

The Role of Investment Funds in Romania

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The main aim of this article is to present the influence of investment funds on the economic growth in Romania between 2007 and 2010. Unfortunately some of the main findings of the paper are: insignificant share of investment funds in GDP, low correlation between inflation rate and the net subscriptions of equity funds, low correlation between benchmark interest rate and bond funds. Instead we validated the direct relationship between monetary funds and the benchmark interest rate. Also, the importance of national investment funds does reflect in: the share of net assets of financial investment companies in the market capitalization, in the share of equity traded at the BSE in the UCITS portfolios, and in the strong growth of net assets in recent years.

Key words: capital market, financial markets, monetary funds, financial system, net assets, banking system, bonds, portfolio assets, benchmark interest rate

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I. Introduction

Contemporary financial markets are now in constant transformation, integration and interdependence. Their importance in the globalization process is significant in a situation where financial conditions in one

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region spread almost instantaneously over the others. In this context the size of international financial markets has increased considerably, along with the growing importance of institutional investors (insurance companies, pension funds, mutual funds, investment trusts) and the decline of individual investors. From this, mutual fund segment is the most dynamic. Their importance derives from the fact that are intermediaries that invest most in the financial market and the fact that their dominant presence in general is making "any aspect of investment performance measurement to the market makers and analysts to be affected by their existence "(Rutterford & Davison, 2007, p. 356).

Investment funds have a very important role on global financial market. First at micro economic level, from the investors' perspective, they behave in terms of importance the following elements:

Investment funds are a significant source for businesses that need capital (Stoica, 2008, p. 70), by transferring financial resources from those who have surplus funds;

Investment funds give investors the opportunity to diversify the portfolio on national and global financial markets (Reilly & Norton, 2006, p. 83), according to investment objectives, increasing the risks dispersion and thus lower volatility;

Investment funds are offering a new line of products for investors (ex. supermarkets and life-stage funds).

The set of benefits conferred by investment funds at the microeconomic level will also affect the macroeconomic level, as follows:

- A developed intermediaries sector positively influences the stock markets by increasing market liquidity and emergence of new effective financial instruments (Stoica, 2002, p. 105);
- Their role can be viewed through the development of other sectors of the financial market, given that both insurance

companies, pension funds and banking groups find in investment funds an attractive investment tool.

Protection of people's savings against inflation (MSCIBarra, 2008). The shares and other variable income securities increase their value once the development of the general price index, being among one of the few profitable ways of investing in conditions of rising inflation.

The influence given by international and global funds in the balance of payments, in order to increase the deficit while the capital outflows are higher than the inflows and vice versa.

Investment funds also offer jobs to people, so a development of this industry implicitly leads to a reduction in unemployment state.

Basically the investment funds, through specialization, financial potency and access to certain databases, have the ability to harness and interpret in a superior way the information. So, they are transforming them into profitable investment process for both investors and issuers, having a positive role on national, international and global financial markets by stimulating the levels of investment.

II. The importance of Romanian investment funds

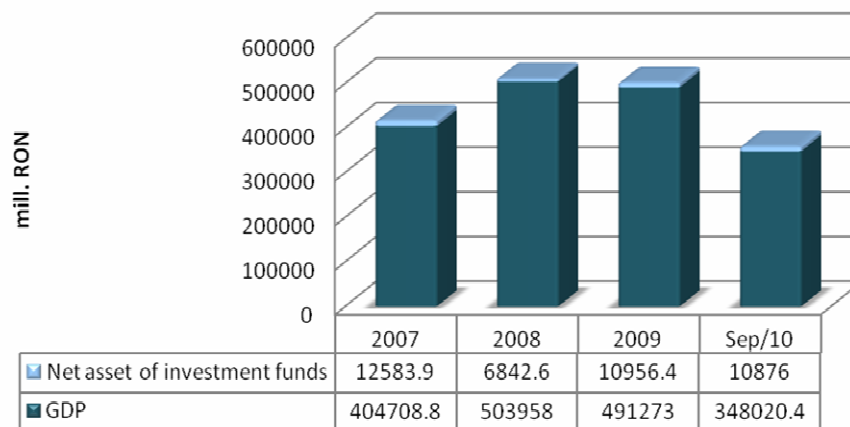
In Romania the section of investment funds stands in a incipient stage of development, a small amount of money being used by the few investors for such investments. This situation has been striving to improve since 2009. This trend of improvement continued also in 2010, due to accelerated growth of the investment's share in monetary funds and bonds. In spite of this the obtained results have never reached the global level of performance.

