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BUSINESS RISKS IN THE SMEs FROM THE NORTH EAST REGION

Literature
reviews
Case studies

Keywords

SMEs

Crisis

Evolution

Risks

Influence factors

JEL Classification:

M10

Abstract

The SMEs can easily adapt to the requirements of today's markets which became more and more competitive. The small and medium enterprises provide new opportunities for the employment and on another hand, they directly and indirectly contribute to support the activities of the large enterprises, either as suppliers or as customers. Fast-growing entrepreneurial companies will play an important role in re-balancing the economies all around the world and, therefore, their stimulation is more necessary than ever. Their rapid expansion outlines a growing potential to create jobs at a time when many European countries are facing high unemployment. In addition, entrepreneurship is vital for the future of emerging markets.

The vulnerabilities of the SMEs are mainly linked to the decreasing available resources, to the excessive dependence on the entrepreneurs' financial decisions and to the changing business environment. In order to revive the SMEs sector in Romania there is a need for more rigorous approaches, based on the implementation of business strategies.

1. Theoretical approaches on the business risks identification.

The prerequisite for the smooth functioning of the business risk management is their correct identification. Basically, identifying business risks is fundamental to determine the optimal level of protection for a given activity. If the risk is underestimated, the protection will be insufficient to cover losses and, if overstated, the cost of protection will reduce the excess proceeds of the activity.

From the analysis of the risk management process, it seems that three fundamental components are required:

- identification and risk assessment
- develop a strategy for responding to risk factors and
- risk control.

The work to identify business risk involves the identification of the risks that may arise during the conduct of an activity (still to be covered) and to determine their characteristics. The risks identification aims both the exposure of the property, of the rights and human resources and the potential hazards that may cause these exposures. The risks identification is accomplished in two stages: the risk perception, namely the awareness that a risk threatens the business project and the identification of the risk itself. The risk categories most commonly used are:

- technical risks: quality or performance, dependence on homologated technology, the requirement to obtain a certain performance;
- project risk management: misallocation of time and resources, inadequate quality of the project plan, unrealistic or incomplete estimations, supply problems, poor communication techniques;
- internal risks: the costs, time and goals are inconsistent, a lack of prioritization between the organizational projects, an

inadequate or discontinuous funding, conflicts in funding or wrong resources allocation to different projects of the organization;

- external risks: changes in legislation, market trends, labour disputes, country risks.

1.1. Tools and techniques for the risks identification.

The analysis of documentation involves a structured analysis of the business project plans and working on hypotheses, using different techniques for gathering information, such as:

- Brainstorming: is the technique the most often used to identify risks. The aim of the method is to obtain a more complete list of the business project risks, this list will be used later in the processes of a qualitative and a quantitative risk analysis. It consists in organizing a large and comfortable meeting with experts, with a multidisciplinary character. During the meeting, which is led by a moderator, various ideas about the business project risks are generated. The meeting goes smoothly and without expressing judgment or criticism of the ideas, regardless of the hierarchical position inside the organization of the participants. The sources of risks are broadly identified and they are shown to be examined by all the participants. The identified risks are then classified and their features are detailed;
- The Delphi technique: it is a way to get expert consensus on a business project risk. The experts are identified but they participate in an anonymous review, without meeting face to face. The officer for risk identification uses a questionnaire that asks about the most important ideas on the

business project risks. Thus, risks are identified and then, they are sent to experts for review and comment. A consensus on the main risks of the business project can be obtained through several iterations of this process;

- The interview: risks can be identified by interviewing experienced project managers and experts in the field. A responsible in identifying the most appropriate risk is choosing those ideas which briefly outline the project, provides information about the structure of activities and assumptions to the participants;
- The SWOT analysis: this technique allows the examination of the business project in terms of strengths, weaknesses, opportunities and threats, in order to increase the area of the considered risk analysis;
- The analysis assumptions: every project is designed and developed based on assumptions, scenarios and assumptions. Assumptions analysis is a technique that exploits the assumptions made by different specialists about business project risks. This technique identifies project risks in terms of inaccuracy, inconsistency or incompleteness of the working hypotheses;
- The technical diagrams: this technique can include cause-effect diagram and it is useful to identify the causes of risks and their potential effects; the system flow diagrams of the processes describe how the elements of a system or a process interact and their causal mechanism which can influence the diagrams; it consists of a graphical representation of the problem, showing causal influences, the temporal order of

the events and other relationships between variables and outcomes.

