

PROFIT VERSUS INSOLVENCY IN ROMANIAN ECONOMY

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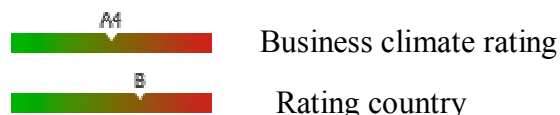
ABSTRACT: *The recession has affected a proportion of 6-7% in Romania, which confronted with the consequences of current deficit and sizable debts in foreign currency. Under these circumstances, Romanian companies faced big difficulties, therefore just a little part of them managed to reach their target - to get profit. Most of the companies are recording losses, and are in insolvency procedure.*

KEY WORDS: *profit; insolvency; rating country; corporations; crisis*

JEL CLASSIFICATION: *G01*

On global scale, the systemic regional financial crisis which represented a fear for a period of time, could be avoided. The impact was less powerful than it was predicted due to the coordinated help of more multilateral institutions, of European Union, central banks and foreign commercial banks continued to back up their local subsidiaries. In the same time, Romania had no choice but to resort to IMF programmes.

The recession affected Romania in a proportion of 6-7%, which confronted with the consequences of the current deficit and big debts in foreign currency. The high risk of crisis, the activity decline and in parallel the deterioration of payment behaviour performed by enterprises at the beginning of year 2009 have determined the reduction of the rate of sovereign risk, Romania being downgraded to B.



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The profit is the key element for the existence and the progress of companies, and of course for developing national and global economy. The profit, in its restrained meaning, is the revenue that is obtained by economic agents, as a product of fund usage, and in its wide mean the profit is the revenue obtained by economic agents as a surplus over the production costs. Total profit has two components: the normal profit and economic profit. The normal profit is the minimum revenue that a company must obtain to function. In this case, the level of total income collected is identified with opportunity costs, which means that by virtue of collections can be assured the continuous activity at the same functional parameters.

Besides these two main types of profit, normal and economic, within market economies in contemporary world there are also encountered other forms, differenced from other points of view, like the one with a special interest that is the profit achieved on markets with imperfect competition - monopoly profit or monopoly overprofit. This is achieved by companies, respectively corporations which ensured their monopoly position on the market and is produced from a large variety of situations in which they have their activity, being able to impose monopoly in the quantity of sold goods, their quality, using the new technical and scientific achievement.

Half of credit institutions in Romania ended year 2009 with a surplus, the achieved profit of these institutions exceed three times over the revenue resulted at the level of banking system. Out of 42 banks, only 22 have recorded profit, and 20 ended the fiscal year with losses. In 2009, in banking system were achieved total profits of 772.3 million lei, 5.7 times less than the peak value of 4,4 billion lei in 2008. Profitable banks cumulated in 2009 revenue of over 2 billion lei, while losses in the system were more than 1 billion lei.

The most profitable two companies in Romania have recorded decreases of incomes with up 23%, for year 2009. Orange Romania, the most profitable company in the country in 2008, was affected as well. OMW Petrom, the second most profitable company in Romania in 2008, had in 2009 decreased incomes with 23%. Despite this result, the net profit of the largest company in Romania has increased with about 33% to 1,368 billion lei. At the end of the list there are a series of companies that no only didn't record profit but are in insolvency procedure.

Out of the analysis realized on the basis of the data provided by the National Trade Register Office, results that in 2009 a total number of 18421 companies were in different stages of insolvency procedure. Out of them, 8950 companies were in general insolvency procedure, 4890 in simplified insolvency procedure, 4543 in bankruptcy and 38 in judicial reorganization. Out of the 18421 companies that were in insolvency procedure, most of them were registered limited companies (95%), followed by joint companies (3%) the rest of 2% being represented by the other forms of organisation.

Analysing the evolution of the counties we observe that the first 10 positions of this top cumulates over 50% of the total insolvencies opened at national level (51.35%). Under 1% of total cases litigate in 2009 are recorded in Giurgiu, Teleorman, Alba, Covasna, Salaj, Mehedinti, Calarasi, Botosani, these counties being also with the lowest number of insolvency. As we can see from the analysis of insolvency cases on geographic zone, the most affected region in 2009 was N-W of Romania with a number of 3516 companies in insolvency, followed by S-E of the country with 3193

cases and Western region with 2280 cases. Bucharest landed on the fourth position with a number of 2109 cases. The regions that were less affected by the crisis were S-W with 1524 insolvencies, N-E with 1660 cases and the centre with a number of 1069.