We can illustrate the little importance of this sector in Romania also by analyzing the share of the total assets of investment funds in GDP from 2007 – September 2010 period.

Analyzing the chart we can observe that the assets of investment funds in the GDP from the analyzed time period, is very little – 3.1%; 1,4%; 2,2% and 3,13%.

Figure1

Share of net assets of investment funds to GDP in Romania-2007- september 2010



Source of data: www.insse.ro, www.aaf.ro

Analyzing the official reports of BNR on the financial stability from the specified time period we can also see that the investment funds industry has a reduced market share within Romania's financial institutions, surpassing only the pension funds of 2008. However the situation reversed since 2009, the largest market share being assigned to the credit institutions and nonbanking financial institutions, which include more than 90% of the financial sector.

Comparing the level of this indicator with that registered in Europe, we can confirm the weak representativeness of the Romanian investment funds. The indicator is being situated far behind the rest of

the European countries excepting Bulgaria. So, it is obvious that the effects of the global financial crisis on this sort of investments cannot represent an excuse for those low values, taking in the account that before 2008 and especially since 2009 the investment funds industry became very important everywhere in the world. The resurgence of this particular industry has been causing the same trend of growth for the analyzed indicator. In Romania the investing funds industry began to develop only with the crisis' arriving. The exception was the year 2008 when there was a narrow tendency of decreasing of this segment compared with the equivalent segments from Poland, Slovakia and Hungary which registered the greatest contractions in eastern and central Europe. The rising tendencies observed in Romania was due to the specific advantages of the short term investments. But this rate of growth is insufficient if we take a look to the growth rates of other countries.

Also a GDP growth till 2008 including, has determined a growth of the net assets, but the penalty component is missing in case of economic recession. That makes impossible the transfers of Romanian capital to a foreign expending market. That is because the funds' assets are almost entirely swallowed by the local market.

Anyway, beginning with 2009, GDP has started to fall (in the background of financial crisis and due to the degradation of economic condition) and the investment funds industry has started to grow (precisely the monetary funds and the ones from the other category). That is why, the ratio between GDP and net asset it remains somewhat constant.

Taking into account that the banking institutions are very important to Romanian economy, and as a result of the modifications suffered by the law system in 2004 (which stipulate their direct execution on the capital market) the number of the banking groups that own investment fund has raised significantly. So, some of the management companies of the investment funds are owned by the banks. In

Romania there are twenty such companies. Eight of them were created by certain banking institutions, but fourteen of them are distributing their funds through the banks. They chose this alternative because of “the banks’ wide networks and highly qualified personal” (Moroşan, 2009, p. 260.). Another major advantage is the inexistence of the distribution cost which reduces the administration fees. About the market share of the management companies, in 2009, the first five of them held about 90% of the net assets’ total value and they belong to the banking institutions as following (Annual Reports of CNVM, 2009): Erste Asset Management – 43,08%, Reiffeisen Asset Management – 30,24%, BRD Asset Management – 8,49%, BT Asset Management – 4,86%, OTP Asset Management – 3,28%. This situation is similar with the ones existing a year before and after. This is due to the fact that these companies charge smaller fees than others. Another factor that determined this situation is the confidence of the people in the investments managed by the banks, given that the mutual funds’ market was affected by major crisis. The clearing and settlements agents accredited by CNVM are also the banks.

