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RESEARCH on RISKS and OPPORTUNITIES

CURRENT SITUATION in ROMANIA

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CONTEXT

1.1 CURRENT SITUATION in ROMANIA

1.1.1 An Overview Regarding the Country's Economy

Romania is a member of the European Union since 2007. The country's economic growth has been one of the highest in the EU since 2010, driven by investment by the private sector. The World Bank classified Romania as a high-income country for the first time, based on 2019 data (per capita income of $12,630) [1].

Romania's priorities include investments in infrastructure, health care, education, job creation, and small and medium enterprise development.

Interesting facts:

- Romania is 5th in the top countries with the fastest average fixed broadband internet speeds (in Mbps) as of April 2021, according to Speedtest.net data.
- Romania has 54 companies in the Top 100 of the biggest companies in Southeastern Europe (SEE), based on 2019 revenues [2].
- The Romanian car manufacturer *Automobile Dacia* leads the top of the largest companies in the region for the sixth year in a row.
- Company UiPath is in 7th place in the top of most valuable "unicorns" globally. The software company for robotic process automation (RPA) was founded in Romania and is headquartered in New York City [3].

In Romania, the growth rates of the real gross domestic product (GDP) in comparison to the previous year were 7,32% in 2017, 4,48% in 2018 and 4,13% in 2019. The Romanian economy contracted by 3.9 percent in 2020, reflecting a better-than-expected fourth quarter performance of -1.4% year-on-year [1].

The effect of COVID-19 on the economy of Romania

The fiscal deficit surged to 9.8 percent of projected GDP at the end of 2020 on the back of COVID-19-related expenditures and lower revenues due to the economic downturn and tax relief. The impact of the stimulus pursued at the European Union (EU) level will play a critical role in the recovery, given the limited fiscal space. Poverty is anticipated to increase in the short term as the protracted impacts of COVID-19 affect domestic income sources and remittances [1].

The Romanian gross domestic product (GDP) shrank 0.2% year-on-year in the first quarter (Q1) of 2021, following a 1.4% contraction in the previous period. This was the fourth consecutive quarter of GDP contraction, but the smallest decline in the current sequence, amid reduced restrictions to prevent the spread of coronavirus.

The global crisis brought by the COVID-19 pandemic caused a drop of GDP due to weak external demand which slowed production and exports, as well as lower consumer spending. Conversely, investments had a positive contribution to growth. Net external demand contributed negatively to the GDP, as exports rose by 0.6% (vs -2.3% in Q4) while imports increased at a faster 5.4% (vs 2.2% in Q4). On the positive note, both government expenditure (3.0% vs -2.3% in Q4) and household consumption (0.8% vs -6.2%) rebounded, while fixed investment grew faster (9.9% vs 6.5%).

The gross domestic product in the first quarter of 2021 was 2.8% higher, in real terms, compared to the fourth quarter of 2020 [4].

As the global economy should stabilize, GDP is expected to rebound by 6% this year and 4.8% in 2022, though the situation remains very volatile [5].

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1.1.2 The Profile of SMEs And Entrepreneurs

In 2019, Romania reached the performance of the lowest number of insolvencies in the last 10 years (6,500), respectively 21% lower than in 2018 and 67% compared to 2009. Also, another record figure is that of active economic entities (companies and PFAs - Authorized Natural Persons) which amounted to 1.36 million entities in Romania in 2019 [6].

During 2019, 134,200 economic entities were established in Romania, while the number of businesses that closed (dissolutions plus write-offs) is 135,700, the natural increase being therefore a slightly negative one.

As a dynamic of the last 10 years (2010-2019), the number of open companies increased by 16%, while the number of closed companies increased by 117.5%. One explanation of the gap between the two indicators could be the fact that the number of de-registrations and dissolutions is strongly influenced by administrative measures [6]. The increase of over 117.5% compared with 2009, where 135,700 businesses closed in 2019, justifies a trend of consolidation [6].

