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BACK TO BUSINESS FROM COMPETITION POLICY POINT OF VIEW

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Abstract: Despite the start of exit strategies from the financial and economic crisis, 2011 events such as the sovereign debt threat in Europe, as well as difficulties on the internal market delays the economic recovery of EU Member States. Against this backdrop, the crisis has had a considerable impact on selected aspects of the EU competition policy and competition law enforcement. Questions were raised about whether and how competition law enforcement should be modified in a time of financial and economic crisis. There was much debate in particular on the control of State aid by the EU and in particular on the application of State aid rules to the financial services sector in these troubled times. To face the continuous challenges of the economic and financial crisis, it is well known that DG Competition adapted its state aid policy by extending the state aid temporary rules and continued its actions towards restructuring financial institutions. As concerns the other areas of EU competition policy, a consensus had emerged at European level that the rules on competition remained to be fully enforced in the light of past experiences of US authorities during the financial ‘Panic of 1907’ or the New Deal after the Great Depression. However, less was inquired about the challenges faced by DG Competition in the application of article 101 of The Treaty on the Functioning of European Union (hereinafter referred as TFEU) and of the Community merger control rules in the context of the economic downturn. It is therefore important to observe that the current economic environment in distress impacts the market behavior of undertakings who seek to justify agreements restricting competition by invoking overcapacity problems or economic crises in their respective sectors. More and more perpetrators of competition rules ask for reduction in fines claiming their inability to pay and consequently the high likelihood of leaving the market. Last but not least, the global slow-down affected the number as well as the nature of the notified merger and acquisitions to the European Commission. That is why this paper will focus primarily on surveying EC’s decisional practice concerning fines, anticompetitive practices and mergers and to a less extent on state aid issues. The core message of the paper is that keeping markets competitive is no less important during times of economic hardship than during normal times (Shapiro, 2009) despite opportunistic calls that the current economic situation requires the setting aside of competition rules.

Keywords: economic recovery, economic and financial crisis, crisis cartels, merger control, state aid policy

Codes JEL: L4, L5
INTRODUCTION

As it happened during the financial Panic of 1907 or the New Deal after the Great Depression, the current economic crisis reopened the discussions in international fora such as OECD on whether competition authorities should condone certain types of agreements which aim at reducing the overcapacity or to apply a less vigorously cartel policy in order to support the well-functioning of markets during economic downturns.1

More exactly, two major challenges arose with respect to the application of Article 101 TFEU by the European Commission.

First, faced with a fall in demand due to the weakening of the buyer power, a number of businesses across Europe are considering entering into agreements or any form of coordination to reduce capacity in their industries hit hard by the crisis so to avoid the risk of going in bankruptcy.

The term traditionally used for these schemes falling under the notion of industrial restructuring agreements is crisis cartel. The outcome of implementing such schemes might be detrimental to competition since collusion decreases consumers’ welfare and inefficient players would remain on the market.

Article 101(1) of the TFEU provides that agreements, decisions of associations of undertakings and concerted practices, which are liable to affect trade between the Member States and have as its object or effect the prevention, restriction or distortion of competition within the common market are prohibited.

As per the wording of Article 101 (1) TFEU, it is obvious that it applies as well to crisis cartels, as with all types of collaboration among competitors.

The second challenge is that more and more perpetrators of competition rules in times of crisis ask for reduction in fines claiming their inability to pay and consequently the high likelihood of their bankruptcy. Financially distressed companies are claiming that the huge fines that the Commission has the right to impose once it finds an infringement of Article 101 TFEU of up to 10% of the incumbents’ turnover might force them even if they are competitive to leave the market.

We shall therefore assess to what extent the European Commission takes into consideration these challenges when enforcing Art. 101 TFEU.

EC’S APPROACH TOWARDS CRISIS CARTELS

As already mentioned, the crisis conditions may trigger collective or concerted action through so-called crisis cartels aiming to reduce capacity or production in excess. As the economic literature underlines, when potential cartelists are faced with the prisoner’s dilemma on whether to exit the market or form part of a cartel, they will compare the expected profit from cartelizing, with the expected profit from competing in the absence of a cartel, taking into account that if the cartel profit during the crisis is low, this may limit the maximum fines to be imposed. Subsequently, if they are convinced that the fines imposed during a crisis are less than under normal market conditions, their incentive to cartelize will be increased (Levenstein & Suslow, 2010).

In its 23rd European Commission Competition Policy Report2, the European Commission argued that agreements to reduce structural overcapacity which involve all or a majority of the undertakings in an entire sector, can be accepted if they are aimed solely at a coordinated reduction of overcapacity and do not restrict the commercial freedom of the parties involved. Agreements involving a smaller number of firms can also be accepted if they aim at allowing reciprocal specialization in order to achieve closure of excess capacity. However, the Commission
clearly indicated that such agreements should not involve any price fixing, quota fixing or market allocations which are actually considered naked cartels.

In the middle of the crisis, EC reopened the discussions on the topic of industrial restructuring agreements within the EU aiming at ensuring a common approach to the problem and in particular trying to better apprehend the notion of the so-called crisis cartels once again.

To ensure a coherent application of EU rules on this thorny issue, on 30 March 2010, the Commission submitted written observations in the Irish beef case concerning an industrial restructuring agreement, pursuant to Article 15, paragraph 3, of Regulation no. 1/2003.

This is a typical example of an agreement between undertakings in a sector experiencing a situation of persisting structural overcapacity which reflects EC’s recent approach in dealing with industrial restructuring agreements under Article 101 TFEU. This agreement consisted in a series of arrangements between ten main Irish beef processors dated May 2002, aiming at achieving a 25% reduction of the total production capacity of the processing industry within one year, voluntary withdrawal of firms from the market with two-year non-compete clauses, restrictions on use of freed plants and on disposal of equipment. Therefore, this agreement attempted to deal with overcapacity by structurally designing the industry in a way that would ensure a proper functioning of the market – by artificially forcing the exit of some market players and raising the barriers to entry while, in the same time, cutting the incentives to compete for remaining market players.

Interestingly, the Irish High Court decided that the agreement did not have the object of restricting competition and therefore did not infringe Article 101(1) TFEU or the equivalent section in the Irish Competition Act.

In view of that finding, the Irish Authority appealed this decision to the Irish Supreme Court. To judge the case correctly, the Irish Supreme Court decided to lodge an application for a preliminary ruling on the application of Article 101(1) TFEU with respect to such industrial restructuring agreements to the European Court of Justice in March 2007.

In November 2008, the ECJ held that the proposed agreement to reduce capacity constituted a restriction of competition by object within the meaning of Article 101(1) TFEU even if it did not have the restriction of competition as its sole aim but also pursued other legitimate objectives. According to the ECJ judgment, the proposed agreement had as its object to encourage some of the beef processors to leave the market and therefore prevented the independence of these companies’ conduct on the market. As a consequence, the Supreme Court referred the case back to the High Court for a decision as to whether the agreement satisfied the conditions of Article 101(3) TFEU. In the end, the High Court did not have to rule on this issue as the parties to the agreement decided not to implement it and withdrew from the proceedings.

The recent case law established in the Irish beef case shows that crisis cartels which aim to reduce industry overcapacity cannot be justified by economic recessions. In a well-functioning free market economy, it can be assumed that market forces alone would normally correct overcapacity problems within a reasonable period of time and price should follow the changing relationship between supply and demand. That means that when demand falls, prices must not, at any circumstances, be artificially maintained at a certain level through coordination between undertakings on the market.

Another lesson we draw is that an agreement to reduce overcapacity amounts in principle to a restriction of competition by object under Article 101(1) TFEU. To obtain the benefit of the Article 101(3) TFEU exception for an agreement which restricts competition, whether by its object or its effects, the parties bear the burden of proving that the agreement leads to pro-competitive effects which offset the restrictive effects on competition by showing that the restrictive agreement meets the four cumulative conditions mentioned in paragraph 3 of Article
101, i.e. that the agreement contributes to improving production or distribution, or to promoting technical or economic progress, it allows consumers a fair share of the resulting efficiencies, it does not impose unnecessary restrictions and finally, it does not pursue the elimination of competition.

It is obvious from the ECJ case law in Irish beef that it will be very difficult for the parties to succeed with a defence under Article 101(3). In its contribution to the OECD, EC explains that this type of overcapacity market failure, though rare, could occur in particular situations of stable, transparent and symmetric market structures and where giving up capacity is costly for the firms. Therefore, when attempting to defend a restructuring agreement on efficiency grounds the parties would need to establish that the industry concerned indeed suffers from a structural overcapacity problem, i.e. market forces alone cannot remove that excess overcapacity.

Further, the indispensability criterion contained by the third condition of Article 101(3) would be difficult to be proved by the incumbents. Undertakings invoking the benefit of Article 101(3) would have to prove that other seemingly realistic and less restrictive means to combat the crisis in their sector such as the intensification of competition between the processors or mergers between individual processors would be significantly less efficient than the industry-wide coordination agreement.

Actually, merger control explicitly provides for an appropriate tool to facilitate the consolidation of industries facing structural problems such as overcapacity, namely the failing firm defence. It can be applied in situations "where the competitive structure of the market would deteriorate to at least the same extent in the absence of the merger." We shall further detail this issue when dealing with the challenges faced by the EC in applying its merger control rules.

Therefore, exempting a crisis cartel under Art. 101 par. 3 TFEU is only the exception confirming the rule that anticompetitive agreements between undertakings cannot be tolerated, even in times of crisis. Competition law is to be applied at all times, including times of economic downturns and recession-induced fall in demand when industries may suffer from overcapacity.

The EC recent review of industrial restructuring agreements in the context of the Irish beef proceedings in Ireland demonstrates EC’s seriousness in not changing its policy in investigations carried on pursuant to Article 101. Further, it is fully consistent with the approach adopted by the EC in its Guidelines in which the focus is on the economic analysis of the likely effects of restrictive agreements.

**FLEXIBILITY ON FINES**

We shall now tackle the second of the aforementioned challenges related to application of Article 101 TFEU during the financial and economic crisis, namely incumbent’s persistent call for reduction of the fines.

With the onset of the world economic crisis in mid-2008, the number of businesses claiming their Incapacity of Payment (hereinafter referred as ‘ITP’) and requesting a fine reduction put pressure on the Commission to take into consideration the economic circumstances and the economic situation of offenders when imposing fines for infringements of competition law.

Inquiring into the available legal framework, it appears that the Commission is not legally bound to take into account the financial situation of a company when setting fines since the fact that a fine brings about the insolvency or liquidation of a company is not prohibited by Community law. However, EC does have some provisions to deal with “inability to pay,” but in the past had generally interpreted these rules very strictly and had been unwilling to accept these claims from the parties involved in illegal conduct.

More specifically, the European Commission’s Fining Guidelines from 2006 stipulates at point 35 that the Commission may “in exceptional cases... take account of a company’s inability
to pay in a specific social and economic context’ provided that the fine ‘would irretrievably jeopardise the economic viability of the undertaking concerned and cause its assets to lose all their value’10”. Therefore, the wording of point 35 makes it clear that EC may take account, at its discretion, of the critical financial situation of individual businesses.

Despite these rules being in place for several years, it was only in the wake of the economic crisis that, in November 2009, the Commission accepted an ITP claim for the first time on this specific point of the 2006 EU Fining Guidelines in the Heat Stabilisers decision11 and significantly reduced the fine of one company in view of its difficult financial situation. When assessing the company’s claim that it is unable to pay, the Commission looked in particular at indicators of company profitability, capitalisation, solvency and liquidity. To carry on the assessment, it used financial statements for recent years and future projections, financial ratios measuring a company’s financial strength, profitability, solvency and liquidity, company’s relations with banks and shareholders. The Commission assessed as well whether a company’s assets would be likely to lose significant value if it were to be liquidated as a result of the fine.

Since then, the Commission has granted significant fine reductions—between 25 and 75 percent, in a number of cases.

The bathroom equipment manufacturers’ cartel case marks a milestone in EU antitrust enforcement. It is the first cartel case in which the Commission granted substantial reductions of the fines for a number of the defendants because of their precarious financial situation. In this case12, 17 companies were sanctioned for fixing the prices for baths, sinks, taps and other bathroom fittings for twelve years in six EU countries. Ten of the companies made ITP applications to the Commission claiming that they would be unable to pay a substantial fine because of their precarious financial situation. The Commission accepted that defense only for five of the ten companies, reducing the fines imposed on three of them by 50% and reducing the fines imposed on another two of the companies by 25%.

In a similar vein, in the “prestressing steel producers cartel” decision, 17 producers of pre-stressing steel were punished and the Commission, after having reviewed 13 ITP applications, granted reductions of 25%, 50% and 75%, respectively, only to three companies13. The overall amount of fines was thus reduced from €518 million to €458.4 million.

With respect to the huge amount of requests received of fine reductions following the sanctioning decision, Vice-President Almunia said: “It is amazing how such a significant number of companies abused nearly the entire European construction market for such a long time and for such a vital product. This was almost as if they were acting in a planned economy. It further added that: “the Commission will have no sympathy for cartelists; recidivists will be fined more and inability-to-pay claims will be accepted only when it is clear the fine would send a company into bankruptcy, which is rare even in the current difficult times”14.

In the animal feed phosphates first settlement cartel case15, one company was granted a reduction of 70 per cent of its fine on the basis of inability to pay.

The restrictive approach of EC on ITP claims is proved by the rejection of two applications for fine relief based on inability to pay lodged by two companies in February 201116 who participated in the Aluminium Fluoride cartel sanctioned by EC in June 2008.

More recently, in March 2011, the Commission accepted a post-decision ITP claim and lowered the fines imposed in 2007 on three companies in the Prym group in the Fasteners cartel case17.

In this case, it appears that, while appealing, Prym sought interim measures to suspend execution of part of the fine and a release of part of the bank guarantee, although the latter application was subsequently withdrawn. Prym also applied to the EC for fine relief under point 35 of the 2006 Fining Guidelines, which procedure led to this decision.
Prym’s fine was consequently reduced by €25 million. The corresponding interest, amounting to €4.5 million was also waived. Overall, the Prym group’s fine was adjusted to approximately €15.5 million from approximately €45 million, including interest.

For the second time in 2011, more precisely in December 2011, the Commission reduced fines to one undertaking in the Refrigeration Compressors settlement cartel case, showing its increased receptiveness to take account of companies’ financial difficulties in the economic crisis.

Therefore, all these ITP claims were accepted by the EC in the midst of an economic and financial crisis of unprecedented magnitude in the history of EU antitrust enforcement.

All these examples prove that the Commission may be willing to accept a defendant’s “inability to pay” as a reason to grant a significant reduction of the fine if it would otherwise put the defendant at the risk of bankruptcy.

At the same time, it appears that EC has a number of reasons why ITP reductions are confined to the very minimum. According to point 4 of the 2006 Guidelines, deterrence is sought as a primary objective of the Commission’s fining policy. Reducing the fine amount below the deterrent level as well as reductions granted under the leniency and settlement notices, risks leading to under-enforcement in the area of antitrust (Camilli, 2006).

It appears as well from the assessment of EC practice of handling ITP claims that fine reductions targeted more mono-product companies that were of relatively small size and whose fine reached the 10 % threshold.

As long as the economic downturn persists, EC’s lenient approach towards “inability to pay” pleas is likely to continue. However, it becomes obvious from the review of ITP applications that they have been cautiously judged by the EC following a case-by-case analysis. By doing this, the EC seeks to maintain the equal treatment of companies operating on the internal market and to safeguard at the same time the deterrence function of its antitrust enforcement policy.

The level of fines imposed by the European Commission seems also to prove these allegations. In 2007, before the outbreak of the financial crisis, the overall amount of fines imposed by the EC reached €3.38 billion. As it appears from the table below, in 2008, there was a drop to €2.26 billion while in 2009, the drop continued to be significant, and reaching €1.54 billion. After this decrease, an impressive increase of fines occurred in 2010 amounting to €2.86 billion while in 2011 a significant drop to €614 million emerged.

Fines imposed by the EC (not adjusted for Court judgments) - period 2008 – 2012 (last change 28 March 2012)

What happened in 2010 is that the Commission managed to impose two individual fines ranking amongst the 10 highest fines in the history of EU cartel enforcement and the fifth highest
aggregate fine in an EU cartel case. At the same time, we should not overlook that the infringements penalized in the most recent decisions took place, in most cases, well before the crisis.

MERGER CONTROL POLICY AND PRACTICE

The financial and economic crisis affected merger control as well. First, there was a question of whether rescue mergers resulting in nationalization of financial institutions needed to be notified under normal conditions. The Commission made it clear in the German Hypo Real Estate case in which Hypo Real Estate was taken-over by an entity owned by the German state that the transaction did not include any safeguards to protect Hypo’s autonomy and that post-merger the company would not constitute an economic unit with independent decision-making power within the meaning of the EC Merger Regulation.

As it happened in the German Hypo Real Estate case, most of the transactions that occurred in the European banking industry during the economic and financial crisis escaped merger review by the Commission since there was no change of control.

Moreover, where banks were saved by a competitor, rather than national governments, many mergers did not match the two-thirds rule provided by the EU Merger Regulation for the mergers having a community dimension. For instance, the Lloyds/HBOS merger in the United Kingdom and the Commerzbank/Dresdner merger in Germany have been dealt with by National Competition Authorities in the relevant EU Member States.

So, in most of the cases, ailing banks were saved by the injection of public money and guarantees issued by the national governments, and raised important state aid issues as we shall see in the final part of this article.

Second, the financial and economic crisis on EU and national merger control practice impacted on the number of the notified transactions. While in 2007 the number of mergers reached the impressive number of 402, it significantly dropped in 2008 and 2009 to 347 and 259, respectively. In 2010, it was only slightly higher than in 2009, recording a level of 274. As at 30 September 2011, the European Commission reported that for 2011 it has received 251 notifications, broadly consistent with the number of notified cases in 2010, but down from the significantly higher numbers of notifications before the outbreak of the financial crisis.

Third, the crisis had various impacts on the number of mergers depending on the sectors of the economy involved. Thus, there was an observed continuity in the energy and pharmaceuticals sectors which were apparently not that strongly affected by the crisis whereas there was a significant worsening of the situation in the air transport sector (Calvino, 2010).

For example, in the Lufthansa/ SN Brussels Airlines case, particularly in the view of the current consolidation process of the European airline sector, on June 22, 2009, the Commission approved the acquisition by Lufthansa of SN Brussels Airlines conditional upon the implementation of a set of remedies offered by Lufthansa to alleviate the Commission’s competition concerns, in particular on a number of routes between Belgium and Germany and Belgium and Switzerland. In this way, it safeguarded that consumers have a competitive choice of airline services in Europe.

In other cases, undertakings have been forced to divest divisions or businesses to satisfy Commission State aid conditions. For example, in RBS assets/Banco Santander, in order to receive the EC’s approval of its restructuring plan, some problematic assets were offered for divestment by RBS, together with some other businesses, in the context of the Commission’s investigation of state support granted to RBS, including two State recapitalizations amounting to more than £45 billion and the treatment of a huge portfolio of impaired assets.

Overall, the companies that were merging did so not because they wanted to expand their markets but rather wanted to preserve them (defensive mergers). This picture under the
EC merger control rules suggests that while there were fewer mergers motivated by the willingness of financial investments, there were many more mergers with industrial consolidation as the main objective.

Fourth, the crisis had some impact as well on the EC merger control rules, from procedural point of view.

For example, in the BNP Paribas/Fortis merger 24 merger proposal which concerned the acquisition of Fortis' Belgian and Luxembourg assets by BNP Paribas, EC demonstrated that exceptional times require urgent measures to be adopted faster than usual. Notwithstanding the fact that the case raised substantive concerns and required a remedy, the Commission adopted its authorization decision two weeks before the ordinary deadline. The merger transaction was only cleared subject to conditions relating to the credit card market, so as to avoid narrowing consumer choice for credit cards.

The Commission was also willing to grant derogation from the normal standstill obligation allowing the implementation of a merger immediately, pending the outcome of the review under Article 7(3) of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings 25 in Santander/Bradford & Bingley Assets 26. In 2011, as at 30 September 2011, 3 more such derogations have been granted by the Commission 27.

Another area where EC shows some flexibility on timing is when it ensures the enforceability of the commitments proposed by the parties to the merger by making the clearance of the merger subject to conditions and obligations. Due to the fact that the merging parties may face difficulties in finding suitable buyers under these turbulent times, EC revised Notice on Remedies 28 acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004 of October 2008 provides either for upfront buyers in order to guarantee the effectiveness of the proposed remedy or for the extension of the divestment period upon request by the parties showing good cause.

