

Impact Of The Financial Crisis On Small And Middle Enterprises In Romania. The Differences Between Urban And Rural Evolutions

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Abstract: - Economic literature recognizes the essential role of public policy firms in the economy of any country. Public policy firms are the main source of entrepreneurial skills, innovation, job creation, proving to be the most active sector of the economy and also manifesting as a driving force in Romania's remarkable economic progress. Revealing the economic and social benefits led to consideration of the SME sector as an area of strategic interest for the economy. In 2008 the financial crisis started having a large number of negative effects in Europe, causing large adjustments to the business environment in the Member States. These were materialized into decreased turnover of the businesses, loss of jobs and disorder in the general economic area and social environment. The study aims to determine what were the effects felt by businesses due to lower purchasing power in the household and whether there were mutations in the major sectors of Romanian economy. Firstly, the influence of the effects of the financial crisis on key macroeconomic indicators and how structural adjustment due to new macroeconomic context took place.

Key-Words: - economic crisis, economic growth, business

JEL Classification: - R11, G01, L1.

1. Economic background

The beginning of the new millennium meant economic recovery for Romania, driven by the implementation of the *acquis communautaire*, expansionary fiscal policy, increased banking flows, the contribution of foreign direct investment and the favorable external circumstances. All of these have created a favorable macro stabilization in a post-transition economy in Romania and facilitated recovery of domestic production.

The global economic crisis was felt in Romania beginning with second half of 2008. This was imported to some extent, in particular by reducing external demand and foreign investors' reluctance to allocate resources in a turbulent environment. But the most important effects occurred due to an overlap of external shocks and a much deeper structural crisis, which the Romanian economy dragged over time.

One of the causes of the economic crisis in Romania was the very engine of economic growth which proved to be unsustainable in the long term. Consumption credit needs, based on current and real estate speculation (at the expense of investment in human capital or fixed capital accumulation) have also contributed to the economic growth once the international context has worsened.

Moreover, fiscal policy was a pro-cyclical one and expansionist budget deficit increased from 0.8% in 2005 to 5.4% of GDP at end-2008. As government revenues were boosted by an overheated economy, increasing government spending in projects with low multiplier effects as well as increasing public wages above productivity. This policy significantly affected the much needed fiscal space for economic recovery.

In early 2009, in order to avoid a bottleneck in financing external deficits and to pay pensions and salaries of civil servants, the government resorted to loans and assistance from the International Monetary Fund, World Bank, European Bank for Reconstruction and Development and the European Commission worth about 20 billion euro. Moreover, policy makers have been forced to cut wages by 25% from the public department due to the steep drop in revenue from the state budget.