During 2019, the number of active economic entities[1] in Romania increased by 3% compared to 2018, by 16.5% compared to 2015 and was 32% above the level of 2009, to 1.36 million professionals at the end of December 2019, the maximum of the last 10 years. There were 378,700 active PFAs (28% of the total) versus 985,000 companies (72% of the total). In the period 2014-2019, there is an increasing preference for companies (increase of 27%) comparing to PFAs (decrease of 4%) [6].

Number of insolvencies in 2020 in Romania

According CITR Romania[2] analysis: the year 2020 registered a lower number of insolvencies, but with a greater impact on the economy. The decrease in insolvencies in general (with 12% in 2020, compared to 2019) is due to postponement, as a result of the fiscal facilities provided by the Government since the beginning of the pandemic and the court strike at the beginning of the year [7].

In 2020, the direct impact of the pandemic on some industries was observed, such as that experienced by HoReCa[3] and transport. Based on the domino effect, it can be estimated that in 2021 related industries such as: automotive, automotive components production, aviation, tourism, agriculture, meat production, dairy, bakery and livestock farming will face difficulty.

According to the CITR analysis, in 2020 an average of seven companies with a monthly impact entered insolvency and restructuring, just over half of the number registered the previous year. But, looking at the impact of these companies on the economy, the fact that 26% of companies also recorded debts to the state, amounting to 149 million lei, it can be concluded that it was not a natural continuation of the downward trend of insolvencies, but a worsening of the health of Romanian companies [7].

The sectors of activity with the most impact companies that were involved in insolvency and restructuring are: industry (26%), trade (14%), energy (10%) and agriculture (10%).

As expected, the pandemic also had effects on entrepreneurial initiatives - fewer and fewer Romanians decided to open a business in 2020: National Trade Registry Office (ONRC)[4] data show a decrease of almost 19% in the number of companies set up compared to 2019. The most discouraged have former entrepreneurs in the fields of agriculture, forestry and fishing (-52%), entertainment, cultural and

[1] Professionals registered in the Trade Register who have not declared their suspension of activity and are not in any of the conditions that may lead to the loss of legal personality are considered active, from a legal point of view. From the total number of professionals registered in the Trade Register, were excluded professionals with temporary suspension of activity, branches, deregistered professionals, professionals in dissolution, liquidation, judicial reorganization, bankruptcy, insolvency, etc.
[2] CITR Romania, part of Impetum Group, is the leader of the insolvency market in Romania
[3] HoReCa meaning Food service and *hotel industries.*
[4] NTRO - National *Trade* Register Office

recreational activities (-51%), manufacturing (-40%), social security in the public system (-33%) and hotels and restaurants (-29%) [8].

Concerning on the effects of an economic crisis on entrepreneurial activity there is no consensus in the literature. According to some authors, the situations of weak growth, recession, or stagnation may favor innovation and discovery of opportunities. On the contrary, other authors consider that economic slowdowns have a negative effect on entrepreneurial attitude, reducing discovery of opportunities and investment in innovation.

Newly created and closed companies in January-April 2021

At national level the number of deregistered companies increased by 43.46% in the first four months of 2021, compared to the same period of 2020, to 21,776 de-registrations, according to statistics from the National Trade Registry Office (ONRC).

By fields of activity, the highest number of de-registrations, compared to Jan-Apr 2020, was in:

- wholesale and retail trade, repair of motor vehicles and motorcycles – 5,998 (plus 47.44%);
- agriculture, forestry and fishing – 2,003 (plus 60.11%); and
- construction – 1,967 (plus 41.21%).

1.1.3 The General Risks that the Companies are Facing

According the Risk Assessment provided by COFACE (02/2020), in Romania, the business environment is relatively good. Although not always available, corporate financial information is usually reliable. Debt collection and the institutional framework may have some shortcomings. Intercompany transactions may run into occasional difficulties in the otherwise secure environments [9].

