

ASSESSMENT OF INSTITUTIONAL PERFORMANCE OF RESTRUCTURING AND PRIVATIZATION PROCESSES

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ABSTRACT

Experience of Romanian “pre-privatization” restructuring and large-scale privatization showed some major elements that underlined new paradigms. Initial conditions, modes of restructuring and privatization, institutional environments, and particularly the capacity of governments to regulate determine efficiency outcomes. These important processes have created functional relationships between institutions, correlated with the government strategy and specific legislation. New specialized institutions have been set up (State Ownership Fund -SOF, Agency of Restructuring and later the Office of State Participations and Privatization in Industry-OPSPI)

A comprehensive strategy and methodology for restructuring, encompassing both the corporate and financial sectors, was put in place once the economic crisis in Romania is judged to be systemic in scope. The extent of the restructuring, the required resources and timing became the critical issues. The European Bank for Reconstruction and Development (EBRD) had governance and enterprise restructuring as basic indicator of economic transition and defines it as effective corporate governance and corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring.

The shift in the role of Romanian government from a “top-down approach” for general restructuring to “top-down” only for ownership restructuring was possible only after the critical mass of companies has been privatized through the SOF (later transformed in the Authority for Privatization and Management of the State Ownership-APAPS) and OPSPI . Thus, the residual number of companies, were privatized or listed at the stock exchange during the second wave of restructuring, started in 2001 and continued during the financial crisis. We noticed new instruments, specific to privatization, that were used in the last five years: spin-offs, mergers and listing of minor packages of stocks from SOEs. Series of performance-based indicators of the restructuring and privatization institutions have been calculated .

Keywords: restructuring of SOE, privatization, liquidation, corporate governance, privatization, economic crisis

JEL codes: D21, D23,D24, G28, G32,G34, L33, O16.

INTRODUCTION

The purpose of this paper was three-fold:

- to do the assessment of the Restructuring and Privatization Processes in Romania and the role of the institutions involved from 1992 to 2013 ;
- the analysis of the institutional performance of restructuring and privatization processes;
- to underpin the correlation between the restructuring results, followed by privatization and the impact on macroeconomic figures;
- to study the effects of restructuring and privatization on a representative number of companies

LITERATURE REVIEW

The key for the success of the transition process in Eastern Europe is gradualism argues Cohen (1993). He claims that a rapid transition will fail and the outcome will be massive unemployment, bankruptcies, and social distress, ultimately requiring the intervention of the state. In this view, the development of proper institutional structures, such as tax laws, financial intermediaries, and capital markets, must precede the formation of property rights.

Economists who favor rapid transition are concerned with many of the same problems, but claim the key is macroeconomic stability. Macroeconomic stability for them consists of low inflation, economic growth, low unemployment, and stable fiscal and monetary policy. Sachs (1997) argues that monetary growth, due to budget deficits, additional government spending, and credit expansion, is the main cause of inflation. Bruno (1994) on the other hand, argues that the monetary overhang and price liberalization that resulted in unstable prices throughout Eastern Europe could have been less severe. According to Sachs (1992), privatization of enterprises is important for a successful transition. Thus, he claims that commercialization should be the first step toward privatization. Commercialization converts the enterprise into a treasury owned joint-stock company. While Lipton and Sachs (1990) favor a rapid approach they doubt that it will produce immediate increases in productivity or managerial efficiency.

After commercialization, the next step requires the restructuring of the enterprises. Although a logical course of action, this policy prevents the rapid implementation of reforms within individual enterprises. Boycko and Shleifer (1993) argue that the prerequisite for this step is the depoliticization of firms. In contrast, Blanchard et al. (1994) question whether traditional Western stabilization methods can be effective in an economy where state ownership prevails. In the neoclassical paradigm, the establishment of private property involves three major steps in the following order: commercialization, restructuring, and privatization. The main difference between the gradual and rapid approach in the neoclassical transition process is not the agenda of issues, but the pace at which this process is implemented. Examining Romania's transition process reveals that the new government has followed the neoclassical paradigm. It is also clear that after a decade of reform

Romania's attempt at a big bang approach has, as predicted, evolved into gradualism. In a description of the legislation and government intervention that has occurred Daianu (2001), Stan (1995), Earle and Sapatoru (1993), and Demekas and Kahn (1991) all claim that the Romanian economy, under the rule of Ceausescu, was the most Stalinist regime in Eastern Europe.