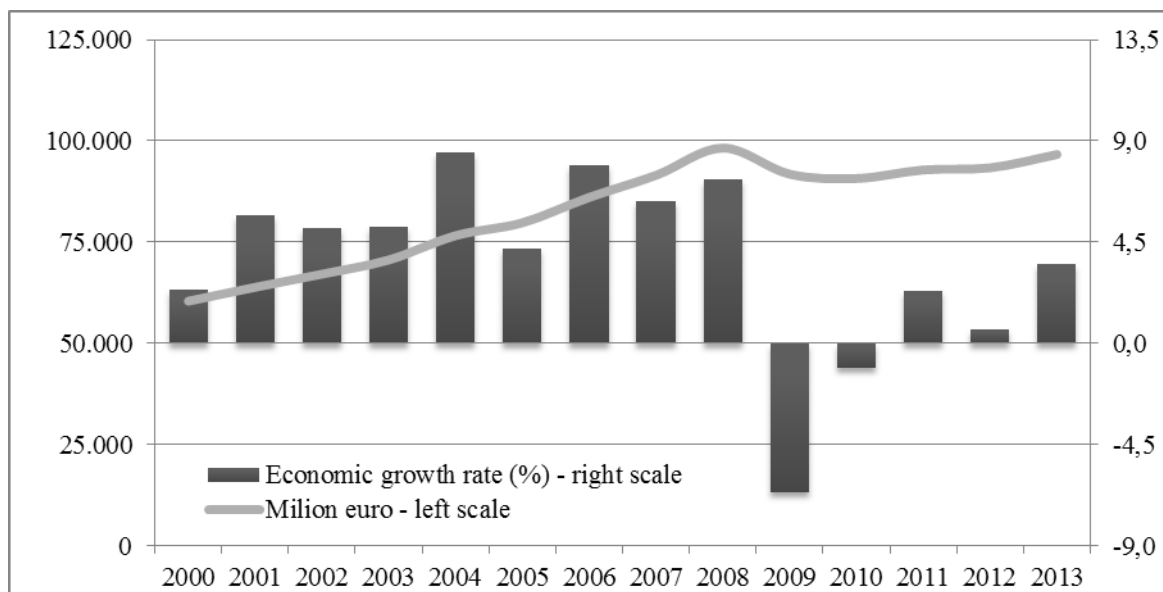


Fig. 1. Evolution of the GDP growth rate in Romania
Data source: Eurostat

The evolution of the structure of GDP shifted over the past 20 years in the Romanian economy. From a share of about 44% of GDP in 1990, the industrial production has come to represent 31% in 2000 and 26% in 2008, amid operating under potential or even closing representative factory in monoindustrial cities. The services sector has significantly increased its share in GDP from 26% in 1990 to 55.6% in 2010, but it's still far from the EU mean (73.7%) (Lazea, V., 2008, p.231). In what follows, the author analyzes the impact of the economic crisis on the Romanian enterprises and how their dynamics influenced the sectoral share of GDP.

2. Impact of the economic crisis

The exceptional economic context of the last decade reflects some of the vulnerabilities and difficulties faced by businesses in Romania. Despite the large turmoil on financial markets, small and middle enterprises (SMEs) were one of the vectors of post-crisis job recovery and an element of overall economic recovery. This article attempts to perform a comprehensive analysis regarding the role of active enterprises in the internal economy, marking the SMEs demographic issues and their contribution to economic progress.

With the adoption of Law no. 31/1990 and Decrees-Law no. 66 and 67/1990, has been registered a veritable "explosion" of new private businesses due to reduced role of SMEs in the pre-transition period. The transition to a market economy in Romania in the 1990s meant, essentially, the evolution of two major components for the local suppliers of goods and services on the market: transfer of ownership of enterprises from state to private individuals (privatization) and the emergence of new enterprises, as a result of private initiative. These two evolutions occurred more or less simultaneously, and at different rates, which generated large effects on the labor market. If privatization of the large industrial hubs has meant in the eyes of the new owners prospects for productivity increase by reducing the number of workers (thus amplifying unemployment), the new private sector created most of the new jobs in Romania, thus absorbing the surplus workers.

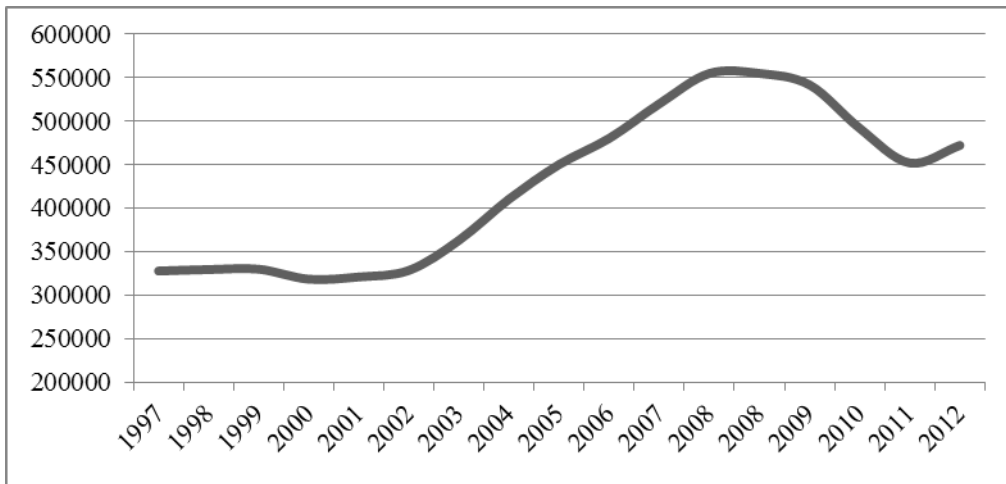


Fig. 2. Evolution of active enterprises in Romania

Data source: National Institute of Statistics (Statistical Business Register Administration - REGIS);