Strengths

- Large domestic market
- Significant agricultural potential: wheat, barley, rapeseed, etc.
- Limited energy dependency on coal, oil, gas and uranium
- Large-scale renewable power generation
- Diversified and competitive industry thanks to an inexpensive workforce

Weaknesses

- Demographic decline: low birth rate and emigration of well-trained youth

- Strong regional disparities in education, vocational training, health and transport; rural areas lag behind
- Low participation rate of Hungarian and Roma minorities, youth and women in the economy
- Large underground economy
- Inefficient agricultural sector
- Slow bureaucratic and legal processes; corruption.

Romania Rating

Moody's completion of a periodic review of ratings of Romania State that "The 'BAA3' rating of Romania is underpinned by Moody's assessment of '*BAA2*' economic strength [10], balancing strong economic growth and structural weaknesses that constrain the country's potential (public infrastructure); '*BAA3*' institutions and governance strength, balancing strong public opinion support to improve the anti-corruption framework and diminished fiscal credibility; *'BAA2'* fiscal strength, taking into account deteriorating public finances, with a widening of both the headline and the structural deficit, and still better-than-peers fiscal metrics; and '*BAA*' susceptibility to event risk, driven by the political risk and by external vulnerability risk due to a widening current account deficit [10].

Main obstacles to business development in Romania [11]

While some progress has been made since joining the EU in 2007, companies in Romania still report challenges regarding the independence and efficiency of the judicial system, corruption, bureaucracy, and political instability. Romania's poor infrastructure continues to have a negative impact on business costs, productivity, public safety, and the country's ability to attract foreign investment. The country's connections to the rest of the EU's transportation infrastructure are still underdeveloped, which holds back the country's ability to realize its full potential for new investment, trade, and tourism.

Romania is not a member of the "Euro Zone", so payments are made in local currency – the New Romanian Lei (RON). However, many companies and consumers have debt denominated in euros, and most big-ticket consumer items (i.e., real estate, cars, and major appliances) are priced in euros. This creates trade inefficiencies due to higher transaction costs and exchange rate fluctuations.

Many U.S. firms operating in Romania face ongoing challenging with recruiting and retaining employees. A fast-growing economy, increasing investments and the ability for Romanians to work for higher wages elsewhere in the EU had led to a labor shortage. This shortage is more pronounced in north and western parts of the country where employers often bus-in workers from villages. While unemployment rates are higher in the Moldova region, companies report that skilled works are harder to find in the lesser-developed eastern areas of the country.

All companies operating in Romania report complaints with frequent legislative changes without prior private sector consultations. Regulatory Impact Assessment (RIAs) are very rare, and laws can change with little notice.

Uncertainties and risks to the growth outlook are high, but generally remain balanced [11].

Romania’s economy is projected to recover from the COVID-19 pandemic by 2021 with positive quarterly growth beginning in late 2020 or early 2021.

Small and medium-sized enterprises' main barriers to digitalization in Romania 2020 [12,13],

- Lack of financial resources – 30%;
- Regulatory obstacles – 20%;
- Lack of skills, including managerial skills – 8%;
- Internal resistance to change – 8%;
- Lack of information technology infrastructure – 8%;
- IT security issues – 5%; and
- Uncertainty about future digital standards – 5%.

In 2020, the main barrier to digitalization for one third of the SMEs surveyed for the study performed by STATISTA Business Data Platform was the lack of financial resources, followed by regulatory obstacles. Five percent of respondents also considered the uncertainty of future digital standards to be an obstacle to their development [12].

Innovation performance keeps improving in EU member states and regions, according to the latest European Innovation Scoreboard 2021, published by the European Commission [13].

Based on their scores, EU countries fall into four performance groups: Innovation Leaders, Strong Innovators, Moderate Innovators and Emerging Innovators.