1.2. Planning the risks response.

Risks response planning is the process of developing options, determining conducive actions to enhance the opportunities and reduce threats against the business objectives. This process includes identifying and assigning responsibilities for each agreed risk response and to ensure that the identified risks are properly distributed for the reply. The effectiveness of risks response planning directly determines the increase or the decrease of the business risks.

Planning should be correlated with the severity of the risks, with the cost objective achieved in the proper time, in order to be successful, planning must be realistic and take into account the context of the business project, it must be accepted by all the parts involved in the project business and must be assigned by a manager of the organization.

The tools and techniques for risks response planning may be used as follows:

Avoidance: Risk avoidance is based on the change of the business project plan, to eliminate business risks or to protect against the impact of risk upon the objectives. Some causes of risk may occur from the early stages and can be solved by classification requirements, obtaining information, improving communication or by a qualified expert. Examples of risk avoidance are: additional resources and additional time, adopting a known approach to avoid an innovative or an unknown provider;

Transfer: the transfer of risk is to seek a transfer of risk to a third part with responsibility for risk response. The risk transfer does not remove it, but gives the responsibility of managing this risk to a third part. The transfer of responsibility for risk is most effective when the business comes to financial risk exposure. Transfer financial risk always means to pay a risk premium by the risk acquirer. This may

include premiums, guarantees. Also, the contracts can transfer the responsibilities of risk to another business partner. For example, a fixed price contract may transfer the risk to the seller;

Attenuation: This technique aims to reduce the probability and/or the impact of the risk under an acceptable threshold. The attenuation is based on the principle that an early adoption of a preventing action of the risk is more effective than trying to repair the consequences after the harm has occurred. However, the cost of risk mitigation actions must be related to the probability of the impact risk. The risk attenuation can be done by implementing new ways of actions to reduce risk (eg by adopting less complex processes, conducting additional tests or by choosing a stable supplier);

Acceptance: this technique indicates that the team managers of small or medium organization decide not to change the risks the business is facing, or they are not able to identify other risks and to find a proper response strategy. An active acceptance may include developing a backup plan to be achieved when there is a supplementary risk. The passive acceptance supposes no action, allowing the project team to face the risks as they arise. The backup plan (contingency plan) can be an useful tool for the risks that may occur while the business development.

1.3. The risks evaluation by occurrence probability and impact.

The business risks assessment can be done by estimating two dimensions: (Böcker, K.,2008, p. 179-200).

Impact: It measures the impact of each risk and refers to the importance of the probable loss. Values are given on a scale from 1 (negligible impact) to 4 (very high impact).

Probability: this establishes the possibility of occurrence of the event on a scale of 0 to 1.

In the evaluation process, the risks are classified in four categories:

- Strategic risks: These are risks that affect the company values and it can lead to bankruptcy, stagnation or fall in activity as a result of the inability of the organization to adapt itself to a specific competitive, constantly changing environment; these are specific risks including changes in customer priorities , threats from the traditional competitors and emerging changes in the brand perception, changes in the access to financial capital, to the human capital, new developments in technology, the global movement of the economic and geo -political factors, legal changes and regulation, quite numerous in the current economy ;
- Economic risks: These risks include changes in the interest rates, in the exchange rates, commodities, shares and other property, in credit and other liquidity risks;
- Operational risks: There are risks related to key people and their career planning, the composition and the orientation of the Board of Directors, the orientation of the human resources and employment, information technology systems, accounting, auditing and control systems, regulatory compliance, design errors, productivity and disruptions in operations and supply chain;
- Hazard Risk: the risk that determines the decrease of the non-financial assets because of the natural phenomena, physical damage of the real assets, the employees' actions, events that affect the liability, the product revocation and integrity, as well as the business interruption.

In order to assess and accomplish an efficient risk management, both the small and medium organization and its managers

must learn to approach the risks in terms of a holistic view and subsequently, to reduce the internal and/or external financing risks. (Terry, C.; Webb, M.; Griffith, M.,2001, p. 14, 60,87).