The new generation of businesses has contributed to economic and social progress in Romania. Looking from this perspective, the development of SMEs acquires significant importance both to urban and rural areas. The demographic evolution of SMEs reveals two distinct phenomena, showing sensitivity SMEs to macroeconomic changes and spillover effects of the foreign markets. Thus, there is a steady increase in the time frame 2000-2008, the number of enterprises significant started a significant decline with the first effects of the financial crisis in the 2008-2010 interval. By the mid 2011 the number of active enterprises was reduced at the level of the year 2005.

In the peak year of 2008, the number of registered SMEs in the Trade Register reached the level of 508.266 (more than half compared to 2003). The establishment of new enterprises was encouraged by public policy instruments: fiscal measures aimed to multiply the number of new legal entities rather than strengthening and developing the existing ones. Based on these facts, managers of firms in difficulty tended to abandon the original business, and to start a new business, relying on fiscal benefits.

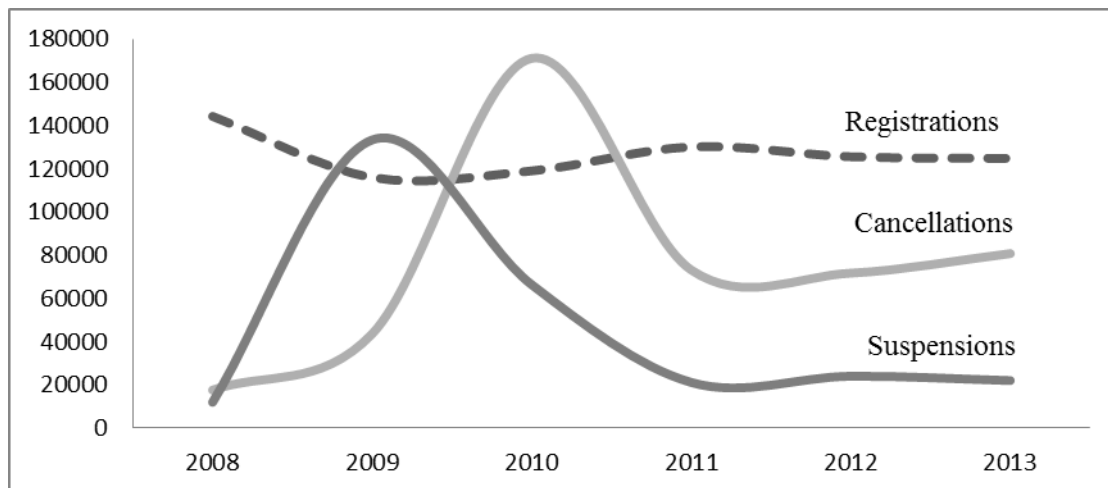


Fig. 3. Evolution of registrations, cancellations and suspensions businesses

Data source: National Office of Trade Register (www.onrc.ro/statistici);

Also the decision of entering or leaving the market was significantly affected by the economic crisis, political instability and the introduction of flat-rate tax that firms was forced to pay regardless of their income. (Government Emergency Ordinance 34/2009):

- Compared with 2008, in 2009 the number of business registrations fell by about 15%. From 2009 to 2011, registrations increased again by about 20%, only to fall back to around 6% in 2012;

- 2009-2010 was revealed as the difficult timeframe for the SMEs. In that interval approximately 171.146 units ceased operations. Also, 2010 was the year with the lowest number of registrations (only 119.048 of start-ups, compared to 144.239 in 2012);
- In 2008, when the first adverse effects of the economic crisis have appeared in the Romanian markets, we notice a temporary gap between the number of suspensions and cancellations. The number of suspensions was higher (17.676) than the erasures (12.019). The situation is explained by the fact that entrepreneurs have used in the first stage of the crisis the suspension of operations because the removal procedure was more expensive and more bureaucratic (according to art. 237 para. (2) of Law no. 31/1990, republished, inactivity duration not not exceed 3 years).

