

# **Developments and Constraints for the Romanian Small and Medium-Sized Enterprises**

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*Abstract: The small and medium sized enterprises are important for any country, both economically and socially, being, as it is often said, 'the backbone' of the economy. The past three years were particularly difficult for SMEs in Romania and as a consequence a large number suspended their activities or closed down. This paper will try to analyse the developments and the constraints of the Romanian SME sector, over the past years and especially during the financial crisis.*

## **1 Introduction**

During the almost half century of communist regime in Romania, any forms of private entrepreneurship or private business were forbidden. Although, as a general rule, the communist regimes suppressed the private enterprises, in some neighbouring countries of Romania, some forms of private initiative and entrepreneurship were accepted. That particularity of Romania determined a severe lack of entrepreneurial culture, very visible especially in the first years after the changes from 1989, but which can still be seen, even now, after more than 20 years of market economy.

That lack of entrepreneurial culture was translated through a lack of appetite for investments and especially for the risk implied by them, a lack of business ideas and especially of the knowledge of making a business plan and the abilities to put that into practice. Those factors were corroborated with the preference for a stable job, unwillingness of association and performing team work, and, last but not least, with a poor understanding of the market economy mechanisms. All those factors combined with the extremely difficult macroeconomic problems generated by the transition process created an unfriendly and unstable business environment, which made the birth of the SMEs sector very difficult in our country.

The process of transition to a functional market economy was long and painful and Romania has experienced everything that was possible in terms of macro economy, in the last twenty years: periods of recession (during 1990 – 1992 and during 1997 – 1999), recovery (1993 – 1996), growth (starting from 2000 to 2008) and again recession from 2009, with a small recovery in 2011.

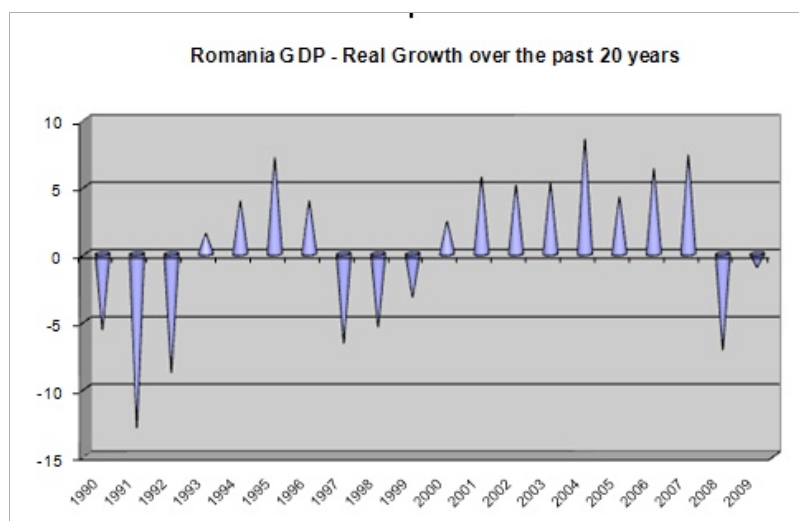


Figure 1  
Romania GDP  
Source: BNR, INS

Beside those dramatic periods of recession (as we can see in the figure 1), the biggest problem for an entrepreneur was probably the inflation, especially during the '90. Inflation was a phenomenon wherewith most of the Romanians were not familiar, because, during the communist regime, prices were fixed and established by central authorities.

The inflation effects, in the first years of transition, had devastating results on the birth and development of the SMEs sector in Romania, at least for the following reasons:

- firstly, inflation had devalued the savings of the population, thus destroying the potential capital to start a small business;
- secondly, in those years, when the inflation was around 200% (see figure 2), it was practically impossible to finance a business through a bank credit (how big should the interest rate be for that credit?);

- last but not least, that huge inflation made it very difficult, if not impossible, to write a business plan, essential for any business.

If, to these problems that we have already mentioned, we add: the massive depreciation of the local currency, the so-called 'stop and go' governmental reforms, the frequent agreements with the IMF (most of them were not completed) and the bankruptcy of some important local banks, then we have the full picture of the business environment which made the birth and the development of the SMEs extremely difficult in Romania.