Frydman, Rapaczynski et al (1993) – discussed about legal and ownership structure, institutions for state regulation, overview of privatization process and the initial transformation of enterprises. Some authors refer to transition economies in the early stages of transformation as a “weakly structured market economy” (Dobrescu 1996) or a “previously centrally planned economy” (Calvo and Fenkel 1991). Grosfeld and Senik (1996) They were thinking that the change of ownership was a necessary and a sufficient condition of capitalism. The literature on financial repression and financial reform provides a thorough macroeconomic link between the development of financial markets and economic growth (Fry 1982, 1993, 1995, Roubini and Sala-i-Martin 1992, Rayon 1994, Chang 1994). The need for a closer analysis of the microeconomic roots of financial repression, however, is a new approach in the studies of financial markets in developing and transition economies (Amrit-Poser 1996, Popa 1998). Nicolescu et al (1996) – developed the “efficiency-based” restructuring concept and Crum and Goldberg (1998) – analyzed restructuring as a complex set of decisive measures in order to increase competitiveness.

The inter-enterprise arrears, as well as the bank, tax and wage arrears phenomena provide a good example of a microeconomic problem in the financial markets of Romania. The accumulation of inter-enterprise arrears can also cause inflation. Monetary control can be defeated by firms that circumvent a tight credit market by creating their own liquidity through trade credits (e.g. Daianu, 1994). Credit and liquidity constraints affect indiscriminately viable and non-viable businesses, or, even worse, create adverse selection effects – artificially sustaining large loss-makers and preventing new private firms from developing profitable investment projects (see Berglöf and Roland 1997 and 1998).

As shown in Croitoru and Schaffer (2000) for the case of tax arrears, an increasing real gross arrears aggregate would be a sign that more and more firms are running into arrears. In Romania's case, the commitment of the government to economic reforms by liquidating inefficient firms Stiglitz (1994, p. 238) would have extended mainly to state-run utility companies because they were the biggest actors in accumulating enterprise arrears (Santarossa, 2001; OECD, 2002).

Bowman and Singh (1999) classified restructuring activities into three categories namely portfolio restructuring, financial restructuring and organizational restructuring. Kornai (2000) considers that the pre-privatization restructuring serves as a useful screening device in order to interest private investors, who buy the firms.

Debande and Friebe (2004) advocates for the firmly reestablishing of the State control of SOE cause it avoids that (unproductive) managers abuse and divert capital or funds which are for restructuring. Djankov (1998) – selected a sample of Romanian companies from the period 1992-1996. He concludes that isolating programs have delayed restructuring imposing budget constraints on loss-making enterprises. On the other hand Djankov (1999) – studies the relation between ownership structure and enterprise performance in newly independent states: Georgia, Kazakstan, Kyrgyz Republic, Moldova and Russia. He concluded

that non-linear analysis showed some significant relation between different types of ownership and enterprise restructuring. Fidrmucova (2000) made an analysis on channels of restructuring on a panel of Czech companies and found that investment is not a significant determinant of enterprise performance. Koh, Dai & Chang (2010) – examined the impact of lifecycles on restructuring strategies. Distress firm's access to different types of restructuring strategies is limited by the lifecycle stage they are in. Frydman, Hessel & Rapaczynski (2001) – followed the entrepreneurship and restructuring of enterprises in Central Europe (Czech Republic, Hungary and Poland) and explained the market impact of ownership on firm performance. Sterman (2002) analyzed restructuring as diverse activities such as divestiture of under-performing business, spin-offs, acquisitions, stock repurchases and debt swaps. Gibbs P.A. (2007) considers that restructuring means changes in the operational structure, investment structure, financing structure and governance structure of a company.

THE ASSESSMENT OF INSTITUTIONAL PERFORMANCE OF RESTRUCTURING AND PRIVATIZATION IN ROMANIA

The last decade of the past century was dominated by paradigmatic controversy on the sequences of restructuring and privatization processes. The economy was registering suboptimal economic performances characterized by severe declines in the GDP; huge losses of the state-owned companies, and huge inter-enterprise arrears that accounted for over 35% of Romania's GDP.

There were two main perspectives on how the transition process and privatization should occur: (1) a gradual process or (2) a "big-bang" or "shock-therapy" approach to the establishment of property rights.

Moving from a command economy to a free-market one is a complex process involving the establishment and evolution of institutional arrangements that support a private property rights system.

The solutions designed and managed by the macro decision-makers of the time (starting with 1993) focused on a "top-down" model of restructuring, which precedes the privatization process and were institutionalized and included in common governmental and international financial institutions programs (such as "stand-by" loans concluded with IMF, IBRD, and EBRD, etc).

