

## **RELEVANT FUNDING OF THE SMEs BUSINESS DEVELOPMENT IN ROMANIA IN THE CURRENT EUROPEAN CONTEXT INFLUENCED BY THE ECONOMIC CRISIS**

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### ***Abstract:***

*The business success of an economic entity largely depends on the funding politics they adopt, during which there is a need to identify those funding sources to ensure both the expected profit and the maximization of the value of the entity. In this respect, our scientific approach is in line with concerns about finding the most efficient funding sources of the SMEs activity in Romania in the context of the European economy stongly affected by the global economic crisis. The main objective of this approach has been to make an analysis on the prime funding sources of the eligible SMEs and on how they are relevant to the development of their activities, as well as on how they considerably contribute to the economic growth of the country.*

**Key words:** SMEs, funding, economic crisis, rate structure

**Jel Classification:** A10, L2, L26, O11, G01.

### **1. Introduction**

Small and medium-sized enterprises (SMEs) hold a crucial role in the development of every nation's economy, generating to a great extent part of GDP both in trade and industry or services. SMEs are characterized by dynamism, flexibility and innovation, being able to adapt to the changes that occur in economy, to rapidly sense the trends of the market and to be the promotors of change. The economic activity of the entity aims at obtaining profit and at maximizing the value for investors. To achieve this objective is not an easy thing, the management of the

company will have to take into account the uncertainty generated by the fact that the economic environment is characterized by constant change, the economic activity having a fluctuating evolution in time. Consequently, the development of an entity largely depends on the funding politics it adopts and on the need to identify those specific funding sources that will ensure maximum profit [1].

The economic crisis in the eurozone and the wave of sovereign debts hit the 23 million of existing European SMEs in 2011, SMEs that would provide two thirds of the number of jobs in the private sector. Under these circumstances, firms had to fund themselves, to adopt crisis strategies, to lay off employees in order to survive in an internal or/and European market that had a modest demand and lots of structural deficiencies.

Few European States have realized the importance of these enterprises and have initiated funding, re-funding and guaranteeing projects for SMEs. Most of them have left the most important source of jobs and of economic growth generator on the verge of abyss [7].

In Romania, statistically speaking, SMEs are present in a proportion of 99.7% of all enterprises, generating around two thirds of jobs in the private sector.

## ***2. The need of SMEs access to funding***

In practice, small and medium-sized enterprises can resort to the following ways of funding: own/ internal sources; external sources (bank loans); public sources; venture capital funds; commercial paper loans – factoring and discounting – government securities (shares or bonds) in the capital market, support to business incubators; equity participation and support granted to business angels.

When choosing a funding source, the entrepreneur must take into account the following *criteria*, beyond obviously their cost: the funding source experience in working with entrepreneurs; the funding source reputation; the assistance provided; other services (in some cases, the funding source offers free or at reduced rates services, such as financial statement analysis, elaboration of financial projections, elaboration of a business plan, etc.).

When it comes to SMEs particularly, the access to one or more of the funding sources mentioned above is closely related, on the one hand, to the development stage of the enterprise and, on the other hand, to the offer of funding sources available in the market at the time, and addressed to SMEs [2].

The funding sources from the category of those oriented to development and innovation are complex and require both an appropriate regulatory framework

and adequate institutions, too. Consequently, the access to funding is an extremely important factor in the development and growth of the SMEs since it influences their ability to invest in the economic relaunch after the period of economic and financial crisis [6].

Based on the analysis of the dynamics of the main forms of SMEs funding in Romania, one can notice an uneven degree of disponibility and accessibility of specific financial instruments for each phase in the development of an SME. On phases of evolution, it is noticed that [5]:

➤ **The necessary funding** when starting a business (pre-seed phase) doesn't seem to be an insurmountable difficulty, and this has been demonstrated by the average of more than 10,000 recorded entities per month in the pre-crisis period (2003-2007) and by the relatively small number of customers of the main 4 high microfunding societies;

➤ **The initial funding** (early stage; seed/start-up phase) is problematic for most of the entrepreneurs because of the lack of business angels networks with regional and national coverage, the lack of venture capital instruments (seed & early stage venture capital funds) and of hybrid and flexible funding instruments of relatively small amounts (up to 200,000 euro).

➤ **Funding the first stage of development** (emerging growth) is difficult especially for the new entities (start-up) and small innovative ones, for the same reasons mentioned with regards to the initial funding, noting that the amount needed is higher than for the former.

➤ **Funding the development** (emerging growth/development) of a SME by means of a bank credit is the form of financing slightly more developed, and it is supported by the guarantee funds. However, the bank credit is available for a maximum of 25% of the number of SMEs (especially medium-sized ones) as compared to 70-80% in the developed European countries.

