SMALL FIRMS IN ROMANIA IN THE CONTEXT OF THE TRANSITION TO A MARKET ECONOMY

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This paper focuses on the Romania's small firms in the context of the ongoing transition to the market economy. Analyzing their evolution, it has documented that small firms are important contributors to the renaissance of local entrepreneurship. Most significant is that small firms have been providing the conditions necessary for new businesses to start and for the developing of the existing ones. In the perspective of EU integration small firms are confronting the challenge of improving their competitiveness.

Introduction

After the December 1989 revolution, Romania abandoned the command economy model. The transition to a market economy model has proved to be very long and difficult. Although important steps have been accomplished, transition has suffered from delays in implementation and lack of commitment to the cause of the reform by Romania's leaders. Another aspect that made transition process so difficult was that what ultimately needed to be changed was peoples' mentality. Communist ideologists had strived to model a man with a superior labor conscience. The result was that communism had destroyed the entrepreneurial system (Dubravcic, 1995). During transition entrepreneurial system has had to be rebuilt and this is primarily the role of small firms. This paper focuses on the impact that small firms have had on Romania's economy in the context of the transition to a market economy. After a theoretical presentation of the functions played by small firms in a market economy, this paper analyzes the conditions they found in Romania immediately after revolution and their subsequent development.

The role of small firms in a market economy system

Before analyzing their functions, it is useful to note that the class size of a firm is determined by several aspects: the number of employees, the volume of activity and the value of its assets[209].

Michael Porter's model explains the place that small firms have in a market economy in terms of market share and specialization. According to Porter there are two major strategies

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[209] In Romania small firms include actually two categories of firms. The smallest ones are called micro-firms. They are defined as firms that employ up to nine workers and with revenues less than the equivalent of two millions euro. A second category of small firms include those who employ between 10 and 49 workers and with revenues or assets less than the equivalent of 10 millions euro.

firms employ in their search of competitive advantage which ultimately translates into profitability (Porter, 2001). Surprisingly, firms do not really have a choice. Thus, large firms obtain the competitive advantage by low costs, facilitated by scale economies. Comparatively small firms obviously do not have the resources to engage in cost-oriented competition. The only solution available for them is to differentiate their products by innovative products, technologies or services.

However, Porter's approach is meant to stress the need for strategic planning in the quest for competitive advantage and therefore is not comprehensive. In particular, Porter's model overlooks that in some industries small firms are important suppliers of components and sub-assemblies to large manufacturers. The latter often consider it uneconomic to produce them and there is no need for vertical integration because small firms are totally dependent on them. This does not mean that a large firm cannot establish a small unit to cater for such business by itself. This sort of relationship is common in the motor industry where large firms often subcontract to small suppliers works that demand speed and flexibility. It is also common in retail business where small producers supply increasingly powerful retailers. The third category of small firms operates on the same markets with large firms. One explication for their survival is the possibility that in oligopoly conditions they are simply tolerated by large firms. Another possibility suggests that the sheer courage and determination of managers accounts for the survival of small firms in such cases. (Waite, 1973).

From a marketing perspective it is important that small firms will provide for a need that otherwise will not be satisfied since large firms find it uneconomical to enter such small markets. From a macroeconomic perspective, one important contribution of small firms is that they form a "seedbed" in the sense that they provide the conditions favorable from which new business can be started and from which the existing ones can grow through internal resources, borrowing or mergers (Waite, 1973). Small firms also contribute to innovation in their sectors. The Bolton Committee established in 1969 to examine small firms sector in the US took the position that the greater degree of innovation in small firms is due a more flexible organizational structure, coupled with personal involvement and drive of the managers (Waite, 1973). Finally, the economic literature agrees that small firms have a major impact on local communities. In services for example, small firms account not only for the large majority of firms in the sector, but also for a large proportion of the employment in the region where they function. It is also the case that a small firm, which has its roots in a local community, would be more attached to its value and thereby more involved locally than a large company (Waite, 1973).

Small firms in Romania

Initial conditions found by small firms in Romania

Since the collapse of communism, ex-communist countries have begun a transition to market economy. Romania has designed apparently a comprehensive transition program. Although there were no blueprints to guide transition strategist, some issues seemed logical to address. Liberalization of markets was a first obvious step and Romania was quick to address it. In the first years after the revolution, the operation of the foreign exchange market was modified and external trade liberalized. Price controls were gradually eliminated, as were consumer price subsidies. Since liberalization was fallowed by a significant output loss and high inflation, stabilization became another obvious target.

Significant legislative progress has been made[210]. Free entry-exist conditions immediately allowed a boom of small enterprises, which arguably performed the same functions as in old-established market economies. As mentioned before, a prime factor that made transition so difficult was the destruction of the entrepreneurial system during communism.

