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*Gábor Hunya et al.*

## **An Assessment of the Access by Romanian SMEs to Structural Funds**

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Gábor Hunya is Research Economist at the Vienna Institute for International Economic Studies (wiiw). The report relies on joint work with the research team of the underlying project, Irina Dumitriu (Romanian Banking Institute, Bucharest), Réka Horváth (Faculty of Economics and Business Administration, Babeş-Bolyai University, Cluj-Napoca), Iuliana Klebeev (Project Consulting AGE, Bucharest) and Sascha Ruhland (Austrian Institute for SME Research).

This paper is based on the final report of a research project conducted with the financial support of the European Commission in the framework of the tender 'Access by Romanian small and medium-sized enterprises to structural funds and support mechanisms', Tender No. CCI 2009.CE.160.AT.062. Financing for this project, in an amount of EUR 90,000, came from the European Regional Development Fund. The opinions expressed are those of wiiw only and do not represent the Commission's official position.

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## **Summary**

*Romanian SMEs can directly benefit from the Sectoral Operational Programme 'Increase of Economic Competitiveness' (SOP IEC) and some parts of the Regional Operational Programme (ROP) in the period 2007-2013. Research commissioned by the Directorate General for Regional Policy of the European Commission made a strategic evaluation of SMEs' experience with these support programmes and their needs for support in general. This paper is the summary of the final report of the project carried out in the first half of 2010.*

*In the context of the research underlying this paper, a standardized survey was implemented as an instrument for collecting primary data on the situation, the demands of and the development barriers to Romanian SMEs. The results of the survey were verified in standardized interviews and focus groups with consultants and SME administrators. The results reflect first-hand information on the problems of SMEs with the implementation of EU funds.*

*The main findings of the project reveal that Romanian SMEs are at a rudimentary stage of skills, organization and market knowledge if compared with similar economic units in more advanced EU member states. Their development aims are rather short-term and not very complex. They lack the knowledge, expertise and staff to participate in complex tenders and in application processes. Learning by doing is, however, increasing their capacity to access external, including EU, funding.*

*Gaps were identified between the development needs of SMEs and the design of the support programmes. The needs of SMEs to increase their competitiveness cover a whole range of areas with very diverse objectives. Weighing the identified needs of SMEs against the key areas of intervention and indicative operations of the EU support programmes, one can conclude that most needs of SMEs are covered by the two current operational programmes in one way or the other. However, the way the support package was designed and structured is deficient in supporting the development of SMEs. SMEs need more simple and transparent mechanisms which they can understand and cope with. In addition, they need the support of competent consultants.*

**Keywords:** *SMEs, EU support programmes, Romania*

**JEL classification:** *D2, G3, H7, L2, R1,*





## **An assessment of the access by Romanian SMEs to structural funds**

### **1 Introduction**

Romanian small and medium-sized enterprises (SMEs<sup>1</sup>) have already gathered some experience with EU-funded programmes for the 2007-2013 financing period. These programmes are operational and can provide various forms of support to SMEs. But SMEs may not be in the position to access EU funds for several reasons, including lack of skills and collateral financing or inefficient support services. The aim of the project underlying this paper was to give a strategic evaluation of the business environment and of SMEs' capacities to access EU-financing and support services. The research team also identified the gap between the range of services offered under the EU Operational Programmes and the potential demand of SMEs. All the research was undertaken in a regional framework in order to point out the special problems of backward areas.

The **objective of this paper** is to report on the results of the comprehensive research project which assessed the business environment of SMEs in Romania and their competence in carrying out development projects in order to improve their competitiveness. For achieving this objective the research team undertook the following tasks:

- provide a comparison of the situation of SMEs in the European context, and by regions in Romania;
- survey and assess the development goals and support needs of SMEs;
- survey and assess the competencies and managerial skills of SMEs to see how far their problems are related to internal shortcomings;
- assess the supply of financial services, government and EU support schemes as well as the business support infrastructure and services together with the experience of SMEs with them;
- based on the survey results, assess the gap between the programmes offered under the EU support programmes and the needs of SMEs;
- assess the specific weaknesses of SMEs in drafting applications for funding.

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\* This paper relies on joint work with the research team of the underlying project, Irina Dumitriu (Romanian Banking Institute, Bucharest, Romania), Réka Horváth (Faculty of Economics and Business Administration, Babeş-Bolyai University, Cluj-Napoca, Romania), Iuliana Klebeev (Project Consulting AGE, Bucharest, Romania) and Sascha Ruhland (Austrian Institute for SME Research).

<sup>1</sup> SMEs are defined according to the EU definition ([http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm)) and as enterprises with less than 250 employees and EUR 50 million of turnover.

This paper follows the structure of the assessments listed above. In the final section it gives policy conclusions explaining the low rate of success of Romanian SMEs in attracting EU funds and their low rate of satisfaction with the current support schemes.

## 2 Main characteristics of SMEs in Romania

SMEs in Romania have some peculiar features if compared to their EU counterparts.<sup>2</sup> Some of these features, such as the relatively low density of SMEs, are due to general economic backwardness. Others have a historical background such as the relatively big weight of medium-sized and large companies in output and employment. The number of SMEs per thousand inhabitants in the non-financial business economy was 18.9 in 2005, less than half of the EU average. In the years of fast economic growth in Romania, 2005-2008, conditions were advantageous for setting up new business activities, boosting SME density to 23.6 per inhabitant<sup>3</sup>.

Romanian companies are somewhat larger than the average of the EU; 99.6% of them are SMEs (EU average: 99.8% in 2006). In Romania SMEs have a lower share in the national economy in terms of value-added and employment than in most other EU members (Table 1). These shares increased rapidly in the 2000s due to the restructuring of large state-owned enterprises, thus the weight of SMEs in employment rose to 71.4% in 2008.

Table 1

### Share of SMEs in the non-financial business economy, 2006, %

	Bulgaria	Hungary	Austria	Poland	Romania	EU-27
Number of enterprises	99.7	.	99.7	99.8	99.6	99.8
Value-added	53.2	51.9	.	48.4	49.6	57.7
Persons employed	72.6	72.2	.	69.8	63.6	67.4

Source: Eurostat, Enterprises by size class – overview of SMEs in the EU, Issue number 31/2008.

Another difference to the EU average appears in the size structure of SMEs. Micro-enterprises are relatively under-represented by all indicators compared with other EU members. This feature may have to do with the inherited firm structure – a structure that had been dominated by large socialist enterprises – and the path of transition, with economic policy measures trying to save some of the enterprises considered of key importance for the national economy.

<sup>2</sup> A set of the standard indicators (number of enterprises, turnover, persons employed, value-added, etc.) is available through Eurostat's 'Annual structural business statistics' (SBS). The most recently published data refer to 2006 (for some countries to 2005).

<sup>3</sup> National Institute for Statistics, Anuarul Statistic 2009.

SMEs in Romania are characterized by **low productivity and low profitability** (Table 2). Even before the current crisis, only half of the SMEs were profitable, more so the small and medium-sized SMEs than the micro-enterprises. While in Austria and Greece micro-enterprises are often highly specialized and innovative, in Romania low profitability may be the result of outdated technology. Although profit dodging is widespread in Romania, SMEs with investment plans and those relying on external financing cannot afford reporting losses.

Table 2

**Gross operating surplus per turnover  
(gross operating rate) (%) 2007, manufacturing**

Employment category	Greece	Hungary	Austria	Poland	Romania
1 to 9	25.2	8.4	26.9	18.2	9.6
10 to 19	10.8	9.2	17.3	14.1	8.7
20 to 49	10.1	9.8	11.9	13.5	10.1
50 to 249	11.2	9.3	10.5	13	10

Source: Eurostat structural business statistics.

The latest 'SME Performance Review' (SPR) of the European Commission, referring to the years before the current crisis, reports the following **peculiar features of Romanian SMEs**:

- starting a business is a relatively fast and uncomplicated process;
- SMEs in Romania have high survival and birth rates (but in 2009 the death rate went up considerably);
- one third of Romanian SMEs are supportive of the legislative framework for SMEs, which is above the EU average of 27% (Hungary 19%, Austria 22%, Poland 24%; the wiiw Survey outlined below shows a much lower rate of satisfaction);
- access to financing is somewhat more difficult in Romania than on the European average but similar to the situation in Hungary and Bulgaria;
- the evaluation of innovation puts Romania among the worst performing EU members;
- the high and growing regional disparities regarding GDP per capita in Romania are reflected in the density and performance of SMEs by region.

The correlation is strong between the density of SMEs on the one hand and the indicators GDP per inhabitant, unemployment rate, and urban and rural population on the other. The correlation is positive for GDP/inhabitant and the percentage of urban population. This means that for a higher GDP/inhabitant we have a higher density of SMEs and for a higher percentage of urban population we also have a higher density of SMEs. At the same time, there is a significant negative correlation between the density of SMEs in a certain region and the unemployment rate and the percentage of rural population.

Table 3

**Main characteristics of Romanian regions, 2007**

Regions	Density of SMEs per 1000 inhabitants	GDP/inhabitant RON	Employment rate %	Economic activity rate %	Unemployment rate %	Urban population %	Rural population %
NORD-VEST	26.7	18610	50.1	68.4	2.9	53.4	46.6
CENTRU	25.4	19579	47.2	68.8	4.8	69.6	40.3
NORD-EST	15.3	12341	55.4	75.0	5.1	43.4	56.6
SUD-EST	21.6	15642	47.9	67.8	4.4	55.3	44.7
BUCURESTI-ILFOV	54.3	43037	52.4	74.1	1.7	92.4	7.6
SUD-MUNTENIA	16.6	15758	52.1	73.8	5.1	41.6	58.4
SUD-VEST OLTENIA	16.4	15097	52.8	73.9	5.1	47.7	52.3
VEST	25.8	22342	50.8	71.9	3.3	63.4	36.6

Source: TEMPO-INSSE, March 2010 and Eurostat March 2010.