2. Realities of the Romanian SMEs evolution against different business risks.

Both in Romania and the EU's countries, the SMEs are defined to be those companies that have up to 250 employees and generate a net turnover of 50 million Euros. At the EU level, there are over 23 million SMEs (a figure recorded in 2011), which represents over 98% of all the European enterprises (http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2010/2011/romania_en.pdf). These businesses provide over 67% of the total number of jobs available in the EU countries. The evaluation of the performance indicators show that, in the European Union, the SMEs continue to be the backbone of the economy; in 2012, they have 99.8% of the active enterprises, in the non-financial sectors of the economy, which equals a total of 20,7 million invested in business. The vast majority of these, namely 92.2% are micro enterprises, with more than 10 employees, according to the European definition. About 6.5% are small enterprises with a number of employees between 10 and 49, and only 1,1% are medium-sized companies with a number of employees between 50 and 249, according to the European classification.

In terms of their contribution to employment, the SMEs bring 67.4% of the existing jobs in the non-financial economy, inside the European Union, in 2012, virtually maintaining the same level as in 2011 (67.4%), but greater than 2010 (66.9%). The share of gross value added of the SMEs suffered a slight decline in the last two years, falling to an average of 58.1% of the aggregate E.U.'s economy.

Romania is well below the European average, concerning the development of the SMEs sector. If the European average amounts to 42 SMEs/1000 inhabitants, in Romania there are around 24 SMEs/1000 inhabitants. According to a recent report made up by the World Bank (Doing Business Report, 2013), Romania is positioned on the 68th place in the world range of countries, in terms of the facilities for setting up a company (a business start-up). Even in such difficult conditions, between 2003-2008, there was a significant increase of the number of the Romanian SMEs. Then, a period of decline followed, between 2008-2012 and the number of such enterprises began to decrease. The economic crisis overlapped with an unstable economic framework and generated a cessation of activity, in less than two years, for about 250,000 SMEs in our country. Looking at the data from the graphic 1, it can be concluded that a substantial fraction of SMEs in Romania (52.30%) have faced some difficult problems in 2008-2012, because of the national and European economic decline. These firms are more vulnerable to contextual challenges than the large firms and only a percentage of 34.51% reported a substantial increase in their activity.

For example, in 2009, there were created about 116,022 SMEs, but the closed cases were 43,615 and the suspended activities registered about 133,362 cases. According to the data provided by the Trade Registry Office, the dynamic of the temporary or permanent cessation of operations of the activity shows that between 2009-2012 about 360,000 businesses were permanently closed or temporarily suspended. Only in 2010, the Trade Registry Office registered 171,146 cases of business cessation.

One of the identified causes of these phenomena, apart from the general crisis, was the introduction of the minimum tax applied by the Emergency Ordinance no. 34/2009 on budgetary rectification and regulation of tax and financial measures,

which came into force on the first of May 2009.

The SMEs provide 50% of jobs, in most of the G20 countries. In all the European countries, in the SMEs operate more than 3 million people. The Romanian SMEs field is the main supplier for jobs, including about a third part of the total amount of the employees from the economic sector. The employment contribution is over 68% of the total number of the working people (the total number of the employees who were active in the Romanian SMEs exceeded 2,5 million, in 2010). The major part of jobs the SMEs offer are in the Trade sector (37.50%) and Services (38.50%) (see graphic 2.). In the last three years, the agriculture appears as being attractive for the Romanian small entrepreneurs, because they are supported not only by the internal potential of the natural resources and by the domestic retail market, but also by the development policies which contain substantial funding from the State's Romanian SMEs. Thus, in 2009, the turnover of the SMEs decreased, compared to 2008 with more than 5% and the number of the employees working in these enterprises decreased with over 12%. The recovery of these SMEs began to emerge starting the end of the 2010, when the turnover of these businesses began to grow again, compared with the same period of 2009. Over 54% of SMEs in the non-financial economy reported profit in 2011. In 2011, the net average of profit in the SMEs represented 5% of their turnover.

The economic and the financial performances of these SMEs, in the present and for the future, must be analyzed taking into account some uncertainties and business risks and by the means of the activities that these companies intend to put into practice to fight them.

According to a survey conducted in 2012 by the National Council of the SMEs in Romania, about 54% of respondents, as

budget and from the European specialized funds.

