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ROMANIAN SME's SECTOR TROUGH CRISIS: THE EFFECTIVENESS OF GOVERNMENT POLICIES AND THE PRESENT SITUATION

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Abstract

SMEs play a crucial role in modern societies; being regarded as the foundation of a global competitive economy. Entire economic concepts evolved based on the SMEs sector evolution like entrepreneurship, innovation, competitiveness, etc. The current paper is aimed at presenting the current state and role of the SME sector in Romanian economy, in light of the challenges imposed by the global financial and economic crisis and the reaction measures taken (or not taken) by the Romanian authorities.

Key Words: *financial crisis, government policies, SME's*

1. Introduction

In the economic literature SMEs are often treated as a hole group that comprises all this sort of companies in the economy, aggregated as a solid sector or at a microeconomic level, that of a single unit and his relation with the intern and extern economic environment components. This useful survey about the current state and role of the SMEs in the Romanian economy addresses both parties involved in the creation and sustainability of a sound SME sector at the Romanian economy level: legal authorities

and government decision factors on one way and Romanian entrepreneurs owning or starting a SME an the other. By making a review of how the SME sector developed trough crisis and the measures that the Romanian government implemented in their aid, a clear image can emerge and useful conclusion can be drawn for future analysis and implementation. This papers starts by making a literature review about the importance of SME sector for a market economy and the role it plays, focusing after that at the particular challenges faced by Romanian small and medium companies while they venture trough the economic crisis. This also brings a fresh Romanian perspective to the current international research done in this field that can contribute to a better understanding on SME role and functions in relation with other economic entities.

In a biannual analysis of the situation of SMEs in Romania - published in 2010 by the National Council of Private Small and Medium Enterprises (CNIPMMR) - shows that for the first half of 2010 a negative value of entrepreneurial index (-8.5 points) was calculated, which shows very unsatisfactory overall evolving business environment and SME sector compared with the same period of 2009. The business environment index as well as SME development index recorded values that reflect a poor business environment in SME sector, compared to the same period of 2009.

The causes of the above situation are multiple and complex, referring, in most cases, to the following issues, arising directly or indirectly from the way government institutions conducts business:

- lack of access to bank financing, blocked by massive public financing through the Ministry of Finance from private banks in order to pay pensions and salaries of public employees;
- excessive delays in legitimate VAT refunds to companies, which is hampering their activities and even driving them into bankruptcy;
- the introduction, in early 2009, of the minimum tax, required to be paid even by the firms that do not record profits.

The main effects of financial and economic crisis in Romania manifested macroeconomic concerns:

- general economic downturn, which affected both domestic and external demand, causing companies to reduce investment and downsize their business, which resulted in an increasing unemployment;
- enhancing the fiscal deficit from 24.6 billion in a period of 9 months in 2008 to 30 billion lei in the same period of 2009;
- Increased difficulties in accessing finance, credit becoming more expensive for both the state and companies. In addition, the high fiscal deficit forced the government to compete with private sector for cash and liquidity in general, in detriment of the latter;
- reduce foreign investment from 14 billion lei in first the 9 months of 2008 to 6,8 billion lei in the same period of 2009, in conjunction with the inclusion of Romania by the credit rating agencies in a risk category well below investment grade (junk);
- increased liquidity risk, both for the banking and the business sectors;
- emergence of solvency risk for both the banking sector (as a result of eliminating "toxic assets" in the portfolio, increasing reserves through asset devaluation, etc.) and for the real sector (depreciation of assets, inability to finance production and investment cycles, etc.);

- manifestation of contagion risk: foreign ownership in the Romanian banking system has an overwhelming share (Greece - 30%, Austria - 24%, Netherlands - 12%, Italy, Hungary, France - by 6%). Redraws of funding from parent companies or closure of branches in Romania had had a chain effect throughout the economy.

Agreements concluded in 2009 between Romania and the IMF, EU and World Bank and the commitments made by major European banks to continue financing have provided external funding and gave investors added confidence in the Romanian banking system.