Administrative procedures and formalities represent a resource-consuming burden for SMEs. Another pressing problem is the mutual indebtedness of companies and especially the payment arrears of the public to the private sector. The general taxation rate of 28% of the GDP in 2008 was the lowest in the EU.<sup>4</sup> This leaves little room to speak of an excessive tax burden in Romania from the 'outside perspective'. SMEs claim, however, that taxes are too high, and this refers first of all to the social security contributions. In fact, Romania relies more heavily on indirect than on direct taxes, the social security contribution in particular is relatively high in EU comparison, and this gives companies the impression of over-taxation. The tax rate increased as of 1 July 2010<sup>5</sup> and the decline in GDP has had the joint effect of raising the fiscal burden to about 31% of GDP, which is considerably higher than two years earlier but still low in European comparison.

As a result of the current financial and economic crisis, profitability has declined and the number of SMEs going out of business increased. Most of the rest fight for survival. **Low profits constitute a serious problem** for future growth as retained profits and other own resources are the most important sources of financing. Also **own resources are very limited** in Romania as the net financial asset position of the population is very weak. The contraction of domestic demand, aggravated by fiscal austerity measures in 2010, necessitates a shift from the domestic market to exports. However, most Romanian SMEs depend solely on the domestic market and have no experience with selling abroad.

<sup>4</sup> Eurostat, Taxation Trends in the European Union, 2010.

<sup>5</sup> The fiscal measures include a mix of expenditure-side measures (cut of public employee salaries by 25%) and revenue-side measures (increase of VAT and tax on interests).

### 3 Main characteristics of the survey carried out in the framework of the project

In order to get an up-to-date view of the needs and capacities of SMEs in Romania the research team applied a **complex research methodology**. First, we went through the available literature and conducted interviews with SME representatives, consultant companies and public authorities at the national and regional level. Interviews were made, among others, with representatives of the national and several regional (județ) chambers of commerce and industry as well as of local business clubs and consultant organizations. Then, to assess the opinion of SME leaders, a standardized survey was implemented as an important instrument for the collection of primary data on the situation, the demands of and the development barriers to Romanian SMEs. The results of the survey were verified in standardized interviews and focus groups with consultants and SME administrators. These focus groups have been organized in the development regions. In addition, the major commercial banks working with SMEs were asked about their experience with SMEs in general and about their activities supporting SMEs in accessing EU funds. The results of the surveys, focus groups and interviews have been summarized and confronted with the aims, requirements and implementation practice of EU-funded projects. The gaps between the needs of SMEs and the EU programmes provided the basis for policy recommendations.

The companies targeted by the **wiiw Survey of March 2010** were about 3500 SMEs recorded on the disk 'Pro-Business Romania 2010' of the Romanian Chamber of Commerce and Industry as well as about 1000 micro-enterprises in the database of the regional operational programme. The company lists were cleaned to contain those SMEs that are eligible to support from EU Structural Funds, SOP IEC and ROP, based on their size, economic activity (not eligible are agriculture, trade and financial activities) and having a valid email address.

The response rate of about 9% was below expectation but shortcomings could be repaired in focus groups and consultations. The total number of responses was 372, of which those with incomplete and contradictory answers were deleted; the remaining 332 were subject to evaluation. The sample size may slightly differ in the case of specific questions. Beyond yes/no and multiple choice questions, also written comments were summarized.

The specific features of the survey sample ensure that the **answers are significant and representative** for the purpose of the project. As an important feature, none of the surveyed SMEs reported losses in 2008 and were thus able to access EU funds. The size structure of the sample deviates from the total population of SMEs by under-representing the micro-enterprises and over-representing the larger SME categories – an approach that is justified, first, by the structure of economic activities (manufacturing SMEs are larger than average), second, by the eligibility for structural funds and, third, by statistical necessity (adequate number of observations in each size category).

The distribution of the sample by economic activity is focused on those that are eligible for funding from the structural funds of the EU (Table 4). A small number of firms in the sample reported a non-eligible economic activity, but they could apply for EU funding as they had some secondary activity that made them eligible, thus they were left in the sample. The most important activities include manufacturing, other business services and construction. The main difference compared to the SME sector as a whole is that trade is widely under-represented and manufacturing is over-represented in our sample while financial activities, agriculture and mining are mostly missing.

Table 4

**SMEs by main economic activity categories, %**

	Manufac- turing	Const- ruction	Trade, hotels	Transport telecom	Finance, real estate, renting	Computer services	R&D	Other business	Health	Other
Sample	38.5	11.5	7.1	6.5	1.6	4.7	1.6	14.6	9.6	4.3
All SMEs <sup>1)</sup>	12.5	9.5	45.0	7.7	in other business	in other business	in other business	19.6	1.9	3.8

1) Active small and medium-sized enterprises from industry, construction, trade and other services.

Source: Anuarul Statistic, Table 15.8.

Table 5

**Regional distribution of the number of SMEs in the sample and in Romania, %**

Development Region	wiiw Survey sam- ple number	wiiw Survey sam- ple share	National share 2008 <sup>1)</sup>	SME number per 1000 inhabitants, 2008 <sup>1)</sup>	GDP per inhabitant 2007 % of EU27
Bucharest-Ilfov	21	6.4	23.6	53.6	92.2
Centru	45	13.6	12.3	24.9	42.2
Nord-Est	68	20.6	11.0	15.1	26.6
Nord-Vest	56	17.0	14.2	26.3	40.2
Sud-Est	39	11.8	11.7	21.1	33.8
Sud-Muntenia	28	8.5	10.6	16.2	34.2
Sud-Vest	23	7.0	7.2	16.2	32.7
Vest	50	15.2	9.4	25.1	48.2

1) Active local units from industry, construction, trade and other services by macroregion, development region, activity of national economy at level of CANE section and size class in 2008; population as of 1 July 2008.

Source: wiiw Survey sample, Eurostat and Anuarul Statistic Table 15.21.

The regional distribution of SMEs in the sample differs from the national mainly by lower representation of the capital district (Table 5). This fact is of advantage for the whole analysis as the most developed region would distort the results for the rest of the country.<sup>6</sup>

<sup>6</sup> The distortions of the survey underlying the White Charter of Romanian SMEs 2009 (National Council for Small and Medium-sized Enterprises in Romania – CNIPMMR, 2009b) are less advantageous, as Bucharest and the Sud-Muntenia regions are widely over-represented to the detriment of other regions.

Among the other regions, one less developed region is over-represented (Nord-Est) and also one of the more developed regions (Vest). Disregarding the capital region, the sample has an almost equal number of cases for the more and the less developed part of the country which ensures good representation of problems arising from backwardness.

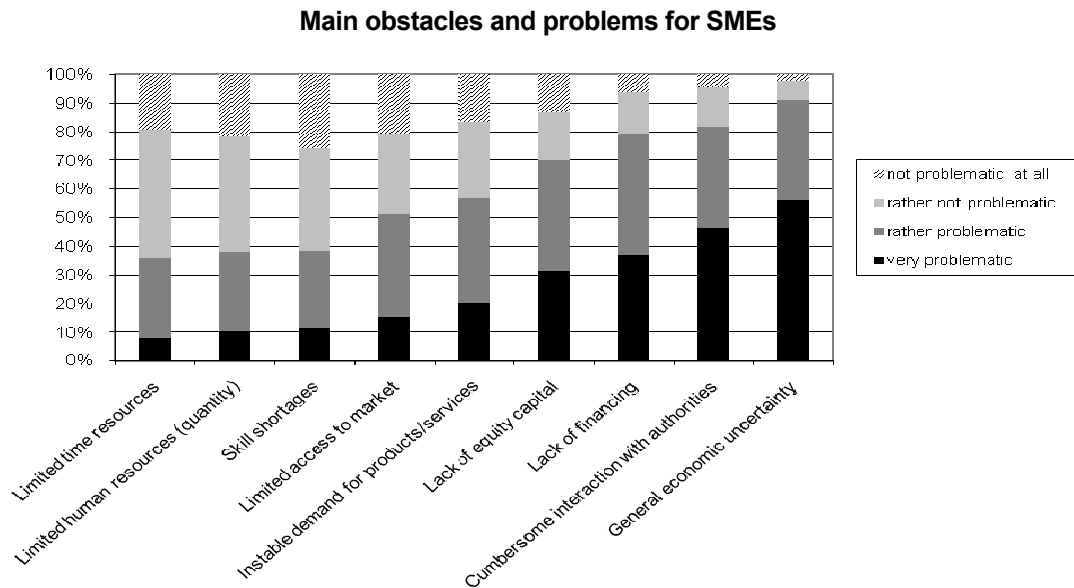
While the international comparisons found the situation of Romanian SMEs in the mid-field of Europe and dynamically improving, the wiiw Survey finds the situation and self-assessment of Romanian companies in 2010 less reassuring, in many ways highly problematic. This is the case despite the concentration of the survey on the more solid half of the SME population. One of the reasons for this discrepancy must lie in the changes of external conditions. The international comparisons refer to the period 2004-2007 when the Romanian GDP grew more than the EU average. The contraction of Romania's GDP in 2009 brought about a completely new situation, unexpected for SMEs and the government alike. The decline of GDP was deeper than the EU average, and the performance of 2010 was also worse than that of the other countries in the region. Therefore, **dissatisfaction among SMEs is increasing** and expectations for the future are not rosy.

#### **4 Demands of the business sector**

SMEs require a supportive business environment, efficient support services and business infrastructure as well as easy access to funding. In accordance, the research team assessed the needs of SMEs in three broad areas: the legislative framework, business support structures and the various forms of funding for development. Results reveal that under the current economic crisis the perceived main obstacles to development have shifted to those related to the economic climate, falling domestic demand, and difficulties in ensuring financial resources. As to the legal framework, remarks of the SMEs reveal that not the general conditions are problematic but the complexity and often contradictory nature of the regulations. Also technical procedures are found to be too cumbersome. **Both before and under the current crisis, SMEs demand lower taxation on wages, more efficient bureaucracy and less burdening state controls.**

When identifying obstacles to growth and competitiveness, SMEs put 'general economic uncertainty' and 'cumbersome interaction with authorities' in the first place (Figure 1). **In the general perception of SMEs, it is first and foremost the government that should take action to improve business conditions. In reality this is not the whole truth.** First of all, a significant part of the business circumstances are externally given, such as the exchange rate, energy prices or demand for products. Second and also importantly, SMEs can learn to adapt to circumstances, improve skills and cooperate with each other. There are support services available which foster such learning, and allow for cutting costs by cooperation.