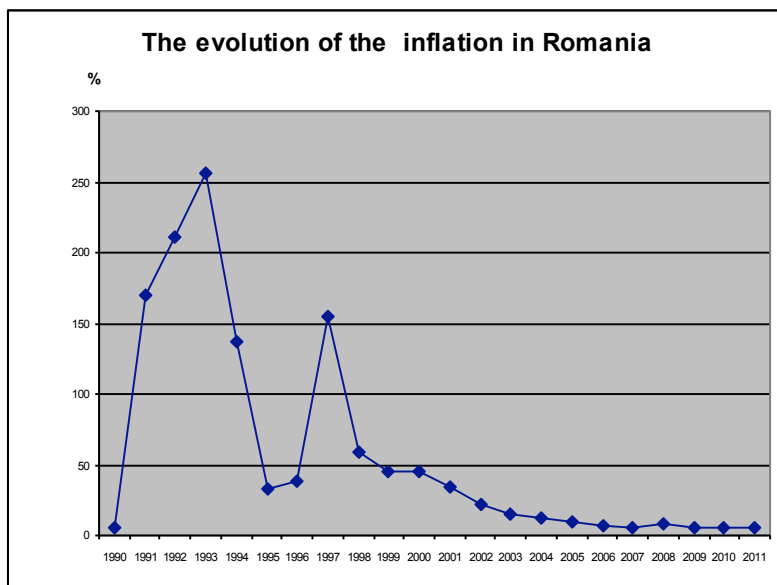


Figure 2  
Inflation

Source: National Institute of Statistic

## 2 The Development of the SMEs in Romania

Despite all those problems, the SMEs sector in Romania started to develop and to grow, especially after the year 2000. Thus, in the year 2008, we had in Romania 26 SMEs per 1000 inhabitants, approximately 600,000 SME (not a bad figure, but it was still far from the EU average, which was of 39 SMEs per 1000

inhabitants<sup>1</sup>). Until 2008, the number of SMEs in Romania registered a strong increase, mostly during the 2000 - 2008 period, when the growth rate was of about 7% per year - approximately 20,000 - 30,000 new SMEs every year . In fact, that was the best period of the Romanian economy in the last 20 years, with strong growth rates every year.

The structure of the Romanian SMEs, according to their turnover and number of employees, for the year 2008, can be seen in the figure 3.

SMEs Turnover (m. euro)	SMEs according their number of employees				Total
	0 - 9	10 - 49	50 - 249	Over 250	
Under 2m	556.304	42,597	4,792	170	603,863
2 – 10m	1,582	4,552	3,948	682	10,764
10 - 50m	122	428	1,023	746	2,319
Over 50m	13	26	87	333	459
Total	558,021	47,603	9,850	1,931	617,405

Figure 3

The structure of the Romanian SMEs

Source: Carta Alba 2009<sup>2</sup>

As we can see from this table, the proportion of SMEs in the total number of the enterprises in Romania is of 99.68% per cent. This percentage is very similar to the proportion of SMEs in EU: 99.8% out of the 20,000,000 active enterprises. If we go further on, the largest number of SMEs is by far represented by microenterprises, which represent 90.38% of the total (the same is true in the EU - 91.8% of the total SMEs are microenterprises).

Also, for the rest of the enterprises, the proportions are pretty much the same: small enterprises (from 10 to 49 employees) in proportion of 7.7% compared to

1 Eurostat – European business. Facts and figures, 2009 edition, p. 46  
[http://epp.eurostat.ec.europa.eu/portal/page/portal/european\\_business/special\\_sbs\\_topics/small\\_medium\\_sized\\_enterprises\\_SMEs](http://epp.eurostat.ec.europa.eu/portal/page/portal/european_business/special_sbs_topics/small_medium_sized_enterprises_SMEs)

2 Nicolescu, O. (2009) coord. – Carta Alba a IMM-urilor din Romania, Editura Lidana, Bucuresti, 2009, p.73

the average in the EU of 6.9%, medium enterprises (from 50 to 249 employees) in proportion of 1.5% almost the same as in the EU of 1.1%, and large enterprises (over 250 employees) represent 0.3% in Romania very similar to the EU proportion of 0.2%.

All these proportions show the overwhelming importance of the SMEs both in the EU and in Romania, and also show that, at least as a proportion in the total number of enterprises and as a structure, things are here very similar to the EU average.

### 3 The problems the SMEs are facing in Romania

Even if the structure and importance of SMEs in Romania are relatively similar to those in the EU, and the contribution to the GDP is more than significant – to the amount of approximately 60 - 70% of it – still, the great majority of entrepreneurs in Romania consider that the business environment is not favourable to them. In a survey carried out by the CNIPMMR [the National Council of Small and Medium-Sized Private Enterprises in Romania] on a sample of 1,723 Romanian entrepreneurs, most of them (i.e. 78%) considered that the business environment impeded the development of the SMEs businesses and only 3.7% considered it to be favourable to the SMEs (see the figure below).