2. Literature review

SME definitions vary greatly across European Union countries and for this reason the SME concept can be a bit confusing. According to Beaver (2002), SME are much easier to describe than to define and there no generally agreed operational or numerical definition of what constitutes a small business". A generally agreed definition is that of the European Commission that takes into account two factors for classifying a business as being micro, small or medium: the number of employees and the firm turnover or total balance sheet. But the majority of the research work relating to SME doesn't present clear clarifications about the definition being used to classify these firms so the reader often doesn't if the author speaks about SME or large firms. The current paper and the documents presented use the European Commission definition of SMEs.

Another concern to be addressed is that even though SMEs play an important role in the economy, they don't always represent an important share of the total economic activity as Audretsch (2000) states. According to him small firms operate at lower levels of output that are not sufficient enough to generate scale

economies and therefore they can be branded as being inefficient or suboptimal at best. In the same time the author recognizes the dynamic role that SMEs play for an economy and the greater change of making innovation then the larger companies.

In a study of Greek SMEs, Caloghirou et al. (2004) found that small firms base their competitive advantage on marketing techniques rather than technology which leads to a myriad of differentiation strategies being used by these firms.

Regarding the role that SME sector plays in the economy Hu (2003) notes that in Asian crisis SMEs were depicted as “an army of ants” for Taiwan to fight the crisis while Liargovas (1998) considers that SMEs are the back-bone of local economies in Europe. Carlsson and Karlsson conclude “*that small firms and entrepreneurship are both necessary for long-run macroeconomic prosperity*”.

Among all authors there is a common consensus that the role played by SMEs in the current economies is based on three important features, specific to SME firms:

1. Entrepreneurship or the willing of each owner of these firms to conduct the business for which the SME was created
2. Employment, their existence providing more employment opportunities and fostering future SME creation (former employees that found their own companies)
3. Competitiveness, the environment in which they live being a very intense one, they have a short life span, with only two options: either they develop into large companies, either they die or are being taken over by larger developing competitors.

In conclusion, all over the world the SMEs sector incorporates a large part of the local economies and is the promoter of local sustainable development. Helmsing (2003) presents such a case for African economies pointing the important role SMEs play in local communities' development.

The same argument is also valid for more developed economies, the SME sector representing more than ninety-five out of one hundred enterprises in countries like Japan, Switzerland, France and Taiwan according to Hu (1998).

3. The current state of the Romanian economy SME sector

In Romania, of the more than 183,000 SME that have suspended their operations only in 2010, 26,000 were active, the main cause of suspension of activity being considered the introduction of the minimum flat tax. By closing these businesses, 56,000 people were directly affected by job loss, while the state lost about 100 million lei revenue for the budget.

Despite optimistic forecasts part from authorities and part from business on economic developments in 2011, the same downward trend is continuing in the current year.

At the end of 2009, the unemployment rate from the private sector has reached 4%, the most affected counties being in northern Moldova region, in particular Botosani and Suceava counties, and the most affected industries being: steel industry, machine building Industry, construction, textile, chemical, mechanical and furniture.

Reality, however, is bleaker than the forecast of specialists, in January 2011 an unemployment rate of 8.1% was recorded for the whole country, the business sector unemployment being 4.5 times larger than that of state owned firms and public institutions. The most affected counties are Mehedinti (with an unemployment rate of 14.5%), Vaslui (13.5%) and Alba (13.4%) and at the other extreme, with lower unemployment rates, being Bucharest (2.4%), Ilfov (2.6%) and Timis (4.4%).

According to a survey conducted in 2010 by CNIPMMR in the eight regions, half of SMEs claimed to be severely (25.49%) or very severely (23.53%) affected by the current economic context. A percentage of 36.27% of the SMEs surveyed

acknowledged environmental impact of new financial and economic climate on their businesses and 11.76% of them said that their businesses have suffered only slightly negative runs.

