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# THE INFLUENCE OF THE EUROPEAN SINGLE MARKET UPON THE SME ACTIVITY

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## ABSTRACT

The analysis tries to highlight the manner in which the European common market will influence the SME activity in Romania. The challenges caused by regionalization and globalization of markets demand the compliance of SME to the competitive environment, by consolidating their market position and benefit from the economical opportunities. Romanian SME could become an economical growth vector only if the real capacity to adapt to a global competition and knowledge based economy is proved.

Regarding this aspect, the authors try to present the most important positive and negative effects on the SME activity. Presently, the small level of competitiveness is due to the lack of necessary capital for supporting investment projects, but also to the constraints of financial sources.

The study reveals the importance of SME in an economy and the Romanian SME capacity of overcoming the difficulties of entering a strongly competitive market. Romania has a SME sector which, although has recently followed a positive trend, it possess performances which are still low in comparison with the countries from European Union, including the countries which entered the European Union in May 2004. The branch structure of Romanian SME is still one specific to a less developed country: industries that use a high level of labor force and that has a competitive advantage related to the small cost of this factor; a small proportion of the tertiary sector; and an increased presence of the SME that have as principal activity commerce (2 times bigger than the European average).

SME sector contribution to economical growth is well known in the majority of the countries of the European Union. If traditionally, small and medium enterprises were considered economical operators belonging to the internal market, today a growing number of SME are managing to conquer the global markets. Approximately one fifth of the SME involved in the productive activity in

the OECD countries realize a proportion of 10 to 40 % of their turnover from international activities. SME contribute in a high proportion to the global industrial exports and increase the volume of foreign direct investments worldwide. Moreover, the European Union experience show that it has a significant contribution to the GDP and to the reduction of the unemployment rate.

## JEL CLASSIFICATION G3

### KEY WORDS

Competitiveness, SMEs (Small and Medium Enterprises), single market

### 1. Introduction

The necessity of increasing the economical competitiveness having in consideration the important global changes (financial and economical globalization, opening of national markets, fasten technological innovations) is highlighted in the context of sustainable economical growth and improving the standard of living. The challenges caused by regionalization and globalization of markets demand the compliance of SMEs to the competitive environment, by consolidating their market position and benefit from the economical opportunities. Once with the market integration, SMEs are making part of a competitive environment not only on the local market, but also on the regional and international market.

SMEs are the most active and dynamical factors of the market economy. SMEs sector contribution to economical growth is well known in the majority of the countries of the European Union. If traditionally, small and medium enterprises were considered economical operators belonging to the internal market, today a growing number of SMEs are managing to conquer the global markets. Approximately one fifth of the SMEs involved in the productive activity in the OECD countries realize a proportion of 10 to 40 % of their turnover from

international activities. SMEs contribute in a high proportion to the global industrial exports and increase the volume of foreign direct investments worldwide. Moreover, the European Union experience show that it has a significant contribution to the GDP and to the reduction of the unemployment rate.

The problems of small firms are important to competitiveness issues because of the potential role that this sector can play in a dynamic economy. Apart from contributing to overall growth and employment, SMEs are an essential element of competitiveness. A well-developed and vibrant SME sector will be an important source of innovation. Most new firms begin in the SME sector and they can also be a breeding ground for new products and services. Moreover, the SME sector is a source of strength for the economy as a whole. Because it can offer a wide range of goods and services, larger firms will always have a choice of supplies and markets also. This means that the economy will have the necessary flexibility to cope with fluctuations. If the structure of the economy is a complex one, because of the layers of firms that are interrelated, the shocks will lose some of their impact as they move through the economy.

The European Union presents a wide range of opportunities for SMEs. One of the biggest achievements is the creation of the European Single Market, a market with around 500 million consumers, from which the SMEs can benefit. Despite this fact, there are many factors that discourage them from exploring these possibilities. For most SMEs, including the Romanian SMEs case, the domestic market is their only market. In fact, according to European Observatory for SME, only one-fifth of the European SME export their products or services outside their home country. The percent of SMEs that have entered deeper in the foreign markets, have set up subsidiary firms, branch offices or entered into joint ventures in countries other than their own is even more low. While large firms have the resources to operate in many markets, for smaller companies, going abroad is an important step. Among the reasons for this lack of penetration, it is worth mentioning the differences in regulatory and legal environment and above all, the lack of capital. The financial investment needed to launch themselves into a new market is a significant barrier to SMEs.

From the SMEs point of view, the enlargement of the EU and the creation of the single market can represent a problem of competitive position. It can mean not only an opening-up to new markets or facilitated access to such markets, but also a potential appearance of new competitors on own domestic markets. The economic impact of the changing business environment on SMEs in current and new Member States depends to a large degree

upon the initial position of enterprises in terms of their relative competitive advantages and disadvantages. The major competitive advantages of EU firms compared with the new Member States include a higher investment capacity (owed to an increased availability and lower cost of finance), the use of more advanced technology, as well as experience with the internal market. The main competitive advantages of the new Member states entering the European Union lies in labour costs.

