to be informed about the documents related to the merger or division.

DISSOLVING AND LIQUIDATING THE COMPANY

Dissolving a company is either a decision of the shareholders, or has causes provided for in the law. Among the general causes specified by the law are: (a) expiration of the duration the company was created for; (b) impossibility to achieve the objective for which the company was created; (c) the court has declared the nullity of the company⁴¹; (d) by decision of the court, at the request of some of the shareholders; (e) as result of bankruptcy; (f) other causes make it impossible for the company to continue to exist (capital has fallen under the minimum level required by the law and shareholders did not take measures to replenish it; the number of shareholders has fallen under five, the minimum required for a joint-stock company, etc.).

Once the decision is taken by the extraordinary general shareholders meeting, it is published in the Official Gazette. Creditors have 30 days to file opposition to the decision.

As result of the dissolution, a liquidation procedure is initiated, by which liquidators take over the administration of the company.

2.1.2. THE LAW ON SECURITIES AND STOCK EXCHANGES

The Law on Securities and Stock Exchanges no. 52/1994 is the second pillar of the corporate governance system in Romania, dealing with the specific situation of the “public companies” -- business entities that raise capital through public subscription or whose securities have been subject of a public offer. The law was drafted in the context of preparing for opening a stock exchange in Romania after more than 50 years of abolition of transactions in securities (and securities themselves for that matter). Unlike the Company Law, which was inspired directly by the Romanian Commercial Code, the Law on Securities and Stock Exchanges was a completely new piece of legislation, drawing on contemporary legislation. The assistance received from Canadian and British experts produced a modern piece of law, with a touch of common law that is not always congruent with the Romanian legal tradition⁴².

Being the first regulatory act⁴³ dealing with securities and capital markets in Romania after 1952 (when the old stock exchanges law was abolished), the law covers several different topics:

- the creation and organization of the National Securities Commission as the regulatory and supervisory authority for the capital market;
- the public offer as the most complex and important operation on the capital markets;
- the securities’ brokers organization and activities;
- the organization, functions and operations of the stock exchange;

⁴¹ The provisions concerning the nullity of a company were introduced through the 1997 amendments to the Company Law and are in line with the first EU directive.

⁴² For example, the classification of the National Securities Commission acts is not in line with Romanian administrative law. According to the Securities Act, the Securities Commission may grant “exemptions” which are not provided for by Romanian administrative law. Not once has the Securities Commission granted such exemptions for public offerings or for investment funds. Another example are the “ordinances”. The Securities and Stock Exchanges law states that the Securities Commission issues “ordinances”. According to the Romanian Constitution, the term ordinance is defined as an act having the power of law, which the Government is authorized to issue during Parliamentary recess or in cases of emergency (and here, Romania’s constitutional system is similar to that of France, Spain and Italy, where the term is also ‘ordinance’ or decrees of the Council of Ministers)

⁴³ In 1993, the Romanian Government had issued Ordinance No. 13/1993, meant to create the legal background for trading securities and for licensing brokers. However, the Ordinance did not deal with stock exchanges as institutions, and did not establish any rules regarding self-regulatory bodies and public offering procedures. Also in 1993, the Government created the legal framework for investment funds (Ordinance 24/1993).

- auxiliary provisions regarding investors protection, external independent auditors, consultation on placement and the compensation and depository systems.

Law 52/1994 governs not only corporate shares but also bonds and all securities issued by the government or local authorities. The intention of the law is to facilitate the financing of business corporations and to provide public access to accurate, safe and exhaustive information regarding the securities traded on the market and the issuing companies.

Based on the Securities and Stock Exchange law, and complementary to it, , the National Securities Commission -- a supervisory and regulatory authority -- issues explanatory rules and directives, which deal in detail with every chapter of the law.

2.1.3. OTHER SPECIFIC REGULATIONS

There are many regulations that may create a special legal regime for certain companies, activities or situations, with an impact on corporate governance. State-owned companies, for example, are subject to a legal regime that differs in certain aspects from the general corporate legislation – the “regies autonomes” are business organizations that do not fall under the provisions of the law 31/1990, but are organized and function under the provisions of Law 15/1990. Even the state-owned commercial companies, which in principle are subject to the general regime instituted by the Company Law, are granted an exceptional treatment for the incorporation procedures, for the transfer of their shares and even for the organization of management (see 2.3.4 below). We will briefly review some of the most relevant special regulations concerning the financial institutions.

BANKING

Banking in Romania is governed by the Banking Law, under which banks are organized as joint stock companies according to the common rules of the Company Law, but cannot conduct specific banking operations unless licensed by the National Bank (BNR). Banks may also act as brokers, clearinghouses, and originators of deposit money. There are two types of transactions in which banks may not deal: leasing, and the sale and/or purchase of securities. If they wish to handle such transactions, they must set up leasing and/or brokerage companies.

The management of banks is subject to some special rules that augment the general rules of corporate governance laid out in the Company Law. Such rules regard the eligibility criteria (professional and reputation-wise) for the managers, powers of representation, and conflicts of interests.

Under Art. 25 of the Banking Law, "the managers of the bank" must be residents of Romania, confine their activity strictly to that deriving from their position in the bank, and, for at least one of the banks managers, be a Romanian citizen. Also, they must hold an academic degree, have a minimum of five-years experience in a banking or financial institution, and prove that their previous activity had led no business corporation into bankruptcy. Appointees to managing positions in banks must be approved by BNR prior to the assumption of duties.

Supplemental to the provisions of the Company Law, the Banking Law sets forth that a person may not be elected to the office of member of a bank's board or, if elected, such person forfeits membership, if he/she is an employee of that particular bank, acts as the auditor or board member of another bank, or, within a period of five (5) years prior to such election, was replaced by the bank, as a remedial measure.

Under the Banking Law, "managers of the bank", must be construed as a member of the Board of Directors or a member of the Directors' Committee⁴⁴, according to the structure permitted by the Company Law, with the difference that, in a bank, only natural persons may be directors. Another

⁴⁴ Art. 26, Banking Law.

distinction between ordinary business corporations and banks is that the board of a bank may not exceed eleven members⁴⁵.

Under the Banking Law, a bank is committed by the signature of at least two "managers", whose limits of competence are specified by each bank's internal regulations, in conformity with the relevant rules of the BNR. Therefore, a bank is always represented by two directors and, as a rule, these are the president and one of the vice-presidents, and by two other persons who must be members of the Board of Directors and, at the same time, members of the Directors' Committee. Which means that not all the members of the board may represent their bank, but such members will perform as supervisors.

Unlike the Corporation Act, which addresses the issue of conflict of interests in a perfunctory manner, the Banking Law deals at length with the conflicts of interests that may appear between directors or between directors and shareholders⁴⁶, although some of the provisions are just a repetition of the similar provisions in the Company Law. For example, a bank director has the following duties:

- to inform the bank, in writing, of the nature and extent of his/her interest therein, whether he/she is a party to an agreement with the bank, is a director in an corporate entity which is a party to an agreement with the bank, or has a material interest or relationship with a person who is a party to an agreement with the bank, other than deposit agreements or valuables custody agreements.
- to report, in writing, to the bank's board of directors, at least once a year, the name and location of his/her associates, and information regarding the material interests of a financial, commercial, agricultural, industrial or other nature of such director and his family;
- to abstain from attending and voting at the meetings of the board devoted to a transaction in which he/she has a material interest or relationship directly concerning his/her estate or business or his/her family's estate or business; for quorum purposes only, when passing a resolution on such transaction, the director concerned will be deemed present.

When a director fails to report the occurrence or existence of a conflict of interests, the bank, a shareholder, or the BNR may petition a court for the annulment of any transaction if such director has a material interest that he/she failed to declare, as detailed above. Another remedy available to the BNR in such a situation is to direct the bank to suspend the defaulting director (for not more than one year) or to replace him/her.

INSURANCE LEGISLATION

Insurance and reinsurance, and the operation of insurance companies are subject to two regulatory acts: Law No.135/1995 (insurance and reinsurance) and Law No. 32/2000 (insurance companies and surveillance of insurance).

Viewed from the perspective of corporate governance, Law 32/2000 covers: types of companies that may conduct insurance and reinsurance activities (only joint stock companies), shareholding (where the terminology is 'significant shareholders, not majority shareholders), financial discipline, and the measures that may be imposed on the management of an insurance company by the competent authority on the insurance market.

For Law No. 32/2000, which is of a recent date and replaces the older Law No. 47/1991, the administrative rules for its application have not yet been issued.

INVESTMENT FUND LEGISLATION

⁴⁵ Art. 27, Banking Law.

⁴⁶ Arts. 29 – 34, Banking Law.

In Romania, investment funds are regulated by Government Ordinance No. 24/1993 ("GO 24"), regarding open end and closed end investment companies, and Government Ordinance No. 20/1998 ("GO 20"), regarding venture capital funds.

Open-end and Closed-end Investment Companies. GO 24 provides that open-end and closed-end investment funds must be managed by asset management companies incorporated as joint stock companies. Such management companies must have a minimum level of capital as determined by the Securities Commission and may only issue nominative shares. Securities dealers cannot hold more than 5% of the shares of a management company, and banks not more than 20%. Likewise, no management company may be a shareholder in another management company. The interdiction also affects the directors and the managers of such management companies.

The internal structure of management companies is governed by GO 24, which does not institute rules different from the Corporation Act. But the relationship between investors and the management company with regard to the investment fund⁴⁷ is amply dealt with both by the law and the Securities Commission regulations, particularly with respect to management contracts and reporting lines.

Venture Capital Funds. In Romania, the operation of venture capital is regulated by GO 20/1998, approved by Parliament in 2000, as distinct from other investment funds, due to their special nature. Romania was the first Central European country to regulate venture capital funds, and to encourage the diversification of investments on the capital market and in the productive sector. Shortly thereafter, Hungary issued similar legislation. The ordinance provides the legal form such ventures may assume (in the form of agreements/unincorporated companies or joint stock companies), and institutes rules for the relationships arising between them and management companies. Compared to EU legislation, the Romanian law on risk capital ventures drew inspiration exclusively from North American experience with an emphasis on investments in securities, with or without assumption of management, starting from the idea that the IPO involve high risk.

2.1.4. THE NATIONAL SECURITIES COMMISSION

The National Securities Commission (in Romanian: Comisia Națională a Valoriilor Mobiliare – CNVM) was established through the Securities and Stock Exchanges Law 52/1994 as a legal “autonomous administrative authority”. Under Romanian public law, the CNVM is not subordinated to the government, it is subject only to parliamentary control. The five members of the Commission (including the President and the Vice-president) are appointed by the Parliamentary for a five-year term.

The purpose of the Securities Commission as set by law (art.6) is:

- to promote a well functioning securities market;
- to protect investors against unfair, abusive and fraudulent practices;
- to insure proper information to securities holders and the public at large on securities issuers;
- to establish a proper framework for the activities of securities brokers and dealers, the regime of their professional associations and the bodies in charge of running the securities market.

The CNVM performs three main functions: monitoring, regulation, and representation.

On the **monitoring** side, the CNVM acts directly, or through its employees, including the Commissioner of the Stock Exchange. By delegation of competence, the monitoring function may also be exercised by self-regulatory bodies.

⁴⁷ An investment fund may be established as a joint stock company or as an agreement. In the latter case, it is not a legal entity.

The **regulatory** side of its activities includes the general organization of securities markets, the licensing of market operators, and the related public filing. In exercising this function, the CNVM may issue regulations and directives, all having normative power.

CNVM regulations cover aspects such as:

- organization and operation of securities markets;
- licensing and operation of investment funds and of the companies that manage such funds;
- organization and operation of collective deposits of securities;
- organization of the Securities Records Office;
- licensing and operation of brokers, independent auditors, and investment advisors;
- sale or purchase of public offerings;
- approval of regulations regarding transactions conducted on the stock exchange or the OTC market;
- operations of clearing houses.

The CNVM directives (currently known in Romania as "instructions") lay out rules with regard to:

- formation and operation of professional security broker corporations and brokers;
- reports, data, and information to be communicated to the CNVM and reports, data, and information to be communicated to the public by issuers, owners of securities and brokers; bookkeeping procedures, circumstances and deadlines for communication and/or filing;
- confidential and privileged information;
- transactions involving significant shareholders, and direct transactions with securities;
- transfer of controlling and majority positions;
- exemptions that may be granted by the CNVM.

CNVM issues individual decisions on the establishment or dissolution of institutions, issues or revokes licenses to market operators (including securities companies and individual brokers), cancels or confirms acts performed by its representatives, grants exemptions, revokes powers, issues ordinances, confirmations and approvals.

The three principles by which CNVM conducts its operations are:

Transparency: CNVM publishes in the Official Gazette of Romania all the regulations and directives issued. CNVM often co-operates with the professional associations in the elaboration of regulations and instructions.

Communication: , There are no rules providing for the CNVM to promptly and completely inform investors. There are some directives for regularly informing investors about the status of issuers of securities, confidential and privileged information, public offerings, etc. As a result of its rather limited capacity to handle communication, the CNVM prefers to pass its obligation to inform the public towards the issuers themselves, the stock exchange or the OTC market. In other words, communication is mainly provided in an indirect way, from the issuer to the investor, and not directly

from the CNVM to investors. An example is the Code of Ethics of the CNVM personnel, under which their obligations are mainly directed to market operators rather than to investors. This has led, in the past, to conflicts regarding the access permitted to individual investors to the incorporation documents of mutual funds, of the companies managing such funds, and to their financial statements.

Proportionality: Under the Securities Law, the CNVM has been vested with limited regulatory powers. It is for this reason that the CNVM may authorize professional bodies to issue their own regulations regarding the conduct of market operators, trading mechanisms, accounting rules, or it may delegate part of its monitoring prerogatives. Sometimes, however, the boundary between the competence of the CNVM and the professional bodies is crossed.

2.2. THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS

OECD Principles of Corporate Governance

I. The corporate governance framework should protect shareholders' rights.

II. The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights. .

2.2.1. THE LEGAL RIGHTS OF SHAREHOLDERS

The Company Law sets the two general principles that govern shareholders treatment: the principle of equality among shareholders in the same class and the principle of indivisibility of the shares. We have seen that the Romanian legislation provides for only two classes of shares – regular/voting shares and preferential/nonvoting shares. There are extremely few cases when companies have issued preferential shares.

Many of the legal provisions have, in one way or another, an impact on shareholders' rights and treatment, including the provisions regarding the rules and the quorum for different types of shareholders meetings, those protecting minority shareholders, the rules regarding corporate disclosure, the rules on shares registry and the compensation and depository system that secures shareholders' ownership rights etc. In this section we will focus only on the specific rights mentioned as such by law.

The law grants shareholders two types of rights: patrimonial and non-patrimonial⁴⁸.

The **non-patrimonial rights** refer to:

- The right to participate in the general shareholders meetings. Shareholders have the right to participate in meetings even if on a certain matter they have interests that diverge from the interests of the company – but in this case they must abstain from voting. Holders of non-voting shares do not participate in the regular shareholders meetings but meetings dedicated to preferential shareholders.
- The right to vote. Every shareholder has the right to vote in proportion to the number of shares he/she holds. Limitations on the number of votes that can be cast by a single shareholder are only possible if they have been included in the Constitutive Act of the company. In special situations (such as conflicts of interest) certain shareholders have to abstain from voting. Agreements among shareholders to vote in a certain, concerted way, as well as transfers of voting rights not related to the transfer of shares, are illegal.
- The right to information. Shareholders have the right to examine the shareholders' registry and the register of the minutes of shareholders meetings. They can also examine the financial statements before the annual meetings, as well as the administrators and the censors' reports. Shareholders may ask for excerpts or copies from these documents. Between the general shareholders meetings, but not more than twice a year, shareholders have the right to review certain documents specified in the Constitutive Act.
- Special minority rights:

⁴⁸ In practice it may be very well-argued that all rights are, directly or indirectly, patrimonial.

- shareholders representing 10% of the voting rights (or less if the Constitutive Act so provides) may ask directors/administrators to convene a general meeting;
- every individual shareholder has the right to notify the censors on certain facts he deems they should investigate. Censors are supposed to consider such notifications and include them in the annual report. When shareholders representing 25% of the shares (or less if the Constitutive Act so provides) complain to the censors, censors are required to present their conclusions and, if necessary, to call for an immediate shareholders meeting.
- shareholders representing more than 10% of the shares have the right to ask the court to appoint experts for investigating certain operations of the company. A copy of the experts' report is presented to the claimants and another copy to the censors of the company. The fees for the experts are supported by the company.
- shareholders have the right to contest in court the decisions of the general shareholders meeting and to ask for redress.

The shareholders' **patrimonial** rights are:

- The right to dividends. Dividends are paid in proportion to each shareholders' contribution to the paid-in capital, unless the Constitutive Act establishes different distribution criteria.
- The right over the reserves. According to the law, shareholders that leave the company have the right to reclaim not only their paid-in share capital, but their share in the equity of the company.
- The preemption right. In case a company increases its capital through public subscription, the existing shareholders have a preferential right to subscribe to new shares in proportion to the shares they already have. The preemption right is to be exercised during a limited period of time.
- The right to the proceeds from the liquidation of the company – again proportional to the contribution to the capital.
- The right to sell shares. Unlike the social parts, shares are freely transferable.

The main shareholders' **duties** with respect to the company are:

- To pay for the shares subscribed;
- To comply with the provisions of the Constitutive Act and with the decisions of the general shareholders meetings.
- To bear the losses of the company up to the value of their shares.

2.2.2. ABUSES OF SHAREHOLDERS RIGHTS'

In the last part of 2000, Law 52/1994, concerning securities and stock exchanges, was amended through government ordinance no. 229/2000⁴⁹. Among other things, the ordinance provided for enhanced protection of minority shareholders. The adoption of the ordinance was the result of an intense campaign promoted by some investment funds, which were complaining of violations of minority shareholders' rights.

The main criticism of the minority shareholders refers in general to the declining financial performance in companies controlled by strategic investors. Gross profits of the 26 largest companies listed on the BSE and the RASDAQ were plotted since 1998, before privatisation, to June 2000, to show how profits of USD 20-30mn. turned into losses of USD 30mn. during the period. In one of the most famous cases, BROADHURST investment funds brought to court RENAULT, the majority shareholder of DACIA Pitesti, showing that sales of DACIA cars declined dramatically immediately after the privatisation.

According to AARO, one of the main explanations for the deterioration in performance is related to abuses of majority shareholders and lack of sufficient monitoring and control from other stakeholders. An inventory of the most important forms of abuse compiled mainly by the SIFs includes⁵⁰.

■ Diluting minority shareholders of companies through:

- Capital increases without prior revaluation of existing capital. The “nominal” capital of companies has eroded because of the high inflation prevailing in Romania. As the Romanian Accounting System does not provide for automatic corrections, periodical “revaluations” are done. If a majority shareholder decides in the general assembly to increase the capital without performing such revaluations, shareholders which do not use their option to participate in the capital increase are diluted by much more than normally allowed. This would not be true if the correct value of the initial capital had been used. Dozens of such operations have been documented by the SIFs. One recent example is the decision taken in April 2001 by RENAULT (holding 80% of the shares in DACIA Pitesti) to increase the capital of DACIA from 2,500 to 5,800bn. ROL, without first adjusting the capital of the company which had not been revalued for 7 years. This is the third similar operation performed in the last two years, and for the first two, Broadhurst Investment, which holds 7.% of the shares in DACIA, opened court cases.
- Capital increases through in-kind contribution of the majority shareholder. Minority shareholders are confronted with three forms of abuse: for in-kind contribution, the legislation does not provide preemption rights for the existing shareholders, which are necessarily diluted; the in-kind contribution is usually over-valued and sometimes has nothing to do with the activity of the company; the in-kind contribution is performed without prior revaluation of the existing capital. In COMET Bucuresti, a retail trading company having a registered share capital of ROL 8.6bn (less than USD 300,000) the majority shareholder decided to increase the capital with the contribution of a non-functioning helicopter evaluated at USD 550,000. CONDEM Bucuresti, a company where the majority shareholder is a Romanian natural person, the share capital was doubled by including as in-kind contribution six patents held by the majority shareholder. CHIMCOM SA Bucuresti, the majority shareholder in ROMAQUA Group increased the capital by transferring the intellectual property rights on a patent it was

⁴⁹ The provisions of Ordinance 229/2000 will be examined in 2.2.3. below.

⁵⁰ Many newspapers presented extensively the arguments brought by both minority and majority shareholders. See for example *Bursa* issues no 20, 21, 24, 29, 30 in January and February 2001; *Adevarul Economic* no.7, 8, February 2001; *Ziarul Financiar* in January and February 2001 etc.

holding and which was evaluated at more than the existing share capital. Afterwards, an increase of capital through revaluation of the existing assets was performed.