Table 1. Sector and territorial distribution of insolvencies in year 2009

Activity sector	Total bankruptcies	% total bankruptcies
Wholesale	3684	20,00
Retail	3501	19,01
Transports	2497	13,56
Hotels and restaurants	1237	6,72
Other service activities performed mainly for enterprises	1,022	5,55
Agriculture	979	5,31
Wood and wood products	927	5,03
Textile, textile clothing and footwear	762	4,14
Food and drink industry	573	3,11
Metallurgical industry	496	2,69
Real estate transactions	281	1,53
Chemical products and substance production	223	1,21
Clearing waste, salubrity and similar activities	206	1,12
Other personal activities and services	204	1,11
IT	172	0,93
Automotive industry	166	0,90
Recreational, cultural and sport activities	157	0,85
Financial intermediation	139	0,75
Postage and telecommunications	129	0,70
Extractive industry	54	0,29
Health and social care	47	0,26
Electrical and thermal production and supply, water and gases	31	0,17
Total	18421	100,00

A comparative analysis of the existing situation in 2008-2009 emphasize the same most affected industries, with no content differences between the two periods in Top 10 industries from the point of view of bankruptcy number, which highlights the weaknesses of these domains and the reduced capacity of companies to adapt to markets new conditions. Even if the first three positions - wholesale, retail and constructions - concentrates the most of recorded insolvencies in 2009, respectively 52,5%, comparing it with the previous year we observe a decrease of 4% of the rates of these positions, from 56,27% in 2008, showing the expansion of the problems to the other domains.

The main engines of the economy from 2004-2008, trade and constructions have collapsed in 2009, determining decrease in GDP of 7,1%, these being the most affected sectors by the crisis and which record the highest number of insolvencies. According to data provided by National Institute of Statistics, the decrease in GDP was determined by the low volume of gross added value in all sectors of activity, the most

affected being retail, car and hardware fixing, hotels and restaurants, transports, telecommunications and constructions which contributions to GDP was 31,1%.

