The evolution view on the insolvency phenomenon in post-December Romania

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Abstract. The purpose of this article is to present the evolution of the phenomenon of insolvency in post communist Romania. An important feature of a market economy it is the active selection mechanism by which solid and efficient firms supersede the least effective and the goods and new activities to replace the old. Present article attempts describes the provisions of the Romanian insolvency law, is investigating the facts existing and possible remedies that could lead to increased competitiveness and functionality of the Romanian economy.

Keywords: bankruptcy, economy sector, closing indicators

1. Introduction

Some entrepreneurs and companies are unable to withstand the competitive pressures and are removed from the market, their resources shifted to a more efficient use. The Schumpeterian notion of "creative destruction" includes this dynamism. The creation of a new economic system in our country has intensified the process of selection which has acquired such an importance far greater than in Western market economies. The communist economic structure was inadequate to a market system and forced to undergo dramatic reform, it is indispensable to change or closure of many enterprises and a strong restructuring process.

Extensive growth of the private sector during the debut of transition and high rates of market entry and exit points this sorting mechanism. The purpose of insolvency proceedings is to regulate the mechanism of selection, establishing the formalities of market exit and reentering the assets and other resources of bankrupt companies for new businesses and activities. Moreover, insolvency gives legal guarantee for potential lenders and investors that even in case of bankruptcy or financial disorder will manifest those legal processes to stop the rampant speed by assets and to regulate division of bankrupt company from its creditors.

This article presents the phenomenon of post-revolution Romanian bankruptcy, examines the facts existing at the time of 1989 and the two trends, corresponding to two intervals: the bankruptcy of large banks and industrial giants (1990-2005) and firms due to international financial crisis (2008-). Also, it

is explained the distribution on the main areas of activity of companies became insolvent and international comparisons of the components of this procedure.
In terms of methodology, the article proposes an analysis of bankruptcy law, both nationally and at EU and international level. In addition to legal texts and interpretation, the paper offers an economic perspective on bankruptcy and insolvency, based on documentation to allow a comparative analysis of bankruptcy, regionally and internationally.

2. Literature review

The reason itself of insolvency law is in the need of creditor protection. Indeed, the purpose of insolvency proceedings is to provide ways to cover liabilities insolvent debtor or the debtor's reorganization, where possible, either through bankruptcy reorganization where the idea is useless (Balcerowicz, 2003).
The insolvency proceedings, as the mechanism of market economy, must to ensure rapid removal from the market of debtors which are in a hopelessly compromised situation, to prevent that their state of insolvency to infect business and lead to other bankruptcies. The elimination from the market it intends to be the individual debtor or manager’s debtor, legal entity, managers proved unable to compete or have been guilty of fraud to the detriment of creditors. They will be sanctioned a financial, criminal or professional, as a consequence of bringing their company insolvent. The removal from the market does not affect, necessarily, the debtor company. A viable or repressible business can continue to operate if it is separated from its incompetent or fraudulent managers and assigned to new managers to be able to cope with the rigors of economic competition (Daianu, 2004).

3. The evolution of the insolvency phenomenon

Into the bankruptcy phenomenon, 20 years post-revolutionary highlights two trends: first trend is taking place during 1995-2005 and is marked by the collapse of banks and industrial giants, and powerful second wave of bankruptcies is caused by the financial crisis started in 2008.
Thus, the first period (1995-2005) is characterized by failure of state banks, pyramid schemes and the disappearance of communist industrial giants, the largest bankruptcy taking place now. The largest bankruptcies Bancorex (2,000 million), Agricultural Bank (950 million), FNI (730 million) occur in this period.
Beginning with 1990, Romania was teeming with many banks, large and small. Depicted to “beneficiaries" in the slogans' more or less promising, these new banks were considered indicators that illustrate Romania's return capitalism. Unannounced, after 1995, it became increasingly clear that despite the feeling of prosperity transmitted by their super luxurious premises, most of these institutions were just giants with clay feet. With the treasures consumed by huge loans granted to “beneficiaries" who' did not have returned, some banks have come one by one in default.
For the most part, the ‘90 bank failures were caused by fraud managers and chairmen. The sound "collapse" post-December Romania's banking history was undoubtedly the BANCOREX, the Third Millennium Bank no reaching in 2000. This was due to inadequate management that caused many bank failures, and the fact that banks were a valve for the economy non reorganization effects, adding a large volume of bad loans. Factors that led banks to unable survival were determined by devaluing the national currency against the dollar liquidity crisis that coincided with an increase in the volume of bad loans and economic environmental degradation leading to failure of the private sector and thus make a profit in their final bankruptcy, which caused the credit forgiveness. Costs of "restructuring" of the banking system, supported by the state budget, namely the taxpayers, have exceeded 4 billion.