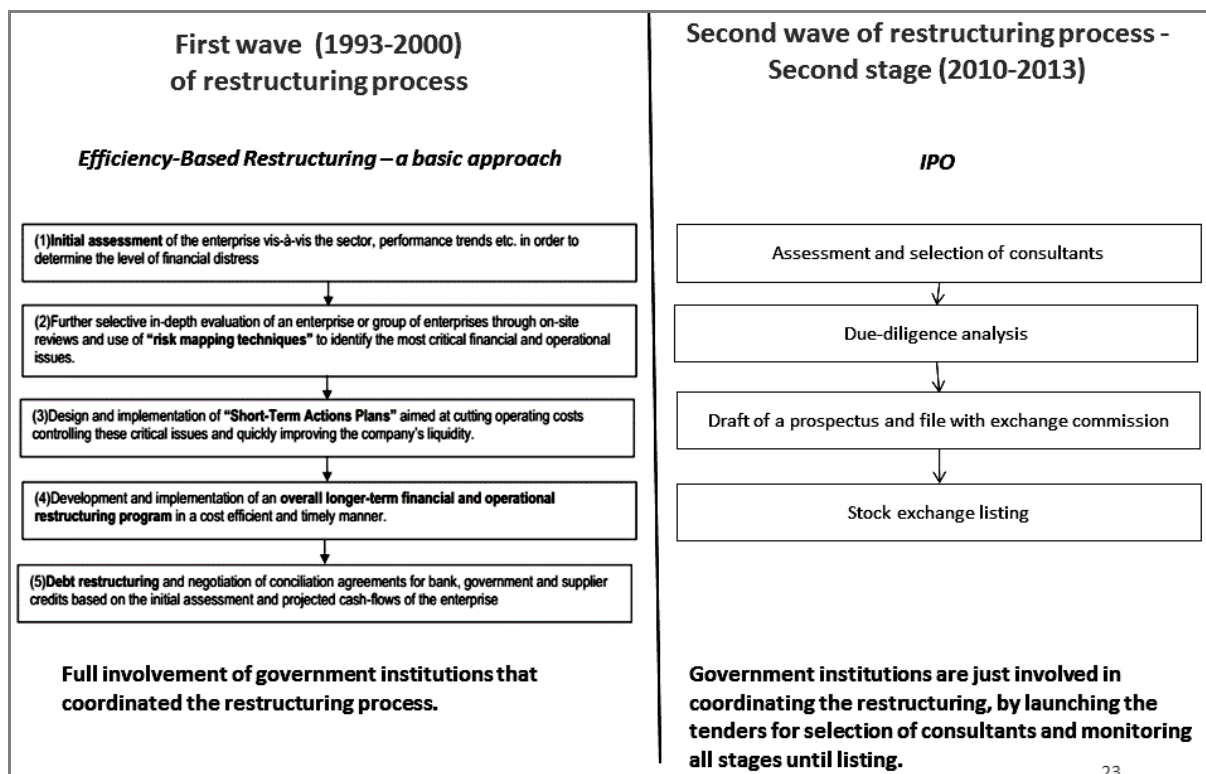
The "Pre-Privatization" process was designed to define the strengths and weaknesses of the enterprise, put in place a program to enhance the strengths and minimize the weaknesses – simply, the process identifies the risks and clarifies to some extent the value and with this a "price" can be developed for negotiation with potential investors. Not knowing the value and risk associated with an enterprise are the single biggest obstacles to privatization.

Experience of Romanian "pre-privatization" restructuring and large-scale privatization showed some major elements that underlined new paradigms. Initial conditions, modes of restructuring and privatization, institutional environments, and particularly the capacity of governments to regulate determine efficiency outcomes. These important processes have created functional relationships between institutions, correlated with the government strategy and specific legislation. New specialized institutions have been set up (State

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Fig.1 The waves of restructuring in Romania



This first wave has been followed by a second wave starting from 2001 that included a limited number of companies but of higher value and impact on the economy (biggest banks, big industrial and energy companies, former regies autonomes etc.)

The second wave of restructuring meant a change of paradigm for companies in need of restructuring, developed in two important stages, when SOE were listed at the stock exchange, privatized or placed in a „stand-by” process in order to be restructured. Thus, the methodology of restructuring in the second wave has been retooled and correlated with the evolution of the macroeconomic conditions and agreements with IFI's. The EBRD index of privatization show a direct relation between the two waves, as Romania received a higher value for this index as it moved to next level of restructuring and privatization.

THE ASSESSMENT OF INSTITUTIONAL PERFORMANCE OF RESTRUCTURING PROCESS

The restructuring process of the state-owned companies in Romania started by the **Government Decision no. 301/06.29.1993** with an special surveillance program for some companies selected on the basis of their critical financial status with a negative impact on the Romanian economy, as a result of the accumulated outstanding debts to the suppliers, banks and state budget. The first exercise included 30 state-owned companies from various sectors :chemical, petrochemical, machine building, metallurgy, construction materials and textile industries. The coordination of the overall process was in charge of a Restructuring board made up of representatives of the Ministry of Finance, the Ministry of Industries, the State Ownership Fund and the National Bank of Romania. The setting up of the Selective Restructuring Division within the SOF led to the termination of the initial Restructuring Comitee.

In order to increase the coherence and unity in the mobilization of the mechanisms, operations and human resources required for the materialization of the restructuring process – generator of the implementation of macroeconomic reforms and adjustment options expressed by the Government, the Agency for Restructuring was set up by Government Decision no. 780/1993.