## 2. The current state of Romanian SMEs and their place on the single market

As far as concerns the Romanian SME sector, it can be said that, although it has recently followed a positive trend, it possess performances which are still low in comparison with the countries from European Union, including the countries which entered the European Union in May 2004. The branch structure of Romanian SMEs is still one specific to a less developed country: industries that use a high level of labor force and that has a competitive advantage related to the small cost of this factor; a small proportion of the tertiary sector; and an increased presence of the SMEs that have as principal activity commerce (2 times bigger than the European average), fact easily noticed in the table below:

Table 1  
*Structure by type of activity of small and medium enterprises, 2004*

BRANCH OF ACTIVITY	ROMÂNIA	UE
Industry	14,4 %	10 %
Agriculture	3,2 %	-
Construction	5,0 %	13 %
Commerce	50,2 %	25 %
Turism	0,8 %	6 %
Transport	4,6 %	6 %
Services	16,9 %	30 %

Source: National Agency for Small and Medium Enterprises – Governmental strategy for sustaining and supporting the development of SME in the 2004-2008

The majority of Romanian SMEs use antique technologies, the quality of their products and services is usually low, and the average value of work productivity is 19 times lower than the EU one.

Table 2  
*Work productivity- Comparative analysis*

<b>WORK PRODUCTIVITY (EURO)</b>	<b>MICRO</b>	<b>SMALL</b>	<b>MEDIUM</b>
Europa-19 (UE 15 + AELS)	40.000	75.000	105.000
Romania	2.688	3.688	3.542

Source: National Agency for Small and Medium Enterprises – Governmental strategy for sustaining and supporting the development of SME in the 2004-2008 [2]

Romania does not possess an antreprenorial tradition, in 2006 the average number of SMEs being 26 enterprises by 1000 inhabitants, but it is still a lot under the EU average (50 SME at 1000 inhabitants). There also exist, major differences as far as concerns their distribution on regions, Bucharest being situated on the first position. The Bucharest-Ilfov region, with a 48,56 SME/ 1000 inhabitants density is the only region of the country with a similar structure to the EU countries, followed by the NV, V and Centre region, with an average of 25 SME /1000 inhabitants, the SE region with 23 SME/1000 inhabitants and the lowest regions in SME, SV, S, and NE with an average of almost 18 SME/1000 inhabitants.

In 2004, the small and medium enterprises represented 99 % of the total number of companies that functioned in Romania (403.000 in 2004) and they covered half of the of the employed population.

As employers, IMM sector is situated below the European average (56,6 % in 2004 ) (Table 3). Nevertheless, the level of employment in SME sector had a positive evolution in the period 2002-2004 (16,7 %) [1].

Table 3  
*Small and medium enterprises in the economy (comparative dates)*

	<b>% NR.SME / TOTAL ENTREPRISES</b>	<b>% EMPLOYEES OF SME/ TOTAL ECONOMY</b>	<b>EMPLOYEES /SME</b>
<b>Romania 2002</b>	99,5	51,1	5,9
<b>Romania 2004</b>	99,5	56,6	5,8
<b>Europe 19</b>	99,8	69,7	5

Source: National Institute of Statistics, 2003 SME European Observatory [3]

The impact of integration upon the SME sector depends on their capacity of responding in a flexible way to the requisites of a highly competitive market and of adapting

rapidly to the structural and cyclical changes of the global economy. Romanian SMEs could become an economical growth vector only if the real capacity to adapt to a global competition and knowledge based economy is proved.

The type of activity performed by the SMEs, in other words, their degree of internalization plays an important role in establishing the measure in which the single market affects the activity of SMEs. Enterprises with their main activity of production and services active internationally will have to face an increased competitiveness. For these type of enterprises, the capacity of innovation plays a crucial role. In other words, they will have to change their strategies, products and services adapting them to the new working environment. They will be also obliged to fulfill the common legislative framework regarding the European standards and quality certification. On the other hand, the enterprises which do not have their activity focused on export, will face the increased competitiveness, not in the short period of time after the accession to the single market, but in a long term horizon.

Therefore, there is a need to increase the volume of investments in the productive sector, as well as the need of encouraging antreprenorial ideas and innovation in the profitable sectors, for improving Romanian competitiveness. The Romanian SMEs sector should develop its competitive basis and have a stronger impact on the national and international markets. A significant support in this direction concerns the access at alternative and adequate financing sources, to foster the initiative and developing the activity of existing SMEs.