The competition existing between the UCITs’ net assets and the amounts of money in bank deposits demonstrate the relevance of the investment funds’ local market. During the period 2007 – 2010, we can observe that the UCITs’ assets reached the following values: 6,6%, 2,5%, 3,5% and 3,8%. These values are determined first of all by the increasing amounts of money attracted by the credit institution in the latest two years, especially of those in foreign currency, and second by the decreasing of the investment funds’ assets in 2008, followed by a rapid growth. So, considering that the share of the amounts of money invested in UCITs is very small compared to the savings invested in credit institutions – though it is increasing since 2009 – we can’t talk about a shift of the investments from the bank deposits to the funds’ market, which in Romania is based on the banking system. So, in spite of the fact that in the last two years the growth rates of investments funds’ industry is much higher than that of saving rates by the

instrumentality of credit institutions, it is not enough to match the growth rates of investments funds with other European countries.

The direct relation between the inflation rate and equity funds, that means the investment funds' function of peoples' savings protection against inflation, at a national level cannot be applied. That is because the level of net underwritings is too low, and every year is inversely correlated with the inflation rate. Not even the weak correlation between the interest rate and the bonds' funds is surprisingly, given that the beginning of funds industry phase affects these. An indirect relation takes place only since 2009 when the decreasing of the benchmark interest rate – from 10,25% to 8% in 2009 and to 6,25 in 2010 – takes place at the same time with the growth of the underwritings of bonds funds with about 140% in 2009 and about 30% in 2010. This trend continues to this day, given that BNR has maintained constant the benchmark interest rate (6,25% until December 2011). This has determined the maintaining of a low interest rate offered by the banks. This fact, put in touch, on one hand with the higher yield of the bonds funds (of maximum 14,5% in 2009 and 11,79% in 2010 according to Aviva Investors Romania, 2010) and on the other hand with the investors' increased risk aversion (who redirected their investments towards bonds funds because of the stock market crash) had led to the development of this fixed income instruments.

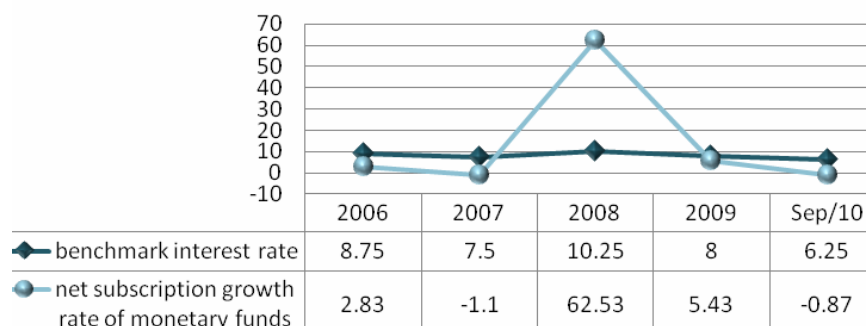
Theoretically, there would be a direct relation between the interest rate and the investments in monetary instruments. In that an increase in benchmark interest rate charged by banks would lead also to an increasing in the efficiency of monetary funds, given that the portfolios are mainly consisting of short and medium terms bank deposits and certificates of deposit. So, the monetary funds are a good saving alternative in preference to bank deposits, because they offer a higher return together with many other advantages.

Analyzing the chart situated below, we can observe the direct correlation between the benchmark interest rate and the growth rate of the monetary funds' net underwritings. Until 2007 the monetary funds were never attractive for the investors. In that period they had lower efficiency compared to the competition who offered higher interest rates (that includes the current accounts). For that reason it is unlikely for the investors to prefer them.

The situation with regard to monetary funds is reversed since 2008, when they have grown more than six times net subscriptions, and have registered an increase of 164% of net assets. This trend occurred against the backdrop of increasing the benchmark interest rate to 10.25% in that year, because they offer much higher yields than bank deposits (since the portfolios have integrated bonds and government securities) and because of the uncertainties that dominated the market. The increasing trend of subscriptions is conserved in the next two years, but to a lesser extent compared with the previous year.