Figure 1



Source: wiw Survey, March 2010.

While conducting the surveys and focus groups, the research team very often faced a sceptical attitude on the part of the SMEs to any possible improvement in government policy. This was frequently expressed by simply declining cooperation with the survey team. A reason for frustration is that in the official three-party consulting on new legislation SMEs do not feel properly represented. They **call on the government to listen to their needs**. They are mostly not aware that more efficient self-organization may improve interest representation.

**Lack to financing is perceived by SMEs as one of the main current obstacles to development.** As for future demand, almost all SMEs expect that the importance of financing will increase significantly or will at least remain unchanged. The rising demand for financing is related to the development plans of SMEs and their need to invest even in the current circumstances of economic and financial crisis. The levels of satisfaction with bank loans and equity financing are in the medium-high range. The main **reasons for dissatisfaction are the cost of financing** (high interest rates and commissions charged for bank loans), **inflexible loan eligibility criteria**, cumbersome analysis of credit applications and excessive collateral requirements. SMEs demand simpler procedures and tailored banking products. SMEs encounter also difficulties in accessing grants, still they have an understandable preference for freely available funds such as those under the EU programmes.

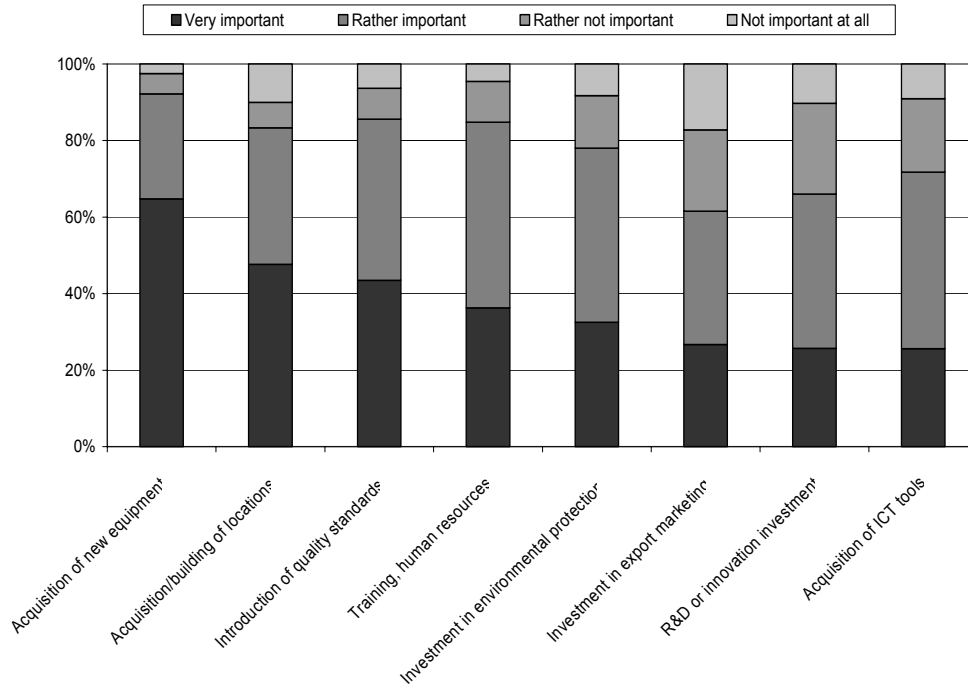
SMEs formulated the above demands for support with the aim to carry through development projects. These projects are rather simple and with a short-term perspective. SMEs do not intend to develop into innovative, exporting, high-technology companies. Innovation and R&D needs rank last in that regard (Figure 2). Most SMEs wish to simply survive or to expand the current activity by investing in new equipment or acquire a new company loca-



tion. Even the modest development goals of SMEs may fail if competences and skills of the management are insufficient.

Figure 2

**Investment priorities with regard to the future development of SMEs, % of respondents**



Source: wiiw Survey, March 2010.

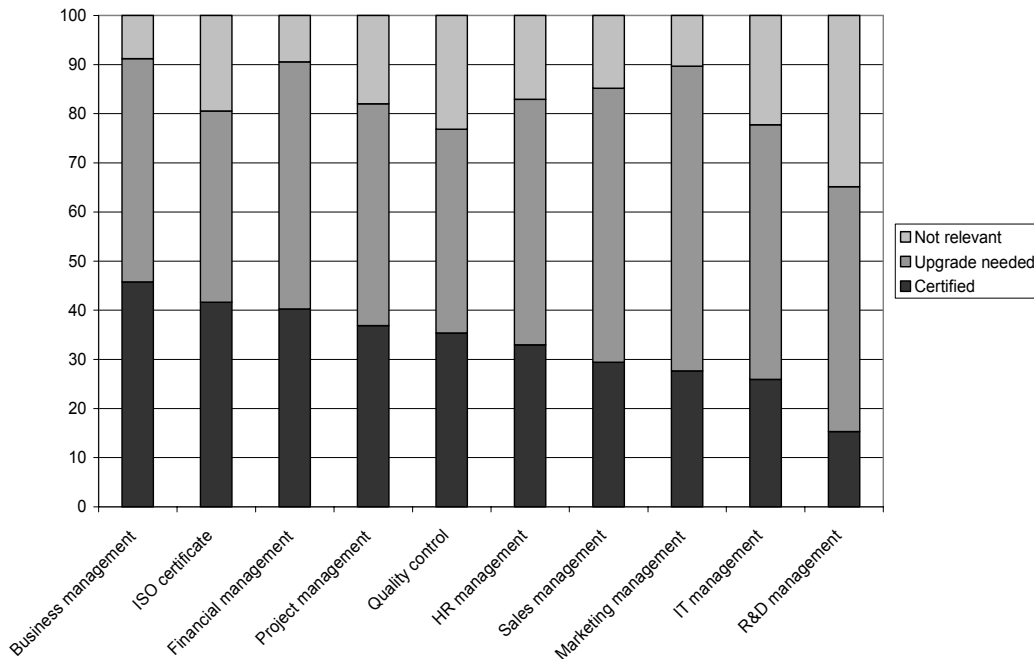
## 5 Assessment of managerial skills and competences

Skills and the ability to apply modern managerial methods are important in order to develop a successful enterprise; shortages of the right skills can be a hurdle at any stage of business development. SMEs tend to have fewer managerial resources and lack economies of scale. The most important skills in order to carry through development projects include the ability to think strategically, develop realistic business plans and demonstrate the ability to carry through projects. Some of these skills can be studied in the educational system, others can be trained in specialized courses and again others require learning by doing.

The certification of competences is based on the methodologies developed by the National Council for Adult Vocational Training, which at the same time is the National Authority for Qualifications. In accordance with these methodologies, business training providers may require authorization of their training curricula. Managers can receive diplomas in certified training courses at accredited institutions in various fields of management which are recognized at the national or international level.

Figure 3

**Areas in which the management of SMEs is certified or needs upgrade,  
% of respondents**



Source: wiiw Survey, March 2010.

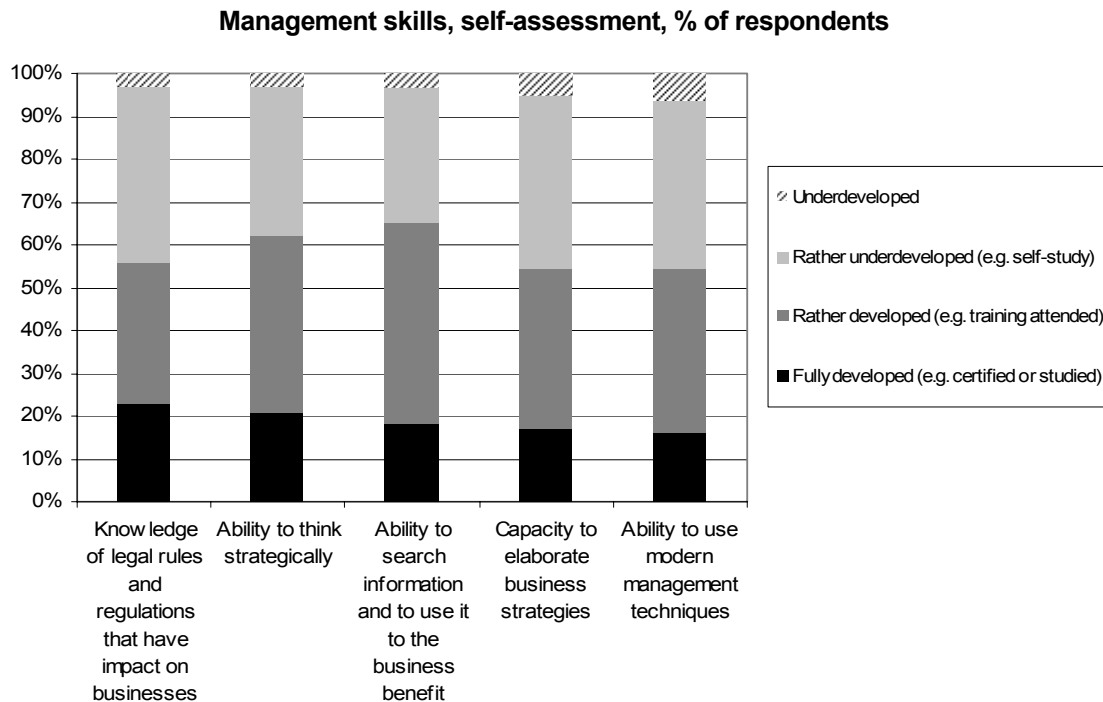
The **level of certified managerial competences of SMEs is low** in all areas of competences (Figure 3). However, most managers expressed the need to update or improve their management competences, particularly in areas such as marketing, sales and IT. It is worth noting that the area considered the least relevant is R&D management. This shows that most SMEs do not see innovation and R&D as a prerequisite for their competitiveness.

The self-assessment of **available key managerial skills** reveals that less than 20% of respondents assessed their managerial skills as fully developed; about 40% consider their skills as rather developed (Figure 4). The most developed skills are the ability to search for information and to use it to the benefit of the business. This illustrates the positive impact of the development of the information society. SMEs know how to find information if they do not possess the necessary abilities themselves. The most underdeveloped skills are the 'capacity to elaborate business strategies', the 'ability to use modern management techniques' and the 'knowledge of legal rules and regulations'. In fact these are the most important skills necessary for applying for funding.