➤ **Funding the development phase** of SMEs through venture capital investments (formal venture capital funds) and, respectively, through issuance of shares and bonds on the capital market is possible (for a few dozen of medium-sized entities), but extremely selective, due to a relatively high value of transactions (over 2 million euro) and due to rigorous criteria of selection which usually include a history of profitable operation for several years, an exceptional potential of growth and an enhanced market position.

In this context, the Government intend to act in support of diversity and a better targetting of financial instruments meant to sustain the SME sector, by

developing the existent instruments for an economic relaunch preparation, while maintaining restrictive conditions for funding the SMEs in the period of 2010 – 2011 and creating the required institutions and financial instruments [8].

Also, considering that investments represent a key element for economic recovery, for creating new jobs, for reducing technological delays, the Government seeks to encourage and support them as the main form of improving the SMEs access to funding.

A major issue SMEs are confronted with in the current conditions of the economic crisis is the reduced access to funding, a constraint that might jeopardize the resumption of the economic growth itself, considering the SME sector's contribution to GDP.

Under the circumstances, the necessity of funding from the European funds available for Romania after EU's membership represents an opportunity, not only in the context of socio-economic development in the National Development Plan of Romania 2007-2013, but also in the context of correcting the effects of the economic crisis. Moreover, the Authority for Structural Instruments Coordination (ASIC) in the National Strategic Report regarding the implementation of the Structural and Cohesion Funds – 2012 states that, although no elements to impose change strategy have been identified, elements approved at the level of National Strategic Reference Framework and operational programs in the context of the current economic situation, during the year 2013 we may consider the possibility of adjusting the approved operational programs in the sense of a rapid capital infusion into the economy in order to diminish crisis effects.

In the period 2007-2013, Romania has received non-repayable financial support from the European Union through the agency of 5 funds: the European Regional Development Fund (ERDF), the Cohesion Fund (CF), the European Social Fund (ESF), the European Agricultural Fund for Rural Development (EAFRD) and the European Fisheries Fund (EFF).

### **3. The characterization of funding sources for SMEs through specific potential rates**

The structural rates of funding sources for SMEs highlight the relative importance and the evolution in time of different methods used by the entity in order to cover the necessity of financial and material resources. The following are considered to be the most relevant:

**Indebtedness** is an indicator which offers the possibility to appreciate the way firms can pay their obligations by providing a measure of net results volatility. Among the main partial indicators, the following will be determined:

- **Debt Coverage Degree (DCD)** determined as the ratio between equity (E) and the amount of debt (AD)

$$DCD = \frac{E}{AD} \times 100$$

This shows a value of 34.8% at country level, the debt volume of the entire sector of SMEs amounting to 462,700 million, an increase with 6% as compared to the previous year. The highest values of the debt coverage are in Bucharest-Ilfov (36.9%), and in the Central part of the country (38.8%), while the lowest values can be found in the North-East (31.4%), South-East (31.2%) and South-West (31.4%). By region, the highest weight in the total SMEs sector debts is in Bucharest-Ilfov region (50.14%), followed at a distance by the rest of the regions with weights between 3.48% and 9.31%. The regional distribution of the debts' structure is shown in Table 1. A first observation refers to the improvement of the indicator's value as compared to 2005, when the level of this rate was 15.2%. The second observation concerns the relatively homogeneous level of the regions' indicator, all with values above 30%.

**Table 1. The Regional Structure of the  
Volume of Total Debt (%)**

Ref. No.	Development Region	Volume of total debt in 2011(%)
1.	North-East	6.44
2.	South-East	7.74
3.	South	7.20
4.	South-West	3.48
5.	West	7.35
6.	North-West	9.31
7.	Centre	8.34
8.	Bucharest - Ilfov	50.14

Source: White Paper of SMEs in Romania in 2012

▪ **Autonomy Global Rate (AGR)** characterizes the assets' coverage degree through the volume of equity whose details are to be found by regions in table 2.

$$AGR = \frac{CPR}{ACV} \times 100$$

The experts are of the opinion that a level of over 1/3 indicates a state of normality. As compared to the national average of 46.7% (-4% compared to 2010, respectively -15% from 2009) it is a state of relative normality, though deteriorating in the latest years.