- Transferring profits outside the company. Koyo Seiko, majority shareholder in KOYO Alexandria (producer of bearings, listed on the RASDAQ), was said to have extended loans to its Romanian subsidiary, at interest rates much higher than the market average. The company GAVAZZI STEEL Otelul Rosu, controlled by an Italian natural person, was acquired for USD 10,000 the Virgin Islands firm GAVAZZI STEEL CONSULTANTS, belonging to the same person. Against a commission it was supposed to assist the Romanian company in marketing and sales. The majority shareholder in ZIMBRUL Suceava, a Romanian natural person, required the company to purchase all supplies and sales through a firm held by his daughter.
- The “empty shell” tactic, by which the assets of a company are transferred to other parties by:
 - abusive sale of critical assets of a company. SC - SUMEL MASINI DE CALCUL Târgu Mures sold all its productive assets; in order to continue operations, the company had to rent the same assets from the new owners. SC DECEBAL Drobeta Turnu Severin sold the main three assets to firms where the majority shareholder of DECEBAL had a stake, at prices representing 10-15% of the 1994 book value.
 - use of the assets of a company as collateral for credits obtained by the majority shareholders.
 - transfer, through mergers and divisions, of the assets of a company to new entities controlled by some of the existing shareholders, directors or executives.
- Abusive allocation of profits. The employees associations, majority shareholders in companies privatised through MEBO, decide in the general shareholders meeting to distribute to employees more than half of the profits as “employee profit sharing”. Not much is left for the dividends to which outsiders are entitled.
- Delays in the payment of dividends. Although the decision is taken in the general shareholders meeting on the distribution of the dividends, companies postpone for years the effective payment.
- Limited access to information for minority shareholders, who only rarely have a seat on the board or the censors’ committee.

The Foreign Investors Council, an association of 81 large foreign investors in Romania, took the lead as representative of “strategic investors” who consider some of the provisions of ordinance 229/2000 to be excessive.. Although certain individual companies, like Koyo and Renault, offered explanations on some of the particular accusations brought against them, the majority shareholders were in general less specific as to the solutions they endorsed.

The Romanian Chamber of Commerce and Industry also intervened in the debate in favor of rational and balanced solutions. After two months of intense debates, Ordinance 229/2000 was abrogated in February 2001. The government committed itself to issue new, more comprehensive and balanced legislation for improving the minority shareholders protection.

2.2.3. INITIATIVES TO PROTECT MINORITY SHAREHOLDERS

Apart from the amendments to the Company Law already mentioned, the most important attempt to reform the corporate governance legal framework was made in 2000 when the government issued Emergency Ordinance no. 229/2000 amending Law 52/1994 on the Securities and Stock Exchanges. Ordinance 229/2000 became popular as the “law for minority investors’ protection” and is one of the pieces of legislation that generated fierce debates and an intense coverage in the media. It was one of the rare occasions when prestigious international publications like The Economist or Financial Times

mentioned a rather technical dispute in Romania. In February 2001, four months after it was adopted, during which major foreign investors having controlling positions in different Romanian companies were crying fault, Ordinance 229/2000 was revoked by the new government after the general elections. However, the government promised to soon issue new, more balanced regulations, taking equally into consideration the interests of minority and majority shareholders.

Although Ordinance 229/2000 is not in force anymore, we will briefly present its main provisions, which reveal some of the problems and provides a rough idea of potential solutions that may be considered for improving the corporate governance legal framework in Romania⁵¹.

SHAREHOLDERS' INFORMATION

- To provide better information to shareholders, Ordinance 229 proposed new reports to be prepared and presented by the directors/administrators at the annual general meeting or, if requested by shareholders holding at least 10% of the share capital, on a quarterly basis. The Securities Commission was supposed to issue detailed regulations regarding the form and content of the reports. They were supposed to include “all useful and material information” and, at a minimum, the reports should provide shareholders with the financial and patrimonial situation of the company, the adopted or planned economic and competition policy and the projected evolution of the company.
- A new claim and answer procedure for publicly traded companies was proposed, whereby shareholders holding individually or collectively 10% of the share capital may file a claim with the directors and/or censors regarding any particular issue, operation or transaction. Within fifteen business days, the directors and/or auditors must review the operation in question and issue a report. If unsatisfied by the report, the filling shareholders have the right, at their own expense, to have one or more experts appointed by the court to review the operation in cause and prepare a report. Once this report is delivered to the directors/auditors, they must analyze it and propose appropriate corrective measures.

SHAREHOLDERS' CONSENT

- Under the amendments proposed by Ordinance 229, any time a director, employee, shareholder or “involved person” intends to execute an agreement with a company whose value is at least 1% of a company’s share capital, the directors are required to convene a general meeting of shareholders in order to approve (or disapprove) the proposed transaction. Any person who has an interest in the transaction must abstain from voting.
- Any transaction that involves acquiring, disposing of, exchanging or executing a security on fixed assets in the patrimony of the company, whose value exceeds 10% of the share capital, must be approved by an extraordinary general meeting of the shareholders. Similar approvals are required for leasing for more than one year company’s assets if the value of the transaction exceeds 10% of the book value of the assets of the company, and for associations entered into by the company for more than one year. Failure to obtain such approval may result in the court annulling the legal act at the request of any shareholder, as well as legal proceedings against the directors and/or manager for any prejudice caused to the company.

CUMULATIVE VOTING

- A new voting procedure is proposed for the election of board members in publicly traded companies if requested by shareholders who hold, individually or collectively, shares representing at least 15% of the share capital or at least 15% of the voting rights in the general meeting. If

⁵¹ See Victor Paduraru, Todd Shollenbarger, *Minority Shareholders' Rights – Romania*, in the Linklaters&Alliance bulletin “Central & Eastern European News, Issue 4, January 2001.

cumulative voting does not result in minority shareholder representation at the directors' level, then minority shareholders at least have the possibility to appoint one of the auditors.

PURCHASE OF MAJORITY SHARES

- Currently, the law permits acquisition of a majority share position only through a public offer. The Ordinance proposed to authorize the acquisition of a majority position in publicly traded companies through means other than a public tender, provided such acquisition is followed by a public offer within sixty days for all remaining shares.

CAPITAL INCREASE

- Any capital increase in a publicly traded company must be approved by the Securities Commission, which should ensure that shareholders have the ability to exercise their preemption rights. The capital increase cannot be registered with the relevant independent registry without having the consent of the Securities Commission and the Securities Registration Office will only register shares that have been subscribed, and paid in full as of the date of the subscription.
- Prior to registering any capital increase the company must revalue the fixed assets in its patrimony if the inflation rate was over 10% since its last revaluation, taking into consideration the usefulness and market value of the respective assets. New shares will be distributed pro rata among existing shareholders for any increase.
- If the share capital is to be increased through in-kind contribution, the Ordinance requires that such contribution first be appraised by an expert appointed by the general shareholders meeting. Shareholders holding, individually or collectively, at least 5% of the registered share capital may ask the court to appoint an independent expert appraiser, at their own expense. If the minority shareholders' expert's valuation differs by more than 10% from the valuation made by the general assembly's expert, the directors and the minority shareholders must jointly appoint an expert to reconcile the difference. At the same time, Ordinance 229 gives shareholders which do not participate in the in-kind contribution a right of preemption by means of pro-rata cash contributions, thereby avoiding any dilution.

OTHER PROTECTIONS

- For any merger between publicly traded companies, the Ordinance provides that the exchange rate for the shares participating in the merger be determined by reference to the market value of the shares of the relevant companies – which is to be calculated by averaging the value of the shares for the last three transactions, plus the inflation rate.
- The Ordinance expressly forbids shareholders, directors or employees with a “dominant position” from “abusing” such a position by using unfair or fraudulent acts whose purpose or possible effects would jeopardize and affect shareholders' rights.
- The Ordinance makes express the right of shareholders to attend the general meeting⁵², provided identity is substantiated. Failure to provide access leaves open the possibility to have a court suspend or annul a resolution at the request of the shareholders whose access was restricted – providing their shares represent at least 5% of the share capital.
- According to the Romanian Company Law, the extraordinary general meeting of the shareholders may delegate certain functions to the directors (art. 114). The Ordinance proposes that, at the

⁵² Abuses occurred by which shareholders were denied physical access to general meetings; in some cases, access was restricted based on a decision of the general shareholders meeting. However, such abuses are forbidden even by current legislation and shareholders may ask for redress in courts. But because the court procedure is quite complicated, it is hoped that clearer legal provisions can prevent such abuses.

request and at the expense of any shareholder, the directors will be required to release copies of those minutes and decisions that include on their agenda the duties delegated to the directors by the general meeting. Any shareholder has the right to attack in court any decision made by the directors pursuant to delegation, if such decision infringes upon any shareholders' rights recognized by the law.

- Any shareholder has the right to attack in court any decision made by the general assembly of shareholders, if such decision infringes upon any shareholders' rights recognized by the law.
- According to current provision of the Company Law, shareholders having 10% of the share capital in a company have the right to ask the directors to call a general meeting. An abuse developed in practice, whereby the directors would call the general meeting but would not place shareholders' issues on the agenda – thereby effectively precluding consideration of the issue or issues. The Ordinance make explicit in this context the right of such minority shareholders to have their issues placed on the agenda for the general meeting of shareholders, provided they are within the powers of the general assembly of shareholders.
- In addition to the other notification vehicles provided by the law, the Ordinance requires that notices be sent through registered mail to “significant shareholders” (more than 5%).
- The Ordinance also clarified two issues related to the “reference date” which determines the identity of shareholders entitled to participate in the general meeting and to receive dividends. It is also specified that dividends should be paid to all shareholders within 60 days of the date of the general meeting approving the distribution of dividends.
- The Ordinance makes clear that a person cannot be appointed as the “independent censor” required by Law 52/1994 to certify the financial statements of publicly traded companies if he has a “special business relationship” or any other relationship with any shareholder, director or manager of the company.

Many of the provisions of Ordinance 229/2000 address practical situations, when directors or majority shareholders abused their position. However, in most cases, the existing legal framework has solutions for such abuses. The real problem is that many shareholders feel frustrated by the long and costly court procedures they have to initiate for redress. Although clearer legal provisions may help, increasing the capabilities and competence of the judiciary is the best way to protect shareholder rights.

2.2.4. INSIDER TRADING AND MARKET MANIPULATION

According to art. 86 of Law 52/1994 on the securities and stock exchanges “any person which is in a position to obtain confidential and/or privileged information is forbidden to make use of such information nor to make it public or to facilitate disclosure to its own or to third parties' advantage.” The same law defines (in art. 2) confidential and privileged information:

- *Confidential information* is information of any nature regarding an issuer or any of the securities thereof, that are not accessible to the public or have not been disclosed yet which, if disclosed, could influence the price or other aspects of the transactions with the respective issuer's securities or its associated companies, as well as of companies where the issuer has a majority position;
- *Privileged information* is information of any nature regarding an issuer or any of the securities thereof that is not known to the public and is susceptible to influence the decision of a reasonable investor.

An “insider” that has access to confidential information is defined as someone who:

- a) has access to information:

- as a member of the management, supervision or assimilated structures of the issuer;
- during the period he is employed by the issuer;
- as an investor in the securities of an issuer.

b) has access to such information by virtue of a position or relation identical to the ones specified under point a) above with a legal entity having itself access to such information;

c) has obtained such information from any of the above mentioned persons or in any other way.

The Securities Commission has also set norms of conduct for brokers and brokerage companies aimed at preventing insider trading and market manipulation. Regulation no. 3/1996 regarding the licensing of brokerage companies provides⁵³:

- Brokerage companies are forbidden to carry out transactions aimed at artificially influencing the price of securities or creating the impression of a high volume of transactions;
- Brokerage companies are forbidden to post quotations or place orders that may create a misleading perception regarding the real market price for a given security;
- Brokerage companies and their employees are forbidden to operate trades in a certain security based on confidential or privileged information, or to disclose such information to a person that may obtain benefits from trading.

Failure to comply with insider trading rules is sanctioned with fines for the brokerage company and/or the broker.

In practice, insider trading and market manipulation is difficult to prove. Sometimes, certain transactions suggest that confidential information may have leaked and rumors are frequently the main driving force on the market, especially for the RASDAQ.

2.2.5. THE STATE AS SHAREHOLDER

Ever since the adoption of Law 15/1990 regarding the reorganization of the state economic units into “regies autonomes” and commercial companies, successive governments have tried to identify ways for improving the effectiveness of corporate governance in state-controlled enterprises. Law 15/1990 itself allowed for a major separation between the “commercial companies”, which were supposed to be organized and function under the general regime put in place through the Company Law and the so-called “regies autonomes” whose legal regime was sketched in Law 15/1990.

For the “regies autonomes” the corporate governance structure was built around a board whose members are appointed by the ministry or public institution having a certain regie under its direct authority. In many cases, the members of such boards are managers of the regie and civil servants in a ministry, usually the Ministry of Industry or the Ministry of Finance, but outsiders may also be appointed. The members of the board have the same broad responsibilities as the administrators in a commercial company. The whole system is strictly bureaucratic, based on bureaucratic incentives and controls.

The state-owned commercial companies, most of them organized as joint-stock corporations, were supposed to adhere to the corporate governance structures recommended by the Company Law. As a surrogate of a General Shareholders meeting the single shareholder – the state represented by the State Ownership Fund – appointed representatives in a Council of State Trustees, which in turn made

⁵³ Art. 28. Regulation no. 3/1996 was supplanted by Regulation no. 3/1998, amended by Regulation no. 1/2001.

nominations for the board of administrators. The system mimicked the regular corporate governance structure but was evidently quite artificial. Instead of adopting profit maximization as an objective, these politically sensitive boards and the managers of state companies tended naturally to espouse a bureaucratic attitude. The weakness of the State Ownership Fund and its limited capacity to properly monitor its representatives at shareholders meetings and in the boards of administrators contributed to the distortion of the corporate governance system in state-owned companies. Instead of producing profit for the shareholders, state companies focused primarily on producing material and/or political benefits for the managers, the board members and other stakeholders.

The privatisation of the state companies was supposed to be the solution for better alignment of the interests of directors/managers with profit maximization. But privatisation advanced slowly while the economic performance of state companies deteriorated abruptly. This is why some analysts proposed intermediate solutions⁵⁴ that would better align interests of managers/directors with economic performance. A practical attempt was Law 66/1993 – the management contract law.

Law 66/1993 was applicable only to companies or “regies autonome” where the state holds more than 50% of the shares. The Law was an attempt to set forth objective criteria for selecting “professional” managers, to give them enough power to run the companies, with a better, performance-related incentives system which would align their interests with profit maximization. For the first time, managers would get shares in their companies as compensation for good performance.

Unfortunately, the legal implementation of the law was a setback. Law 66/1993 created a legal hybrid by assimilating the manager with the members in a Board of Directors. The manager has the same responsibilities as the Board of Directors, but is employed by the company if he/she is a natural person. The manager can also be a legal person, but in this case the legal person has to appoint a representative who must be a natural person.

The nature of this contractual relationship is inconsistent. If the manager is a natural person, the contractual relations with the company are set under the provisions of the Labor Code. If the manager is a legal person, the contractual relations are not clear, because an agency contract between the legal person (manager) and the company is required, along with a contract with the representative of the manager, the natural person. It is not clear who concludes the contract with the representative of the manager and on what law the contract is grounded (mandate or labor contract?)

If, in addition to management performance, one considers the supplementary cost incurred from incoherent structuring of authority levels which do not allow real separation between the control function and the management function, then it is possible to conclude that agency costs for state-controlled companies went up as a consequence of management contract law.

From the beginning, Law 66/1993 was controversial and inconsistently applied. It was modified by Emergency Ordinance 39/1997, but this Ordinance was short-lived, being rejected the same year by the Parliament. The EO 39/1997 was an attempt to restore the board of administrators, giving managers a role subordinated to the board. This difference was necessary, although its purpose was also political, as there were no clear-cut criteria with regard to the nomination of the members of the Board of Directors. Besides, the executive managers were members of the board of directors/administrators with no voting right, so to some extent they were assimilated to the Directors’ Committee provided for by Law 31/1990, except that the rights were not similar. The objective was to restore the distinction between the control function and the management function, but it did so in a quite incoherent manner.

⁵⁴ Aurelian Dochia, *Conducerea unităților economice cu capital de stat în perioada de tranziție (The Management of State-owned Economic Entities during Transition)*, in *Tribuna Economică* nr.2/1992;

Another Emergency Ordinance (no. 49/1999) was set forth in 1999, which abrogated Law 66/1993. The new regulation introduced the management contract, while maintaining the legal jargon of Law 31/1990. Consequently, no confusion was possible between a management contract and a contract concluded with the executive managers, but it is strange that all the management contracts concluded before the effectual date of this law were maintained until their termination.

In April 2000 this Ordinance was also rejected by the Parliament, so that now the simultaneous application of Law 66/1993 (considering its abrogation by O.U. 49/1999, also rejected by the Parliament) and Law 31/1990 is debatable.

2.3. THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

The OECD Principles of Corporate Governance

III. The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

“Stakeholders” is a notion that barely exists in Romania’s emerging corporate governance culture. This should not be a surprise, considering the context in which the new corporate governance system was instituted. From the corporate governance point of view, the transition is mainly a reassertion of the owners’ rights over a company. This is a revolutionary change compared to the situation which prevailed under communist rule, when “public” or “collective” ownership theoretically gave everyone a stake in the “socialist enterprise”. In many ways, the transition is a struggle aimed at limiting the influence of different stakeholders and strengthening the position of the owners. This basic fact (which has not been emphasized in previous works on transition and corporate governance) places the whole discussion related to stakeholders in a context that is distinct from the one prevailing in the advanced market economies.

In Romania there are only two categories of stakeholders that seem to be widely accepted as having legitimate interests in companies’ corporate governance: employees and creditors. However, neither of them is systematically treated as a legitimate stakeholder by the boards.

Employees derive their stakeholder rights from the constitution, as well as from labor and trade-union legislation. In addition to rights granted by law, such as a minimum wage and social protection rights, employees have the right to be informed and to express their opinion to the board on issues like restructuring plans and reductions in the labor force. However, the rights vary in their practical applications. In large state-owned, or formerly state-owned companies, employees tend to have more influence, mainly on decisions related to wages, work conditions or protection of social rights. In the smaller and private companies, employees rarely have a say when critical decisions are made. Cases where employees are systematically informed about the financial performance of their company, or are consulted on important decisions, are exceptional. There are some cases where trade union leaders or other employees’ representatives are appointed to the boards of their company (or another company), but these are exceptions. Except for wage negotiations, it is rare that employees’ representatives are systematically invited to the meetings of the board.

The rights of workers to contact authorities, board members, and shareholders on illegal and unethical behavior by management and other parties have also been violated. It should be noted that much controversy surrounds the various allegations, which include stories of intimidation, physical abuse and even one murder case. Protection of ‘whistle-blowers’ is poor and should receive serious attention from the criminal authorities.

Workers also have the right to collective representation, whether or not they belong to a union. This right is generally respected. Overall, trade unions are strong in Romania, especially in state-controlled companies. Strikes and similar labor actions have been common in Romania, a situation that would have probably been made worse if procedures for moderation and arbitration were not in place. Union opposition to restructuring and privatisation has been one particular area of conflict (see box). While there have been problems in the privatisation process that have affected labor, union opposition to restructuring has at times seemed myopic and counterproductive. Unions have also used their political influence to put governmental pressure on private companies experiencing labor disputes.

While employees have means to make their voice heard by the boards if necessary, bank creditors are in a weaker position. During the normal course of the business, creditors have limited possibilities to intervene in defending their rights. It is exceptional for banks to have representatives on the boards of companies, and when it happens it is either because of special personal relations among directors, or

because the bank is itself a shareholder in that company. For prudential reasons, the banking law provides that a bank cannot hold more than 20% of the shares in a specific company – usually, the stake is much lower – which does not necessarily grant banks a seat on the board.

Apart from banks, there are few other creditors, as the bond market is still in its infancy. Very few corporate bonds have been sold to the public until now and there are no corporate bonds listed on the stock exchange. According to the law, bondholders may hold general meetings where they can appoint representatives to the company. Representatives have the right to participate in the general shareholders meetings and can also challenge in court certain decisions of the board.

Creditors are given more power when a company defaults on its debt, and insolvency and liquidation procedures are initiated under the provisions of Law 64/1996 regarding bankruptcy and liquidation. Although a syndic judge is appointed to run the procedures, major decisions are to be approved by the creditors. Creditors decide whether they accept a reorganization plan, which gives the company a second chance to continue its business, or go directly into liquidation.