At the same time, **strategic thinking seems to be relatively wide-spread in Romania**. Half of the surveyed SMEs base their activity on short-term development strategies (1-3 years), 19% on medium- and long-term ones, while in 26% of SMEs such strategies are currently under preparation. Only 4% do not have a plan or strategy at all. The high

frequency of planning shown by the wiiw Survey is due to methodological reasons: the survey disregards SMEs active in trade and is confined to the more successful SMEs. These strategic plans were often imposed by the necessity of applying for structural funds, were written by consultants and do not reflect the level of competence in the SMEs. In fact, **nearly one third of respondents consider the lack of experience as one of the main reasons for not applying for external funding.** This finding is supported by the survey result revealing the lack of certified competences in project and financial management.

Figure 4



Source: wiiw Survey, March 2010.

The lack of internal expertise also applies to a large extent to those firms which managed to submit applications for EU funds (46% of respondents, out of which 31% applied successfully and 15% unsuccessfully). **The proportion of SMEs that used external expertise for the application process is 66%**, out of which 44% exclusively and 22% not exclusively and relying also on internal expertise. External expertise is in general necessary for the application but relying on such expertise is by far no guarantee of success. In fact, the share of SMEs that did not rely on external support is higher in the case of successful than of unsuccessful applicants. The average success rate of applications to grant competitions is rather low, pointing to limited tendering skills and qualities.

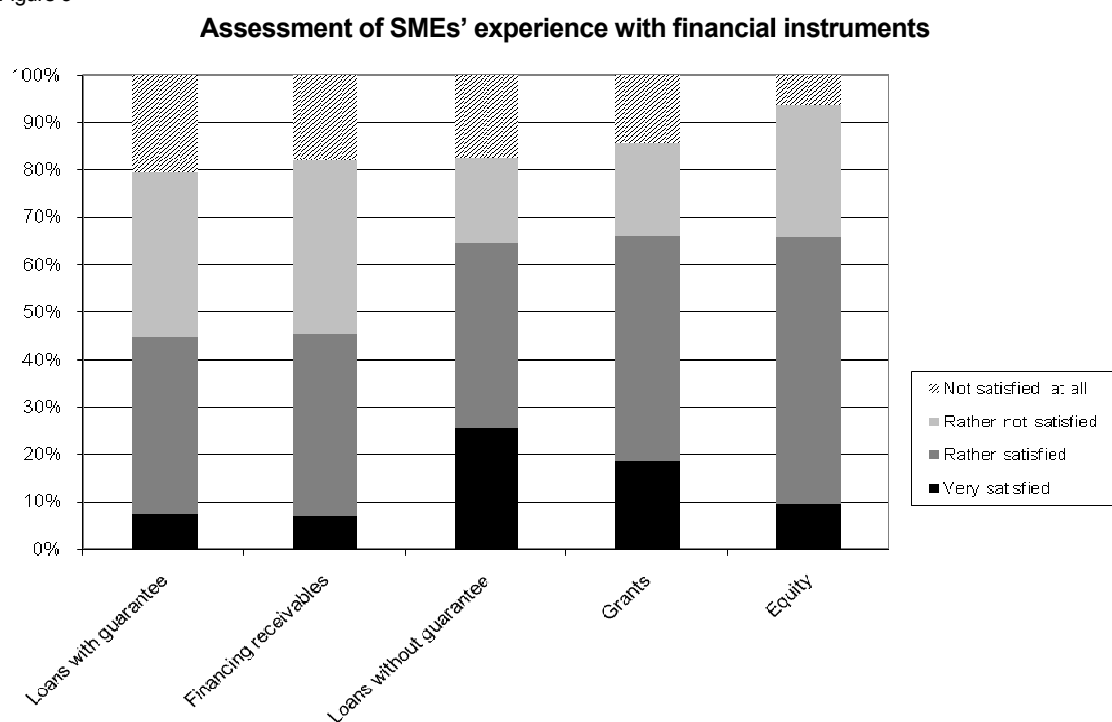
As most SMEs do not have their own staff skilled to write strategies and application documents, they **need a consultant but do not have appropriate criteria for selecting a good one.** Consultants are usually selected based on the fees, but those with the lowest fees are usually less experienced and less competent. If the project is not financed, SMEs

lose the fee paid to the consultant – or, what is even more frequent, in the case of a fee contingent on success, it is the consultant who risks no or very late payment of the fee.

## 6 Supply of financial services for SMEs

One of the most important external conditions to formulate and carry out development projects is financing. The research team assessed the available forms of financing to SMEs and the satisfaction of companies with the various forms of financing. It was found that the most important source of financing is represented by own resources. External financing is mainly confined to credits. Due to the specific characteristics of SMEs (high risk, low market experience), private financing is very expensive and financial institutions are less interested in assisting this sector. Public support in the form of credit guarantees, national public support and EU support are substantial but below the needs of SMEs. Only recently has the target market of credit institutions shifted to SMEs because the majority of the large corporations have already decided which financial institution they prefer to work with, but the SME sector is still in the course of establishing its banking preferences. Some banks initiated a campaign with products specially designed to meet the particular financing needs of the SME sector and this trend is expected to continue. Guarantee schemes for SMEs are effective and play an active role in the development of the sector, but there is still room for more private guarantee funds. Factoring, leasing and venture capital activities play a marginal role in financing SMEs and have even decreased during the crisis.

Figure 5



Source: wiiw Survey, March 2010.

While the demand for various grants, funds and guarantees is high, SMEs see many obstacles in accessing these instruments. They are critical of the requirements and procedures. They demand better, faster and less complicated access to funds.

The critical attitude is widespread but this does not mean that SMEs are altogether unsatisfied. When asked by the wiiw Survey about the level of satisfaction with various financial instruments used by SMEs (Figure 5), the highest level of satisfaction was expressed for the use of grants (66%), of equity financing (66%) and loans without guarantees (64%). (This, however, does not mean that they were very satisfied, but just that they were not dissatisfied.) In the case of those SMEs that used or are using loans with guarantees and those relying on financing receivables, more than half are rather dissatisfied or not satisfied at all (55%).

When asked about the **main reasons for dissatisfaction regarding loans**, SMEs pointed out that:

- the interest rates and commissions charged for bank loans are high, therefore the credit cost is high, making these funds prohibitive for both the financing of current operations and planned investments;
- inflexible loan eligibility criteria, cumbersome analysis of credit applications, excessive collateral requirements in comparison to the loan value, non-negotiable credit agreements with many hidden traps are problems – thus banking costs cannot be planned.

Also the Romanian National Bank reported that after September 2008, increasing costs of financing are among the main factors that caused the decline of domestic demand for corporate credit, regardless of companies' size.<sup>7</sup>

## **7 European Union and Romanian government support for SMEs**

SMEs can directly benefit from the Sectoral Operational Programme 'Increase of Economic Competitiveness' (SOP IEC) which is one of the seven instruments under the convergence objective for achieving the priorities of the National Strategic Reference Framework. SMEs are also the target of parts of the Regional Operational Programme (ROP) the objective of which is 'to support and promote a sustainable balanced economic and social development of the Romanian regions by improving business environment and infrastructure for economic growth'. Support goes mainly to infrastructure and projects to improve the physical, human and social conditions but also micro-enterprises of local and regional importance can access funding.

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<sup>7</sup> 'Report on financial stability', National Bank of Romania, 2009, p. 71 (analysis based on information available as of 31 May 2009).

Priority Axis 1 of the SOP IEC is targeting SMEs directly. The Framework Document (Ministry of Economy and Finance, 2007) outlines for what purposes SMEs can receive funding in the following Key Areas on Intervention (KAI):

KAI 1.1 finances productive investments including

- small investment projects;
- large investment projects;
- introduction of international standards;
- access to new foreign markets;
- technical assistance, consultancy support to improve the efficiency of companies.

KAI 1.2 offers access to leveraged financing (JEREMIE) (not functional yet).

KAI 1.3 finances business support services such as competitiveness poles, consultation, clusters.

SMEs are also eligible for the following Indicative Operations in the SOP IEC:

- 2.3.1. support for high-tech start-ups and spin-offs;
- 2.3.2. development of R&D infrastructure in enterprises and creation of new R&D jobs;
- 2.3.3. promoting innovation in enterprises;
- 3.1.1. supporting access to internet and to connected services;
- 3.3.1. support for integrated ICT business systems and other electronic business applications;
- 3.3.2. sustaining the development of e-commerce systems, and other internet-based solutions for businesses;
- 4.2. valorization of renewable energy resources for producing green energy.

The ROP segments available for the enterprise sector aim at setting up enterprises, rehabilitating industrial sites, supporting micro-enterprises and developing tourism. Priority Axis 4 of the ROP, 'Strengthening the regional and local business environment', includes three key areas of intervention:

- 4.1 development of sustainable business support structures of regional and local importance,
- 4.2 rehabilitation of unused polluted industrial sites and preparation for new activities,
- 4.3 support for the development of micro-enterprises.

While the first two areas improve the local and regional business infrastructure, the third provides support directly to the smallest SMEs in activities such as manufacturing, construction and business services. In addition, ROP Priority Axis 5, 'Sustainable development and promotion of tourism', the key area of intervention 5.2 'Setting-up, development and modernization of the tourism infrastructure' can address SMEs among other eligible entities.

A large number of projects were submitted under the operations addressed to SMEs within both programmes by mid-2010. The total budget claimed by the submitted projects has been well above the amount allocated for the support of SMEs. This proves that companies are interested in the financing opportunities offered by the EU. But successful applications have been rare. The amount of funds approved and contracted has been only 4.3% of the claimed project value (Table 6). The poor results are due to the inefficient and long project assessment process and to the weaknesses of SMEs in writing proposals that meet the requirements imposed by the managing authorities. The latter aspect will be subject of the main part of this paper.

