Structural Funds’ Use by the SME Sector in Romania – Structural Expectations, Difficulties and Impacts

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Abstract: While the process of strategic planning at the level of the European Union and the Member States incorporates a strong support component for the creation of growth and jobs in the SME sector, and the financial setup is put in place both through EU and national instruments, it is relevant to understand the extent to which these policies and financial instruments can ensure a genuine, sustainable effect on the activity of microenterprises. The paper is divided in four parts.

The first part presents the facets of the Romanian National Strategic Reference Framework which refer directly and indirectly to the policy measures and financial support for the SMEs. The second part refers to the technical aspects (mechanisms, results, impacts) associated to project financing for SMEs, both in the implementation period and in the phase of operating the investment. The third part refers to the financial aspects (sources of financing and cash flow management) incurred by the implementation and operation of projects addressing the SMEs sector. The fourth part collects main conclusions on the issues discussed and groups them around some topics of discussion: the actual need for structural funds in the SMEs sector versus the opportunity hunting; the short term effects versus the long term impact; the risks versus the benefits of resorting to structural funds; the structural versus volatile effect at macroeconomic level in terms of economic growth and job creation.

JEL classification: M21, H81

Key words: Structural Funds, SMEs, Sustainability, Impact

1. INTRODUCTION

Absorption of structural and cohesion funds is an important priority of the Romanian Government. A substantial allocation of funds from the European Union needs to be optimally exploited, representing a key resource for developing the Romanian economy and society in the short, medium and long run.

Achieving an absorption level of at least 90% of the allocation available to Romania requires a significant and permanent effort, as well as the functioning of a complex, modern and transparent system to ensure the efficient use of public funds, which involves a process of adaptation of the legal, institutional and procedural mechanisms, as well as a profound change of mentality.

However, structural funds absorption should not be considered an objective per se, but a tool to ensure economic and social development and progress. A realistic

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assessment of the absorption and use of structural funds requires an indepth analysis of possible collateral effects induced.

2. THE LEGAL AND STRATEGIC FRAMEWORK

Articles 158-162 of the Treaty establishing the European Communities stated that the Union should promote an overall harmonious development and strengthen economic and social cohesion by reducing development disparities between regions. In 2007-2013, the instruments to these objectives have their legal basis in a package of five regulations adopted by the Council and European Parliament in July 2006:

- **Regulation no. 1083/2006 of 11 July 2006**, which defines the principles, rules and standards for implementing the three cohesion instruments: the European Regional Development Fund (ERDF), European Social Fund (ESF) and Cohesion Fund;

- **Regulation no. 1080/2006 of 5 July 2006**, which defines the role and areas of intervention of the European Regional Development Fund (ERDF), such as promoting public and private investments to help reduce disparities in the Union;

- **Regulation no. 1081/2006 of 5 July 2006**, which defines the role and areas of intervention of the European Social Fund (ESF), which will be implemented in accordance with the European strategy on employment;


An important document to be considered at the background of the present paper is the **Strategy Europe 2020**, which launched a new vision for Europe's economy over the next decade, based on an enhanced coordination of economic policies to generate economic growth and increased employment of labor to help EU economic and financial recovery. The new strategy focuses on the following key areas: knowledge and innovation, a more sustainable economy, higher employment and social inclusion work.

From the Romanian National Strategic Reference Framework for the current programming period we have selected three operational programs which can be considered linked, to a lower or a higher extent to the development of the SME sector as a key driver for economic development:

- the Regional Operational Programme;
- the Sectoral Operational Programme Increasing Economic Competitiveness;
- the Sectoral Operational Programme Human Resources Development.

**The Regional Operational Programme (ROP)** addresses all the 8 development regions of Romania and is co-financed by the European Regional Development Fund (ERDF). The EU contribution will represent up to 85% of the total public expenditure. The total budget allocated to the ROP is approximately 4.4 million euro for the period 2007-2013.

**The Sectoral Operational Programme Increasing Economic Competitiveness (SOP IEC)** directly addresses the first priority of the National Development Plan (NDP) 2007-2013 i.e. “Increase of economic competitiveness and development of knowledge-based economy” and the second priority of the National Strategic Reference Framework (NSRF) 2007-2013 i.e. “Increasing the Long Term Competitiveness of the Romanian Economy”.
The general objective of SOP IEC is to support an increase in the Romanian companies’ productivity, in compliance with the principle of sustainable development, and to reduce the disparities compared to the average productivity of the EU. The target is an average annual growth of GDP per employed person by about 5.5%. This will allow Romania to reach approx. 55% of the EU average productivity by 2015. In terms of figures, the EU contribution to SOP IEC budget for the 2007-2013 programming period is 2.554 million euro.