In practice, however, it is generally acknowledged that creditors' legitimate interests in companies are insufficiently protected in the current institutional arrangements. This is especially true during bankruptcy proceedings, which are extremely long and generally conducted with a bias towards management and other 'corporate incumbents'. Considering the abuses many creditors have been confronted with over the years, and the many fraudulent schemes banks that creditors have been victims of, it is no surprise that the cost of credit continues to remain very high and that most banks prefer to lend to the government.

Privatisation and Labor Conflict in Romania

ALRO Inc. is a major producer of aluminum in Romania. Sixty percent of production is exported and its products are traded on the London Metal Exchange. Since 1997 ALRO shares have been listed and traded on the first tier of the official listing of the Bucharest Stock Exchange. Though the state still holds over 50% of the paid-in capital of ALRO, the economic performance of the company is strong. Over the last year, ALRO paid net dividends of over 17 million US\$, a great amount by Romanian standards

In 1999, at the request of FPS and the Ministry of Industries and Commerce, a study for the privatisation of ALRO and ALPROM, another company in the aluminum industry located in the same region as ALRO, was made by foreign experts. They suggested a merger, then privatisation of the new company. In October 2000, another foreign advisor advocated privatising ALRO and ALPROM as a “package deal” with a strategic investor, without a previous merger of the two companies. This new decision by FPS provoked a massive protest of the trade unions in the two companies involved. Their leaders have declared the following:

“ ALRO and ALPROM have created together, on the industrial platform of Slatina town, an economic microsystem, with more than 10,000 employees and with another 16,000 employees in the 60 economic agents, upstream and downstream Slatina. In this context, the privatisation of the two companies has to be made in the interest of Romania, otherwise we all shall watch the biggest transfer of the national wealth abroad. We are not against the privatisation of the two companies, but this should be done in the general interest of the Romanian metallurgical sector and national economy”.

The protest meetings that followed these allegations stopped the privatisation process.

In March this year, APAPS made an attempt to increase capital by a public offering, preceded by the exercise of preemptive rights. According to privatisation law, the state is not entitled to participate in any capital increase, hence the proposed operation meant, in an obscure way, a masked privatisation (this episode is described in more detail in section 2.4.1.).

This initiative provoked the protest of the trade unions. They again organized protest meetings and made incendiary allegations: “ The method chosen by APAPS is, practically, a masked privatisation aiming to satisfy mean interests”. Union opposition has for all intents and purposes suspended the privatisation of either company, in spite of their profitability and potential value to outside investors.

The privatisation of **CS Resita** was considered a success story. The American strategic investor committed itself to invest approximately 60 million USD until the end of 2000 and another 62 million USD in the four next years.

However, they have not fulfilled their investment commitments, nor their promises regarding repayment of certain debts to the state. The trade unions initiated a strike, claiming that the American company, Noble Ventures, had not observed its contractual obligations, that the steel mill’s economic performance was disastrous due to bad management, that production was interrupted and that wages were paid with long delays. The Resita steel mill has so many debts that any of its creditors may ask the Court to start judicial reorganization and restructuring of the company, or even its winding-up.

In June, the labor dispute was at its peak: 220 employees of CS Resita were on hunger strike and another 2,000 were gathered into protest meetings in front of the County Hall. A local court obliged the management of the company to pay the pending wages and to accept the presence of trade union leaders at the meetings of the Board of Administration.

At the end of June 2001, a Governmental delegation led by the Minister of Privatisation started negotiations with the trade unions. The result of the negotiations was the judicial reorganization of the company, preserving, however, the present shareholding structure. At the same time, the Resita Downhill signed a protocol with the trade unions, undertaking to pay emergency unemployment indemnities from the local budget; the amounts to be distributed to be reimbursed by the employees when resuming their activity.

2.4. THE BOARD OF DIRECTORS AND THE OVERSIGHT OF MANAGEMENT

OECD Principles of Corporate Governance

V. The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

The board of directors is the cornerstone of the corporate governance system. In most jurisdictions, the board is the interface between the shareholders and the executive managers of the company in charge of day to day operations. The Romanian Company Law sets forth solutions for the appointment of the board of directors/administrators and for the organization and effective functioning of the board that are in line with the European continental tradition. One of the most criticized characteristics of the board system in Romania is the presence of a large number of politically appointed members. After parliamentary elections, a wave of change regularly sweeps through thousands of companies, with representatives of the new political majority replacing members of the board who do not enjoy political support anymore⁵⁵. The Financial Investment Companies (SIFs), although private, still have boards with a large number of political figures – seven out of the eleven members of the newly elected board of SIF IV Muntenia are Members of Parliament. What is more curious is that sometimes genuinely private companies invite politicians to take a seat on their boards: the Daewoo Magnolia Heavy Industries Company (a shipyard controlled by Daewoo) recently appointed two PDSR MBPS to its board – and the case is not singular.

2.4.1. BOARD NOMINATION AND STRUCTURES

BOARD NOMINATION

In accordance with Law 31/1990, the nomination of the directors/administrators, or of the sole administrator, is made exclusively by the general assembly of the shareholders⁵⁶. The director/administrator⁵⁷ can be either a natural or a legal person. In limited companies by shares, the administrator shall be a partner⁵⁸, while in joint stock companies any person, shareholder or non-shareholder, can be an administrator.

If the administrator is a legal person, he is bound to nominate a natural person as permanent representative. The representative has the same obligations as the administrator and is accountable both under civil and criminal law, just like any other administrator-natural person. Moreover, the legal person that designates a representative is severely liable⁵⁹. The nomination of the representative shall not occur before an administrative contract (which has to be in a written form) is signed by the parties -- the legal person and the business corporation -- through a shareholder.⁶⁰ If the administrator is a natural person, the law makes no specific provision, although it does not rule out the possibility of having an explicit written contract. In practice, however, there are very few cases where the natural

⁵⁵ See for example Adrian Barbulescu, *PDSR se infiltreaza in consiliile de administratie ale firmelor de stat (The SDPR is infiltrating in the boards of administrators of the state firms)*, in Curentul, April 25; *APAPS a schimbat conducerile a peste 1000 de societati (APASP has changed the management structure in over 1000 companies)* in Curentul, May 14.

⁵⁶ Art. 111 par. (2) (b), art. 113 (l) (implicit provision), art. 134, par. (4)

⁵⁷ We should emphasize again that in the Romanian legal discourse the members of the board are called “administrators”, while the term “director” is reserved for executive managerial positions.

⁵⁸ Art. 183 of law 31/1990 on commercial companies, republished.

⁵⁹ Art. 136 par. (2) of law 31/1990

⁶⁰ Art. 136 par. (2) of Law 31/1990

persons appointed as directors/administrators have concluded such a contract – except for state-owned companies that were examined separately in 2.2.5 The State as Shareholder. In most cases, the contractual relations between the administrators and the company are implicitly derived from Law 31/1990 and from the Constitutive Act.

Romania requires that the sole administrator, or at least half of the administrators, should be Romanian citizens⁶¹, unless the Constitutive Act provides otherwise⁶². In other words, the law complies with the principle of contractual freedom and gives shareholders the right to decide on the nomination of foreign citizens to the Board⁶³.

For the election of the members of the board the law specifically requires a secret ballot procedure. In spite of the secret ballot, elections rarely bring out surprises in the nomination of the board – the majority shareholder, the existing members of the board and the executive managers all have a decisive role in promoting certain candidates.

There are no special provisions to ensure representation on the board of different stakeholders, including minority shareholders. In practice, however, in companies controlled by the state, different stakeholders -- such as financial investors -- generally have a seat as result of agreements with the majority shareholder. Such arrangements tend to be continued after privatization and the new majority shareholder is usually willing to establish good relations with the other partners.

ELIGIBILITY OF BOARD MEMBERS

With regard to the selection criteria for the directors/administrators, Law 31/1990 establishes a quite restrictive regime, although this regime is not always supported by severe sanctions. The requirements specified by the law refer to respectability and legal capacity. Conflicts of interest situations are also disqualifying in the selection of board members. Some supplementary requirements refer to the members of the boards in banks and other financial institutions.

A first category of general requirements refers to respectability or to legal capacity. In this respect, Law 31/1990 stipulates that persons who cannot be founders cannot be administrators either. The persons who cannot be founders are persons that have no legal capacity or persons convicted for fraudulent management, abuse of trust, forgery, use of forgery, fraud, embezzlement, false testimony, bribery, as well as other criminal acts specified by Law 31/1990⁶⁴.

The second category of requirements refers to cases of conflict of interest. Therefore, Law 31/1990 provides that the administrators cannot be censors. The interdiction is valid because the cumulated functions eliminate the distinction between internal and external financial control. At the same time, the law provides that a person cannot sit on more than three Boards of Directors concomitantly⁶⁵,

⁶¹ Citizenship in the case of the natural persons and nationality in the case of legal persons

⁶² Art. 134 par. (3) of Law 31/1990.

⁶³ This is in contrast to the situation before 1940, which made it compulsory to appoint Romanian citizens for at least half of the seats on the board.

⁶⁴ Art. 6 par. (2) of Law 31/1990. When it refers to “founders”, the text of the law is intended to the business corporations set up through public subscription. However, the wording of art. 135 of Law 31/1990 shall be corroborated with art. 6 par. (2) of the same law, as it regulates the management of the stock companies in general.

⁶⁵ Law 31/1990, art 142: “(1) no one can operate in more than three Boards of Directors concomitantly. (2) The interdiction mentioned on par. (1) does not refer to cases when the person elected to the Board of Directors is the owner of at least one fourth of the aggregate stock or takes the office of administrator of a business corporation that owns the one fourth”.

cannot be an administrator, censor or shareholder/general partner in a competing company, or carry out the same kind of trade on his own account⁶⁶.

In order for a nomination to the board to become legally valid, the administrator is required to constitute a guarantee – either double their monthly remuneration or the nominal value of 10 shares⁶⁷. The administrators are also bound to register their signature specimen with the Trade Registry.

Banking Law no. 58/1998 sets special rules for the nomination of directors/administrators in a bank that are complementary to the provisions of Law 31/1990. Only natural persons can be appointed as administrators in a bank and the board of a bank can have a maximum number of 11 members. The administrators of a bank must be residents of Romania, fulfill exclusively the function for which they were appointed, and at least one of them should be a Romanian citizen. Moreover, the administrators must hold a university degree, have at least 5 years experience in financial-banking activity and should not be liable for the bankruptcy of a business corporation. The banking law specifies that a person is excluded from the position of administrator if he or she has violated the banking laws, either in a previous similar position or as an executive manager or censor. These situations of misconduct are specified by Law 58/1998. The administrators of a bank must get the clearance of the central bank before taking office⁶⁸.

Similar special provisions are in place for other financial institutions – insurance companies or investment funds.

REVOCATION OF THE MEMBERS OF THE BOARD

The members of the Board can be revoked by the shareholders convened in the general assembly at any time. The revocation does not need to be motivated.

In the case of the banks that have problems, the Board of the National Bank has the right to replace the existing board of directors/administrators with a “special administrator”⁶⁹ and a special management regime. During special management, the shareholders of the bank cannot appoint other administrators.

Revocation is not frequent in practice – usually members of the board resign if they feel they have conflicts with the majority shareholder that could eventually lead to revocation.

BOARD REMUNERATION

The directors/administrators are entitled to be compensated for their work as members of the board. Art. 148 of Law 31/1990 specifies that “fixed fees and any other pay or benefits can be granted to administrators and censors only based on a decision of the general meeting (of shareholders)”. Directors’ may also take a share of the benefits of the company – but only if such remuneration was decided by an extraordinary general shareholders meeting or was written in the Constitutive Act of the company. Although it is legally possible, it is not customary to compensate members of the board in shares.

⁶⁶ Art. 142 par. (5) of Law 31/1990: “The members of the Directors’ Committee and the executives of a joint stock company cannot be, without the approval of the Board of Directors, administrators, members of the Directors’ Committee, censors or associates with unlimited responsibility of other competing companies or having the same line of business and cannot carry out the same trade or a competing trade in its own account or in the account of another person, as such cases are liable to be sanctioned by revocation and charged to pay damages”.

⁶⁷ Art. 137 par. (1) of Law 31/1990.

⁶⁸ Art. 25 of Law 58/1998. These requirements are detailed in the Norms No. 2/1999 issued by the National Bank of Romania, modified by Norms 10/1999.

⁶⁹ Art. 80 of Law 58/1998

Board members who assume extra responsibilities, such as the chairman/president of the board or members of the Directors' Committee, receive compensation proportional to their supplementary tasks. The remuneration of the members of the Directors' Committee is established by the other members of the board within the limits set by the Constitutive Act. If no such limits are defined in the Constitutive Act, then the general assembly has to decide.

In state-owned companies the remuneration of the members of the board was frequently established in relation to the general manager's salary. This created incentives for the members of the board to approve high salaries for the executives, in order to raise their own remuneration.

In practice, although formally the provision of the law is respected in the sense that shareholders approve the remuneration of the boards, there are ways to go beyond the approved remuneration either by "adjusting to inflation" the amount approved, or by granting "bonuses" that were not explicitly submitted to shareholders' approval.

THE STRUCTURE OF THE BOARD

According to art. 134 of Law 31/1990, the company is administered "by one or several administrators, that are temporary and revocable". When several administrators are appointed, they form a "board of administrators" headed by a chairman/president of the board appointed among the members of the board. At the same time, art. 140 of the Law provides that "the board of administrators can delegate part of its powers to a Directors' Committee composed of members selected among the administrators". The president of the board can at the same time be the general manager or manager of the company, in which case he also heads the Directors' Committee. The board selects and hires the managers and other employees of the company.

Thus, Romania has adopted the "unitary" structure of the board. But in many large companies the existence of a Directors' Committee is made up of administrators who assume an executive role, suggesting a hybrid structure. The hybrid structure does not explicitly include a surveillance council -- all members of the board have the same broad responsibilities and are still equally accountable -- but in practice the non-executive members of the board tend to assume more of a surveillance role.

In practice, most large companies have at least one independent (non-executive) member on the board⁷⁰. The companies listed on RASDAQ tend to have the unitary type structure of the board while the companies on the Bucharest Stock Exchange are more frequently organized under the hybrid structure. Also, in small- and medium-sized companies there are less non-executive members of the board than in larger companies. Private companies also more frequently adopt the unitary type of structure, where the main shareholder also holds the position of president/chairman and director-general (chief executive officer). Affiliates of foreign companies prefer to maintain a dual structure, where one of the top positions – chairman of the board or general manager – is held by the representative of the foreign owner while the other position is given to a local "specialist".

It should be mentioned that for certain types of companies, such as investment funds, an organizational structure that specifically provides for a "surveillance board" completely separate from the executive tasks is required. The five Financial Investment Companies can choose to organize themselves either as "self-managed" entities or they can separate the portfolio management functions (entrusted to a specialized assets management firm) from the other functions. Currently, only SIF IV Muntenia has adopted the split structure.

Romanian companies rarely use specialized committees outside the directors committee. Part of this may reflect the existence of the censors, who would seem to serve some of the functions of an audit or

⁷⁰ There are no empirical studies on the structure and effective functioning of the boards in Romania; therefore, the estimates in the text should be considered an "educated guess".

censors committee. In practice, however, the lack of specialized committees greatly reduces the effectiveness of the typical board.

2.4.2. BOARD FUNCTIONS

Romanian legislation is rather general regarding the functions of the board. In accordance with the provisions of art.70 par. (1) of Law 31/1990, the administrators "can carry out all the operations required in order to achieve the objectives of the company, within the limits specified in the Constitutive Act". Art. 72 stipulates that "The duties and liability of the administrators are regulated by the provisions concerning the mandate and those specified in the present law." The main limitations to the powers of the board refer to the scope of business (administrators cannot undertake actions that are not within the scope of the company's business) and the decisions reserved by the law to the shareholders meetings. The law does not clearly specify the administrator's duty of care and loyalty to *all* shareholders.

In practice, the effective functions assumed by a board depend to a large degree on the structure of the board, the professional and human qualities of board members and on the position and personality of the general manager-chief executive officer. Large companies, as well as financial institutions, tend to have strong boards, actively involved in corporate strategy decision-making and in monitoring corporate performance. In many other companies, however, including private companies, boards have a formal role of "stamping" managers' decisions. Theoretically, boards have power in nominating the key executives and in establishing their remuneration; but, in practice, boards tend to follow the majority shareholder's choice.

LIABILITY OF ADMINISTRATORS

If the rights and obligations of the administrators are set by a legal proxy contract, their liability is derived from the contract⁷¹. However, Romanian law also includes a liability for torts in the case of prejudices, as well as criminal liability for perpetration of deeds considered criminal offences.

Civil liability. The administrators are liable if they do not fulfil their mandate in compliance with the administration contract, the statutory act and/or the law. Administrators are also held responsible for wrongdoing perpetrated by their predecessors, in the case that they neglected to inform the censors whenever they discovered such wrongdoing.

The administrators are jointly, severally and subsidiary liable. The liability is not extended to the administrators who can prove (based on the minutes of the board meetings and written notification of the censors) that they disapproved a certain decision. Bringing an action for liability belongs to the general assembly of the shareholders that appoint a representative⁷². It is very difficult for shareholders to sue board members directly. The action can also be brought by creditors, but only in the case when the company is undergoing bankruptcy procedures.

The law specifies that administrators are jointly liable for: (a) the effective existence of payments made by subscribers; (b) for the reality of dividends actually paid; (c) for the existence of the registers required by the law and for correct and fair bookkeeping; for the truthful fulfillment of the decisions of the General Assemblies⁷³.

⁷¹ Prof. dr. Stanciu D. Carpenaru: "Management of companies under the provisions of Law 31/1990", Commercial Law Journal no. 2/1993, pg. 40, Bucharest, 1993.

⁷² Art. 150 of Law 31/1990. The provision is taken over by art. 154 of the Romanian Commercial Code, except that in this law, the action against the administrators is brought by the censors. The text was liable to criticism from the very beginning, because other persons had no right to take action in Court (such as creditors, or other persons taking an interest)

⁷³ Art. 73 and 144 of Law 31/1990.

In all the other cases, administrators are severely liable. It is obvious that such cases refer to bad management where the responsibility of an individual member of the board can be identified. Although, in terms of procedure, action brought against all administrators is not ruled out. Moreover, the administrators' liability can be subsidiary when it pertains to deeds perpetrated by executive managers or by other employees of the company. In the last case, liability's role is that of a "guarantee that does not replace the responsibility of the person who committed the deed resulting in damages..."⁷⁴, but is grounded on the administrators' failure to perform the control function.

Criminal liability. Under criminal law administrators are held responsible for prejudice brought to a company or bankruptcy caused by fraud. Law 31/1990 enumerates about 22 criminal offences that administrators may be liable for, including: (a) the use of the company's assets or credit for their own benefit or for an end that is contrary to the company's interests; (b) spreading false information or using other fraudulent means in order to obtain a benefit to the detriment of the company; (c) payment of dividends out of fictive benefits, without proper financial statements or based on false financial statements etc. Prosecutors may initiate criminal action against administrators.

2.4.3. MANAGERIAL ENTRENCHMENT

In most companies, managers have a strong position in their relations with the board, derived from different sources:

- Both in state-controlled and private companies, managers tend to learn they owe their position not primarily to the board of directors/administrators, but directly to the controlling shareholder. As a result, managers are frequently in a position to influence nominations for board seats, reversing normal authority;
- Managers have access to and control over the information in the company, which gives them an advantage over the other members of the board;
- The structure of the board also favors managerial entrenchment. In companies where the president of the board is also general manager/chief executive officer, the board of administrators has a weaker position in monitoring management. The same applies when the board is dominated by executive directors; The lack of specialized committees also weakens the position of the board relative to management.
- The process for nominating board members is not well-defined in the law and offers shareholders few protections. For example, it does not require any information on nominees to be distributed directly to share holders. When combined with dispersed ownership structures, managers have ample room for maneuvering in the process of nominating members of the board and subsequently in the organization and functioning of the board;
- The weakness and passive/bureaucratic attitude of the board members appointed by the ministries or other public institutions in state controlled companies encourages managers to assume broader responsibilities and to intervene in board decisions.
- Perhaps most seriously, the absence of independent board members in either state controlled or private companies ensures that all board members have close ties to management and controlling shareholders. Currently there are no requirements, either in company law or listing requirements, that companies have independent members.

⁷⁴ Prof. dr. Stanciu D. Carpenaru: "Management of companies under the provisions of Law 31/1990", Commercial Law Journal no. 2/1993, pg. 40, Bucharest, 1993.

The current situation of the balance of power between managers and the board is in line with the prevailing view that during transition, when companies are confronted with so many changes and uncertainties, strong management is needed in order to improve effectiveness in decision-making. The experience of the first half of the 1990s, when managers were frequently removed at the demand of the trade unions, reinforced the idea that managers should be given proper powers and defenses if they are to generate economic performance.