Table 6

**Value and number of projects submitted and contracted in the SOP IEC  
by development region (31 June 2010)**

	Total	Sud	Sud-Est	Sud-Vest	Vest	Nord-Vest	Nord-Est	Centru	Bucuresti-Ilfov
Value of projects submitted, RON million	19985	1407	1717	2293	8262	1771	1353	1832	1350
Value of projects contracted, RON million	868	112	229	105	85	94	15	122	106
Number of projects submitted	3750	377	387	316	302	617	542	721	488
Number of projects contracted	929	91	95	98	61	139	142	176	127

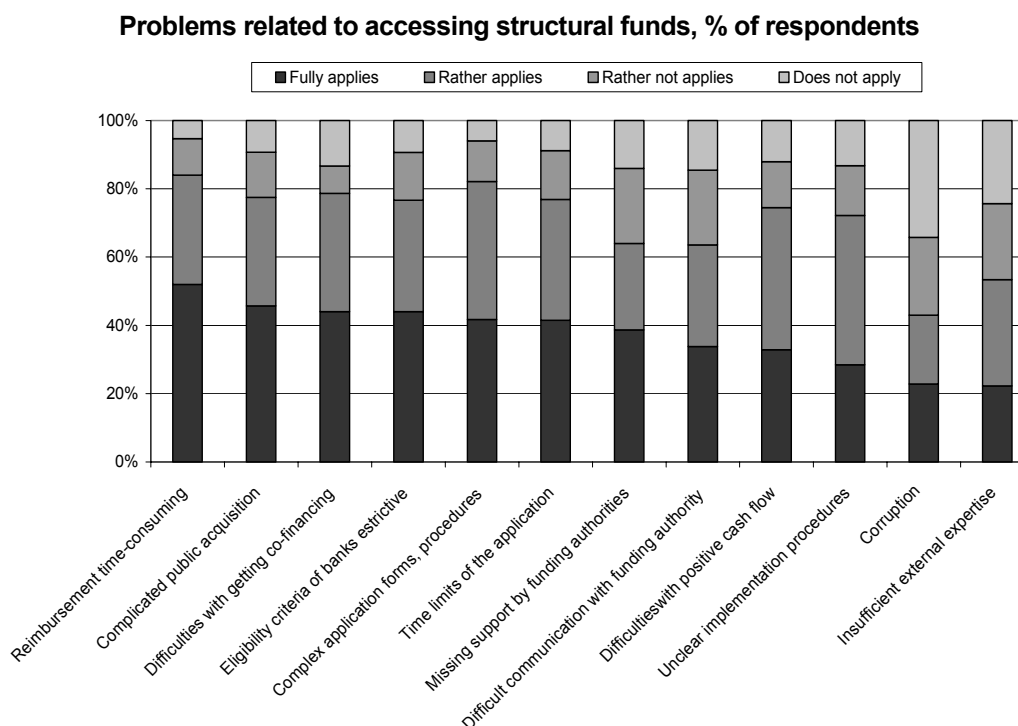
Source: Managing authority for the SOP IEC.

**The main difficulties and problems** SMEs face during the application process and project implementation are ranked as follows (Figure 6):

- reimbursement procedures are time-consuming (84% of respondents): in most cases the reimbursement period exceeds even the period mentioned in the funding guidelines and financing contract, which is considered to be too long anyway;
- it is difficult to cope with complex application forms and procedures: 82% of respondents consider the application forms and procedures too complex (42%) or rather complex (40%);
- obtaining the financial resources to co-finance the project: 79% of SMEs think that it is too difficult or rather difficult to obtain co-financing;
- public acquisition procedures are complicated (78%);

- the eligibility criteria for financial support are too or rather restrictive (77%);
- time limits in the application process (77%);
- difficulties in ensuring a positive cash-flow (75%): only 12% of SMEs think that a positive cash-flow during a project's implementation is not a problem at all;
- the implementation procedures need to be clarified (75%);
- corruption is considered to be a major problem by less than half of SMEs (42%).

Figure 6



Source: wiiw Survey, March 2010.

The representatives of the Management Authorities for ROP and SOP IEC confirmed on various occasions that SMEs encounter difficulties in obtaining financial resources to co-finance their projects. Because of this, about 20% of micro-enterprises and 13% of small and medium-sized enterprises – beneficiaries of first call for proposals from 2008 – gave up the projects' implementation.<sup>8</sup> On the other hand, representatives of banks opine that for those potential beneficiaries of EU funds who lack own resources to finance a project it is necessary to initiate discussions with the banks in the early stage of preparing the project. 'Many firms were stuck after the project was approved by the Management Authority, due to the problems encountered at the bank: insufficient guarantees, oversized projects or inadequate structure of the project; as a consequence, some firms were forced to abandon the project implementation.'<sup>9</sup> Another problem is the lack of correspondence be-

<sup>8</sup> Statement by the Management Authority of SOP IEC at the conference organized by Ziarul Financiar on 5 March 2010.

<sup>9</sup> Ramona Ivan, Executive Manager, BCR, March 2010.



tween the eligibility criteria asked for by the Management authorities and those required by the banks.

Consulting both with SMEs' managers and banks reveals that **SMEs' request for more funds in the form of grants and other leveraged funding is not always justified**. SMEs often lack the required projects based on real market demand. Still, EU structural funds could be a viable alternative to domestic financing. However, these funds also need co-financing from banks or own resources, and at present meeting the co-financing needs appears to be a larger problem than benefiting from the EU funds.

**National support programmes to SMEs play a much smaller role than EU-financed projects** but the two sources of financing complement each other. The Romanian government has developed several national multi-annual programmes to grant direct support from the budget of the responsible ministry to SMEs aiming at improving their competitiveness.<sup>10</sup>

1. support for the handicrafts and traditional arts;
2. development of entrepreneurial skills for young people and facilitation of their access to finance a start-up – START;
3. development of Entrepreneurial Culture of Women Managers of SMEs;
4. development and modernization of supply chains for products and services delivered by SMEs;
5. TINCOOP – organization of the national fair of co-operatives (cut in 2009);
6. TIMM – organization of the national fair of SMEs (cut in 2009);
7. UNCTAD-EMPRETEC Romania – support for the development of SMEs (expired in 2009, funds were included in START to finance training courses for SMEs);
8. support for the development of SMEs by covering the tax paid for reinvested profits (terminated as reinvested profits became exempt from taxes);
9. setting-up and development of business incubators;
10. support for business ownership transfer;
11. support for SMEs' access to training and consultancy services;
12. support for start-ups and development of SMEs.

In 2010 the budget of these programmes was reduced by 27% against the previous year. In 2009, only 16% of the number of applicants concluded the financing contracts; more

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<sup>10</sup> See Ministry for SMEs, Trade, Tourism and Liberal Professions, 'Ghidul surselor de finantare pentru IMM' (Guide for SMEs financing sources), November 2007.

than 19% of those who signed the contracts cancelled them and more than 25% of them renounced to take the entire financing. Also in 2010 the access conditions were improved as co-financing requirements were set lower. For start-ups the co-financing went down from 49% to 30% and for craftsmen from 30% to 10%. In addition, to facilitate the access to finance, the managing authority (AIPPIMM) has signed contracts with banks and the National Guarantee Fund for SMEs. Assessing the government support programmes one finds positive reactions from SMEs but also several critical points related to the size and the way to access them. Criticism expressed by applicants concerns the lack of transparency in the selection procedure and difficult conditions for implementation:

(wiiw Survey):

- authorities change the rules during the project implementation;
- there is a lack of cooperation between authorities;
- there are some contradictions between the rules specified in guidelines and the legislation;
- the evaluation process of the submission folder takes too long and the investment opportunity may become redundant meanwhile.

## **8 Business infrastructure and business support structures to support SMEs**

Modern business infrastructure and business support structures may enable SMEs to solve some of their problem with setting up and implementing development projects. In Romania such establishments are still rare. Since 2000 there have been various international support programmes for incubators, industrial parks and clusters which led to a certain development in this field. The investment projects of companies in industrial parks have benefited from a specific state aid and support scheme since 2007 (Ordinance No. 296/2007 of the Ministry of Administration and Interior). The incentives include exemption from the building and land tax and from the tax for the modification of land use. To assess the success is rather difficult as there is currently no official register of the existing industrial and technology parks, business and technology incubators, etc.

The government's incubator programme started with three entities, another four are to be developed. The more developed regions (Centru, Vest, Nord-Vest) can benefit from a higher number of such structures. According to information from the internet portal on incubators<sup>11</sup>, the total number of business and technological incubators is 52, of which 48 are functional. Assessments reveal that most business incubators lack resources as well as managerial experience and provide low quality of support services. But there are also examples of internationally well-connected and innovative incubators. One of the most successful of those is located in the Sud Vest Oltenia region (IPA CIFATT Craiova). Another successful incubator is located in the more developed Vest region: the Timisoara

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<sup>11</sup> <http://www.portalincubatorimm.ro/incubatoare>

Software Business Incubator supports companies which are specialized in software development.

The number of **functional industrial and logistics parks** is 91, of which 48 are accredited as industrial parks according to Government Ordinance 65/2001 and have a total surface of 1600 ha. They are concentrated mainly in the Sud-Muntenia (in the vicinity of Bucharest) and Centru regions and are located mainly at existing industrial platforms or dismantled military camps (brown-field parks). According to the executive manager of the Association of Industrial Parks of Romania, the occupation level is about 90-95% in brown-field parks and 65% in green-field parks. Usually the companies are interested in being located in such establishments because of the fiscal incentives they receive, the good access to utilities and the proximity to transport infrastructure. Nevertheless, **many industrial parks have structural deficiencies** (location, design and structure are inadequate), their development is not based on market demand and managerial expertise is lacking. The strategy of most parks targets foreign investors and it is not known how many of the companies settled in the parks are SMEs. Very few SMEs are established in the parks but those that settled there expressed in interviews their satisfaction with the services of the parks.

The location of the 48 accredited industrial parks shows significant discrepancies at the regional level.<sup>12</sup> They are concentrated mainly in the Sud-Muntenia (in the vicinity of Bucharest) and Centru regions and are located mainly at existing industrial platforms or dismantled military camps (brown-field parks). The most successful industrial parks are in Craiova (Sud-Vest region) and Cluj (Nord-Vest region), due to the large foreign investment projects of Ford and Nokia. As is often the case, a large pilot project attracted further investors but rarely local SMEs.

