

# STRUCTURAL MODIFICATION ÎN ROMANIAN ECONOMY

Dan DONOȘ<sup>1</sup>

e-mail: donosad@yahoo.com

## Abstract

Changes in the economy have been significant and dynamic with the overall result of fostering economic growth but also with imbalances that have accumulated over time at the enterprise level and the entire economy. Several issues have emerged, namely the need to recapitalize businesses. It has been noticed that their funding pattern has changed significantly, raising questions of sustainability. Debt financing has replaced equity financing by generating debt leverage, being the largest in the EU. Then, it is difficult to get in and out of the market easier. It is necessary to stimulate the economy by setting up new companies, increasing their number but also rejuvenating them as most Romanian companies have passed since their first youth. New businesses, but also the old ones, must focus on innovative and knowledge-based development. Another aspect is to improve the work of tax authorities. The high level of taxation is one of the most pressing issues for businesses. The degree of polarization and heterogeneity is required to decrease. The degree of heterogeneity has increased, so there is only one pole of economic power in the country and there is still no evidence of the emergence of a second. In addition, weaker economic firms have failed to improve their economic performance over the past two decades. There are also policies that favor certain categories of companies and need to be reviewed. There is a need for a neutral policy regarding small and medium enterprises towards corporations and for companies with majority foreign capital compared to Romanian capital companies.

**Key words:** economy sectors, recapitalization, polarization

The number of active businesses has doubled over the past two decades 1. If at the end of 1994 there were about 300 000 such entities, in December 2014 their number was over 600 000. (BNR, 2015). The growth rate of the number of active companies remained in almost all years in the positive territory, irrespective of the evolution of GDP.

However, the number of companies per 1 000 inhabitants in Romania remains at the lowest in the EU (22, while the EU average is 43 in December 2014) (BNR, 2015). The more companies there are, the more competition is favored, including the assumed risk.

The largest increase in the number of companies was in construction and real estate (more than 12 times in the period 1994-2014, however, the starting base is still reduced. In these sectors, the highest rates were also recorded non-performing loans. Despite the significant increase in the number of firms, the degree of concentration in some economic sectors remained important. The Herfindahl-Hirschman index, calculated on both gross value added and of turnover by sector of activity companies and the county in which they are registered reveals a degree of concentration relatively high in certain economic branches,

namely administrative divisions. The most obvious in this respect are the extractive industry and the sector utilities. This is mainly due to the low number of companies that operates in these industries, but also the existence of a company that has an important role in that branch at the level of a particular county (most likely the heir of a former self-governing administration, especially utilities).

## MATERIAL AND METHOD

The quality of entrepreneurship has significant improvement. Almost half of the active companies in Romania not only reduce by their activity the added value produced in the economy, but the registered losses have fully consumed their own capital.

Significant progress has been made over the past 12 years in starting a new business, both in terms of time and cost of setting up a company. On the other hand, the exit of the companies from the market, seen from the perspective of the ease of solving the insolvency process, is more difficult. Then, the GVA / company indicator (real convergence criterion, created by analogy with the GDP / per capita indicator) shows that the economic force of Romanian firms is relatively far from the EU average. GVA / company is 42% in Romania vs. EU (respectively 126,600 euros,

<sup>1</sup> "Ion Ionescu de la Brad" University of Agricultural Sciences and Veterinary Medicine, Iasi

compared to 300,339 euros in December 2014) (BNR, 2015). The situation is similar to that of other countries in the region (values for Romania are superior to Bulgaria, Lithuania, Slovakia or the Czech Republic, but slightly lower than Poland or Latvia;

The halving of the share of negative equity firms would increase the GVA / company ratio by 46% and 61% of the EU average. In fact, it would be the average level in the economy. The problem is that the average value hides a high degree of polarization to two extremes, polarization that has not improved over the past decades. At an extreme there are relatively few Romanian firms that can compare to the EU average from the GVA perspective they generate (about 29,000 companies) (BNR, 2015). Though minorities, these firms are also the ones that matter to Romania's economy (producing 87% of corporate GVA in December 2014). Half of the firms in the economy are at the opposite extreme: they generate GVA below 2% of the EU average.

Romania's economy is made up of smaller companies. The passage of time did not guarantee an increase in the size of the company. In most cases, businesses have remained in the classes of their birth. In the rest of the situation, the rule is that firms move into a lower class on size. Cases where the passage of time leads to significant accumulation of assets and increase in employees or turnover are exceptions.