These examples prove that EC has been willing to ensure procedural flexibility of merger control rules in order countervail the impact of the economic crisis.

Fifth, similar to EC’s fining policy enabling the reduction of fines for companies in financial distress, EC policy and practice in merger control enables the Commission to take into consideration the failing firm defense. Thus, the European Commission may decide that an otherwise problematic merger is nevertheless compatible with the common market if one of the merging parties is a failing firm 29 as long as the conditions set out in the Guidelines on horizontal mergers would be met, i.e the acquired undertaking would in the near future be forced out of the market if not taken over by another undertaking; the acquiring undertaking would take over the market share of the acquired undertaking if it were forced out of the market, there is no less-anti-competitive alternative purchase 30.

Failing firm defence was accepted by the EC for the first time in Kali und Salz 31. The case concerned the joint venture between Kali and Salz and Treuhand and the concentration of the rock-salt and potash activities of Kali and Salz, a subsidiary of the German chemical company BASF and MdK, a state-owned company of the former German Democratic Republic. At first sight, it seemed that the concentration would have created a monopoly on the market (98 per cent in the market for potash products).

The transaction was nevertheless considered not to create a dominant position (this was before the introduction of the SIEC-test in EC merger control) taking into account that MdK was highly unlikely to survive given that the State trustee couldn’t continue to inject any further capital into the loss-making business. There was also evidence clearly showing that despite significant efforts to divest the business, no other third party had made an offer for the company. The potash market was in a state of over-capacity and there was limited or no scope for efficiencies among
companies other than Kali & Salz. Further, even in the absence of the proposed merger, it was very likely that the market shares of MdK would go to Kali & Salz.

Therefore, to meet the conditions for failing firm defense, the parties to the merger would have to prove that the deterioration of the competitive structure of the market that follows the merger cannot be said to be caused by the merger.

The only case since the Kali & Salz case where the Commission found that the failing firm conditions were met was the BASF/Eurodiol/Pantochim-case\textsuperscript{32}.

More recently, the Commission’s contribution to 2009 OECD Policy Roundtable on the Failing Firm Defence clarified that “The current framework for the analysis of failing firms is well balanced as it allows for the smooth restructuring of the economy without causing impediments to competition. Loosening the failing firm criteria in times of crisis is therefore not required”\textsuperscript{33}.

Thus, despite the fact that the Commission’s merger control assessments takes into account the economic environment and the evolving market conditions (Kroes, 2008) in light of the higher probability of potential bankruptcies reflected in a bigger number of defensive mergers, the concept of a “failing firm defence” was used only to a limited extent\textsuperscript{24}. This illustrates that the Commission has resisted softening the requirements for the failing firm defence to ensure that competition is not harmed.

Actually, times of financial and economic crisis may drive the less efficient market players out of the market leaving room only for stronger and efficient players. But, this can, in turn, facilitate strong growth in the period following the crisis (Fingelton, 2009).

**STATE AID CONTROL**

The financial crisis provided clear evidence that when one bank fails, it may trigger the collapse of the whole financial sector even beyond the borders of one country.

Against this background, the emergency temporary State aid framework for financial entities introduced by the Commission proved to be a powerful EU instruments to protect a level playing field in the financial sector throughout the EU since the end of 2008.

Between October 2008 and October 2011, the European Commission approved €4.5 trillion (equivalent to 37% of EU GDP) of state aid measures to financial institutions\textsuperscript{35}. The Commission further estimates that as a direct result of the financial crisis, banks incurred almost €1 trillion in losses between 2007 and 2010 while €1.6 trillion in aid and guarantees has so far been injected into the European banking sector.

All the above figures show that the application of the emergency temporary State aid framework for financial entities by the EC has been useful and timely since it prevented a domino effect of failing institutions from seriously damaging the real economy and the potential disintegration of the internal market. However, it becomes obvious that it has implied a massive use of public funds to restore trust in the financial sector and implicitly, huge losses for taxpayers.

A number of important banking failures during the crisis such as Fortis, Lehman Brothers, Icelandic banks, Anglo Irish Bank and more recently Dexia have revealed serious shortcomings in the existing systems and the need to regulate large cross-border serious turbulences in the financial markets at EU level.

Fortunately, the recent proposals adopted by the European Commission for bank recovery and resolution at EU level\textsuperscript{36} are very likely to meet current challenges.

Their main purpose is to ensure the winding-up of the financial institutions in an orderly manner while preserving those services which are critical for the financial stability without relying on taxpayers’ money. With respect to this recent initiative, President Barroso said: “The EU is fully delivering on its G20 commitments. Two weeks ahead of the summit in Los Cabos, the Commission is presenting a proposal which will help protect our taxpayers and economies from
the impact of any future bank failure. Today’s proposal is an essential step towards Banking Union in the EU and will make the banking sector more responsible. This will contribute to stability and confidence in the EU in the future, as we work to strengthen and further integrate our interdependent economies.\footnote{OECD, Directorate for Financial and Enterprise Affairs, Competition Committee (2011). Global Forum on Competition, Crisis Cartels, DAF/COMP/GF(2011)6.}

We can therefore argue that these developments are positive since they complement the current instruments of state aid control in place in order to better deal with the financial institutions in distress and cross-border banking failures. They represent as well an important step towards a banking union at EU level.

**CONCLUSIONS**

Despite a number of challenges faced in enforcing the State aid rules and also the antitrust and merger control rules under these turbulent times, the EC managed to maintain unchanged its competition and State aid rules. At the same time, it made the necessary procedural adjustments to take into account the deteriorating market conditions in which the businesses are operating, contributing thus to an effective response to the crisis.

We have shown throughout the paper that the EC does provide for the option of reducing the cartel fine if the company is unable to pay and it did and it will enforce it as long as the economic downturn persists but the conditions attached are very stringent and case specific. Tough conditions are in place as well for companies seeking to legalize crisis cartels in their sectors. In the field of merger control, the rules as they stand provide as well for a certain degree of flexibility especially in terms of the time limits for the approval process of mergers in times of crisis as well as in normal times.

Overall, EC’s approach with respect to crisis cartels, flexibility on fines, merger control and rescue and restructuring state aid measures for banks in distress in the ongoing crisis definitely shows that the purpose of all competition policy instruments is the elimination of the consumers harm rather than the protection of inefficient competitors who would contribute to slowing down the recovery process.

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Abstract: As a result of the changes in the global economy and of the increase of the price of energy from classical sources, the European Union has set an ambitious objective: by 2020, 20% of the generated energy should come from renewable sources - wind energy is expected to supply between 12 and 14% of the overall demand. As a member of the EU since 2007, Romania certainly is influenced by these policies. This article includes an overview of the world wind power production, characteristics of the extraordinary wind power market development in Romania, the new challenges and business opportunities, as well the future development of the green energy generation.

JEL Codes: M11, L94

AN OVERVIEW OF THE RENEWABLE ENERGY AND PARTICULARLY OF THE WIND ENERGY

The development of the wind energy generation in Romania can be labelled as spectacular. At the beginning of 2000, only 7MW were generated by a few turbines scattered all over Romania. Then, in 2009, the first wind farm was built, with an installed power of 18 MW, at the end of 2010, there already were 462 MW, while at the end of 2011 the capacity was of 982 MW. In 2011, approximately 700 million Euros were invested in wind farms, Romania thus ranking on the important 7th place in the top of European countries in terms of the investments in wind farms and 5 percent of the overall investments in this field. If we make a calculation, it would mean than, in 2011, one million Euro was invested every 12 hours and the production capacity being doubled over a single year.

Cernavodă is hosting the nuclear plant with two operational reactors for the production of nuclear power, with a capacity of approximately 700 MW each. This reference is always taken into consideration when the installed wind energy production capacity is discussed. Practically, in 2011 the production capacity of a reactor installed at the Cernavodă plant was exceeded by the wind power planed installed. And the development does not stop here.

Figure 1. EU Member state market shares in 2011. Source: Wind in Power 2011 European statistics – EWEA.
Who are the investors: the Czech from CEZ are building a project of EUR 1.1 billion in a wind farm of 600MW in two localities in Dobrogea (the SE area of Romania, close to the Black Sea shore) – the investment is expected to be completed in 2012. The Italians from Enel Green Power are yet another important investor with approximately 270 MW set up in different localities from the same locality, Dobrogea. In fact, we shall see that most investors choose this area located on the Black Sea shore. Other large investors are the Portuguese from Energias de Portugal (with 228 MW), the Spanish from Iberdrola (80-MW) and the French-Belgian group GDF Suez (500-MW) – data supplied in the reports drafted by Transelectrica, the Romanian national electricity carrier. According to the data supplied by Transelectrica, at the end of the first quarter of 2012, wind projects with a capacity of 1,140 MW were operational, which means that this sector already attracted investments of more than EUR 1.7 bill. Apart from these projects, more than 20,000 MW are now either with executed grid connection contracts, or in the stage in which the technical grid connection approvals were obtained.

Renewable energy sources have grown to supply an estimated 16.7% of global final energy consumption in 2010 (Figure 2). Base on the report issued by REN21 organization in 2011 - Renewable energy policy Network for the 21st century: In the power sector, renewable accounted for almost half of the estimated 208 gigawatts (GW) of electric capacity added globally during 2011. Wind and solar photovoltaics (PV) accounted for almost 40% and 30% of new renewable capacity, respectively, followed by hydropower (nearly 25%). By the end of 2011, total renewable power capacity worldwide exceeded 1,360 GW, up 8% over 2010; renewable energy comprised more than 25% of total global power-generating capacity (estimated at 5,360 GW in 2011) and supplied an estimated 20.3% of global electricity. Non-hydropower renewable exceeded 390 GW, a 24% capacity increase over 2010².

Figure 2. Renewable energy share of global final energy consumption, 2010.

During 5 years (the period from 2006 through 2011), total global installed capacity of many renewable energy technologies grew at very rapid rates. The fastest grow 58% annually was for Solar photovoltaics (PV). It was followed by concentrating solar thermal power (CSP) 37% increase, growing from a small base, and wind power, which increased 26% (Figure 3).

A study carried out by EurObserv’ER – Wind Power Barometer in 2012 estimates the global installed wind turbine capacity at about 238.5 GW in 2011. In 2011 Asia was the world’s biggest market (52%) ahead of Europe (24.5%) and North America (19.7%). Europe still has the largest wind power capacity in the world with 40.6% of total in 2011.
According with Wind in Power 2011 European statistics - The European Wind energy association EWEA, regarding 2011 annual installations we have:

- 9,616 MW of wind power capacity (worth some €12.6 billion) was installed in the EU during 2011, a similar figure to the previous year (9,648 in 2010);
- Wind power accounted for 21.4% of total 2011 power capacity installations;
- Renewable power installations accounted for 71.3% of new installations during 2011: 32,043 MW of a total of 44,939 MW of new power capacity;
- More renewable power capacity was installed during 2011 than any other year, an increase of 37.7% compared to 2010;


If we are looking at the trends we can see that the EU’s total installed power capacity increased by 35,468 MW net to 895,878 MW, with wind power increasing its share of installed capacity to 10.5% (93,957 MW), and renewable capacity increasing its share to 31.1%.
A special remark: The EU power sector continues its move away from fuel oil and nuclear, with each technology continuing to decommission more than it installs;

- Germany remains the EU country with the largest installed capacity, followed by Spain, France, Italy and the UK;
- The wind capacity installed by the end of 2011 would, in a normal year, produce 204 TWh of electricity, representing 6.3% of electricity consumption – up from 5.3% the year before.

**Figure 5. Cumulative wind power installations in the EU (GW).**

Source: EurObserv’ER – Wind Power Barometer in 2012

**Figure 6. Installed wind power capacity in the European Union at the end of 2011.**

THE GREEN ENERGY MARKET IN ROMANIA IS BOOSTING

In 2007 the Romanian government approved a long term Energy Strategy 2007-2020. The strategy is taking into consideration the energy developments in the European Union as well as the developments in the National Energy System. The government’s strategy emphasizes on:
• increasing energy efficiency
• boosting renewable energy
• diversifying import sources and transport routes
• modernizing lines
• protecting critical infrastructure.

The electricity demand in Romania has decreased during the ’90s, and several power plants (especially the thermal ones) were decommissioned. However, as the economy recovered in 2000, the demand increased. The electricity generation unit operational in Romania, thermal plants, water plants or the nuclear reactors in Cernavodă, have the net power available in the system of 16,445 MW, but the units actually used were of approximately 10,000 MW.

The level of the national targets for the weight of electricity from renewable sources in the final power consumption in the horizon of the years 2010, 2015 and 2020 are of 33%, 35% and, respectively, 38%. (according to the law 220 adopted by the Romanian Parliament in 2008). The most promising energy sources for Romania are wind, biomass and hydro sources. The share of electricity produced from renewable energy resources in the national gross electricity consumption was about 29% in 2004 and close to the target of 33%, in 2010. Considering the important investment level required, this objective can only be achieved through foreign capital and know-how investments, in combination with a generous support mechanism.

At the end of 2010, in Romania, there was an installed wind capacity of 462 MW, supplement in 2011, by another 520 MW. On the overall, at the EU level, another 9,367.7 MW were installed last year. Only Sweden, Great Britain, France, Italy, Spain and Germany added a higher number of wind power MW last year as compared to Romania. In the ranking of the largest installed capacities, Romania is in the second half, on the 15th place, very close to Belgium (1,078 MW installed at the end of 2011) and followed by Bulgaria (612 MW installed at the end of 2011). The ranking is led by Germany, with a total of 29,075.6 MW, of which 2,007 MW installed in 2011. The second place is occupied by Spain, with 21,673 (914 MW newly added), and the third place is occupied by Italy, with 6,737 MW (932.7 new MW).

Situated on the south of Romania and having one border at the Black Sea shore, Bulgaria started his plan of developing wind power plans with some years in advance of Romania. In 2010 were 237 MW installed and at the end of 2011, 612 MW. The total capacity installed in Romania over passed the one in Bulgaria in 2011 and the trend show that this difference will be wider in favour of Romania in the following years.

The main institutions on the energy market in Romania:

a. Regulation: ANRE - National Authority for Energy Regulation in Romania with responsibilities in:
• monitoring and implementation of energy regulations;
• issue/ suspension of operation licenses;
• setting procedures and rates for the energy and natural gas market.

In so far as the renewable energy promotion scheme is concerned, ANRE will be involved in:
• draw up of the Accreditation Regulation (secondary law);
• accreditation of power plants benefiting from the promotion scheme, according to the Accreditation Regulation;
• setting of the compulsory levels to be achieved each year;
• regulation allowing the guaranteed or priority access to the grid;
• monitoring of the projects benefiting from the promotion scheme.

b. Transport and infrastructure: Transelectrica - the national electricity carrier, playing a key role on the Romanian electricity market. The company manages and operates the power transport system. Transelectrica is liable for the electricity transport and for the development of the market infrastructure and the assurance of the Romanian energy system security.

c. Control and organization of the power trading market, including green certificates: OPCOM - the Romanian electricity market operator - plays the role of electricity market manager, offering the coordinated, viable and efficient environment for the performance of the commercial transactions on the wholesale electricity market under correctness, impartiality, independence and transparency terms (as per OPCOM – statutory documents). OPCOM is one of Transelectrica’s branches. OPCOM is the regulatory body, liable for the green certificates market control.

Currently, there are 84 suppliers and 57 producers on the Romanian electricity power market.

Transelectrica is state-controlled, through the Ministry of Economy, which holds 73.68% of the titles. Proprietatea Fund holds a share of 13.49% of the company’s capital, and a package of 12.81% of the titles belongs to several shareholders. The company is listed on the Bucharest stock exchange since 2006. Pursuant to the agreements concluded with IMF (International Monetary Fund), the sale of additional packages of 15% of the shares was decided in 2012. According to the agreements with IMF the sale of the entire majority package is desired. We cannot currently examine the implications of this privatization, but it shall clearly change the Romanian electricity market.

FACTORS THAT ALLOWED FOR THE DEVELOPMENT OF THE INVESTMENTS IN THE FIELD OF WIND POWER GENERATION

The important investments in the field of wind power generation were influenced and encouraged by two important factors:

– The natural conditions in Romania favorable to the development of wind farms
– The support scheme proposed and adopted by the Romanian state. This scheme relies on the following elements: freely traded green certificates to subsidize renewable energy production and mandatory production quotas for energy suppliers.

In 2011, the problem of the instability of laws in the field was solved. After a lengthy authorization process, last year, Romania received the European Commission’s approval to implement the renewable sources energy generation support scheme proposed through the Law 220/2008.

According to the scheme, wind energy producers will receive two green certificates (documents monthly issued by Transelectrica, attesting a quantity of MWh of electricity produced from renewable sources and traded based on bilateral agreements or on the centralized market) by 2017 and one certificate starting 2018.

The green certificates received by producers from renewable sources can be traded independently of the quantity of energy they represent, on the green certificates market, which is distinct from the energy market or on the centralized green certificates market set by the Romanian electricity market operator, OPCOM. The minimum and maximum price levels for the green certificates are set through the law.

In 2011, the Romanian government decided to double the value of green certificates for the generation of wind energy and to maintain this value until 2017. At the same time, this led to
the increase of the sanctions for distributors who do not observe the production quota. The maximum green certificate price was increased to € 0.055 per kWh and the minimum price to € 0.027 per kWh.

The value of the green energy support scheme is of more than EUR 10 billion - according to the data supplied by the National Authority for Energy Regulation (ANRE).

At least 83 countries — 41 developed/transition countries and 42 developing countries — have some type of policy to promote renewable power generation\(^5\). The 10 most common policy types are feed-in tariffs, renewable portfolio standards, capital subsidies or grants, investment tax credits, sales tax or VAT exemptions, green certificate trading, direct energy production payments or tax credits, net metering, direct public investment or financing, and public competitive bidding.

**Figure 7. Renewable energy promotion policies by country.**

Romania has combined a compulsory production quota with a green certificates trading system as the main support mechanism.

One green certificate attests a quantity of 1 MWh of electricity produced from renewable energy sources, and the mandatory quota system is meant to promote renewable sources energy...
generation, through the purchase by the suppliers of mandatory electricity quotas generated from such sources, in order to sell them to the served consumers. The trading of green certificates and the setting of the Centralized green certificates market are ensured by OPCOM – the green certificates market operator. The Green certificates’ rates range is according to the Government Decision. The minimum price is imposed in order to protect producers, while the maximum price is meant to protect consumers.

For 2008-2014, the green certificates’ trading value falls between a minimum trading value of EUR 27 /certificate and a maximum trading value of EUR 55 /certificate.

Electricity is traded separately from green certificates. The certificates’ price is included in the rate for the distribution of electricity to the end consumer. In fact, the end consumer covers the green energy development price.

According to the data supplied by the National Authority for Energy Regulation (ANRE), in 2011, producers received EUR 95 million, and for 2012 it is estimated that approximately EUR 300 million will be paid.

Green certificates are allocated yearly to the renewable energy producers according with the estimated electricity quotas. There is a peak in certificate trading volume each January link to the annual allocation date of the green certificate.

According to the statistics, the main cost of an investment in a wind power plant project is the equipment (75% of the overall value), the rest representing costs related to land, infrastructure and grid connection.

At a world level, there are large wind turbines producing companies, such as Vestas (Denmark), General Electric (USA) or Siemens (Germany). They supplied the equipment for most projects developed in Romania. At the same time, in the case of a project developed by Iberdrola (Spain) in Dobrogea, an agreement for turbines delivery was concluded with the Chinese producer Sinovel.

‘Ziarul Financiar’ – an important Romanian business newspaper – is following the evolution of wind power plant investments in the Romanian market in an article from the end of July 2012: ‘Vestas, the world’s leading manufacturer of wind turbines, with almost EUR6 billion in revenue in 2011, has installed EUR550 million worth of wind turbines in Romania over the last two years’.
Despite the major investments already made in the construction of the Romanian wind farms (approx. EUR 1.7 bill.) no local facilities for the production of such equipment were developed so far. This is one of the benefits wasted by the Romanian industry, unable to take advantage of the wind power generation boom.

Source: REN21 - 2011 report.

Figure 9. Market shares of top 10 turbine manufactures, 2011.

