*Theoretical and Applied Economics*
*Volume XVIII (2011), No. 4(557), pp. 129-140*

# The Global Economic Crisis Challenges for SMEs in Romania

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**Abstract.** *The economy of the European Union (EU) has left behind the downturn and is gradually recovering. In 2010, both the EU and the Eurozone posted economic growth, mostly because Germany did better than expected. All considered, the German economy is growing at a faster pace than in the last two decades. Recession, however, has persisted in states like Greece, Romania and Latvia, and analysts expect growth rates, especially in Eastern Europe, to remain low in the next period. Recovery in this part of Europe largely depends on a pickup in the activity of small and medium-sized enterprises (SMEs), which were seriously affected by the credit crunch the economic crisis entailed. The adverse impact on most SMEs causes a decline in the development rate and a rise in the number of bankruptcies. But the growth of the German economy, however, has a beneficial effect on companies in Central and East European states as well.*

**Keywords:** SMEs; economic crisis; Romania; Germany; Eastern Europe; economic developments.

**JEL Codes:** M21.
**REL Codes:** 14K.

## Content

In September 2008, the collapse of Lehman Brothers marked the starting point of the financial crisis that then triggered the world economic crisis.

The world economy seems to recover faster than certain economists anticipated, mostly because of the drop in aggressive interest rates, of the emergency credit of the central bank and the governmental financial stimulus.

According to analysts, the European Union's economy has left behind the free fall period and is gradually recovering.

The main factors determining the recovery are the scope of the problems in the banking sector (showing in harsher lending terms) and the obstacles as to restoring people's confidence. The slow export growth rate (notably to the Eurozone) and the drop in foreign investment in the region are another two factors further influencing the recovery.

The latest statistics supplied by Eurostat indicate that in the fourth quarter of 2010, the economy of the Eurozone and that of the European Union grew 0.2% and 0.3%, respectively, from the previous quarter, and 2.1% and 2%, respectively, from the same period of the previous year. The highest growth was posted in Bulgaria and Lithuania (1.7%), but it is to mention that for eight member states of the European Union the data are still not available.

The trade balance of the Eurozone recorded, in November 2010, a deficit of 0.4 billion Euros, compared to +3.1 year earlier. In the European Union the deficit stood at 14.7 billion Euros, as against 7.3 billions in November 2009.

In connection with inflation, the data supplied by Eurostat early in 2011 show that in 2010 the inflation rate averaged 2.2% in the states that adopted the single currency and 2.6% across the European Union.

Moreover, Eurostat shows that the unemployment rate stagnated in December 2010 at 9.6% in the European Union, and 10% in the Eurozone, the total number of jobless people in the 27 member states rising to over 23 millions.

Since the beginning of the economic crisis in 2008, it has been noticed that plummeting production has had a major effect on SMEs in the EU. The European Commission's annual report on SMEs shows that the crisis has hit medium and large companies harder than small and micro ones. A major issue SMEs have to cope with is that of access to financing. The profitability of SMEs in the EU is under huge pressure, which diminishes the number of new market entries and increases the number of exits. Implicitly, the phenomenon entails growing unemployment. According to the same report, the production of SMEs has been marked by the sharpest decline since 1930.

At the level of the European Union, SMEs stand for 99% of all enterprises. The 23 million small and medium-sized enterprises account for nearly 70% of jobs in the private sector.

Here below is a presentation of the economic situation in Germany, Eastern Europe and Romania.

**Germany**

In 2010, both the EU and the Eurozone posted economic growth, mostly on account of Germany's performance. Overall, the German economy is growing at a higher rate than in the last two decades. For most sectors, 2010 brought profits, despite experts' gloomy forecasts.

After having fallen for four quarters in a row, from Q2 2008 to Q1 2009 (Figure 1), Europe's biggest economy returned to growth in April-June 2009, being one of the first states to leave recession behind.

