



## SMALL AND MEDIUM SIZED ENTERPRISES AS THE DRIVING FORCE OF ROMANIAN ECONOMIC GROWTH

**Alina Ligia DUMITRESCU**

*Institute for World Economy of the Romanian Academy, Department of Governance of European Integration, Romania,  
E-mail: [alinaligia1@yahoo.com](mailto:alinaligia1@yahoo.com)*

**Abstract** *The article focuses on enhancing the role of SMEs in Romania as a growth factor. It examines the role of SMEs especially in increasing value added and labor productivity in EU. The paper pays special attention to the principles underlying the Small Business Act and to the importance of entrepreneurship development as a source of new jobs. In conclusion, the number one priority in Romania is to facilitate the finance access for SMEs. Without SMEs access to adequate funding and no liquidity, no business can operate, invest and grow. This means ensuring financial market stability and strengthening banks, while ensuring that credit policy is focused on stimulating SME development. Another top priority for the development of SMEs sector in Romania is to increase innovation and youth entrepreneurship. Last, but not the least the top priority for developing SMEs as driving force of Romania economic growth is to promote SMEs internationalization.*

**Key words:**

Small and Medium Enterprises, Entrepreneurship, Value Added, Productivity, Internationalization

**JEL Codes:**

L25, L26, M2, M13

### 1. Introduction

According to European Commissions, the small and medium-sized businesses are comparatively more prevalent in Romania compared to EU as a whole. According to the Small Business Act (SBA) Fact Sheets-2012 Romania, which is produced as part of the SME Performance Review (SPR), Romania's SME sector is characterized by a greater importance of small and medium-sized enterprises, to the detriment of micro-firms. In 2012, the medium-sized enterprises in particular reveal above-average contributions to employment 21.1% and value added 20.6%. Overall, the SME sector contributes less to value added and equally to employment when compared to its European counterparts on average, which suggests that the labour productivity of SMEs in Romania is lower. European Commission underlines that this may be the partly due to the industrial structure of the Romanian economy. In terms of sector distribution, the trade sector dominates, accounting for 42% of SMEs, as compared with only 30% in the EU. The remaining SMEs are distributed among services (34%), manufacturing (10%) and construction (13%).

In Romania, there is as an important potential of economic growth and economic recovery by increasing value added and productivity of SME on one side and changing the distribution of the economic sectors in favour of increasing industry share. The key sectors for restoring competitiveness of the European firms are the

high-tech manufacturing and knowledge-intensive sectors. Furthermore, on 18 March 2014, the European Commission has released a memo on SMEs: feedback on Green Action Plan, underlining the importance of the significant role of small and medium size enterprises in industrial renaissance, in order to increase the contribution European industry makes to EU GDP from the current level of 15% to that of 20% by 2020.

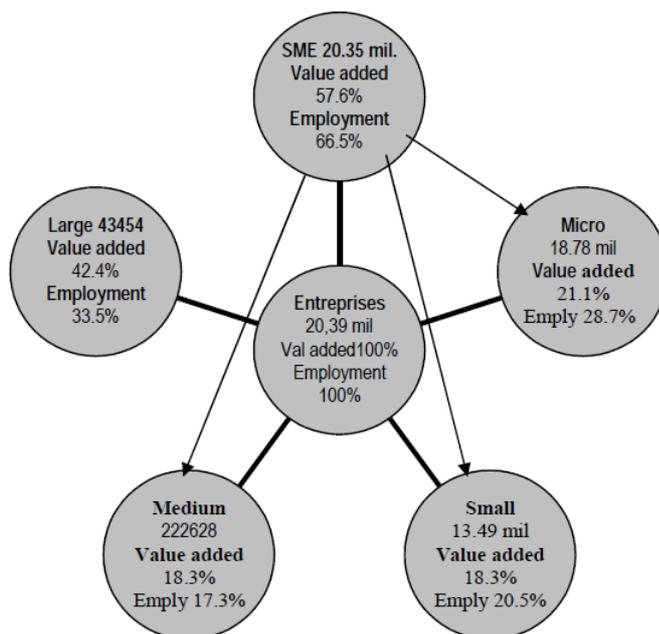
### 2. The Role of SME in European Union Economic Recovery

SMEs acted as a driving force for the EU economy, during the 2008-2009 crises, given that corporations/ large companies were more affected. While the European economy is still struggling to overcome the financial and economic crisis, European SMEs make significant efforts on their way to recovery based on their ability to restructure more easily to the market needs and their mobility to adapt more quickly to the challenges of globalization. Considering the definition of SMEs in the EU, they represent the vast majority of companies doing business in the EU.

The final annual report entitled "A recovery on the horizon?", funded by the European Commission, shows that SMEs accounted over €3.4 trillion value added at current prices against a total value added produced by the private, non-financial sectors of approximately €5.9 trillion. A considerable contribution of European SMEs in 2012 was to the services and manufacturing sectors.