Speaking about others countries, green energy was considered as an opportunity for creating new jobs (for example in US from the beginning of the mandate, Obama Administration considered that the new jobs created will the .green jobs’) but so far the results are rather disappointing. There are a lot of reactions from the economy claiming that there are just a few new jobs in new green industry and on the top of that these new jobs reduced more jobs in the .traditional’ energy industry. The opinion of The Wall Street Journal from November 28, 2011 has a suggestive note Forget „clean energy”. Oil and gas are boosting the US employment’. The article identified, based on the official statistics, that the „clean energy’ created not as many new jobs as it was expected.

According with Canadian Centre for Policy Alternatives in 2012 report, A Green Industrial Revolution’ is mentioned: „Another key challenge is that many of the jobs from non green industries (like oil industry for example) are highly paid unionized jobs. At the same time, many service sector jobs from the green industry are low paying and provide little job satisfaction.’ There are some aspects that should be taken in consideration by the Governments of the countries looking for developing the „green energy’.

ROMANIA ENJOYS SIGNIFICANT AND PROPERLY DOCUMENTED WIND POWER RESOURCES, BUT THERE IS A PROBLEM RELATED TO THE EXCESSIVELY ACCELERATED DEVELOPMENT

Romania reaches the top 10 most attractive countries in the world in terms of wind power energy investments for the first time, according to the latest Country Attractiveness Indices Report, issued by Ernst & Young. This progress reflects the newest investments in wind farms on the territory of Romania. The index calculated by Ernst & Young ranks Romania on the same place as Poland and Ireland in terms of the attractiveness of the wind power market and very close to countries such as Sweden, France and Italy. The general index, which includes the score for all the renewable energy categories (wind, solar, geothermal, and biomass), places Romania on the 13th place at a world level in terms of the local market attractiveness for the development of energy projects in all these fields4.
Romania is regarded as having the highest wind power potential in the area, with an overall estimated capacity of 14,000 MWh. In Figure 10 the relevant regions for wind energy are Dobrogea (East - having one border at the Black Sea shore) and Moldova (North-East of Romania).

According to Transelectrica data, at the end of March 2012, wind power projects with a capacity of 1,140 MW were operational. Apart from these projects, more than 20,000 MW are currently either with signed grid connection agreements, or in the stage in which they obtained technical grid connection approvals. This capacity is higher than in all energy production units operational in Romania, whether we are talking about thermal plants, hydroelectric power plants or about the nuclear reactors in Cernavodă.

If all these wind power plants projects would be completed, the value of the investments would reach EUR 30 billion. The problem is that the system does not allow for the integration of more than 3,000 MW in wind projects. There is a balancing capacity (through hydro capacities, for instance) for 3,000 MW of wind power in the system, while Romania’s wind power potential is of 14,000 MW.

Another problem is related to the power demand that does not rise to the offer level. There still are no large consumers in the grid (large industrial groups) that would absorb the generated energy surplus. There were projects for the development of new steel plants, but these projects were postponed due to the difficult world economy context.

The particularity of the wind energy production is that this is not linear; it depends on the wind activity so there are some periods having a pick and others with no energy production. For these variations there is a need of balancing the total energy production energy level. The load balancing activity is not yet a difficult task thanks to the important part of the electricity produced by hydro power plants in Romania. Also the load is covered from coal, gas, oil and nuclear sources. Moreover, is under construction a 1000 MW Pump-Storage Hydropower Plant situated in Tarnita - Lăpuşteşti North-West of Romania. It will be the largest hydro-electric load balancing system in Romania.

At the same time, there is the danger of the green certificates market saturation in certain periods related to the peak production seasons, due to the low trading level thereof on the market. The situation is monitored by OPCOM, and the increase of the green energy production expected for 2012 can bring numerous green certificates on the market.

Transelectrica’s role – the Romanian electricity transportation and distribution operator plays an essential role in the development of the national electricity infrastructure. According to the data presented by Transelectrica, investments in the expansion and modernization of the national grid are required, amounting to € 2.5 billion, in order to be able to settle the increasing number of grid connection demands.

For export, Transelectrica’s main role will be to ensure the interconnection of the national grid to the networks in the neighboring countries. Last year, an interconnection with Hungary was performed, and there are plans in progress for the interconnection with Serbia and...
the Republic of Moldova. There also is an ongoing pre-feasibility study, related to the interconnection with Turkey through an underground cable through the Black Sea.

**CONCLUSIONS AND FINAL REMARKS**

The Romanian government approved a long term Energy Strategy 2007-2020 that emphasizes on increasing energy efficiency and boosting renewable energy. The level of the Romania national quota for the renewable sources electricity weight in the final electricity consumption in the perspective of the years 2020 is of 38%. If we compare it to the target proposed by the EU for the entire Union (20%), Romania has set ambitious targets, above the European average. The share of electricity produced from renewable energy resources in the national gross electricity consumption was close to the target of 33%, in 2010.

The development of the wind power generation in Romania is spectacular. From 7MW at the beginning of the years 2000, we are talking about 982 MW in 2012. Romania is in top 10 most attractive countries in the world for wind power investments, according to the Erns&Young report of 2012.

As other countries interested in the development of renewable energy, Romania has adopted a support scheme. The Romanian system for the support of the renewable energy generation is based on green certificates and imposed production quotas. As compared to other countries in the area, the support system was permanently adapted and the subsidies and quotas were increased. The support system can be regarded as an example for the other states in terms of the attraction of investors, and the number of installed megawatts is a proof of success. Attractive combination of weather conditions and an attractive support mechanism ensure proper investments output on the long term.

Important international players are active in the Romanian wind power generation market like the Czech from CEZ, the Italians from Enel Green Power, the Portuguese from Energias de Portugal, the Spanish from Iberdrola and the French-Belgian group GDF Suez. The volume of the investments in the last two years (2010-2011) is more than EUR 1.7 bill. There are no local producers for wind turbines and the big world large wind turbines producing companies take the advantage of the booming industry, such as Vestas (Denmark), General Electric (USA), Siemens (Germany) and the Chinese producer Sinovel.

There are still series of problems for the Romanian developers in the field, such as:
- funding problems, due to the high investment volume required for such projects;
- grid connection-related problems;
- low consumer volume;
- possible green certificates market saturation.

Efforts are made to improve the energy infrastructure, and Transelectica, through its position of national energy carrier, plays an essential role. Thus, without investments in new lines, without the increase of the power consumption, without the development of new large power consumption industrial centers, many of these wind farm projects will remain on paper only. At the moment the system does not allow for the integration of more than 3,000 MW in wind projects and to increase it requires the development of balancing capacities.

Transelectrica is held by the Romanian state in a percentage of 78%, and the agreements concluded with IMF aim at reducing this share. It is beyond doubt that, on the long term, the decision to privatize most Transelectrica shares will strongly influence the development of the Romanian electricity market.

Many projects were announced over the past years. It is too early to clearly state whether all these projects will actually be developed, but the wind capacity is expected to significantly grow over the next few years. A part of this capacity will be absorbed by the internal market
through the increase in the number of consumers, and the rest will have export potential. The interconnection of the national grid to the networks in the neighboring countries was ensured and the possibility of the interconnection with Turkey is considered. Depending on the investment decisions, the Romanian renewable energy industry will enjoy growth over the years to come.

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THE IMPACT OF CULTURE ON BUSINESS STRATEGY

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Abstract: The central issue in strategy formulation is identification of environmental forces, and preparation of a plan of action to deal with them. Environmental scanning enables the firm to identify these forces which calls for gathering information. This in turn involves deciding what to look for, where to look, and what to select from the multitude of information available. The process is not an objective and mechanistic activity that is free of human biases. The scanning and information gathering is a culturally based perceptual process. The external environmental assessment aspect of strategy formulation is a five-step process of scanning behavior, information selection, interpretation, validation, and prioritizing. Because these steps are based on culturally programmed perception processes, country differences can be expected in each step. Strategy formulation and implementation also deal with internal organizational issues that center around relationships among people. Both internal and external steps in the strategy process involve perception and thinking, and both are influenced by culture. Therefore, the process of strategy making varies among people of different cultures. This paper addresses these issues and discusses implications of cultural differences on strategy process.

Keywords: Culture and Strategy, Impact of Culture on Business Strategy

JEL Codes: M16

INTRODUCTION

The central issue in strategy formulation is identification of environmental forces that may have an influence on the organization and preparation of a plan of action to deal with them. Environmental scanning should enable the firm to identify these forces. Doing this not only calls for information gathering, but also for deciding what to look for, where to look, and what to select from the multitude of information available. The process is not an objective and mechanistic activity that is free of human biases. The scanning and information gathering is a culturally based perceptual process. The external environmental assessment aspect of strategy formulation has been described by Susan Schneider as a five-step process of scanning behavior, information selection, interpretation, validation, and prioritizing. Because these steps are based on culturally programmed perception processes, country differences can be expected in each step.1

Strategy formulation and implementation also deal with internal organizational issues that center on relationships among people, such as the place of individuals and groups in the society, the hierarchy, power, and authority. Both internal and external steps in the strategy process involve perception and thinking, both of which are influenced by culture. Therefore, the process of strategy making varies among people of different cultures. In the following we address these issues in two parts. First, we discuss how people relate to the environment. Second, we
examine the relationship among people. Using the understanding formed in the first two parts as a framework, we proceed with the explanation of cultural difference in perception and thinking and the implications of cultural differences on strategy process.

**RELATIONSHIP WITH THE ENVIRONMENT**

American and many other Western societies consider exploitation of nature a desirable action. People are considered to be masters of the world and this belief leads to an engineering orientation toward nature. It means that the physical environment should conform to the design made by people. If there is any mismatch, it is the physical environment that should be changed to fit the plans and obstacles in the path are destroyed. In contrast to this proactive and engineering view, some cultures believe in a symbiotic relationship with the nature. Native Americans, for example, instead of attempting to change the environment, believe in living in harmony with the surroundings, and trying to be a part of it, not apart from it. The mental framework used by an engineering-oriented person is very different from a symbiotic mentality. Each mentality leads to a different scanning behavior. An engineering-oriented person looks for data in support of change and intervention in the environment. In contrast, preference to live in harmony with the environment leads a symbiotic-oriented person to search for non-destructive alternatives.

Scanning behavior is also influenced by the belief that people are able to control the environment. The fatalist beliefs of Buddhists and Muslims’ conviction that events are predetermined limit their scanning behavior. If environmental forces are beyond the control of individuals, and if events are preordained, what is the use of a strategy? This is not to say that Moslem or Buddhist businesses function with no plans or strategies. It involves the acknowledgment in these cultures of the limits of human control. This is in sharp contrast to the American “can do” mentality and belief in self-determination.

Strategy formulation above all is a mental exercise and a thought process. Thinking patterns among people vary. This variation is due to cultural programming that influences perception and shapes the individual psyche. In the simpler life of pre-industrial societies, people were accustomed to direct contact with objects and persons. In their thinking, they relied on visual associations between events and the environment. Industrial societies have grown complex and have substituted abstract concepts for the visual association, concrete objects, and relationships. Daily life in civilized societies therefore relies more on conceptualization and abstraction. Cultures, however, vary in their methods of conceptualization and abstraction. There are cultural differences in the use of cognitive models of environment for interpretation of the nature and the world. An important cognitive model that very much influences organizational life is a causation model that is used to explain events.

Research findings suggest, for example, that there is a difference between the way Americans and Japanese perceive causation. In short, the type of information that we select from our scanning process is a function of cultural upbringing. Cultural differences result in various perceptual models that are the product of our abstraction process. Synthesizing these findings, Robert Doktor suggests that the managerial practices of Japanese and Americans are due to different views of causation. A different use of brain structure and differences in cognitive models lead to two different causation maps. American thinking is shaped by Aristotelian logic that assumes an action-reaction process, the position that events occur in “response” to one or more prior events. Most Japanese use an “environmental” model of causation. They rely on the concrete data received from primary senses. They emphasize the more concrete environmental relationships such as group consensus, nation, and security.

As Richard Nisbett stated “… two different approaches to the world have maintained
themselves for thousands of years. These approaches include profoundly different social relations, views about the nature of world, and characteristic thought processes. Each of these orientations—the Western and the Eastern—is a self-reinforcing, homeostatic system. The social practices promote the world-views; the world-views dictate the appropriate thought processes; and the thought processes both justify the world-views and support the social practices. Understanding these homeostatic systems has implications for grasping the fundamental nature of the mind, for beliefs about how we ought ideally to reason......”

The American cognitive model is logical, sequential, and it is based on an abstract concept of universal reality. Japanese cognition is based on concrete perception that relies on sense data, emphasizes the particular, rather than universal, reality, is not abstract, and has a high sensitivity to environmental context and relationships. The abstract concepts used by Americans to explain organizational behavior, such as leadership, morale, and decision making, are not well defined in the Japanese language.

Western cultures, and particularly the American culture, place a high value and priority on rational, objective, and factual information in support of business decisions. Aristotelian logic used by Europeans, North Americans, and other nations assumes the existence of an "objective" truth. Errors are considered to be the source of differences. Quite often, people attempt to reach an understanding by discarding areas of disagreements and building on the areas on which they agree. Japanese, however, try to include multiple views and build on variations. This is similar to the variation between the two different images of the same object. A three-dimensional view is due to the differences between the two images. Discarding the variations between the two images, results in a two-dimensional, flat object. For the Japanese, the objective truth of Aristotelian logic is a foreign concept which does not have an exact equivalence in Japanese and therefore does not make sense. The translation of the term "objectivity" into Japanese does not quite match the meaning implied by it in the English language. The Japanese translation for the foreign word "objectivity" is kyakkanteki, which means the guest's point of view, and subjectivity is shukanteki, meaning the host's point of view.

There are fundamental differences between the way Westerners and Easterners view the world. Westerners pay more attention to objects, while Easterners focus more on the overall surroundings. Consequently, Easterners are more likely to detect relationships among events than Westerners. Westerners believe more than Easterners in the ability to control the environment and see the world as composed of objects, while Easterners see the world as composed of substances. This leads to Westerners method of organizing by categorizing the objects, and Easterners emphasizing the relationships. Because of Easterners' heightened perception of the environment, they attribute causality more to the context, and tend to resolve contradiction and conflict by seeking a middle option between two positions. Westerners on the other hand, rely more on logical rules and in resolving contradiction insist on the correctness of one side. Table 1 summarizes the differences between Easterners and Westerners.

We can surmise from the preceding discussion that scanning behavior is a function of assumptions regarding the nature of "truth and reality." It also brings to our attention that other aspects of the scanning behavior, namely, selection, interpretation, validation, and prioritization, are influenced by mental frameworks and the interpretation of our observation of environmental phenomenon. Observations of the managerial practices of other nations, for example, are interpreted using our cultural cognitive maps. Application of our cultural cognitive maps for understanding and evaluating the people of other cultures is also called a self-reference criterion (SRC). SRC is the unconscious reference to one's own cultural values. SRC may lead us to wrong conclusions. For instance, in the past few decades, the success of Japanese business has lead to the study of Japanese managerial practices, in a search to find the "secret" to their achievements.
Reinventing Business in a Changing World

Using SRC, we have erroneously interpreted the Japanese decision-making process as consensus. Because Japanese include input from different levels of the hierarchy and involve many employees in the process, their collective decision making has been labeled as reaching consensus. If consensus means reaching the same decision, then interpreting the Japanese approach as consensus decision making is incorrect. The Japanese collective decision making can best be described as the process of informing all involved about future adjustments and paybacks. The outcome of any decision will cause inconvenience for some and benefit for others. To the Japanese, the main focus of the decision-making process is for all to make a mental note of each individual’s benefits and inconveniences for future adjustment. This, therefore, would call for a collective participation in the process.\textsuperscript{10}

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Table 1. Difference between Easterners and Westerners

<table>
<thead>
<tr>
<th>Issues</th>
<th>Easterners</th>
<th>Westerners</th>
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</thead>
<tbody>
<tr>
<td>1. Assumption about composition of world</td>
<td>See substance</td>
<td>See Objects</td>
</tr>
<tr>
<td>2. Pattern of attention and perception</td>
<td>Attention to environment and relationships</td>
<td>Attention to objects</td>
</tr>
<tr>
<td>3. Relation to environment</td>
<td>Symbiotic relationship with nature. Environmental controllability is limited</td>
<td>Engineering orientation toward nature. Many opportunities to control environment</td>
</tr>
<tr>
<td>4. Change vs. Stability</td>
<td>See stability</td>
<td>See changes</td>
</tr>
<tr>
<td>5. Preferred pattern of explanation of events</td>
<td>Focus on objects and their environment</td>
<td>Focus on objects</td>
</tr>
<tr>
<td>6. Habits of organizing</td>
<td>Emphasize relationship</td>
<td>Categorizing</td>
</tr>
<tr>
<td>7. Resolving conflict and contradiction</td>
<td>Seek middle way</td>
<td>Insisting on the correctness of one belief vs. other’s</td>
</tr>
<tr>
<td>8. Use of formal logical rules</td>
<td>Not rely on logical rules. Use environmental model and relationships: Concrete data received from primary senses, e.g. group consensus</td>
<td>Rely on logical rules: Aristotelian, action-reaction process</td>
</tr>
</tbody>
</table>

In the same vein, the use of SRC in the interpretation of Japanese practices has resulted in another misunderstanding. According to American cultural models, conformity implies losing uniqueness, accepting uniformity, and submission to the rule of the majority. Therefore, it is not a complement to call someone a conformist. Conformity, however, is translated into Japanese “as sharp perception of the situation, unique sense of adaptation with reality, quick orientation and reaction to cope with various situations, responding to the needs of the overall situation.” “Conformity” to the Japanese, using their own standards of desirability in judging behaviors, implies something desirable because it involves understanding others and the ability to comprehend situations from their viewpoints. It seems that the Japanese sense of conformity more closely corresponds to the “flexibility” of the Americans. In contrast, the American sense of conformity implies rigidity and inability to change. Along the same line, the most important function of job rotation, for the Japanese, is to make each worker think “in one another’s head” and become mentally connected with others, while the purpose of job rotation in America is to reduce monotony and boredom. As a side benefit, of course, job rotation is utilized to build different skills among the workers, so that they can be employed interchangeably.

RELATIONSHIPS AMONG PEOPLE

Managerial functions, including strategy formulation, are based on the premise involving patterns of interpersonal relationships. It is accepted that in a business enterprise people will relate to each other in a predictable fashion. This predictability of behavior involves cultural programming such that a superior’s order, and a subordinate’s response, follow an expected pattern, and agreed on modes of behavior. The same is true for other relationships in the organization. Organizational hierarchies are established to deal with these relationships. The American work relationship is based on contractual arrangements that are based on earnings and career opportunities. An American, for example, in fulfilling his or her job responsibilities, expects to receive corresponding rewards. No one is expected to make an individual sacrifice, unless other employees do the same. On that basis, strategies are formulated, and environmental opportunities are considered worthwhile to pursue, if they fit this framework.

In contrast, Japanese firms have a larger assortment of alternatives for strategic choices. Employees understand that each individual may be called on to make personal sacrifices for the benefit of the company. Such sacrifices, however, are interpreted differently. Japanese employees’ sacrifice for the sake of their company is ultimately for their own benefit rather than self-sacrifice. If their sacrifice makes the company prosper, it will be their gain.

At the heart of the American strategic planning process is the concept of a fully functional market. The governing force of this market is pure, albeit theoretical, competition. Fair contractual agreements provide continuity for transactions between the managers as employers, and employees. In effect, in this market the employees sell their labor for a price. The strategy process and the associated scanning behaviors are bound by these rules. In contrast, the governing principle for the French organization is the honor of each class, in a society that has always been, and still is, extremely stratified. In France, “superiors behave as superior beings and subordinates accept and expect this, conscious of their own lower level in the national hierarchy but also of the honor of their own class.” Unlike the Americans, French consider management a “state of mind.” Successful French managers share a distinctive sense of belonging to the French managerial class called cadre.

Most French managers come from engineering schools and see managerial work as requiring an analytical mind, independence, intellectual rigor, and the ability to synthesize information. French managers are excellent at quantitative thoughts and expression, and the numeric aspects of strategy formulation. They believe that their achievement and high position
is due to their intellectual ability. Consequently, senior French managers think their intellectual superiority entitles them to make the most critical and important decisions. Large French organizations are characterized by a centralized decision-making, hierarchical, and compartmentalized structure. Senior managers make all the important decisions, and expect to know all that happens in the firm so they can check everyone’s decisions. This hierarchical arrangement is reflected in the physical structure of the typical large French firms. Often, the chief executive’s office is on the top floor, and the typing pool in the basement. Large public and private institutions hire the best students from top engineering schools, and assign them to fast-track positions. These protégés develop an informal network that exists throughout the French managerial class. The French educational system is set up such that a high proportion of the best brains from each generation are channeled into business, civil service, and government. Such a system brings close cooperation between the French government and business. The special relationship between the French education system and business and also French cultural attributes create a unique managerial mentality. A simple way of explaining this uniqueness is to use the often-cited statement by a GM president. The French equivalent of “What is good for General Motors is good for the United States,” is “what is good for France is good for Peugeot.”