Regarding the measures taken by public authorities to reduce the impact of economic crisis on SMEs, they were rated as "unsatisfactory" by the majority of entrepreneurs (80% of respondents), only 13% of respondents considering the measures as "satisfactory" and 1% as "good."

However, the effects of the crisis are not felt the same throughout the country, the counties that are better connected to the global economy feeling the full effects, while the less developed areas being less affected. Thus, the least affected by the crisis will be "the country's southern and eastern counties, mainly agricultural, rural and still predominantly tributary of traditional economic relations, which has the lowest GDP and Dambovită, Giurgiu, Suceava, Bacău and Iași.

On the other hand, it is estimated that the counties affected by major economic and financial crisis will be those in the west, northwest and center of the country, such as: Timiș, Arad, Bihor, Alba, Sibiu, Valcea, Argeș, Bistrița-Năsăud and Galați.

In general, greatly affected by the crisis are / will be industrial areas whose economy depends to a high extent to large companies that are geared primarily for export, since they also support SMEs in the region, local providers and large local enterprises.

"The White Charter of SMEs - 2010", produced by CNIPMMR, stresses that in the first half of 2009 over half of SMEs have faced serious problems due to economic crisis and have reduced activity, 14, 8% have gone bankrupt and only 4.23% have boosted business.

Entrepreneurs invoke the evolution of the legal framework as the most common negative element that influenced the activities and performance of SMEs, and also excessive bureaucracy, corruption, political changes or the International

Monetary Fund and World Bank policies towards Romania.

In the same document, entrepreneurs show their discontent towards the economic environment which prevents business development for 58.18% of SMEs and favors it only for 17.13% of the companies. As a comparison, in the first half of 2008, the economic climate was considered to be business friendly for 51.61% of companies, and for 42.91% of companies in 2007.

The factors that contributed to the SMEs decline in Romania are considered to be:

- Major difficulties in ensuring the necessary funding and liquidity
- A collapse in demand for products and services both nationally and internationally, as reflected in reduced exports and domestic sales;
- Extremely high taxation
- Large increases in prices of raw materials, energy and food;
- Variations in exchange rate and inflation;
- Financial blockage caused by late payments, slow and costly judicial procedures to resolve trade disputes;
- Unstable legal framework, bureaucracy and numerous administrative barriers affecting SMEs activities;
- Very low rates of European funds absorption;
- Insufficient measures to support SMEs during the crisis;
- Insufficient state aid and difficult to access existing ones;
- Excess of inspections of local and central authorities on SMEs;
- Steady growth of utilities costs and the lack of measures to facilitate SMEs access to utility networks;
- Social dialogue being mainly quantitative without proper consideration from the government part of social partners' proposals in the fields of law and economics.

Some of these factors are common to SME all around the European Union , but others were more specific to the Romanian context, especially those related to public policies and government reactions to the current crisis.

4. Government actions (or reactions) meant to help the Romanian SMEs

Since October 2008 the Government has developed an action plan to tackle the economic crisis, that had to be applied from 1 January 2009 and which provided, inter alia:

- allocate a minimum of 10 billion Euros over the next four years for investment in the economy;
- reducing social insurance contributions (CAS) with ten points;
- allocation of 220 million lei for social housing;
- an award of 5% tax reduction of the tax to pay on time by companies and individuals;
- Tax exemption on dividends reinvested and invested in new companies;
- Providing incentives to businesses for each new job created, in amount of 1,000 Euros if they employ people who are unemployed for more than three months;
- allocation of 500 million Euros in addition to "The Farmer" scheme;
- increase the share capital of CEC Bank by 250 million Euros in order to finance SMEs and investment in agriculture.