**The Sectoral Operational Programme Human Resources Development (SOP HRD)** sets the priority axes and the key areas of intervention in Romania in the human resources field in order to implement the EU financial assistance through the European Social Fund. SOP HRD is an important instrument in supporting the economic development and structural changes. Moreover, the investments in human capital will complement and will confer sustainability to the increase of productivity in a long term.

A highly qualified labor force, with a high level of education, having the capacity to respond to the new technologies and to the changing needs of markets, is essential for a competitive and dynamic economy. Romania will promote active labor market policies to increase the adaptability and flexibility of labor force. It is envisaged to support a higher level of participation on the labor market, as a base for a competitive knowledge based economy.

The EU allocation for SOP HRD is 3.476 million euro.

From the list of key areas of intervention in which SMEs are eligible beneficiaries, we have selected three areas of intervention to depend the analysis, as follows:

- ROP - Key Area of Intervention 4.3 - Support for the development of micro-enterprises;
- SOP IEC – Key Area of Intervention 1.1 - Productive investments and preparation for market competition of enterprises, especially SMEs;
- SOP HRD – Key Area of Intervention 2.3 - Access and participation to continuous vocational training.

For the selected key areas of intervention we have analyzed the target indicators at program level, with a focus on the indicators including or related to SMEs.

The selection was made in such a way so as to ensure a diverse and complementary consideration of types of support offered to SMEs through the structural funds program: de minimis schemes for microenterprises, more complex state aid schemes for SMEs in order to increase competitiveness, support for human resources development in the SMEs.

For the key area of intervention dedicated to micro-enterprises from the ROP, the target indicators are presented in Table 1.

<table>
<thead>
<tr>
<th>Table 1. Indicators set up by ROP, KAI 4.3</th>
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</thead>
<tbody>
<tr>
<td><strong>Cumulative indicative targets</strong></td>
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<tr>
<td>Output indicators</td>
</tr>
<tr>
<td>Micro-enterprises supported (no.)</td>
</tr>
<tr>
<td>Result indicators</td>
</tr>
<tr>
<td>New jobs created by the micro-enterprises supported (no.)</td>
</tr>
</tbody>
</table>

*Source: Regional Operational Programme 2007-2013*
For the key area of intervention dedicated to SMEs from the SOP IEC, the target indicators are presented in Table 2.

### Table 2. Indicators set up by SOP IEC, KAI 1.1

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Cumulative indicative targets</th>
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</thead>
<tbody>
<tr>
<td><strong>Output indicators</strong></td>
<td></td>
</tr>
<tr>
<td>SMEs assisted for direct investment operation (number)</td>
<td>100</td>
</tr>
<tr>
<td>SMEs assisted for certification (number)</td>
<td>120</td>
</tr>
<tr>
<td>SMEs participating in international fairs (number)</td>
<td>40</td>
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<tr>
<td><strong>Result indicators</strong></td>
<td></td>
</tr>
<tr>
<td>New jobs created and maintained in enterprises assisted (number)</td>
<td>100</td>
</tr>
<tr>
<td>Certified SMEs (number)</td>
<td>60</td>
</tr>
<tr>
<td>The share of SMEs supported out of number of total eligible SMEs (%)</td>
<td>-</td>
</tr>
<tr>
<td>The increase in turnover for SMEs assisted (2 years after the project) (%)</td>
<td>-</td>
</tr>
</tbody>
</table>

*Source: Sectorial Operational Program Increased Economic Competitiveness 2007-2013*

For the key area of intervention dedicated to companies staff from the SOP HRD, the target indicators are presented in Table 3.

### Table 3. Indicators set up by SOP HRD, KAI 2.3

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Cumulative Indicative Targets</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Output indicators</strong></td>
<td></td>
</tr>
<tr>
<td>The number of participants in continuous vocational training (CVT) programs</td>
<td>55.300</td>
</tr>
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<td>of which - women</td>
<td>24.885</td>
</tr>
<tr>
<td>Share of enterprises providing CVT for their staff (%)</td>
<td>-</td>
</tr>
<tr>
<td><strong>Result indicators</strong></td>
<td></td>
</tr>
<tr>
<td>Number of businesses assisted financially for employee participation in CVT</td>
<td>4.100</td>
</tr>
<tr>
<td>Number of persons receiving counseling / guidance - CVT</td>
<td>56.000</td>
</tr>
</tbody>
</table>

*Source: Sectoral Operational Programme Human Resources Development 2007-2013*

Once achieved, the above mentioned indicators have the power to generate structural improvements in the SME sector, which can benefit from financial resources
at very low costs in order to develop their production capacity, to expand, to become more competitive, more efficient and more effective.

However, as derived from Goodhart’s law, if these indicators are to be considered targets, they stop being good indicators in measuring the structural effects of the funds absorption. A lot of additional factors which may limit the expected effect of structural funds on SMEs should be considered. They can be of technical or financial nature.