CONCLUSION

Management literature has begun to recognize that American management theories are not universal. The strategic management process is the product of management theories and practices that are rooted in the American culture. Although the general framework, namely the objective of winning in a competitive global marketplace, is universal, the methods, approaches, and orientation to it are not universal. Recognition of cultural differences in the strategy process enables MNCs to understand not only the competition, but also the orientation and attitudes of local managers of its foreign subsidiaries. Acknowledging the influence of culture in the strategy process results in relevant and appropriate managerial practices.

There are practical implication of recognizing the influence of culture on strategy. It is not uncommon for MNCs to have managers from different cultures working together. For example, Howard Stringer, an American, is Chairman of the Board of Directors of Sony Corporation of Japan. For four years, from 2005 to 2009, he was the President and CEO of Sony. During these years, he had to work with Japanese executives in crafting various strategies for Sony. His years of service as the President of Sony did not bring about the expected results. One can argue that he had the difficult task of combining Western and Eastern cultural assumptions in managing Sony. We could imagine some of the hurdles of such a case. Managers from different cultures may craft a particular strategy based on their cultural assumptions without realizing those assumptions are not necessarily shared by others.

For example, for some issues people of different cultures may not necessarily disagree on a particular option. Their apparent agreement may be based on different assumptions and consequently may face problems as they go along. For instance, they may agree on the value of decentralization but for different reasons. Some agrees because they believe that nothing is lost by the division due to decentralization. Others may agree because see each part as independent and makes sense to decentralize. In all of this, they use a different cultural framework to come to the same conclusion. Awareness of different way of thinking and cultural background would be useful. Future disagreements on issues that have previously been agreed upon may be construed as unethical due to misunderstanding of the basis for agreements and the interpretation of personal integrity. Each may interpret personal integrity differently. To some, personal integrity is adhering to absolute principle regardless of the situations. To others, each case depends on the situation. Therefore, future disagreements on issues that have previously
been agreed upon may be considered as unethical due to misunderstanding of the cultural basis for agreements and the interpretation of personal integrity.

8. R. E. Nisbett, Geography of Thought, 44-45.
11. Ibid., 109.
12. Ibid., 103.
16. Ibid., 84.
CENTRAL DEPOSITORY - A PILLAR FOR INNOVATION IN THE ROMANIAN CAPITAL MARKET

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Abstract: The paper tries to demonstrate the innovative role of the Central Depository in the process of Romanian capital market consolidation. In a permanent changing economic environment the Central Depository has been under permanent innovative change at multiple layers: in its mission and institutional structure, in the range of offered services and in the implemented processes. By a detailed immersion in the specific data and in the logic of institutional operation processes the authors put in the lights the importance of this institution in establishing a new architecture for the Romanian capital market and also in the coherent implementation process of the international standards.

Motto: “It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change”
Charles Darwin

DEPOZITATRUL CENTRAL – GENERAL PRESENTATION AND CHARACTERISTICS

Depozitarul Central since its inception in 2007 is permanently an important pillar in implementing the main objectives of the Romanian capital market regarding the harmonization with the European trends and the international best practices.

Depozitarul Central is part of the Bucharest Stock Exchange Group representing the central Romanian Securities Settlement System for local and international investors.

It operates as efficient “cross road” for clients, domestic and international settlements and safekeeping (issuer and investor CSD). Currently Depozitarul Central is serving a diversified and demanding client structure represented by:

- 1,622 issuers
- 73 banks and brokers
- 7,895 institutional investors
- 9,180,285 retail investors

Depozitarul Central provides a comprehensive range of services in three main areas: settlement, registry / custody and asset services. The company operates a flexible and cost efficient settlement system, ensuring that cash and securities are exchanged in a timely and secure manner for a multitude of domestic and international securities.

Together with market experts, Depozitarul Central is defining the best practices for the Romanian post-trade market, flows, roles and responsibilities.

Depozitarul Central provides international settlement and custody services for equities, Eurobonds and other debt instruments from 20 markets, located on 3 continents. The pool of eligible currencies for settlement is expanded at 13 currencies, being the only CSD in the region
which offers both Free of Payment and Delivery versus Payment services for all cross-border links.

**Table 1. Depozitarul Central- main services delivered**

<table>
<thead>
<tr>
<th>Service</th>
<th>Description</th>
</tr>
</thead>
</table>
| Clearing and Settlement                      | DvP real-time settlements
Modern matching functions
Settlement of cross-border transactions       |
| Account and asset services                   | The client is offered the possibility to customize the account structure for its own needs (omnibus & individual acc.) |
| Remote membership                            | International clients direct securities account relationship: reduces the instructions cut-off time, direct access to CA* information, cost efficiency |
| Corporate action and dividend payments        | Include also Issuer Services                                                |
| Asset Optimization                            | Collateral management:
- Pledges
- Lending and Borrowing                                                           |
| Additional Services                          | Risk management
Reporting                                                        |
| Client Relationship Management               |                                                                             |

* CA stands for Corporate Actions

On the basis of its main strategic objective — **Providing a Reliable and Efficient Infrastructure for the Market** – Depozitarul Central is very actively involved and focusing on the harmonization and integration of the post-trade industry in Europe.

The design of Depozitarul Central’s system RoClear ensures a very high settlement rate, and a very high cash netting efficiency.

As a user-governed organisation, Depozitarul Central’s duty is to deliver both short term and long-term benefits to its clients and the market. To achieve this, Depozitarul Central experienced staff has and continues to focus on the needs of the clients, in order to offer them an efficient and customized range of services as well as innovative and tailor-made solutions, all aimed at helping the clients to achieve their business potential.

Since February 2008, Depozitarul Central opened its first cross-border link, opening the Romanian capital market towards listing and trading of foreign issuers, and extending the range of securities which Romanian investors can access through one access point.

The extension of the operations range was realized through implementation of the cross border transfers and settlement messages based on ISO 15022 standards. Since 2010, Depozitarul Central’s international market coverage has been further extended with the introduction of four operational links with the markets of USA, South Africa, Bulgaria and Canada.
Depozitarul Central has also domestic links with the Government Securities Depository and Securities Settlement System operated by Banca Nationala a Romaniei (Central Bank of Romania), SaFIR, to allow for Government Bonds to be traded at the Bucharest Stock Exchange (since 2008), as well as for bonds issued by international financial institutions and deposited in the RoClear system to be used as eligible collateral in monetary policy operations (since 2012).

The **robustness and reliability in the processes** of Depozitarul Central are grounded in international solid best practices of the industry, as presented in the Table 2:

**Table 2: The basic activities and applied practices giving robustness and reliability of the Depozitarul Central processes**

- Entity regulated and supervised by the Central Bank and National Securities Commission
- Proprietary system for messaging & inquiries (RoClear)*
- It operates with constant 20% available capacity, which is continuously updated
- Domestic settlement in central bank money
- Organization of 70 people with an average of 10 years experience
- Stringent operational risk-control procedures, including internal and external audits
- Standardization: SWIFT** and online facilities (RoClear Connect)
- Robust backup data center

* *RoClear is the clearing and settlement, custody, depository and registry system operated by Depozitarul Central

** SWIFT stands for The Society for Worldwide Interbank Financial Telecommunication; SWIFT is an automated mean of communication using standardized messages (according to the international standards issued by the International Standards Organization, ISO)

Source: Depozitarul Central’s web site

The quality of services is on permanent focus for Depozitarul Central. In our research we detected as main driver of customers satisfaction regarding the quality of services the following elements:

**Table 3: The drivers of the quality of services for Depozitarul Central**

- Depozitarul Central is a client focused organization, with active relationship management and client service departments (voice of the client / client ownership / trusted advisor)
- 85% of inquiries resolved same day
- It has implemented “Know Your Client” procedures
- The reporting process is timely and flexible (customized and through multiple channels)
- It uses an efficient pre-settlement risk management process (settlement fails rate is zero)
- An active role is played by User Committees [Target2 Securities*, SWIFT – National Market Practice Group, Market Implementation Group and building Client Advisory Committee]

* **TARGET2 Securities (T2S) is a pan-European system, developed under the coordination of the European Central Bank, to support the real-time processing of cross-border and domestic securities settlements throughout Europe.

Source: Elaborated by the authors based on Depozitarul Central’s documents
DEPOZITARUL CENTRAL - A PILLAR FOR INNOVATION IN THE ROMANIAN CAPITAL MARKET

At the beginning of 2012 it has been celebrated the 5th anniversary of Depozitarul Central as separate legal entity. It was a big challenge for the organization to develop best of breed new products and value-added services, striving to be fully aligned to the highest industry standards. A planned step by step implementation took place and, after these five years, Depozitarul Central has the potential to play a significant role in the region.

Depozitarul Central was pro-actively involved in the European initiatives that will shape the post-trade environment. Following closely the development of the European projects and future legislation, and being committed to offer its clients services at international standards, which can only be found in major capital markets, in only 5 years of operation, Depozitarul Central developed the building blocks of a coherent strategy to establish Bucharest into a regional financial center. Creating an extended network of international links, positioning itself as an early supporter and adopter of the pan-European settlement system Target2 Securities and starting early the preparations for the new European post-trade reality proves that the company is embracing change and is adapting its strategy to the benefit of its existing and potential clients.

Currently, the world is in a process of changing cycles and models, financial analysts talking about the New Normal. Where next for Securities Servicing? Adapting to all of these changes is a challenge to all the players. The new dynamic calls for the ability to adapt to a changing environment, and the debates about the recovery should be focused on innovation and competitiveness. As part of the post-trading edifice of the Bucharest Stock Exchange Group, the aim is to sustain the construction of a more investor-friendly marketplace, and to efficiently compete in the new European environment. In this sense, innovation should be at the heart of business development. Research and innovation offer possibilities both to respond to the many challenges currently facing the new European environment. Having the clients’ expertise on board from the start was of key importance in working together towards our common goal of making Romania a better place to invest. An ongoing dialogue helped Depozitarul Central ensure that the quality of its services best meets the clients’ specific needs, business requirements and strategy. With each passing year, Depozitarul Central continues to offer new services and products, covering all post-trade areas.

Table 4: Main services developed by Depozitarul Central during the first 5 years of activity

- Increasing the investors accessibility to Depozitarul Central’s services, by enabling market participants (brokers and banks) to issue statements of accounts for their clients
- Links to 20 international markets, settlement in 13 currencies
- New settlement mechanism for international securities
- Direct borrowing and lending services, further developed into a comprehensive model, based on the Global Master Securities Lending Agreement
- Bilateral link with SaFIR*, the Central Bank’s depository for Government securities
- Developing the matching system and system functionalities to support OTC (Over-the-counter) settlements, including turnaround trades**
- Dividends payment service, with added functionality which allow distribution through market participants for their clients
- Hosting issuer’s AGM (Annual General Meetings) documentation on Depozitarul Central’s web site
- Omnibus accounts functionalities for clients
- Registration and settlement of a diversified range of domestic and international securities: equities, fixed-income securities, structured products, ETFs***
**SaFIR** is a central securities depository (CSD) operated by the Central Bank of Romania. SaFIR ensures the depositing of government securities and certificates of deposit issued by the Central Bank of Romania, as well as the settlement of operations in such financial instruments.

**Turnaround trades** are Over the Counter (OTC) trades which have a corresponding trade in the stock exchange.

**ETF** stands for Exchange-Traded Funds

Source: Elaborated by the authors based on Depozitarul Central’s reports and documents

The biggest challenge that we had to face from the beginning was to provide our clients with the best of what is available internationally, in the shortest possible time.

We have gained cross border experience, we have links in 20 countries located on 3 continents, and we are able to settle in 13 currencies. Besides the portfolio transfers with foreign central securities depositories, Depozitarul Central provides delivery versus payment cross-border settlements, as well as corporate actions and asset servicing related to foreign securities, acting as a gateway for the community.

A lot of work has been made to assess the market practice compliance, to identify critical topics and to enhance the level of automation. Often it is what you cannot see below the waterline that can have the biggest impact. In response to the growing demand for harmonization, it provides a new state-of-the-art settlement system to the market. Depending on the business needs and settlement volumes, clients are able to choose between using the real-time and screen-based interface, both channels providing security and ISO compliant tools over the instructions. SWIFT capabilities for Settlement and Reconciliation are in place from the 1st of November 2011, for the benefits of risk mitigation and cost savings that can be passed down to the end investors. The next step is the standardization of the Corporate Action processing. Depozitarul Central has established a group under the umbrella of the Romanian Market Implementation Group and Romanian National Market Practice Group, driving to achieve a high degree of standardization and operational efficiency in the corporate actions processing, according to the European standards.

The new borrowing and lending service, developed under the Global Master Securities Lending Agreement, for both fixed income and equities, was another innovative solution for Romania. The service was built on the ISO 15022 infrastructure, allowing Depozitarul Central’s clients to manage their collateral holdings and exposure more efficiently.

The mission of Depozitarul Central continues to align the efforts to become more competitive in a rapidly changing financial market environment. Europe is approaching a key period in the delivery of a single integrated market for financial services, both from regulatory and technical sides.

Depozitarul Central has just signed the European Central Bank’s TARGET2 Securities (T2S) Framework Agreement, being the only Central and Eastern European central securities depository (CSD) which is leading the first migration wave to T2S. Previously, Depozitarul Central was the first non-euro Central and Eastern European central securities depository which signed, three years ago, the Memorandum of Understanding on T2S with the Eurosystem. To make sure that Romanian financial community will benefit from first-hand information, Depozitarul Central has been involved in the T2S project since its inception. Romania has one of the largest T2S National User Groups and the establishment of such a group proved to be a valuable step in improving communication and cooperation among all relevant constituencies, as well as the proactive participation of market players and authorities to the successful implementation of T2S in Romania. T2S intends to build a pan-European domestic settlement marketplace, similar to the Markets in Financial Instruments Directive (MiFID) and the Single European Payment Area (SEPA)
initiatives. In T2S it will be as easy to settle cross-border transactions as it is today to settle domestic trades. This will enhance the ability of issuers and investors to reach across national borders, lowering the cost of capital for issuers. The investors will benefit through reduced costs and optimized spreads. T2S will allow investors to diversify their investments. With a pan-European settlement platform, the custodian banks could potentially maintain fewer CSD links for a region and thereby reduce their infrastructure costs.

T2S will be also an indispensable tool for banks to optimize their collateral management, eliminating the need to shift securities across CSDs in order to use them. New business models will be operated: tax specialized services, asset optimization, or income collection.

The changes in the European CSD industry, both as a result of the T2S initiative, and of the common regulatory framework proposed by the European Commission, amplified the challenges ahead. Depozitarul Central’s team is working hard in the design of its services, and it will make them ready for the first migration wave of T2S. Currently the objective is to provide our clients with direct and indirect access to T2S and accommodate their requirements to euro and non-euro settlements, in Europe and beyond. The introduction of choice and competition represents for Depozitarul Central and its clients the “Passport” to the new post-trade reality. By adopting T2S at an early stage, the Romanian securities industry has shown that is willing and able to adapt quickly to every change, and position Bucharest as a regional financial hub, encouraging the international players to invest in the Romanian market, attracting new capital and securities issuers, and giving the clients the ability to stay ahead.

With the new infrastructure improvements breaking down the old logistical barriers, now is the perfect time to say, without any doubt, that Depozitarul Central is bringing its contribution to building a modern capital market, being able to find the right place in a functional global market. The entire organization is fully committed to build Bucharest as a regional financial center, and to be better providers of competition and innovation.

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SOCIAL AWARENESS IN A CHANGING BUSINESS WORLD

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Abstract: As business changes, either because of the business cycle or modifications in social arrangements, it is important for managers to be socially aware. This is especially true in nations like Romania that are emerging from a command economy, where decisions were supposed to be made based on an engineering, as opposed to a humanistic, model, and where interpersonal distrust interfered with interpersonal sympathy. Nevertheless, unless business persons can anticipate and/or respond to altered conditions, their decisions are apt to have unintended consequences. Both the big picture must be considered. If a complex techno-commercial environment requires decentralization, as it almost surely does, what are the effects on one’s customers and employees? Likewise, if individuals need to be more self-directed, what impact does this have on demand or supply? Both an ability to engage in role-taking and introspection facilitate an understanding of what is required. These enable managers to identify cultural fads and cultural lags that shape the behaviors of those with whom they do business.

JEL Codes: Z13

A TECHNICAL PERSPECTIVE

At least since the advent of Taylorism (Taylor, 1911), many executives have sought a scientific foundation for their business decisions. In the name of profit or rationality, they have attempted to reduce the degree of uncertainty to which their enterprises are exposed. To this end, they have attempted to emulate the hard sciences by introducing exact calculations into their activities. This was especially so in Marxist influenced command economies, such as that of Romania, where planners sought to dictate the most efficient ways of engaging in business. Among the practices to which they have repaired are Dynamic Systems Theory, Six Sigma Analysis, and Total Quality Management (Pande and Holpp, 2001). While each of these has some merit, much is left out.

Managers must, of necessity, cope with numerous transformations in their organizational environment. Both internally and externally, they must deal with changes in political, strategic, and environmental contingencies. Unless they do, they are liable to be blindsided by unexpected developments. Under these circumstances, not only may a business’ fortunes suffer, but the very enterprise in which the actors are engaged may be imperiled. Particularly, if they are in, or have moved to, a market economy, this is the case.; hence the need to improve the chances of getting things right.

While there is no magic formula for dealing with market and regulatory challenges (even within democratic societies), it remains possible to boost the odds of success. Needless to say, the complexities involved are staggeringly multifaceted, especially in a techno-commercial environment. Nevertheless, some approaches are more sound than others. In particular, expecting exact calculations to provide all the correct answers is unwise. Given the need for
greater levels of organizational decentralization, it falls upon the personal, socially informed, judgments of business persons to deal with these matters.

Managers and entrepreneurs who have been accustomed to imperative economic systems must therefore adjust to the uncertainties of making their own decisions. They may also have to alter their interpersonal relations. Where perviously the coercion and dissimulation characteristic of command economies generated distrust, they must learn to be more sensitive to the beliefs and motivations of colleagues, subordinates, and customers (Courtois, et al., 1999).

A SOCIAL PERSPECTIVE—BEYOND THE HUMAN RELATIONS MODEL

The business environment is a human environment, and a human environment is per force a social environment. Many of the problems with which business persons must contend emerge from social dynamics. The ways that individuals deal with each other often determine the best means of interacting with them. This is not a new discovery. For nearly a century, market-oriented business consultants have touted the importance of human relations. Their chief focus, however, has been on keeping employees happy. In the simplest terms, a contented worker was thought to be a productive worker.

Recently, as human resources departments have sprouted across the commercial landscape, the emphasis has transitioned to encouraging diversity. These challenges have occasioned the use of consultants of a variety of stripes, most of whom promise to protect organizations from external hazards. Nonetheless, there is more to being socially aware than these specialities suggest. While psychology, economics, political science, and business theorists have each contributed to expanding the social horizons of managers, sociology has remained outside the tent. This is understandable in light of the hostility many contemporary sociologists express toward commercial endeavors.

This is a shame because the broader vision some sociologists can bring to the table allows neglected issues to come into view. It is therefore useful to step back and consider some of these perspectives. What do sociologists say about social relationships and what are the implications for those engaged in economic concerns?

THE ROLE SOLIDARITY PERSPECTIVE

Ours is what sociologists describe as a Gesellschaft society (Toennies, 1966). We live in a world where we interact with, and depend upon, multitudes of strangers. People do not love, or help, each other merely because they know one another. To the contrary, most individuals remain anonymous outsiders to the overwhelming majority of the members of their own societies. Nonetheless, most of the time they remain cordial, that is, unless a hostile social environment makes them less so. Moreover, most people are sufficiently trustworthy to be depended upon to furnish essential resources for those who count on them.

This circumstance should be fairly obvious, yet many people expect us to improve social conditions by fostering universal love. According to this model—one inherent in socialism—we must learn to support one another’s aspirations from altruistic motives. Unless we do, it is asserted the competitive zeal of the marketplace will be our undoing. The problem with this prescription, however, is that, as Romanians learned, universal love is a chimera. It has never occurred and, given the nature of genuine love, never will.