After this, in early 2009 a new anti-crisis plan - "common anti-crisis platform measures" - which contained a total of 74 measures, was discussed by the Government. Among the measures included can be mentioned:

- full subsidy from the state budget for 2009 the employer's social contributions for a salary of up to 1,000 lei per person in order to stimulate the creation of at least 50,000 jobs in small businesses;
- support business by ensuring the establishment, within the CEC Bank, a fund designed to increase SME access to finance, setting counter-Fund lending for SMEs and changing legal framework in order to provide pre-financing for SMEs accessing structural funds;
- guiding and stimulating exports to emerging countries that are less affected by the crisis, including the opening of five centers to promote public-private

partnership in Moscow, Beijing, Chisinau, Cairo and New Delhi;

- simplification of administrative procedures by identifying a number of 25 licenses, permits or licenses and their gradual elimination, support for "one stop shops" (including virtual) to manage the activities of the establishment until the dissolution of companies;
- Exemption from payment of contributions to the state budget and social insurance for technical unemployment (but not more than three months) for companies forced to make personnel cuts in 2009;
- amending the Tax Code to eliminate the requirement to pay VAT on exports, in line with EU practices, or accepting bank instruments specific export VAT (bank guarantees, letters of credit rating or warranty);
- tax exemption of reinvested profits and dividends,
- limiting through the State Budget Law, the allowances of VAT for local authorities budgets;
- capital injections and measures to stimulate or support auto industry, petrochemicals and mining.

To improve and stimulate the economy in crisis, the ruling coalition adopted in August 2009, 32 anti-crisis measures, which will have been implemented through 2010.

Those 32 anti-crisis measures were added to the 28 measures implemented before July 1, 2009, plus four measures carried over from the first semester (non-taxation of reinvested profit, capitalization CEC Bank, public-private partnership, and to supplement the budget for research).

In the area of supporting small and medium businesses, the Government has increased state aid scheme for SMEs five times and has decided to postpone for six months, the payment of debts for firms that are affected by the economic downturn, with two conditions: The first condition is that the current monthly debt to the State is paid, the second condition being that they must prove, by a system of safeguards that they can and have the means to pay their outstanding debt in the future.

At the same time, the procedures relating to European funds accessing were simplified and an increase of pre-financing rate for European projects, from 15% to 20% and 20% to 30% was made available.

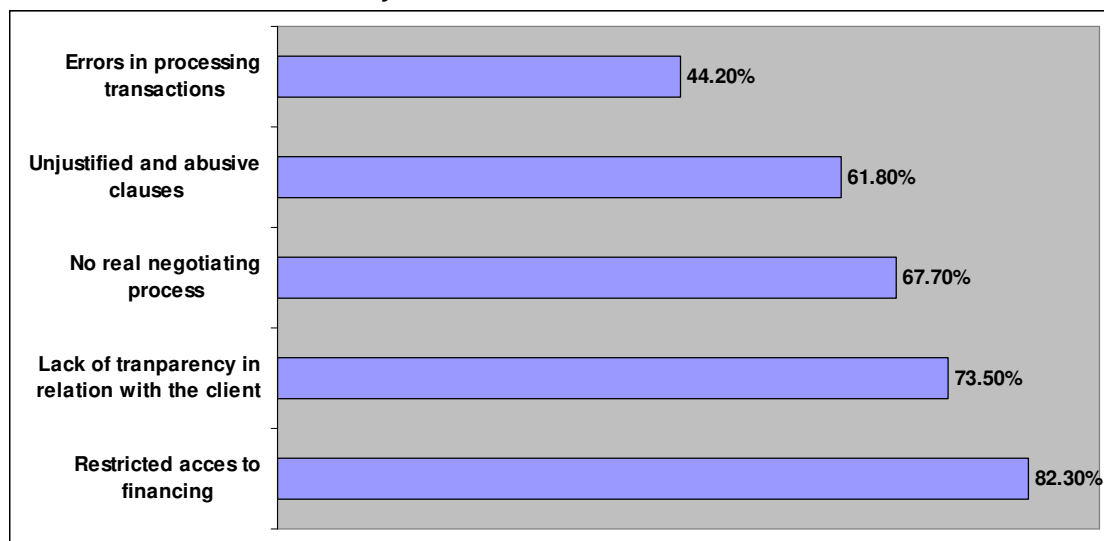
Implementation of these measures has not generated the expected results. Conversely, increased taxation and the introduction of flat tax, have threatened more and more SMEs by bankruptcy.