Figure 2

Evolution of net subscriptions monetary fund and the benchmark interest rate in Romania: 2006-sep.2010



Source of data: www.bnro.ro, www.aaf.ro

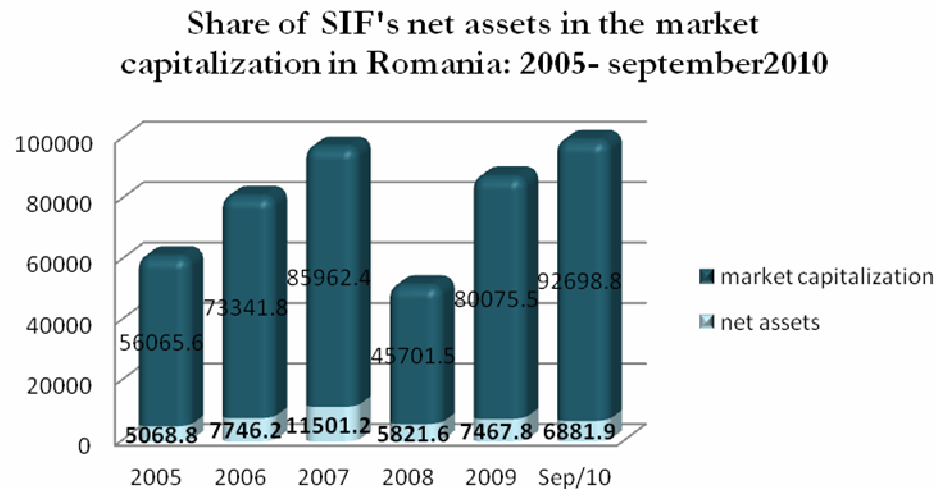
Although interest rates fell to 6,25%, the growth trend was maintained. That is because the yields are higher than those offered by bank deposits, since fund managers can negotiate with the banks higher interest rates than those offered to the public. This negotiation is possible because the funds accumulate large amounts. The growth also maintained is due to the anti-crisis measures taken by the Government where is also found relief from capital gains tax applicable to such types of funds.

Also, the largest share market of monetary funds belongs to the banks, because of the strategy adopted for the sale of these products and because of the fact that most investors are coming from existing customers of the bank (the monetary fund is then a complementary to deposit). So, the trend of growth was maintained until the present, but at a slower rate. That is due to the very high decrease of benchmark interest rate to 6,25% and hence the lower yield monetary funds, in the conditions under which they are seen as short-term and very short-term investments.

However, not only the dependence on the rate of inflation and on the benchmark interest rate have contributed to the growth of investment fund's net assets and have influenced investor's behavior. It arose as a result of capital market development and rebuilding population's confidence in the investment funds. So, particularly important is the role that investment funds have in the local stock market development, both within the market capitalization and in terms of investment policy adopted by fund managers.

The chart below shows the market share evolution of the five SIF in the national stock market. The total market capitalization weights have relatively constant between 2005-2009 (9.04% 10.56% 13.38% 12.72%, 9.33% and 7,42% respectively), but the share in total trading volume is particularly high, ranging between 30% and 85% in the analyzed period.