What then is the alternative? How can millions of people maintain social cohesion when they cannot know, never mind care deeply about, the vast majority of their fellows? One answer has to do with the nature of social hierarchies, whereas another owes to the ubiquity of social roles. This paper is concerned with the latter. Classical sociological theorists such as Herbert
Spencer (1889) and Emile Durkheim (1933) introduced us to this perspective over a century ago. Nevertheless, its repercussions for business endeavors have largely been disregarded. This, however, does not change the fact that we are all embedded in extensive networks of social roles (Turner, 1962). Much of the work required by a complex society demands the development of a far-reaching division of labor. Those who belong to large-scale communities occupy a series of niches in which they specialize in some types of work—but not others. As a consequence, they must interact with role partners whose activities complement their own. It is by working in ways that are mutually interdependent that all benefit.

**THE RESPONSIVENESS MODEL**

Some years ago the anthropologist Mary Ainsworth (1978) made a far-reaching observation. In studying the nature of mother-child relations in Uganda, she discovered that the most successful mothers were the ones who were the most responsive to their babies. These were the ones who noticed when things went wrong and provided what their babies needed, when it was needed. As it happens, the same sort of responsiveness is beneficial in facilitating the activities occurring in adult role partnerships (Fein, 2005). When two parties have interlocking roles, be these as husband and wife, boss and worker, or salesperson and client, the task in which they are jointly engaged is apt to proceed most productively if they are mutually responsive. If they can accurately recognize each other’s contributions and react in ways that suit the achievement of their shared objectives, the outcome of their labors is more likely to accord with their hopes.

Role partners habitually engage in as social negotiations (Biddle, 1979; Haylek, 1988). They participate in a give-and-take of demands and counter-demands that are regularly adjusted to meet their on-going needs. While they may not recognize this process while in its midst, skilled role partners know how to modify what they do in a way that jibes with the modifications they elicit from a collaborator. In the end, neither is exclusively a winner or a loser, but both come out ahead in the sense that they accomplish their objectives more effectively. This sort of flexibility is especially valuable in a rapidly changing environment. Only with it are they liable to foster the shared responses that meet their evolving needs.

Clearly, these considerations apply to business persons trying to adjust to the demands of their customers, their employees, or government agents. Just as a husband may have to make allowances when his wife has a hard day with a kids, and she must be alert to his mood when he arrives home from the office, so an accountant may need to understand the political objectives of auditors or a supervisor to be sensitive to the cultural imperatives that determine his subordinates’ worldviews. In each of these cases, what works best differs according to the social relationship in which it is operating. What then are the skills and attitudes that make for mutually responsive collaborations? Likewise, what are the benefits of doing so?

**ROLE-RELATED SKILLS**

Sociologists have devoted a great deal of effort to analyzing role relations. As a consequence, much is known about what works and what does not. In what follows, two factors will be discussed. These have been selected because they are particularly useful in changing social contexts. They have also been chosen because they are not usually associated with the roles of business persons. These skills are respectively role taking and introspection. As we shall see, these are related to each other. And while they entail personal attributes, their social dimensions will shortly come into focus.

It must also be noted that these capacities are integrated into a propensity to be “self-
directed” (Fein, 2012). Self-directed individuals are those who are capable of making quality decisions, even in an environment of uncertainty (Kohn, 1969). Able to solve problems independently, they possess the personal characteristics to provide leadership for others. Because they are experts in the activities in which they are engaged, but also because they are emotionally mature enough to commit to doing them effectively, their likelihood of choosing well is above average. As it happens, one of the aspects of competent self-direction is skillful role taking.

It is to George Herbert Meade (1934) that we owe the concept “role taking.” As a pioneering symbolic interactionist, he was concerned with how individuals coordinate their separate activities. What do they do to make sure that their behaviors fit together? If people tend to see things from their own perspectives, how do they manage get their actions into alignment? Meade found the answer in our unique perceptual abilities. We humans are cognitively able to comprehend our environment in such a way that we picture both the future and the past, and even imagine things that never were, or will be. Something seems to have changed in the way we our minds work some seventy-plus thousand years ago (Damasio, 1994) that provided us with an incomparable capacity to visualize events that are out of sight.

In any event, this faculty enables us to gain access to each other’s minds to a degree not found in other animals. We can, as it were, see things from each other’s perspectives. In the case of role taking, what we do is imaginatively place ourselves in the shoes of others. We try to see things from their point of view. More than this, we attempt to feel things from their standpoint. Accurate role taking is important because when we respond to another, we must be appropriate. We cannot be responsive role partners if we do not know what others are seeking. Nor can we be responsive if what we propose is not well received. Because individuals hermetically sealed in their own bubbles are oblivious to what is going on in others, they cannot make valid predictions of impending rejoinders. As a result, they find it difficult to engage in meaningful problem-solving.

Closely related to role taking, and therefore equally important to competent self-direction, is introspection. In order to understand what is taking place inside others, it is vital to obtain an accurate assessment of what is occurring inside one’s self. We humans may differ from one another, but we share a common humanity. This being so, the starting point for an accurate forecast of what others will do begins with an accurate understanding of oneself. For many, however, the difficulty arises in achieving a correct analysis of one’s own responses. Many people are not in touch with their inner-most feelings and aspirations. Sadly, these tend to be repressed in societies that punish people for being themselves. Just as Freud (1953-1964) hypothesized, but for social reasons, they repress materials that do not fit with the expected self-image.

This tendency to avoid introspection is especially acute in command economies. Indeed, this is one of the advantages that middle class persons raised in a market economy enjoy when it comes to being proficient decision makers. Unhappily, among the politically disadvantaged, the risk of uncovering an embarrassing weaknesses is great. Learning to engage in honest self-analysis, therefore, takes courage. None of us are as strong as we might wish to be, hence when it comes to introspection, and role taking, the objective is not to concoct the most inspirational narratives, but to come closest to identifying reality. Especially in business, where the way things are has a nasty habit of determining what is profitable, honest assessments can provide the difference between success and failure.

**KEEPING UP WITH CHANGES—THE BIG PICTURE**

The time has come to apply the above social skills to keeping up with changes in the business environment. As those who operate in the marketplace know, conditions can be altered more quickly than it is possible keep tabs on. Without producers having realized it, a product may lose its market viability. The managers at Nokia or Blockbuster are surely aware of this. By the
same token, legal ground rules can be modified such that an entirely new business model is required. Here the executives at AT&T have some experience. Similarly, social norms can be so volatile that it is difficult to determine what meets customer needs.

Demand economies, such as were found in the Soviet bloc (including Romania), sought to forestall change with centralized planning. Their goal was to replace the vagaries of the marketplace with rationalized strategies that could be calculated to the third decimal point. If only the most logical decisions were made, and provided in advance, then surprises would be held to a minimum. Executives would not have to worry about the swings of the business cycle because these would be outlawed. Nor would they have to fear fluctuations in consumer tastes because these would be tamed by giving buyers what they needed, as opposed to what they wanted.

With the world-wide emergence of market-based economies, this aspiration has been set aside. If anything, insecurities have multiplied as the areas in which people do business have expanded. With the advent of greater international competition, business people not only have to keep track of domestic changes, but foreign ones. Indeed, what happens abroad is sometimes as decisive as what happens at home. This was demonstrated by the ramifications of a potential Greek default.

How then can role taking and introspection improve the capacity of practitioners to keep pace with changing events? Since each of the former is a micro-level skill, how can they be applied to macro-level events? The answer is that small and large scale phenomena are in harness. What occurs on one plane can decide what happens on the other. For example, when the Greek government could no longer meet its financial obligations, it had to repair to the European Union for support. This was offered, but only in return for proposed austerity measures. Spending had to be cut, which entailed reducing the number of persons employed by the government. But this, in turn, impacted individuals who took to the streets to make their displeasure known. In short, the larger picture and the smaller picture were in interaction.

This said, there are two important aspects in which keeping up with macro changes can be facilitated by the micro considerations of role taking and personal introspection. These are respectively the impact of “cultural lag” and of “cultural modeling.”

But before continuing, a word must be said about culture. This term, as used by social scientists, refers to “learned and shared ways of life.” It is macro in the sense that it applies to entire communities, but micro in that it is operationalized in the behaviors of individuals. So potent are cultures that they can encase individuals in iron cages at least as robust as those Max Weber (Gerth & Mills, 1946) described as operative within bureaucracies.

CULTURAL LAG

As indicated above, cultures are learned. In fact, many of their aspects are internalized when we are young. As such, they become part of who we are. They consequently influence the way we interpret the world and how we estimate what is likely to happen in the future. The universe may change around us, but the frame of reference we utilize to judge what is happening tends to remain static (Ogburn, 1922). An example is provided by attitudes toward entrepreneurship. Even as this becomes more necessary, it may be shunned by people raised in a system that demonized it.

Cultural lag also affects political arrangements. Thus, when the Arab spring roiled the streets of Egypt, many Westerners perceived this as the prelude to democratic reforms. They assumed that because everyone wants to be free, Egyptian would seek to emulate western-style political arrangements. The problem was that Egyptian culture provides no templates for this sort of polity. Instead, people embraced what they knew, which for a large majority was Islamic fundamentalism. They wanted a return to Sharia Law, not unfamiliar innovations. Romanians
will recognize the same attitudes in ordinary workers, who, although glad to see communism go, are nostalgic for the job security it provided.

Business persons capable of role taking generally recognize emerging opportunities before others. If so, they are able to take these into consideration in time to get ahead of the commercial curve. Those who do not, in contrast, make plans oriented toward the past. They may, for instance, produce products that no longer suit customer needs.

Role taking is useful in that it enables us to see what is not on the surface. Sometimes it is not what people say, but what they are prepared to do, that makes the difference. In these case, introspection can make role taking more accurate. Those who are aware of their own attitudes, assuming they share the same culture as their role partners, can tap into reactions that do not make sense to outsiders. Even if the impulses they uncover are destructive, these can determine what people do. This also, of course, applies to government regulators. They may be irrational as a result of having been socialized under a different system, but that does not cancel out their actions.

Cultural lag is a fact of life. It is powerful, but its ramifications are only visible to those prepared to look for it. Progress too is a fact of life, but how it is shaped is frequently determined by the cultural conditions from which it emerges.

CULTURAL MODELING

Also frequently overlooked because it does not comport with rationalistic paradigms is cultural modeling (Merton, 1968; Bandura, 1971). Most people like to think of themselves as independent operators. They imagine that they make a majority of decisions from scratch. Nonetheless, much of what we do is in imitation of others. In fact, our ability to model behaviors is one of our species’ strong points. As a fundamental feature of cultural learning, it enables us to build upon the advances made by our predecessors.

In truth, even adults have a penchant for modeling behaviors after others. If, for instance, people grow up under deprived circumstances, then find themselves dining in a fancy restaurant, they will observe others to determine what they are supposed to do with their napkin. It is to this predisposition that we owe the phenomenon of the fashion leader (Gladwell, 2000). Most people feel uncomfortable dressing in an unaccustomed manner; hence they avoid standing out.

This proclivity for following the leader is well understood by merchandisers. Less understood is the degree to which role taking and introspection can help identify these trends. Because business persons are themselves embedded in the same culture as their customers, colleagues, and employees, they can utilize their reactions to identify what others model. They will notice what others are noticing and have some sense of why one prototype, rather than another, is adopted. Errors are, no doubt, possible. Just because people share a common culture does not mean they always react the same way. Still, those who are alert to their own responses are more likely to detect disparities.

Self-conscious culture users have a leg up on the competition. They can be more competent as decision-makers because in their awareness of themselves and others, their judgments are less automatic. They can also analyze the implications of what they perceive more accurately than can those who operate from intuition alone. In these cases, role taking and introspection do not take over from rational calculations; they enhance them. By adding a social context that has been detected via one’s own social skills, decisions are liable to be more accurate, as well as more timely. In a world where changes occur with dizzying rapidity, this social awareness provides another mechanism for keeping up with events.
CONCLUSION

We humans are social creatures. This does not change when we enter a commercial environment. Those who deny their social nature by attempting to over-quantify their decisions are apt to leave out important considerations. Although who we are as human beings, in a world populated by billions of other humans, can produce discomforting imprecision, nonetheless this is reality. It is therefore essential that business persons understand the nature of culture, the mechanisms through with it can be ascertained, and the consequences cultural lag and cultural modeling. This becomes ever more significant as marketplace complexities demand further decentralization.

REFERENCES

NET PROMOTER SCORE: KEY METRIC OF CUSTOMER LOYALTY

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Abstract: The paper aims to analyze the use of the net promoter score (NPS) as key metric of customer loyalty and business growth. The main objectives are the following: to clarify the contribution of NPS to the capability of the organization to increase customer loyalty; to investigate the adoption of NPS in the marketing practice of global market players, to study the measurement of brand NPS on the Romanian market as well as to identify the limitations of this indicator. NPS is a key metric of the attitudinal loyalty and may positively impact the behavioral loyalty. However, business growth and purchasing intentions cannot be forecasted only based on this indicator.

Keywords: customer loyalty, loyalty metrics, net promoter score, sales growth
JEL codes: M30, M31, M39

INTRODUCTION

Since the 50s, marketers have considered of paramount importance the concept of customer satisfaction and its measurement. At the beginning of 90s, the attention of marketers was captured not only by the acquisition of new customers, but also by the retention of those already existing in the company’s portfolio. In the middle of 90s, a new approach evolved. Customer loyalty became the buzzword of marketers. Customer satisfaction lost its top position in the portfolio of marketing key performance indicators in favor of loyalty metrics.

The present paper focuses on the net promoter score in relation to customer loyalty and sales growth.

CUSTOMER LOYALTY AND NET PROMOTER SCORE

Loyalty may be analyzed from an attitudinal or a behavioral perspective. One of the landmark definitions of loyalty that combines both approaches was suggested by Oliver in 1996. According to this definition, loyalty is a deeply held commitment to rebuy or repatronize a preferred product/service consistently in the future, thereby causing repetitive same-brand or same brand-set purchasing, despite situational influences and marketing efforts having the potential to cause switching behavior. However, a satisfied customer does not become necessarily a loyal customer.

In 2003, Frederick F. Reichheld shook the pillars of the marketing constructs stating there is the single number marketers have to grow, more precisely the net promoter score (NPS). Reichheld underlined that complex measurements of satisfaction and retention do not lead to business growth. He suggested that marketers should invest primarily in research that correlates the responses with the actual customer behavior (purchasing patterns and referrals) and with the company growth. Together with Satmetrix and Bain & Co., Reichheld studied 4,000 consumers to identify the most effective questions to predict the desirable customer behavior.
The major conclusion of the research was that a single survey question can serve as growth predictor. The question referred to the customer’s willingness to recommend and was formulated as follows: “How likely is that you would recommend [company X] to a friend or colleague?”. The measurement scale was from 0 (“not at all likely”) to 10 (extremely likely). Depending on the level chosen on the scale, customers were included in one of the following three categories: promoters (levels 9 or 10), passives (levels 7 or 8) and detractors (levels 0 to 6).

The new metric (net promoter score) was calculated by subtracting the percentage of detractors from the percentage of promoters for a specific company/brand. The term net promoter score was trademarked by Satmetrix System Inc. The ownership of trademark is shared between Satmetrix, Bain & Company and Fred Reichheld.

ADOPTION AND USE OF NPS BY GLOBAL MARKET PLAYERS

The net promoter score had a period of “glory” in the first decade of the millennium. Outstanding corporations set ambitious objectives relative to the net promoter score in order to achieve substantial business growth.

Illustrative is the example of General Electric. The process of NPS measurement was accomplished gradually. In the first stage, the corporation started the application in several businesses and in a second stage aimed to adopt the NPS system in the entire organization.

Initially, in October 2004, the first attempt to apply NPS was made by the GE Healthcare business unit. The GE Healthcare’s European Diagnostic Imaging business registered a low score in the surveys. The reason customers were not eager to recommend this business was the long response time in case of technical problems. Compared to a 30-minute interval expected by the organizational customers, the European diagnostic imaging business reacted in an average of 40 minutes. Faced with dissatisfied customers, the management decided to analyze the activity of the call center and to redesign the entire process based on the Lean Six Sigma, in order to decrease the response time to 10 minutes (Maddox, 2006). The outcome of these improvement efforts was an increase in the NPS by 15 points for that business.

Energy was another business of GE that benefitted from the application of NPS and Lean Six Sigma. In 2006, the improvements were significant: 30% in the customer outage cycle and 25% in the parts repair cycle. As a consequence, the NPS augmented by 5 points (General Electric, 2007). The initial score for the parts business was -11 and within it, the quote process scored -33 (Maddox, 2006). The average interval to deliver a quote was 30 days and the average conversion rate was 17%. These results underline the utility of the NPS.

General Electric aimed to establish a companywide performance measurement system based on the net promoter score. In 2005, the Chairman and CEO Jeffrey Immelt decided to tie up to 20% of senior executives’ annual bonuses to the NPS (Maddox, 2006).

However, in 2007, NPS received only a very short mention in the annual report. The corporate management stated “We are using Net Promoter Scores to measure our progress with customers.” (General Electric, 2008). Since 2008, no reference to NPS has been made in the annual reports (General Electric, 2009). This may reflect a radical change compared to the approach promoted during the period 2004-2007. The international debate and criticism relative to the net promoter score have impacted negatively the decision of the company to monitor NPS as a key driver of business growth.

Philips is another example of corporation that measures the NPS. The company started to use NPS in 2006 as “key single metric of customer experience”. In 2007, 43% of the key businesses had industry-leading scores and the goal for 2010 was set to 70% (Philips, 2008). In 2008, NPS was measured in all the strategic areas and 47% of the key businesses achieved industry-leading scores (Philips, 2009).
A slight shift in the perspective of Philips relative to NPS occurred in 2009. During the period 2006-2008, the company focused on permanently enhancing the NPS performance, considering this indicator the key single metric of customer experience. Since 2009, the company continued to consider NPS a useful metric, but only “a tool to measure the loyalty” of customers to the Philips products (Philips, 2010). The company used NPS in its efforts to improve customer experience across all touch points. This change in the approach was probably determined by the increased criticism faced by NPS from various theorists and practitioners. The new perspective of Philips mirrors the international debate on the NPS topic. While still important for the organization, NPS ceased to be “the one and only” metric of customer loyalty and tool for business growth.

In 2009, the increased use of NPS at Philips contributed to winning the 42nd place among the 100 most important global brands according to the annual study made by Interbrand. Industry-leading scores were achieved by 60% of the key businesses (Philips, 2010). Such results reflected a significant increase in the share of businesses with (co-)leadership scores from 50% in 2007 to 51% in 2008.

In 2010, NPS was perceived by Philips as “key leading indicator for sales growth” (Philips, 2011). The year 2010 was very important for the management agenda of Philips and one of the objectives was to accelerate change by increasing the number of businesses with NPS (co-)leadership positions. In an international environment marked by turbulences, the NPS slightly increased for Consumer Lifestyle and was stable in Healthcare. While the NPS increased for the BRIC markets and Western Europe, decreases were registered in North America and the rest of EMEA (Philips, 2011). The company aimed at expanding the NPS program to its key markets. Overall, the percentage of businesses with industry leading-scores remained relatively stable (59%). The target of 70% leading scores set for 2010 at the beginning of the NPS program was partially achieved.

In 2011, the NPS performance was rather positive. Industry-leading scores were achieved at Lighting and Consumer Lifestyle. Leading positions have also been obtained in the key geographic areas such as China and the US. In Europe, while the score for LED Lighting increased in Germany, the NPS for Healthcare declined in France (Philips, 2012).

As declared in the Annual Report 2011, Philips “will continue to use NPS as a measure of customer experience” in 2012. In the future, the company will focus on achieving NPS leadership positions compared to competition and on improving own absolute NPS positions with customers.

General Electric was one of the first companies to include NPS in the portfolio of major business indicators and to tie management bonuses to such scores. However, the monitoring of NPS progressively declined in importance. In contrast, the practice of Philips shows that customer-centric organizations continue to monitor the evolution of NPS and ensure a permanent benchmarking both externally against competitors and internally against the various key businesses of the organization. In six years, approximately two thirds of the Philips businesses have industry leadership or co-leadership (challenger) positions. The company is determined to continue augmenting NPS in order to provide an improved customer experience with a positive impact on both customer loyalty and corporate sales.

These examples show that companies overpassed the stage of unconditional adoption of NPS considering it a panacea of and a propeller of business growth. At present, without forgetting about NPS, major global players became more realistic in their expectations from this metric and its ability to contribute to an increased bonding between customers and companies.

