

# The Development of the SMEs Sector in Romania. An Approach Regarding the Dynamics and the Perspectives

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## *Abstract*

*This paper focuses on the development of the SMEs sector in Romania. In the first part there are revealed the main approaches concerning the role of SMEs in the economy, and especially their contribution to the “knowledge based economy”.*

*The second part defines the methodological framework, presenting the six main indicators that are analyzed: number of enterprises, number of persons employed, gross value added, apparent labour productivity, rate of profitability and propensity to invest.*

*The third part presents in an organized way the study results and the most relevant five tendencies, concerning SMEs sector in Romania, that are deriving from the data analysis.*

*The forth part aims to present a number of six general recommendations that are capable to soften the economic crisis effects over the SMEs from Romania, and, what is the most important, to create a incentive framework for the creation and the development of SMEs. The presented recommendations are based on two elements: the results of the current study, and the best practices concerning the SMEs sector development from all over the world.*

**Keywords:** *SMEs, economic crisis, knowledge based economy, labour productivity, profitability, investment, gross value added*

**JEL classification:** L29, O33

## **1. Introduction and Theoretical Framework**

As the evolutions of the recent years have shown, knowledge became the main engine for productivity growth and economic development, therefore enforcing a paradigm change over the economic phenomenon that materialized in the development of the “knowledge based economy” concept. The “Small Business Act” for Europe reveals that “managing the transition towards a knowledge-based economy is the key challenge for the EU today”, also emphasizing the decisive and, at the same time, privileged role of the SMEs for accomplishing this goal.

The main characteristics that SMEs are credited with, such as dynamism, flexibility, adaptability and innovative capacity, are placing them in the position to benefit from the profound changes that are taking place in the socio-economic environment. Becoming more precise, such evolutions as the growth in population's education level, globalization, informatization, the use of externalization etc., that actually encourages and accelerates the transition process to the new economy, are representing rather opportunities than threats, at least for the majority of SMEs. Another interesting aspect regarding this approach refers to the fact that, as it is pointed by some authors (Nicolescu O., Nicolescu C., 2008), there is a clear similarity between the knowledge based enterprises and the SMEs that mainly consists of such essential characteristics as: entrepreneurial spirit, lean structure, dynamism, flexibility, little tangible assets etc. In addition to the already discussed relationship between the SMEs and the transition to the knowledge based economy, it is important to mention that the SMEs sector, as the main supplier of jobs and gross value added from an economy (Schmiemann, 2009), has an important role in the socio-economic stabilization and the attenuation of the development gaps between different regions, the overall prosperity being impossible to achieve without its support. There are even studies (Grigore, 2006) that aim to analyze the differences between economies through an investigation of the SMEs sectors that they have.

Given the importance of this sector, there are a lot of studies regarding SMEs that use different criteria in defining them and also different approaches in the analysis part. Although being pretty heterogeneous, they can be classified from the coverage perspective in generalized (that presuppose the same criteria in defining the SMEs from all economic sectors) and differentiated (that use different defining criteria depending on the sector that is involved), and, regarding the number of indicators taken into account, there are unidimensional and multidimensional approaches (Schmiemann, 2009). Although this diversity, the unidimensional approach concerning the number of employees became the dominant one in most of the countries in the world. So, the SMEs are divided into three categories: medium-sized (less than 250 employees), small (less than 50 employees) and micro-enterprises (less than 10 employees). Having established the general framework of the researches over the SMEs, it is interesting to mention the change in the paradigm vis-à-vis this sector (Zoltan, Laszlo, 2007), from one that pointed the role of small and medium-sized enterprises in imposing and consolidation of the democratic system, to one that emphasizes its economic and social efficiency. This fundamental change in the way this sector is analyzed brought therefore to more rigorous conclusions and recommendations that approach broadly the SMEs productivity and efficiency issues (Gavrilă, I., Gavrilă, T., 2007). In other words, the building of a robust economy has as a prior elements the continuous development and efficientization of the SMEs sector.

As a response to the needs this sector faces in the real economy, the European Commission formulated and supports policies concerning the SMEs, policies that are based on five main principles: cutting red tape, improving SMEs

access to markets, promoting entrepreneurship, improving SMEs' growth potential in a sustainable way, strengthening SME policy communication and consultation with stakeholders. The complexity of these areas of interest captures pretty exactly the semantics of the "SMEs development" concept, that first of all presuppose their growth in efficiency and efficacy. In addition to these strategic directions followed by the European Union comes a study (Ayyagari, Beck, Demirguc-Kunt, 2007) which, using a mix of econometric models in the analysis of data series from different countries in the world, concluded that the development of the SMEs from manufacturing business is positively influenced by the effective protection of property rights and the reduction of the entry costs. Another author (Marin, 2002) gives the policy makers a clue on how to boost the SMEs sector expanding, at least a quantitative level, therefore pointing that there is a direct and tight connection between the percent of the micro enterprises and the density of the SMEs, in other words, the numeric growth in this sector can be achieved through stimulating the creation and the development of micro enterprises.

