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## The Influence of the Business Environment on Small and Medium Enterprises

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*The Small and Medium Enterprise sector in Romania has been significantly affected by the global recession in the years 2008-2009; currently it is making efforts to revive it, thanks to important role it occupies in the economy of any country. SMEs raise wide debates, especially on fiscal measures. In Romania, SMEs represent 99.7% of all businesses, generating two-thirds of jobs in the business and half of gross value added. This paper focuses on the development of SMEs and hence on business environment in Romania. The purpose of this paper is to present the influence which regulations and evolution of businesses environment have on the SME sector.*

**Keywords:** *business environment, small and medium enterprises, economic crisis, taxation, indicators*

**REL Classification:** *K20, O40*

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### Introduction

According to the European Charter for Small and Medium Enterprises, adopted by EU leaders in 2000, small businesses are the backbone of Europe's economy, capable to assure sustainable economic growth, to create more jobs and better jobs and to ensure the increase of social cohesion.

Romania started the development of the SME sector only after 1990, is still having a serious gap to Europe and even other former socialist countries.

The development of the SME sector is closely related to predictability, transparency and stability of the business environment from a state level.

The business environment influences the business's operations and performance, in general, and SMEs, in particular.

In literature, the influence which business environment has on the development of the SME sector, on performance of a company is a topic of wide interest. According to studies, the development of micro-enterprises and SMEs represents, also, a path to a better life. One of these studies is "Voices of the Poor" (conducted on 60,000 people around the world) of the World Bank. It says that the poor people expect to escape poverty through income earned from their own business or wages earned as employees.

Based on this study, Rocha (2012) in his research (The Impact of the Business Environment on the Size of the Micro, Small and Medium Enterprise Sector; Preliminary Findings from a Cross-Country Comparison) indicated that a simplified business environment, supported by fiscal and budgetary policies could support the development of SMEs, contributing, in this way, to improving the living conditions of households with small incomes and with fewer chances in terms of employment opportunities. Also, researchers such as Angahar (2012) and Storey and Johnson (1987) have pointed out that SMEs play an important role in creating jobs and reducing poverty. Siddharthan (2004) stated that attracting investment by business environment largely depends on physical infrastructure and government, but an exclusive focus on physical infrastructure, labor law; fiscal and monetary policies may not produce the desired results.

The researchers have also tried to analyze business in connection with various aspects of enterprise performance. Roudaut (2006) believes that business environment influences firm performance directly. The results of one of his papers indicate that globally informal firms are less technically efficient than formal ones. Efficiency difference between formal and informal firms is, mainly, the result of an unattractive business environment, more than a poor management. On the other hand, while Ayyagari et al.(2005) examined the effect of different dimensions of business environment on the manufacturing sector in the field of SMEs in 76

countries, Norjaya and Norzalita (2010) considered business environment and agro-food SME sector in Malaysia. Oni and Daniyan (2012) in their work focused on investigating the relevance of business environment to performance of SMEs. Ghani et al. (2010) studied the critical internal and external factors of business environment in Malaysia and found that external factors which become opportunities for companies are supported and encouraged by the government, and the threats are represented by bureaucratic procedures that companies must face to obtain various approvals and certifications.

Okwu et al. (2013) in their study (Business Environment, Job Creation and Employment Capacities of Small and Medium Enterprises in Lagos State, Nigeria: A Descriptive Analysis) emphasize that the business environment in which SMEs operate has a particular, special relevance for their abilities to create jobs and provide employment opportunities. This study used a descriptive approach to examine the ability to create jobs in the SMEs sector in the economy of Lagos, Nigeria. The analysis was based on ten elements characteristic of business environment and two indicators of SMEs relevance. The research showed that the small business sector is dominant. Also, the study revealed that inadequate access to external financing, competitive pressures, many taxes, fees and other corrupt practices are some of the factors militating against the development of SMEs sector. According to research findings, special emphasis should be placed on encouraging female entrepreneurs.