Figure 3



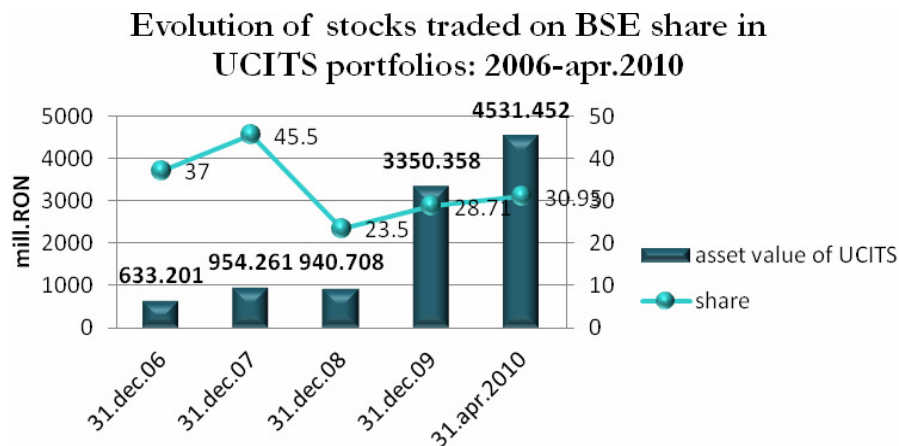
Source of data: www.bvb.ro, www.aaf.ro

Fairly large share of the SIFs and the increase of their assets by the year 2007 was mainly due to: the lack of attractive investment alternatives, the discount to market value of the asset components, price corrections that are delayed (especially when they have a increasing trend), the fact that are the most liquid shares and not least due to increased holdings of the threshold from 0.1% to 1%. Especially in 2006 and 2007 financial investment company's performance generated upward trend of Romanian stock exchange on the background of increasing volume of transactions.

In 2008, although share capitalization of the SIFs in total capitalization remained relatively constant, this is not due to their performance, but to the stock market decline, which led to lower total market capitalization by almost 47%, lower number of transactions by 13 % and hence BET-FI decreased by 84%. These reductions have led to lower prices of the shares and reduction in financial investment company portfolio performance.

The stock exchange recovery trend was retaken in 2009, but growth accelerated stock market capitalization (which is almost the amount from 2007) exceeded significantly the increase of financial investment company net assets (28.3%). That's due to high volatility prices recorded during the year. Almost the same thing happened in 2010, when SIF's net asset fell because of the portfolio component (it had less liquid shares).

Figure 4



Source of data: www.aaf.ro

Therefore, the most important sector of national stock market is represented by SIF (over 50% of the market). They play an important role in the stock exchange. Next we will analyze the role of mutual funds in the capital market by reporting the traded equity of BVB in UCITS portfolio in Romania.

From the graph we can see that fund managers have adjusted their investment policies depending on the evolution of portfolio assets. Thus, while the market value of shares traded in the composition of portfolios is high (in 2006 and 2007), providing high yields, then the high share of investments in quoted shares is high. Capital market turbulence in Romania in 2008 which caused the reducing of equity

price and consequently the yield offered by them, has reduced the share of traded equity on the BSE in the existing portfolio of assets. Stock market development since 2009 once again led to a slight increase of listed equity, a trend that manifests itself today, due to the increasing of the indices. Therefore, managers change their investment policy based on stock market developments.

Conclusions

In conclusion, while subscriptions in investment funds in Romania is still low compared to all European countries, their role in financing the real economy is not negligible - although it is found behind the banking system – observing an increase since 2009, and continuing with a lower rate of growth in 2010. Consequently, unlike other states in which the reduction of this industry has led to the decline of financial market, in Romania the risk induced by this sector on the financial system as a whole is still relatively low. That is because of the low share of owned assets by them in total assets.

Regarding the interrelationship between investment funds and investment growth, we checked the validity of assumptions made about the role of investment funds. Therefore, are not surprising the conclusions that we have reached: insignificant share of investment funds in GDP, low correlation between inflation rate and the net subscriptions of fund shares, low correlation between benchmark interest rate and bond funds. Instead we checked the direct relationship between money funds and the benchmark interest rate. The correlation between investment funds and the macroeconomic indicators is weak for the Romanian economy, on the one hand due to the reduced share of the funds in the total economy, and on the other hand because of developments atypical features a maturing market.

The importance of national investment funds does reflect in both the share of net assets of financial investment company in the market capitalization and in the share of equity traded at the BSE from

UCITS portfolios, on the one hand, and in the strong growth of net assets in recent years compared with increasing amounts placed in bank deposits.

The increasing trend of investment funds sector has started in terms of the global financial crisis. Is expecting that, after the stock market recurrence, after the economic recovery and because of the impact of implementation the European directives, their role on the Romanian financial market to grow considerably. This will eliminate major differences now compared with other European countries. In this regard the adoptions of certain measures are required by the competent authorities and by the investment management companies. These include: developing alternative distribution channels (like the Internet), attracting and launch of new financial tools, improving services related to promoting, a stable fiscal framework.

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