## RESULTS AND DISCUSSIONS

Developments in the size of firms have led to a growing role and, currently the majority of SMEs in the Romanian economy compared to corporations. According to statistical data (World Bank), 2011 If in 1994 corporations held 83% of the non-financial corporations' assets, in 2014 the share became 42%. The same dynamics was observed in the number of employees: SMEs employed 20% of the employees of all firms in Romania at the end of 1994, reaching 65% in two decades (BNR, 2015). Changes with the same finality, but with a lower amplitude, were recorded for the contribution to value added and turnover. The SME contribution to turnover has become a majority (53% in 2014 compared to 34% in 1994), but in the last decade this contribution has not increased, although SMEs have benefited by a rising volume of assets and employees (BNR, 2015).

The results in Romania indicate the usefulness of a balanced approach of the authorities regarding the role of SMEs and the role of corporations in the economy. First, just

like we have shown in the previous section a convergence towards the EU average values on GVA / firm implies the existence of larger companies in the economy great. Second, SMEs have a higher degree of pro-cyclicality than corporations, so in the ascending cycle of the SME economic cycle they have a stronger action in the direction of GDP growth than corporations, while in times of recession or economic and financial crisis corporations seem to better manage shocks.

Innovative and knowledge-based development (high-tech and knowledge-intensive services) in Romania was relatively modest. Compared to the rest of Europe, we continue to be at the bottom of the leaderboard. According to the number of active companies, Romania's economy remains dominated by lower service knowledge service providers (grouped in less knowledge-intensive sectors), but the trend is to significantly reduce this characteristic (Neagu F. *et al*, 2016). The share of firms in less knowledge-intensive services fell from 81% to 56% between 1994 and 2014. In contrast, the number of service-intensive firms has risen from 4% to 20% over the same period (BNR, 2015). There is still no solid assurance that this is the meaning of the economy, because the share of knowledge-intensive firms in total active companies had a peak before the crisis (23.2% in 2007), after which the evolutions were sinuous, on a falling rule background. The same dynamics was also observed in the share of gross value added generated by these companies in the total GVA produced by all Romanian companies (the share increased from 7% in 1994 to 18% in 2014, the maximum being recorded in 2006, when it reached 20%) (BNR, 2015). Despite these significant developments in the knowledge-intensive services sectors of the past two decades, Romania continues to occupy positions in the second half of the EU ranking in terms of the share of these sectors in GDP (2.7% in 2012) (BNR, 2015). Companies that produce high-value and innovation-based goods (medium-high-tech and high-tech sectors) have not increased their presence in the economy over the past decades.

Companies producing lower-value and less-value-added goods on innovation (low-tech and low-tech medium) were one of the ways the main development of the first decade of the investigated period, but after the trend in 2004 was to diminish their role in the economy. The share of these companies in the total number of active companies in Romania remained relatively unchanged between 1994 and 2014. The diminishing role in the economy is more evident in analyzing the contribution of low-tech and medium low-tech companies to GVA production generated by non-financial corporations (which has fallen from a peak reached in 2003, 27% to 16% in 2014) (BNR, 2015). Activity analysis shows that the economy has been very dynamic over the past two decades. Entrepreneurial spirit was open to change. Rankings by sector with respect to the number of firms or the contribution to the value created in the economy have changed significantly. Trade firms dominated the 1990s, but their share declined continuously (from 68% in 1994 to 35% in 2014), regardless of the evolution of GDP. However, the GVA contribution of commercial firms remained relatively constant. An opposite trend was taken by firms in the service and utilities sectors. Their share in the number of active companies in Romania increased continuously, irrespective of the economic cycle, reaching the first position according to the activity sector criterion (39% of total companies in 2013, compared to 17% in 1994) (BNR, 2015). In the case of industry or agriculture, the situation was the opposite: the share in the total number of firms remained, but their contribution to GVA was significantly reduced.

The average life of a firm is about 7 years (if we introduce the constraint that the firm also has a turnover greater than zero, the duration decreases to 5 years). Of the almost 1 406 000 active companies set up in Romania from 1990 to December 2014, 12% had an average life of 1 year, while 29% have a life expectancy of more than 10 years. The Romanian economy's veterans 20 (over 21 years old) represent 7.5% of the companies active in December 2014 (3.2% of the total number of active companies set up in the last 21 years). The average life expectancy is 40

per cent of the total companies. On average, over a period of 7 years, about 40 per cent of companies are inactive (BNR, 2015).