Satmetrix monitors the NPS for various sectors and companies. The Satmetrix Net Promoter® Benchmark Study released in March 2012 presented the scores for more than 200
brands for 22 industry sectors across 7 major industry groups: financial services, insurance, online services, retailing, technology, telecommunications, and travel & hospitality industries. The study was based on the answers of 30,000 US consumers. The highest net promoter scores in 2012 were achieved by the following companies: USAA 83% - the highest score not only in the financial services, but also across all the seven industry groups; USAA 74% in the auto insurance sector and 71% for the homeowners insurance sector; Virgin America 66% in the travel sector; Marriott in the hospitality sector; TripAdvisors 33% in the travel Website sector; Apple 71% in the technology sector; Google 51% in the online service sector; Amazon 76% in the online shopping sector; Trader Joe’s and Wegmans 73% in the grocery and supermarkets sector; Costco 71% in the specialty retail sector; Lowe’s 54% in the hardware and home supply retail sector; Safelite Autoglass 48% in the auto repair retail sector; Verizon 37% in cable and satellite TV and 18% in the Internet service telecommunication sector etc.

NPS became a metric monitored periodically to identify the intentions of customers to generate positive and negative word-of-mouth about various brands.

**NPS Measurement in Romania**

The NPS adoption in Romania was marked by a time lag compared to the trends in the US and Western Europe. For a relatively long period, the local businesses did not invest in research studies able to facilitate the monitoring of this metric.

However, in 2009, in Romania, the first research on this topic was designed and implemented by Futurelab and the Daedalus Group. The study was the first to allow NPS benchmarking in various consumer product sectors and between them.

Futurelab applied the solution called *brand express*. The survey was syndicated. The data collection method consisted in telephone interviews. The research sample included 1,000 category users randomly selected for each market. The interviewees were 14-65 y.o. inhabitants (respectively 18-65 y.o. for alcoholic beverages, insurance and banking categories) from the urban environment.

The range of monitored categories included food products (yoghurt, margarine, chocolate, coffee, processed meat, cooking oil), beverages (still water, sparkling water, nectar and natural juice, still drinks), toiletry products (tooth paste, shower gel, shampoo), household products (dishwashing products, detergents), as well as gas stations, banks and analgesics. The scores resulted from research revealed the high performance of star brands and identified the “lame ducks” in each market.

In the plain yoghurt market, the NPS market average (calculated as the mean of the NPS for the measured brands) was 25.4%, the share of promoters being approximately 49% and the share of detractors approximately 21.4%. In this market, the Activia brand of the Danone Group reached the highest NPS, respectively 63.2% with a share of promoters of 66.2% unmatched by any competitor or by another yogurt brand of the Danone Group and with a share of detractors of only 3.0%. The NPS of Activia is remarkable. In the fruit yoghurt market, the NPS for Activia was 56.3%, based on a share of promoters of 67.2% and a share of detractors of 10.9%.

In a market with many players and a diversified product portfolio that provides customers with various possible choices, the performance of Activia “stands out from the crowd of yoghurt brands”. This score reflects the high attachment of users to the Activia brand.

The entire marketing policy of Danone for Activia led to the progressive building of this brand on the Romanian market. Firstly, one reason of the high NPS may be that Danone defined a specific target for Activia, specifically the women segment. The brand addressed one of the present health challenges for women and mirrored this targeting choice in all the communication campaigns. Secondly, another reason of the extremely favorable score may be that users resonate...
with the distinctive and clearly communicated value proposition of the brand. Unlike other yoghurt products, Activia was positioned as functional food that was designed to improve digestive health. In essence, the concept of functional food refers to a food product that acquires a function such as health promotion or disease prevention due to the addition of a biologically-active compound. Thirdly, the high score may also be the result of the very intensive marketing communication for the Activia brand. Danone invested heavily in advertising for its brand portfolio. The share held by Danone in the advertising expenditures on the yoghurt market was 71% in 2010 (Stoian, 2012). The NPS of Activia was matched by no other brand from the yoghurt market.

According to the research made by Futurelab and the Daedalus Group, other examples of brands with top NPS scores in their categories were: Rama margarine 50.6%, Borsec still water 54.2%, Borsec sparkling water 58.4%, Santal nectar 55%, Prigat still drink 46.3%, Nurofen Raceala si Gripa cold and cough medicine 62.9%, Nurofen analgesic 46.8%, Fairy dishwashing detergent 74.5%, Elseve shampoo 75.4%, Dove shower gel 78.1%, Colgate tooth paste 68.3%, Bunica cooking oil 59.1%, Matache Macelarul processed meat 45.3%, Milka chocolate tablets 70.4%, Snickers chocolate bars 68.2%, Jacobs coffee (R&G) 60.7%, ING Bank 44.1%.

A weak NPS is not necessarily a positive NPS. On the Romanian market, several brands “succeeded” to achieve significant negative scores. In other words, for these brands the share of detractors surpassed the share of promoters. Examples are the following brands: Antinevralgic P -10.1% (compared to an average NPS of +21.3% for the analgesic category), Bancpost -9.4% (compared to an average NPS of +19% for the bank category) and Laura 12.5% (compared to an average NPS of +28.1% for the chocolate tablets category).

These figures show that Romanian consumers would more likely recommend global brands. Few Romanian brands received the highest NPS in their categories.

**NPS: THE SINGLE PREDICTOR OF LOYALTY AND BUSINESS GROWTH?**

In 2005 and 2006, the findings of several research studies were placed in the foreground due to the positive correlation they revealed between the net promoter score and business growth.

A study accomplished on a random sample of 1,256 adult consumers led the researchers associated with London School of Economics and The Listening Company to state that word of mouth predicts sales growth for banks, car manufacturers, mobile phone networks and supermarkets in the UK (Marsden, Samson, Upton, 2005). Both word-of-mouth advocacy rates and negative word-of-mouth were statistically significant predictors of annual 2003-2004 sales growth. Research findings showed that a 7-point increase in NPS may be correlated with a one percentage point increase in the growth rate. Every 2% reduction in the negative word-of-mouth correlated to less than 1% growth (i.e. 0.414% more growth).

A study done by Bain & Company also provided evidence that NPS is a predictor of growth. The researchers concluded that a 12-point increase in NPS may correspond to a doubling of a company’s growth rate (with substantial variations from one industry to another) (Reichheld, 2006a).

Such findings led business people to focus on NPS as growth driver. Suddenly, decision-makers thought of measuring a single metric – the NPS - instead of a complex loyalty index. However, experts actively expressed their criticism relative to this approach.

Referring to NPS, Gupta and Zeithaml (2006), mentioned that "In a departure from the rigor of academic research, some scholars and practitioners claim that complex measurements are unnecessary to capture loyalty. Notably, Reichheld (2003) claims that the only number a company needs is one that reflects customers’ intention to recommend the firm to others." In an indirect manner, the two researchers disagreed with the limitation to a single key metric to predict loyalty and growth.
The research made by Morgan and Rego (2006) ranges among the first that questioned the statements relative to NPS as single predictor of loyalty and growth. Before 2006, no empirical evidence was available relative to the customer feedback metrics that are the most valuable in predicting future business performance. Morgan and Rego used American Customer Satisfaction Index data. They investigated the correlations between six satisfaction and loyalty metrics and the COMPUSTAT and CRSP data-based measures of different dimensions of firm’s business performance during the period 1994-2000. The three customer satisfaction metrics analyzed in the study were: (i) average customer satisfaction score; (ii) top two box customer satisfaction score; (iii) proportion of customers complaining. The three loyalty metrics applied by companies and approached by the study were: (i) net promoters; (ii) repurchase likelihood; (iii) number of recommendations made by a customer (Morgan and Rego, 2006). According to the research findings, out of the three satisfaction indicators, the average customer satisfaction score is the most valuable in predicting the future business performance. As regards the loyalty metrics, those based on recommendation intentions (“net promoters”) and behavior (“number of recommendations”) have little or no predictive value. Such results initiated a strong debate relative to the predictive capabilities of the net promoter score.

Keiningham et al. stated that the claims made by Reichheld (2003, 2006a, 2006b) “has not been subjected to rigorous scientific scrutiny and peer review” (Keiningham, et al., 2007) and remained “largely untested by the scientific community” (Keiningham, et al., 2008). The study performed by Keiningham et al. (2007) replicated the methodology applied by Reichheld, Satmetrix and Bain & Company, but the findings negated the validity and generalizability of the former studies. Researchers used longitudinal data from 21 firms and more than 15,500 interviews from the Norwegian Customer Satisfaction Barometer. They made a comparison with the results obtained by their peers on the bases of the American Customer Satisfaction Index. The conclusion was that NPS is neither the superior metric when linked to firm revenue growth nor the uniquely significant indicator of customer loyalty (Keiningham, et al., 2007, 2008). In addition, customer loyalty attitude does not necessarily lead to loyalty behavior. In essence, NPS is not superior to other loyalty metrics in predicting business growth.

Customer loyalty is a very complex behavior that cannot be understood using a single key metric. Even if an indicator seems to reflect many relevant aspects, it cannot provide organizations with all the necessary triggers to enhance the attitudinal and behavioral loyalty of the target market.

In fact, a bundle of indicators may be considered in the process of assessing customer loyalty. Some of the most valuable metrics that must be used in connection are the following: number of referral – word-of-mouth and “word-of-mouse”, decision to purchase again, decision to purchase different products, decision to increase purchase size, customer retention and defection rates (Hayes, 2008). A multidimensional measurement approach increases the likelihood of business growth generated by sound strategies of customer acquisition and retention.

The NPS came under scrutiny and many experts considered on one side that alone, the “recommend” question is not a good predictor of business growth and on the other side, the “satisfaction” and “purchase same” questions are as good predictors as the “recommend” question. The use of three loyalty indexes is considered better than the answer to one “recommend” question. The three indexes suggested are the following: (i) advocacy loyalty index (ALI) – an average across “satisfaction”, “recommend”, “choose again” and “purchase same” questions; (ii) purchase loyalty index (PLI) – an average across “purchase different”, “purchase increase” and “purchase frequency” questions; (iii) retention loyalty index (RLI) – the reverse coding of the “likability to switch to a different supplier” (Hayes, 2008). These indexes reflect both
attitudinal and behavioral loyalty. Together, *advocacy, purchasing* and *retention* are better predictors of business growth, because they reflect the multiple facets of the relationships between suppliers and customers.

Dixon, Freeman and Toman (2010) introduced the customer-effort score (CES) as loyalty metric for contact-center interactions. They surveyed 75,000 B2C and B2B customers about their recent service interactions (among which live phone calls, web, chat, and e-mail). The research approached diverse sectors from consumer electronics to packaged goods, from banking to travel and leisure, in North America, Europe, South Africa, Australia, and New Zealand. In the study, they compared three metrics – customer satisfaction (CSAT), net promoter score (NPS) and customer-effort score (CES) – from the perspective of their power to predict customer loyalty. The CES was calculated based on the customer answers to the question “How much effort did you personally have to put forth to handle your request? (measured with a scale from 1 = very low to 5 = very high)”. The research findings showed that NPS was a better predictor than CSAT, however a poorer predictor than CES.

There are specialists that consider NPS a metric relevant to companies and advise organizations to monitor this score in combination with other indicators of growth and loyalty. Hanson (2011) underlined that NPS use is recommended for industries driven by satisfaction and overall quality, not in the price-driven sectors. He recommended the use of “NPS+”, respectively the use of the NPS metric together with other drivers of business success.

Whitlark and Rhoads (2011) have also investigated the NPS capability to predict revenue growth and have compared the predictive performance of NPS to other loyalty metrics. Their longitudinal research (from July 2008 to September 2009 and from January to March 2010) focused on a retail service company with 82 distinct units and studied the correlation among the monthly revenue data, the net promoter score and other loyalty metrics. The survey was based on questionnaires administered via e-mail and telephone. The overall number of filled questionnaires reached 50,000 (each customer being surveyed only once per quarter).

The findings of Whitlark and Rhoads (2011) differ from those of Keiningham et al. (2007). More specifically, the authors concluded that: (i) NPS is a leading indicator of revenue growth; (ii) overall satisfaction, willingness to recommend and intent to repurchase are not necessarily good predictors of revenue growth; (iii) a generic loyalty index does not necessarily outperform a single-item loyalty metric (if one can find the right item); (iv) recoding the willingness to recommend into a net promoter score improves the item’s predictive power. The study revealed that simple correlation between net promoter score and revenue was 0.289 that is a low value, even if it is statistically significant due to the large sample size. Whitlark and Rhoads draw the attention of managers to the consequences of the decision to use NPS or a single-item loyalty metric instead of a loyalty index. Such a decision has some drawbacks due to larger sample sizes to be studied, the difficulties related to the tracking of period-to-period changes as well as the use of complicated predictive analytics and statistical modeling.

Hayes (2011) underlined several drawbacks of NPS and advised practitioners to apply the RAPID approach (based on retention, advocacy, and purchasing loyalty indexes) to monitor loyalty instead of the single NPS perspective. Firstly, a single-item evaluation is less reliable than the RAPID approach. Secondly, the NPS is ambiguous because is the result of a subtraction and different situations may lead to the same result (a specific score may be the result of various combinations of the shares of promoters and detractors). The NPS centers on advocacy and as a consequence monitors only one of the facets of loyalty (retention, advocacy and purchasing). In addition, Hayes recommends practitioners a selective approach in terms of key loyalty metrics. They should apply those measures of loyalty that correspond to their specific needs correlated with the situation of the company. Managers may select and apply more one of the loyalty indexes
that focuses on retention, advocacy and respectively purchasing, depending on the major issues faced by their organizations.

CONCLUSIONS AND RECOMMENDATIONS

The net promoter score is a metric that stirred the debate among theorists and practitioners on the most relevant indicators to predict loyalty and sales growth.

The main strengths of the NPS metric may be summarized as follows: (i) an indicator that may be easily calculated by subtracting the share of detractors from the share of promoters; (ii) applicability in various sectors driven by satisfaction and quality, not by price; (iii) measure of the advocacy loyalty, respectively of the intention to provide positive word-of-mouth; (iv) positive (but low) correlation with revenue; (v) a better predictor of loyalty than the simple customer satisfaction indicator.

However, the positive features are overshadowed by several drawbacks: (i) lack of qualitative information about the reasons of positive or negative word-of-mouth; (ii) an oversimplified vision of loyalty limited to the intended referrals (shares of promoters and detractors); (iii) metric limited to the attitudinal loyalty that does not include the behavioral loyalty; (iv) a high NPS reflecting attitudinal loyalty does not always lead to behavioral loyalty; (v) reliability issues due to the sampling errors associated with the calculation of both the share of promoters and the share of detractors.

Consequently, the NPS is a metric that should be used together with other indicators of loyalty, in order to avoid the possible systematic errors in interpreting the attitude and behavior of customers. All the facets of loyalty should be monitored – advocacy, purchasing and retention loyalty. High NPS values achieved by a brand compared to competitors could lead - but not necessarily - to better results and market position against the other industry players.

Managers should apply NPS as important loyalty metric positively correlated with revenues without using it as single predictor of loyalty and business growth. A methodology requirement is the use of large samples in order to obtain a relevant level of certainty. The use of a multi-item index for loyalty measurement is more advisable than a single-item metric. Combining the quantitative perspective provided by the net promoter tool with qualitative insights about customers may provide a better understanding of customer perceptions, motivations and expectations.

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NEW ARCHITECTURE OF ROMANIAN FINANCIAL MARKET

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Abstract: The paper highlights the financial market modifications after the economic crisis started in 2007 and the observed effects on Romanian economy. EU has recently aligned the regulation of local financial markets for preventing other similar crisis in the future. In this context, newly designed framework translates into additional constraints for Romanian economy, dependent by foreign capital inflows. The most affected sector is private firms, which relies on external financial resources to generate growth, this in absence of major state investment projects. Further, we analyze how the EU funds, state aids and internal financing of the company could offset the negative effects of financial constraints for private firms, helping them to regain the capacity to generate profits in challenging financial environment.

Keywords: economic crisis, financial market, contagion channels, private firms, financial framework, constraints, EU funds, state aids, internal financing

JEL Codes: F19, F20, F34, G15, G28, G30, G32

1. INTRODUCTION

The recent economic crisis recalls of economic fundamentals, to Keynesian approach. The crisis spilled over entire world, with unprecedented intensity and speed, through diverse distribution channels. The economists analyzed the root causes of the phenomenon, still no consensus up to date, but few general accepted opinions were highlighted.

A.K. Rose and M.M. Spiegel (Dec, 2010) define the main cause of crisis the unsustainable increase of real estate market price. This further contributes to over-leveraged private individuals and to expand the credit volumes. J. Vanek (Nov, 2010) attributes the crisis to destructive trade. Starting to Leontief paradox and production factors theory, he defines the destructive trade as that form of trading which conduct to transfer of manufacturing goods and related capital to the country with low-labor-cost advantage, depriving the home countries by the productivity assets and the workers by lots of jobs. Capital control has changed, during the Great Recession US owned the largest reserves versus European countries which were in great debts; currently US faced the largest debts in the history, while China and few other countries owned the largest foreign exchange reserves. F. Haile and S. Pozo (2007) and later on C. Bario (2010) explain the crisis through inconsistency between the fiscal and monetary policies. They doubted the policy makers’ ability to properly react both to the market turmoil and to normal periods. Moreover, many other economists criticize the European Central Bank interventions during the crisis melt-point to release on intra-banking market significant quantities of liquidity
on undiscretionary manner. Freixas (2009) argues the crisis is due to the imperfect, inefficient capital market, in absence of common regulatory framework and prudentially.

The crisis speed of spilled over the developed economy initially, and over entire world, in the second phase, made the economists to sustain the contagion effect of crisis.

Eichengreen, Rose and Wyplosz (1996), Gerlach and Small and Medium Entreprisessts (1995), Goldstein (1998) argues, based on empirical studies, the crisis is contagious. They demonstrate the phenomenon spilled-over the world due to macroeconomic similarities and trading linkage. Other economists such as Calvo (2005), Kaminsky and Reinhart (2000), Masson (2004) attributes the crisis contagion to beggar-the-thy effect and the globalization of financial and capital markets. More comprehensive version, in our opinion, issued by F. Haile and S. Pazo (2007), who defines four distribution channels for the crisis: common shock, trade linkage, macroeconomic similarities and financial linkage. The recent economic and financial crisis confirmed the contagion theory, as the most affected were industrialized-developed countries, with significant flows of capital and goods as the result of globalization.

Rationally speaking, the emerging market seems to be collateral victim of this crisis, due to dependency by the capital and market for highly developed countries. Financial crisis stopped the intrabanking capital flow due to the system failure fear, and reflected in emerging zone through decrease of aggregate demand and negative economic growth and sharp contracting GDP. Romania is the case, which will be discussed later.

In this context, the recent appointed Basel Committee and Financial Stability Council have decided to reinforce the stability of banking system in order to mitigate the systemic risk. In this context, newly designed framework translates into additional constraints for Romanian economy, dependent by foreign capital inflows. The most affected sector is private firms, which relays on external financial resources to generate growth, this in absence of major state investment projects. Further we analyze how the EU funds, state aids and internal financing of the company could offset the negative effects of financial constraints for private firms, helping them to regain the capacity to generate profits in challenging financial environment.

The rest of the paper is arranged as follows: Section 2 discusses international financial market outlook, Section 3 describes Romanian financial system and the last Section 4 analysis the how the EU funds, state aids and internal financing of the company could offset the negative effects of financial constraints for private firms. Section 5 concludes the paper.

2. MACROECONOMIC OUTLOOK

In this context, the recent appointed Basel Committee and Financial Stability Board, and the IMF and the G20 have decided to reinforce the stability of banking system in order to achieve the global economic security. The economists’ unanimity agreed the financial system in modern economy needs common regulation and supervising for understanding the more complex and comprehensive market. In this view, the regulators, European Banking Association (EBA) and Basel Committee, have recently proposed new Capital Requirements Directive (CRD IV) and the Basel III framework. The general goals of both rules are the followings:

- to force the banks to hold more and better capital than previously done;
- to offset the tenor mismatching between capital consumers (corporate sector) and capital contributors (household sector);
- to improve the transparency and monitoring of entire industry;
- to have a single, common governing rule.