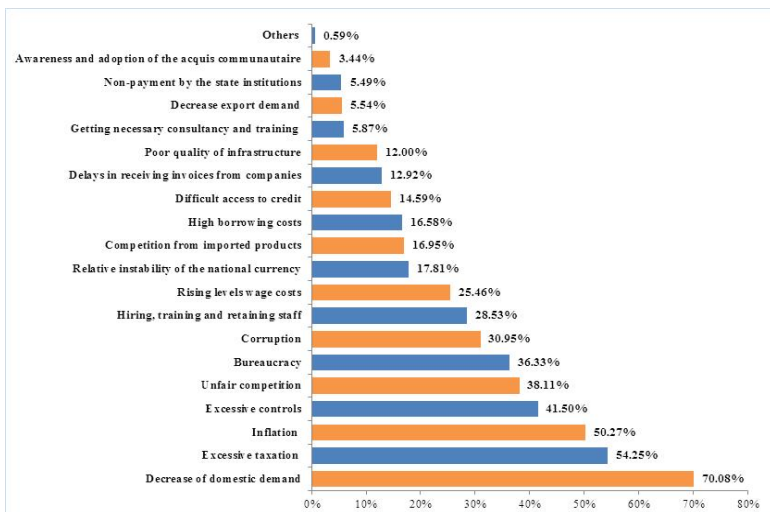
An interesting approach took into account the functioning of HM Customs & Excise, one of the oldest government departments in the UK, which supporting small businesses. The case study illustrates how the department plays a crucial role in providing supporting services that balance the interests of SMEs and helps to reduce the burden of bureaucracy and uncertainty in their business environment.

Chadamoyo and Dumbu (2012) investigated the influence of business environment and competitive strategy on SMEs in Mucheke light industry. The research results revealed that the innovation strategy, cost and competitive advantage are the key competitive strategies of SMEs, business environment being a tough one in terms of legal factors, social, political and economic. Another conclusion is that SMEs should seek strategic alliances to cover many markets, to properly manage Key Performance Indicators (KPI), and the government to relax regulations on SMEs sector.

## The current situation of the Romanian business environment

The business environment of a country is represented by all the legal, administrative, moral, ethical rules and values that create the establishment and operation framework of firms in a given area. After 1989, despite the fact that almost all political parties have declared their intention to create an attractive business environment in Romania to support economic growth, attracting foreign capital and encouraging the domestic one, which generates progress and prosperity for citizens, although efforts have been made, it can be said that the current situation is far from satisfactory. The evolution of the business environment directly influenced the development of SMEs in Romania.

Attracting investments in Romania requires a predictable and stable tax system, a significant improvement of the business environment. In our country, tax evasion, which affects both direct taxes and indirect taxes, is still a problem. Due of poor predictability, private firms find it quite difficult to draw up a business plan for a medium and long term, and SMEs face many difficulties (shown in Figure 1) in accessing markets and developing affairs.



**Figure 1:** Major difficulties encountered by SMEs in 2013

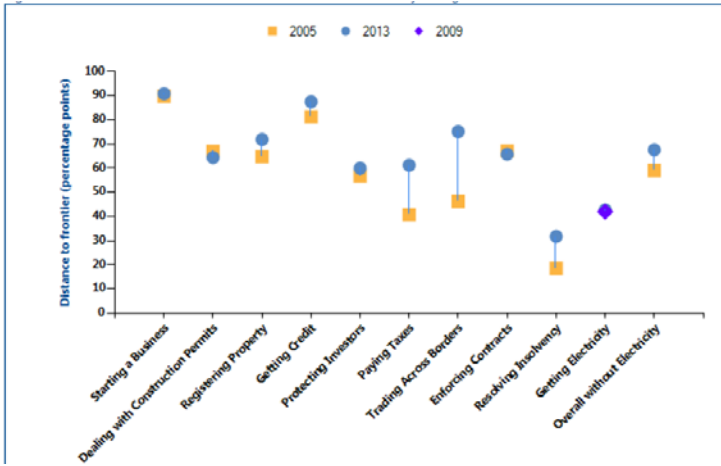
Source: White Paper of SMEs in Romania in 2013

As we can see, the main difficulties are represented by decreasing of domestic demand, excessive taxation, inflation, corruption, bureaucracy, etc. But taxation is a major factor in investment decisions because it is a cost of doing business, regardless of type, size or geographical location. Therefore, it is desirable a simple, transparent and stable tax system, which enables companies and investors to plan long-term strategies that ensure a coherent management of the business. For example, according to the amendments to the Fiscal Code, as from January 1, 2014 the income tax for small and medium enterprises (SMEs) was again amended, being reduced from 3% to 1.5%, which points out a lack of stability of the tax system, even if this measure is good for business environment.