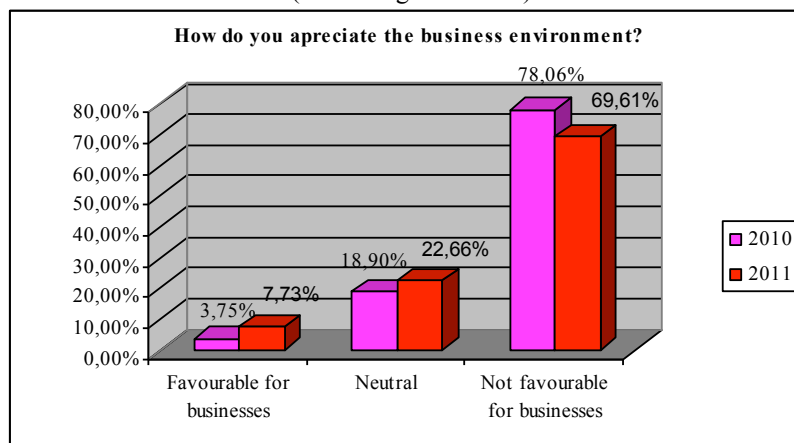


Figure 4  
Business environment and the SMEs  
Source: Carta Alba 20113

3 Nicolescu, Ovidiu (2011) - Carta Alba a IMM-urilor din Romania, Editia a IX-a, Presentation Transcript, Bucuresti, 2011

Which are the factors determining this negative perception? The graph below classifies the obstacles of the SMEs. Romanian entrepreneurs have identified almost twenty such obstacles and barriers of the SMEs (see below the figure referring to the problems).

The problems identified by the SMEs in Romania can be divided into two large groups:

- the old and unsolved problems;
- problems severed or generated by the financial crises started in 2008.

The first category of old and unsolved problems that the SMEs have been facing for a long time comprises: excessive taxation, bureaucracy, the competition with the imported goods, the training and keeping of employees, excessive fiscal controls, weak infrastructure, consultancy, knowing and adopting the *acquis communautaire* etc.

The second category, of the problems severed or generated by the financial crises, comprises: the diminution of the domestic demand, delays in the collection of receivables, the high cost of loans and the difficult access to them, the volatility of the exchange rate (especially at the end of 2008), inflation, the non-payment of invoices by the state institutions, the decrease of the export demand etc.

We are going to try hereinafter to see the first three most important problems identified by the SMEs (two older ones: the excessive taxation and bureaucracy, and one that rather pertains to the financial crisis: the decrease in the domestic demand) and to present their impact.