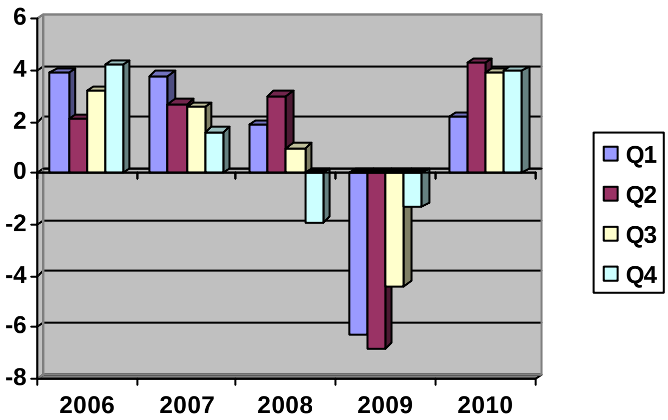
The German economy has grown gradually beginning in the second quarter of 2009, when it increased 0.5% from the first three months of the year. Over July-September 2009, the growth averaged 0.7%, whereas over October-December it stood at 0.3%. 2010 again saw economic growth: Q1 – 0.6%, Q2 – 2.3%, Q3 – 0.7%, Q4 – 0.4% (Table 1, Figure 1, Figure 2).

Table 1

**Gross domestic product in terms of market prices**

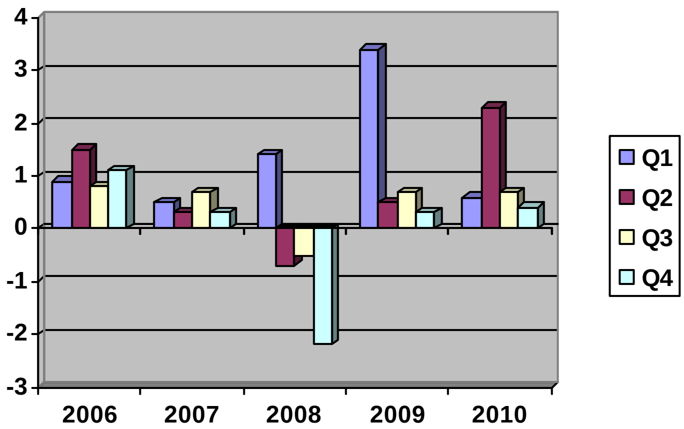
| Year. quarter | | Value bn euro | Year on year change (%) | Value bn euro | Change from previous quarter (%) |
|---|---|---|---|---|---|
| 2010 | IV | 111.61 | 4.0 | 110.05 | 0.4 |
| | III | 111.13 | 3.9 | 109.64 | 0.7 |
| | II | 108.58 | 4.3 | 108.88 | 2.3 |
| | I | 104.62 | 2.2 | 106.43 | 0.6 |
| 2009 | IV | 107.31 | -1.3 | 105.83 | 0.3 |
| | III | 106.95 | -4.4 | 105.49 | 0.7 |
| | II | 104.10 | -6.8 | 104.77 | 0.5 |
| | I | 102.37 | -6.3 | 104.27 | -3.4 |
| 2008 | IV | 108.73 | -1.9 | 107.99 | -2.2 |
| | III | 111.88 | 1.0 | 110.40 | -0.5 |
| | II | 111.66 | 3.0 | 110.90 | -0.7 |
| | I | 109.30 | 1.9 | 111.66 | 1.4 |
| | IV | 110.84 | 1.6 | 110.16 | 0.3 |
| 2007 | IV | 110.84 | 1.6 | 110.16 | 0.3 |
| | III | 110.74 | 2.6 | 109.88 | 0.7 |
| | II | 108.38 | 2.7 | 109.10 | 0.3 |
| | I | 107.29 | 3.8 | 108.75 | 0.5 |
| 2006 | IV | 109.07 | 4.2 | 108.25 | 1.1 |
| | III | 107.93 | 3.2 | 107.05 | 0.8 |
| | II | 105.53 | 2.1 | 106.17 | 1.5 |
| | I | 103.38 | 3.9 | 104.55 | 0.9 |

**Source:** Federal Statistics Office.




**Source:** Federal Statistics Office.

**Figure 1.** *Year on year GDP evolution (%)*




**Source:** Federal Statistics Office.

**Figure 2.** *Quarter on quarter GDP evolution (%)*

The latest data made available by the German authorities show that, overall, the economy grew by 3.6% in 2010 (Table 2), by far exceeding the initial expectations. Marked growth occurred on the background of growing exports and domestic consumption recovery. For 2011, however, analysts expect a lower growth rate, i.e. only 1.2%, with industry further being a circumstantial driving force.

Table 2

**Year on year GDP change, %:**

| 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|
| + 3.2 | + 1.2 | + 0.0 | – 0,2 | + 1.2 | + 0.8 | + 3.4 | + 2,7 | + 1.0 | – 4.7 | + 3.6 |

**Source:** Federal Statistics Office.

There is a certain sensitivity to the various economic risks manifest mostly outside the German economy. Nevertheless, overall Germany's economy has displayed a markedly upward trend, managing to set off most of the adverse impact of the economic crisis.