With a score of 35.1, Romania is only an Emerging Innovator. Over time, performance relative to the EU has remained the same. Romania’s strengths are in sales impacts and digitalization & environmental sustainability. The top three indicators include medium and high-tech goods exports, broadband penetration, and venture capital expenditures [13].

1.1.4 Entrepreneurial/Business Failure Rates Across the Risks

Potential insolvency risks are linked to situations that an SME may encounter when operating in competitive markets [1]:

- cash flow crisis caused by a large unforeseen expense, tax bill or a purchase
- loss of business from increased competition
- loss of an important customer
- unexpected drop in sales (or an inconsistent period of sales)
- key employees and management leaving or becoming ill
- impact of regulatory changes
- overtrading - significant increase in business without sufficient capital
- inflation and bank interest rates
- lack of financial control and poor management information, particularly in the early years of the business
- fraud, especially combined with the point above

SMEs' financial distress and insolvency challenges can either develop over medium to long-term periods or be the result of sudden unexpected crises, such as the ongoing COVID-19 pandemic [12].

Companies with businesses under 100,000 euros per year were more affected by the effects of the pandemic in 2020, half of the managers believe that their own company has been affected by Covid-19. The declared average decrease in business is 20% in the fourth quarter of 2020, compared to the second quarter of 2020. In addition, the increase in turnover estimated for 2021, when compared with 2020, is about five times smaller in the case of small companies, compared to big companies (1% vs. 5%) [14].

The difference in the decrease in profit in fourth quarter of 2020 versus the second quarter of 2020 is uplifting in this respect: a decrease of 22% for small companies and only 12% for large ones. In addition, profits are expected to continue to decline for smaller players by 4% in 2021, while large companies are already expecting growth this year [14].

The difficulties in the area of cash flow are obvious, half of the managers claiming that they had problems with working capital. Under these conditions, only 10% of small business managers are relaxed or very relaxed about how the national economy is evolving, while 19% of them are worried or very worried [14].

At the same time, small companies do not have an equally solid return base in 2021. Based on the fact that the main measures implemented during the pandemic were aimed at reducing staff recruitment, marketing & research costs, and also investments [14].

The pandemic has highlighted the importance of digitalization, more than ever, so that it is ranked 5th in the list of top priorities, even before access to credit. In first place, as expected, is the increase in sales and job retention, followed by improved customer relations and investment [14].

However, small-scale entrepreneurs expect an increase in demand this year and argue that they are more oriented towards increasing productivity, albeit at the expense of reducing costs. In addition, at least at the declarative level, the pandemic has become the catalyst for a paradigm shift in business: 64% say that the pandemic will generate an intensification of innovation at the company level, and 71% talk about a rethinking of strategy [14].

1.1.5 Opportunities

Based on IMF predictions, Romania is set to see one of the fastest recoveries post-COVID in Europe, extending the overperformance from the last decades [15].

A first advantage of Romania would be the labour market, which still offers productive employees at lower costs compared to other countries. In manufacturing, Romania's labour costs are comparable to China's and several times smaller than in Western European countries, while in the high-value added sectors things also look good; though IT&C wages can be half of the levels seen in Western European countries, living costs in Romania (particularly real estate-related) suggest that the purchasing power of the average IT employee may actually look better than in other European nations [15].

A second major advantage is geographical position; with geopolitics becoming increasingly relevant, Romania is in an important region for its Western allies. Somewhat elevated corruption and a historically low drive for reforms constitute major drawbacks but, then again, Romania did score the 5th best economic performance in the world even in consideration of these factors [15].

Automation (both in production and in commercial service) is another important trend. Over 40% of jobs in Romania could be exposed to the risk of automation (including in services), this is much higher than other EU countries. This will infiltrate somewhat gradually, as wages continue to rise in Romania. The number of robots in the Romanian industry has increased to 18 robots per 10,000 employees in half of Poland's level and several times smaller than Czechia's. If the state policies can remove the negative externalities from automation, this process will prove a very positive dynamic, as it will likely support Romania in climbing even higher on the economic complexity ladder in terms of its output [15].