	2008	2009	2010	2011	2012
Registrations	24,3%	-2,5%	-8,5%	3,6%	0,6%
Suspensions	-91,0%	100,8%	213,0%	-11,9%	9,1%
Companies became insolvent	-	-	10,4%	-26,7%	-9,4%
Cancellations	-59,5%	-74,5%	133,7%	2,1%	-11,2%

Table 1. The dynamics of SME sector compared to the previous year
Data source: National Office of Trade Register (www.onrc.ro/statistici);

Evolution of the number of registrations and cancellations show similar trends, with different particularities of each area of residence, also collaborated with the evolution of domestic and international economic environment as follows:

- In 2009 the number of SMEs registered in rural areas declined compared to 2008 (33.386 versus 34.188). While in urban areas, the number of registrations has brought a significant decrease (from 80.019 to 60.318 enterprises);
- In 2010, in the rural areas, registrations increased by 6.545 enterprises over the previous year. In contrast, in urban areas the downward trend began in 2009 maintained;
- In 2011, the economic recovery meant an increase of new enterprises, both in rural and urban areas (4.484 - rural, 4.648 - urban).

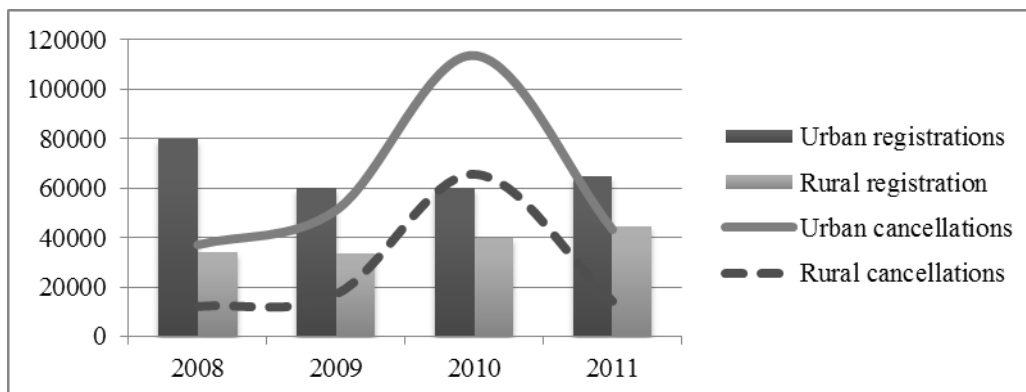


Fig. 4. Evolution registrations and cancellations SMEs by residence area
Data source: National Office of Trade Register (www.onrc.ro/statistici);

As for the evolution of the number of erasures in urban and rural areas we can relate that:

- The trend of erasures, beginning with the year 2008, is similar in both areas of residence, but differ in intensity;
- The year 2010 has proven to be a very difficult year for businesses in rural and even worse for urban areas SMEs. Number of cancellations in the cities of Romania was approximately 2-fold higher compared to 2009;

- The macro stabilization that took place after 2011 and the reduction of fiscal weights was manifested by reducing number of erasures in both cases (rural and urban).

The number analysis of registrations and cancellations, leads to the conclusion that SMEs demography at both the rural and the urban area, is heavily dependent on macroeconomic conditions, the degree of integration in domestic and foreign markets and fiscal policies adopted in the period.

If until the outbreak of the economic crisis in Romania (2008), the ratio of registered firms compared to the cancellations was higher than one (2.2 in urban areas and 2.8 in rural areas), the ratio was reversed when economic conditions became difficult (2010) for SMEs: 0.6 registered businesses per business radiated in urban areas and 0.5 registered businesses per business radiated in rural areas (own calculations based on National Office of Trade Register). Throughout the analyzed period, the amplitude stands higher ratio in rural areas. This shows that the number of registrations or cancellations in rural areas is more sensitive to economic conditions, than urban SMEs. This is an indication that rural firms are less prepared to absorb adverse economic shocks. Also, when conditions are favorable we can remark a spectacular growth of new businesses in rural economies, compared to urban environment. This shows the lack of continuity of business in the rural areas and the fact that Romanian law and banking system does not give enough incentives or support to troubled enterprises.