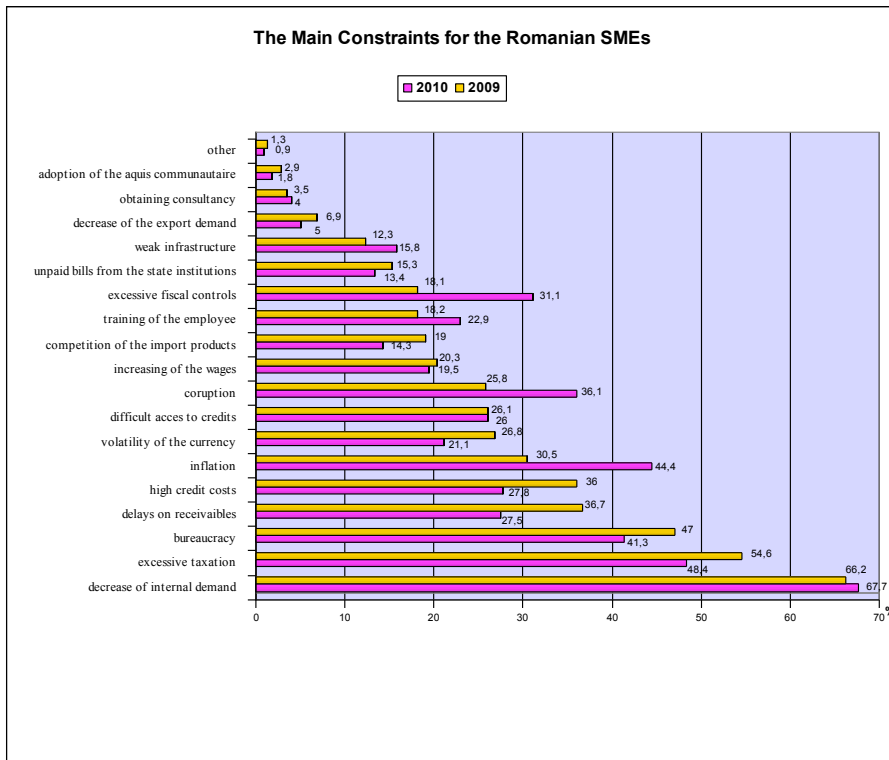


Figure 5

The constraints for Romanian SMEs

Source: Carta Alba 2011<sup>4</sup>

The problem most often mentioned by the entrepreneurs was the decrease in the domestic demand, something that is easily understandable as it is connected to the debut of the financial and economic crisis, which severely hit Romania in 2009, leading to a dramatic decrease – of over 7% – of the GDP, to which a decrease of 1.5% was added in 2010. Moreover, since the mid-2010, the decrease in the domestic demand was accentuated even more by the dramatic austerity measures adopted by the government: the cut of salaries in the budgetary field by 25%, the freezing of pensions, the reduction by 15% of certain social benefits etc., plus the great increase of the VAT, from 19 to 24%.

4 Nicolescu, Ovidiu (2011) - Carta Alba a IMM-urilor din Romania, Editia a IX-a, Presentation Transcript, Bucuresti, 2011

Apart from those causes related to the austerity measures adopted by the government, the decrease in the domestic demand was also determined by a high degree of indebtedness of the population, as well as of the companies, which took place before the crisis. Practically, brutal adjustments were made in Romania, during the financial crisis, specific to a ‘hard landing’. To exemplify it is easy to think about the brutal reduction of the current account deficit caused by the financial crisis. It abruptly went down from a (unsustainable) level of 13.4% of the GDP in 2007 to 4.5% in 2009 (it has almost the same value today).

The increase of the GDP in 2011 did not mean very much for the domestic demand, being rather based on exports.

The second problem identified by the SMEs is the excessive taxation. Since 2005, Romania has introduced the flat income tax for both the personal incomes and the companies’ profits. The level of this tax, of 16%, may be considered rather attractive by the business environment. Still, things are not as they seem, if we are to compare them with the neighbouring countries, also EU member-states, which have an even more attractive taxation level for companies: 10% in Bulgaria or 10 to 19% in Hungary according to the profit obtained (the SMEs being advantaged). Moreover, social contributions for pension funds, health and unemployment, owed by both the employee (16.5%) and the employer (around 28%, 33%, 38% according to the working conditions), have a level that we appreciate as being very high.

Despite all these, what makes taxation be considered excessive is not necessarily its level, but the large number of taxes that have to be paid by a company. Romania owns the sad title of world “vice-champion” as to the number of annual tax payments: 1136. According to a study carried out by the World Bank, only Ukraine has a larger number of annual tax payments: 135. Practically, a Romanian company makes 113 tax payments, spends 222 hours to calculate and pay the, and the total tax rate is of 44.4% of the profit. Therefore, it is not the tax level that is exaggerated (in Hungary the total tax rate is of 52.4% of the profit<sup>7</sup>, while in Bulgaria is of 28.1%<sup>8</sup>), but the large number of taxes and parafiscal contributions, as well as their payment frequency.

Another important reason for the excessiveness of taxation, especially by the SMEs, was the introduction, in 2009, of an aberrant tax applied to companies. We speak here of the so-called annual minimum tax, owed by any company, i.e. a fixed amount of money that a company had to pay, even if it had losses. The

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5 Georgescu, Florin (2010) – Macroeconomic Indicators and Financial Sector Developments in the Recent Crisis Context, National Bank of Romania, Bucuresti, 2010, [www.bnro.ro](http://www.bnro.ro)

6 World Bank, International Finance Corporation, Pricewaterhouse Coopers (2012): „Paying Taxes 2012. The Global Picture”, p.14

7 <http://www.doingbusiness.org/data/exploreeconomies/hungary/#paying-taxes>

8 <http://www.doingbusiness.org/data/exploreeconomies/bulgaria/#paying-taxes>



minimum tax was, not just an aberration, but also discriminatory for the SMEs for the following reasons:

- it discriminated the SMEs, as compared to the big corporations, because that tax was very regressive with the increase in turnover; while the smallest SME had to pay minimum 500 euro, the biggest corporation had to pay only maximum 10,000 euros;
- it was against the common sense that SMEs had to pay taxes on “profit” if they registered losses;
- even supposing that some companies were doing fiscal evasion, the period of economic crisis was not the best moment to introduce such a tax; however, for big corporations it was much easier to do fiscal evasion compared to the SMEs (e.g. using the tax havens).