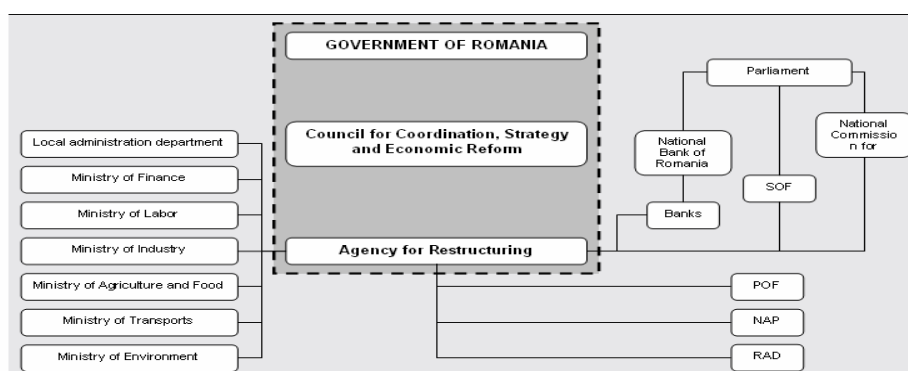


Fig. 3 AR's relations with other entities involved in restructuring

	TOTAL INDUSTRY 1995			TOTAL AGRICULTURE 1995			GENERAL TOTAL AR 1995		
	Forecast	Achieved	%	Forecast	Achieved	%	Forecast	Achieved	%
I. MEASURES – TOTAL (technical, organizational, management - no.)	1.077	873	81,1%	975	720	73,8%	2.052	1.593	77,6%
II. OWNI EFFORT (million lei)									
1 Closed capacities (mil. lei output)	722.138	3.068.767	425,0%	13.723	448.685	3269,6%	735.861	3.517.452	478,0%
2 Assets leading to closing of capacities (mil. lei to salvage value)	*	439.324		*	300.869		*	740.193	
3 Sales of assets (mil. lei)	27.275	6.495	23,8%	2.750	3.061	111,3%	30.025	9.556	31,8%
4 Lay-offs – total (no.), of which:	(23.745)	(19.796)	83,4%	(3.427)	(1.989)	58,0%	(27.172)	(21.785)	80,2%
– with severance of 6 salaries (no.)	(17.667)	(15.249)	86,3%	(3.427)	(1.013)	29,6%	(21.094)	(16.262)	77,1%
III. OUTSIDE EFFORT									
1 SOF credits (mil. lei)	213.294	100.390	47,1%	202.001	79.474	39,3%	415.295	179.864	43,3%
2 Bank credits (mil. lei)	368.000	217.000	59,0%	293.000	279.000	95,2%	661.000	496.000	75,0%
3 Budget (recovery fund) – total (mil. lei), of which:	175.419	147.263	83,9%	11.420	1.431	12,5%	186.839	148.694	79,6%
– for gas and energy (mil. lei)	149.333	129.314	86,6%	9.157	1.044	11,4%	158.490	130.358	82,2%
– for severance payments (mil. lei)	26.086	17.949	68,8%	2.263	387	17,1%	28.349	18.336	64,7%
4 Conciliation – total (mil. lei), of which:	1.314.955	843.096	64,1%	603.992	503.376	83,3%	1.918.947	1.346.472	70,2%
a) with the state budget – rescheduled tax (mil. lei)	320.909	319.671	99,6%	22.646	20.243	89,4%	343.555	339.914	98,9%
b) with banks (mil. lei)	118.324	112.525	95,1%	381.073	358.499	94,1%	499.397	471.024	94,3%
c) with the suppliers (mil. lei)	875.722	410.900	46,9%	200.273	124.634	62,2%	1.075.995	535.534	49,8%

Fig.4 Synthetic efforts in 1995 for the commercial companies in the AR's portfolio

The analysis undertaken by the Agency for Restructuring highlighted that the main causes of the critical financial situation of the SOE under special surveillance were mainly related to:

- the loss of traditional markets, especially of the former CMEA ones;
- overcapacity;
- overstaffing;
- insufficient financial resources for carrying a normal activity;
- the severe need to modernize the operating capacities in order to:
 - cut the specific material and energy costs with positive effects on cost reduction;
 - improve the quality of products with positive effects on the competition level;
 - resolve the serious environment protection problems;
- the lack of well defined strategies and actual business plans;
- obsolete technologies;
- low value added by product;
- ineffective and unskilled management facing new market conditions;
- inefficient in-house control systems;
- high pressure of the unions and low labor discipline.

With a view to resolving the problems arising, all the FRP's included:

- actual measurable steps to reduce costs and improve collections;
- credible projections to demonstrate how a positive cash-flow can be generated;
- reducing dependence on the governmental financial support as subsidies and guarantees for new credits;
- the approval of equipment replacement and modernization costs in order to increase incomes and decrease expenses without leading to capacity expansion or new costly investments.