In addition to the fragility of SMEs in rural economic conditions, we notice a significant gap (rural compared to the national) in terms of their number relative to the population. If in 2012 at national level density was about 19.2 SMEs per 1000 inhabitants, in rural areas the density was only 7 SMEs per 1000 inhabitants (about 3 times lower than the national average and 6 times lower than the European Union mean).

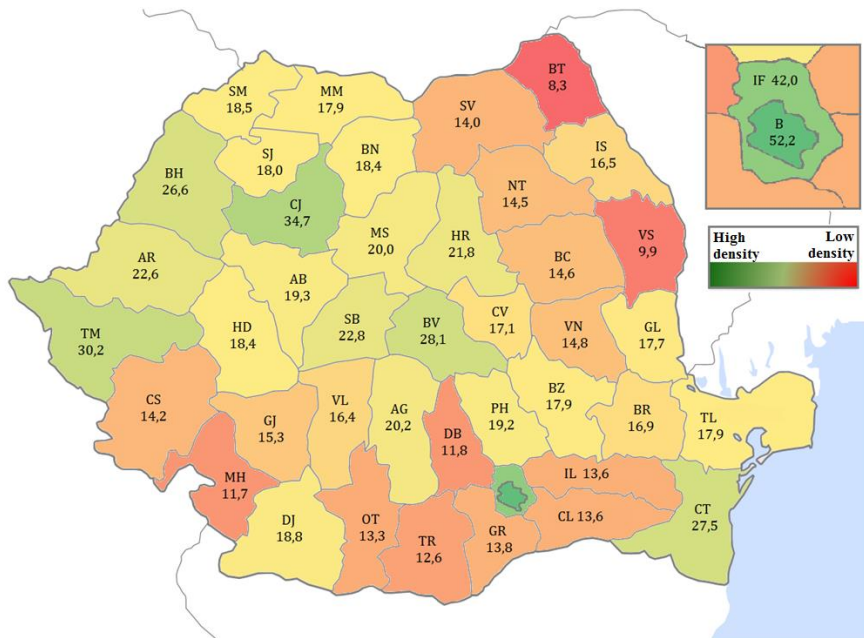


Fig 5. SMEs density at NUTS 3 level in Romania (SMEs per 1000 inhabitants)

Source: map and calculations made by the authors based on the National Institute of Statistics;

Empirical evidence indicates that a high agglomeration of firms is a source of significant economic growth. According to Pişlaru (2012, pp. 139-146) the impact of gross value added of SMEs influenced the growth rate of the national GDP by 97.3%. The economic model used as benchmark the 1997-2010 period. Also, the same authors have captured a 68% correlation between the growth rate of GVA (gross value added) by the SME sector and economic growth. Furthermore the exports of SMEs influenced about 90% the total exports of the Romanian economy.

The evolution of turnover of SMEs naturally followed the path implied by macroeconomic developments in 2005-2012. It is noted in this growing trend of turnover of firms in periods of sustained economic growth (2003-2008), followed by a sharp correction since 2009, when the index declined by 11.4% as a result of decline in sales. Weak economic recovery took effect on growth of turnover of enterprises, indicator rising to the level of 2008. Sales growth was reflected in the year 2012, when there was a spike in turnover.