In the end, the government realised the absurdity of that tax and, approximately one year after, in October 2010, the government abolished it, but the evil had already been done. As a result of the minimum tax, 133,000 SMEs suspended their activities in 2009 for a period of three years (11 times more than in 2008) and, even worse, 18,766 SMEs closed down in 2009, five times more than in 2008 (according to the National Trade Register Office<sup>9</sup>). We appreciate that those figures would be even bigger, if the procedure for closing a company was not so complicated and expensive for a small entrepreneur.

Another tax measure troubling the SMEs was the prohibition of deductibility of the expenses with fuel for the company’s vehicles, with some exceptions (taxis, freight vehicles etc.). The measure was partially reanalysed in 2011, that is, the deductibility of 50% of those expenses was accepted; however, the problem was only half solved.

Similarly, we can also notice a positive tax measure to support SMEs. We speak here about the possibility granted to micro-enterprises to choose between the tax on profits (16%) or on the turnover (3%) under certain circumstances. The micro-enterprises that may opt for this type of tax of 3% are those that have a turnover less than 100,000 euro and do not carry out their activities in certain domains, such as the banking system, gambling, consultancy etc. This facility granted to micro-enterprises was eliminated at the end of 2009, but reintroduced in January 2011.

Consequently, we may notice not only an excessive and widely-spread taxation, but also a terrible lack of predictability in this field.

The problem of bureaucracy, which appears as the third major difficulty that small and medium-sized enterprises are confronted with, is an old one, to which no satisfying solution was found (or some did not want to find any), although there

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<sup>9</sup> <http://www.onrc.ro>

were promises related to that from the different governments that succeeded in leadership along the years. With reference to bureaucracy as an obstacle in the carrying out of their activity, SMEs understand by it a complicated legislative framework with many requirements, materialised in the claim for a large number of notices, licences, permits and authorisations. For each one of these, there are special normative acts and procedures, as well as a series of institutions responsible for their issuance.

Obtaining these notices, licences, permits and authorisations necessary to a SME involves a series of large expenses, both financial and time-related, as some of them may take several months to be obtained.

During the past few years, their number has significantly decreased, by merging or eliminating them, now being 48% less than at the beginning of 2009. In spite of all these, their number is still high: a study carried out by the CNIPMMR shows that there still are 254 authorisations, licences etc. requested by the SMEs, as compared to 491 at the beginning of 200910.

#### **Conclusions:**

After having analysed the business environment where the SMEs carry out their activities and after we have seen their evolution and the main problems they are facing, in the final part we will try to draw some conclusions and make some proposals to support the development of the SMEs in Romania.

The SMEs in Romania have had a good development, especially after the year 2000, but they were strongly affected by the 2008 financial crisis, as well as by some other factors: administrative, fiscal (see for example the introduction of the minimum tax).

The SMEs are essential for any country and even more for an emerging one like Romania, because of their contribution to the GDP and also because of their large number of employees, being, as it is often said, 'the backbone' of the economy of a country. Beside these arguments, SMEs are important because they are dynamic and innovative, as well as flexible and adaptive. Therefore, the SMEs are the ones on which one country can rely, also in bad times, because they will not move to another country when the state advantages are over, when the salaries increase, when the demand decreases or for other reasons (see the example of Nokia factory in Cluj: after only four years of activity they decided to leave Romania in 2011).

Taking these arguments into consideration, we consider that the SMEs should not encounter obstacles and problems as we have seen, but they should be encouraged and supported by everybody, and especially by the state. In this respect, we made some proposals which we think can support the Romanian SMEs:

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10 <http://www.cnipmmr.ro>

- Reduction of the flat tax rate to 10%, as in the neighbouring countries from the EU or, at least, for the SMEs which obtain a profit up to a certain level (see the example of Hungary);
- Maintain the option for the micro-enterprise to choose the turnover tax (3%);
- Reduction by some per cent (4-5%) of the taxes on the salaries in order to reduce the fiscal burden for the SMEs and to stimulate new employments;
- Reduction of the bureaucracy by simplifying the administrative procedures, increasing the transparency, continuing the process of reducing the number of required authorizations, permits etc. and their costs;
- Effective implementation of the measures included in the Small Business Act, the EC document for supporting the SMEs;
- More stable and predictable laws;
- Supporting the SMEs in accessing structural funds, including by guaranteeing the credits asked to co-finance the European projects.

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