Both sectors combined employed 74 million people and produced €2.9 trillion of value added, with 85% of all European SMEs working in these two sectors. It is underlined that of the estimated 5.1 million enterprises operating in manufacturing and construction, 99.6 % are SMEs. The utilities (including electricity, gas, steam and air conditioning, water supply, sewerage, waste management and decontamination) and extractive

industry sector accounted for a total of 149,000 enterprises, of which, 98.8 % are SMEs. The total of 20.35 million of the European SME plays an important role in increasing employment. SMEs represent 66.5% of total employment in Europe in 2012. SMEs have produced 57.6% of gross value added generated by the private economy, non -financial EU during 2012.



Source: Author based on European Commission data

Figure 1. European Union: Value Added and Employment in 2012

The importance of the industrial manufacturing sector for employment and growth in the EU is highlighted in the recent industrial policy strategy, and especially in the strategy “Europe 2020” which aims a competitive and innovative industry able to withstand global challenges. The recent publications of the European Commission, namely the “European Competitiveness Report 2013” and “Industrial Performance Scoreboard 2013” emphasizes the importance of industrial manufacturing sectors the EU economy and highlights how to stimulate innovation, promote the products with high value added and the international trade, in order to ensure sustainable growth and prosperity. In this strategy, mainly SMEs from the manufacturing sector are vested with significant powers both in stimulating growth and creating jobs.

The EU total budget for the period 2014-2020 sums up 1082 billion euro, of which 32% represents the EU Cohesion Policy funding, which is the main financial instrument of the European Regional Development Fund and European Social Fund. The Cohesion Policy for 2014-2020 will focus on funding a smaller number of the strategy “Europe 2020” priorities and on increasing

the competitiveness of SMEs as a part of these priorities. For example, two of the top priorities are improving energy efficiency and promoting renewable energy use by SMEs. Thematic objectives include additional technology for research and innovation, information, communication and education, skills and lifelong learning, all of which are relevant to the policies for SME development and are strongly oriented towards entrepreneurship.

### 3. Small Business Act and Entrepreneurship

The Commission Communication COM (2008) 394 entitled “Small Business Act for Europe” has launched 10 guiding principles for the implementation of the policies to stimulate economic activity of SMEs, both at EU and Member States. These principles are essential to produce more value added, to stimulate a fair competition for SMEs and not least to improve the legal and administrative framework across the EU, namely:

- a) Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is stimulated;

b) Supporting honest entrepreneurs that have faced bankruptcy to get a second chance to re-launch the business. According with European Commission data, approximately 50% of new SMEs fail in the first five years. In order the entrepreneurs in the EU to be able to produce economic growth, they must allocate more assistance from state. Further, companies do not have an adequate support system, enabling them to prevent bankruptcy.

c) Design strategies according to the "Think Small First" principle

d) Government determination to react promptly to the needs of SMEs;

e) Adapt public policy tools to SME needs: facilitate SMEs' participation in public procurement and better use of the state aid to SMEs;

f) Facilitating SMEs' access to finance and develop legal and business support payments on time in all commercial transactions;

g) Supporting SMEs to benefit more opportunities offered by the Single Market;

h) Promote the upgrading of skills in SMEs and all forms of innovation;

j) Enable SMEs to turn environmental challenges into business opportunities;

k) Encourage and support SMEs to benefit from the growth of markets outside the EU.

In the Commission Communication COM (2012) 795, entitled "Entrepreneurship is a powerful driver of economic growth and job creation" shows that entrepreneurship is a powerful tool, which leads to the creation of new businesses, opens new markets and stimulates the development of new skills and capacities. In the industry sectors, entrepreneurship is particularly important for the rapid development of several sectors identified as growth promoters in the Commission Communication COM (2012) 582 on industrial policy, namely: "clean" advanced manufacturing technology, key enabling technologies, organic products, sustainable industrial production, construction and raw materials, clean vehicles and smart grids. Entrepreneurship makes economies more competitive and innovative and is a key factor in achieving the objectives of EU economic policies.

Paul Rübiger (2014) shows that politics does not create jobs, but business entrepreneurship makes this possible. From his point of view, an efficient public policy requires an economic, fiscal and logistical environment where entrepreneurship can flourish. In Rübiger's (2014) opinion, the objectives for the future policy development of SMEs should focus on improving access to finance and to the markets within the EU and globally and promoting entrepreneurship and entrepreneurial culture. Because of the fact that SMEs in the EU are diverse and heterogeneous, the initiatives to improve access to finance must include diverse and

innovative measures, taking into account the specific features of each category of SMEs. (Rübiger2014)

The European Commission stresses that new enterprises, especially SMEs, are the most important source of new jobs: they create 4 million new jobs every year in the EU. While three years ago, 45% of Europeans were registered as freelancers (self-employment) employment, in 2012 this percentage dropped to 37% in the EU. On the other hand, compared with the United States the rate is greater 51%, and respectively China 56%. Moreover, when new businesses are founded, they grow more slowly in the EU than in the U.S. or developing countries. So, there is a potential for employment in SMEs, which may reduce substantially unemployment in the EU. According with Eurostat data, the euro area (EA18) seasonally adjusted unemployment rate was 12.0% in January 2014 and in the EU-28 unemployment rate was 10.8%.