2.4.5. THE ROLE OF THE CENSORS

The censors are part of the Romanian structure of corporate governance. While the general shareholders' assembly serves as an instrument for formulating the resolution of the company, and the administrators are in charge of the execution of the resolution, the censors' role is to monitor the administrators, provide financial oversight, and check compliance with legislation. The censors monitor not only the company, but also the activity and the decisions of the board. The censors do not have a role in the decision making process, though they usually participate in the meetings of the board of administrators and eventually express their opinion on different current matters.

Romanian legislation has adopted the internal auditing system. According to Law 31/1990, the general shareholders meeting appoints three censors and three substitutes (if the Constitutive Act does not set a higher number), of which at least one is required to be a certified or expert accountant. The censors are elected among the shareholders -- with the exception of the certified or expert accountants -- for a term of three years. In companies where the state holds more than 20% of the shares, the Ministry of Finance has the right to recommend one of the censors⁷⁵.

It should be noted that in public companies the internal censors system is supplemented by external censors. The financial reports of public companies have to be certified by external censors authorized by the National Securities Commission.

In fulfilling their role, the censors have two main duties: to monitor the administration of the company and to check financial statements. The conclusions of the censors' inspection are presented in a report submitted to the general shareholders meeting. The general shareholders meeting cannot approve the yearly financial statements unless the censors' report is presented.

Other duties of the censors specified by law are:

- to check every month the cash in the company as well as the securities belonging to the company;
- to call for the ordinary or extraordinary shareholders' general meeting, when the administrators fail to do so;
- to participate in the general meetings and to demand for certain issues considered by them to be important enough to be included on the agenda;
- to check whether the administrators have fulfilled their obligation to deposit a guarantee;
- to check whether the administrators or liquidators comply with the law and the Constitutive Act;
- to appoint, together with the administrators, a temporary administrator in case of vacancy, and to call for a general shareholders meeting for a definitive nomination;
- to call for a general shareholders meeting when they find the request of shareholders representing 25% of the share capital is justified.

⁷⁵ Art. 154 of the Law 31/1990.

Censors also have an obligation to inform shareholders and directors/administrators on irregularities they have uncovered.

While the censors would seem to have the potential to ensure good corporate practices, in reality they are largely ineffective in their assigned roles. They tend to follow the lead of management and the controlling shareholder. Their relationship with the board is ambiguous, and their existence seems to prevent the board from (or provides an excuse not to) engaging in certain core competencies, such as supervising internal audits.

2.5. TRANSPARENCY AND DISCLOSURE

OECD Principles of Corporate Governance

IV. “The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.”

Company Law no. 31/1990 as amended in 1997 specifies the records a joint-stock company is required to keep, as well as the minimal disclosure requirements to shareholders and other interested parties. Higher disclosure standards are applicable for the companies listed on the Stock Exchange, these standards being imposed by Law 52/1994 on the Securities and Stock Exchanges and by Stock Exchange regulations. Accounting rules and procedures are set by Accounting Law no.82/1991.

It should be mentioned that, along with the legislation, the media has proved to be one of the most important forces and vehicles for promoting transparency and disclosure with regard to corporate governance. Apart from publishing the different announcements required by law (notice of the meetings, important events, changes in ownership etc.) all major newspapers have regular comments and analysis on capital markets and on companies. All major Internet portals have links to the institutions of Romanian capital markets and there are several specialized sites full of informative content.

But the most important contribution of the media came from investigative reporting. In fact, most of the “scandals” showing frauds, abuses or cases of mishandling of a situation by the authorities were initiated by the media.

2.5.1. CORPORATE FINANCIAL AND OPERATIONAL DISCLOSURE

Art. 172 of the Law 31/1990 enumerates six “registers” a joint stock company is required to keep, “in addition to the records provided by the law”⁷⁶:

- a) the shareholders register that records the name and the address of the nominal shares owners, as well as the payments made for shares. The shareholders’ register has to be updated prior to every general shareholders meeting, but not less than once a year⁷⁷. The company can have the shareholders register maintained by an independent specialized registry. The companies listed on a stock exchange are compelled by Law 52/1994 to keep their shareholders register with an independent registry authorized by the Securities Commission.
- b) a register of the general shareholders meetings, which is a collection of the minutes of the meetings;
- c) the register of the board of directors/administrators meetings – recording the minutes of the discussions of the boards, the decisions and the votes;
- d) the register of the directors’ committee meetings – recording the minutes of the discussions in the directors’ committee;
- e) the register of the discussions and conclusions of the censors;

⁷⁶ The “records provided by the law” are the accounting books treated below at 2.4.2.

⁷⁷ Regulated through Government Decision no.855/1995.

- f) the bonds register, similar to the shareholders register, records all bonds issued and settled, as well as the identification of bondholders, when bonds are nominal. The register for dematerialized bonds and for bonds listed on a stock exchange is subject to the provisions of law 52/1994.

The registers mentioned under (a), (b), (c) and (f) are the duty of the board to keep, the register under (d) is the duty of the directors' committee and the register (e) under the censors' duty.

The directors/administrators have an obligation to put at the shareholders' disposal the registers under (a) and (b) and to issue copies of the records in these registers at their own expense. The same applies to the bonds' register, which should be made available to bondholders.

Shareholders' access to information was extended in 1999⁷⁸ through provisions aimed specifically at minority shareholders. According to the new art. 133¹ and 133², between the general meetings, but not more than twice during a fiscal year, shareholders have the right to consult documents specified in the constitutive act. Consequently, shareholders may notify the board of directors/administrators in writing, which have an obligation to answer within 15 days from the date the notification was filed. Shareholders representing more than 10% of the capital may ask the court to appoint experts to check certain operations of the company and to present a report. The fees of the experts are to be paid by the company – unless the request was ill-intentioned.

The most comprehensive document by which shareholders are informed about the evolution of the company is the annual report of the directors/administrators, accompanied by the report of the censors. Both reports have to be presented every year at the general shareholders meeting and constitute the basis for the decisions made by shareholders.

Art. 176 of the Company Law specifies that “the administrators have to present to the censors, at least one month in advance of the general meeting, the balance sheet for the previous fiscal exercise, with the profit and loss account, accompanied by their report and by supporting documents”. The censors have an obligation “to check whether the balance sheet and the profit and loss account are prepared in line with the law and correspond to the registers, whether the registers are regularly updated and whether the evaluation of the patrimony was performed in conformity with accounting rules.” (art. 158). The censors' review is presented in a report to the general meeting.

As a general rule, there are no specific provisions regarding the structure or the content of the administrators' annual report, except the requirement that it should be presented in written form. The report should present clearly and in a concise form the situation and the evolution of the company in the previous fiscal year; the performance, the difficulties and problems that have confronted the company; the most important events, the activity of the subsidiaries, the evolution of the transactions with shares – for listed companies – and comparisons of the performance indicators with previous years.

In practice, the quality of the administrators' reports vary substantially. They tend to be good for the large companies listed on the Stock Exchange and for financial institutions, but mediocre and formal for many small- and medium-sized companies, or for companies that are not exposed to public scrutiny.

The administrators report, together with the other documents to be submitted for the shareholders' attention and vote in the general meeting have to be deposited at the company's headquarters and subsidiaries 15 days before the meeting in order to be reviewed by shareholders. Shareholders may obtain, at their own expense, copies of the balance sheet and of the administrators' and censors' reports.

⁷⁸ Law 99/1999 concerning measures for the acceleration of the economic reform. art. viii.

Sometimes companies discourage shareholders from asking for copies of the reports by establishing relatively high costs for the copies. For example, ALRO, one of the blue chips of the BSE, fixed a ROL 1mn. (approx. USD 40) price for its year 2000 reports – well above the cost of producing a copy of the report. The same company produced a long and a short form of the report – the long form being reserved for “significant shareholders”.

Within 15 days after the general meeting, the financial statements and the reports approved by the shareholders are presented to the territorial office of the fiscal administration. One copy of the same documents with the visa of the fiscal administration is lodged with the Trade Registry, where the public can consult it. While most companies comply with the legal requirement of presenting the documents to the fiscal authorities, an important number of companies fail to submit their annual reports to the Trade Registry, or they are very late in doing so.

Law 52/1994 sets higher disclosure standards for the companies listed on the stock exchange. The annual reports of such companies are prepared in accordance with instructions of the securities commission that specify the minimal content, the form and the moment the report is to be made public. Listed companies are also required to publish a summary of the annual report in the press. Half-year financial statements have to be made public and the securities commission may decide to ask for quarterly reports (art.82). Listed companies send “current reports” to the Securities Commission and to the Stock Exchange in which they have to announce any important event that may influence investors’ decisions.

Failure to comply with reporting requirements was a chronic problem for the BSE. Starting with the year 2000, both the BSE and the Securities Commission sanctioned many companies and discipline improved. But surprises continued to happen – the latest being the saga of ALRO’s decision to proceed to increase capital through revaluation of assets and issue of new shares. Rumors about such an increase were circulating in the market and hesitantly denied by the company officials. Then on 14 May 2001 ALRO was suspended from trading. The next day the call for an extraordinary meeting of the shareholders was published. The increase of capital was on the agenda of the meeting. But the details on the increase (the sequencing of the two operations, the price for the new shares etc.) were missing. The strong reaction of the press and the trade unions obliged the authorities (the privatisation agency, APAPS, is the majority shareholder in ALRO) to give some explanations, but ALRO shares started to fluctuate on the stock exchange (up 14.8% on May 15, down 6.8% on May 16 and up 7.5% again on the next two days). The Stock Exchange General Commissioner asked the Securities Commission to sanction the company and the members of ALRO’s board, but the Securities Commission decided it had no legal ground to apply sanctions⁷⁹. In fact, the whole operation was a covert privatisation of one of the “crown jewels” of the Romanian economy and the lack of transparency for such an important transaction risk to seriously undermine the credibility of the Securities Commission and weaken the BSE.

On the occasion of the ordinary general shareholders meeting, administrators presented another important document – the budget for the subsequent fiscal year and the program of activity of the company. Although the Company Law specifies that the program of activity is presented “as the case may be”, most large listed companies do prepare the document. The content of the document is, however, variable from company to company – sometimes specific objectives are set, as well as the measures envisaged to meet the targets, at other times only a general indication is provided as to the revenues and main categories of expenses. The budget and the program of activities are the only documents giving shareholders the possibility to discuss and take position *ex ante* on the managers’ intentions. By setting numerical targets, the document establishes a benchmark against which the performance of the administrators may be measured. However, because of the volatility of the macroeconomic environment (high and unpredictable inflation), in most cases the general shareholders

⁷⁹ For a critical overview of the operation see Teodor Ion, “Lovitura de stat” de la “ALRO” Slatina (A “coup d’etat” in ALRO Slatina), *Adevarul Economic* nr.21, May 2001.

meetings entrust administrators with the power to adjust the initial provisions of the budget. The “benchmark function” of the budget is thus weakened as the boards adjust targets according to their interest to show good performance.

2.5.2. ACCOUNTING PROCEDURES AND AUDITING REQUIREMENTS

The legislation is more specific on the financial statements a company is required to prepare and present to shareholders and to third parties. The provisions of the Company Law are augmented by the provisions of Accounting Law no. 82/1991. According to art. 27 of the Accounting Law, the financial statement of a company is composed of three documents: the balance sheet, the profit and loss account -- both with the corresponding annexes -- and the administration report.

All three corporate governance bodies have a role in the preparation of the financial statement. The effective drafting of the financial statement is done by the directors/administrators (in practice, based on managers’ input). The censors check the information included in the financial statement with the company’s books and signal irregularities in their report. Finally, the general assembly of the shareholders approves the document or requires changes.

In drafting the financial statement the directors/administrators have to observe some basic rules set through the Accounting Law: a) all entries in the balance sheet have to be in line with the data recorded in the company’s books and should reflect the real situation of the assets and liabilities; b) no compensations are allowed between different accounts that are consolidated in the balance sheet, as well as between different revenues and expenses positions included in the profit and loss account; c) share capital is a constant amount on the books. The directors/administrators are legally liable for the organization of bookkeeping and for compliance with the legal norms.

Traditionally, the Ministry of Finance sets accounting rules. Directed primarily towards providing information to the tax authorities and to the government, the Romanian accounting system allows very little scope for judgmental accounting entries, provides limited disclosure and, therefore, is of little help for users like managers and shareholders. A “chart of accounts” is set by law that includes all accounts and account numbers to be used by all entities (with the exception of the banks and not-for-profit institutions, which have different charts of accounts). The principle of the chart of accounts is that all companies will record the same item in the same account irrespective of the business activity⁸⁰.

A first attempt to improve the accounting regulations was made in 1994, when a new “chart of accounts” was introduced. The system then adopted allowed the measurement of a company’s assets and liabilities in a manner broadly consistent with International Accounting Standards, but still failed to include certain essential information such as the cash flow statement and proper disclosures, including notes to the financial statements. While the new system allowed for a degree of judgmental accounting entries, in practice those which do not have any tax consequences are rarely made, reflecting the unwillingness of most accountants to record entries other than those that are required to calculate taxable profit.

Only certified or expert accountants have the right to oversee preparation and to sign the financial statements of a company. The accounting profession was organized into an independent professional organization – the Body of Certified and Expert Accountants⁸¹ – with the purpose of establishing professional standards, monitoring compliance and sanctioning members. However, the Ministry of Finance maintained a role in both the accountants’ certification process and in setting professional standards, causing the Body of Certified and Expert Accountants to complain repeatedly about interference.

⁸⁰ See *A comparison of International Accounting Standards and Romanian Accounting Regulations*, prepared by Pricewaterhouse Coopers Romania, on the site www.majorcompanies.ro

⁸¹ Government Ordinance no. 50/1997

In April 1999, the Ministry of Finance issued the first two public documents directed at harmonizing the presentation of the Romanian financial statements with the formats prescribed by the EU IVth Directive and setting up a conceptual framework for the future development of accounting standards in accordance with IAS. Subsequently, in the year 2000, detailed accounting standards which are IAS compliant were published. Regulations on the preparation of group accounts, in accordance with the EU VIIth Directive have also been published. All these new accounting regulations began to apply in the year 2000 to companies that meet two of the three criteria set by the EU IVth Directive: turnover, total assets and number of employees. In February 2001 the latest piece of legislation was issued⁸², which establishes the principles and the basic accounting rules, the form and the content of the financial statements.

Thirteen companies, most of them listed on the Bucharest Stock Exchange, prepared year 2000 financial statements in accordance with the new regulations⁸³; another 197 companies started in 2001 and 600 will start in 2002. All large-sized public companies will apply the new accounting standards in 2005; for small companies a simplified accounting system will be put in place.

Auditing is also changing. Traditionally, censors were entrusted with the role of auditors, according to the Company Law. Censors are shareholders' representatives. they are elected among the shareholders – although one of the three censors has to be a certified accountant and, therefore, may be an outsider. Censors oversee the administration, check compliance of the financial statements with the books and make sure records are properly maintained.

A first step towards the professionalisation of the censors' function was made through Law 52/1994, which requires public companies to have their books certified by an independent censor selected from a pool of censors authorized by the Securities Commission⁸⁴. The external/independent censor, whose report is addressed to the Securities Commission and to the Stock exchange, does not substitute for the internal censors committee.

⁸² Order of the Ministry of Finance no. 94/2001. See Maria Manolescu, Georgeta Petre *In plina actualitate, implementarea reglementarilor contabile armonizate cu Directiva a IV-a a UE si cu Standardele Internationale de Contabilitate (Implementation of the Accounting Regulations harmonised with the EU IVth Directive and with the International Accounting Standards)*.in *Adevarul Economic* no.21/2001.

⁸³ However, for tax purposes, the old regulations will be applied. Under the IAS, part of the current profits turn into losses, having a negative impact on budget revenues.

⁸⁴ Chapter VII of the Law 52/1994, on the external censors.

Main Differences between Romanian and International Accounting Standards

Procedures for restating RAR into IAS compliant statements have been developed. In fact, many foreign companies, or companies that have relations with foreign partners, currently keep their books simultaneously in compliance with RAR (for tax purposes) and with IAS (for managerial purposes). There are four differences from IAS that impact most on the Romanian companies' financial statements:

Hyperinflation

- IAS 29 requires that the financial statements of any entity that reports in the currency of a hyperinflationary economy should be adjusted to take into account the effects of inflation. The financial statements are restated in terms of the measuring unit current on the balance sheet date, and the net loss on the net monetary position is included in the income statement and disclosed separately as the restatement adjustment. IAS standards suggest that economies should be regarded as hyperinflationary if the cumulative inflation rate over a period of three years exceeds 100%.
- RAR does not address the issue of hyperinflation. To date, the only adjustments that have been made in this area are a number of revaluations of fixed assets based initially on government decisions. However, these revaluations did not necessarily result in assets being assessed at fair market value and extreme care should be taken when relying on such revaluations.

Foreign exchange

- IAS – Foreign currency transactions should be translated into the company's reporting currency using the exchange rate on the transaction date. The average rate for a defined period may be used as an approximation, providing the exchange rates have not fluctuated significantly during that period. All monetary assets and liabilities should be translated at the closing rate on the balance sheet date. Non-monetary assets and liabilities carried at cost should be translated at historical rates, while those carried at fair value should be translated at rates applicable when the fair values were determined. Foreign exchange gains or losses should be reported as part of the profit or loss for the year. Those that relate to the revaluation of monetary items that form part of, or are used to hedge the company's net investment in a foreign equity, should be recognized within shareholders' equity.
- RAR – Foreign currency transactions should be translated into the company's reporting currency using the official National Bank rate on the transaction date. All monetary assets and liabilities should be translated at the closing rate on the balance sheet date. Non-monetary assets and liabilities carried at cost should be translated at historical rates and the difference should be presented in specific balance sheet accounts. Foreign exchange gains or losses, should be reported as part of the profit or loss for the year.

Depreciation

- IAS – Depreciation should be provided on all depreciable assets. No specific method of depreciation is specified, although the methods used should be disclosed and applied consistently by management.
- RAR – Depreciation should be provided on all depreciable assets, on both intangible and tangible assets, with the exception of freehold land. The law sets compulsory useful lives to be used when depreciating the assets that are usually longer than the generally accepted useful lives under IAS.

Equity reserves

- IAS – No specific guidelines exist regarding the appropriation of profit to retained earnings.
- RAR – A legal reserve of a maximum two times the par value of share capital must be maintained by annual appropriation of 20% of the net profit, until it reaches the amount of the share capital, and 10% yearly afterwards, until the maximum amount is achieved. Statutory reserves are constituted annually from the net profit in accordance with the company's articles of incorporation. Other reserves may be constituted from the net profit for covering losses, or other reasons in accordance with the shareholders meeting decision.

External auditing was not required, except for banks. However, some large companies, especially foreign-owned, occasionally asked one of the “big five” auditing firms to scrutinize their books and prepare auditing reports. Parts of these reports were eventually circulated to shareholders or to a larger audience, according to the board’s decision and interests.

In the context of reform of the accounting system, new provisions were issued on the auditing profession and activities. Audit reports prepared by external independent auditors will become compulsory for all public companies, following the same phased implementation extended until 2005. Based on Government Ordinance 75/1999, the Chamber of Auditors was created as a professional organization, a first step to integrating the EU VIIIth Directive. The Chamber already has around 500 members and has adopted the IFAC handbook as the local standard for auditors.

In spite of these important reforms, significant efforts are still required for Romania to achieve adequate standards of auditing and accounting. Currently, investors and the public feel that important information is not disclosed, or disclosed late, and what is disclosed is sometimes not trusted. Successful reform will require both companies and the accounting and auditing professions to make significant improvements in their standards and practices.

2.5.3. INFORMATION ON SHARE OWNERSHIP

According to the Company Law, shareholders and third parties have the right to be informed on the ownership structure of a company. To that effect, the Company Law has put in place a two-tier mechanism:

- the shareholders’ registry each company is required to keep – where every shareholder can check not only their own position but also other shareholders’ stakes. Companies may delegate the task of keeping the shareholders’ register to an independent specialized registry.
- the Trade Registry, which keeps public records on shareholders.

According to the Securities and Stock Exchange Law, public (open) companies are also required to register their securities with the Securities Record Office set up by the National Securities Commission and to conclude a contract with an independent specialized registry for keeping updated and accurate evidence on the shareholders’ ownership. For each new entry in the central shareholders’ file, the independent registry has to record at least the following information:

- the name and address of the company;
- the company’s unique registration number with the Trade Registry;
- shareholder-related information: name and address, identity document number, the number of shares held (or the value of the principal in the case of bonds), series of the shares (if any) and nominal value. A registration number with the independent registry is assigned to each entry.
- details on any limitation on the company’s liability or conditions affecting transferability.