On the other hand, interventions on simplifying administrative burdens, especially those aimed to facilitate SMEs' access to finance, have not brought the expected results in terms of competitiveness of SMEs in the market or increasing absorption of EU funds. Also, the volatility of the economy, translated by the lack of predictability and exchange rate evolution, represent worthy of consideration threats for the business environment in Romania.

As mentioned above, a country's business environment must be characterized by predictability, transparency, stability but also the transparency of public decisions. The World Bank is one of the bodies carrying out an annual report, Doing Business, which evaluates all indicators measuring the predictability of the business environment.

As evidence of this, the Doing Business Report 2014 shows that Romania ranks 73 in global rankings on the business environment, specifically the ease of doing business. More worrying is that Romania's position remained unchanged between 2008 and 2013, while in most new EU countries has been an improvement (e.g., Bulgaria ranks 58). It should be noted that this report only covers the globally small and medium enterprises. Also, Doing Business introduced the distance to frontier measure.



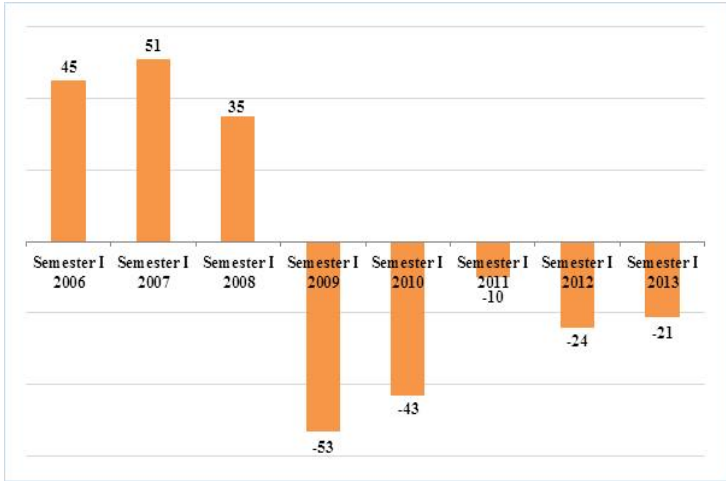
**Figure 2:** How far has Romania come in the areas measured by Doing Business?

Source: Doing Business Report 2014

The distance to frontier measure (Figure 2) shows how far on average an economy is from the best performance achieved by any economy on each Doing Business indicator since 2005, except for the getting electricity indicators, which were introduced in 2009. The measure is normalized to range between 0 and 100, with 100 representing the best performance (the frontier). The overall distance to frontier is the average of the distance to frontier in the first 9 indicators sets shown in the figure and does not include getting electricity. As can be seen from figure 2, Romania has the best score on starting a business indicator (ranked 65 in 2012 and 60 in 2013).

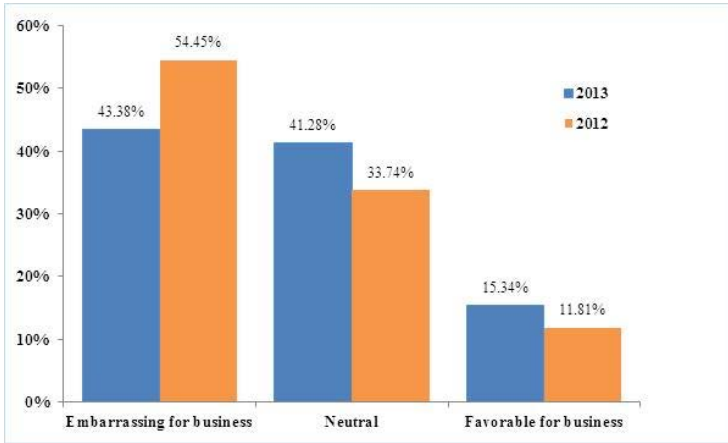
At the national level, bi-annual evaluation of the overall situation of SMEs, conducted by the National Council of Private SMEs in Romania (CNIPMMR – Romania), is based on determining the entrepreneurial index (the first half of 2013 (4.3 points) compared with the first half of 2012 (4.6 points) showed an unsatisfactory development of the business environment and SMEs sector). This is calculated as a weighted average between business environment index (26 points - recorded value on the first semester of 2013, reflecting a satisfactory progress overall business environment compared to the first semester of 2012 - 20 points), SME development index (the value of