Even if the rules aim to create stability, the short-to-medium term effect is to change the paradigm of entire industry. The reshaping of financial system implies significant social and economic costs. Two consulting firms McKinsey and O. Wyman tried to measure the implication
of new rules over financial market and further over real economy. Basel III will have significant impact on the European banking sector mainly. The studies show that by 2019 the industry will need about EUR 1.1 trillion of additional Tier 1 capital, EUR 1.3 trillion of short-term liquidity, and about EUR 2.3 trillion of long-term funding. An increase of 1% of the Tier-1 ratio results in a -0.2% decrease in GDP (other studies estimate decreases of up to -0.6%). Also, the increase in demand for liquid assets of 25% leads to a decrease in GDP of -0.1% according to the Qualitative Impact Study (QIS) issued by Basel Committee (2011). Besides the amounts listed before, an average increase of 1-2% in European GDP till 2019 should require additional EUR 1 trillion in lending.

This is translated in an overcapacity of the system reaching 9% of the market, that should be shifted in the next 2-3 years to capital and private market. In absence of large scale M&A at least at European level, the banks are forced to shrink, and not everybody will survive. In this challenging environment, a new concept became more and more common between banks: rationalization. The banks should rationalize: the Risk Weighted Assets (RWA) by staying in capital light relationship, the balance-sheet (B/S) by cutting the relationship that requires costly funding such as structure lending and the last but not the least, to rationalize the costs by keeping the efficient location. The cost issue is more complicated than appear, as RoE for banking system in 2011 was only 8% (International Monetary Fund, 2012), versus acceptable value of 12-14% (revealed by the same sources).

In order to regain the capacity to generate profits, the industry should change completely the intermediation credit model, should reinvent the cost management and should take the comparative advantage of home market. The regional banks should focus on the location which ensure scale and margin and to exit from the unprofitable zone. Creative cost management seems to be the most challenging part as long as the fixed base costs tends to increase. Technology and innovation could make the difference.

3. ROMANIAN FINANCIAL SYSTEM DESIGN AND REAL ECONOMY

Regional Tier II banks dominate the Romanian system as it is revealed by the Table 1, even so, post-crisis period shows the foreign banks slowly diminished the participation in total lending portfolio. Most probably the shrinking will be more evident starting to 2012, the shock of new regulations being observed in Q4/2011, when the increase of lending portfolio stopped (National Bank of Romania, Monthly Report).

Table 1: Market share of foreign portfolio

<table>
<thead>
<tr>
<th>Credit volumes share of foreign portfolio</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans, of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans</td>
<td>75,338</td>
<td>85,384</td>
<td>77,923</td>
<td>81,224</td>
<td>91,179</td>
</tr>
<tr>
<td>Loans of foreign capital banks</td>
<td>66,057</td>
<td>75,297</td>
<td>66,428</td>
<td>69,068</td>
<td>–</td>
</tr>
<tr>
<td>%</td>
<td>87.68</td>
<td>88.19</td>
<td>85.25</td>
<td>85.03</td>
<td>–</td>
</tr>
</tbody>
</table>

Source: National Bank of Romania Annual Reports and Periodicals

The table highlights the participation of Regional Tire 2 banks in total industry exposure – Loans (total banks credits to private sector), Loan of foreign capital banks (the foreign capital banks credits to private sector)
If we take a look to the macroeconomic figures of Romania during 2007-2011 (Table 2 – Macroeconomic figures), we can argue the trading and financial linkage with developed countries, heavy affected by crisis, was the major contagion channels. Year 2009 was the mayhem of crisis in Romania, with awry drop in GDP, export, FDI and lending. By offsetting the negative effect of recession, the state forced to use IMF sources and consequently, to accept the supervising process which followed.

Before and post crisis, the Loan/GDP ratio have increased gradually, as the loan developed quicker than the GDP. We notice also the credit portfolio keep more than 60% of GDP annually, proving the real economy reliance of external financing. Having in mind the market share of foreign banks loans exceeds 85% of Loans to private sector (Table 1 – Market share of foreign portfolio), we can conclude the financial flow from Regional banks is a must for our economy.

**Table 2: Macroeconomic figures**

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>124,653</td>
<td>139,761</td>
<td>118,268</td>
<td>124,126</td>
<td>136,518</td>
</tr>
<tr>
<td>%</td>
<td>–</td>
<td>12.12</td>
<td>(15.38)</td>
<td>4.95</td>
<td>9.98</td>
</tr>
<tr>
<td>Loans</td>
<td>75,338</td>
<td>85,384</td>
<td>77,923</td>
<td>81,224</td>
<td>91,179</td>
</tr>
<tr>
<td>%</td>
<td>13.33</td>
<td>8.73</td>
<td>4.23</td>
<td>12.25</td>
<td></td>
</tr>
<tr>
<td>Foreign Currency Lending (% in Loans)</td>
<td>55.3</td>
<td>57.8</td>
<td>60.1</td>
<td>63.0</td>
<td>63.4</td>
</tr>
<tr>
<td>Loans/GDP (%)</td>
<td>60.44</td>
<td>61.09</td>
<td>65.88</td>
<td>65.43</td>
<td>66.79</td>
</tr>
<tr>
<td>Export (FOB)</td>
<td>29,549</td>
<td>33,628</td>
<td>29,116</td>
<td>37,293</td>
<td>45,040</td>
</tr>
<tr>
<td>%</td>
<td>13.80</td>
<td>(13.41)</td>
<td>27.89</td>
<td>20.77</td>
<td></td>
</tr>
<tr>
<td>FDI</td>
<td>7,049</td>
<td>9,310</td>
<td>3,554</td>
<td>2,238</td>
<td>1,901</td>
</tr>
<tr>
<td>%</td>
<td>(32.07)</td>
<td>(61.82)</td>
<td>(37.02)</td>
<td>(15.05)</td>
<td></td>
</tr>
<tr>
<td>Sovereign Debt</td>
<td>38,711</td>
<td>51,762</td>
<td>65,616</td>
<td>72,909</td>
<td>75,597</td>
</tr>
<tr>
<td></td>
<td>33.71</td>
<td>26.76</td>
<td>11.11</td>
<td>3.68</td>
<td></td>
</tr>
</tbody>
</table>

**Source: National Bank of Romania Annual Reports and Monthly Periodicals**

The table presents the macroeconomic figures during 2007-2011 (paranthesis indicate negative values) – GDP (Gross Domestic Products), Loans (total banks credits to private sector), FDI (Foreign Direct Industry), Sovereign Debt (public debt towards internal and external creditors)
Post-crisis period the industry performances were pretty fragile as Table 3 depicts. System ROE is far away European average value of 8% (International Monetary Fund, 2012) due to provision volumes and extremely large fixed cost carried forward by inadequate infrastructure, increased cost of capital and personnel expenses. In this context, doubled by capital and liquidity pressure, the 2012 should be the start of rationalization and reform.

Table 3: Banking sector performances

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROE</td>
<td>9.43</td>
<td>17.04</td>
<td>2.89</td>
<td>(1.73)</td>
<td>(1.4)</td>
</tr>
<tr>
<td>LTD</td>
<td>108.72</td>
<td>122.03</td>
<td>112.8</td>
<td>113.46</td>
<td>118.80</td>
</tr>
<tr>
<td>Capital Adequacy:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital to Risk Weighted Assets</td>
<td>13.78</td>
<td>13.76</td>
<td>14.67</td>
<td>15.02</td>
<td>14.51</td>
</tr>
<tr>
<td>Tier 1 Capital to Risk Weighted Assets</td>
<td>11.60</td>
<td>11.80</td>
<td>13.40</td>
<td>14.20</td>
<td>13.90</td>
</tr>
<tr>
<td>Default Rate</td>
<td>1.6</td>
<td>2.8</td>
<td>7.9</td>
<td>1.9</td>
<td>14.1</td>
</tr>
</tbody>
</table>

Source: IMF, Country Report No.12/73, April 2012

The table 3 presents the evolution of performance indicators of banking industry over 2007-2011 as per RAS reporting up to 2010 and IFRS for 2011. ROE (computed as Net profit/Equity), LTD (Loan/Deposit), Capital Adequacy, Default Rate (Nonperforming Loans/Total Loan Portfolio)

If we apply the overcapacity of European banking system of 9% to local industry volume, we will find EUR 8.2 billion funding gap in the next 2-3 years and a proportion of this must be shifted to the capital market and private investors. Assuming the scenario of estimated GDP growth with 1.5% for 2012 and respectively 3.5% for 2013 (IMF reports), additional EUR 6.9 billion should be consolidated at funding gap figure. Summarizing, EUR 15.1 billion needs Romanian economy for surviving to financing turmoil and further to turn to growth.

In the absence of M&A and relatively tinny appetite of individual investors, Romanian economy and private sector, in particular, needs alternatives.

4. ALTERNATIVES FOR ROMANIAN ECONOMY

We identify three major sources of financing the gap of real economy, in absence of banks financing, M&A and private capital investors. Further the paper analyses how EU funds, state aids and internal financing could cover the economic needs of capital and liquidity. In my opinion, these three sources could offset the negative effects of financial constraints for private sector, helping them to regain the capacity to generate profits in challenging financial environment.

EU funds allocation for Romania (segmented after destination in 4 categories, Structural and Cohesion Funds, European Funds for Agriculture and Rural Development, European Funds for Fishing and European Funds for Guarantees in Agriculture) totals EUR 34.6 billion during 2007-
Remained portion for 2012-2013 is EUR 14 billion, for which the state should take all the necessary actions to increase the absorption rate, this being the biggest source of financing the economy as we will demonstrate later. Unfortunately, the absorption rate issue depends by policy makers’ ability to speed up the deal flow for approval process, and to negotiate better terms and condition with EU for disbursement.

From private sector, the main beneficiary of EU support is Small and Medium Enterprises’ sector, which represents 98% of the firms registered on Romania (Ministry of Economy).

Table 4: European funds allocation

<table>
<thead>
<tr>
<th></th>
<th>Total 2007-2013</th>
<th>Absorption rate as of 04/12</th>
<th>Allocation for 2012</th>
<th>Allocation for 2013</th>
<th>Total 2012-2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Structural and Cohesion Fund</td>
<td>19,668</td>
<td>7.4%</td>
<td>3,372.82</td>
<td>5,597.21</td>
<td>8,970.03</td>
</tr>
<tr>
<td>European Fund for Agriculture and Rural Development (FEADR)</td>
<td>8,124</td>
<td>19.9%</td>
<td>1,450</td>
<td>1,357.85</td>
<td>2,807.85</td>
</tr>
<tr>
<td>European Fund for Fishing (FEP)</td>
<td>231</td>
<td>17.42%</td>
<td>50</td>
<td>66.3</td>
<td>116.63</td>
</tr>
<tr>
<td>European Fund for Agriculture Guarantee (FECA)</td>
<td>6,580</td>
<td>70.7%</td>
<td>1,000</td>
<td>1,174.13</td>
<td>2,174.13</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>34,609</strong></td>
<td><strong>12.81%</strong></td>
<td><strong>5,872.82</strong></td>
<td><strong>8,195.82</strong></td>
<td><strong>14,068.64</strong></td>
</tr>
</tbody>
</table>


The table 4 depicts the funds allocation for Romania

To compute the reliable amount of EU funds for financing the economic needs of the next period 2012-2013, let us start from the assumptions of targeted absorption rate of 2012 and 2013, 20% and respectively 30% (Ministry of European Affairs). These rates are achievable in case of accelerate the infrastructure programs, which will offer additional jobs for local companies, the general contractors and entrepreneurs. Consequently, the funds for 2012 and 2013 are EUR 2.5 billion and EUR 3.5 billion, summing EUR 6 billion. At this amount will be added the state contribution for own projects limited to 20% (EU agreement) and private sector sources for investment projects, estimated to 20% of projects value (industry practice Debt/Equity=80/20). Total amount for public contribution during 2012-2013 is EUR 550.2 million (Ministry of Transport and Ministry of Environment) while for private sector the amount reached EUR 1.177 billion.

The second source of financing the gap is state aids and related co-financing programs. Currently, there are four governmental programs that mixed state and foreign sources available for encouraging the investments in private sector, covering almost all industry segments. The
funds allocation for 2012-2013 is EUR 881 million and eligible firms are both Small and Medium Enterprises and Large Local Corporate. Private source for these programs, following same anterior assumptions equals EUR 352.4 million.

Summarizing all the aforementioned in the Table 5, Romanian economy could, in optimistic scenario, to collect EUR 8.9 billion for financing the needs. We computes the gap of local system EUR 15.1 billion, of which EUR 8.2 billion from estimated deleveraged of banking industry and EUR 6.9 billion to ensure the further GDP growth. So, still remains uncovered EUR 6.2 billion, and, unfortunately, this deficit affects the economic growth of the country, as primarily sources will refund the banks deleveraging.

Table 5: Financing sources

<table>
<thead>
<tr>
<th>Source of investments finance</th>
<th>2012-2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 State aids for private investment projects (HG 1680/2008; HG 753/2008)</td>
<td>630,0</td>
</tr>
<tr>
<td>2 European Funds for private and public investment</td>
<td>5.949</td>
</tr>
<tr>
<td>3 SEE Grants</td>
<td>169,0</td>
</tr>
<tr>
<td>4 Norway Grants</td>
<td>82,0</td>
</tr>
<tr>
<td>5 State participation for public projects</td>
<td>550,2</td>
</tr>
<tr>
<td>6 Private participation in the projects</td>
<td>1.529,4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8.909,4</strong></td>
</tr>
</tbody>
</table>


Table 5 represents the structure of financing for Romanian economy during 2012-2013

In this unfriendly environment, the third source of covering financing gap, namely the internal funds of the firms should cover as much as possible the remained portion of EUR 6.2 billion. In other words, the reinvested profit of Romanian private firms must tend to this amount. Here we face 2 dilemmas: are the private shareholders willing to switch the profit distribution rate and to keep more money in the firms to finance the growth and to what price? In the first case, the state intervention with tax stimulus for profit reinvested will be most welcome, and this again depends on policy makers. The second case is more complicated, as the internal funding is more expensive then any other financing, the capital owners expecting notable returns in exchange of his investment in high risk macroeconomic environment.

In the event of banking system deleverage with 9%, the private firms faces more constraints related to affordability to keep existing loans in place: this relates to financial standing...
of the firm, quality of the assets pledged/mortgaged and the acceptance of loan re-pricing. If the investment projects might benefit by diverse EU and state grants, the working capital financing needs the reshaping of working capital key drivers management, in order to generate enough cash to support the business growth.

5. CONCLUSIONS

In this context, due to limited access to additional capital for financial sector, Romanian economy should survive with more constraints as the result of highly dependency by foreign capital inflows. The most affected sector is private firms, which relies on external financing as primarily source to generate growth, this in absence of major state investments. The private firms, majority small and medium size (as per European Union segmentation) are the engine of growth in any economic sectors. This paper tests how the EU funds, state aids and internal financing of the firm could offset the negative effects of financial industry shrinking, and further to turn to growth. We estimate the impact of banks deleveraging to EUR 8.2billion and additional EUR 6.9billion to sustain the GDP to perform expected growth. Existing available funds, namely EU funds, state aids and private participation in investment projects barely cover the system deleveraging. The remained portion of EUR 6.2billion, representing almost entire amount needed for economic growth, is subject to internal financing and innovative management. Here, the fundamental question is could the adequate profit reinvestment rate effectively cover the gap of funding at economic level and turn on to growth? The issue should be subject of further investigation.

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INNOVATIVE OPERATIONS STRATEGIES FOR THE CREDIT AND DEBT COLLECTION TEAMS OF THE NON-FINANCIAL CREDITORS

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Abstract: The paper presents innovative elements of operations strategies in the areas of credit and debt collection management that allow the first-line, non-financial creditors, such as telecommunications and utility companies, to effectively leverage the customers’ ability and willingness to pay their bills, hence likely to improve the companies’ financial bottom-line in an ever-changing business environment, while reducing customers’ indebtedness and securing their credit worthiness and satisfaction.

Keywords: Operations Strategy; Credit Management; Debt Collection Management
JEL Codes: D23, D24, M1, L2

INTRODUCTION

Motto: There are three levels of organizational vision: 1. The Do-able; 2. The Conceivable; 3. The Previously Unthinkable.

Anonymous

By the end of 2011, two and a half million Romanians were blacklisted in the credit information databases of Romania, out of which about two million were part of Preventel, the telecommunication shared blacklist functioning since 1998. The Romanian Credit Bureau has reported in February 2012 that the bank loans’ bad debt rates ramped-up to 14% – 50 percent more than 2009 level, while the bad debts in telecommunications and utilities were up to 20 percent of total revenues of the business. The banks, financial services, telecommunication operators, utilities, collection specialists and bailiffs have reported significant changes in the payment behavior and collections landscape in Romania. In 2012, about 65 percent of Romanians considered that the payment of utility invoices drove them into debts, while only 50 percent were claiming that the credit loans and leasing deals were impacting on their indebtedness rate. The non-financial creditor companies - telecommunications and utilities -, wanting to re-coup outstanding debts, need to implement best practice endeavors that recognize the evolutions of the consumers’ payment behavior, credit worthiness and indebtedness in Romania.

Therefore, the author, having been involved for more than ten years in the credit and debt collection management activities within telecommunications and utility companies, has pursued for a thorough investigation of their benchmark business practices and operations strategies. The author has employed research techniques such as one-on-one interviewing, questionnaires, analysis of company reports, observation of daily operations, consulting and solution implementation etc in order to configure a leading-edge operations strategy suite that may contribute to the efficiency and effectiveness of those first-line creditors’ credit and debt collection teams.
The Fundamentals of Credit and Debt Collection Operations Strategies for Telecommunications and Utility Service Industries

Operations refer to any productive activity, whether manufacturing or services, with operations management concerned with ensuring that such activities are carried out both efficiently and effectively. To this extent, all managers are operations managers, since they are presumably concerned that their departments should be efficient and effective, whatever their function. While the business strategy provides the overall direction for any organization, the operations strategy is narrower in scope as it relates to products and services to fulfilling the customer needs, processes, methods, operating resources, quality, costs, lead times, and scheduling. A truly effective operations strategy is the result of cascading down of the organization strategy. Formulation of business strategy should capitalize on the operations’ strengths and mitigate the weaknesses, while the operations strategy must stay consistent with the overall strategy and must be formulated to support the goals of the organization, out of which - what the customer wants and competitiveness - typically play a core role. (Mincu, 2006)

The economic climate, crisis and/or recession have a significant impact on any company’s operations strategies to achieve the firm’s mission. As the credit and debt collection operations of the non-financial creditor organizations such as telecommunication and utility companies represent the focus of the paper, several aspects of their business growth and financial health to date need to be discussed; since 2008-2009, these organizations have encountered a rough business perspective into collecting their bills issued to their customers, within the contractual payment terms.

During the last decade, the global telecommunications industry has experienced growth and change on a massive scale. This has been brought about by increased global competition, accelerated pace of technology developments, market-led demand for ever-more sophisticated communications and, last but not least, by the impact of the economic downturn and subscriber behavior. The focus for sustainable growth has shifted to growing revenue from existing subscribers, along with the acquisition of new subscribers by tempting them away from competitors, facilitated by the regulators’ decisions of imposing free mobile number portability or adding challenges onto the roaming and termination fees. This has led to a reduction in profit margin, on a background of a relentless downward pressure on tariffs with increased and expensive bundling to remain competitive. As the financial crisis has drawn risk management into sharp focus for telecom operators as first-line creditors, the factors outlined above are now impacting the credit and debt collection operations strategies across the customer lifecycle, forcing operators to aim to optimize both revenue and profit margin through understanding of the complex liaison between attracting new subscriber contracts, the management of revenue from the existing client base, on the background of streamlining the policies of the bill collections process.