Public companies are required⁸⁵ to submit to the National Securities Commission reports on any change in their ownership structure within 15 days from the occurrence of such a change. The change in ownership structure is defined by the law as a situation where a shareholder, alone or together with associated parties as defined by the law, reaches 5% of the voting shares in a company, thus becoming a “significant shareholder”. Shareholders having over 5% of the voting shares are required to disclose every single transaction. A shareholder aiming to take a “controlling stake” (over one-third of the voting shares), is required to make a public offer for the acquisition and a shareholder reaching a

⁸⁵ Article 88 and 89 of the Law 52/1994.

majority position (over 50% of the voting shares) shall make a public offer for all the shares on the market.

According to National Securities Commission Regulation no.2/1996, the current reports should include information on:

- changes in shareholding structures;
- the identity of the person or the entity that takes control of the company as well as, if necessary, the identity of the person controlling that entity;
- the existing form of control;
- the degree of control or the reason for which it is believed that the company will be controlled;
- the amount paid in exchange of, or the ways through which control is achieved;
- the description of the transaction under which the person or entity took control, including the identity of the person waiving control;
- details on the source and conditions under which financing was assured in the transaction;
- description of any issues related to the transaction which might determine it to be temporary, or of any anticipated potential changes in the control position.

The current reports are also submitted to the information department of the stock exchange and are made available to investors through publication in at least one national newspaper. Failure to comply with the obligation to submit timely and current reports is sanctioned with fines and repeated breaches may result in delisting. It was only in 2000 and 2001 that the Securities Commission and the BSE became more rigorous in enforcing the provisions concerning current reporting. Now, information on “significant shareholders” is regularly published in the media.

It is known that investors sometimes use different stratagems in order to circumvent the obligation to report when they reach the 5% threshold – the most common being the use of nominees for buying blocks of shares of less than 5%. It is quite difficult for the Securities Commission to check such arrangements, and almost impossible when foreign-based intermediaries are used. Foreign-based intermediaries also make it difficult to know in practice who the ultimate owner of a block of shares is.

2.5.4. DIRECTORS, MANAGERS AND RELATED PARTIES DISCLOSURES

Romanian legislation has only one provision specifically regarding directors’ disclosure obligations. Law 31/1990 specifies (art. 145) that a member of the board is required to inform the other members of the board and the censors, when he has, directly or indirectly, a personal interest in a certain transaction that is opposed to the interests of the company. The same applies when the director/administrator has knowledge of any of his relatives having an interest in a transaction that is opposed to the interests of the company. The directors/administrators that fail to disclose such interests are liable for the eventual damages incurred to the company.

ANNEX: CAPITAL MARKETS IN ROMANIA

ORGANIZATION AND FUNCTIONING

Although shares started to be occasionally traded soon after the Company Law no. 31/1991 set the legal ground in 1991, it was only in 1994 that the Law on Securities and Stock Exchanges no. 52/1994 created the conditions for an institutional capital market to exist. In April 1995, the National Securities Commission decided (Decision no. 20/1995) on the creation of the Bucharest Stock Exchange. After an intense preparation period, during which Canadian technical assistance played an important role, on 20 November 1995 the Bucharest Stock Exchange resumed operations⁸⁶ with six companies listed and one trading session per week.

The Bucharest Stock Exchange is organized as a non-profit, self-financing “public institution”. As a self-regulated body under the supervision of the Securities Commission, the BSE issues its own regulations and rules regarding membership, listing and trading, clearing, settlement and registry activities. The BSE also monitors and enforces compliance.

The Stock Exchange Association is the highest decision-making body of the Stock Exchange. It was set up in June 1995 by the 24 securities firms licensed to operate on the Stock Exchange. Now, around 120 securities firms are members of the BSE. According to its Charter, the Exchange Association is aimed at properly administering the Stock Exchange system in order to ensure continuity of trading on the BSE in an efficient, transparent and law-abiding way, and offering adequate protection to investors. The Exchange Association is also in charge of the functioning of the registry and the clearing and settlement system that is part of the Stock Exchange infrastructure.

The Exchange Association elects among its members the 9 members Exchange Committee -- the executive body of the Stock Exchange. In its turn, the Exchange Committee appoints the General Manager of the Stock Exchange who is responsible for implementation of its strategies and the day-to-day operation of the Exchange. Both members of the Exchange Committee and the General Manager have to be confirmed by the National Securities Commission. The National Securities Commission also designates a General Commissioner as its permanent representative on the Stock Exchange. Although the General Commissioner has a role of observer (with no voting or decision-making power), he can propose that the Securities Commission cancel certain decisions of the Exchange Committee or of the General Manager.

Two permanent committees support the Exchange Committee: the Ethics and Conduct Committee, in charge of monitoring stock exchange discipline and sanctioning breaches of regulations, and the Listing Committee, in charge of admission to listings on the stock exchange.

The Bucharest Stock Exchange has all the traditional departments of similar institutions – trading, listing and membership. In addition, the BSE has departments dedicated to auxiliary services – the registry department, a clearing and settlement department, the IT department and the public relations and market development departments.

The BSE has three separate listings for different securities, submitted to different listing requirements:

- Securities issued by Romanian legal entities.
- Bonds and other securities issued by the state, by the central and local administrations and by other authorities.
- Foreign securities.

⁸⁶ The first Stock Exchange in Romania was established in 1882, but it was closed in 1948.

No listings have ever been recorded on the state bonds and foreign securities sectors. Listing of the treasury bills was long expected by market players in anticipation that the volume of trades and the liquidity on the stock exchange would be greatly improved. However, the Ministry of Finance was reluctant to let treasury bills be traded on the stock exchange and only now a solution seems to have emerged that would create a market for treasury bonds.

A company is listed on the BSE upon request, provided that it meets certain criteria. Two sets of listing criteria have been established: for **high-grade** companies, listed on the first tier of the Stock Exchange and for **lower-grade** companies, listed on the second tier of the exchange.

General requirements for listing on the second (base) tier of the Bucharest Stock Exchange

- The issuer must have lodged the respective securities with the National Securities Commission Registration Office;
- The securities to be listed must be freely transferable and dematerialized. The BSE only lists securities represented by an entry in an electronic register and securities in paper form that have been immobilized according to BSE procedures;
- The issuer has to conclude with the Exchange a Registry Contract (by which the Exchange will provide depository, registrar and transfer agent functions) as well as Listing and Maintenance contracts;
- The issuer must prove it has the capacity to provide securities holders with adequate services and appropriate information flows. Disclosure shall be made by the issuer in accordance with the provisions set out in the “Disclosure” chapter of the Stock Exchange regulations and procedures, in order to insure equal access of all securities holders to the information needed to make investment decisions. Periodic disclosure refers to the annual and semi-annual financial reports and other statements required by the Exchange on a regular basis, according to the maintenance procedures;
- The issuer’s minimum share capital must be the equivalent in ROL of Euro 2 million;
- The issuer has to pay the listing fees set out in the Exchange’s procedures;
- The issuer has to have appointed a Liaison Officer in charge of keeping permanent contact with the Stock Exchange;
- The annual financial statements of the issuer have to be audited by an external independent auditor.

Companies that do not meet the criteria for listing on the second (base) tier of the stock exchange have the option to have their securities traded on the “unlisted” sector of the BSE. There are currently 13 companies traded on the “unlisted” sector of the stock exchange – most of them formerly listed companies.

For the services provided, the Bucharest Stock Exchange charges fees which constitute the basis of its revenues (Stock Exchange Association membership contributions provide for another share of revenues). In general, the BSE charges 0.3% of the value of a trade on the seller and 0.22% of the value of a trade on the buyer. For large transactions (over USD 100,000) the fees are lower. Apart from trading fees, the BSE charges other fees for listing, for registry services provided to issuers, etc.

In order to track market performance, the Bucharest Stock Exchange has devised a set of indices⁸⁷. The BET index (Bucharest Exchange Trading) was launched on 22 September 1997 and is built on the ten most liquid securities listed on the first tier of the BSE. Since September 2000, a limit has been introduced weight of a stock in the index, which cannot be more than 25%; two securities, ALRO and the ROMANIAN BANK FOR DEVELOPMENT, are currently subjected to the 25% threshold.

In April 1998 a new index was launched – the BET-C (composite), which includes all securities traded on the BSE. When in December 1999 the five Financial Investment Companies were listed on the BSE, a decision was taken not to include them in the composition of the BET and BET-C indices because of the special character of these securities. Instead, a dedicated “financial” index, BET-FI, was launched in November 2000, after one year of trading when SIFs prices had stabilized.

The BSE is responsible for monitoring all market activities in order to ensure compliance with the law and regulations, minimize market volatility and protect investors. In order to enforce discipline and assure investors’ protection, the BSE disposes of several instruments to prevent market volatility, to ensure discipline of issuers and brokers:

- Trade suspension to prevent market volatility. Initially, trade in a particular security was suspended when its price fluctuated by more than 15% during a trading session. Currently, monitoring of market volatility is based on the negative variation of the BET index from its closing value of the preceding trading day. A warning message appears when the index falls by 10%, a 30-minute trading suspension is applied when the index falls by 12%, whereas a 15% fall triggers definitive suspension for the rest of the session.
- Temporary suspension from trade as a sanction for companies that do not observe listing requirements and BSE regulations. This is the most frequent sanction and is normally triggered by a failure to comply with disclosure requirements.
- Downgrading from tier I listing to tier II – applicable when a company ceases to meet the tier I listing requirements. Several such downgrades occurred in past years, especially in 2000 – most frequently for companies that did not observe reporting and disclosure requirements.
- De-listing is applied when a company repeatedly fails to comply with BSE rules and requirements.
- Brokers may be suspended from performing trade for various reasons. The most serious violations, like price manipulation or insider trading, are reported and sanctioned also by the Securities commission, which may decide to withdraw the operating license of the person or the brokerage house involved.

Until recently, the Stock Exchange was hesitant in imposing sanctions and many violations of the rules and regulations were disregarded. This attitude was motivated by the fear that a tougher approach would discourage market players and would further contribute to weakening the stock exchange. However, after serious frauds were discovered, such as theft of shares initiated by, or having the complicity of, some brokers⁸⁸, the Exchange Committee decided to take a firmer stance. In 2000 a “cleaning” operation was initiated, aimed at improving the standards and making the BSE an investor-friendly and trustworthy environment.

From a technical perspective, the Bucharest Stock Exchange is based on an advanced software platform -- the HORIZON trading system and the EQUATOR clearing -- settlement and registry

⁸⁷ A complete presentation of the indices system may be found on the BSE web site, www.bvb.ro

⁸⁸ In 2000, over 300 cases were submitted to the Securities commission, some of them being also being investigated by the police. See George Vulcanescu, *Miliarde in ancheta* (Billions under investigation) in *Piata Financiara* no. 10/2000.

system – that integrates trading with clearing and settlement⁸⁹. All brokers are connected to the BSE by remote terminals (although booths on the trading floor are also available). The system is order-driven and it automatically matches orders. When sell orders are entered, the actual existence of securities is automatically checked. The settlement cycle is T+3. While the Stock Exchange acts as a counterpart for all trades, it also carries out clearing and settlement. The broker receives clearing and settlement reports that indicate only the net position on funds and securities. Each broker has settlement accounts with an authorized settlement bank; on T+3 all settlement banks settle their net position on funds through the National Bank of Romania, paying to, or receiving funds from, the Stock Exchange. The securities are electronically settled by the system, as each client has an open account with the stock exchange register⁹⁰.

TRADING AND PERFORMANCE

In December 2000, the market capitalization of the Bucharest Stock Exchange (BSE) stood at less than USD 400mn. or 1.4% of GDP; after adding the newly listed Romanian Bank for Development the market capitalization becomes 2.9% of the GDP. This is among the lowest market capitalization in Central and Eastern European countries, where Slovenia has a market capitalization of 8.2% of GDP, Hungary 21%, Poland 19.8% and the Global Emerging Markets average is 52%. Bulgaria, with a capitalization of 1.2% of GDP, is the only country in the region comparable to Romania.⁹¹

Table A1: Bucharest Stock Exchange trading statistics

Year	No. of companies listed	No. of shares traded	No. of trades	Total turnover, USD
1995	9	42,761	379	964,374
1996	17	1,141,738	17,772	5,279,372
1997	75	568,152,039	607,318	251,927,242
1998	126	889,576,015	506,497	193,705,492
1999	127	829,974,047	404,017	67,952,185
2000	115	1,779,900,757	429,949	86,245,986

Source: BSE

Since its inception in 1995, the BSE has progressed in terms of volume of activity: the number of companies listed increased from the initial 6 to 127 at the end of 1999 and the number of shares traded in 2000 was 1,500 times higher than the shares traded in 1996. The total turnover remains low however – after the 1997 peak of USD 251mn. the turnover fell to USD 68mn. in 1999, recovering to USD 86mn. in 2000.

⁸⁹ For technical details, see article *The Bucharest Stock Exchange at millenium crossroads* prepared by BSE and published on the web site www.majorcompanies.ro

⁹⁰ A more detailed presentation of the clearing – settlement procedures, in *Romanian capital markets review*, prepared by Alpha Finance Romania and published on the web site www.majorcompanies.ro

⁹¹ Source: SG Emerging Markets Equity Research. It should be noted that sometimes statistics present consolidate figures for different classes of securities and/or listing requirements, making comparisons difficult. For example in Bulgaria the Official Market has three segments, A, B (Parallel market) and C (Provisional market) which do not really match the structure of the Bucharest Stock Exchange – some of the segments are closer to the over-the-counter conditions which in Romania fall under the RASDAQ trading system.

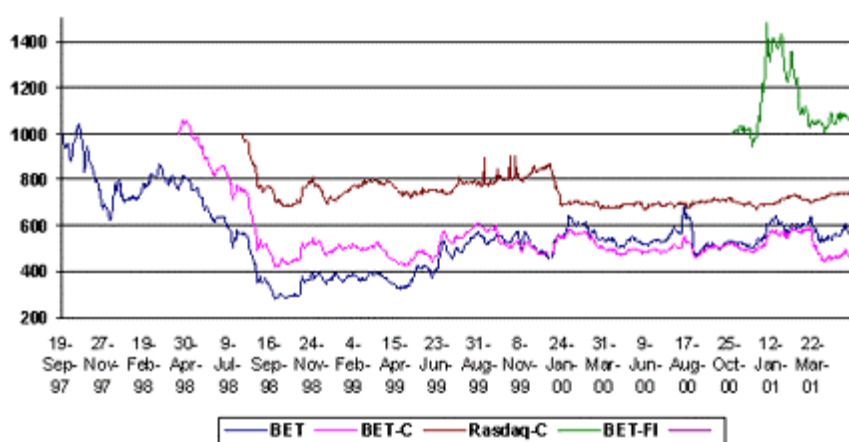
Table A2: Bucharest Stock Exchange performance indicators

Indicator	1995	1996	1997	1998	1999	2000
Market capitalization (USD mn., end of period)	100.4	60.8	632.4	357.1	316.8	363.2
Total turnover (USD mn.)	0.9	5.3	251.9	193.7	67.9	86.2
Liquidity	0.96%	8.68%	41.18%	54.15%	39.45%	23.85%
Turnover ratio		6.19%				
Market P/E ratio			72.51%	36.94%	20.17%	25.48%
P/BV			10.7	8.22	8.82	3.98
Dividend yield				0.38	0.62	0.41
				10,66%	7.84%	7.48%

Source: www.bvb.ro

The valuation of shares on The Bucharest Stock Exchange seems low compared with other markets, at least by some measures. The price/book value ratio is less than 0.5, while in Poland shares are traded at 1.5 – 1.6 their book value, in Hungary at 2.2, or in Greece at 2.8. The price earnings ratio of 4 in 2000 is by far the lowest in the region (it is 10.9 in Poland, 10.2 in Hungary, 10 in Turkey and 14.3 in Greece) and the dividend yield of 7.5% on the BSE stands well against 2.8% in Greece. At the same time, both market capitalization and liquidity are lower on the BSE than on the neighboring markets. What more is, the dominant market trend has been decline in the last few years, as market indices reveal. Launched at 1000, the BET index is currently around 550; in dollar terms, the fall is even more severe – current BET/USD is 143 points.

Romanian Share Indices through Time



Trading has been the most important contribution to the total volume of transactions. In 1999 and 2000 Eight primary offerings and private placements were carried out through the BSE. In spite of the

diversification that was taking place over the years in the transactions carried through the BSE, the exchange remains predominantly a trading place, not a capital-raising instrument (Table 7). The BSE also plays a role in the privatisation process since the State Ownership Fund, the privatisation authority, sometimes uses the stock exchange for placing some of the residual blocks of shares it holds. At the end of 2000, 9% of the shares of BANCA ROMÂNĂ PENTRU DEZVOLTARE-Groupe Societe Generale, was offered on a secondary public offer. As a result, BANCA ROMÂNĂ PENTRU DEZVOLTARE (BRD) was listed on the BSE, increasing the market capitalization from USD 400 to almost USD 800mn.

Table A3: Structure of transactions on the Bucharest Stock Exchange

Year	Total value (USD)	of which, %			
		Normal trading	Primary public offerings	Secondary public offerings	Private placements
2000	83,774,384	68.2	0.0	6.6	25.1
1999	92,261,593	81.1	12.2	6.7	
1998	208,041,460	90.1		9.9	
1997	271,464,565	98.8	0.1	1.1	
1996	4,919,559	100.0			
1995	1,210,811	100.0			

Source: BSE

Analysts⁹² distinguish three phases in the evolution of the stock exchange. The first, between the fall of 1995 and the spring of 1997, was characterized by slow and hesitant growth. Few companies were listed and their quality was poor. As credit was cheap, raising capital on the stock exchange was not an attractive alternative for the companies.

The second stage was the most spectacular and full of promise, but it lasted only two trimesters in 1997. The radical economic reform program announced in February by the new government issued after the election and the strong support manifested by the international financial institutions were sufficient reason for foreign institutional investors to buy shares that looked undervalued and with huge growth potential. Both turnover and market capitalization skyrocketed.

In October, the backlash on the market was already evident, inaugurating the third stage in the evolution of the BSE. Disappointment over the pace of reform and the outbreak of crisis in southeast Asia and Russia rendered investors much more nervous about the Romanian market; most of them quit, driving down prices and the volume of transactions. In spite of the growth recorded in 2000, the stock exchange did not completely recover. Proposals were made in 2000 to reduce the number of trading days in an attempt to cut costs for both brokers and the BSE itself.

The year 2000 was when the first takeover battle was engaged on the BSE. The majority shareholder Samsung Deutschland and Lindsell Enterprises fund fought over OTELINOX Targoviste, driving up its market share price more than 80% up in two months.

⁹² Florin Pogonaru, Camil Apostol, *Romanian Capital Markets: a Decade of Transition*, in *Economic Transition in Romania*, Proceedings of the Conference "Romania 2000. 10 Years of Transition", World Bank / The Romanian Center for Economic Policies.

A big step forward was made in 2000 with the two bond issues that took place on the exchange. One, made by INTERNATIONAL LEASING, enjoyed a full success while the other, made by local wine producer BACHUS Buzau, was eventually annulled as the minimum of 60% of the total amount hadn't been subscribed. INTERNATIONAL LEASING's request that the bonds issued be listed was denied, so in the end there were no bond listings on the BSE.

THE COMPANIES LISTED ON THE BSE

There are 115 companies currently (April 2001) listed on the Bucharest Stock Exchange. One of them (BTR -- the Turkish-Romanian Bank) has been suspended from trade since November 2000⁹³, so BSE statistics actually include only 114 companies, 23 on the first tier (blue chips) and 91 on the second tier.

The average market capitalization is USD 7.5mn per company, but the market is very concentrated: the largest 10 companies account for 80% of the market capitalization, while the last ten make up only 0.2% of the market cap – due mainly to the Romanian Bank for Development which accounts for half of the capitalization⁹⁴. Turnover is also unevenly distributed – the most heavily traded 10 companies account for 72% of the turnover in the market.

With one exception (the automobile producer DACIA), the ten largest companies on the BSE also achieve a much better performance (Table 8) than the market average, which is 70% for debt/equity ratio, 8.5% for the return on equity (ROE) and 2.6% for the return on assets (ROA).

The aluminum smelter ALRO, two pharmaceutical companies (TERAPIA and SICOMED) and the automobile producer DACIA are the only non-financial companies listed in the top ten.