State owned firms' participation in the reconstruction of the entrepreneurial system was quasi-nonexistent. Political class was reluctant to address the reform of state owned enterprises because of the social and political cost that would have been implied. They failed to understand the consequences of postponing a healthy solution to this problem. In the first ten years only palliative measures were taken[211]. As a consequence, state-owned enterprises continued to perpetrate the non-entrepreneurial system of the past communist era. In particular they continued to be production-oriented. From a marketing perspective, consumer's needs and thereby market requirements were completely overlooked and all the functions of the enterprise were production-subordinated.

Another aspect of Romania's enterprises at the beginning of transition was the poor superior management's quality. In most cases enterprises were managed by good specialists, engineers, economists. Sometimes they proved to be good administrators. However, superior managers need especially visionary thinking which would enable them to identity the weaknesses and strengths of their firm, to take advantage of the market opportunities and to avoid possible threats. This translated into an irresponsible investment policy. From various motifs, the state considered it was its duty to cater for large state enterprises. Their tax burden, loan conditions and even prices had to be adapted to compensate for their handicaps (Dubravcic, 1995). Soft budget constraint syndrome spread quickly across the whole economy, amplifying the negative phenomenon the Romanian economy was confronting[212]. Moreover, the delays in privatization prevented strategic foreign investors from contributing to the renaissance of Romanian's entrepreneurship through their financial resources and management expertise.

Under these circumstances it is easily understood why small firms were so important to the reconstruction of entrepreneurship in Romania (but also in the other ex-communist countries). In opposition to the rigid and inefficient systems of state owned enterprises, the small firms' sector has successfully confronted from the beginning market and financial constraints. Small firms succeeded due to their flexibility of the organizational structure and decisional system. Except for the high-tech sectors like microelectronics and biotechnology, which require huge investments, in Romania small firms have proved more capable to either generate innovations or to buy and implement the newest technologies.

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[210] Of prime importance has been Law no 31/1991 which regulates commercial firms. Law 15/1990 and Law 58/1991 have addressed privatization of state owned enterprises. Law 11/1991 regulates the competitive environment and Law 47/1991 has focused on bank system's regulation.

[211] On the basis on Laws 15/1990 and 58/1991, six holding companies (one State Ownership Fund and five Private Ownership Funds) were created and, until enterprises were privatized, they were the owner of more than 6000 enterprises. Under a PHARE funded program, ownership certificates worth 30% of the social capital of former state owned enterprises were distributed to public.

[212] As in the case if the other ex-communist countries, at the beginning of transition Romania has experienced a significant output loss. For the first decade real income fell down almost continuously, except for a short recovery in '93-'94. Whereas in 1989 GDP per capita was estimates at $1563, in 1992 the combined effect of a 46% drop in output and a depreciation of the exchange rate have dropped the GDP per capita to $680 (Frausum, Gehmann, 1994). Inflation soared for 10 years, with inflation rates as high as 210.4% in 1992 and 256% in 1993 (Anuarul Statistic al Romaniei, 2004).

The evolution of small firms in Romania

Small firms have been largely private-owned and were born after 1990. They are considered the main source for private investments, economic growth and employment opportunities. In 2001 they contributed 55% to Romania's GNP and approximately 40% of the workforce was employed in small firm's sector (Bucurean, 2005). Their structure and evolution has been influenced by the overall conjecture of Romania's economy. Immediately after the revolution, small firms' sector saw an explosive growth.
Table 1 shows the evolution of the number of small firms from 1991 to 2001.

Table 1. The evolution of the small firms' number

	1991	1992	1993	1994	1995	1996	1997	2001
Small firms at the end of the year	81671	206190	314973	441705	496930	546511	574282	407.878
Newly registered small firms during the year	81671	124519	108783	126732	55525	49581	38412	12.521
Start ups of small firms (%)	---	152.5	52.7	40.2	12.5	10.0	3.8	1.2
Disappearance of small firms (%)	---	1.1	0.9	0.8	0.7	0.6	0.6	-

Source: Oficiul Național al Registrului Comerțului, 2001. "Sectorul privat de IMM din România" – Raport anual.

As Table 1 shows, impressive start ups rates of small firms were registered from 1991 to 1996. After 1996, the start ups rate of small firms in Romania fell bellow the average values in UE (1.2% compared with 8-3% in UE in 2001).
Table 2 shows further data about small firms grouped by activity.