Having the above mentioned elements, it is important to highlight that this study will focus on the identification of the most relevant tendencies in the SMEs sector from the perspective of six indicators considered to be relevant: the number of enterprises, the number of persons employed, the gross value added, the apparent labour productivity, the rate of profitability and the propensity to invest.

## **2. Methodology**

This study of ours is based on the statistical data series on Romanian economy, data sources used being mainly the "Romanian Statistical Yearbook", and the "White Charter of SMEs in Romania" (which, besides classical data on SMEs, succeeds to quantify and analyze elements with a profound qualitative and psychological character, such as the perceptions over opportunities and difficulties). The data from these publications is centralized and structured as dynamic series, making therefore possible for the analysis process to conduce to the synthesizing of the main tendencies. The area of interest of this study focuses on enterprises that have their main activity in industry, construction, trade and other services.

As mentioned earlier, the study focuses on six relevant (at least from our point of view) indicators: number of enterprises, number of persons employed, gross value added, apparent labour productivity, rate of profitability and propensity to invest. It is important to emphasize that the current study is aiming to interpret the dynamics (the timeframe that is targeted is 2004 - 2008) of the variables listed above, this is why increased attention will be paid to the rates of growth, that actually represent the basis for the analysis made. In order to make it clear, we will present briefly each of these six indicators.

*Number of enterprises* represents one of the most often used indicators in the studies that address the SMEs development problematic. It is considered to be a proper proxy to illustrate the level of the entrepreneurship spirit from a country,

especially when it's divided by the population number (the density), making therefore possible the comparison between different states, regions and even localities. At the same time we should be realistic about the limits this indicator has, being a quantitative one, of course it is supplying the base for the qualitatively expansion, but taken, alone it doesn't offer much information about the efficiency and the effectiveness of the SMEs.

*Number of persons employed* is also a very popular indicator taken into account, and this is because of the social implications it brings along. In other words, being at the foundation of the most important argument in supporting the thesis that SMEs should be treated with priority because they are the only ones that still create jobs, the number of persons employed gives us a clue over this sector development tendencies, and also over the employment structure (analyzed in evolution) – SMEs vs. Large enterprises.

*Gross value added*, in comparison with the first two, is an indicator of results, representing actually the amount of salaries and other elements related to labour factors cost, profit, exploitation subsidies, fixed capital amortization, after subtracting production taxes. In our study we focus more on the comparison between the SMEs and the large enterprises, therefore using undeflated values is acceptable as soon as it applies to all of them.

*Apparent labour productivity* is defined as gross value added (at factors cost) per person employed. The word “apparent” refers to the fact that this is a broad evaluation of what happens physically at the production level. This measure will be analyzed from two perspectives concerning the rate of growth (determined using the growth rates of gross value added and persons employed), and the ratio between the SMEs labour productivity and the mean labour productivity over the all enterprises.

*Profitability rate* is calculated as the ratio between the gross result of exercise and the gross value added at factors cost, and represents pretty well the performances of the enterprise. In other words, this measure reveals the SMEs capacity to accomplish its primary reason of existence, being one of the variables that illustrates enterprises efficiency.

*Propensity to invest*, determined as the ratio between the gross investments and the gross value added at factors cost, is aiming to emphasize the future development perspective of the SMEs sector. The specificity of this measure consists actually in the fact that it is a present allocation of resources for future results and therefore it is catching the mentality, vision and risk tolerance that entrepreneurs and managers manifest in real life.

### **3. Results**

The main results are synthesized in *Table 1* and *Table 2*, and they bring to our attention some particularities of SMEs regarding the six analyzed indicators and their evolution over time. In order to maintain it comprehensible, on the base of the analysis results, were formulated five main tendencies.

In the Romanian economy there are identified some tendencies regarding SMEs, which actually illustrate the change in the balance between them and large enterprises. We can say that they are emphasizing the transition to the knowledge based economy. Given their importance, we will present the main characteristics of these tendencies from the perspective of the six variables that we analyzed.