The FRP's, as Figure 3 shows, provided for 1995 measures oriented mainly to:

- closing of capacities representing the equivalent of a production worth 735,861 million lei;
- sales of assets worth 30,025 million lei;
- staff reduction of approximately 27,172 persons of which 21,094 with severance payments totaling 6 salaries.

Additional measures were provided for which financing shall be supported by the SOF, the Ministry of Finance and the banks as follows:

- funds worth 415,295 million lei from SOF for modernization and technology upgrading;
- bank credits worth 661,000 million lei;
- state budget allocation worth 186,839 million lei from the financial recovery fund destined both to energy and gas payments and to severance payments totaling 6 salaries to the staff downsized per the FRP's.

The work-out process was carried out by direct negotiation depending on the debtors' payment capability and the creditors' financial power.

Of the total number of 120 commercial companies under special surveillance, in the portfolio of the Agency for Restructuring, between August 25, 1995 – September 26, 1995 a number of 115 commercial companies were conciliated (39 from industry and 76 from agriculture); conciliation agreements were signed with the main suppliers and the financing banks (BCR, BRD, BANCOREX, EXIMBANK) and also the Ministry of Finance signed agreements for tax facilities.

Synthetically, the results of the conciliation process at the 115 commercial companies that signed the conciliation agreement are as follows:

- of the total debts of 1,918,947 million lei on September 29, 1995, 1,343,664 million lei (71%) were conciliated;
- of the total conciliated debts of 1,343,664 million lei, 964,070 million lei represent rescheduled debts to the suppliers, banks and the state budget (71.8%), 6,856 million lei represent reduced payment of the debts to the suppliers, banks and the state budget (0.5%) and 372,738 million lei represent cancellation of penalties granted by the suppliers, banks and the state budget (27.7%).

THE ASSESSMENT OF INSTITUTIONAL PERFORMANCE OF PRIVATIZATION PROCESS

The legal framework set up for the privatization included the following:

- Law 58/1991 regarding the privatization of commercial companies;
- Law 77/1994 regarding the associations of the employees and management of the companies under privatization;
- Law 55/1995 for acceleration of privatization process amended by the Law 129/1995;
- Emergency Ordinance of the Government 15/1997 regarding the modification of the Law 58/1991;
- Emergency Ordinance of the Government 88/December 1997 regarding the privatization of SOE ,approved through Law 44/1998 and Government Decision 55/1998 regarding the approval of the methodological norms concerning the privatization of the SOE and assets sale, as well as the Organizing and proper functioning Regulation of the State Ownership Fund.

The privatization process in Romania has been quite heterogeneous, involving all the major methods employed in transition economies: employee buyouts, mass privatization, and sales to outside investors. The privatization process in Romania has been quite heterogeneous, involving all the major methods employed in transition economies: employee buyouts, mass privatization, and sales to outside investors.

The Management-Employee Buyout (MEBO) Method

Transfer of shares to employees, through giveaways or sales at low prices, has been a common privatization method in transition economies due to the relative ease of administrative and political implementation. The method is controversial, however, and frequently alleged to be ill-suited to the restructuring demands of the transition. On the one hand, insider privatization may improve work incentives, company loyalty, and support for

restructuring. If ownership is widely dispersed among employees, it may also facilitate takeovers by outsiders. On the other hand, employees may lack the necessary skills, capital, access to markets, and technologies necessary to turn their firms around. Corporate governance by employees may function particularly poorly when the firm requires difficult restructuring choices that have disparate distributional impacts within the firm. MEBOs were most common in the years 1994 and 1995, although employees continued to buy out their companies through 1998.

The Mass Privatization Program (MPP)

The second major method used in Romania was mass (or “voucher”) privatization. As elsewhere in Eastern Europe, the rationale for this method was that the speed of privatization could be increased by overcoming the problems of insufficient demand due to low domestic savings and reluctance of foreign investors (Earle, Frydman, and Rapaczynski, 1993; Boycko, Shleifer, and Vishny, 1994). These programs were intended to jump-start domestic equity markets with a rapid release of shares, but with the risk of highly dispersed ownership. The Romanian mass privatization program (MPP), carried out in 1995-96, had as main features: in most companies included in the program, only 60 percent of the shares were offered. In those deemed strategic, which tended to be relatively large firms, the figure was only 49 percent. Even these percentages were reached in very few companies, due to the peculiar asymmetry in the treatment of excess demand and excess supply in the allocation procedure. The consequence of the MPP was inevitably an ownership structure heavily dominated by the state, which usually retained a majority stake, with a highly dispersed group of private owners. Shares allocated in the MPP were taken from the portfolios of both the SOF and the five POFs, but the POFs could regain some shares if citizen-participants in the MPP exercised their option to place their vouchers with them.

Privatization through Sales to Outsiders

The third major privatization method employed in Romania involved case-by-case sales of large blocks of shares to outside investors. The most important methods were sealed-bid tenders and auctions, in which not only the price offer but also the business plan, investment and employment promises, and other considerations were taken into account by the SOF in pre-selecting the buyer.