Romania's economy is made up of companies that have passed "first youth". Most active companies are older than average life expectancy in the economy (56% of companies are older than 7 years). Age extremes are relatively equal represented. Young firms (aged up to 3 years) represent 22% of the population, while veteran firms (over 20 years old) represent 15% of all active companies in Romania in December 2014. Companies set up between 1995 and 2000 (and who were between 15 and 20 years old in December 2014) are the least represented in the population of 2014 (World Bank, 2011). The authorities' focus should be on encouraging the creation of new firms. Although they have a modest contribution to the stock of total assets, to that of the number of employees or value added in the economy (about 2% in the year of establishment), newly created firms contribute substantially to those flows (for example, in year 2014, these firms generated 44% of the VAB change in the economy) (BNR, 2015). Under these circumstances, the authorities' efforts to ensure that the entry of a company into the market is as little expensive as time and money is needed.

Productivity of work for enterprises run by managers who have studies the most relevant for the economic sector in which the company is active with about 4% above the level of the companies led by managers in the economic field, respectively by 74% over those obtained by the companies where the directorate has other studies or no higher education (BNR, 2015). Also, companies of the first two categories make a higher profit and are characterized by a higher investment rate than that enjoyed by enterprises run by managers with studies in other fields or without higher education. The debt ratio (measured as the ratio between total debt and equity) is more reduced, and the recovery of claims is superior.

At the aggregate level, the firms in 2014 achieved roughly the same results of the profit and loss account as well as the companies present in the economy 21 years

ago. There have been several cycles over the two decades analyzed, but the results of 2014 are close to those of 1994. Structural changes over the past decades as well as medium-term growth outlooks should lead to more accelerated positive developments in the future. Drawing the line after 21 years, the net result of the companies had a modest evolution for an emerging economy (but explainable to some extent for a transition economy). Average annual growth rate of net result for the period 1994-2014 was 1.7% (Neagu F., Dragu F., Costeiu A., 2016)

Strong polarization is a feature of Romania's economy. Mean calculated values for the whole of the non-financial sector are not relevant. Investigating firms that have their turnover, total assets or value added gross to a difference of  $\pm 10\%$  compared to the average sector companies will encompass 1% of companies. The widening of the variation ranges to  $\pm 25\%$  from the average will increase the set of companies to 3% and the increase of the variation to  $\pm 50\%$  characterizes 8% of the active company's population in Romania (BNR 2015).

An evolution that mitigates the negative effect of strong polarization is the fact that the number of companies that fall into the category of those generating the tendencies to the level of the economy increased in the period 1994-2014. The number of firms with higher than average results increased significantly in the case of total assets and the number of (over 5 times in the period 1994-2014).

The degree of heterogeneity in the economy has increased over the two decades investigated. The minority of those generating trends in turnover, value added, total assets, etc. has strengthened its positions. The ratio between 75 and 25% has either increased almost continuously, or has been maintained at high levels over the past 21 years, both in terms of total company assets, but also in

terms of gross value added by companies, their employees (BNR, 2015).

A high degree of polarization and heterogeneity is common to others European economies. It is what shows the shape of distributions of various structures balance sheet: the share of fixed and current assets in total assets, respectively the share of capital and liabilities in total liabilities, regardless of the size of the firm.

## CONCLUSIONS

In two decades after December, changes in Romania's economy were multiple and alerts. The number of companies has doubled, SMEs have taken the leading role to the detriment corporations, private capital has taken the place of the state, and foreign firms have almost the same contribution to generating added value as firms with indigenous private capital (with high perspectives to become dominant). Many structural changes have also occurred at the level of companies' balance sheets. I interpreted them as being sustainable on the balance sheet and less sustainable on the liabilities side. The question is if these changes of the last decades are favorable? Synthesizing the entire activity, a Romanian company in the period 1994-2014, the cumulative net result is strong positive. It is a result obtained under high uncertainty conditions marked by the process of transition to a market economy, a process that has also created opportunities that are not meet in developed economies. This whole image hides shades important. Average growth rates are only one minority of firms. Romania's economy has remained strongly polarized (even growing from many perspectives).

## REFERENCES

- BNR 2015** – Raport asupra stabilității financiare 2015.  
**Cazacu A., 2015** – *Competitivitatea externă a României*, ASE.  
**Neagu F., Dragu F., Costeiu A., 2016** - *După 20 de ani: schimbări structurale în economia României în primele decenii postdecembriste*, Caiete de studii nr. 42, BNR.  
**World Bank 2011** – *Leveraging trade for development and inclusive growth: The World Bank Group Trade*