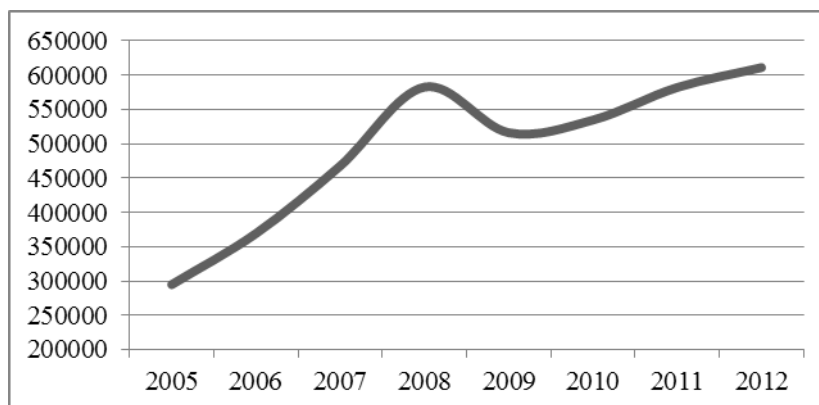


Fig. 6. The global evolution of turnover of the SMEs (million RON)
Data source: National Office of Trade Register (www.onrc.ro/statistici);

The impact of macroeconomic shocks manifested differently depending on firm size class. Thus, while in small and medium enterprises turnover decreased by 10 to 11%, the micro-enterprises managed to maintain their sales and register a positive evolution of the turnover. But change in turnover in the period 2005-2012 reveals major transformations (the changes are also illustrated in Figure 7):

- Medium-sized enterprises, which attained a turnover comparable to small businesses since 2007 becomes the most prominent category, indication of reaching a new phase in the development of firms;
- Small businesses faces the most significant reduction in sales during the crisis, reaching to be overcome by microenterprises regarding the global turnover in 2010;
- Microenterprises record slower growth in turnover during the ante crisis period, but manages to maintain sales during the crisis;
- Throughout the 2005-2010 period, the contribution of SMEs to the overall turnover was higher than large companies. Both during growth and during the crisis, sales trends SMEs was better.

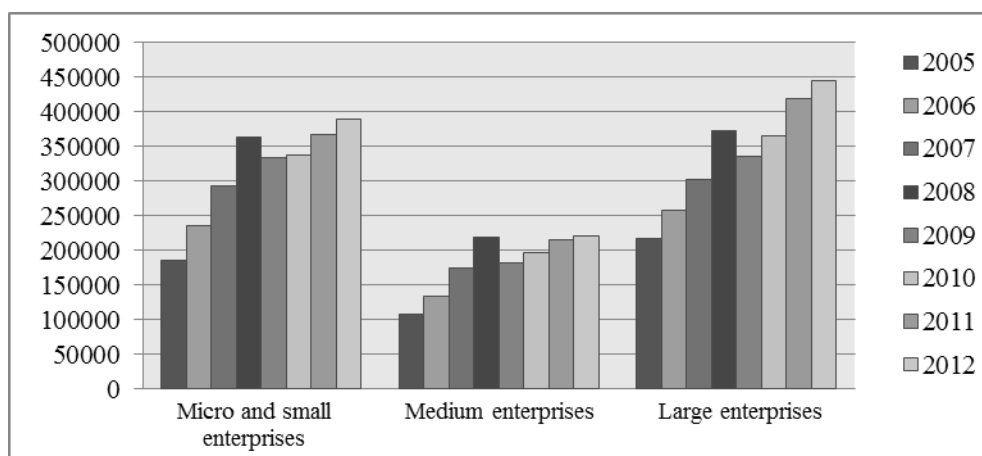


Fig. 7. Evolution turnover of Romanian enterprises depending on size class (million RON)
Data source: National Office of Trade Register (www.onrc.ro/statistici);

3. Structural shifts

At national level, the main sectors in which businesses operate can be determined using two important indicators: the number of enterprises and number of employees in each sector.

In light of the number of enterprises, the service sector is best represented, accounting for about 80% of all enterprises in 2012. Trade is the economic branch in which firms are the most numerous (about half of SMEs Romania are engaged in the wholesale distribution activities or retail). Share of enterprises in manufacturing industry, was around 10% in total of enterprises (their number ranged from 51,849 in 2008 to

46.004 in 2012). Also, within the industrial sector, a small number of businesses are active in the production and supply of energy, gas and air conditioning (1.050 enterprises in 2012) and the rest in mining activities (1.098 enterprises in 2010). The primary sector (agriculture and mining) is represented by an approximately 3.6% of active companies in the Romanian economy. As for the number of employees, manufacturing absorbs much of the labor force (about 1.4 million people), followed by trade and other services.