A fourth point that Colliers consultants believe will shape the next decade is related to globalization, in the way that trends may start becoming less global and more regional. This has the potential to offer quite a lot of opportunities for countries like Romania, which can serve as re-shoring destinations for advanced European economies. Brexit and the reshuffling of relations between advanced economies and China should lead to some positives for Romania and the CEE region as-a-whole [15].

A major opportunity which Romania should take advantage of relates to EU funds: the coronavirus aid package, in addition to the normal allocation for the 2021-2027 period for Romania is around EUR 80bn or one third of the country's GDP. After a decade and a half as a member of the European Union, Romania should be capable of absorbing all of these funds. As Romania has grown so well despite the lack of infrastructure, such investments would lead to major improvements, and this would unlock a significant and sustainable GDP growth. That said, some changes to taxation may be necessary in this context.

As e-commerce will become a staple of everyday life and deliveries are required to take place within a short duration of time (often same day delivery), retailers will need a heavier warehouse presence, including last mile logistics, as well as in other parts of the country. Automation will also be featured much more frequently as companies will try to circumvent higher labour costs and lower availability of labour altogether. The next frontier will consist of integrating even newer technologies into logistics, such as driverless cars, robot or drone deliveries and so on [15].

The residential sector is a major driver of land market deals. Colliers consultants believe that in a decade's time, the residential scene in Bucharest and some of the few lively cities in the country will thrive, as more and more people will move here for economic opportunities. Taking into account the need to replace the very old stock, these towns should absorb a decent amount of deliveries each year [15].

On the flipside, smaller towns and those with limited economic opportunities, as well as rural areas that are not closely connected to large cities, ought to see a good supply of older apartments/ houses, lowering appeal for new projects. In the context of ongoing internal migration towards cities, with Romania's urbanization rates are much lower than those seen in Western Europe. The population of towns in Romania will gradually increase over the next decades, even as the country's population decreases [15].

1.1.6 The Programs That Support the Entrepreneurs

1.1.6.1 EU Level

- Horizon Europe - funding programme for research & innovation
- InvestEU
- Single Market Programme
- Enterprise Europe Network in 2022 and beyond
- European Innovation Council Fund
- EEA and Norway Grants
- Erasmus for young entrepreneurs
- Eureka Investment Readiness Programme
- European Agricultural Fund for Rural Development (FEADR) - Setting up young farmers and setting up new rural enterprises

1.1.6.2 Country Level, Romania

A. EU funds in the financial program 2021-2027

- Smart Growth, Digitization and Financial Instruments Operational Program (POCIDIF) - several priority axes, mainly targeting stimulating SME access to finance for innovation through digitization;
- The Sustainable Development Operational Program (PODD) - focusing in particular on investments in key sectors;
- Education and Employment Operational Program (POEO) - developing an entrepreneurial culture, supporting entrepreneurship and the social economy; and
- Regional Operational Program (ROP) - investments aimed mainly at SMEs in areas of smart specialization.

B. National Programs

<u>Ministry of Economy, Entrepreneurship and Tourism</u>:

State economic support package:

- micro-grants
- grants for working

- grants for investments in production
- grants for the food service and hotel industries

Ministry of Education: competition of projects financed from the Institutional Development Fund for state universities: Area 4: Supporting the activities of Student Entrepreneurial Societies (SAS) within universities.

C. Private programmes and initiatives

- Digital Innovation Zone
- Regional networks to support entrepreneurship
- Corporate Social Responsibility (CSR) projects of large companies
- NCOs Programmes and projects (Orange Foundation Romania, Foundation for the Promotion of Small and Medium-sized Private Enterprises, National Council of Small and Medium Sized Private Enterprises, Young Entrepreneurs Association from Romania (PTIR), Association "Women in Business" etc.