Outlook for the SME sector in 2011 are not encouraging, especially given that effective and consistent measures are yet to be seen. According to a survey by the National Union of Romanian Employers 19-23 October 2009, on a sample of 2,000 SMEs managers, entrepreneurs are pessimistic regarding the growth perspectives of Romanian economy in 2011. In addition, it is estimated that the economic situation of

SMEs will continue to deteriorate in 2011, restructuring plans and a further market contraction leading to the bankruptcy of many enterprises. The main reasons of this situation are considered to be: political instability (42%), the international context (29%) or poor lending policy of banks (23%). Moreover, entrepreneurs are further concerned, by the possible increase in taxation in 2011, including the introduction of new taxes, but also by increased fiscal control actions which lead to fines for almost all companies involved.

About the difficulties faced in relation with credit institution, a survey directed by CNMPIR in October 2010 on a sample of 101 SMEs revealed five major concerns, the main one being the restricted access to financing. (Table 1.)

Table 1. Issues faced by Romanian SME's in relation with credit institutions



For the SME sector to exit the crisis, managers believed that political stability is essential, as important as tax reduction and access to state support funds.

Representatives of SMEs consider that a "special attention to those businesses which are the initial and intermediate links in the chain of value" it is absolutely necessary and also "urgent adoption of concrete and effective measures" to ensure:

- Placement of SMEs in the center of national policies as an essential element of the economic system;
- improving access to lending by banks and other financial organizations for SMEs, including the facilitation of loans guaranteed by the state for entrepreneurs;
- reducing of taxation levels and stimulating the development of new SMEs, by offering tax breaks to ease the financial situation of firms: paying VAT on collection, lower

social contributions, reduced excise duty on gas, electricity and fuel;

- Implementation of the EU's commitment to simplify administrative tasks;
- Creation and implementation of European Community instruments to promote capitalization, networking, investment and staff training of the SMEs;
- Promotion and support services for businesses;
- Ensuring same condition in the European industry and global market for Romanian SMEs in relation to European ones.

5. Conclusions and implications

Although, SMEs play a vital role being the leading employer and largest contributor to GDP, managers of Romanian SMEs are rather pessimistic about the expectations for business development in 2011. Therefore the adoption of measures designed to improve business climate for this firms is even more important.

According to a survey conducted on a sample of 69,000 companies across Europe by the Association of European Chambers of Commerce and Industry - Eurochambres, in Romania, the 2010 business confidence indicator was the highest in Europe, whereas in 2011 the lowest records among the EU were recorded with quite significant variations from one region to another (38.2% of respondents believe that 2011 will be business friendly, 35.9% believe that there will be stagnation, and 25.8% think that this year will be unfavorable business environment).

Romanian managers are equally pessimistic about the turnover expectations (41.7% of respondents consider that they will stall and 26.8% that they will fall), changes in domestic demand (38.1% of respondents felt that domestic sales will stagnate, and 27.7% consider that they will fall), exports (for 46.9% of respondents they will stagnate, while exports will register a decrease in opinion of 21.3% of the respondents), employment (52.5% consider that employment will stagnate, and that employment will decline in opinion of the

27.5% of the respondents) and investments (48.0% of respondents felt that they will stagnate, against 19% who consider that they will experience a decrease).

In the EU, along with Romania, the most pessimistic expectations for 2011 are recorded in Cyprus and Slovakia, and the highest expectations in Portugal, Denmark, Netherlands and Poland.

At national level, most optimistic expectations for business development in 2011 is recorded in the Macro region 3 (Arges, Calarasi, Dambovitza, Giurgiu, Ialomita, Prahova, Teleorman, Bucharest, Ilfov), but it is unlikely that these expectations to materialize in the absence of upward trends in terms of investment, domestic and external demand for products and services and consistent government measures to aid the SME sector.

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