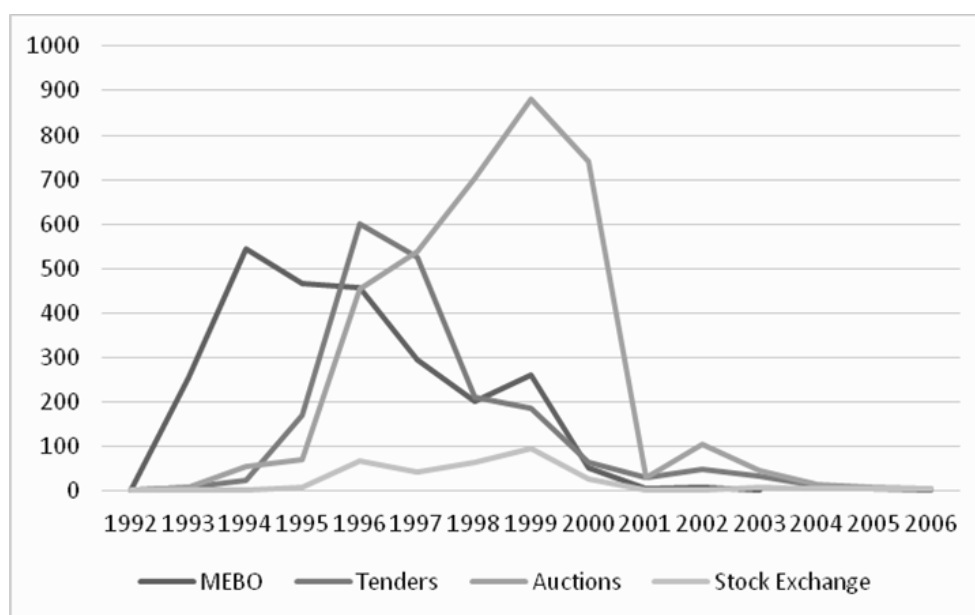
Privatization through Stock exchange

This type was used through :Romanian Stock Exchange,OTC(RASDAQ) and I nternational Stock Exchanges

As an example,in the following table is represented the number of companies that have been privatized and the methods of privatization used by SOF between 1992-2006:

Table 1 Number of companies privatized in Romania through different methods

Year	MEBO	Tenders	Auctions	Stock Exchange	TOTAL
1992	1	0	0	0	1
1993	253	8	9	0	270
1994	543	22	55	1	621
1995	465	170	71	9	715
1996	456	602	454	66	1578
1997	296	527	537	42	1402
1998	202	209	702	64	1177
1999	259	185	880	94	1418
2000	50	64	740	26	880
2001	4	31	29	2	66
2002	9	48	104	1	162
2003	2	33	45	7	87
2004		12	14	6	32
2005		6	8	4	18
2006		2	6	4	14
TOTAL	2540	1919	3654	326	8441

**Fig.5 Number of companies privatized in Romania through different methods**

After 1999 this process overlapped with preparations for accession to the European Union (2000-2007) which, in addition to the effort involved in transposing the *acquis communautaire*, required transformation and adaptation of administrative capacity in favor of the anticipation and management functions, with consequences for the effective functionality of the labor market as well.

In the second decade (after 2000) when the economy started growing – sometimes spectacularly - Romanian society began gradually to rid itself of a mode of thinking and acting geared primarily to times of crisis, under the impact of a flow of announcements from private companies and the public sector relating to opening of new units and new job creation.