After 1991, another phenomenon occurs in Romania: the pyramid schemes or investment funds that went overseas. Many individuals have benefited from widespread poverty which had Romania, speculating desire to get rich quick. FNI collapse in 2000 left about 300,000 people without 700 million Euros.

Based on Table 1, it can be seen that during this period, even if bankruptcy procedure was cumbersome and poorly applied, there is great failures: first, banks: Bancorex (2,000 million), Agricultural Bank (750 million), Bankcoop (500 million Euros), Dacia Felix Bank (290 million), pyramid schemes: FNI, Caritas, Gerald and large industrial companies: RAFO, Tractorul, Petromidia. Also be noticed that these large bankruptcies occur in a period of great economic distress, major bankruptcies passing each over 200 million Euros.

The second period is from 2005. The bankruptcies of Romanian companies rarely exceed the value of 200 million Euros, which means a maturation and development for our economy. The financial crisis has taken a toll among Romanian companies, considered not too long ago "armored" against financial difficulties. Creditors not held accountable either name or size of company debt, such as companies entering insolvency: Diverta, Flamingo, PIC, Leonardo and K Tech Ultra Pro. Not just the big names have been affected by vortex debt; more than 55,000 new cases of insolvency were recorded during the financial crisis. Beginning in 2008, practically the first year the global financial crisis began to unfold in the country; companies with business sum of over 11.3 billion Euros have entered into insolvency, 5.6% of total turnover in Romania.

Examining Table 1, it is concluded that during this period, large bankruptcies are between 100-200 million Euros, their cause was the financial crisis that started in 2008, and no improper practices of the prior period. Now, major failures come from industrial sector (IRS and PSV) and trade (Leonardo, Relad PIC).

Table 1 Top of the largest bankruptcies in post-December Romania

Company	Sector	Date of bankruptcy	Euro million
Bancorex	Banking	1999	2000
Agricultural Bank	Banking	1998	950
FNI	pyramid scheme	2000	730
Bankcoop	Banking	2000	550
Bank Dacia Felix	Banking	1999	290
RAFO	Oil	2003	260
Tractorul Braşov	Industry	2003	243
Relad International	Pharmaceutical distributor	2009	206
International Railway Station	Industry	2010	175
Petromservice PSV Company	Oil +media	2008	160
PIC	Retail	2008	154
Leonardo	Retail	2008	136

In Table 2, we present the evolution of the number of bankruptcies in Romania during 1996-2011. Note that the first maximum is the period 1997-1999, when our country was in a strong economic recession, the number of bankruptcies of companies exceeded 3,000 annually. Later this year, the number of bankruptcies decreased to 1000 annually. With the advent of Law 85 in 2006, the number of bankruptcies increased to over 10,000 annually. Economic crisis hit translates into an increase to 18,000 of the number of bankrupt companies.