The SMEs sector in Romania contributes to about 58% of the national GDP. The turnover in SMEs represents more than 58% of the total turnover achieved in the national economy

Romania is one of the European countries seriously affected by the Economic and Financial Crisis. The economic crisis has touched the financial performances recorded in the last few years by the Romanian SMEs. (see graphic 3. and graphic 4.). About 80% of the small and medium Romanian firms were unable to develop their activities, being affected by the difficult evolution of the business environment. Considering the economic situation in Romania in 2011 and 2012, there is a lack of confidence of the small entrepreneurs in the governmental measures. But in 2012, a positive economic revival (a slight improvement) has occurred, that favoured the business development among the Romanian small entrepreneurs, considered the current business environment as to be not favourable to the business development. This study revealed that the main difficulties faced by the Romanian SMEs, in 2011, as they were the following: the decreased domestic demand, the excessive taxation, excessive bureaucracy, the inflation, corruption etc.(see graphic 5.). It should be noted that the embarrassing conditions that affects the activity and economic performance of these companies are, as follows:

- decline in the domestic demand;
- excessive taxation;
- bureaucracy;
- excessive controls;
- high borrowing costs;
- delays in cashing invoices from the private companies;
- corruption;
- inflation;
- difficult access to credit;
- recruiting, training and motivating staff;

- relative instability of the national currency;
- non-paid invoices by the state institutions;
- increasing wage costs;
- poor quality of the infrastructure ;
- competition made by the imported products;
- decline in the export demand;
- obtaining necessary consultancy and training company;
- knowledge and adoption of the communautaire acquis.

Another survey, conducted by the National Council of the SMEs, among the Romanian small entrepreneurs, underlines that about half of them does not predict any activity, rather do not elaborate short, medium or long term business strategies. However, the small and medium firms in Romania are ranked as to be the second in the central and eastern region of Europe, in terms of optimism, linked to the effects of the financial crisis, after the Austrian ones. Thus, most of the small entrepreneurs from Romania intend to expand its business, in a moderate manner, in the near future (C.N.I.P.M.M.R., (2012), 2012, Cartea Alb a IMM-urilor din România, The SMEs' White Book).

3. Study on the main environmental risky factors which influence the SMEs from the North East region, Romania

The objective of this research was to identify the internal and external major factors which influence the present activities and the future of the SMEs from the North East region. In 2010, 13,846 small and medium enterprises offered jobs for 53,120 employees. In 2008-2010, suffering from the impact of the global economic and financial negative trends, the SMEs in this region experienced a downward trend. The largest decline was registered in the field of the construction industry and in trade. In 2010, the turnover of these companies decreased, compared to 2008, by approximately 30%. The unemployment

rate, in 2009, stood at around 9%, almost double compared with the rate registered in 2007.

The method used in this paper work is based on a questionnaire to a sample of 120 top managers of the SMEs in the NE region, coming from various fields of activity, operating on the market for more than two years. The management of information and the data collection was conducted in the early 2013.

The main objectives of the present study were:

- What are the risks the managers coming from the analyzed SMES recognize;
- The turnover of the company in the present year can be compared with the level of the turnover from last year;
- What are the strategies for the future in these SMEs;
- What the managers think about the main factors that will influence the turnover of their company the present year?

In the first stage, a total of 35 risks were identified. The evaluation results using the probability and the impact of the identified risks, based on questionnaires and by processing information from the documentation provided by the managers of SME taken under the analysis, are shown in Table Risk Assessment. (see. table 1.).

Risks in the red zone should be resolved first because they are the ones that can create great difficulties and are critical for the small firm, while the green zone have the lowest priority, as they are minor risks. The interviewed managers have appreciated that the occurrence of some unforeseen risks in the general strategy of the company, because of a lack of a risk strategy may be a critical risk, with a probability of 0.80 and an impact factor 2, while some significant risks, such as environmental economic risk, prices risk, funding risk, credit risk, competition risk, coming from the changing environment, have a low risk for our managers, with

probabilities between 0.8-1.2, and impact factor 2. There are some comments to make about the managers' economic education and their capacity to understand and face the business risks.

3.1. Data analysis.

At the question related to the evolution of the SMEs turnover to be done this year, compared to the last year turnover, 43% of respondents expected that the turnover increase, 37% of respondents expected that the turnover decrease and 20% of respondents expected that the turnover to remain unchanged. Given the overall economic performances of the regional SMEs in 2012 compared to 2011, 40.06% of SMEs in NE region had identical results in 2011, 12.20% had much weaker results from 2011 and a rate of only 1.95% enjoyed much better economic performance than in 2011.

The demand size was chosen as the main influencing factors (40% of respondents), followed by the economic circumstances with a percentage of 36%, the available sources for financing by 18% and 6% for other factors (see graphic 6.).