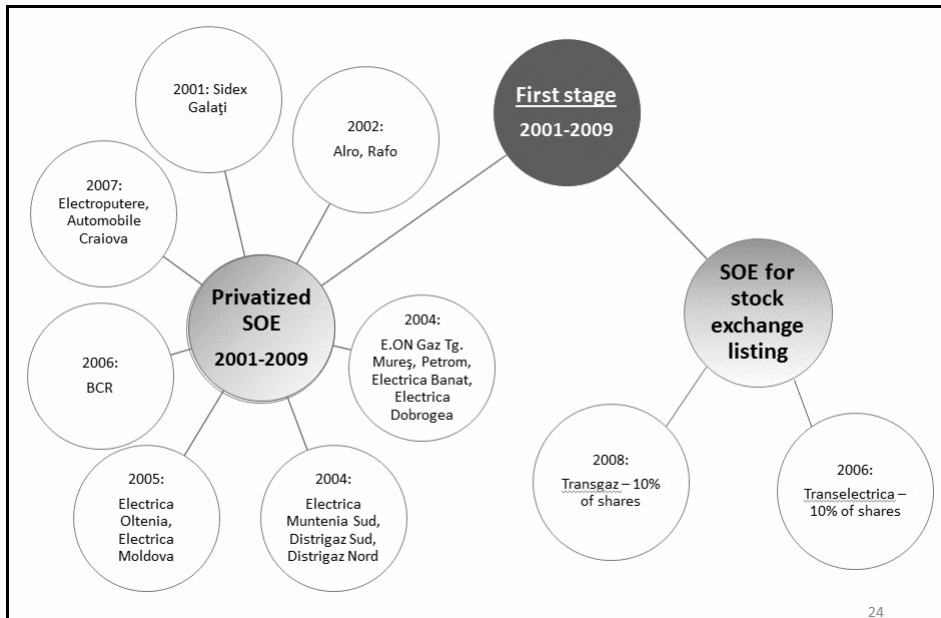


Fig.6 The first stage of restructuring

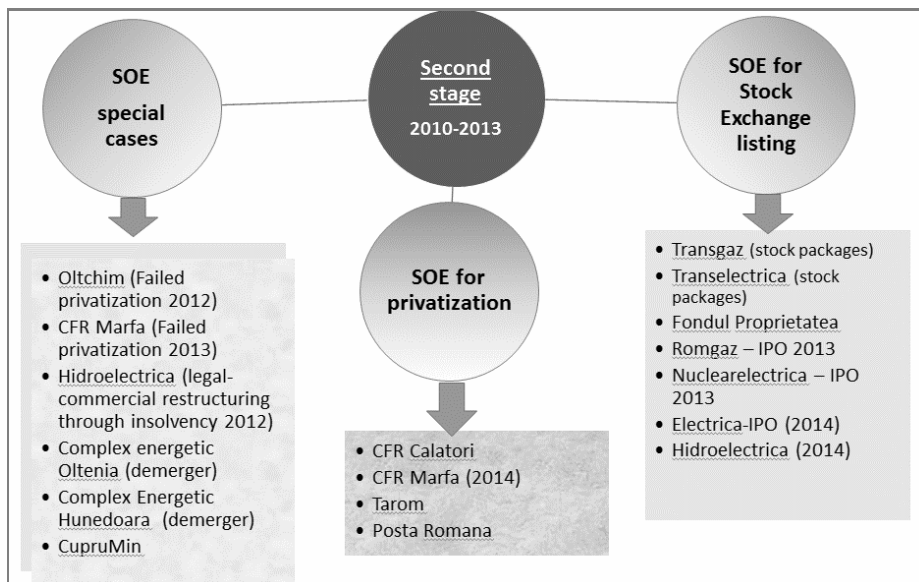


Fig.7 The second stage of restructuring

Following the severe downturn during the 2008–09 crisis, Romania has made significant progress in restoring macroeconomic stability. Large external and fiscal imbalances have been reduced to more sustainable levels under two consecutive IMF Stand-By Arrangements, supported by the European Union and the World Bank. Since 2010, Romania

has maintained continued market access and has begun to rebuild fiscal, capital, and reserve buffers even as it has started to make large repayments to the Fund.

Romania successfully completed in June 2013 a 27-month Stand-By Arrangement (SBA), including a three-month extension, equivalent to SDR 3,090.6 million (€3.4 billion, 300 percent of quota). The authorities have requested a successor 24-month SBA with proposed access of SDR 1,751.34 million (about €2 billion, 170 percent of quota). The first tranche of SDR 194.7 million would be made available upon program approval. The authorities intend to treat the SBA as precautionary and have also requested support from the European Union (€2 billion), while €1 billion remains available under a World Bank policy loan.

The key objectives of a new program are to provide a buffer against possible external shocks, while assisting Romania in preserving the hard-won macroeconomic stability and catalyzing difficult structural reforms that were initiated under the previous program. In particular, the program seeks to:

- (i) safeguard sound public finances underpinned by a stronger institutional fiscal framework;
- (ii) continue monetary and financial sector policies that restore buffers shielding the economy against external shocks; and
- (iii) reduce bottlenecks to the country's growth potential and competitiveness through structural reforms. The program aims to preserve investor confidence by ensuring policy discipline and stability.

