The Determinants of Borrowing in the Case of the Newly Exchange-Listed Firms in Romania: When Budget Constraints and Adverse Selection meet Cronyism.

Recent studies show that budget constraints are among the main determinants of corporate borrowing in transition economies. Empirical evidence from Eastern European countries suggests that mandating harder budget constraints persuades banks to reduce their lending to distressed firms.

This paper takes a fresh look at the determinants of borrowing of Romanian corporations. Unlike previous studies centered on state-owned firms, we focus on the newly restructured, (partly) privatized, and exchange-listed Romanian firms. We hypothesize that corporate borrowing is explained more fully by budget constraints, financing needs, and ownership structure.

The sample used in this analysis consists of 580 corporations listed on the Bucharest Stock Exchange and over-the-counter market (RASDAQ) between 1997 and 1998. The methodology emulates in part a recent study by Shyam-Sunder and Myers (1999).

The results complement very well the findings of earlier empirical work: newly exchange-listed Romanian firms make use of a low level of financial leverage when compared to western firms. Moreover, new borrowing is inversely related to the firms’ financing needs, and correlated with the nationality of individual stakeholders (Romanian nationals have somewhat better access to bank credit). This state of affairs can be attributed to a mix of high adverse selection costs, high real interest rates, and hard budget constraints. The relationship between ownership structure and corporate borrowing is quite puzzling. Existing corporate governance and agency costs theories are not able to shed much light on this issue. An interpretation that accounts for the political and historical context of the transition – that is, cronyism – appears to be much more valid.

The political cronysim contention emerge as compelling because the majority of Romanian individual stakeholders are political and/or former corporate insiders; they represent the emerging capitalist class, and provide strong economic and political support to the reform oriented government that acceded to power in 1996. This interpretation also fits best in the historical and cultural landscape of the Romanian transition, fraught with corruption and political scandals since day one. At any rate, in spite of abundant political undercurrents, the dominant determinants of corporate borrowing remain the nature of budget constraints, the magnitude of adverse selection, and obviously the level of real interest rates.

The big picture is nonetheless encouraging. There are clear indications that, despite being painfully slow and tormented, the transition process is eventually creating competitive, healthy firms, while reshuffling the entire economic system. Unquestionably, there is evidence of nascent market discipline in the system.

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