Other answers appear as follows: 57% of interviewed managers expect that the staff number remain unchanged, 23% of respondents expected the number of employees to diminish and 20% of managers expected the number of employees to grow.

The final questions underline that the main influencing factor was considered to be the size of the market demand or the quantitative aspects of the market order (37% of respondents), followed by the economic situation (24%), the legislative changes like the late taxation (21%), the price increase (9%), politics (6%) and other factors (4.(see graphic 7.).

Regarding the targets of the SMEs in NE Region for 2014, many of these firms (43%) declare the main objective, as maintaining the business to its current size and another significant objective of the business is to moderately expand (41%).(see graphic 8.).

It should be noted that each business development goal have a risk dose; risks if not managed or properly quantified can quickly lead the company to bankruptcy. The realities of the Romanian business environment has given us many examples of very fast expanded small businesses, more than they can afford, and because they did not anticipate risks, they were the subject of a bankruptcy, instead of a successful business. Those who had an organic growth, a healthy and effective risk management succeeded to survive and even have increased in full financial crisis.

Conclusions.

The SMEs in Romania are placed at a crossroads, with a fragile stability that varies in the different economic sectors or from one region to another. The generalized crisis has forced the Romanian enterprises to evolve in an unfriendly economic environment, characterized by structural imbalances, in a tax system and banking system reluctant to credit the small firms with long lasting effects. The Romanian SMEs are insufficiently prepared to compete successfully in the European unique market. Six years after joining the European Union and in the spectrum of the consequences of the global crisis, a characterization of the Romanian business environment highlights many of the vulnerabilities of the SMEs in our country.

One of the most important challenges for the establishment, the growth and the survival of SMEs' remains their access to funding. Though they provide 50 % of the jobs in most developed countries, the SMEs attract only a very small percentage of the total investments. The investments in the SMEs for the G20 are 574 billion, representing 6% of the total 9.250 billion in all the forms of investment and the vast majority of the funds are coming from the bank lending.

Only 17.5 % of the Romanian thinks to initiate a business perspective on their own within 6 months. This percentage puts

our country on the 56th position of 59 evaluated countries and ranked it on the last position among the countries with efficiency-oriented economy. A percentage of almost a half (45.99 %) of the adult population of Romania avoids starting up a new company for fear of a possible financial failure.

According to certain analysis and reports, the SMEs sector in the Bacau county recorded a slight recovery in 2011 and 2012. Thus, although in 2011 the number of the SMEs has declined by over 4% compared to 2010, the turnover of these SMEs increased by 17% compared to 2010, while their gross profit grew by over 40 % compared to 2010. The number of employees working in the SMEs sector, in this department of the country, increased also, by almost 6 % compared to same period of 2010

Productivity and profitability of SMEs reveals the precarious situation of the SMEs in Romania, in terms of efficiency and competitiveness.

As a final conclusion, the SME sector in Romania is far to be a solid and competitive segment of the national economy.

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Authors' short presentations:

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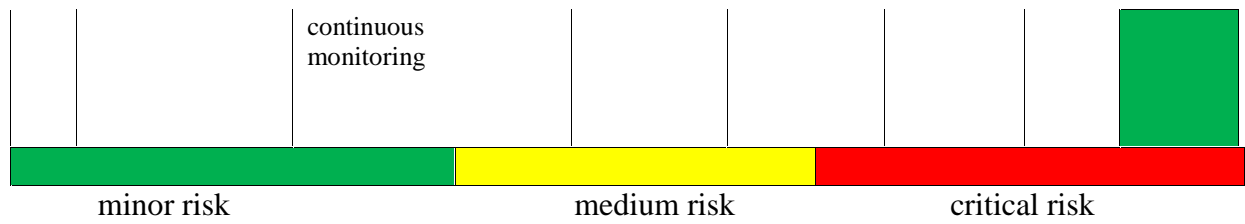
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and research are: business, knowledge management, intellectual capital, financial management, financial investments and bonds markets.