Table 2 Evolution of the number of bankruptcies in Romania during 1996-2011

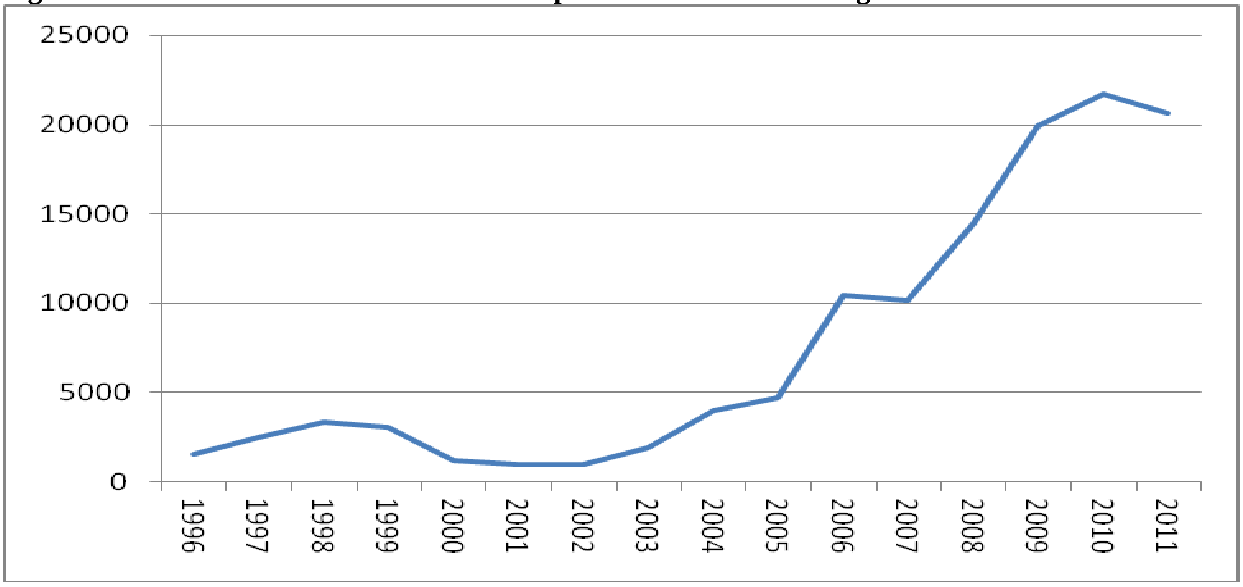
Year	Number of bankruptcy

1996	1605
1997	2540
1998	3391
1999	3069
2000	1208
2001	1009
2002	1027
2003	1969
2004	3982
2005	4736
2006	10431
2007	10198
2008	14483
2009	19894
2010	21692
2011	20651

Source: National Trade Register Office, Ministry of Justice

The debts of 54,000 companies which entered into insolvency proceedings by the end of last year totaling over 20.2 billion Euros of which were recovered in 2009-2011 a percentage under 10%.

Figure 1 Evolution of the number of bankruptcies in Romania during 1996-2011



Source: National Trade Register Office, Ministry of Justice

In 2008-2010, the insolvency application had increasingly higher and so the number of bankruptcies has increased significantly compared to 2006-2007, reaching more than 14,000 insolvencies per year. The increasing of the bankruptcies number has been determined at this time the desire of creditors to recover debts as quickly, so insolvency is one of the fastest legal tools to recover debts from debtors. With the advent of economic crisis, the insolvency was only a tool to ascertain the facts, namely that the weakness of Romanian companies to pay debts growing larger. More and more companies have used insolvency proceedings to compel the debtors to respond and pay debts, but the economic crisis; most companies have failed transaction settlement and entered into insolvency proceedings. The years 2008-2010 had a marked evolution in the number of bankruptcies in Romania, especially after the establishment of economic crisis; many lenders have misused the insolvency procedure, which opens in the current economic conditions too easy. It should be noted that the chances of success in a reorganization plan are very small, only 1% of cases fail to successfully complete the reorganization plan.

Table nr.3 Methods of insolvency trigger in Romania

YEAR	Number of insolvency application			Million euro
	Creditors	Debtors	Total	
2006	6311	4120	10431	1695.4
2007	6370	3828	10198	3762.9
2008	9233	5250	14483	5906.6
2009	11723	8171	19894	7733.5
2010	10833	10859	21692	7702.8

Source: National Trade Register Office

As it can be seen in Table nr.3, before the crisis, the applications for opening the proceedings were brought by creditors in two thirds, but in the crisis, the requests by debtors are equal to creditors. Insolvency procedure is normally a tool from which economic environment heals, but in conditions of deep economic crisis, this tool should be used judiciously because many companies will disappear, and the chances of effective recovery will be increasingly less.

In 2008 there were 14,000 open cases of insolvency, but in 2009 the number was over 18,000, in 2010 to exceed 21,000, which led to large economic imbalances, the most affected sectors are trade, construction, real estate, agriculture. The main reason leading to this situation is the blockage of the credit, most companies use as the main source of funding for bank loans (Table 3).