SELECTED COMPANIES' PERFORMANCES

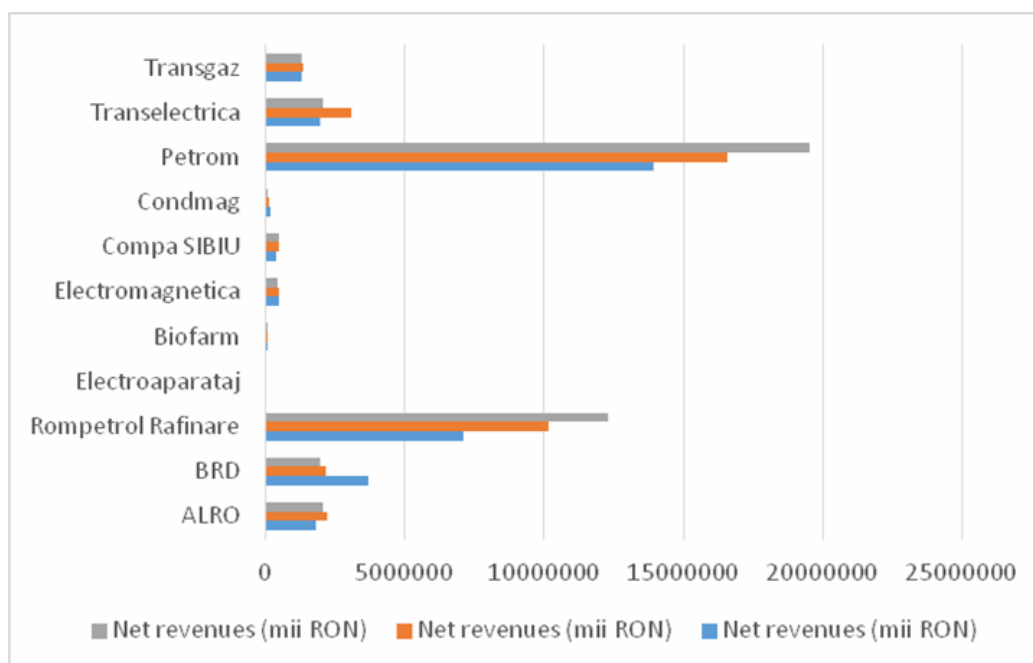


Fig.8 Net revenues of selected group of companies from 2010-2012

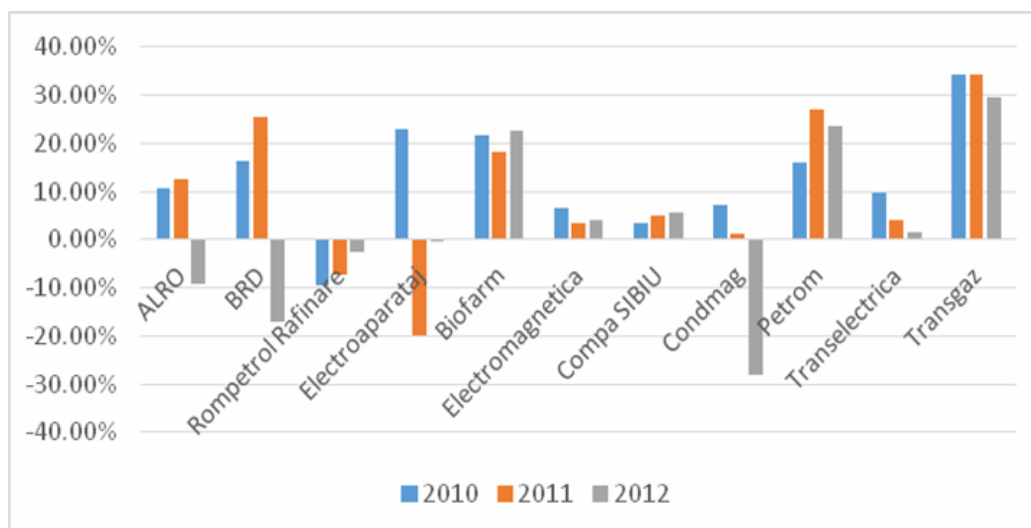


Fig.9 The post-restructuring gross profit margin of selected companies from 2010-2012

CONCLUSIONS

A change of restructuring paradigm: switching from “pre-privatization restructuring” to “ownership restructuring” starting with the second stage of FW

This segregation in waves and stages on the one hand and of the results of restructuring (in immediate -short-term and long-term as result of the finalization of the restructuring process through ownership restructuring in the second stage of the FW, on the other hand gives us the possibility to better quantify the effects of the restructuring process in Romania.

A key result is that the effects of restructuring in both waves are positive, which provides evidence in support of the structure-conduct-performance hypothesis, while at the same time some relevance of the efficient-structure hypothesis cannot be rejected.

Large-scale restructuring was a process both useful and efficient.

Djankov conclusion (that the large scale restructuring process had no results) was made on a methodological error, because the first FRP were set up in 1995-1996, and the results of the implementation of an FRP is measurable and relevant on a short –term basis (30-90 days) cumulated with medium and long term (2-5 years) that escaped from his calculation (his data base was consisting in 1992-1996 period, and cumulated effects were not yet visible);

Delayed results of privatization that crystallized by the end of first wave did not deny the principles that governed the first wave of restructuring process;

Residual stock of mid and big companies that entered the restructuring process in the first wave where privatized in the second wave (first stage). Significant improvement of macroeconomic results (GDP, FDI and exports) and stock exchange (BET index) in the second wave of restructuring.

The correlations showed us high correlation in terms of impact of government and enterprise restructuring on privatization and also moderate correlation in terms of effects. The restructuring process must be seen on long term basis, as its effects are correlated with the macroeconomic results.

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