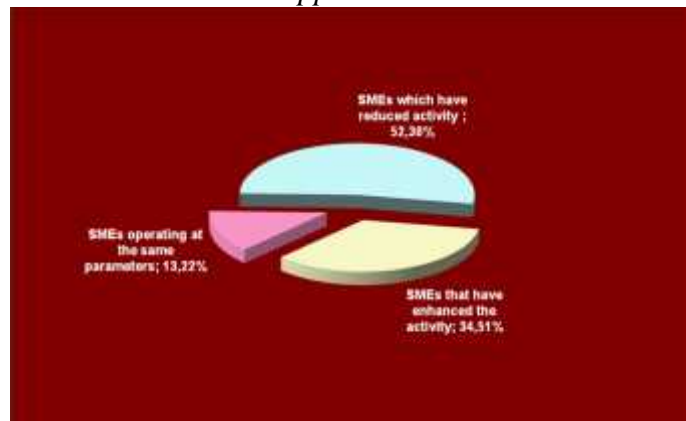
Appendix A

Table 1.
Table Risk Assessment

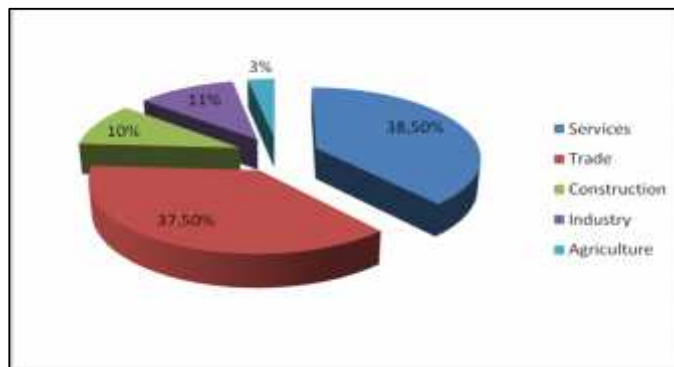
No.	risk name	risk description	risk type	impact factor [1-4]	probability [0-1]	risk factor	priority
1	Strategic risk	The occurrence of some unforeseen risks in the general strategy of the company, because of a lack of a risk strategy	Strategic	2	0,80	1,60	
2	The risk of major fluctuations in prices	The impact on the company's significant variations in prices and quantities of the raw materials	Economic	1	0,50	0,50	
3	The risk of disputes	Suing the company for various reasons	Strategic	2	0,50	1,00	
4	Economic environment risk	Risks due to changes in the local, national and European economic environment	Economic	2	0,60	1,20	
5	Credit risk	Major financial risks because of macroeconomics changes	Economic	2	0,35	0,70	
6	Funding risk	Risks from the lack of a long-term strategy on financing risk	Strategic	2	0,50	1	
7	The property risk	Risk due to possible disputes regarding the property	Operational	2	0,05	0,10	
8	Risk contestation procedures	Risks due to the failure in the organization and analysis of the employees' and / or customers' complaints	Operational	2	0,40	0,80	
9	Competition risk	Risk due to the increased competition and because of the lack of a competition	Strategic	1	0,50	0,50	