### Rates of growth

Table 1

	2005 — 2004	2006 — 2005	2007 — 2006	2008 — 2007	Annual mean rate
<i>Number of enterprises</i>					
SMEs	9.83%	6.69%	8.27%	6.85%	7.90%
Large enterprises	-4.05%	-2.90%	0.16%	-0.38%	-1.81%
Total	9.76%	6.65%	8.24%	6.83%	7.86%
<i>Number of persons employed</i>					
SMEs	5.53%	6.32%	7.29%	3.32%	5.61%
Large enterprises	-4.87%	-4.28%	-0.50%	-0.22%	-2.49%
Total	1.18%	2.16%	4.42%	2.08%	2.45%
<i>Gross value added</i>					
SMEs	24.16%	26.65%	30.62%	41.80%	30.64%
Large enterprises	12.04%	17.67%	19.96%	34.29%	20.72%
Total	17.48%	21.93%	25.21%	38.15%	25.46%
<i>Apparent labour productivity</i>					
SMEs	17.65%	19.12%	21.75%	37.25%	23.70%
Large enterprises	17.78%	22.93%	20.56%	34.59%	23.80%
Total	16.10%	19.35%	19.91%	35.34%	22.46%

## Annual rates

**Table 2**

	2004	2005	2006	2007	2008
<i>Profitability</i>					
<b>SMEs</b>	35.04%	36.56%	43.12%	27.36%	18.07%
<b>Large enterprises</b>	16.65%	18.68%	25.31%	26.60%	10.55%
<b>Total</b>	24.90%	27.15%	34.08%	26.99%	14.52%
<i>Propensity to invest</i>					
<b>SMEs</b>	61.84%	63.51%	74.35%	114.25%	70.46%
<b>Large enterprises</b>	77.18%	76.34%	62.64%	66.70%	58.12%
<b>Total</b>	70.30%	70.25%	68.41%	91.13%	64.63%

***Tendency 1: Micro-enterprises are predominant in the Romanian economy***

The share of SMEs in the total number of enterprises from industry, construction, trade and other services, after a constant growth over the analyzed period, is 99,66%. Looking more deep in the structure, in the total number of SMEs, the micro-enterprises represent 89,52 %, such a situation being similar to the one from the European Union. The constant expansion of the micro-component of the SMEs can be explained by the fact that there was identified a indirect relationship between the size class and the number of enterprises growth rate. Thereby, the annual growth rates of the number of enterprises taken as mean over the analyzed period are: for micro enterprises – 8,10 %, for small ones – 7,27 %, for medium – 2,17 %, and for the large enterprises – -1,81 % (it is actually a decrease in number).

***Tendency 2: SMEs are the only ones that still create jobs***

Between 2004 and 2008 the number of persons employed in SMEs have expanded with almost 583 143 (in comparison with the situation from the large ones, that presupposed a decrease with a 164 747 jobs), that, in growth rate, means 5,61 % / year. As this tendency shows, the argument that the SMEs are the only ones that have the capacity to create jobs is a real one, the social impact of this sector being indispensable for the future economic development.

***Tendency 3: The gross value added share produced by SMEs is expanding***

The structural changes that take place in the economy brought to a new distribution of the gross value added between the SMEs and the large enterprises. So, if in 2004 the contribution of SMEs covered 44,85 % of the total, in 2008 it already became major – 52,73 %. This tendency actually emphasizes the expanding role of SMEs in the economy.

***Tendency 4: The profitability rate and the propensity to invest are higher in SMEs than in the large enterprises***

The profitability rate in SMEs is higher than in the large ones, remaining so during the whole analyzed period. Regarding the dynamics, it is clear observable the change that happened from 2007, when, after Romania entered the European Union, the rise of competition on the home market brought to a decline in the level of profitability rates. Although in 2008 the propensity to invest is also higher than the one from the large enterprises, the evolution of it is partially different. In other words, in 2004 it was an opposite situation, but because of faster growth in SMEs, near 2006, this measure overcame the one from large enterprises.

***Tendency 5: The apparent labour productivity is growing faster in the SMEs than in the large enterprises, and is getting closer to the mean measure of the overall enterprises***

Although the level of apparent labour productivity in SMEs is lower than the one from large ones, starting with 2006, the annual growth rate concerning SMEs was significantly higher. So, this tendency brought to a continuous catching up process. A quantitative expression of these elements is represented by the ratio between the SMEs labour productivity and the mean labour productivity over the all enterprises, which rose from 0,771 in 2004 to 0,803 in 2008.