An important step made in 2002 was the creation of National Fund of Credit Guaranteeing. Twinning with the most important Romanian commercial banks has been consolidated, determining a strongly increase in credit operations and higher potential investment capacities for the SMEs, facilitating the access to loans when the guarantees offered by SMEs are insufficient. By the guarantees offered, this Fund has contributed to the maintenance and creation of 35.000 workplaces. The first three positions as far as concerns the fields of activity of the supported SMEs were commerce, services and constructions.

The recent results proved the important role played by this Fund in improving the access to finance for those SMEs that have eligible business plans, but do not possess sufficient material guarantees or financial resources (table 4).

Table 4

INDICATORS	2005	2006
Turnover (lei)	1.300.620	7.501.720
Net profit (lei)	3.179.580	10.206.000
Guarantees (bil.Euro)		122

Source: National Fund of Credit Guaranteeing for SME

Therefore, during the year 2006, FNGCIMM has obtained a net profit of approximately 10.206.000 lei, over 3 times higher than the one from the previous year. The turnover has registered at the end of the year 2006 an increase with 576,78% in comparison with the year 2005, from 1.300.620 lei to 7.501.720. The volume of guarantees has increased four times in comparison with 2005, reaching a level of over 122 billion Euro for credits with a total amount of over 250 billion Euro.

Although the Guarantee Fund has improved in a transparent way its efficiency and capacity of sustaining a larger number of small and medium enterprises as far as concerns the access to finance, there is this permanent need for the existent facilities to be extended and improved, in order to help the enterprises to reach the European Union level, to increase the amount of added value created and profitable investments made by the SME sector. There still exist some constraints related to financing, that could be solved by accessing the new structural funds, destined to investments in new

technologies and implementation of quality systems, or consultancy services that could offer the SME sector the right perspective in the market.

The entrance of Romania in the European Union was perceived by the majority of SMEs like a big opportunity for their developed activities. Having in consideration one recent survey of ANIMMC through the SME sector, it is considered that the factors of the common market supposed to have a strong positive impact upon the SME activity are easier access to the market (35,67%), improved regulation (31,67%), the existence of better or cheaper suppliers (19,76%), better access to new technologies (5,14%), more correctly public acquisitions procedures (3,76%), a better cooperation for innovation (3,43%) (figure 1).

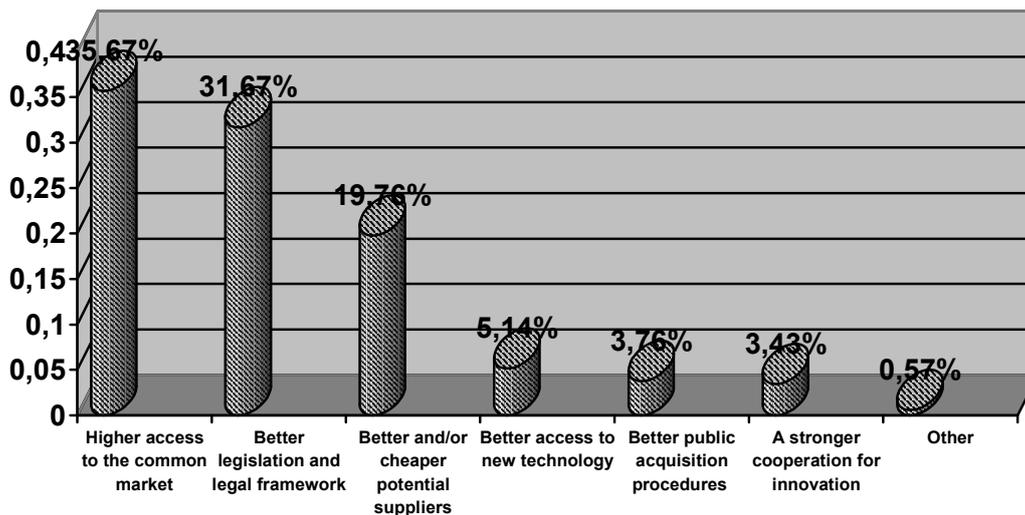


Figure 1 - Impact of the European Single Market upon the SMEs activity [4]

### 3. Financial opportunities for Romanian SMEs

Therefore, it is expected that the recent entrance of Romania in European Union will have a positive effect upon the Romanian economy through the valuation of the real supplementary financial opportunities for the small and medium entrepreneur.

The financial perspectives of the SMEs highlight some important funds meant to have a significant contribution of increasing their capacity, of growing the overall competitiveness.

The estimated value of the structural funds destined to the SME sector will be of approximately 800 billion Euros for the 2007-2013 period. This financing will be supported by the Regional Development European Fund.

„Increasing the economical competitiveness and developing the knowledge based economy ” is one of the six national priorities of development established in the National Development Plan. The objective in reaching these priorities is the rapidly reduction of national and regional socio-economical disparities, and an orientation and stimulation of socioeconomic development of Romania, likewise European Union Cohesion Policy.