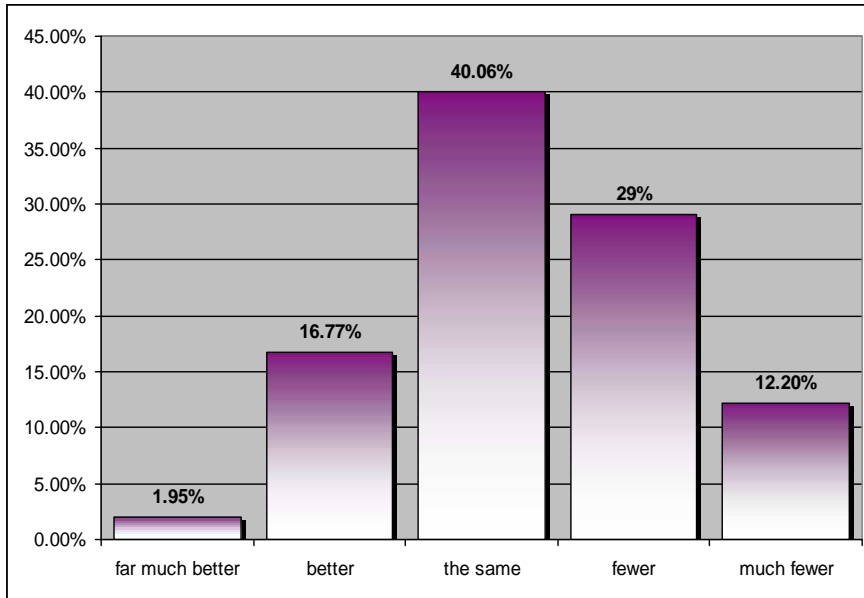
Appendix B



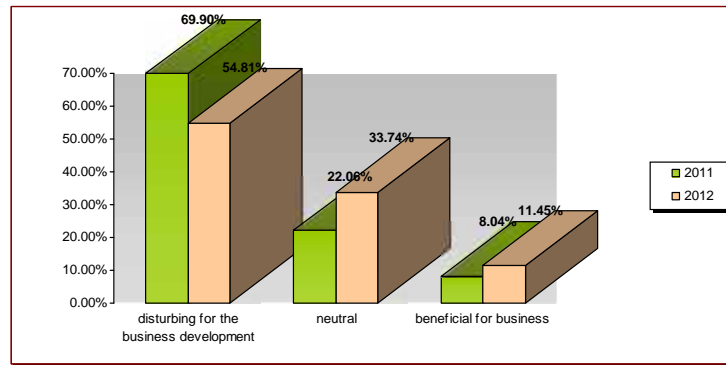
*Graphic 1. Dynamics of the surveyed SMEs between 2008-2012.
 (adapted to the data from the SMEs White Book, 2012, Editura Sigma, Bucharest)*



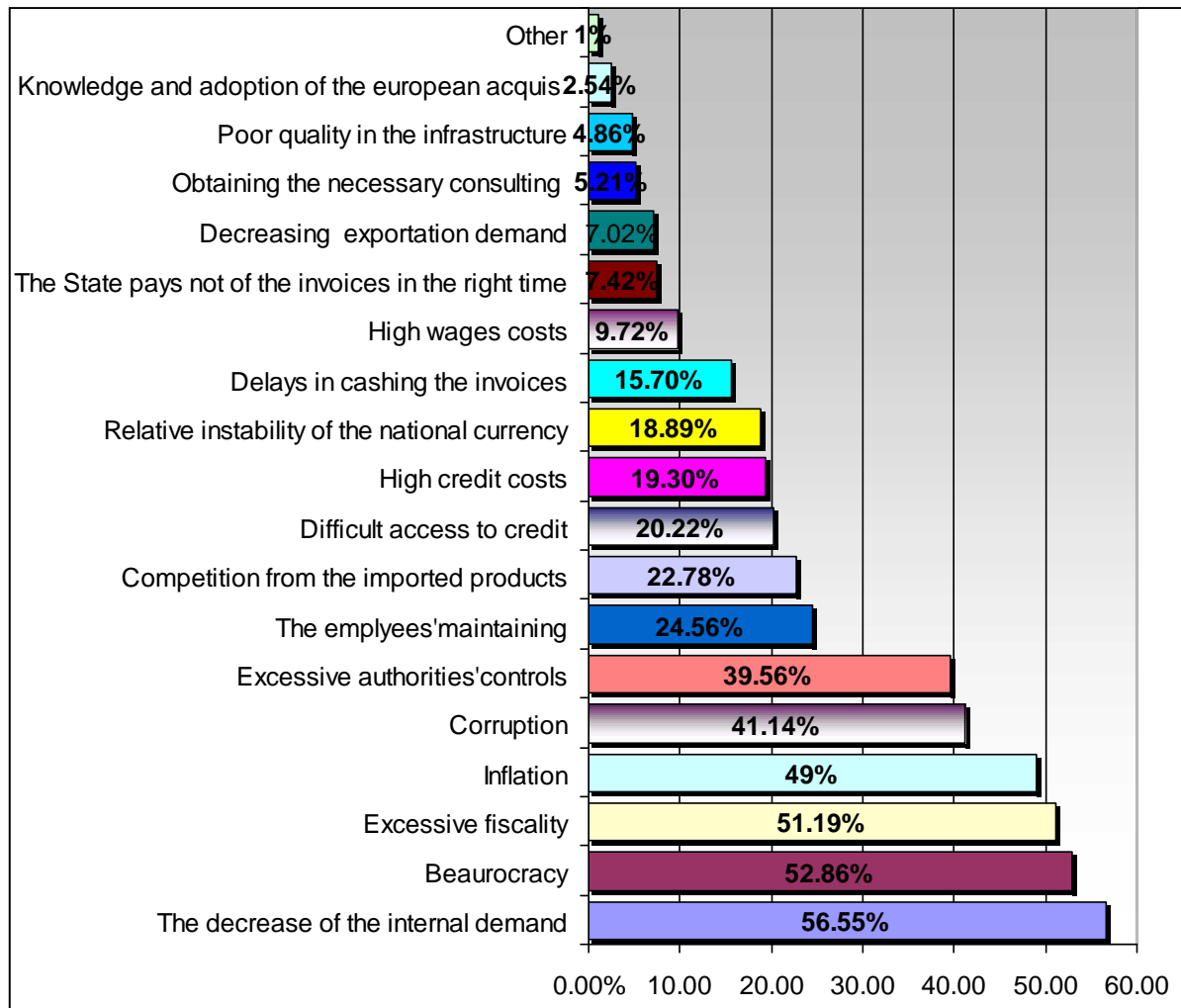
*Graphic 2. The distribution of the Romanian SMEs on fields of activity.
 (adapted from the data of the Forecasting National Commission, 2012)*