the first half of 2013 was -8 points, reflecting an overall very unsatisfactory development of the SMEs sector compared to the first half of 2012 when he equaled -2 points) and the index reflecting the appreciation of entrepreneurs (Figure 3), which has seen an increasing trend towards the first half of 2012). Should be noted that an unstable and unsatisfactory business environment entails an unsatisfactory development of the SME sector.



**Figure 3:** Evolution of the appreciation entrepreneurs' index  
Source: [www.cnipmmr.ro](http://www.cnipmmr.ro)

Regarding the assessment of entrepreneurs (the CNIPMMR results of the investigation of a sample of 1,858 entrepreneurs - nationally representative) on the overall evolution of the business environment in Romania in 2012 and 2013 it can be said that most entrepreneurs see it as embarrassing one for business development (Figure 4).



**Figure 4:** Feedback on the overall evolution of business environment  
Source: White Paper of SMEs in Romania in 2013

## The evolution of the SMEs sector in Romania

Romania is one of the European countries most affected by the recession, because the economic growth before the crisis was mainly based on foreign direct investment, which declined sharply when the global economic crisis have been felt by foreign investors. The crisis had a strong impact on SMEs in Romania, causing the end of positive evolutions previously known for a relatively long period of time (2000-2008).

Overall, the SME sector in Romania has evolved in recent years similar to the EU-27, having a share of 99.7% of the population of enterprises. There are slight differences in the structure of the SME sector by size class, meaning that the microenterprises in Romania have lower percentage (88%) compared to the European average of 92.2% and small firms accumulate 10% of SMEs that is more than the weight recorded in the EU by this size class (6.5%).

Although participates significantly to job creation (66%) and total turnover (58%) of the non-financial economy, balance sheet analysis to 11.31.2011 has showed that the structure of the SME sector is not consistent numeric or consolidated. In relation to population, Romania has an undersized number of active enterprises, which express a low density of SMEs, only 56% of the European average, which is unevenly distributed



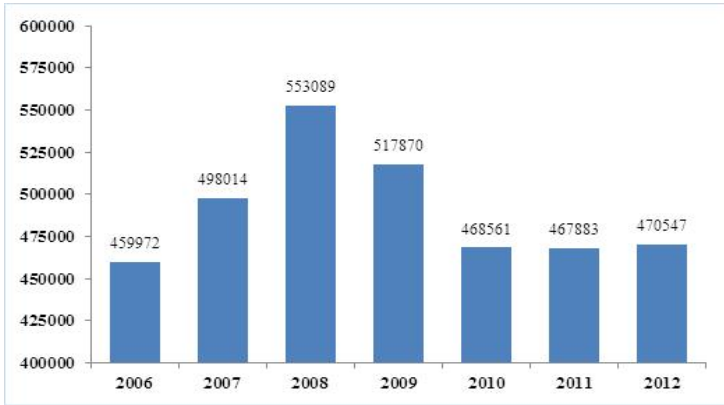
(Figure 5) in the eight development regions (of course, this is caused by the degree of development and the area of each region). Against this background, overlap negative demographic trends reflected by the decrease of the number of companies registered to National Trade Register Office (ONRC - Romania) in 2012 and in the first quarter of 2013 towards previous year.

Region	Weight of SMEs in each region	Number of inhabitants	Density SME/1000 inhabitants
BUCHAREST-ILFOV	22.69%	2.042.226	50.23
NORTH-WEST	13.95%	2.495.247	24.35
CENTER	12.31%	2.251.302	23.54
WEST	9.41%	1.730.146	23.46
SOUTH-EAST	11.94%	2.399.604	21.54
SOUTH-WEST OLTIENIA	7.48%	1.977.986	16.45
SOUTH MUNTENIA	11.17%	2.998.679	16.10
NORTH-WEST	11.05%	3.148.577	15.12
ROMANIA	100%	19.043.767	22.95

**Figure 5:** The weight and density of SMEs in the 8 development regions, 2011  
Source: PPF report on the SME sector in Romania, 2013 Edition

In terms of sectorial distribution on economic activity, there is a higher concentration of SMEs in Romania in the wholesale and retail trade (38 %), compared to the EU average of 30%, followed by the services sector in the hotels and catering areas, transport, real estate and business services (29 %), construction (18%) and manufacturing (10%).