Table A4: BSE largest ten companies' performance

Company	Market cap, USD	PER	ROE %	ROA %	Debt/Equity %
Banca Romana De Dezvoltare (Brd)	394,252,751	3.9	26.7	3.6	0.0
Alro (Alr)	114,482,197	2.0	77.7	49.3	31.6
Automobile Dacia (Dac)	52,857,911	-1.7	-237.8	-29.1	62.0
Banca Turco-Romana (Btr)	29,002,558	*	*	*	*
Terapia (Ter)	20,134,063	3.7	26.6	21.9	5.5
Banca Transilvania (Tlv)	16,935,316	2.1	58.2	9.9	0.0
Sicomed	15,716,184	3.4	18.3	15.4	5.4
Sif Trasilvania (Sif 3)	15,653,244	1.9	6.9	6.8	0.1
Sif Banat-Crisana(Sif 1)	14,097,475	0.9	15.1	14.4	0.0
Sif Muntenia (Sif 4)	13,914,715	2.7	5.7	5.4	0.0
Average	68,704,641				

Source: BSE

The equipment (42 companies) and consumer goods (26 companies) industries are the best represented on the stock exchange; in terms of market capitalization, the materials and financial sectors have the heaviest presence (Table 8). It is evident that the structure of the companies listed on the stock exchange do not mirror the structure of the economy as a whole, especially in terms of market capitalization. It is also interesting to note that there are wide variations in the "quality" of the companies listed – the price/earnings ratio ranges from 2 (companies in the chemicals sector) to 8.67

⁹³ In May 2001 the trade of BTR shares was resumed, but on the unlisted category of the stock exchange.

⁹⁴ In the last few weeks, the price of BRD shares dropped to half the initial value. As a result, market capitalization was drastically reduced and some of the calculations based on earlier data should be revised accordingly.

(service companies). The chemicals companies are, however, very indebted – their debt-to-equity ratio is 110%, while the pharmaceutical companies’ debt represents only 7% of their equity. The energy sector has a unique performance – a negative debt/equity ratio, due to the fact that four companies in the sector have a negative equity (RAFO Onesti in the first place)!

Table A5: Sectoral structure of the companies listed on the Bucharest Stock Exchange

Sector / no. of companies	Market capitalization	Biggest	Smallest	Average	PER	Debt/Equity %
	USD					
Pharmaceuticals / 3	37,927,372	15,716,184	5,156,297	12,624,457	5,45	7
Energy / 5	15,291,498	11,167,679	384,653	3,058,299	5,95	-22
Materials / 10	121,143,392	114,482,197	77,160	12,114,339	6,88	35
Equipment / 42	40,355,793	6,191,415	14,412	960,376	3,65	45
Consumer goods / 26	76,477,037	52,957,811	86,609	2,941,424	3,51	42
Services / 7	10,541,241	2,746,724	85,971	1,505,891	8,67	26
Financial / 9	105,892,926	394,252,751	1,984,677	11,765,880	2,77	*
Chemicals / 11	27,933,389	8,860,761	142,847	2,539,399	2,00	110

Source: BSE. Sectors defined according to BSE classification.

The financial sector is clearly dominant on the stock exchange. Two banks and the five Financial Investment Companies (SIFs) are among the largest and most traded companies on the stock exchange. While the BRD (the ROMANIAN BANK FOR DEVELOPMENT) has a free float of only approximately 10% (shares acquired by the employees and the 2.5% placed on the public offer), BANCA TRANSILVANIA and the SIFs are also among the most liquid securities – they have a free float close to 100%. Because of special provisions in their statutes which limit the number of shares held by a single investor to 5% of total shares in the case of BANCA TRANSILVANIA and to 0.1% in case of the SIFs, these companies have a dispersed ownership that favors high liquidity.

In fact, the five SIFs are some of the most notable actors on the Bucharest Stock Exchange, both as significant shareholders in many of the companies listed and as companies listed themselves – some of the largest, most liquid and attractive placements. Since November 1999, when the five SIFs were listed on the first tier of the BSE, the capitalization and liquidity of the market improved substantially; almost half of the number of shares traded on the BSE in 2000 were SIF shares, contributing 22% to the market turnover.

The FINANCIAL INVESTMENT COMPANIES are the result of the Romanian mass privatisation program, which provided for a free distribution of 30% of the share capital in state-owned companies to all adult citizens⁹⁵. At the end of 2000, each of the five SIFs had over 9 million shareholders. At the same time, each SIF has assets including listed and non-listed companies, as well as financial placements (bank deposits etc.) (Table 10 and Appendix 2).

⁹⁵ For details, see chapter 1.3.2. below.

Table A6: The Financial Investment Companies' holdings

Indicator	SIF 1	SIF 2	SIF 3	SIF 4	SIF 5
Market capitalization, ROL bn.	373	247	415	369	342
Assets, book value, (ROL bn. 31.12.2000), of which	2,184	3,308	3,233	2,664	2,927
- – shares	2,469	2,950	2,833	2,237	2,505

Source: BSE and annual reports.

The market capitalization for the SIFs varies between USD 9.3mn. for SIF 2 and 15.6mn. for SIF 3. With a large discrepancy between their net asset values and market capitalization, SIF's shares make a very interesting speculative placement, in spite of their relatively high risk.

One of the distinguishing features of the SIFs is that they regularly pay dividends. Indeed, many of the companies listed on the Stock Exchange do not distribute dividends and sometimes, although a decision to distribute dividends is taken, companies do not pay or defer payment for months or years. According to information available in mid-April 2001 (April is the month when General Shareholders Meetings take place to approve the previous year's financial results), approximately one-third of the companies listed on the BSE will distribute dividends. The others will reinvest profits or have to cover previous years' losses. A number of companies systematically capitalizing dividends by issuing new shares, a solution that has merits for the company (which does not risk a reduction in liquidity) and for shareholders (for fiscal reasons). One company (OLTCHIM) has proposed that shareholders distribute newly issued bonds in exchange for dividends due since 1994!

Non-payment of dividends is one of the most frequent complains of investors. Apart from cases of abuse (to be dealt with in chapter 1.4.4.), companies are frequently victims of the Romanian accounting system, which creates illusory profits.

In any case, low level of dividends and payment problems both contribute to making investment in BSE securities unattractive. Analysts⁹⁶ have calculated that, with just a few exceptions, the return on investments in BSE listed securities is inferior to the return on a bank deposit. This is a telling observation on the actual state of the capital market in Romania.

⁹⁶ Carol Popa, *Doar o treime din societatile listate la bursa platesc dividende (Only one-third of the companies listed on the BSE pay dividends)*, published in the weekly Capital, no. 16, April 19, 2001.(in Romania)

The Registry, Depository and Compensation System

The depository and compensation system is regulated by Law 52/1994 on the securities and stock exchanges. The Law establishes that:

- All operations auxiliary to the securities trading – registry, depository and compensation – have to be carried out exclusively by legal entities authorized and working under the supervision of the Securities Commission.
- These legal entities dedicated to servicing the securities transactions should be organized as joint-stock companies having as shareholders only banks, stock exchanges, brokerage houses, insurance companies, or other legal entities authorized by the Securities Commission.
- The depository and compensation companies should adopt a management structure granting them operational and administrative independence from the interests of their shareholders.
- The depository and compensation companies operate through compensating and depository agents – stock exchanges, brokerage houses, banks etc. - authorized by the Securities Commission.

The National Securities Commission has issued detailed regulations concerning the organization and functioning of the registry, depository and compensation companies.

THE “RASDAQ” OVER-THE-COUNTER TRANSACTION SYSTEM

ORGANIZATION AND FUNCTIONING

By 1996, the Romanian Mass Privatisation Program (MPP) had created a huge number of shareholders in all state-owned companies. Millions of these shareholders were locked into many obscure companies. Selling stock was difficult and inefficient, as only local, non-transparent and fragmented markets were available. The issue had a political dimension too: the risk of falling prices, cheating and fraud because of imperfect markets for MPP-resulted securities was undermining one of the main objectives of the privatisation which is fair and equitable distribution to all citizens. The need for an operational market capable to support large-scale transactions was obvious and urgent.

The technical specifications for building such a market were, however, daunting. About 16 million Romanian citizens (the entire adult population) had received privatisation vouchers, many of them exchanged against shares in some of the 4,000 companies included in the MPP. All shares were issued in a dematerialized form. That Romania succeeded in rapidly putting in place an over-the-counter transaction system called RASDAQ (the Romanian Association of Securities Dealers Automated Quotation) is to a great extent due to the substantial financial and technical support received by the National Association of Securities Dealers (NASD) from the United States Agency for International Development (USAID),.

The NASD, a professional organization of brokerage houses created in January 1995 by 25 founding members, established the institutional framework (rules and regulations) needed to support RASDAQ trading, drawing on the fair trading and customer protection practices of the US market and on the NASDAQ organizational model. In September 1996, the National Securities Commission granted the NASD a Self-Regulated Organization statute, i.e. it delegated the responsibility for regulating the market and monitoring compliance by the brokerage houses with its Rules of Fair Practice.

In order to operate the electronic trading system based on a customized version of the PORTAL software platform used by the American NASDAQ, the NASD has set up a fully owned subsidiary organized as a limited liability partnership – the RASDAQ SRL.

The PORTAL technology, which accommodates trading in around 6,000 companies, allows for a de-localized market consisting of a network of computer terminals. By using their personal computers as trading terminals with direct access, the dealers enter bids and offer quotations for securities. Once entered into the system, they are available in real time to all other users. Trades can be subsequently negotiated by telephone or through the system. Interested investors may follow the evolution of the market by using the “view only” facility of the system. The system also enables the NASD Monitoring and Surveillance Department to supervise trading activities on the RASDAQ and to intervene with a “message” function every time there is a reason to believe that the Rules of Fair Practice have been violated. Important violations are reported to the NASD Disciplinary Committee for investigation and sanctioning, if necessary.

Apart from the NASD and the RASDAQ SRL, other organizations contribute to the functioning of the OTC market: the National Company for Securities Clearing, Settlement and Depository (NCSCSD) and the independent registries⁹⁷ and custodian banks.

The NCSCSD provides the brokers and banks with services related to securities transactions like trade recording, trade settlement and custody. Functioning in a dematerialized environment, the NCSCSD imports trades at the end of each trading day, validates and processes them for settlement on a settlement cycle of T+3. Registered as a “clearing house” with the National Bank of Romania, the NCSCSD processes all money movements for transactions through an account at the National Bank, providing efficiency and protection in settlement operations.

Set up in August 1996, the NCSCSD is organized as a joint-stock company owned by more than 160 Romanian financial organizations such as banks, brokerage houses, the Bucharest Stock Exchange and the NASD. The NCSCSD was granted Self-Regulatory Organization status by the National Securities Commission. It has a 5-member Board of Administrators, while day-to-day operations are ensured by an Executive Manager and a staff of 18 employees.

The RASDAQ-listed companies hold their shareholder registry with one of the eleven authorized registry service providers. Most of them still use the services of the Romanian Shareholder Registry, a joint venture set up in 1996 by eight Romanian banks, which was initially the sole beneficiary of the listings of shareholders in all the Romanian companies privatised through the MPP. The shareholders’ registries usually offer on-line access so that trades may be checked and settled through the electronic system of the exchange.

As a general rule, securities that are actively traded on the market are registered with the NCSCSD, due to a faster processing of the orders. However, at the client’s request, securities can be registered with another registry.

RASDAQ provides three products:

- the regular securities market – on which stocks and bonds can be traded;
- the Public Offerings market, which can accommodate any kind of public offering;
- the electronic auction market – a trading system specifically designed for selling the residual shares held by the State Ownership Fund in line with the provisions of the privatisation legislation.

⁹⁷ Further details on the organisation of the OTC market may be found on the RASDAQ web site www.rasd.ro

The RASDAQ trading system is quote driven, enabling brokers to input and negotiate orders on their computer screen. Trading is limited to the members of NASD, which are supposed to have a minimum share capital level, different for brokers, dealers and market makers. At the same time, brokers as individuals have to be licensed and must be employed by a NASD member.

The revenues of the RASDAQ are derived mainly from transaction fees. Currently, the buyer pays a fee of 0.07% on the transaction value, while the seller pays 0.15%. For each terminal connected to the RASDAQ system, brokerage houses pay a USD 50 monthly subscription. RASDAQ ended the 2000 financial year with losses. In order to correct the situation, the NASD planned to increase fees starting in May 2001⁹⁸.

Companies do not pay listing or other fees. A company may decide to list its shares on the RASDAQ OTC market without any prior conditions or requirements to be fulfilled. There are no disclosure requirements. Most companies have been actually listed on the RASDAQ because of a legal provision imposing listing to all companies included in the mass privatisation program. Therefore the RASDAQ was perceived as the “exchange of the MPP”.

As the RASDAQ is based on loose regulation, there are not many sanctions provided. The National Securities Commission or the NASD may decide to temporarily suspend transactions in a particular security in order to protect investors and to maintain the confidence of the public in the market. But usually suspensions occur only when companies transfer their share register from one independent registry to another.

The RASDAQ Composite is the official market index, launched in July 1998. It is a market capitalization index, monitoring all stocks listed.

As opposed to the BSE, on the RASDAQ there are no prevention rules for failed trades. No limits are imposed on the number of shares brokerage houses can buy and no instrument is in place to check whether the shares offered for sale are effectively available. Failed trades are therefore more frequent.

Fraudulent transactions are, however, a much more serious problem of the RASDAQ market. Many cases of theft of shares have been reported, where brokers took advantage of the weaknesses in the security systems of the independent registries and operated trades on behalf of unsuspecting shareholders. The securities commission has asked the registries to improve protection by assigning an extra individual code/password to each investor who has shares deposited with a registry.

Some brokers took advantage of an ambiguity in the regulation: trades with settlement periods longer than the usual T+3 became disguised lending operations among market participants (repo contracts), which, if unregulated, distort prices and competition in the market. Several brokerage houses were confronted with serious financial problems and some were suspended in the last part of 2000, when the Securities Commission explicitly banned such operations⁹⁹.

Because of the growing number of problems the RASDAQ was confronted with, the National Securities Commission decided to temporarily recall NASD’s statute of Self-Regulated Organization. A sense of “crisis” prevails¹⁰⁰ and NASD members seem incapable of agreeing on solutions. Eight restructuring proposals were presented in NASD’s General Meeting in April 2001, but no decision

⁹⁸ Carol POPA, *ANSVM a majorat taxele pe piata RASDAQ*, in Capital, no.17/2001

⁹⁹ See George Vulcanescu, *CNVM a stopat tranzactiile la termen pe piata extrabursiera (The NSC has stopped the terms transactions on the OTC market)*, Piata Financiara no. 11/2000

¹⁰⁰ RASDAQ is “short of time, ideas and money” as a journalist depicts the situation – see Laurentiu Ispir, *Piata RASDAQ isi cauta perlele ingropate (The RASDAQ market is looking for its buried pearls)*, in Ziarul Financiar of April 3, 2001

was taken¹⁰¹. Merging the Bucharest Stock Exchange and the RASDAQ market is one of the most radical reform ideas, but no investigation was made to evaluate the technical compatibility of the two systems, the costs and the implications. Most brokers however seem to prefer an alternative solution – to split the market into several tiers, where the best companies would be admitted to listing on the first tier, with strict trading rules, disclosure and other investor protection requirements.

TRADING AND PERFORMANCE

There are currently (April 2001) 5427 companies listed on the RASDAQ OTC market. Almost half of them are not actively traded and around 1500 companies have never been traded since they were listed for the first time. Even among companies that are recorded by statistics as having been traded in a particular year, many are traded only occasionally. Under these circumstances, statistics regarding the market capitalization for the RASDAQ as a whole should be treated cautiously. However, it should be

Table A7: **RASDAQ trade statistics**

Year	Number of trades	Number of shares traded	Trade value ROL bn.	Trade value (USD)	No. of companies traded	No. of active brokerage houses
1996	3.072	7.009.584	4	969.454	224	n/a
1997	447.099	796.387.743	2.830	386.099.048	2.427	127
1998	542.026	1.400.620.770	3.790	419.296.270	3.337	197
1999	272.276	2.133.810.745	3.620	242.225.310	3.267	184
2000	122.462	943.196.609	2.360	116.597.930	2.978	150
Total	1.386.935	5.281.025.451	12.604	1.165.188.011		

Source: *Piata RASDAQ 1996-2000*, on www.kmarket.ro

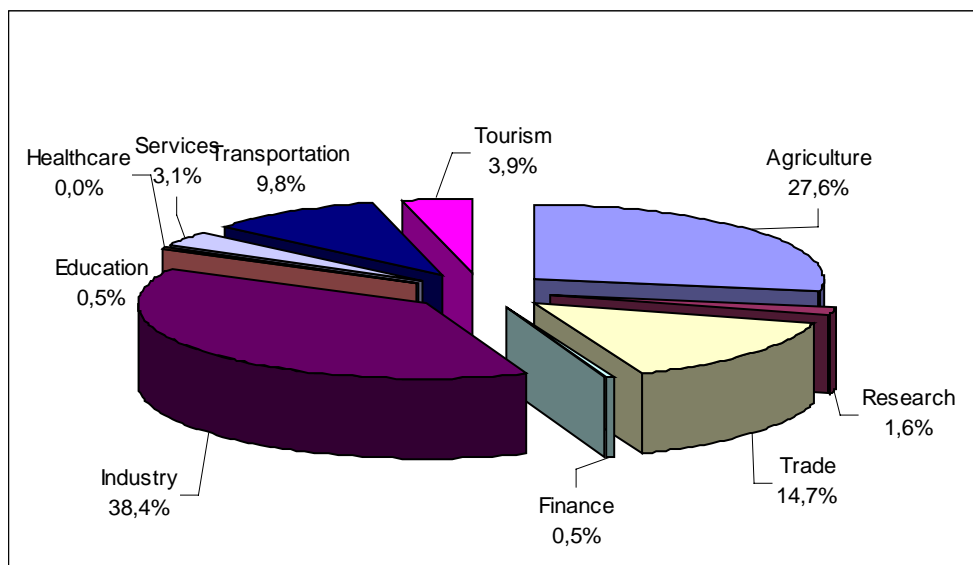
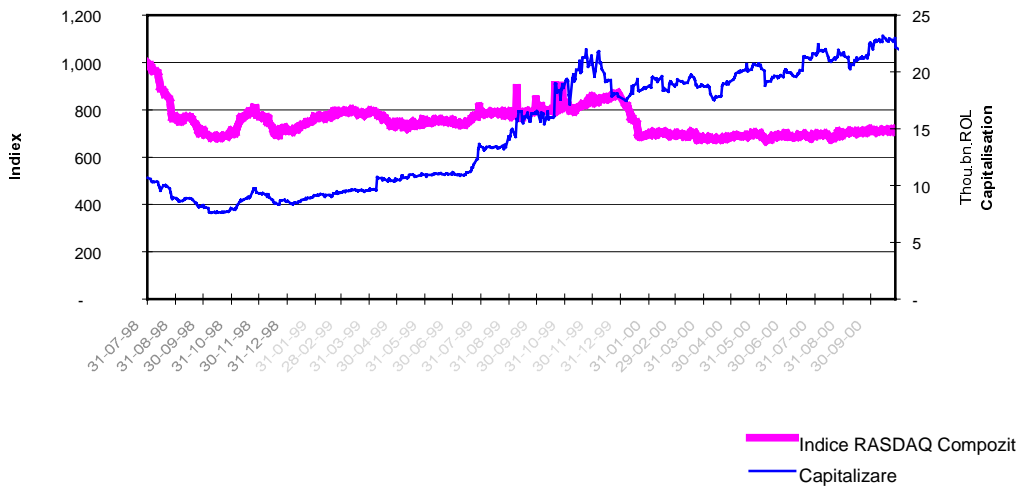
noted that the market capitalization for the RASDAQ was, in general, higher than the market capitalization of the Bucharest Stock Exchange. Currently, the RASDAQ market capitalization stands at around USD 900mn., down from a maximum of over USD 2bn. reached in July 1997. Historically, the RASDAQ's evolution has been similar to that of the Bucharest Stock Exchange, with a peak in 1997 followed by a prolonged decline.

¹⁰¹ Laurentiu Gheorghe, *Reformarea RASDAQ este doar în faza de intenție (The RASDAQ reform is only at the intention stage)*, in Capital no. 16/2001

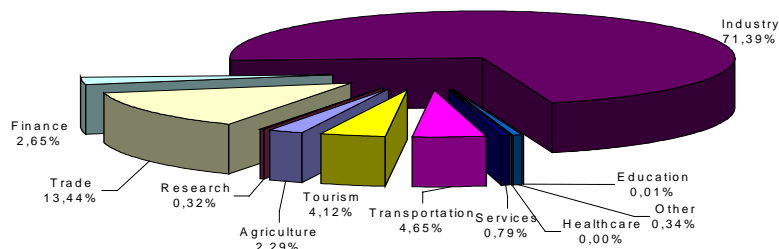
Because the RASDAQ was essentially a trading platform for the companies included in the mass privatisation program, the number of companies listed did not significantly change, while the sectoral structure of the companies listed on RASDAQ closely mirrors the structure of the economy in general (see chart). However, trades are concentrated in industry, which makes up over 70% of the total volume *of* trades since the beginning of the OTC market.