Private consumption expenditures continued to grow in 2010. After visible reinvigoration in the second quarter of 2010, in the third and fourth quarter consumption spurred economic growth in general.

External economic relations favorably influenced growth in the fourth quarter of 2010. A contribution in this respect was made by higher exports of goods, which in September last grew 3.0% in current prices, after having slightly declined (0.2%) the previous month.

The trend is for exports to keep growing, even though at lower rates. To note, however, that exports have only slightly exceeded the peak reached before the economic and financial crisis, in price and season adjusted terms.

Germany has increasingly close commercial ties with the emerging markets, which are posting high growth rates. But, just as before, the industrialized countries represent the most important commercial partner, accounting for three-fourths of exports in 2010. Many of these, however, currently have to cope with an unfavorable economic situation and high unemployment.

German exports to Eastern Europe grew by 22% in the first 10 months of 2010. With an estimated growth rate of 4% in the region in 2011, German exports bound for Eastern Europe are expected to rise by 10%.

Imports, too, have already returned to the level before the crisis, with price adjustments.

Both the trade balance and the current account balance posted surpluses in 2010 – 15.6 and 13.2 bn Euros, respectively (seasonally adjusted). Positive balances in the same period of the previous year were exceeded by 5.0 and 2.9 bn Euros, respectively.

Therefore after an extended decline, the indicators related to expectations regarding exports began growing again.

To reach these positive results, the authorities in Berlin adopted a first anti-crisis package in 2008, with long-term solutions that could be applied rapidly and had immediate results, the main goals being to stabilize the German financial system and stimulate growth and employment. Early in 2009 there followed a second package of measures that pursued particularly to have GDP growth resumed and to ensure social stability.

Even though the government's economic stimulus programs and export growth helped the country out of recession in the second quarter of 2009, in that year Germany's economy recorded its poorest performance ever since World War II.

In 2010 the German government continued to apply anti-crisis measures but this time it was against the background of Germany's best economic evolution since reunification, recorded in Q2. Thus a law was passed, under which 80 bn Euros are provided over a 4-year period, covering most of the austerity program.

The positive evolution of the German economy exerted a favorable impact on the labor market as well. In 2010 the unemployment figure fell below the 3 million threshold for the first time after autumn 2008.

The unemployment rate continued its decline, going from 7.7% in 2009 down to 7.0% in 2010, which was the lowest level in the past 20 years. In January 2011, unemployment in the biggest European economy stood at 7.4%.

It has been noted that during the current economic crisis unemployment has grown at a lower rate than in the case of the previous recessions in Germany, thanks largely to the generous subsidies the government came up with to stimulate the companies. The latter did not operate layoffs, but switched to shorter work hours.

On the other hand, Germany is facing a major problem, i.e. the shortage of skilled labor. Demographic developments indicate that the workforce keeps declining. To secure the needed skilled labor, decision-makers supplemented the budget allocated to education and research for 2010-2013 by 12 bn Euros (for 2011 the budget stands at 11.65 bn Euros, which is 6.2% of GDP). In this context, German analysts are more and more often speaking of integrating the migrants, who can contribute significantly to Germany's economy.

As far as the business environment is concerned, the Berlin government has taken measures to encourage it. A special fund for microcredit has been set up, totaling 100 million Euros meant to help small companies that find it had to get financing from commercial banks (individual loans of up to 20,000 Euros are given for a 3-year period). The program is to continue until 2015, 60% of the 100 million coming from European funds and 40% from the budget of the federal Ministry of Labor.

Owing to the measures taken, it can be noted that, despite the crisis, the number of German firms that filed for bankruptcy in 2009 was lower than the number of newly established companies, and the ratio further declined in 2010.

The latest data released by the Federal Statistics Office show that in October 2010, 13,374 firms went bankrupt, or 5.7 less than year earlier, whereas over January – October 2010 the number of bankruptcies stood at 140,440, which is 3.6% less than in the same period of 2009.