	Number of enterprises			Number of employees		
	Number	%	2012 compared to 2008	Number	%	2012 compared to 2008
Agriculture, forestry and fishing	16.080	3,4%	15,41%	121.632	2,6%	5,89%
Mining industry	1.098	0,2%	1,37%	83.597	1,8%	-30,04%
Manufacturing industry	46.004	9,7%	-24,57%	1.394.550	30,0%	-20,65%
Production and supply of electricity, gas, and air conditioning	1.050	0,2%	51,81%	85.002	1,8%	-17,52%
Water distribution; sewerage, waste management and remediation activities	2.925	0,6%	19,11%	78.190	1,7%	11,05%
Constructions	44.607	9,4%	-33,14%	563.603	12,1%	-37,95%
Wholesale and retail trade; repair of motor vehicles and motorcycles	169.723	35,9%	-26,17%	1.083.985	23,3%	-19,11%
Transport and storage	34.064	7,2%	-1,25%	350.735	7,5%	-5,67%
Hotels and restaurants	23.499	5,0%	-0,66%	145.925	3,1%	6,16%
Information and communication	17.508	3,7%	-14,51%	148.859	3,2%	-5,27%
Financial services and insurance	6.625	1,4%	-3,25%	478.678	10,3%	3,43%
Real estate	12.737	2,7%	-15,94%			
Professional, scientific and technical	52.337	11,1%	-13,08%			
Administrative services and business support service activities	16.904	3,6%	-15,24%			
Education	3.200	0,7%	16,22%	11.300	0,2%	19,52%
Health and social care	9.063	1,9%	4,26%	36.808	0,8%	27,62%
Arts, entertainment and recreation activities	4.738	1,0%	-5,32%	-	-	-
Other service activities	10.025	2,1%	-17,43%	71.854	1,5%	9,57%
Total	472.187	100%	-17,53%	4.654.718	100%	-13,61%

Table 2. Number of SMEs in the main sectors in 2012

Data source: National Office of Trade Register (www.onrc.ro/statistici);

During the economic crisis, there were some noteworthy evolutions that worth mentioning. Significant changes were recorded in:

- The construction sector: after a sharp increase of the number of firms (over 60% from 2007 to 2008) in the pre-crisis period, amid residential real estate developments, strong economic growth, multiplying yards (the development of large commercial sites, construction and modernization of transport infrastructure, rehabilitation of hospitals and educational institutions associated with EU accession and structural funds absorption etc) in this sector, there has been register a severe reduction (-33.14% in 2012 compared to 2008). Companies from this sector have been most affected by the negative macroeconomic conditions, through the limitation of financial resources and a drastic reduction in the number of real estate projects, both public or private. Thus, approximately 14.782 active companies were removed from the economic landscape in a short period time (2008-2012). Also related services such companies dealing with real estate transactions have significantly reduced their number (-15.9%).
- The service sector: in this branch, there were three areas in which the number of registered SMEs increased: Production and supply of power, gas and air conditioning (increase of 51.81% from 506 companies in 2008 to 1.050 in 2012); Water supply, sanitation and waste management (up 19.11% from 2008) and education sector (16.22% increase from 2008, especially in the private sector). Of course, these areas are not very significant given the small weights in the total active enterprises in Romania, but viewed per whole economic sector, the economic agents providing services have proven sustainability in an unstable economic environment;

- Agricultural sector: an encouraging trend noted among traders in this sector. Number of farms that were market-oriented activities increased by 15.41% due to the possibility of grants intended to develop the rural and agricultural sector (see National Rural Development Programme).