#### **4. Recommendations**

***Recommendation 1: The state to approach with priority the paying process of its obligations to the suppliers of goods and services from the private sector and to make it possible to compensate a part of them with the taxes the suppliers owe***

As it is known, a major problem in the crisis times comes from the arrears, that are actually normal self protecting mechanism that organizations use for their survival, that conducts to the money circulation blocking, and therefore to economic disfunctionalities. If private organizations can not be blamed that they are procyclical, the state's situation is fundamentally different. Making arrears deepens the crisis and frankly causes the failure of lots of enterprises, that are mainly SMEs. Because this money that the state is owing to the suppliers of goods and services is critique for the survival of an SME, it should look forward to take prior attention in honoring its obligations to this sector, or at least allowing compensating part of them with the taxes the suppliers owe. It fair enough that states should elaborate and implement measures that affect medium and long terms, but in crisis times, although we all know that in the future the situation will be better, to see this future we should survive the short term problems that the crisis brought. In other words, the economic recovery and future development is tightly linked to the SMEs sector viability, that is why such a measure is an imperative one.

***Recommendation 2: Making the exemption for reinvested profit a functional development tool for the SMEs***

This recommendation is important at least from two perspectives: a) it helps the SMEs to benefit from the “positive effects” the crisis brought in (the investments a cheaper in such times, making it easier to access new technology); b) it is a fair measure because it helps the enterprises that are performant, the ones whose business is still viable. As such a measure already exists in Romania since October 1, 2009, it is appreciated by the specialists as very difficult to apply. In order to make it functional, a certain number of changes is required. One improvement that would help is introducing the possibility to deduce from the imposable base (through amortization) the value of the equipment that got financed by reinvesting the profit. In present, by not allowing such a thing, the measure is actually not an exemption from taxation the reinvested profit, but more its delaying, helping only the cash-flow. Another change that boost the usage of this measure, and therefore its effectiveness, is to make it applicable for a larger range of investments (ex.: not only for tangible goods, but also for the intangible ones). Concerning this item, an interesting proposal comes from the Romanian International Fiscal Association that suggests making the assets bought through financial leasing also eligible for this measure.

***Recommendation 3: Reducing the labour taxation***

As the analysis has shown, the largest share of working force is employed in SMEs. Such a situation makes this sector more sensitive to the labour taxation that is in place today. In order to support the SMEs not to layoff employees just because of the cash-flow problems, such a measure is required, being pretty clear that its benefits are capable to boost the whole economy in the recovery direction. Unlike the second recommendation, this one is a “profit insensitive”, which means that it helps SMEs regardless of whether they are making a profit or not. Such an approach aims to soften the cash-flow problems of the SMEs and to encourage “labour”.

***Recommendation 4: Capitalization of the Romanian National Credit Guarantee Fund for SMEs and the CEC Bank strategic orientation towards the SMEs lending process***

This kind of measures were taken in almost all the developed countries in the world, its prior goal being helping the SMEs to access finance. The economic crises made the banks more reluctant to the financing of the private sector, this being the effect of the procyclical behavior (in boom times the risk is underrated, but in crises the temptation is to overrate it). Actually, through the Romanian National Credit Guarantee Fund for SMEs, there are completed the guarantees brought by SMEs as collateral to the loan. It is important to emphasize that this measure is the most favorable for the state, being the “cheapest” possibility to facilitate business financing. Another way of encouraging financing SMEs is to impose it as a strategic orientation for the CEC Bank, the state having this possibility as the major shareholder.



**Recommendation 5:** *Sustaining a campaign that will promote the Romanian exports in the extracomunitary countries, facilitating therefore the access to new markets*

As the home market is still very low, mainly as a result of the macroeconomic adjustments that a made nowadays through austerity measures, one of the solutions for the enterprises that export is to access new markets. We propose that the state should make a campaign to promote exports in the extracomunitary countries (countries that are not so bad affected by the crisis), this measure being able to produce positive effects not only for the enterprises directly involved in exporting, but also a wide range of suppliers and subcontractors.

**Recommendation 6:** *Building an affordable training and consultancy system for the SMEs*

It is well known that the training and the consultancy are nowadays indispensable “tools” for an enterprise, and especially an SME, that aims to be performant. This recommendation was actually formulated by Professor O. Nicolescu, and we have “transplanted” it in our Recommendations chapter because of its great importance for the development of the SME sector, and therefore the whole economy. Considering the priority of this sector, it is desirable the state to subsidize this activity, making it affordable for a vast majority of SMEs.

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