4. Distribution on industries of the insolvencies number

The distribution of the bankruptcies number from 2008-2011 on activity fields shows a change in the projected Top 5 sectors in which "shock wave" of financial crisis was felt first. Although, the first two positions are located, as in previous years, companies from commercial sector, it is remarkable the castle between wholesale and retail trade (on second position in the ranking of 2007). Also it mentioned the rising of the construction sector into third place in the top 5, and transport and furniture industry entering in the top, the number of insolvencies in these areas exceeding the one in agriculture and food industry sectors at the end of 2007 the top 5 as a percentage of total failures.

Table 4 The sectors with the highest bankruptcy rates in 2004-2011

Sector	2004	2005	2006	2007	2008	2009	2010	2011
Wholesale and Distribution	20	23	18.3	22.85	24,53	20.00	19.65	19.24
Retail	12,38	22	18.5	16.84	22	19.01	19.26	19.53
Agriculture, forestry, hunting and fishing	19,69	16.4	13.2	7.21	10,24	5.07	3.08	3.03
Food and beverages	13,18	12.4	10.8	7.57	8.1	3.11	4.84	2.97

Textiles	9.4	11.2	5.4	5.3	5.2	4.14	3.79	2.69
Construction	4.2	5	5.6	7.55	11,50	13.56	14.62	15.66
Transportation	2.3	2.8	3.6	7.94	5,60	6.72	7.18	7.05
Manufacture of wood and wood products	5.6	5.4	5.5	5.89	5,48	5.03	4.40	3.82
Hotels and restaurants	2.8	2.9	3.1	4.32	5,40	5.55	5.88	6.11

Source: Coface, the National Trade Register Office, Ministry of Justice

The safest sectors, with a share of total insolvencies under 1%, remain energy industry, mining, telecommunications and financial intermediation. Energy and mining industries cannot however be compared to a field where access is easy on the trade market and the number of firms and that competition is very high.

Table 5 The sectors with the lowest bankruptcy rates in 2004-2011

Sector	2004	2005	2007	2008	2009	2010	2011
IT	0.3	0.13	0,68	0,91	0.93	0.90	0.88
Mining and quarrying	0.33	0.38	0,32	0,90	0.29	0.47	0.5
Machinery and equipment	0.32	0.51	0,96	0,65	0.9	0.79	0.95
Financial intermediation	0.3	0.38	0,59	0,54	0.75	0.91	1.0
Electricity, water and gas	0,13	0.10	0,32	0,19	0.17	0.18	0.19
Health and social care	0,18	0.13	0,18	0,13	0.26	0.32	0.37

Source: Coface, the National Trade Register Office, Ministry of Justice

Judicial reorganization procedure is rarely used, because the debtor must recognize insolvent and to express its intention to reorganize its business. This is hard to Romanian companies, their administrators not easily recognizing that their companies are insolvent, trying to save themselves, rather than resort to the supervision of an expert, and finally to open insolvency proceedings.

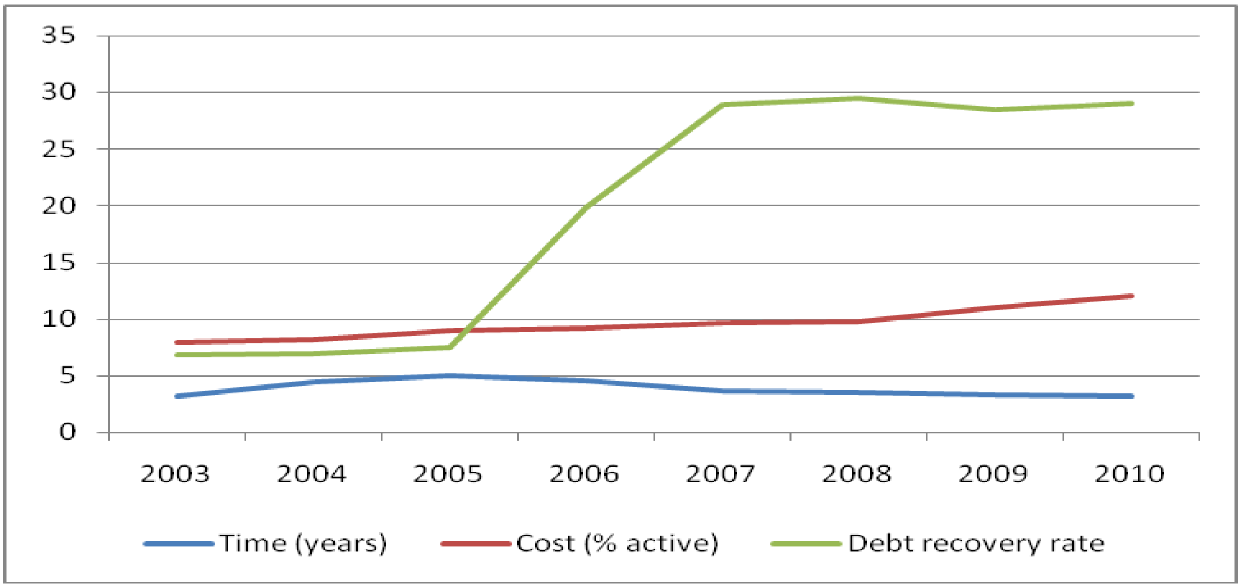
Table 6 Evolution of indicators for closing a business in Romania 2003-2010