In order to obtain economies of scale, to improve the use of resources, to foster innovation and thus increase productivity, companies with similar or linked activities may form clusters, creating new and complex organizational structures which are beneficial for both the member companies and the region where they are located. **Clusters of various forms** are part of the government's R&D and innovation policy. Various programmes are based on EU initiatives and last as long as external financing is provided. According to the INNOVA country report on Romania<sup>13</sup>, poor infrastructure seems to be the biggest barrier to the country's cluster policy but also poor coordination and lack of responsiveness to demand are important problems. According to the European Cluster Observatory<sup>14</sup> Romania is well-

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<sup>12</sup> Ministry of Administration and Interior website,  
<http://www.mai.gov.ro/Documente/Dir%20pt%20zone%20asistate%20si%20ajutor%20de%20stat/PROPRIETARI%20TERENURI%20PARCURI%20INDUSTRIALE.pdf>.

<sup>13</sup> <http://www.europe-innova.eu>

<sup>14</sup> [http://ec.europa.eu/enterprise/policies/innovation/facts-figures-analysis/european-cluster-observatory/index\\_en.htm](http://ec.europa.eu/enterprise/policies/innovation/facts-figures-analysis/european-cluster-observatory/index_en.htm)

positioned among the European countries from the point of view of 'natural' bottom-up clusters.

The business support services cover the whole country, but there are **important discrepancies at regional level** regarding the range and quality of services provided. The strongest providers of services are concentrated in the more developed regions (Vest, Nord-Vest and Centru), while in less developed regions (Sud-Est, Sud-Vest, Nord-Est) the offer is quite poor. In terms of number of companies, more than 40% are located in the Bucharest-Ilfov region, followed by Nord-Vest and Centru region, while in Sud-Vest there were only 4% of the consultancy companies in 2008. The discrepancy is even higher from the point of view of turnover: in Bucharest-Ilfov the consultancy companies registered 63.4% of the total turnover, while for the other regions that percentage is much lower. Vocational training providers and training programmes are also concentrated in the Bucharest-Ilfov region, the lowest shares are found in the Vest region, followed by Sud-Muntenia and Nord-Est, Sud-Est and Sud-Vest.

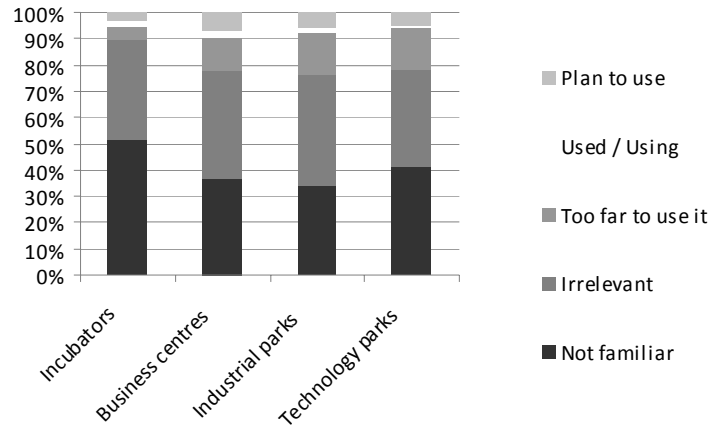
Each region has some strong natural industrial clusters, but only in sectors with low technological level. Several programmes exist at the national, regional and sectoral level, but there is lack of coordination among them. The best officially acknowledged clusters are concentrated in the Centru, Sud-Muntenia and Vest regions. Those few clusters which are assessed by the Europe INNOVA Cluster Mapping Project received good marks in the European comparison. Technology transfer from R&D to companies is poorly accomplished by the accredited organizations. The most recently identified potential clusters that belong to industries with high technology may increase competitiveness in the Sud-Vest, Sud-Est, Nord-Vest and Centru regions. **The wiiw Survey revealed that SMEs are rarely familiar with, or rarely use business support services but demand more of them especially in the less developed regions.** 35-50% of the SMEs, depending on the type of the enterprise, are not familiar with business infrastructure establishments such as business incubators, technological and industrial parks, and business centres (Figure 7). A large part of those that claim to be familiar with one or the other service declare that those are irrelevant for them. To some extent these SMEs may simply lack information on how these services could be used to their benefit. The most unknown type of business infrastructure is the business incubator, unknown to 51.7% of SMEs.

More than one third of SMEs which are familiar with business infrastructure consider the services offered by these as irrelevant for their business (37.5% for technological parks, 37.8% for business incubators, 40.9% for business centres, 42.3% for industrial parks). This may reflect that the support these organizations offer does not fit SMEs' needs. Geographic accessibility may not be the core of the problem as only a small number of SMEs declare that business infrastructure is located too far from their business headquarters.

The share of SMEs using or intending to use business infrastructure is also extremely low. Only 2.8% of SMEs are using business centres and 2.2% industrial parks. The other categories of business infrastructure are used even less. As for the future, SMEs intend to use these structures more intensively than they do at present: business centres 7.1% of SMEs, industrial parks 5.6%, technological parks 5% and business incubators 3.4%.

Figure 7

Level of familiarity with and use of business infrastructures, % of respondents



Source: wiiw Survey, March 2010.

The conclusion concerning business infrastructure is that SMEs are poorly informed about the existence and availability of such services and also about the benefits arising from being hosted in such infrastructure. A possible explanation of this situation could be the **'lack of visibility' on the offer side and the lack of effectiveness of promotional activities** applied by service providers to reach potential users. In fact, most of the industrial parks target foreign investors, primarily larger investments. Also the cost of settling in the parks may be too high for SMEs. Lack of demand on the part of SMEs may further be associated with the lack of suitable offer. In case SMEs understand the advantages of such support structures, they consider using them.

As to the **offer of providers of business support services**, this has strongly increased since 2000. The number of companies providing services to enterprises rose from 42,510 in 2005 to 57,190 in 2007 when the total turnover was RON 28.8 billion or 5.6% of GDP. Enterprises providing 'IT and related activities' accounted for the largest part (24.7%) of the total turnover, while business consulting ranked third after architectural services with 22.0%. The financial and economic crisis has also hit the Romanian consultancy market. At the end of 2009, 50% of the management consultancy companies registered a decrease of their turnover and in the case of more than 70% of these companies the turnover went down by more than 10%.

Assessments of the service providers revealed a number of shortcomings. Consultancy companies, generally SMEs themselves, do not have sufficient financial resources for growth. Due to their size they cannot compete with foreign companies, participate in large consultancy tenders or in international projects. Their services are not structured by size or economic sector, or tailored to the individual needs of the various categories of SMEs. The vocational training market reacts only to the short-term needs identified according to the requests of the labour force and employers. There is a lack of financial resources of training providers, and also the quality of the training programmes needs to be improved. Participation in vocational training courses is low, as participants have to pay for it and many courses are found to be too time-consuming and not efficient enough. Many services are supplied in a cooperation of the local or central public administration, private consultancy or training companies and freelancers in a not well coordinated way. Complex development centres for SMEs were set up by foreign donor programmes in the past, but most of them have not been able to survive.

SMEs demand more appropriate support services. The highest present or intended use is measured in the case of consultancy services with more than 70% of respondents, and the chambers of commerce with about 50% of respondents. Fewer companies are using the services offered by professional associations, and very few rely on clusters. Chamber of commerce representatives declared that their organizations try to adapt the services to business environment needs.<sup>15</sup> For example, some chambers of commerce have started new consultancy services.<sup>16</sup> Despite these efforts, SMEs have largely remained unsatisfied. The opinion expressed by the management of the Chamber of Commerce and Industry of Romania is that one reason for the negative assessments might be that enterprises often use too simple criteria in searching for external advice or that they do not have a clear idea of what they are looking for. Also, an unclear communication of needs and expectations by enterprises can lead to dissatisfaction.<sup>17</sup>

## **9 Regional assessment of findings**

The statistical analysis based on the weighted results of the wiiw Survey shows that the impact of belonging to a region (regionality) is strongest regarding the use of EU funds and regarding the involvement of SMEs in R&D projects. Less strong regionality appears as regards the use of some services, e.g. of the chambers of commerce and of industrial parks. The assessment does not show any large impact of regionality related to the legal and administrative circumstances, corruption, access to finances in general, use of training and also in terms of management skills.