Table 3

**Bankruptcies in 2000 – 2010**

| Year | Bankrupt companies | |
|---|---|---|
| | Total no. | Year on year change (%) |
| 2000 | 42,259 | 24.2 |
| 2001 | 49,326 | 16.7 |
| 2002 | 84.428 | 71.2 |
| 2003 | 100,723 | 19.3 |
| 2004 | 118,274 | 17.4 |
| 2005 | 136,554 | 15.5 |
| 2006 | 161,430 | 18.2 |
| 2007 | 164,597 | 2.0 |
| 2008 | 155,202 | -5.7 |
| 2009 | 162,907 | 5.0 |
| 2010 Jan –Oct | 140,440 | 3.6 |
| Oct | 13,374 | -5.7 |

**Source:** Federal Statistics Office.

For the next two quarters, specialists announce a solid though not spectacular performance of the German economy. Thus, as already mentioned, for 2011 a growth rate of 1.2% is expected.

### Eastern Europe

Despite positive signals, in 2010 recession persisted in certain European Union member states (Greece, Romania), analysts predicting that the growth rate will stay low in the next period, notably in Eastern Europe. Economic recovery in this part of Europe largely depends on improvement as regards the situation of small and medium-sized companies, which have been seriously affected by the credit crunch determined by the crisis. This sector was the first hit by the hardships of the crisis.

The growth of the German economy more than it had been expected has had a beneficial effect on companies in the states of Central and Eastern Europe (CEE). German companies in countries like Poland, the Czech Republic, Slovakia or Hungary are expanding as the German economy grows stronger and stronger.

The investment they made helps both Germany and the respective states, and economic recovery in Central European countries based on exports to Germany is increasingly visible.

For this year the economists of the European Bank for Reconstruction and Development (EBRD) anticipate a growth rate of 4.2% in Central Europe, the Baltics, South-Eastern Europe and Central Asia. The economies of states in this region have posted higher growth rates than initially estimated.

For Croatia and Romania, which in 2010 posted a budget deficit, this year is expected to bring economic recovery: the Croatian economy will grow by 2% (up from -1.3% in 2010) and the Romanian one will return to a modest rate of 1.1% (-1.2% in 2010).

The economies worst hit by the crisis are healing more slowly, recovery in Eastern Europe being still braked by the measures taken to consolidate state budgets, which reduce domestic demand.

For the new member states of the European Union, i.e. Romania, Bulgaria, Cyprus, the Czech Republic, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia, the Economist Intelligence Unit (EIU) anticipates for this year a 2.8% growth rate, to be followed by 3.4% in 2012. Inflation in the region will run at 3.2% and 2.6%, respectively. Moreover, according to EIU estimates, the economy of the Eurozone, supported by Germany, will grow by 1.5% this year, only to slow down to 1.3% in 2012. The EU as a whole is expected to managed a 1.6% growth rate both for 2011 and for 2012. Inflation in the Eurozone will average this year 1.2% and will rise to 1.5% next year.

In Hungary, the Czech Republic and Poland, SMEs account for 60 to 70% of all jobs and for about half of each country's GDP, which means they are crucial for post-crisis economic growth.

In *Bulgaria*, bankruptcies multiplied by 63%, but most of the companies that went bankrupt are small, with limited possibilities to cushion the impact of the recession. EIU estimates that this year the Bulgarian economy will manage a modest recovery. The country's crisis response capacity was curtailed by the strict exchange rate of the leva in relation to the Euro and by the need to stick to a strict budgetary policy.

The only country that did not experience recession is *Poland***.** In the last 14 years Poland has uninterruptedly posted positive growth rates, even in 2009 when its GDP grew by 1.8%. That performance, however, has a downside – the growing budget deficit. For the current year, the International Monetary Fund (IMF) expects the Polish economy to grow by 3.25%.

**Romania**

As already mentioned, Romania, alongside Greece, saw its economy shrink (1.2%), whereas all the other EU member states have already left the recession behind.

Along with Hungary and the Baltic countries, Romania is considered as displaying a rather high risk of social instability because of the deteriorating economic situation and (the prospect of) rising unemployment.

At a macroeconomic level, one of the challenges Romania has to face up to is the need to resume economic growth and avoid prolonged recession, to adopt a long-term economic strategy, to implement the structural reforms likely to lend it stability, and to increase the absorption of structural funds.

In this connection, the Government in Bucharest negotiated a financial package with the International Monetary Fund, the World Bank and the European Bank for Reconstruction and Development (EBRD) and other international bodies. That package is designed to support the economy in difficulty, the Government pursuing to reduce the budget deficit to 4.4% in 2011 and to less than 3% in 2012.