Table 2. Main indicators by activity

Indicators	Firms' number (%)	Firm's employment (%)	Sales revenues (%)	Net profits (%)
Industry	9.9	26.2	15.2	28.5
Constructions	2.3	12.5	4.9	11.2
Commerce	70.9	44.9	70.2	45.1
Services	16.9	16.4	9.7	15.2

Source: Oficiul Național al Registrului Comerțului, 2001. "*Sectorul privat de IMM din România*" – Raport anual.

As the table shows, in 2001 a large majority of small firms were found in the commercial sector (71%). Services sector accounted for approximately 10% of the number of existent small firms whereas in industry and constructions small firms were less represented. It is likely that most important for the predominance of small firms in commerce and services has been the comparatively much lower capital needed to start a business in these sectors. Table 2 also shows that overall profits were much lower in commerce than in industry or construction. This might be the consequence of the increased competition in the commercial sector, which one can expect to reduce individual profit rates.

From small firm's evolution in transition period it is conspicuous that small firms have developed over time. After 2000 a new class of firms has emerged as a result of the growing of small firms. This is evidence of a healthy system of small firms. Thereby, since their appearance in 1990, small firms have been the prime source of entrepreneurship, providing an appropriate environment for businesses development.

As mentioned, medium firms are the result of a natural growing process of small businesses. They are defined as those firms who employ 50 to 249 workers and have sales revenues or assets that do not exceed the equivalent of 50 millions euro. The three classes of firms form the sector of small and medium-sized enterprises (SME's). As a general tendency we note that middle-sized firms are growing increasingly important. Bucurean (2005) points out that in 2001 micro-enterprises represented 92.5% from all firms in the sector whereas they employed only 38.1% from the workforce in the SME's sector. In contrast, middle-sized firms represented only 7.1% but they employed 30.2% from the workforce in the sector.

Institutional support for small firms in the perspective of EU integration

After 2000, the Romanian Government has declared its firm support to the development of small firms, enacting important legislation to support this desideratum[213]. A national agency responsible with developing a strategy for small and medium-sized firm's development was created in 2003[214]. The agency's declared mission is to improve the competitiveness in SME's sector in the perspective of EU integration. Several strategic directions are being considered essential for achieving this mission.
First of all, since its appearance in 2003, the agency has acknowledged the financial difficulties experienced by local entrepreneurs. Consequently, it has been committing to improving the access of private firms to financial instruments offered by commercial banks and other financing institutions, through a national fund created in this purpose. A second strategic orientation of the agency is meant to stimulate exports and promote Romanian products abroad. This has been implemented through a national multi-annual program for the period 2002-2005. Third, the agency has been supporting the development of small firms in strategic industries through financial not reimbursable allowances[215]. Finally, the agency has been targeting the developing of human capital in small firms. A multi-annual program for the period 2002-2005 finances the organization of training courses in management, marketing, finance or EU legislation and practices in the SMEs area.

Conclusions

Complex circumstances have made the transition to a market economy very difficult in Romania. One fundamental problem was the destruction of the entrepreneurial system during communist period. After 1990, small firms were the prime exponents of the entrepreneurial system in Romania. They have confronted from the beginning financial

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[213] Law 346/2004 constitutes the main legal bases for small firms' development.

[214] National Agency for Small and Medium Sized Enterprises also has been supervising since 2003 the enforcement of legal provisions in its field of activity.

[215] The agency supports 40% of the cost of the project. Another 45% of the cost is covered by a credit and the entrepreneur covers only the remaining 15%. The support is thereby quite substantial.

constraint, significant competition and a business environment marked by instability and negative phenomenon. Their flexibility allowed them to survive and contribute to Romania's economy both in terms of GDP and employment. They successfully have formed a "seedbed" from which new businesses have been started and from which the existing ones have evolved.

The perspective of Romania's integration in the European Union poses both opportunities and threats to local small firms. The experiences of Greece, Spain or Portugal shows that Romania should expect that in the first years after the integration between 20-30% of the small firms will disappear (Bucurean, 2005). The rapid improvement of their competitiveness is a prerequisite for their survival in the competitive environment of EU economic space, after Romania's accession. Substantial governmental help is available for this purpose and The National Agency for Small and Medium Sized Enterprises has implemented since 2003 a large number of supporting programs. As a result, a 2004 evaluation of small enterprise's sector by OECD, European Commission and BERD has recognized that Romania has undertaken significance initiatives to improve the business environment (Bucurean, 2005). However, the evaluation showed that once again Romania seems to lack the commitment to carry on the necessary measures. In addition, the evaluation has pointed out that European funds are not always spent for their intended purpose of supporting the small firms. All these aspects lead to the conclusion that the improving of Romania's small firms' competitiveness and the success of the country's integration in EU depend on the progress Romania will make in dealing with the corruption problem.

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