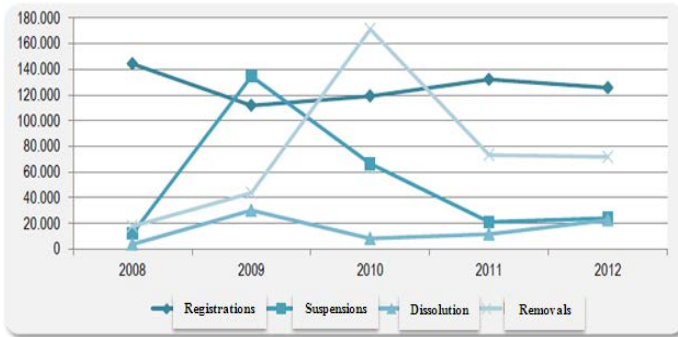
Regarding the evolution of the number of SMEs in Romania, it appears that it has an uptrend in the 2002 - 2008 periods, with an increase of almost 70% of the number of enterprises. As can be seen in the Figure 6 in 2008 were recorded the highest number of SMEs, but from 2009 to 2011 their number has decreased significantly due the economic crisis and unstable business environment. Only in 2012, the SME sector has experienced a slight recovery in this regard. In 2013, the number of registrations (124 816) for natural and legal persons was reduced by 30 844 towards the number of companies became insolvent, suspended, dissolved and radiated (155 660). The small size of the SME sector is a sign of the extension of the crisis.



**Figure 6:** Annual evolution of number of SMEs

Source: own findings based on data from [www.cnipmmr.ro](http://www.cnipmmr.ro)

The changes of evolution of enterprises in Romania were of great importance and with long-term effects, as shown in the statistics published by the National Trade Register. The ratio between the number of registrations, suspensions, dissolutions and removals of companies registered to Trade Registry in the period 2008-2013 indicates unequivocally turbulences occurring in the business environment with the installation of financial and economic crisis. Dynamics of new registrations compared to temporarily or permanently cease operations of activity of enterprises in 2008-2012, can be seen in Figure 7. It should be noted the huge number of suspensions of activity in 2009, and the maximum number of radiated companies in 2010. In 2013 year compared with 2012, the total number of registrations fell by 0,63 % , there were fewer suspensions with 0.83% , while the number of dissolutions increased by 3,15 % . Also the removals have experienced an uptrend, which increased by 12.6% in 2013 compared to 2012. In the first nine months of 2013 were dissolved 17,346 of SMEs and 59,381 have been removed, which means that to every new SMEs registered were suspended, dissolved or radiated two SMEs.



**Figure 7:** Dynamics of registrations to Trade Register  
Source: FPP report on the SME sector in Romania, 2013 Edition

Overall, it can say that demographic evolution of SMEs in Romania has been influenced not only by worsening market conditions caused by the economic crisis, but also the pace and magnitude of changes in the tax system introduced by the Government, as action against crisis. Perceived by business environment as being burdensome, these measures have led many companies to cease their activity. On the other hand, were negatively influenced entrepreneurship initiatives and the creation of start-ups.

## Conclusions

Although significant efforts have been made, lately, Romanian business environment is still one unattractive to foreign investors, as well as local ones. In this sense, our country must intensify its efforts to be able to reestablish, but also to fill the gap that it has towards European Union. In the last years, due to the economic crisis that hit our country too and, also, the harsh regulations of business environment, the SMEs's development was not satisfactory (the current number of SMEs is lower than in 2008) and favorable to a new economic growth.

Therefore, it is necessary to create a stable and predictable business environment to support the SME sector - the most important in the economy, the key of economic recovery. Thus, it is important to take as many steps which lead to improve the business environment and create the premises to revive the investment process (eg: non-taxation of reinvested

profits, reducing taxation on labor, improving SME access to finance etc.), because its evolution influence directly SMEs development.

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