As for the dynamics in terms of number of employees in companies in 2012, compared with 2008, stands the following developments:

- Businesses most affected by the crisis and have made most staff restructuring came from the construction sector (-37.95%, that stands for 155.034 persons), manufacturing industry (-20.65%, 238.681 redundancies, the highest value in absolute terms) and trade (-19.11%, 173,877 persons);
- A part of this workforce was integrated into other economic sectors (especially in firms providing services). Most employments were made in the health and social assistance (14.048 people) Water supply; sewerage, waste management and remediation activities (9.718 people), hotels and restaurants (9.573 people);
- At the end of 2012, most people employed in firms were in the manufacturing industry (30%), followed by commercial enterprises (23.3%) and construction (12.1%).

Small and medium enterprises have also an important role in creating jobs in the economy. In the year 2012, the share of staff employed in Romanian SMEs was approximately 73%. This economic sector provides about three million jobs.

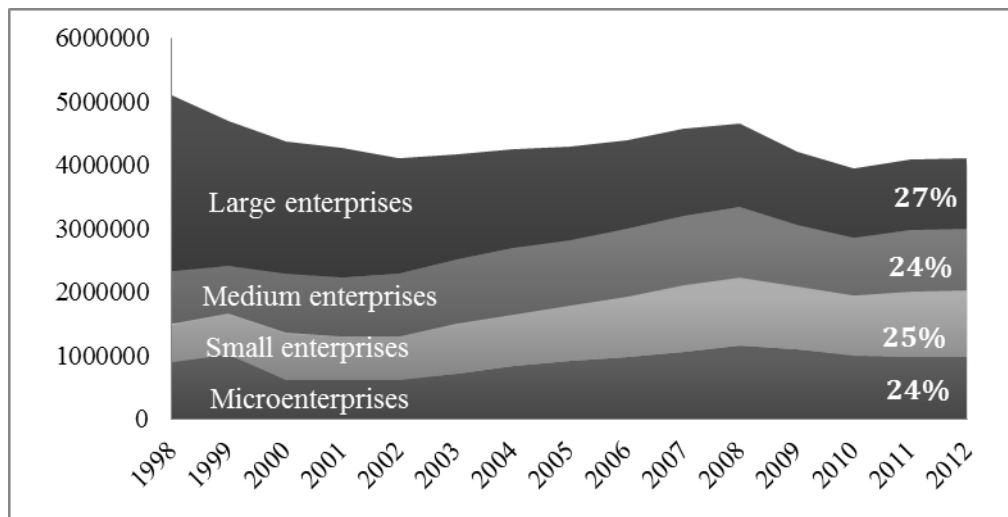


Fig. 8. Evolution of staff in enterprises and their share in 2012

Data source: National Institute of Statistics (Statistical Business Register Administration - REGIS);

Jobs provided by SMEs increased significantly within the privatization process in Romania. If in 1998, the share of employees in the SME sector was 46%, at the end of 2012 it has stabilized around 73%. The growth rate per year in the period 2008-2012 the number of employees was approximately 2% per year. This constant ascent was made with deep restructuring of staff in large state companies and even the private sector within the financial and economic crisis of 2009. If in previous years the economic crisis, SMEs in Romania were an important contributor to the establishment and preserve jobs, this trend was interrupted in the context of the years 2009 and 2010.

Amid global demand reduction generated an decrease in production, whit negative effects on employment. The largest class restructuring occurred in large enterprises and microenterprises. Midsize businesses however tend to return to the values in 2008. This can be explained by the fact that the restructuring measures introduced to combat the impact of the recession were less severe than micro and small enterprises. Unlike smaller companies, there were better opportunities to operate personal adjustments within companies. In contrast, in the micro and small enterprises, the adjustment could not be made without affecting the basic functions.

4. Conclusion

Small and medium enterprises play an important role in any economy and are considered vectors of economic growth, creating jobs and strengthening the middle class in any society. The global economic recession significantly reduced the purchasing power of the population, hence lowering the demand for goods and services provided by businesses, which induced a restructuring of the available jobs, reducing the number of active enterprises, decrease turnover and limiting investments. Although the impact was significant, it also triggered this effect of rehabilitation, meaning that competitive businesses learned to survive in harsh conditions, increasing their productivity through the restructuring process and increasing organizational innovation. This reinforces the idea that SMEs demonstrate a potential for adaptation to the conditions of negative macroeconomic circumstances.

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