At their turn, utilities - electricity, natural gas, water and sewage, housing administration and household waste - continue to face major challenges in recovering money from certain groups of former customers who are in arrears. Especially during the economic downturn and financial crisis of today, the “won’t pay” type of consumer has become very visible, by persistently delaying payments on outstanding household bills in the hope that the utility organization will eventually give up trying to recover its money. Similarly to telecom operators, utilities are increasingly focusing on reducing bad debts and operating costs. Best practice receivable management focuses not just on the debt collected, but also, on minimizing the cost incurred to collecting it. By implementing a system that targets a debtor individually, more of the monies owed are recovered more rapidly, helping the utility improve its working capital situation as well as benefiting from reduced write-offs. (Baltag & Mincu, 2010)
As a consequence of the above hardships, the operations strategies of the credit and debt collection teams activating in service industries such as telecommunications and utilities, need to be built around the specifics of non-financial creditor organizations: (Mincu/7/, 2009)

- The telecom or utility service includes both tangibles and intangibles to enable the service consumption over a time interval (typically one or two months) and is mirrored into an utility bill handed to the customer;
- The contractual payment terms from the bill issuing are short, expressed frequently in days that determine a follow-up of high granularity on the late payers and debtor customers;
- The technology to offer the service helps a lot in the credit and debt collection operations, since permits the service disconnection and reconnection;
- The legislation can facilitate the delinquent customers’ rehabilitation; but only the bank loan contracts give the creditor bank the enforcing right to immediately execute the debtor for the debts incurred; by contrast, the telecom and utility companies need to demonstrate through lawsuits that the customer debt is outstanding, liquid and compulsory;
- The customer’s payment behavior for consuming a telecom/utility service is a combination of ability and willingness to pay, over the credit and debt collection process (see Figure); a telecom/utility service customer demonstrates an ability to pay when is recurrently on time payer; the customer has willingness to pay when the utility bill is on top of the his/her ”shopping list”, fulfilling all promises-to-pay to the telecom/utility company, although the utility bill typically ranks only 3rd - after basic family spending and bank loan pay-back.

**FIVE BREAKTHROUGH ENABLING FEATURES OF OPERATIONS STRATEGIES TO MITIGATE LOWER ABILITY AND WILLINGNESS TO PAY OF THE UTILITY CUSTOMERS**

**Agility**

Agility in operations strategies is given by the knowledge of the local market and the knowledge of the local customer’s behavior. Typically, the non-financial first-line creditors such as telecommunication and utility companies do not know the customer specifics beforehand. Necessarily, those specifics are highly important not only in offering to the customer the right product or service at the right moment, but also for the management of risk. The vetting stage of customers needs to be carefully managed so that connection to the mobile network or installation of utility pipeline will happen rapidly according to the customer’s purchasing decision and expectations. Any signs from combined customer’s demographics, the inclusion in the negative credit databases interrogated (e.g., Preventel for telecom operators), past payment behavior, need to be encompassed into a business model of credit vetting or application scoring, that could hence be predictive of the customer’s risk of non-payment. The score is used for acceptance purpose, for setting both collection timeline (when late in effecting bill payments) and credit limits to manage high usage (credit control). The result of such model would be to welcome the customer in the service network, after extending the knowledge about him/her and attempting to cover part of the assumed risk. For instance, the customer may be required to pay in advance an amount to the account of future invoices; if paid, his/her credit worthiness is recognized by service activation under a subscription contract. (Baltag & Mincu, 2010)

The behavior scoring is respectively, a predictive model based on a number of past invoice payment behavior. A behavior scoring engine implemented with the telecom or utility company will offer maximum agility since provides a dynamic score (e.g., monthly) that will direct timely changes and adjustments of the collection timeline/action plan and credit limits to manage
Figure – The map of credit and debt collection process, from service activation to disconnection
high usage. Moreover, it allows the great capability for any operations team to further segmenting the customers, hence prioritizing work in three basic categories: “self-collectable” (no need to work them, they will pay anyway!), “collectable” (to be worked as much as close to 100 percent) and “non-collectable” (no need to work them in-house, they will not pay anyway; further segmenting may customize the operations for lazy payers, over-indebted or major trauma/personal issues).

Champion/challenger strategies are drills of applying new challenger strategies to the delinquent portfolio to compete against the incumbent champion strategy, with the aim of improving performance across a range of possible performance measures. A continued programme of champion/challenger testing can improve collections results across a variety of measures and can foster a culture of continuous improvement. The heuristic learning strategy optimization represents a multiple, simultaneous champion/challenger tests within the collection strategic decision environment to optimize operations decisions for maximizing cure rates and collection effectiveness such as optimal channel of action (phone, dunning letter, email, SMS), optimal severity of the action, optimal day to take first action, optimal combination of actions.

The operational research techniques above are supporting the decision making if there is customer data available. For example, the utility companies possess an enormous amount of valuable customer data tied up in their mainframe systems, standalone departmental software, or most likely for Romania, in paper files. Therefore, key to agile and competitive service delivery is the implementation of billing systems rooted in customer records. This technology can create a centralized repository for all data relating to each customer, linking the relevant meter, installation and account information with a customer’s transactional history, preferences and relationships to other accounts. (Baltag & Mincu, 2010)

The line of command of the credit and debt collection teams is also indicative of how much agility would be instilled in the processes. The Bad Debt as the core key performance indicator (KPI) may command the subordination to the Chief Financial Officer; in this case, a tight control and approval chain, along to excessive receivable and cash dashboard reporting may determine negative effects on agility and timely call for change. From the telecom and utility companies researched, several have subordinated the credit and debt collection teams to the Head of Customer Care department under the philosophy of getting closer to the customer needs, while others, under direct reporting to the Chief Commercial Officer. For the latter, it is not unusual to find implemented decisions to relax the credit and collection policy, somewhat against the principle of segregation of duties, for the sake of more revenues via accepting more customers and/or stimulating customers to consume more, by loosening-up the acceptance risk guarantee matrix and/or credit limits and conditions. The best approach would be to run such endeavor only with executive blessing, appointing a credit approval committee empowered to decide the customer segments taking advantage of policy relaxation, to closely monitor developments, and to timely revert back to former policy coordinates if things visibly worsen. Nevertheless, at economic downturn the customers become riskier discouraging any conduct to relax the credit vetting policy, so companies need to think twice to apply it, assuming higher loss in bad debts, combined with lower revenues over the time, but with significantly increased acquisition costs.

Customer centricity and satisfaction

Service industries are typically having the customers at the core of the processes and operations in an attempt to fit to customers’ expectations, regardless their good or bad payment behavior. Specifically in the areas of credit and debt collection, meeting customer expectations may bring a quality relationship between two parties engaged in an interaction that transcend a
simple cash transaction. For example, paying for purchases within the agreed payment term means that the mutual respect and the potential to continue doing business in the future are secured. Moreover, it is commonly recognized that individual’s behavior which gives visibility to attitudes, stems from cultural factors and values, so his/her payment behavior itself is tightly knitted to the culture. (Mincu, 2008) Therefore, the customer satisfaction survey become critical endeavor to check and take action upon customer needs, attitudes and cultural profile in respect to the bill payment. Such survey will reveal important recommendations made by the customers with respect to the collections Professionals and strategies for enabling ability to pay and enhancing willingness to pay. For the customer paying the utility bill – good or delinquent payer, it is important that the collection specialist in contact with him/her to show kindness, to be flexible enough so that an agreed solution to coagulate and to have the authority to implement it for the customer. Also the telecom and utility customers consider that frequent communication through payment reminders and high usage warnings may prove to be paramount to preserve their credit worthiness, month over month, so operations need to be set accordingly.

The responsibility for shaping and implementing an action plan to meet the customer needs stay with credit and debt collection operations teams. Yet, to exceed the expectations of the customers represented by the utility bill payers, the operations managers are to implement “caring and daring” tactics (Mincu/7/, 2009) – meaning actions that will pleasantly surprise the customers and show care for them and their families’ wellbeing, while daring to assume a significantly high risk with the debtor customers. Examples of such tactics are: ask the customers to propose an installment plan, accept their promise-to-pay, negotiate and/or cancel any penalties for which customers may be liable; call the customer to advise about significantly high bill value, to avoid bill shock upon receiving the bill, and enhance ability to pay the bill; at economic downturn, temporarily extend payment terms for the company’s suppliers; during difficult times such as flooding and other natural disasters, make contact with the affected customers and announce the prolongation of payment terms until things are getting on track; customize the bill payment deadlines according to the customers’ salary or pension date; understand personal drama and proactively manifest human touch, respect and care for customers in need; reward customers paying earlier than the contractual term; connect with the banks and convince to immediately credit-back the customer account should the customer paid ten times more – situation that happened for hundreds of telecom customers at Romanian currency denomination in 2005.

SUPERB EXECUTION

Once the core operations strategies are set in the areas of credit and debt collection, the implementation may bring a rich opportunity to innovate, improve, and effective resource utilization. For example, a couple of telecom and utility companies have applied with much success the bank loan credit restructuring options – rescheduling, rewrite, renegotiation, typically employed by the financial creditors. Debt rescheduling, through payment in installments, is widely used in telecom and utilities to give customers more time to pay the bill. A more generous and innovative option has been implemented by the water supply company servicing Bucharest area in 2011 - a dunning letter campaign that voluntarily offered to delinquent customers, a supplementary 15-day period to effect payment, otherwise both water supply service will be discontinued. (Baltag & Mincu, 2010) Also a creative layout of the envelopes for the telecom and utility bills and dunning letters may enforce a communication of much impact to leverage the customers’ willingness to pay (see Exhibit).

Debt rewrite has been employed by a telecom operator when launching a “Survival Offer” to customers with two bills overdue. The delinquent customers accept to switch for next two
months to a free 3-Euro price plan, that include free 30 minute on-network usage, with the expectation that they will pay in full the outstanding debts by the end of grace period. The free monthly subscription has tackled the inability to pay any incremental amounts over outstanding debts, while the free minutes ensuring open communication prove to be strong arguments to reduce the customers' unwillingness to pay the outstanding telecom bills. (Mincu/8/, 2009)

Debt renegotiation has appeared with the same company to improve the payment behavior of customers at Christmas time - when typically the family budgets provide the cushion to the combined pressure of an economic downturn as experienced by Romanians starting with October-November 2008 and winter holidays with their traditional celebration and spending. Within the “Happy Day” campaign, any customer being in touch over the call on 22 December with a collection specialist was offered a rebate of 40 percent (individual consumers) or 30 percent (small and medium enterprises) from total bill value, should the customer would pay the remainder within 24 hours from the rebate acceptance over the call. (Mincu/9/, 2009)

In the areas of receivable management, the credit and debt collection teams need to adequately respond to the high seasonality in cash collection e.g., at Christmas, Easter, the month of September - when schools start and the spending to prepare students for a new academic year is pushed-up on customers' “shopping list”, summer holidays and alike. How to bring more cash, earlier? The best response is: Accelerate! Several operational actions may prove beneficial in this direction: allocate additional professionals to perform intensive collection campaigns; run short-term incentive program to stimulate employee recovery rates; send additional dunning letter(s) to delinquent customers; generally shorten rescheduling terms; work highest bill amounts first; ask for payment of unbilled amounts in case of high usage.

Technology is a great enabler of a superb execution. Employing modern credit collection software tools – application processing with application scoring engine embedded, behavior scoring engine, credit limit monitoring and fraud management system; integration with telephony, including Dialer and IVR (Interactive Voice Response machine) - give the opportunity to seamlessly interface with other enterprise systems and to extract and exchange all relevant customer transactional and behavioral data to and from a centralized customer data repository or, in the case of a more fragmented IT environment, consolidate all customer information and communications related to payment arrears. This ensures collections teams have the most up-to-date and relevant information upon which to derive collections strategies. This versatility facilitates the integration and relative weighting of both quantitative and qualitative risk variables and indicators with the application and behavior scoring engines so that telecommunications and utilities will be able to more accurately: predict the likelihood of a customer defaulting; determine the probability of mildly delinquent accounts becoming heavily delinquent; and estimate what percentage of outstanding debt is likely to be repaid. The technology capabilities can contribute to balance automation with live operator so that relevant debts are worked-out with compelling human contact; informing dunning batch campaigns (SMS reminders, collection dunning letters, bar/discontinue and unbar/reconnect etc) are rolled-out; scheduling operations for the most lucrative moments of the day and week as related to customer's habits; or increasing throughput for the credit acceptance policy at peak and non-peak sales times.

To ensure superb execution of credit and debt collection strategies, the professional training and development play a key role. A flagship example has been a coherent and exhaustive training and development program - dubbed “Credit & Collection ACADEMIA” – launched in 2009 in one of the leading mobile communication operators for its credit and collection professionals and managers. During economic downturn periods, more than ever, it is important that companies focus on their customers, to attempt rehabilitation and retain them. Such strategies came with their own costs through significant investment into engaged teams of professionals –
trained and motivated to stay in touch with the customers, with special focus on those having problems to fulfill their financial obligations. The ACADEMIA has aimed to equip the credit and collection professionals with needed “hard” skills i.e., evaluation of customers’ credit worthiness, successfully collecting bad debts in line with financial prudence, and “soft” skills i.e., collecting with much care and human understanding, supporting customers as authentic personal financial consultants, hence securing their satisfaction and retention. A coherent syllabus and curricula have been coagulated into over twenty modules and learning vehicles, to leverage a tangible career progress. “Credit Assessment Workshop” and “Chat & Learn with My Manager!” have been the flagship modules of the program, with the first based on the case study method, while the second, on one-on-one “share and support” discussions. The program has showcased a best practice of an operations manager who has acted with passion and responsibility for the internal customers i.e., his/her employees, while enhancing own leadership competencies with respect to developing people. (Mincu/6/, 2010)

WISE COST MANAGEMENT

Similar to financial first-line creditors, the telecommunications and utility companies have been compelled by the economic downturn to pursue for adjusting the way in which they approach customer revenue collection. Due to little understanding of the customers, telecom and especially utility debt management tend towards a “one size fits all” approach. By early identifying high-risk customers and customizing contact respectively, the speed and rate of collections can be significantly improved with a positive effect on the bottom line; the credit and debt collection teams can model and implement relevant operations for each risk category, rather than treat everyone in the same manner. The collections could be more effectively managed through e.g., collections segmentation, a well designed disconnection strategy, payment plans, smart visit and contact timing of “at risk” populations. For utility companies especially, it is recommended to offer payment arrangements to delinquent customers early on, before ordering service disconnections. This will reduce the labor and costs associated with both executing shut-off orders and subsequent follow-up reconnects; by reducing the number of disconnection orders, existing field staff can be given other money-generating duties, like installing appliances. Therefore, the credit and collections staff can plan their workloads based on priorities far more effectively with better recovery rates against cost to collect.

Most of the organizations with credit and collection teams consider that the cost to collect is represented by the actual cost incurred within the budget allocated. The landmark practice is to pursue for calculating the activity-based costs that encompass all credit and collection–related costs, including costs incurred in other teams than credit and debt collection teams per se, i.e., at retail point-of-sale to collect invoices; customer care calls dealing with very early delinquency or informing on the bill coordinates (in customer service teams) or very late (in complaint departments); fraud prevention or revenue assurance investment under top management supervision etc. Types of expenses include labor costs - including leased personnel, bank charges, postage costs, costs with third party collection agencies etc. Such calculations represent the most appropriate way to ensure cost comparability for different companies’ credit and collection operations. The comparison needs to be done over the results obtained as well, i.e., Bad Debt rate and, as observed by the author, the KPI of Days Sales Outstanding (DSO). If the first KPI is the non-disputed star within any credit and collection KPI dashboard, the second appears as typically used in addition to Bad Debt, by credit and debt collection teams reporting to a Chief Commercial Officer. The reasons stay with the commercial reasons of a DSO increase from month to month e.g., important customer acquisition numbers – naturally or due to relaxation of credit acceptance policy; surge in number of delinquent accounts; better payment terms offered,
especially to large business customers; prepayments billed to risky customers (at activation or high usage-related); temporary hike of late payment penalties; disputed balances etc.

In Romania, the “bank charges” component may be one of the most significant costs incurred by the telecom and utility companies in their efforts to collect the money tied in customer invoices. Therefore, critical to reach operational excellence in bill collections and receivable management is to deploy a bill payment network of scale and scope. The implementation of such strategy needs to be two-fold: gain scale through a national coverage in points of payment where free transaction is provided to the customers paying their bills, to enhance and timely grasp customer’s willingness to pay due to payer’s convenience and comfort; and gain scope by educating and stimulating the customers to choose non-cash/non-conventional payment channels - the vast majority with lower transaction costs for the utility or telecom company (ATM, cash machines, POS devices at merchants, direct debit over bank account, mobile payment, e-payment) -, for increased convenience, instant processing and cutting any waiting time.

The activity-based costing decision has the capability to clarify the alternatives of the operations decision tree: working in-house, outsource or eventually in/back-source. The telecom and utility companies are not having as core capabilities the credit and debt collection areas, but as the service process is evolving, they clearly become first-line creditors of their customers. By following a consistent credit and debt collection operations plan internally, the telecom and utility companies can lower the number of customers that prove resilient to pay eventually. To reduce losses incurred by the disconnected customers, those customers can be outsourced to debt recovery agencies that are experienced in telecom and utilities collections. These third parties need to set-up their operations under the same philosophy of the outsourcer’s operations with respect to customer focus, workforce, debt collection software and technology, dunning actions, timelines etc. While adding on top, the expected positive psychological effects on the customer’s willingness to pay and advanced operations capabilities such as skip tracing and lawsuits actions; and everything done for a performance-based commission fees that give to outsourcer the opportunity of lower the collection costs. The full move of debt collection operations with other third parties can happen along with debt sale when debts of disconnected customers are sold to other companies that become theirs “owners” and virtually, second-line creditors; a specific instance is forward flow - when the debt sale is made to the collection agencies that used to work the debtors in late and legal stages. Another transaction that would end into collection with other organizations is factoring when telecom and utility invoices of active customers (high and medium-risk) are sold to third parties at a cut-off date. Opposite, there is the operations decision to in/back-source when e.g., late collection stage is repatriated within the outsourcer telecom and utility company for various business and operations reasons.

**AMBIDEXTERITY**

The ability to commute timely from “volume” to “variety” operations strategies represents a success factor into offering great value service to the customers while ensuring operations effectiveness. For the credit and debt collection teams, this is happening when they succeed with efficiency to work both bad debts and customer turnover due to non-payment (the forced or involuntary churn). The Involuntary Churn represents a core KPI for these teams that measures performance to retain the indebted customers and to rehabilitate customers’ credit worthiness.

To work bad debts asks for an operational set-up that enables the customer disconnection as soon as possible to avoid cumulating invoices not paid and to keep the balance overdue as low as possible. Operationally, this imposes a decision to work with human operator the highest balances, while automating the collection treatment for medium and low-value
delinquent customers. Moreover, the vast majority of operational endeavors mentioned so far in the paper target primarily to reduce the losses associated with the bad debts.

To work involuntary churn brings the challenge of attempting to rehabilitate and retain the delinquent customer one by one. This entails to massively work the low-value customers with human operator, more expensive but expectedly, more effective. Moreover, the strive for customer retention in the credit and debt collection teams determines the need for a strong collaboration with the marketing, sales, finance, accounting teams to harmonize efforts in achieving all KPIs and diminish likely adversarial approaches. The author refers here to several strategies and tactics to attract customers and stimulate them to consume with the purpose of gaining market share and increasing revenues such as: adoption of a relaxed credit acceptance policy, launch of telecom premium-rate services, granting massive discounts onto the telecom and utility equipment (phone handsets, utility appliances), overlooking preventative usage monitoring over the customers [roaming data services, inadequate utility service offer for the customer consumption profile] etc. The whole organization is hence, expected to pursue for responsible selling and lending, in order to prevent pushing the customers into indebtedness and forced churn. The involuntary churn scoring can be a state-of-the-art method to identify in a timely manner, the customers most likely to churn involuntary, to predict the customer life time as compared to the moment of break-even point (where a new customer will turn into a profitable one, the acquisition costs being less than the revenue). Based on the score, customized collection timelines and action plan can be developed and activated to prevent churn from non-payment.

CONCLUSIONS AND RECOMMENDATIONS

The ability to convert receivables into cash quickly is critical to every company’s financial success, including telecommunications and utility companies as first-line, non-financial creditor organizations. Their credit and debt collection teams play a vital role in company’s cash conversion cycle, along to ensuring as little disruption to the companies’ ongoing business relationship with the customers as possible.

The paper has intended to help operations strategists of these teams to shorten the learning curve in areas new to the reader and to reduce the necessity to learn on-the-job by trial and error. The paper introduces a suite of operations strategies: some of them – The Do-able - already applied on the Romanian market, several others – The Conceivable – in progress. Further, the operations strategies in the areas of credit and debt collection can be reinvented in the near future to a degree that would be Previously Unthinkable. Necessarily, breakthrough credit and debt collection strategies leverage opportunities for companies and teams to stand-by consumers and caring about their credit worthiness, recovering debts with respect, professionalism, human understanding and kindness, especially in times of economic downturn and financial crisis.

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1 As per the results of “Attitude of Romanians on personal debts” Survey of TNS-CSOP upon the request of KRUK International, 27 March 2012, Bucharest, Romania

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**Exhibit – Envelopes for a regular telecom/utility bill and for a dunning collection letter**

![Envelope for a regular bill](image1)

![Envelope for a dunning collection letter](image2)