Graphic 3. The dynamics of the economic performances of SMEs in 2012 compared to 2011. (adapted from the data of the National Statistics Institute, 2012)

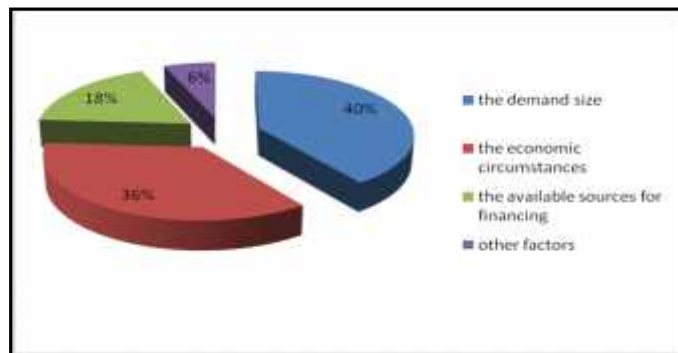


Graphic 4. The overall evolution of the business environment in Romania between 2011-2012. (adapted from the data of the European Commission (2011), Small Business Act Fact Sheet 2010/2011 Romania http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2010_2011/romania_en.pdf.)

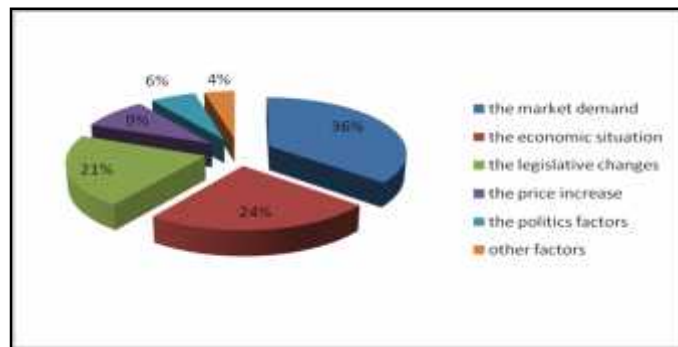


Graphic 5. The major difficulties the SMEs faced in the last 2 years.

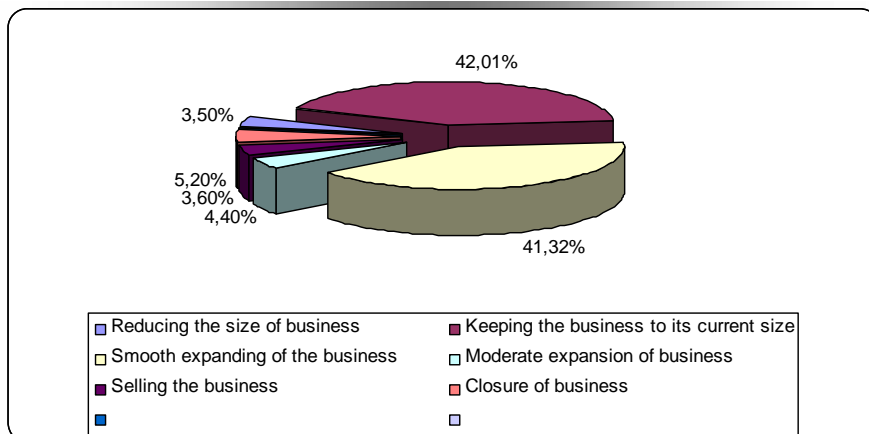
(adapted from the data of the European Commission (2011), Small Business Act Fact Sheet 2010/2011 Romania
http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2010_2011/romania_en.pdf.)



Graphic 6. The main factors influencing the turnover at the level of the local companies.



Graphic 7. The main factors influencing the employees' number in the local companies.



Graphic 8. The structure of the SMEs targets in 2014.