On February 2, 2011 the Government adopted a decision to support young entrepreneurs. The decision involves a state grant amounting to maximum 50% of what the project proposed is worth, but not more than 10,000 Euros, as well as the guaranteeing of loans the young entrepreneurs will raise.

According to Eurostat, in October 2010 Romania's annual rate of inflation was the highest in the EU, i.e. 7.9% compared to the EU's average of 2.3% and to the 1.9% in the Eurozone. To mention that, on the background of effects from the increased VAT, the National Bank of Romania altered its estimate for the 2010 inflation to 8.2%.

On the other hand, the IMF expects for this year an inflation rate of 5.2% (a level Turkey alone has exceeded) and an unemployment rate of 7.1%. Romania, considering the data for the third quarter of 2010, has a joblessness rate of 7.3%.

The sector of small and medium-sized enterprises, the most dynamic in the Romanian economy, is the first to have been hit by the economic crisis. SMEs are much more sensitive to change than the big companies, which have a higher capacity to adjust.

In Romania, the 600,000 SMEs stand for 99.6% of all companies, contributing nearly 80% of GDP and accounting for approximately 60% of all employees.

The adverse impact of the crisis on most SMEs determines a decline in the growth rate and a rise in the number of bankruptcies. Nevertheless, for a small number of SMEs, that is, for those that are aware of the changes in the market and react promptly, this period can prove propitious.

In times of crisis, certain SMEs, unlike the big companies, show greater flexibility, being able much more easily to implement new services and launch new products. The main challenges to SMEs in Romania come from the problem of liquidity and credit, from the declining demand for products and services, exchange rate variations and inflation. Moreover, sudden surges in the price of raw materials are another challenge.

The adverse effects of the financial crisis are visible notably in the case of SMEs in sectors such as commerce, construction and real estate. The drop in exports and investment, and the liquidity blockage are the main effects of the financial crisis, and they certainly affect the companies.

However, Romania has managed to obtain a rise in investors' confidence, at a European level. The business environment in Romania is confident and trusts long-term growth prospects are good, on a background of relative economic stabilization and of signals that financial consolidation, too, is on the way.

Exponents of the Romanian business environment claim Romania's economy will grow this year, such growth being crucial to fiscal and budgetary consolidation with a view to sound long-term economic growth.

The Romanian economy will most likely show a positive trend beginning in the second half of 2011. According to a study by the National Council of Small and Medium-Sized Private Companies in Romania (CNIPMMR), the number of companies registered in the first six months of 2010 declined 3% from the second semester in 2009, whereas the number of companies deleted from the register grew by nearly 465%. The number of firms that made profit in this interval declined by 2%, and the profit itself dropped by 5.1%. The turnover of SMEs diminished by 7.8% on average, losses grew by 7.71%, and investments declined 6.45% from the second half of 2009.

According to analysts, because of the problems in the EU and in other zones of the world, states like Romania will only be able to recover relatively late, based on a rise in exports, the solution being a recovery at internal level, but that takes longer and involves higher deficits.

The estimations of the National Prognosis Commission (CNP) for 2010-2014 are as follows:

- *GDP:* after a fall of 1.2% in 2010, in 2010 a rise of 1.5% is estimated, followed by +3.9% in 2012 and +4.5% in 2013;
- *Inflation:* the average annual rate is estimated at 5.9% in 2010, 5.3% in 2011, with the downward trend to continue to an annual average of 2.8% in 2014;
- *Unemployment:* the unemployment rate is estimated at 8.5% for 2010, to be followed by 8% in 2011 and 6.5% in 2014.

## Conclusions

Economists hold that the sector of SMEs is the most important in the Romanian economy and concurrently the only sector that can determine economic recovery, entrepreneurs being the key to recovery. Stimulating the strengthening of SME potential, they contribute to securing growth resources in times of difficulty.

To help spur economic growth, the Government in Bucharest should further take measures to improve the environment for entrepreneurs, such as tax-exempted reinvested profit, which is one of the most important development levers, and lower taxation of labor.

With a view to backing the SME sector in Romania, it is imperative for the state to pay its debts (over EUR 1.5 billion so far), to invest in infrastructure, encourage absorption of European funds and the normalization of crediting. Moreover, the business environment needs a stable fiscal framework, such as to encourage investment and to attract European money.

Likewise, there is no overemphasizing that, particularly at this time when SMEs are grappling with difficulties, Romania needs very good, highly trained and experienced managers.

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