1.1.7 Crisis Management Strategies

There is no consensus in the literature on the effects of an economic crisis on entrepreneurial activity. Some authors consider that situations of weak growth, recession, or stagnation may favor discovery of opportunities and innovation; whereas others claim that economic slowdowns have a negative effect on entrepreneurial attitude, reducing discovery of opportunities and investment in innovation [16].

Five priorities for business

Companies are feeling the business and financial shock of the COVID-19 outbreak, from the complete or partial shutdown of factories, to supply chain disruptions, to labor shortages and cash flow stress. In an asset document, Ernst & Young has identified five priorities for business leaders to consider, many based on perspectives and experiences from China and other countries in Asia, where Covid-19 first impacted [17].

Putting people-safety first

- Initiate or expand flexible work arrangements
- Provide infection protections for on-site workers
- Issue regular, transparent communications that reassure employees and align with current government policies

Reshape of the strategy to maintain business continuity

- Evaluate short-term liquidity
- Assess financial & operational risks and respond quickly
- Consider alternative supply chain options
- Determine how the crisis affects budgets and business plans
- Monitor domestic and foreign government initiatives of support

Communication with stakeholders (customers, employees, suppliers, creditors & investors, government & regulators)

- Keep customers informed of impacts to product or service delivery
- Develop communication plans that balance caution with a business-as-usual mindset
- Stay in contact with suppliers regarding ability to deliver goods and services
- Review terms and conditions on loans and contracts with creditors and investors
- Consult legal teams for advice on potential liabilities with governments or regulators

Maximization of the use of government support policies

Building resilience and preparation for recovery for the new normal

- Execute revised strategies and continue to monitor the situation
- Review and renew BCPs
- Make decisions and take actions during the crisis with recovery in mind
- Reset business assumptions that underpin the supply chain

Small business in the COVID era: creative strategies tested by small entrepreneurs in Romania [18]

- The state of emergency has forced many small businesses to suspend their activities. To address the extended nature of the crisis, some have identified creative strategies, tools and opportunities through which they continue to serve their customers and even strengthen their position in the market
- In times that are adverse to what we know as "business as usual", businesses that manage to maintain their customers, revenue and employees during this period show a lot of flexibility and creativity in their sales and distribution strategy
- Discovering a new segment or partially/totally reinventing the business
- In many cases, the clientele on which small businesses had relied upon can no longer directly benefit from the services provided. Thus, businesses have reoriented and developed new

service technologies (online) or have identified market segments that they can address during this period

- Reinventing how to reach customers
- Many entrepreneurs, who do not have the opportunity to reinvent themselves during this period or create new products or services, have shown a lot of creativity and tact in optimizing the channel through which their products or services reach end customers
- Partnerships and collaboration
- We keep hearing a slogan in advertisements that, maybe before the crisis would have seemed nonsense, "at a distance, but together we will succeed". There are entrepreneurs who quickly understood that if they make a partnership during this period it will be much easier for them to go through any turbulent times
- As a basic element of a collaborative economy is the interaction and exchange of resources between colleagues, local and community sharing platforms are affected, limiting users' access to some of the services offered
- If some companies in the sharing economy have seen an increase in turnover, this is due to their ability to innovate and pivot their business models according to current needs. For example, some sharing platforms have pivoted key aspects of their business model to provide essential staffing services
- Maintain regular communication with customers
- In an event that the customers do not have access to the services offered by the business at this time, maintaining communication as much as possible is vital. After building the new normal, all businesses want to recover their customers and continue the business relationship
- Invest in the future of the business from now on
- Aspects and developments that would have been helpful during this period
- Analyzing how programmes for SMEs can help both to manage the current needs, but especially to develop the business
- Reshaping/developing the marketing and customer relation plans, as competitors will also plan to return to normal activity
- Investments in technology and infrastructure to enable teleworking and virtual collaboration

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