The RASDAQ is considered to be the instrument of choice for investors aiming to take control over target companies. Buying and selling public offers contribute 30-40% to the total volume of trades. Another 10% (USD 11mn.) was achieved in 2000 in sales of the residual shares held by the privatisation authority through the dedicated auction procedures.

Value And Market Capitalization of The RASDAQ through Time, and Breakdown of Listed Companies and Trades by Sector.



**Distribution by sector of the trades concluded on RASDAQ
since inception**
Total ROL: 12,6 thou.bn.
Total USD: 1,16 bn.



Like the BSE, the RASDAQ is equipped for trading not only shares but also fixed income instruments. In 2000, Certificates of Deposit of one bank (BANCA ROMÂNĂ DE SCONT) were traded for the first time and listing of corporate bonds is envisaged for another company (International Leasing). But it is hard to believe diversification is the solution to the slump of the OTC market.

THE COMPANIES LISTED ON RASDAQ

The large number of companies and their huge diversity in terms of size, quality and, most importantly, frequency of trades makes it very difficult to compile statistics on the RASDAQ as a whole. Instead, we will focus on the Top 100 companies by market capitalization, which represent almost half the volume of the OTC market (Appendix 3).

The RASDAQ does not have a sectoral classification of its own. We have used the sectors defined by the Bucharest Stock Exchange for a breakdown of the top 100 list. According to this criterion, the RASDAQ is dominated by the service companies. There are 35 companies from trade, tourism, restaurants, agriculture and geological research. Thirty-four companies are involved in production of materials, from stone, gravel and marble to pulp and paper, synthetic materials and steel. There are 12 equipment producers, 9 consumer goods producers and 4 energy-related companies. Three insurance companies and a mutual fund represent the financial sector. The chemical and pharmaceutical sectors are represented by one company each.

The largest company on the RASDAQ, SIDEX Galati (steel), has a market capitalization of over USD 32 mil. The ten largest companies on the RASDAQ represent approximately 13% of the total market capitalization. In spite of their similar size, the ten largest companies are very different from a point of view of performance (table 12).

Table A8: RASDAQ largest ten companies' performance

Company	Market cap, USD	PER	ROE %	ROA %	Debt/Equity %
Combinatul Siderurgic Sidex Galati (Coer)	32,377,989	10.6	1.0	0.2	308
Asigurarea Romaneasca					
Asirom (Asra)	19,351,760	24.5	0.8	0.8	4
Romcim Bucuresti (Romb)	17,633,073	-2.12	-5.7	-3.8	48
Neptun Olimp (Neol)	16,077,226	-9.75	-17.7	-12.4	41
Romcif Fieni (Romc)	15,744,677	-20.0	-7.4	-2.4	180
Brau Union Romania (Buro)	15,373,614	*	*	*	*
Santierul Naval Damen Galati (Asti)	15,043,989	1.6	59.1	22.5	153
Carom Onesti (Carz)	12,944,631	-2.49	-63.3	-18.9	-435
Socep Constanta (Socp)	10,146,601	4.33	23.9	20.2	16
Petrotel Lukoil Sa (Pely)	9,903,020	3.23	8.5	4.4	94
Average	16,459,658				

Source: Calculations based on RASDAQ information.

Based on the year 2000 first semester financial data, performance indicators of the ten largest companies on the RASDAQ give a good example of the very mixed nature of the OTC market. More than 30% of the companies traded on RASDAQ are suffering losses – their performance indicators are sometimes impressive in a negative sense. Some of the companies listed are not only having losses, but do also carry huge debts in their balance sheets. Many are technically bankrupt, having debt several times higher than their equity.

The vast majority of the companies listed on the RASDAQ market are sporadically traded. Only around 15 companies are traded regularly, that is, more than half of the time. Some of the largest and most attractive companies have a free float of less than 10% of the shares. In fact, some analysts identified a correlation between the size of a company and the free float – large companies have a smaller free float¹⁰². While for companies with an average share capital of USD 200,000 the free float is over 30%, for companies with a share capital of more than USD 1mn. the free float is typically less than 10%.

RASDAQ is an ideal place for speculative operations. Every week and month a new star is born, an obscure company that for a short period of time is intensely traded, with price increases that make some sellers gain two or three times what they invested a few weeks before. Usually, such an event is driven by a takeover attempt. The rallies on certain companies increase the volatility of the market and, because of the unexpected character of the operation¹⁰³, give RASDAQ investments an air of gambling. The limited information available to investors, the opacity on some operations (like the off-market trades that take place directly between buyer and seller) and fraud cases have also made their contribution to undermining the RASDAQ's credibility.

CONCLUSIONS: WHAT KIND OF REFORM FOR THE CAPITAL MARKET?

The dragging slump in the Romanian capital markets has prompted a lot of criticism and many proposals for solutions to revitalize the BSE and the RASDAQ. At the beginning of April 2001,

¹⁰² Madalina Mocanu, *Societatile cu capital social redus au si multe actiuni ramase neconcentrate (Companies with small share capital have more free shares)*, in Bursa no. 55/2001

¹⁰³ In the sense that it cannot be anticipated by changes in the "fundamentals" of a company.

authorities initiated a systematic analysis of the situation the objective of which was to identify solutions for reviving the market. Prime Minister Adrian NASTASE stated: “After the FNI scandal¹⁰⁴, the confidence in the capital market and in RASDAQ, has declined very much. It is our duty to find solutions. It is clear that without a legislative decision trust cannot be restored.”¹⁰⁵ In the context of the expected negotiations with the World Bank for a new PSAL (Private Sector Adjustment Loan) agreement, improving the legal and regulatory environment for the capital markets is given special emphasis. Mrs. Gabriela ANGHELACHE, vice-president of the Securities Commission, mentioned that new, unitary legislation, in line with the EU directives, was to be prepared before October 31¹⁰⁶. A liberal party legislative initiative was submitted to the Senate in March 2001, which proposed a complete overhaul of Law 52/1994 on securities and stock exchanges¹⁰⁷.

This is the first time since the inception of the capital market that it has received so much attention from the authorities and that reform projects are seriously considered. However, from what has been revealed until now, no definite conclusion can be drawn on the direction and chances of success of the initiative. In fact, it seems that a global perspective is missing, with different constituencies having different views and priorities. Authorities focus on improving the legislative framework. Brokers active in the market have insisted for years that the listing of better quality companies could improve the attractiveness of the Romanian exchanges. Those who nostalgically recall the 1997 upsurge maintain that only an infusion of foreign capital can revive the markets, while others rightly point out that no stock exchange can properly function without domestic capital¹⁰⁸.

Each of these positions is based on factual observation and therefore hardly disputable. Like any other market, the capital market is made up of three elements: supply, demand and the transaction mechanism. The dimension, evolution and effectiveness of the capital market is determined not only by the characteristics and dynamics of each individual component but, to a significant degree, by the proper equilibrium among these components. An effective reform should be based on an accurate diagnostic, which identifies the “laggard” among the three components of the market and specifies measures addressed to bringing the failing element in line with the others. If misdirected, reform efforts result in only marginal improvements, or even worse, in a waste of resources.

A. The current focus of the Romanian authorities on improving the legislative framework of the capital market is based on the (implicit) assumption that the imperfections in the **transaction system** are the main cause of the markets’ decline. The quality of the transaction system is important because it determines **transaction costs**. Better transaction systems induce lower transaction costs, allowing the markets to function more efficiently. It is important to point out that “transaction costs” are not limited to direct costs (like the fees associated with a trade on the exchange) but include indirect costs like the expense required to obtain information in order to make an investment decision, the cost required to monitor an investment, the cost incurred when losses happen etc.

There are many arguments which, in my opinion, demonstrate that the legislative framework and the transaction system in general cannot be held responsible as the main source for the current poor condition of the capital markets. The Romanian transaction system (including the legislative

¹⁰⁴ The collapse of the largest investment fund in April 2000 – see chapter 1.2.2.

¹⁰⁵ Ziarul Financiar,

¹⁰⁶ I.Z. *Programul Bancii Mondiale PSAL-2 prevede termene pentru restructurarea pietei românești de capital (The World Bank PSAL-2 sets deadlines for the restructuring of the Romanian capital market)*, in Bursa no.77/2001

¹⁰⁷ The project (in Romanian) is posted on www.kmarket.ro

¹⁰⁸ Under the signature of its director, the “Bursa” started on April 25 to publish daily a “Program for stimulating the Romanian capital market” built around the idea that domestic capital is the critical factor needed to turn around the exchange. However, the solution envisaged for attracting domestic capital, i.e. a non-regulated market based on bearer shares, is not credible in our opinion.

framework) compares well with other emerging markets and, under certain technical aspects, is in line with some of the most advanced systems. It is exactly the same transaction system that was in place during the 1997 boom of the markets – and at that time nobody complained about its adequacy.

This is not to say that the institutional infrastructure of the capital market cannot or should not be reformed. On the contrary, amendments are needed. But the best legislation and the most efficient institutions cannot supplant the strong demand and the expansive supply that make buoyant capital markets.

- B. The **demand for capital** is clearly the weakest component of the Romanian capital market and it is surprising to see how most analysts ignore such an easily observable fact. Listing more, or even better quality, companies on the stock exchange cannot solve the problem¹⁰⁹. The Romanian economy was confronted with a long and severe recession – between 1997 and 2000, industrial production fell by more than 20%. During recessions, companies tend to focus on restructuring measures and this reduces their investments and demand for capital. An economic recession prompts a worldwide fall in the capital market and there is no reason to expect the Romanian capital market could have done better than the economy in general.

During recessions, the financial performance of companies deteriorates, making investment in corporate securities less attractive than alternative placements. Because the state budget was permanently running a deficit financed mainly through the domestic market, it pushed up interest rates on the money market to levels the stock exchange could not match. Therefore, in the last few years the treasury bills, and even the bank deposits, systematically had offered better returns than average corporate securities¹¹⁰. No wonder that many investors deserted the stock exchange in favor of the less risky and better remunerated placements.

- C. The **offer of capital** was, in general, simply adjusting to the conditions in the economy – reduced demand of capital from the corporate sector and the eviction effect of the budget deficit¹¹¹. Except for a distortion induced by the taxation system in 2000 (when a 10% withholding tax was applied on the stock exchange trades at the transaction value, not at the capital gain), no major institutional obstacles hindered the offer of capital. The scandal related to the collapse of the FNI investment fund in 2000 was the most important event that significantly influenced the offer of capital. Investors' confidence hit record low levels and the capital market experienced a new setback, only partially offset by the mild economic recovery.

In conclusion, the best policy for reviving the BSE and the RASDAQ is to promote economic growth and stabilization. In parallel, a careful and well-targeted capital market institutional reform may contribute to a better business environment. Several measures appear as being the most urgent:

- Strengthening the monitoring and enforcement capacity of the market regulators (The National Securities Commission¹¹² and the Self-Regulated Organizations);

¹⁰⁹ Listing of some companies (the five SIFs in 1999, the Romanian Bank for Development in 2000) stirred hopes that the BSE would attract more capital, but they were short-lived.

¹¹⁰ The Activity Report for year 2000 presented by the National Securities Commission to the Parliament correctly insists on the distorting effect the high interest rates have on the capital market.

¹¹¹ “Lack of capital” is one of the recurrent laments and excuses for the slump in the capital markets. Because of their low revenues, the justification goes, Romanians cannot save and invest sufficiently, so the offer of capital is weak. However, the population has almost USD 3bn. of bank deposits and the huge success of some investment funds demonstrate that Romanians can mobilise savings.

¹¹² The National Securities Commission should be a priority, starting with basics like appropriate premises and staffing.

- Improved and more rigorous standards for brokers should prompt consolidation in a very fragmented profession – the Romanian market cannot sustain the 120-150 brokerage houses¹¹³ that are now struggling for survival¹¹⁴.
- Standards for listing companies on the BSE should be more consistently applied. The sanctions for infringement of the regulations by the companies listed have to be diversified and reinforced.
- Better defined and enforced disclosure requirements, improved accounting and auditing standards and wider and better specified minority protection provisions are among the measures the most awaited for by the participants in the market.
- A decision has to be taken on the future of the RASDAQ trading system and reforms need to be rapidly implemented. The OTC market is an essential part of the Romanian capital market, and under one form or another, it should continue to exist and improve its functionality. The alternative reform solutions advanced until now should be critically examined in order to select one which is viable, not only technically, but also financially.

The existing reform initiatives already address the main problems and gaps in the capital market regulatory framework and the public debate of these initiatives should contribute to further improvements.

¹¹³ The Polish market, ten times bigger than the Romanian one, has around 40 brokerage houses.

¹¹⁴ Stere Farmache, the General Manager of the Bucharest Stock Exchange, was suggesting in an interview that many of the small brokerage houses could become “retail brokers” which do not trade on the BSE but collect orders from small clients.

APPENDIX 1 Companies listed on the Bucharest Stock Exchange

Ranked by market capitalization

March 2001

Symb ol	Company Name	Total number of shares	Share capital ROL mn	Market Capitalizatio n USD	Sector
BRD	Banca Romana De Dezvoltare	348.450.670	1.742.253	394.252.751	Financial
ALR*	Alro Slatina	158.458.182	792.290	114.482.197	Materials
DAC	Automobile Dacia Pitesti	1.919.755.874	685.139	52.857.911	Consumer goods
BTR	Banca Turco-Romana Bucuresti	345.600.000	345.600	29.002.558	Financial
TER*	Terapia Cluj Napoca	306.613.680	306.614	20.134.063	Pharmaceuticals
TLV*	Banca Transilvania Cluj Napoca	173.696.726	173.697	16.935.316	Financial
SCD	Sicomed Bucuresti	138.987.050	138.987	15.716.184	Pharmaceuticals
SIF3	S.I.F. Transilvania Brasov	546.071.666	546.072	15.653.244	Financial
SIF1	S.I.F. Banat-Crisana Arad	548.849.268	548.849	14.097.475	Financial
SIF4	S.I.F. Muntenia Bucuresti	628.485.262	628.485	13.914.715	Financial
SIF5	S.I.F. Oltenia Craiova	580.165.714	580.166	12.910.564	Financial
INX	Otelinox Targoviste	6.100.246	152.506	12.654.680	Materials
ASP*	Rafinaria Astra Romana Ploiesti	219.650.344	132.470	11.167.679	Energy
SIF2	S.I.F. Moldova Bacau	519.089.588	519.090	9.319.452	Financial
OLT*	Oltchim Rm. Valcea	323.588.641	323.589	8.860.761	Chemicals
AZO*	Azomures Tg. Mures	230.458.309	230.458	7.588.357	Chemicals
ARC*	Arctic Gaiesti	228.744.000	228.744	7.160.922	Consumer goods
ELJ*	Electroaparataj Bucuresti	131.427.536	131.428	6.191.415	Equipment
ATB*	Antibiotice Iasi	68.836.310	68.836	5.156.297	Pharmaceuticals
PCL	Policolor Bucuresti	48.925.250	53.742	4.611.481	Chemicals

SNT	Aker Tulcea	4.776.809	119.420	4.157.047	Equipment
NVR	C. N. F. R. Navrom Galati	6.891.551	172.289	3.076.803	Equipment
COS	Cos Targoviste	38.234.558	946.764	2.958.214	Materials
OIL	Oil Terminal Constanta	152.759.924	152.760	2.875.088	Energy
TBM	Turbomecanica Bucuresti	1.980.634	49.516	2.838.762	Equipment
ASV	Astra Vagoane Arad	93.446.703	93.447	2.816.125	Equipment
TRS	Turism Transilvania Cluj Napoca	1.387.122	34.678	2.746.724	Services
IMS	Imsat Bucuresti	35.247.654	35.248	2.652.249	Services
EXC	Excelent Bucuresti	93.857.625	93.858	2.587.784	Consumer goods
RLS	Rolast Pitesti	80.458.243	80.458	2.433.806	Chemicals
AMO	Amonil Slobozia	223.445.352	86.313	2.358.820	Chemicals
BRM	Bermas Suceava	9.492.656	66.448	1.970.998	Consumer goods
ASA	Agras Bucuresti	22.256.000	22.256	1.984.677	Financial
SNO	Santierul Naval Orsova	4.328.630	108.215	1.895.083	Equipments
CMP	Compa Sibiu	74.494.229	74.494	1.756.078	Equipments
IMP	Impact Bucuresti	22.684.207	22.684	1.625.617	Equipments
AMP	Amp American Packaging Tecuci	36.056.042	48.240	1.625.126	Equipments
MPF	Mopaf Vrancea Focsani	21.832.675	22.648	1.450.132	Consumer goods
INT	International Sinaia	11.958.999	11.959	1.398.291	Services
PEI	Petrolexportimport Bucuresti	254.650	38.197	1.349.694	Services
SRT	Siretul Pascani	24.735.853	61.839	1.255.779	Consumer goods
RBR	Rulmentul Brasov	149.664.550	149.665	1.145.925	Equipment
SNC	Santierul Naval Constanta	6.899.522	205.214	1.118.996	Equipment
EPT	Electroputere Craiova	122.978.031	122.978	1.103.940	Equipment
PPL	Prodplast Bucuresti	685.668	17.141	1.034.463	Chemicals
MPR	Mopariv Ramnicu Valcea	23.593.071	23.593	1.096.561	Consumer goods
ARS	Aerostar Bacau	3.403.000	18.679	1.028.174	Equipment

SLC	Silcotub Zalau	4.993.311	12.833	942.276	Materials
PTS	Petrolsub Suplacu De Barcau	19.070.162	19.070	870.882	Energy
GRX	Grimex Targu Jiu	994.465	24.862	862.022	Equipment
ALM	Alimentara Cluj Napoca	56.964.325	56.969	883.442	Services
CIP	Ciprom Ploiesti	46.983.582	46.984	852.378	Equipment
APC	Vae Apcarom Buzau	73.796.185	73.796	852.266	Equipment
ARM	Armatura Cluj Napoca	15.235.039	15.235	832.057	Equipment
UCM	U.C.M. Resita	6.047.949	151.199	823.037	Equipment
MEF	Mefin Sinaia	2.176.319	54.408	820.850	Equipment
ZIM	Zimtub Zimnicea	1.812.578	45.314	820.914	Materials
FAU	Faur Bucuresti	8.691.018	217.275	1.129.743	Equipment
RAF	Rafo Onesti	8.304.100	207.602	754.090	Energy
CRB	Carbid-Fox Tarnaveni	23.544.050	23.544	722.848	Chemicals
DOR	Dorobantul Ploiesti	10.277.394	30.832	700.458	Consumer goods
FTN	Fortuna Bucuresti	1.491.790	37.295	620.897	Equipment
BRC	Berceni Bucuresti	14.186.693	14.187	596.084	Consumer goods
CPR	Chimopar Bucuresti	1.278.550	31.964	579.053	Chemicals
MPN	Mopan Mures	19.374.300	19.374	577.290	Consumer goods
EPN	Ema Piatra Neamt	7.117.950	7.118	562.714	Consumer goods
SOB	Sofert Bacau	87.561.866	87.562	567.392	Chemicals
VAC	Prodvinalco Cluj Napoca	9.066.650	9.067	547.503	Consumer goods
STZ	Sinteza Oradea	44.075.060	44.075	531.966	Chemicals
NVL	Navol Oltenita	52.325.452	52.325	514.274	Equipment
AUR	Aurora Targu-Frumos Iasi	182.996	4.575	513.430	Consumer goods
APS	Apsa Baia Mare	10.314.425		493.683	Equipment
ELN	Allied Deals Elcond Zalau	31.389.650	31.390	485.413	Equipment
CBC	Carbochim Cluj Napoca	1.371.632	34.291	466.281	Materials
ETN	Electrotehnica Bucuresti	510.808	12.770	462.688	Equipment