Geographical repartition of insolvencies recorded in 2009

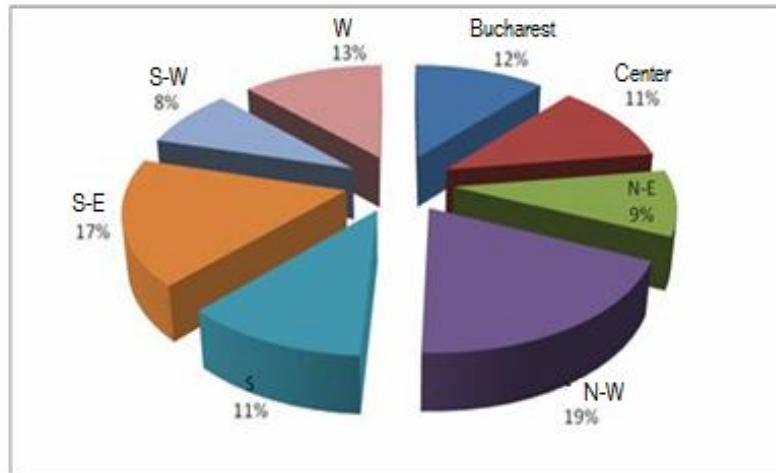


Figure 1. Graphical representation of insolvencies recorded in 2009

Top 10 industries concerning bankruptcies recorded in 2009

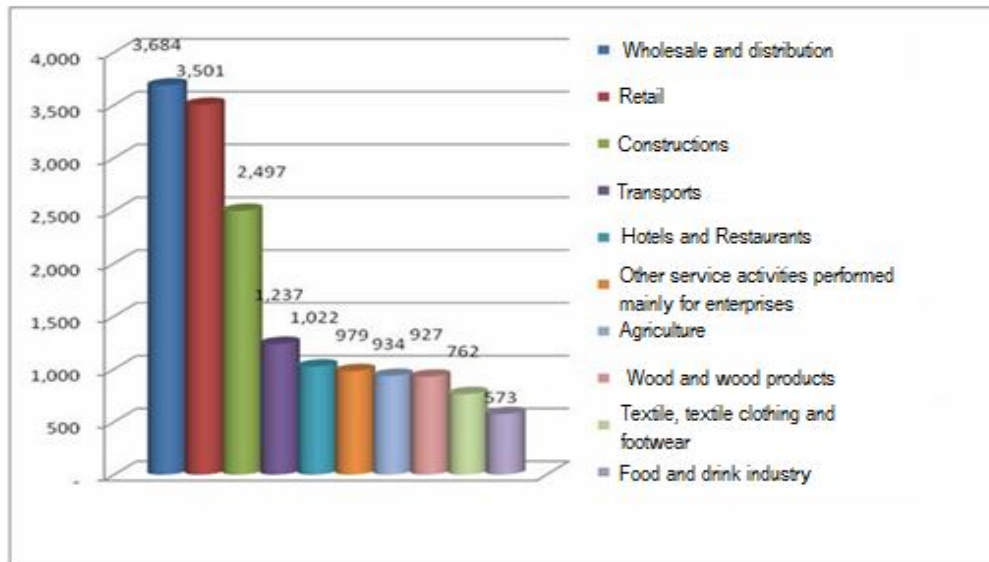


Figure 2. Top 10 industries concerning bankruptcies recorded in 2009

On the first position, with the highest number of insolvencies recorded in 2009 are wholesale and distribution which concentrates 20% of national level of bankruptcies. We can say that the first two sectors in this top had an almost identical evolution, the difference between them is only 1%, but due to the demand contraction and aggravation of credit conditioning, distribution is the most affected field by the recession.

The main characteristics of distribution companies are also the main weak points of them; high stock in trade, low operational margins, limited investments and capitalizations, increased dependency towards creditors. If in the next months will be as difficult from the point of view of sales, is expected that the incapability of these companies to adapt their policies to the new dimensions of the market to determine forward the growing number of insolvencies.

On the second positions according to the number of insolvencies is the retail. The volume of the turnover for this sector, excepting the vehicles has decreased in 2009 with 10.3% due to reduction of fuel sales in specialised stores and food and non-food stores, according to NIS. Therefore, in 2009, comparing to 2008, the retail of fuels for vehicles in specialised stores declined with 19,7%, the non-food retail with 9,6% and sales with food, drinks and tobacco dwindled with 4,5%.

The number of companies in insolvency in this sector was just a bit lower than the one recorded in 2008 (3501 companies then 3553). In the past few years the commerce in hypermarkets contributed to the extinction of small traders, the number of clients who wanted to buy from them being in decrease. The stagnation of the insolvency number in this segment appears to indicate the fact that they have adapted.

After the economic boom in retail when all the players struggled to occupy a space in commercial centres, the year 2009 have brought a period of abatement and restraint of business. The majority of retailers redimensioned the level of their business and adjusted their costs, exerting a big pressure upon suppliers which were under the necessity of reducing prices - so many of the retailers benefited of renegotiations of rent prices, or they could take larger spaces, of better positioned at lower costs than previous year.

Even if the majority of retailers have modified their commercial politics to counter attack the decrease in consumption by promoting the products with the highest commercial margins and by developing their own production lines, there were store chains that weren't that flexible, an example being PIC retailer, which closed 3 out of 5 stores in 2009, ended in insolvency. The year 2010 will bring a stabilization of international retail chains to the detriment of locals, situation which shows that in this business it's hard as an independent operator to compete with the financial power international competitors.

Taking into account the bigger and bigger delays on the chain of supplying and the increased pressure exerted by the creditors, for taking refuge from execution actions initiated by the main paymaster of the company, Flamingo retailer asked for its insolvency, suggesting a reorganisation plan. The negotiations with the main financing bank (ING) had failed, the request of Flamingo to re-echelon the debt being refused, the bank taking the decision to start the enforcement of the stocks in some stores of the company. It appears that in 2009 the company tried to implement a reorganisation plan,

designed to save the company from insolvency and which had as a main target the decreasing of the costs. Even if the company managed to reduce the debts to suppliers and banks, the financial resources of the company have proved to be insufficient to cover the level of the existent debt.

The third position in the top of the insolvencies is taken by construction domain, which recorded a constant increase of the number of insolvencies. According to data provided by NIS, in 2009 the volume of construction projects decreased with 15.1% situation which leads to the growth of bankruptcies in this sector.

On structure elements have been recorded abatements at all components:

- capital reparations (-24.1%);
- new construction projects (-13.8%);
- maintenance and current reparations (-13.2%).

On construction types, the decline has been recorded as following:

- residential buildings with 20.2%;
- non residential buildings with 15.7%;
- engineering constructions with 12.2%.