	2003	2004	2005	2006	2007	2008	2009	2010
Closing a business world position ranking	90	107	110	108	81	85	91	90
Time (years)	3.2	4.4	5	4.6	3.7	3.5	3.3	3.2
Cost (% active)	8	8.2	9	9.2	9.7	9.8	11	12
Debt recovery rate	6.8	6.9	7.5	19.9	28.9	29.5	28.5	29.1

Source: Doingbusiness Reports 2004-2010

As shown in table 6, by 2006 (the adoption of law 85), our country has a time in years to wind up a business very long, between 4.4 and 5 years.

Figure 2 The evolution of the closing indicators for a business in Romania 2003-2010



Source: Coface, the National Trade Register Office, Ministry of Justice

Also debt recovery rate of bankrupt companies was very low between 6.8 and 7.5. After 2006, the time in years for the complete liquidation of firms decreases from 4.6 to 3.3, yet is extremely high. Instead, a positive thing in this period is the increase in debt recovery from 19.0 to 29.5.
We believe that much better for Romania was the enactment of German legislation and not a French style. To illustrate we present the table below:

Tables 7 The evolution of the closing indicators for a business in Hungary, 2003-2010

	2003	2004	2005	2006	2007	2008	2009	2010
Time (years)	3.0	3.2	2.7	2.0	2.0	2.0	2.0	1.85
Cost (% active)	15	14	14	10	8	9	8	7.5
Debt recovery rate	42	43	43.6	44.9	46.6	45.5	44.9	45.3

Source: Doingbusiness Reports 2004-2010

As you can see, all indicators are higher for Hungary than Romania: time (years) 3 in Romania and only two in the neighboring country, cost (% active) 11 in our country compared with 8% in Hungary and debt recovery rate 28.5 in Romania compared to 44 in Hungary.

5. Conclusions

Although, governments in Romania have adopted modern laws on bankruptcy (similar to mature market economies), they were not consistent in implementing the principles of insolvency proceedings. After 20 years of experience, it has not yet been accepted that all companies before the transition can survive in the new market, either because the demand structure has changed dramatically, either because they are structurally inefficient. Instead of allowing these large companies to fail, making the transfer of most of their assets in property other efficient firms, governments in our country have excluded these companies from bankruptcy and financial resources wasted (and scarce) for inefficient subsidies. In many cases, the real reasons behind this policy were rather political than economic.
Trend throughout Europe, and internationally in general, is to change legislation on bankruptcy reorganization process for the purposes of encouraging the reorganization. In Romania, the proposed

changes seem to register in a direction diametrically opposite, namely to encourage creditors. The explanation for this process comes from experience so far of our country, showing that reorganization practice not solution was successful in too many cases, often turning into a real barrier to market exit, such disadvantage creditors and finally carrying so good the structural reforms.

But passing over the actual legal regulations, present or future, it is important to note that through the liquidation, are removed from the market traders uncompetitive due to conjuncture or due to their managerial deficiencies not unable to perform profitable activity. Liquidation has a role in improving the market economy and streamline the trade in the current state of our country and European integration perspective is not only necessary but essential good running of the market economy. In these circumstances the role must be correctly understood and wound be limited by any negative connotations which were assigned in our society.

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