Furthermore, small and medium enterprises will benefit in the year 2007 of an amount of 75 billion lei for supporting their activities, due to programs developed by the National Agency for SME, an amount bigger than the one allocated in the previous year, of only 64 billion lei. There are 14 programs for SME, including:

-*The National Program* for the period 2005-2009 for sustaining the access of micro and small enterprises to consultancy and training facilities, which has a budget of 1.200.000 lei. It is dedicated to facilitate training for the decision making or executive personnel of the SME.

-*The National Program* for the period 2006-2009 of supporting SME in increasing the export activity, which will benefit from a budget of 8.000.000 lei. The Program objectives are: improving the access of Romanian SME on the external markets, reducing the information gap, consultancy services and training of Romanian SME.

-*The Program* of development and restructuring the commercialization activities, which has a budget of 6.000.000 lei, for a number of 400 beneficiaries. Its main objective is to encourage the new technology acquisition in order to increase the economical and technical performances of SME and fulfil the requisites of European Union as far as concerns the level of competitiveness, an increasing protection for the consumers.

- *The Program* for supporting the development of SME, through a budget of 9.600.000 lei. Its objective

consist in growing the overall competitiveness and capitalization of SME, realizing in this way a better consolidation of the capital and of the existent competitiveness to which SME are exposed on the European common market.

- *The Program* for the 2006-2009 period for supporting handicraft and artisan work, with a budget of 1.500.000 lei. This stimulates the handicraft development and the small industry in Romania, strengthens the handicraft men class, which manage this activity individually, or in an organised form, through associations or other organisations, especially in the rural places, but also in the urban ones.

-*The Program* for growing the SME competitiveness through implementation and certifying quality systems, with a budget of 1.200.000 lei. Its main objective consist in stimulating the development of Romanian SME competitiveness and their rapidly accommodation with the strict conditions determined by market globalization and integration in European Union through the implementation of proper certified quality management systems/environment/health and work security/alimentary safety.

The programs are operational beginning with the end of february 2007. The funds allocated to the 14 programs are coming from the state budget.

For a real improvement of the access to financial services by the small entrepreneurs of Romania, especially those from the less developed areas and from the rural areas, that, so far, had a limited access to financial services with reasonable costs, a strong support comes also from the external credits for investments offered by international financial institutions ( EIB, EBRD, WB). The Romanian program of micro-financing will facilitate funds, in RON or Euro, to those banks, financial institutions or microfinancial corporations, in the way that these entities could borrow small and medium enterprises, inclusive the recent made ones. SME could obtain credits from a fund of 88 billion Euro, from which 40 billion Euro are assured by EBRD. Cofinancing this program by European Union and Romanian Government, include 2,5 billion Euro that represent funds for the necessary technical assistance for developing new financial products for SME, improving the risk management procedures and personnel training courses. For encouraging financial institutions to borrow their capital to recent made SME (enterprises with less than 12 months of activity), it has been formed a Fund of Risk of 3 billion Euro, from which 50 % of the potential losses registered by the partner financial institutions will be covered.

On the other hand, starting with may 2007, European Investment Bank is offering a fund with an initial offer of 100 billion Euro that could be accessed by the SME

sector, in order to increase their capital, or financing different grants.

#### 4. Conclusions and recommendations

The biggest constraint for the SMEs in reaching a proper business development and performance that could provide a better position on the common market is access to finance. In order to increase their competitiveness, they currently need to upgrade their knowledge and skills, however informal activities for improving knowledge and skills are most popular. The main barrier for carrying out competence development activities is insufficient budget. Moreover, there is a lack of information and contacts regarding availability of support as well as technology-related issues. Policies for supporting SME competitiveness should pay attention to providing access of SMEs belonging to all main industries, to financial resources and to external resources of knowledge and skills (i.e consultants, SME supporting organisations). There should be paid attention on enhancing the capacity to provide access to formal training, focusing on skills that need to be improved by SMEs in order to be competitive (management, information processing, language skills), provide support for participation of SMEs to informal activities, like visits to expos and trade fairs, and means of collaboration with universities and/or research centers for transfer of knowledge and skills on technology-related issues.

Romanian SME can obtain financing through various financing programs, that presently coexist. In the same time, they could benefit from support services, for increasing their possibilities of accessing these funds or improving their own performances. This is the main reason why this red of consultancy centres should extend its activity and increase their support to SME in the preparation and implementation of the business plans, offering services for initiation in business, marketing, management, consultancy and assistance as far as concerns the organization of the informational systems.

In a knowledge based economy, Romanian SMEs competitiveness depends on their capacity of using in a proper way the current financial opportunities. Only in this way, the SME sector could become the most important pillar of the economy, as they are in the most European Union countries.

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