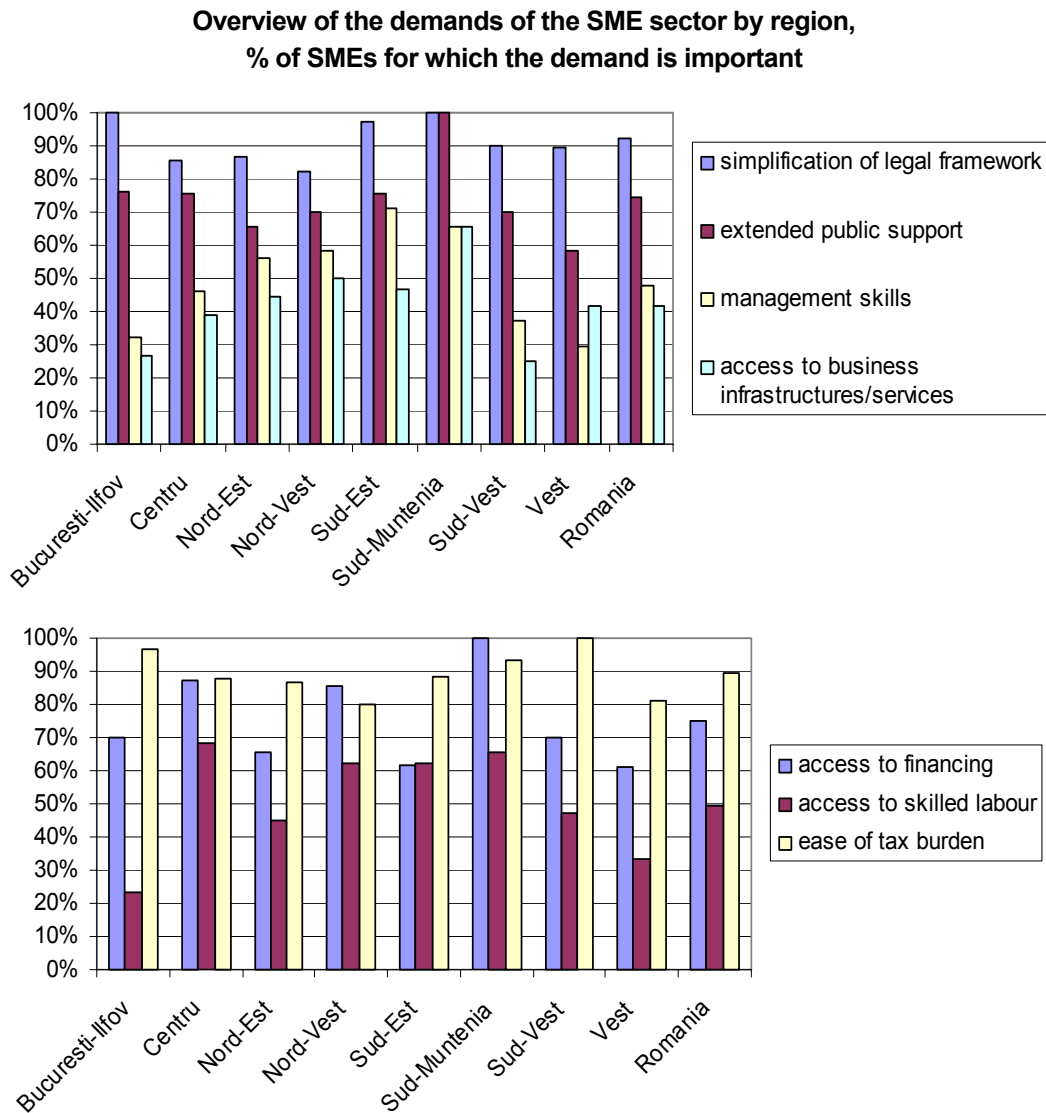
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<sup>15</sup> *Together for your business*, No. 5, Chamber of Commerce and Industry of Romania, October 2009, p. 16.

<sup>16</sup> *Together for your business*, No. 6, Chamber of Commerce and Industry of Romania, January-March 2009, pp. 5 and 7.

<sup>17</sup> Interview with Cristian Tanasoiu, Director of the Chamber Practices Department, April 2010.

Figure 8



Source: wiw Survey, March 2010.

**The regional dimension is unevenly important for individual demands of SMEs** (Figure 8). As for easing the tax burden, this demand is shared by 80-100% of SMEs in each region. SMEs close to the country's political centre, in Bucharest-Ilfov and in Sud-Muntenia, seem to be more mobilized in this respect than SMEs in the rest of the country. The demand for public support is lowest in the Vest region and highest in Sud-Muntenia, which is in accordance with the different needs in regions at a higher and lower level of development respectively, but other regions do not fit into this pattern. The demand for higher managerial skills is more relevant in regions at a lower level of development. More developed regions show higher skills levels and less demand for developing skills. Access to business infrastructure and services is of highest demand in Sud-Muntenia and also higher in other more developed regions than in less developed ones.

**Of all the development regions, Sud-Muntenia stands out with the most pronounced demands.** This is particularly striking in comparison to the neighbouring Bucharest-Ilfov region, which is among the best equipped regions in every respect and SMEs do not voice strong demands here. Among the other less developed regions, Nord-Est, Sud-Vest and Sud-Est lack well-defined characteristics concerning demands of the business sector. In particular, SMEs in the Nord-Est region fail to formulate strong demands. SMEs in the Sud-Est region are more often demanding public support than the average. One reason why the problems of backwardness in specific parts of the country are insufficiently articulated may be that the regions in Romania are large and internally heterogeneous.

**Private funding is available to SMEs in all regions,** but there are differences in the frequency companies use one or the other facility (Table 7). However, the differences are not systematic and not correlated with the level of development of one or the other region.

Table 7

**SME financing by development regions: % of companies of total respondents in the region (multiple choice allowed)**

Financing sources	Development regions							
	Nord Est	Sud Est	Sud-Muntenia	Sud Vest	Vest	Nord Vest	Centru	Bucharest-Ilfov
Own resources	60	75	77	47	77	68	56	76
Bank loans	61	58	48	54	39	54	42	43
Leasing	29	40	38	29	20	18	46	29
Equity issue on the capital market	0	3	0	4	0	1	0	0
Non-reimbursable funds	7	4	5	15	4	14	12	4
Loans from non-banking financial institutions	1	1	2	5	1	5	3	2
Factoring	4	1	0	9	0	3	0	3
Guarantees from the Romanian SMEs Guarantee Fund	5	4	2	1	0	3	3	3

Source: Processed by the Romanian Banking Institute from: *White Charter of Romanian SMEs*, National Council for Small and Medium-sized Enterprises in Romania (CNIPMMR) (2009b).

The regional distribution of EU funds allocated until July 2010 reveals that a more important share of the allocated funds in SOP IEC will be spent in the more developed regions rather than in the less developed ones (Table 6). The capacity of the less developed regions to access funds is limited especially in the Sud region. On the other side, the most developed regions such as Bucuresti-Ilfov, Centru and Nord-Vest take an overproportionate share of the allocated funds. **The result of the first calls under SOP IEC is contributing to deepening the competitiveness disparities between the development regions.** As to the projects under the ROP, here the regional allocation of funds had been



done before the calls following regional equity goals. Thus it is mainly a matter of time that SMEs in the backward regions can get access to the funds.

## **10 Discrepancy between the conditions of EU support programmes and the needs of SMEs**

After having assessed the various needs of SME, the research team weighed the SMEs' development requirements against the support offered to them under the SOP IEC and ROP for the period 2007-2013. Gaps were identified concerning the general design of the programmes, their regional accessibility and the way the programmes were implemented. These gaps reflect not only the perceived shortcomings of the programmes listed in this section but also the weaknesses of SMEs in drafting and implanting programmes (see section 10).

**Gaps were identified between the development needs of SMEs and the design of support programmes.** The needs of SMEs to increase their competitiveness cover a whole range of areas with very diverse objectives. If weighing the identified needs of SMEs against the key areas of interventions (KAIs) and indicative operations (IOs) of the EU support programmes, one can conclude that most needs of SMEs are covered by the current interventions within the two operational programmes in one way or the other. However, the way the overall support package was designed and structured is deficient in supporting the real development of an SME. Basic structural discrepancies between the needs of SMEs and the design of the support programmes call for a new design of the programmes.

- The purpose statement of the programmes deviates from the business philosophy of SMEs. It requires that entrepreneurs follow the European, national and regional strategies and horizontal objectives and be interested in implementing them. SMEs are required to set up development strategies that help to reach the socio-economic objectives of the EU, the government or the local authorities. SMEs are not aware of and cannot follow such goals. They need to be supported in developing and implementing their own business strategies to become more competitive and more profitable. Competitiveness and regional equity could be the general goal of the support programme as the common denominator for both business needs and the government.
- SMEs need more comprehensive programmes. Most of the companies wish to apply for grants with their real business plan which integrates several needs and seeks a complex solution. At present such plans cannot be financed under one programme but only separately, in the framework of different programmes. Applying in several KAIs or IOs makes SMEs difficult to keep track, particularly because the two programmes (ROP and SOP EIC) have different eligibility criteria and rules are not uniform. For the future financial programming period more comprehensive programmes would be necessary.

- As currently SMEs have to apply under several programmes, they need calls that are available in a well-structured order. Currently the opening of calls on different IOs under the SOP IEC is not harmonized in time and content. They do not provide applicants the possibility to get support in accordance with the logical time sequence associated with reaching their business objectives. For instance, permanent application for 'support for consultancy for SMEs' would be needed in order to allow access to this support in parallel with the application for, and then the implementation of, an investment project.
- SMEs' activities are rather diverse and flexible which often does not fit into the predetermined rules of eligibility. SMEs do not see why certain NACE codes of activity are not eligible.
- Funds allocated to SMEs are insufficient for most of the operations compared to the needs. Romania spends a relatively small part of the EU funds on SME support. Meanwhile the government's own support programmes are weakened due to lack of budget financing. Investment financing in particular is in great demand despite the current financial crisis.
- The support of innovative SMEs is insufficient. R&D-related support programmes finance primarily public institutions with weak relations to practical implementation. Although SMEs are mostly not aware of the importance of R&D in their future success, this awareness could be raised by government programmes.

The high number of projects submitted under many of the operations addressed to SMEs within both programmes proves that companies are interested in the financing opportunities offered by the EU in spite of the problems they face in the application stage and further during implementation. But **a gap has been identified between the needs of SMEs and the regional accessibility of EU programmes.** Regional differences in the applications and in their success rate reveal that more backward regions need more support to access funds. Backward areas are particularly undersupplied with information and consultancy. A decentralization of funds management of the SOP IEC programmes could bring information closer to the beneficiaries. In addition, the large size of the Romanian development regions conceals the problem that it is mainly SMEs from regional centres that apply while more remote areas and smaller towns are in a disadvantageous position.

## **11 Weaknesses of SMEs in drafting applications for funds and implementing projects**

The process of drafting applications and the implementation of EU-financed projects call for a set of abilities and competences on the part of the SMEs. They must be familiar and comply with precise and strict rules governing this form of financial support. Before looking for funding sources, potential beneficiaries have to identify what are their real needs and to define clear and coherent ideas of what they want to achieve and how. That means, SMEs

need the ability to think strategically and to develop feasible business plans. From the various sources of information such as surveys, focus groups and consultations, the research team came to the conclusion that SMEs have major weaknesses in applying and implementing EU-financed projects.

**SMEs' main weakness is the absence of a coherent development strategy.** Only one fifth of the SMEs have the necessary strategy at hand when they start the application process for EU funds. This turns out as a handicap compared with those SMEs that have designed development projects available. Only larger SMEs are having adequate development strategies, while smaller ones produce – often unrealistic – strategy documents only for the sake of accessing funds.

Micro-enterprises or smaller SMEs see their main business opportunity in flexibility and fast reaction to market opportunities. They consider this behaviour as an asset and see this opinion confirmed in the rapidly changing circumstances of the financial crisis. They do not agree with the restrictive and segmented structuring of the support programmes and with the cumbersome terms and process of accessing them.