EU support for SMEs is available in different forms such as grants, loans and, in some cases, guarantees. Support can be provided either directly or through programs managed at national or regional level, the European Union's Structural Funds. Also, SMEs can benefit from a range of non-financial assistance measures in the form of programs and support services for businesses. According with the "Community Support Programs for SMEs presentation of the main funding opportunities for European SMEs", there are the following opportunities:

1. Thematic funding opportunities. This type of financing has specific thematic objectives - environment, research, education - designed and implemented by various departments of the European Commission. Typically, SMEs or other organizations can apply directly in these programs, on presentation of sustainable, transnational and value added. Depending on the program, applicants can also include industrial groups, associations of enterprises, business support providers and/or consultants.

2. Structural Funds Structural funds and the European Regional Development Fund and European Social Fund Community funding instruments are the largest funds dedicated to SMEs through various thematic programs and initiatives implemented at the regional level. Beneficiaries of structural funds receive a direct contribution to finance their projects.

3. Financial Instruments. Most financial instruments are available indirectly through financial intermediaries. Many of them are managed by the European Investment Fund.

4. Support for the internationalization of SMEs. Generally consist of assistance to intermediary organizations and/or public authorities in the field of internationalization, which aims to support SMEs in their quest to penetrate markets outside the EU.

Daniel Calleja (2014) points out that the current priority for the EU is to promote the internationalization of SMEs to boost the existing potential for growth in markets outside the EU. In his point of view, this strategic approach is based on the estimate that by 2030, about 60% of world growth will occur in emerging economies. In currently only 13 % of SMEs do business across EU borders, but in the opinion of Calleja (2014) there is potential to increase the number of these SMEs to 36%. In order to give more chance to enterprises to do business, the European Commission launched a successful program called "Missions for Growth". The "Missions for Growth" is underway in seventeen different countries, namely: the Americas (United States, Brazil, Argentina, Mexico, Colombia, Peru, Chile, Uruguay), Asia (China, Myanmar-Burma, Vietnam and Thailand), and North Africa and the Middle East (Egypt, Morocco, Tunisia, Israel) and the Russian Federation. There are more than 800 participants in the project, representing more than 570 companies and business associations from 26 member states, representing both large enterprises and SMEs. All sectors of the economy are represented in these "missions for growth", especially construction, transport and real estate (10%), oil, gas and renewable energy sources (7%), medical devices and pharmaceutical products (6%), key enabling technologies (5%) and tourism (8%). In 2014, several „mission growth" outside the EU are planned to create new business opportunities for SMEs in the EU and help them become more competitive both on the EU and internationally.

#### 4. Conclusions

In conclusion, the number one priority in Romania is to facilitate financing access for SMEs. Without access to adequate funding and no liquidity, no business can operate, invest and grow really; finance is one of the levers of growth for SMEs. According to a public consultation launched by the European Commission in July 2012, limiting access to finance has been one of the major constraints on the growth and the development of entrepreneurship in the EU. SMEs were based on bank lending and therefore existing bank credit constraints due to the global financial crisis have a disproportionate impact on the development of SMEs. Especially, entrepreneurs have difficulties in obtaining financing in the early stages of their business. The European Commission has repeatedly stressed that SMEs can be a source of growth and jobs in the EU if their access to finance is improved. In short, from the perspective of Member States this means ensuring financial market stability and strengthening banks, while ensuring that credit policy is focused on stimulating SMEs development.

In the "Strategy for SME development", the Romanian Government underlines that early stage/startup funding is problematic for most entrepreneurs due to lack of business networks with regional or national coverage, lack of venture capital instruments (early stage venture capital funds) and flexible hybrid financing instruments (mezzanine credit) for small amount (up to 200,000 euro).

Another top priority for the development of SMEs sector in Romania is to increase innovation and youth entrepreneurship. Providing loan schemes specific to young people, such as preferential loans, micro loans or providing guarantees are recommended to replace traditional lending schemes. According to experts the International Labor Organization, granting of loans with low interest rates and/or do not require collateral for young entrepreneurs, that can demonstrate commitment, responsibility and ability to repay the loan through an effective business plan. Also, loan guarantee schemes are an effective way to facilitate young people's access to bank financing, while the government assumes the risk of lending to young entrepreneurs. Small businesses are often launched with personal savings or family resources, but may be promoted by the authorities by reducing administrative and regulatory costs related to young people to help implement business, which often promote innovation and value added.

Entrepreneurial skills are also essential for young people looking for jobs and want to start their own business. Providing practical entrepreneurial experiences for young people can strengthen links between the education system and the real economy to turn creative ideas of many young people in entrepreneurial actions. The European Commission encourages Member States to modernize education systems in order to eliminate the lack of competences and to improve the supply of skills required in the labor market such as digital skills, information technology and the entrepreneurial skills.

The last, but not the least top priority for developing SMEs as driving force of Romania economic growth is to promote SMEs internationalization. Therefore, Romanian SME shave to increase competitiveness of their products on the international market by increasing productivity and the value added of their products and promoting high-tech manufacturing and knowledge-intensive sectors.

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