The main problems which builder confronted with in previous year was the decline of the demand, ceasing projects and investment works due to the lack of funds, the decline of purchasing power and deterioration of the payment behaviour of the partners. Besides these, the high costs of finance and the obstruction of real estate have contributed to deterioration of company's situations which activated on construction market, placing this sector on third place of the most affected industries of year 2009 from the point of view of insolvencies.

Is expected that in 2010 to be as difficult as last year for construction players, considering that in 2009 were released 48833 construction authorisations for residential buildings, in decline with 20.1 % than in corresponding period of previous year. Significant declines have been recorded also in developed regions: Ilfov-Bucharest (3015 authorizations), Centre (-1974 authorizations), South-Muntenia (1884 authorizations), and North-East (-1797 authorizations), declines which will influence the evolution of year 2010.

For the next period, the main engine of economic growth in this field could be constituted by the projects in infrastructure, under this circumstances the associations in construction domain requesting to the authorities measures for reduction of corruption in public acquisitions, sustaining loaning for companies by reducing the credit interest and a new program concerning road and highway construction.

Even if constructions in infrastructure should support construction sector and economy, by propagating the horizontal effect, unfortunately because the lack of funds not only the start and continuation delays, but jeopardizes the existence of a large number of companies.

Out of the first months of 2010 the majority of the companies in construction field which got in payment incapability indicates that also the main cause for that situations was low or no collection from local or state budget of some invoices for already realized workings, and every payment incapability generates a domino effect towards the other creditors of that company.

The transport domain also records a high number of insolvency requests - 1237 - being on the fourth place in the top in year 2008. Having a very tight connection with the level of development of the industry, transports in Romania have recorded in the last few years, alike the other economic sectors not only growths but abatements, year 2009 clearly being a descending one, when was estimated that transport market declined with 20%. The only transport branch which recorded growth was the low cost one, recording 30% higher revenues than 2008; this led of course to deterioration of situation for passenger by road transport, where the decreases are estimated to 30%.

The most bankruptcy was recorded in goods road transport, general economic situation, but also specific problems affecting mostly the small transporters which couldn't reorganize to cope the new market conditions. Those became more and more dissatisfied also because the state delays the deductions, but also because there are more and more taxes, some of them being considered abusive (tolls for passing some cities) and the poor quality of the roads continue to exert great problems for deploying under normal circumstances of the activities, this contributing to increased costs of repairs.

Compared to year 2008, in 2009 hotel and restaurant field have recorded and insolvency growth of 30%, this being the direct result of demand decline on this market also because of more and more restricted access to liquidity.

According to NIS, arrivals recorded in touristic accommodation structures in 2009 have totalled 6.1 mil, a decrease of 13.8% than the previous year. Even though Tourism Ministry have developed a promotion program of Romanian tourism - Romania the land of choice, the Romanian tourists' arrivals in accommodation structures have represented 79.2% in 2009 out of total arrivals, while foreign tourists have represented 20.8%, rates that were near to those in 2008.

The most assured domains, having the lowest rate in total insolvencies recorded in the first half of the year 2009, are postage and telecommunications activities, extractive industry, health and social care production and electrical, thermal energy supplying, water and gases. Nevertheless the main characteristic of investments and the number of players being limited, a comparison with the other very dynamic sectors where the access on the market is easy, and the number of economic agents and respectively the competitors are in large numbers are irrelevant.

In 2010, there will be a slow growth (+1%) despite maintaining almost general politics for adapting, the first semester is marked by a deceleration due to disappearance of temporary sustaining factors, like scrapping bonus or reserve regeneration. The reappearance of the demand in global level which to attract a growth, won't be high enough to reduce significantly the exceeded capacity at the moment.

There will remain the imbalances that were before the crisis, like private household debts, enterprises or banks, real estate excesses, lack or sartorial diversity and affectation of public finances.

Enterprises have made progresses in re-establish their capitalization, by a progressive adjusting of production at a lower cost, ameliorating their productivity. The process should continue with an economical policy (interest rates, public expenses decreasing of taxes) which will be forwardly favourable. We also consider opportune the elimination of minimum tax and reintroducing progressive tax.

After many years of credit growths, clearing of debts of private households and enterprises will be long and in any case, and resuming loaning will be made gradually. In addition, private consume will be stuck of limited by freezed wages and increasing unemployment. Usually, the manoeuvres on budgetary plan will be weak because of adjustment necessity of public finances which will be clearly deteriorated. Finally, this growth will depend mostly of conjuncture maintaining in Western Europe, where the growth will be slow.

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