What is on the one hand the dissatisfaction of SMEs with the current support programmes reveals on the other hand their weakness in terms of thinking strategically. This weakness of SMEs to develop realistic business strategies and development projects has repercussions for EU funding.

Most SMEs lack the experience and internal capacity to do a SWOT analysis or to write a strategy or a business plan. The development strategies and projects written only with the purpose of obtaining external grants distorts the support policies and leads to failures in the implementation phase.

The present situation calls for action from both sides: (i) to make at least part of the support programmes more flexible and faster to meet the needs of smaller SMEs; (ii) to increase the capacity of SMEs and their consultants to improve the quality of business plans and development projects.

It is a widely held perception that information on the different support programmes is spread over very many uncoordinated sources thus not really accessible for SMEs. Information is worded in a way not understandable for managers and they receive unsatisfactory explanation from the Managing Authorities. While the knowledge and skills of SMEs have been developing by experience, the management of support programmes may also be improved. Easily accessible information available close to the SMEs and stable, transparent conditionalities could improve the functioning of the programmes and support the learning process of SMEs.

**Consultants have a key role in the success of applications and the implementation of projects.** When applying for funding, SMEs need to ask for consultancy because they do not understand the requirements stated in the guidelines and because in most cases those requirements surpass the capacity of the SMEs to prepare the application in-house. Problems with the availability of such support can be regional, qualitative and cost related. The weakness of consultant services may aggravate the weaknesses of SMEs.

The strongest consultancy providers are concentrated in Bucharest and in large cities of the more developed regions. In less developed regions and outside the regional centres the offer is quite poor. Also the Managing Authorities and Intermediate Bodies are centralized in Bucharest, or the ROP-related bodies in the regional centres. Businesses located outside the centres are not only less informed but usually have also lower-quality advice for money. The location of SMEs determines the quality of consultation available.

The cost of consultants, especially of good ones, is too high for micro and small enterprises. In the ROP 5% of the eligible cost usually does not cover the fees asked by consultants for supporting the enterprise in the application and implementation process. In the SOP IEC project application, 10% of the eligible cost can cover the consultants' fees although not entirely in case of smaller projects.

**SMEs have generally weak capacity to draft applications.** The lack of trained staff in the field of application for EU funds (a procedure relatively new to SMEs) is one of the reasons why so many projects are rejected in the first stages of the evaluation process. Based on the experience of SMEs and consultants, the best-quality applications can be prepared by a mixed team formed by the company's experts who will also be in charge of implementing the project and specialized consultants who know how to write a successful financing application.

The main problems of SMEs during the elaboration of the projects are linked to the requirements applicants have to fulfil and to drafting the necessary documents. As to the requirements, the terminology of the application is only one of the problems. SMEs have basic shortcomings in identifying themselves with the development regions and the aims of EU policies. Instead, SMEs would prefer to follow their own objective of business development while they would leave the macroeconomic and regional justification to the authorities.

As to drafting the necessary documents, in particular a cost-benefit analysis, there is a general lack of qualified knowledge in Romania both within the SMEs and among the consultants. The terminology and the calculation methods are not properly understood. There is a wide-spread need for capacity building.

**SMEs very often underestimate the collateral problems and risks embedded in a project application:**

- Applicants sign the declaration of engagement to assure their own contribution to eligible and non-eligible costs and the necessary financial resources for optimal implementation of the project without checking before submission the bankability of the project.
- Applicants commit themselves, by signing the application form, to having the capacity to assure sufficient human resources needed for the project implementation even if in many cases they do not have it.
- Applicants overestimate their capacity to meet the project's success indicators and face major difficulties in achieving them.
- The budget of the project is usually not properly evaluating the risks of changes in exchange rate, inflation, fiscal conditions.
- All sorts of miscalculations may occur. The production capacity of the acquired equipment in many cases exceeds the demand for products to be produced. The planned technology may not be the most advanced. The consultation fees and banking costs can be higher than assumed.

**SMEs show further weaknesses during project implementation.** Successful implementation depends to a large extent on the quality of the project preparation and the input of a full-time project manager. SMEs have to devote adequate capacity in terms of human, financial and time resources, follow properly the specific rules and regulations, meet the objectives and attain the result indicators to become eligible for the final reimbursement. As a major obstacle, SMEs lack experienced and dedicated staff for implementing projects.

**Most SMEs lack own financial resources to co-finance projects.** They often underestimate their self-financing obligations. Also the financing needs due to the ex-post reimbursement of costs are often disregarded. Even if since recently the beneficiaries may use as guarantees the assets acquired by the project and may benefit from a pre-financing mechanism, they still need to raise a credit. SMEs usually turn to banks too late, only after their project has been approved by the authorities. The level of financial indicators in the approved project is usually less demanding than those imposed by the banks for providing a credit. Thus a large number of approved projects are not bankable.

**SMEs that have already implemented projects** financed from structural funds **are more familiar with the requirements** and can use the staff from the implementation team to write new projects. With the experience gained in the period 2007-2013, SMEs and consultants will be more skilled to apply for and to implement EU-financed projects in the next programming period. Also the authorities have to undergo a learning process and realize that serving the interest of SMEs and meeting their demands is in their good interest. However skilled SMEs and their consultants may become during the present programming

period, they will need more accessible funding in a structure they can more easily cope with as well as on-the-spot support of Managing Authorities and Implementation Bodies. An assessment of the results of that learning process will be necessary towards the end of the current programming period in order to adjust the programmes and processes. As for now, the conclusions of our evaluations call for some general and also for some rather urgent corrections.

## **12 Policy conclusions**

The policy conclusions based on the research conducted in the framework of this project refer to the support needs of SMEs. We have assessed neither the institutions designing and implementing the government's SME policy, nor the Managing Authorities and Implementing Bodies of EU programmes. Our knowledge is based primarily on the views of the SMEs surveyed and interviewed. In this context, some general problems have been identified:

- Romania is in a competitiveness crisis which showed up in a wide foreign trade deficit in 2008-2009. Raising international competitiveness is therefore a target for all segments of economic policy. Raising the competitiveness of SMEs is part of it. Nevertheless, small and especially micro-enterprises are characterized by lower productivity and slower growth of productivity than medium-sized or larger companies. SMEs, in particular micro- and small enterprises, are not export-oriented and in general not innovative. Support spent on the non-innovative and domestic market-oriented SME segment may yield lower overall productivity increases of the economy than support spent on larger entities. Support to micro- and small enterprises is generally of local importance and part of labour market policy rather than a competitiveness policy issue. Support to larger projects of SMEs may be better conceived in a way providing special support for participating in innovation and internationalization.
- Romania is in an economic recession due to contracting domestic demand. SMEs are particularly affected as they supply primarily the domestic market. Development aims targeting an increase in employment or output are often not feasible for them. The support they need in the present circumstance may aim at consolidation and not at expansion, i.e. at an increase in efficiency by means of production cost saving restructuring, adjustment of production to demand and exploring new markets and products. In this process neither the output nor the employment of the company may increase – in fact it may decrease.
- Romania is in a fiscal crisis. Soaring budget deficits prompted a stabilization policy which introduced austerity across the whole public sector. The government has also cut spending on SME support programmes, and in the current situation it cannot be reasonably expected to allocate more money to those programmes in the near future. The budget of the EU support programmes is given for the whole seven-year period of the

financial perspective and may not be increased to fill the gap left by vanishing domestic programmes. But Romania can improve institutions and procedures in order to benefit from a more rapid flow of EU funds. To this end the government has to ensure the co-financing in those projects where the public sector is the beneficiary. It may also support SMEs accessing loans to ensure their co-financing. There is a danger that the lack of finances on the part of the government or the companies may hinder the access to EU funds. Due to the fiscal constraints a request of SMEs and stakeholders for an increase in public support to the sector is not really feasible. Raising the volume of support money from domestic sources is unrealistic in the short run. But international support may be redirected to cover some of the needs. For the next financial perspective of the EU starting in 2014, an increase in funds for SME support could be feasible both from EU and from government resources.

- The general impression is that Romania is in a governance crisis with a weak government, limited institutional capacity and weak ownership of policies agreed with international organizations. Economic policy steps are often taken ad hoc, with no impact analysis, and there is no ex-post evaluation of most of the policy steps either. In the framework of the current austerity policy, expenditures for government administration have been cut, salaries reduced. A collateral damage can be that the motivation and efficiency of civil servants and government offices declined.
- Most of the SMEs are at a rudimentary stage of skills, organization and market knowledge if compared with similar economic units in more advanced EU member states. Their development aims are rather short-term and not very complex. They lack the knowledge, expertise and staff to participate in complex tenders and in application processes. Learning by doing is increasing their capacity to access external, including EU funding. Still they need more simple and transparent mechanisms which they can understand and cope with. In addition, they need the support of competent consultants.

The five above points formulated as features of the current crisis have deeper roots and are also of a lasting nature. They are linked to the level of the country's economic and social development which is quite low compared with the more advanced EU member countries. Medium-term development forecasts do not expect a swift recovery of the Romanian economy even if the catching-up process to the EU average GDP may resume after 2011. The next EU financial period will not find the country in much better shape than it is currently in, thus development plans can be realistically based on the present knowledge. In such circumstances the procedures related to EU funding are too complex and costly for the authorities and a simplification would be in their interest just as in the interest of the beneficiaries. One may consider simplifications in all respects:

- less segmented programmes,
- clearly formulated and simple conditions of application,
- procedural simplification,

- speedier decision-making,
- more flexible conditions during the implementation,
- faster re-imburement of costs.

**A simplified support scheme would fit the development needs of Romania better than the current segmented and complex one.** At the same time, **the capacity of SMEs can be improved to apply for and to implement development funding by targeted and interactive support.** Simplification means to bring the demands and conditionalities of the financing programmes closer to the capacities of the SMEs. This would also be in line with the limited administrative capacity of government offices. But simplification has its profound limits. Development support can only go to viable companies where the money is effectively used. This has to be ensured by the conditionalities of support. At the same time, one can also expect an improvement of knowledge-based learning by doing. SMEs and the authorities may learn to deal with complex issues while implementing EU programmes.



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