**Table 2. Autonomy Global Rates  
by Development Regions**

Ref. No.	Development Region	AGR in the year 2011
1.	North-East	44.44
2.	South-East	47.7
3.	South	47.13
4.	South-West	55.6
5.	West	44.23
6.	North-West	42.50
7.	Centre	47.97
8.	Bucharest - Ilfov	47.1

Source: White Paper of SMEs in Romania in 2012

▪ **General Solvency Rate (GSR)** characterizes the way entities deal with debts. The indicator is calculated as the report between the volume of total assets (VTA) and the volume of total debt (VTD)

$$GSR = \frac{VTA}{VTD} \times 100$$

The minimum value of general solvency rate is considered to be 1/4, where the minimum weight of the equity in the total of funding sources is around 30%. For sub-unit values (or under 100) there is a major risk of insolvency of entities, a risk for the entities in all regions. Details on the value of the indicator, by region, are presented in table 3.

**Table 3. General Solvency Rates  
by Region**

Ref. No.	Development Region	GSR in the year 2011
1.	North-East	70.7
2.	South-East	65.5
3.	South	66.6
4.	South-West	65.0
5.	West	72.8
6.	North-West	68.7
7.	Centre	81.0
8.	Bucharest - Ilfov	78.4

Source: White Paper of SMEs in Romania in 2012

The situation is alarming, the rate being below 100% in all regions, still strongly improved as compared to 2008 when the national average was 28.1%, in 2010 it was 69.1% and in 2007 it was 75.8%, at present the national rate is 74.5%.

▪ **The Rotational Speed of the Capital (RSC)** is an indicator of efficiency of the equity's usage and it reflects the changes in the economic activity. The indicator is calculated as the report between the turnover (T) and the equity (E).

$$RSC = \frac{T}{E} \times 100$$

In a year, the speed was averaging 3.5 in 2008, 3.9 in 2009, respectively 3.2 in 2010. In comparison with 2008, the speed was reduced by 38% in 2009, and by 15% in 2010 as compared to 2008, in parallel with the regional homogenization. In 2010, the general trend was that of improving the rotational speed (+8,4% at national level), and in 2009 of deteriorating by 15% in parallel with a regional detachment, the efficiency classification is shown in table 4.

**Table 4. Equity Rotation Rate  
By Regions (%)**

Ref. No.	Development Region	ERRR in the year 2011(%)
1.	North-East	393.2
2.	South-East	406.9
3.	South	423.3
4.	South-West	411.3

5.	West	311.9
6.	North-West	404.9
7.	Centre	297.3
8.	Bucharest - Ilfov	280.1

Source: White Paper of SMEs in Romania in 2012

#### 4. Conclusions

The special extent known by the appearance and development of SMEs demonstrates that small business represent, for lots of individuals, the chance to record themselves in the social-economic competition race, which creates jobs and stock exchanges.

In most countries of the world, small business have crucially contributed to the economic development. The famous scientist Peter Drucker states that small business represent *'the primary catalyst of the economic growth'* [3]. Consequently, stimulating the SME sector should not focus mainly on conjunctural financial support measures which, while complying with the regulations in the field of competition, may introduce more volatility in the operating conditions and in anticipating the evolution of the business environment. Much more beneficial it would be for them to ensure a competitive business environment, stable and predictable.

The Government policies should stimulate the SMEs competitiveness in the long term, considering the major deficiency in competitiveness of the SME sector in Romania, as compared to the SMEs in the European Union. In this context, the identification of opportunities arising from the current crisis is of crucial importance, vis-à-vis the funding of SMEs, with regard to:

- granting credits for the cash-flow need of the SMEs throughout the projects' application;
- facilitating access to loan guarantees granted to SMEs through consolidated mechanisms for guaranteeing the loans;
- improving the access of the SMEs to the capital risk markets, as well as the measures aimed at raising awareness of the investors to the opportunities offered by the SMEs;
- granting the possibility for all banks, regardless of size, to easily implement flexible credit lines of the EIB and the EU's instruments;
- accessing funding programs, preferably with foreign funds, in order for that real infusion of capital to be accomplished, which is so necessary at present, too;



- proposing projects that truly respond to the needs of SMEs, significantly shortening the time of decision making, granting repayable funds to be used for payment of the consultants (these expenses are usually eligible in projects and they can be recovered).

According to the National Guarantee Credit Fund for Small and Medium-Sized Enterprises (NGCFSMEs), only 15% of the Romanian SMEs are credited by banks, while the percentage in the Union Europe approaches 70%. Funding represents one of the most important problems of the SMEs in Romania, many of these entities being affected by the reluctance of the banks to credit them. The SME sector acutely feels the need of specific funding instruments, of some guaranteeing schemes, of supporting the market access in the light of increasing competition in all areas.

Economic revival is subject to SMEs access to funding. The economic crisis has affected the relative weight of financial instruments required by SMEs: the demand for investment loans and leases has decreased dramatically, while the loan demand for working capital and guarantees has massively increased. Therefore, access to funding has been restricted by commercial banks, because of the financial crisis, affecting the business of small and medium-sized entrepreneurs by reducing net income and cash flows.

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