VES	Ves Sighisoara	19.518.005	19.518	419.615	Consumer goods
CPL	Carmetaplast Deva	497.938	12.448	446.357	Materials
FOR	Foraj Sonde Craiova	16.528.850	16.529	384.653	Energy
UAM	Uamt Oradea	22.567.125	101.552	378.772	Equipment
RCR	Rocar Bucuresti	32.275.280	32.275	372.178	Equipment
STR	Stratusmob Blaj	30.221.408	30.221	342.724	Consumer goods
TMR	Tomiris Iasi	1.033.201	25.830	331.454	Consumer goods
AER	Aeroteh Bucuresti	748.976	18.678	325.076	Equipment
MCN	Mecanica Ceahlau Piatra Neamt	884.943	22.123	317.507	Equipment
FRL	Frial Constanta	483.016	12.075	318.207	Services
ART	Artrom Slatina	5.654.474	141.927	303.538	Equipment
NCL	Nicolina Iasi	2.662.263	66.557	290.184	Equipment
HTR	Hitrom Vaslui	1.206.093	30.152	282.415	Equipment
ABR	Abrom Barlad	2.515.164	62.879	272.452	Materials
VAP	Cramele Prahova	10.303.150	15.389	233.314	Consumer goods
CAS	Casirom Turda	27.532.236	27.532	229.496	Materials
MOL	Moldomobila Iasi	25.138.150	25.138	247.730	Consumer goods
UTN	Uton Onesti	802.480	20.062	218.411	Equipment
UZC	Uzuc Ploiesti	1.226.261	30.656	208.264	Equipment
PTR	Petros Ploiesti	927.303	19.070	192.794	Equipment
AMC	Amco Otopeni	310.586	7.764	194.926	Equipment
UZT	Uztel Ploiesti	1.170.800	29.270	176.751	Equipment
MDS	Moldosin Vaslui	2.224.885	55.622	142.847	Chemicals
ALF	Mobila Alfa Oradea	15.295.725	15.296	138.211	Consumer goods
CMF	Comelf Bistrita	2.094.285	7.567	138.100	Equipment
ALB	Albapam Alba Iulia	10.070.600	10.070	114.830	Consumer goods
ROB	Robinete Industriale Bacau	812.197	20.305	113.418	Equipment
FEL	Feleacul Cluj Napoca	6.180.525	6.180	108.059	Consumer goods

ENP	Comp. Energopetrol Campina	436.931	10.923	107.188	Equipment
CRN	Carne Arad	1.235.635	30.891	100.606	Consumer goods
AMY	Amylon Sibiu	3.763.500	3.763	88.205	Consumer goods
SDT	Sidertrans Calarasi	6.074.371	6.074	85.971	Services
NTX	Netex Bistrita	8.638.400	8.638	81.454	Consumer goods
ELC	Electroceramica Turda	339.181	8.479	77.160	Materials
IRS	M. P. Iris Barlad	5.250.125	5.250	73.651	Consumer goods
ASM	Asam Iasi	683.903	17.097	71.307	Equipment
CRT	Ciorapi Timisoara	4.725.115	4.725	86.609	Consumer goods
ECT	Electrocontact Botosani	258.010	8.479	14.412	Equipment
	Total	9.571.187.663	13.560.936	854.423.759	

APPENDIX 2 MAIN ECONOMIC INDICATORS FOR THE FIVE SIFS

Financial Investment Companies (SIF)

billion ROL

INDICATOR		1997	1998	1999	2000
Share capital, end of period,	SIF1	482	482	549	549
	SIF2	522	522	519	519
	SIF3	550	546	546	546
	SIF4	520	565	628	696
	SIF5	563	563	580	580
Total assets, end of period,	SIF1	2,038	2,302	2,596	2,184
	SIF2	2,768	3,035	3,083	3,308
	SIF3	2,443	2,555	2,947	3,233
	SIF4	1,957	1,854	2,216	2,664
	SIF5	1,769	2,145	2,400	2,927
Shareholders' equity end of period,	SIF1	1,956	2,194	2,485	2,782
	SIF2	2,703	2,914	2,992	3,123
	SIF3	2,236	2,431	2,805	3,054
	SIF4	1,797	1,688	2,046	2,420
	SIF5	1,696	2,045	2,298	2,752
Net assets, end of period,	SIF1		1,652	1,536	2,019
	SIF2		1,087	804	1,020
	SIF3		1,263	1,770	2,513
	SIF4		1,252	1,925	2,415
	SIF5		980	1,426	1,990
Net assets per share, end of period, ROL	SIF1		3,428	2,800	3,679
	SIF2		2,083	1,550	1,965
	SIF3		2,312	3,241	4,602

	SIF4		2,217	3,409	3,842
	SIF5		1,740	2,458	3,430
Revenues, total	SIF1	97	144	198	476
	SIF2	64	134	127	248
	SIF3	135	173	258	314
	SIF4	159	193	232	354
	SIF5	95	201	252	339
Expenses, total	SIF1	9	25	67	226
	SIF2	18	30	46	84
	SIF3	42	60	108	131
	SIF4	23	61	85	114
	SIF5	33	53	120	142
Profit before tax	SIF1	88	120	131	250
	SIF2	46	104	81	164
	SIF3	93	112	150	183
	SIF4	136	131	148	240
	SIF5	96	148	132	197
Dividends, total	SIF1	55	58	71	132
	SIF2	38	66	57	113
	SIF3	61	78	87	109
	SIF4	81	94	112	161
	SIF5	63	63	64	122

Source: Annual reports

APPENDIX 3 THE TOP 100 COMPANIES LISTED ON THE RASDAQ

by market capitalization

Symbol	Company Name	No. of shares	Share capital ROL	Market cap USD	Sector
COER	Combinatul Siderurgic Sidex	252.319.761	6.307.994.025.000	32.377.989	Metals (steel)
ASRA	Asigurarea Romaneasca Asirom	29.177.900	29.177.900.000	19.351.760	Insurance
ROMB	Romcim Bucuresti	15.583.522	389.588.050.000	17.633.073	Construction materials (cement)
NEOL	Neptun-Olimp	8.357.951	208.948.775.000	16.077.226	Tourism (hotels and restaurants)
ROMC	Romcif Fieni	126.496.550	126.496.550.000	15.744.677	Construction materials (cement)
BURO	Brau Union Romania Sa	43.799.921	1.094.998.025.000	15.373.614	Brewery
ASTI	Santierul Naval Damen Galati	6.122.672	153.066.800.000	15.043.989	Shipyard
CARZ	Carom Onesti	8.552.841	213.821.025.000	12.944.631	Chemicals (Synthetic rubber)
SOCP	Socep Constanta	114.475.248	114.475.248.000	10.146.601	Handlings
PELY	Petrotel-Lukoil S.A.	43.759.796	1.093.994.900.000	9.903.020	Refinery
STRV	Pcc Sterom Sa	5.710.167	142.754.175.000	8.286.349	Drilling and oil well exploration equipment
BACR	Banca Carpatica Sa Sibiu	1.000.000	100.000.000.000	8.341.277	Bank
PTRM	Petromidia	36.268.400	906.710.000.000	7.523.713	Refinery
MLCM	Moldocim	15.357.686	383.942.150.000	7.240.639	Construction materials (cement)

MINE	Minerva Bucuresti	2.931.717	73.292.925.000	6.592.890	Food, beverage and tobacco wholesale trade
ALPO	Alprom Slatina	6.817.649	170.441.225.000	6.042.875	Aluminum processing
IMEP	Ana-Imep Pitesti	79.847.078	79.847.078.000	6.023.240	Production of electric motors, generators and transformers
RLMP	Timken-Romania	10.181.061	254.526.525.000	5.952.040	Bearings
CSIA	Casial Deva	128.224.798	128.224.798.000	5.803.559	Construction materials (cement)
AMRO	Ambro	7.646.140	191.153.500.000	5.767.842	Pulp and paper
HEBI	Hermes Bistrita	309.537	7.738.425.000	5.310.510	Retail trade with textiles
COIB	Comtex Arad	293.605	7.340.125.000	5.207.810	Wholesale trade with textiles
VICQ	Victoria Prahova	7.174.978	179.374.450.000	4.465.249	Tyres
REGA	Romaqua Group Borsec	72.557.104	264.787.405.000	4.378.658	Mineral water production
BUTU	Bucuresti Turism	2.207.751	55.193.775.000	4.291.729	Tourism (hotels and restaurants)
METE	Metex Galati	2.967.639	74.190.975.000	4.199.706	Retail trade with garments
DUCL	Ductil	77.000.000	77.000.000.000	4.065.930	Metallurgical products
ICEZ	Icme Electroizolante	65.665.912	65.665.912.000	3.962.790	Electrical wires
TUFE	Turism Felix Baile Felix	2.785.747	69.643.675.000	3.782.555	Tourism (hotels and restaurants)
COLH	Comcereal Galati	197.507.556	197.507.556.000	3.724.730	Services for the agriculture mechanization, fertilization and phytosanitary protection

CITU	Cimentul Turda	2.111.621	52.790.525.000	3.584.013	Construction materials (cement)
ATRA	Astra Bucuresti	2.016.000	50.400.000.000	3.579.928	Insurance
ICMB	Icme Ecab Bucuresti	151.580.126	151.580.126.000	3.487.492	Electrical wires
FREX	Forex Suceava	27.899.778	27.899.778.000	3.509.406	Wood processing
MARN	Marmosim	42.197.255	42.197.255.000	3.342.294	Marble processing
GECM	Generalcom Bucuresti	14.919.050	14.919.050.000	3.098.979	Retail trade
ELMA	Electromagnetica	19.994.127	45.986.492.100	3.016.502	Production of radio-television transmitters, telephones and telegraphs
SANE	Sanex	140.119.718	280.239.436.000	3.052.951	Sanitary items
SOMR	Sometra Copsa Mica	15.909.435	397.735.875.000	2.403.419	Lead, zinc and tin production
AMBU	Amco Buftea	63.089.097	63.089.097.000	2.397.913	Light metals packaging materials
NAPP	Napolact	9.699.011	9.699.011.000	2.304.672	Cheese and milk production
BARU	Bad Rulmenti Brasov	27.315.573	27.315.573.000	2.164.957	Wholesale trade with equipment for industry
ROFU	Romarc Fuel	93.675.225	93.675.225.000	2.124.637	Trade with various products
HIOT	Hidrotehnica Galati	2.805.336	70.133.400.000	2.203.410	Hydrotechnical constructions
MAIA	Mamaia Constanta	4.545.733	113.643.325.000	2.057.436	Tourism (hotels and restaurants)
ROMT	Romportmet	33.859.850	33.859.850.000	2.044.677	Handlings
CMVX	Comvex	3.337.683	83.442.075.000	2.014.217	Warehousing
SCDM	S.C.D.M.A.I.Unirea Bucuresti	2.082.921	13.606.816.600	2.004.623	Retail trade

MOEX	Mobitex Bucuresti	378.585	9.464.625.000	2.000.374	Retail trade with furniture and other household items
UZIN	Uzinexport	14.693.750	14.693.750.000	1.995.153	Retail trade with equipment for industry, trade and navigation
SOCA	Socalp	2.088.139	2.088.139.000	2.154.142	Restaurants
GRIA	Grupul Iatsa	4.339.887	108.497.175.000	1.964.268	Maintenance and repairs of vehicles
PACY	Palace Sinaia	19.952.470	19.952.470.000	2.011.338	Tourism agency
ARMD	Armedica	67.011.403	67.011.403.000	1.950.510	Pharmaceuticals
FORD	Foradex	2.051.359	51.283.975.000	2.104.735	Activities of geological research, exploitation, prospecting and cartography
ATPA	Athenee Palace	8.474.025	60.792.655.350	1.917.706	Tourisms (hotels and restaurants)
ERCA	Hercules Baile Herculane	56.120.064	56.120.064.000	1.906.252	Tourism agency
SIDG	Siderurgica	24.924.723	623.118.075.000	1.890.026	Metals (steel)
SIVN	Silvania Zalau	3.006.330	75.158.250.000	1.870.948	Tyres
CNMP	Cnm Petromin	22.487.571	562.189.275.000	1.938.964	Sea transports
BRCR	Braiconf	7.469.250	7.469.250.000	1.845.268	Garments
TRUX	Tractorul-Utb	392.335.249	392.612.857.000	1.786.387	Tractors production
ONZV	Ont Carpati	1.166.259	29.156.475.000	1.759.528	Tourism agency
TITA	Titan	15.484.175	15.484.175.000	1.757.635	Bakery products

COCR	Cocor	301.691	30.169.100.000	1.706.848	Retail trade with food, beverage and tobacco mainly
XFOA	Fondul Oamenilor De Afaceri	6.450.744	175.079.642.904	1.703.135	Mutual Fund
CMCR	Comcereal Slobozia	29.845.594	29.845.594.000	1.717.831	Services for the agriculture mechanization, fertilization and phytosanitary protection
BBGA	Bbg Alum	5.783.311	344.581.236.002	1.638.146	Metallurgy (alumina)
AGAL	Agromec Albesti	725.400	725.400.000	1.562.505	Services for the agriculture mecanization, fertilization and phytosanitary protection
OPTX	Optimex	20.908.226	20.908.226.000	1.499.307	Retail trade
PTRO	Petrotub Roman	14.554.139	363.853.475.000	1.482.147	Steel and cast iron production
STIB	Stirom Bucuresti	6.837.203	170.930.075.000	1.477.614	Glass manufacturing
GRND	Grandemar	7.621.649	7.621.649.000	1.438.264	Construction (extraction of stone)
DANA	Danubiana Bucuresti	6.652.354	166.308.850.000	1.380.886	Tyres
INOR	Intfor	1.354.842	33.871.050.000	1.382.805	Metals
VAOX	Varotex	405.525	10.138.125.000	1.376.579	Garments
AMIC	Amic	352.332	8.808.300.000	1.375.414	Extraction of stone and gravel
SROY	Combinatul Siderurgic Resita	12.153.289	303.832.225.000	1.385.780	Metallurgy (steel)
IPRU	Iproeb Bistrita	36.234.500	109.790.535.000	1.366.669	Electrical wires and cables
BUCU	Bucur Obor	13.375.750	13.375.750.000	1.654.656	Trade with various products

ROAT	Romarta Bucuresti	15.591.472	15.591.472.000	1.421.452	Trade with various products
CHOB	Chimcomplex Borzesti	7.155.984	178.899.600.000	1.359.936	Chemicals (Inorganic products)
TPRO	Tepro - Iasi	5.361.928	134.048.200.000	1.351.292	Manufacturing of steel tubes and pipes
FBRX	FibreXnylon	7.733.172	40.212.494.400	1.312.536	Synthetic fibres manufacturing
STNM	Santierul Naval 2 Mai Magnolia	8.465.949	211.648.725.000	1.310.914	Shipyard
ERCN	Euroconstruct	68.223.728	68.223.728.000	1.426.201	Construction materials (concrete)
SCPH	Scpi Hameroc	1.355.570	33.889.250.000	1.278.213	Extraction of stone and gravel
MEBY	Luceafarul (Meta-Tex Combac)	271.273	6.781.825.000	1.317.612	Retail trade with textiles
ARCC	Ardealul Carei	12.496.825	12.496.825.000	1.231.915	Refined oils and grease manufacturing
MEVE	Meva	1.613.153	40.328.825.000	1.216.877	Production and repair of materials for railways
SMOB	Samobil	26.737.500	26.737.500.000	1.210.161	Furniture production
AROA	Aro	10.562.666	264.066.650.000	1.195.187	Automotive
SEOM	Semrom Muntenia	7.727.199	193.179.975.000	1.201.195	Wholesale trade with cereals, seeds and forage
FILD	Filatura De Bumbac Gura Humorului	1.126.781	28.169.525.000	1.192.631	Cotton fibres manufacturing
RLAL	Koyo Romania (Rulmenti Alexandria)	6.148.424	153.710.600.000	1.159.511	Bearings
SNBB	Santierul Naval	2.279.280	56.982.000.000	1.117.589	Shipyard

	Braila				
ZADR	Zahar Arad	9.844.281	138.863.427.786	1.156.609	Sugar production
IAME	Iame	910.658	68.299.350.000	1.132.967	Electrical components for engines
TRMP	Trivale M.Pitesti	145.670	3.641.750.000	1.129.575	Retail trade with textiles
TOMI	Tomiris Constanta	1.072.400	26.810.000.000	1.092.098	Miscellaneous retail trade in non-specialized shops
	Total	3.028.621.927	20.321.622.450.142	403.768.487	

APPENDIX 4 Main Legislation Relevant to Corporate Governance

Core Legislation		
<ul style="list-style-type: none"> • Law 31/1990, The Company Law. Last amended in 1997 		The basic piece of corporate legislation, setting the rules for the creation, organization, functioning and dissolution of commercial organizations and the key rules and procedures for corporate governance.
<ul style="list-style-type: none"> • Law 26/1990, on the Trade Register. Last amended in 1998. 		Complements Law 31/1990, setting grounds for the national system of companies' registration, through which basic information on companies is made available to the public.
<ul style="list-style-type: none"> • Law 52/1994, The Securities and Stock Exchanges Law. 		Establishes the rules for the organization and functioning of the National Securities Commission, for brokerage houses, the stock exchanges and stock exchange operations, sets standards for investors' protection and guidelines for the organization of the compensation and depository systems.
<ul style="list-style-type: none"> • Law 15/1990 on the re-organization of economic units as regies autonomes or commercial companies. 		The debut of the enterprise reform. Establishes special rules for corporate governance in state-owned entities
<ul style="list-style-type: none"> • Ordinance 49/1999 concerning the management of companies in which the state or local administration has a majority position. (replaces Law 66/1993 on the management contract). 		Special provisions regarding corporate governance in state-owned companies.
Subsidiary Regulations of the National Securities Commission		
Regulation no.7/2000 on the organization of the National Securities Commission.		
Regulation no.5./000 concerning the clearing of securities' trades on the organized markets.		
Regulation no.2/1999 on the organization of the unlisted securities market.		
Regulation no.13/1999 on the electronic auctions on the RASDAQ market.		
Regulation no. 11/1999 on trading fixed income instruments on the RASDAQ market.		
Regulation no. 6/1998 concerning the organization and functioning of the self-regulatory organizations for regulated securities markets.		

Regulation no. 3/1998 concerning the licensing and operations of the securities brokerage houses.	
Regulation no.9/1997 concerning the requirements, registering criteria and licensing procedures for independent registrar companies.	
Regulation no. 1/1996 concerning the statute of the general commissioner of the Stock Exchange.	
Regulation no.2/1996 concerning the periodic and continuous information that securities issuers have to observe.	
Regulation no. 15/1996 concerning private placement.	
Regulation no. 16/1996 concerning the public offer for acquisition of securities.	
Regulation no. 2/1995 concerning the activity of the independent external auditors.	
Regulation no. 4/1995 concerning the activity of the securities placement consultants.	
Regulation no. 5/1995 on the code of ethics and conduct of the members and staff of the National Securities Commission.	
Regulation no. 6/1995 concerning the public offer for sale of securities.	
Special Legislation	
<ul style="list-style-type: none"> • Law 58/1998 on banking (update of the initial Law 33/1991) 	Stipulates special conditions for the organization and functioning of banks, including corporate governance related provisions.
<ul style="list-style-type: none"> • Law no. 32/2000 on insurance and reinsurance (update of Law 47/1991) 	Stipulates special conditions for the organization and functioning of the insurance companies.
<ul style="list-style-type: none"> • Ordinance 24/1993 on the creation and functioning of the open investment funds and of the investment companies as financial intermediaries. 	Organization, functioning and supervision of investment funds.
<ul style="list-style-type: none"> • Law no. 64/1995 on the liquidation and bankruptcy procedures. 	Special rules concerning corporate governance during liquidation and bankruptcy procedures.
<ul style="list-style-type: none"> • Law no. 133/1996 on the transformation of the Private Ownership Funds into Financial Investment Companies. 	The birth certificate of the SIFs.
<ul style="list-style-type: none"> • Ordinance 20/1998 concerning the venture 	Another group of players on the capital market.

capital funds.	
<ul style="list-style-type: none"> • Law no.36/1991 on agricultural companies and other forms of associations in agriculture. 	Particular rules for the organization and operations of agricultural entities.
Reform-related Legislation	
<ul style="list-style-type: none"> • Law 58/1991 on the privatisation of commercial companies 	The original legislation establishing the framework of the privatisation process.
<ul style="list-style-type: none"> • Law 77/1994 on the creation of employees and managers associations in companies targeted for privatisation. 	The MEBO law, which has a significant impact on the ownership structure of listed companies.
<ul style="list-style-type: none"> • Law 55/1995 on the acceleration of the privatisation process. 	The law that sets in motion the mass privatisation program; a long term effect on the ownership structure.
<ul style="list-style-type: none"> • Emergency Ordinance no.88/1997 	Latest major reshuffle of the privatisation legislation.
<ul style="list-style-type: none"> • Law 18/1991 on land restitution. 	Dismantling of the cooperative farms system and restitution of land to private owners.
<ul style="list-style-type: none"> • Law no.82/1991 on accounting; Ordinance no. 50/1997 concerning the activity of the expert and licensed accountants. 	Sets the framework for accounting and financial reporting and standards for the accounting profession.
<ul style="list-style-type: none"> • Ordinance no. 75/1999 on auditing. 	Auditing becomes compulsory for public companies.
<ul style="list-style-type: none"> • Law no. 13/1991, on the collective labor contracts; Law no. 15/1991 on collective labor disputes resolution. 	Some of the basic rights of employees.
<ul style="list-style-type: none"> • Emergency Ordinance no. 230/2000 concerning the universal pension funds. 	An important potential influence on the capital market in the future.