3. **Technical aspects associated with project financing for SMEs**

SMEs investments supported by European funds may be an important driver for economic development especially in times of economic decline. As simple as this statement may seem, there are a lot of complicating and even blocking factors in the process.

Some of the major problems encountered in the implementation of projects contracted by SMEs include:

1. Difficult and volatile rules related to public procurement procedures to be applied in order to spend the budgets projects co-financed from structural funds.

   Although they are bodies of private juridical nature, SMEs must apply full or simplified public procurement rules when it comes to spending public money. In Romania, legislation regarding public procurements is complex and volatile. More and more restrictive rules induce a lot of delays in the process. Since they do not normally work with public procurement legislation when performing their ordinary procurements, SMEs are also vulnerable to make mistakes in the process and are therefore vulnerable to financial corrections from authorities in charge with monitoring and auditing the process. Other problems may occur in the procurement are: delays in the start of the procurements, condition upon the approval of the tender documentation by the national body in charge; insufficient expertise of the SME human resources to deal with large public procurements; contradictory points of view expressed by national authorities in charge; delays in signing procurement contracts; failures in the timely execution of contracts.

2. Changes to the initial contracts are time consuming and may induce delays.

   While in their ordinary activities, SMEs take the flexibility and speed to react in real time, when it comes to modifying the content of the project application because changes in their operational or market conditions, a lot of delays and restrictions may occur. These changes can only be performed if statuted in an addendum approved by the authority funding the project, which requires time and effort.

3. Delays in the communication with the authority financing the project.

   Since not so many steps in the implementation can be done without prior approval or at least consultation with the financing authority, SMEs have to keep up the pace of their activity to these restrictions in order to avoid mistakes. Moreover, the bureaucratic burden of implementing such projects may detour resources for the operational activities of the company to the tasks for implementing the projects.

4. Unclear and untested sustainability for some of the investments.

   To promote sustainable projects, SMEs can prepare a viable strategy to ensure continuity of the project beyond the end of the financing contract. Sustainability can be backed up by: technical prerequisites necessary to increase performance; launching
high quality products and services with major impact on the market; increased living standards of the project target groups by improving access to employment.

Project sustainability strategies envisage, among others:
- Opportunities for SMEs to transfer project results at various levels throughout the country as a model of good practice;
- Monitoring to ensure multiplier effects for the project results through the development and implementation of new activities;
- Mainstreaming of project results after completion of the project;
- Capitalizing the technical, scientific and financial added value for the SMEs, by setting up new institutional structures, financial and logistical procedures after completion of the project.

4. **FINANCIAL ASPECTS ASSOCIATED WITH PROJECT FINANCING FOR SMEs**

A simplified assessment of access to structural funds could point out the easy and friendly use of financial resources free of charge. It is clear the extent to which such reasoning is simplifying.

First, not all the resources are free. In most of the cases the SME has to bring its own percentage of financial resources for the implementation of the project.

Second, money is not available as an advanced payment. With some exceptions in which pre-financing mechanisms are put in place, the SME has to be able to advance its own money for implementing a project and be ready to wait until part of this money is reimbursed by the financing authority.

To these considerations two other difficulties can be added:

1. difficult access to additional resources (bank loans) for SMEs to be able to manage their cash flows, in order to cover the own contribution and the advanced payments.

Banks are not sufficiently motivated and reassured to consider the project financing contracts as collaterals for loans that they could give to SMEs. This puts a burden on the shoulders of the SMEs who are not able to cover the own contribution and the advanced payments from their own financial resources.

2. delays in receiving the reimbursements

While reimbursement periods are stipulated in the financing contracts, normally there are delays. They can be due to the beneficiaries themselves because of not submitting correct and/or complete documents and because of not submitting adequate answers to the clarification requests. However, many of the delays are due to the managing authorities/intermediate bodies because of low speed of processing reimbursement requests. Such situations affect to an even higher extent the cash flow of the SMEs.

5. **CONCLUSIONS**

While having a correlated analysis of the programme indicators for the three operational programmes included in the analyse and the set of technical and financial difficulties mentioned before, we have tried to organize our set of conclusions around the following pillars:

1. **the actual need for structural funds in the SMEs sector versus the opportunity hunting**

Some SMEs hunt the opportunity of accessing structural funds with the sole purpose of getting financial resources free of cost, without any correlation between the
project and their development plans and business strategy. Should such situations occur, the SMEs can be severely affected by the difficulty in achieving the targeted indicators and the burden on the cash inflow generated by the genuine activities of the respective companies.

(2) the short term effects versus the long term impact

As for many of the grant interventions, impact assessment is a very complex process. While job creation is part of the programme target indicators and is likely to be achieved being perceived as a contract obligation for the SME, there is no clear trace of the sustainability of the jobs created. SMEs may hunt the development of a business that they are not able to manage further, after the grant is ended.

In order to ensure long term impacts, SMEs have to be aware and capable to cover the operational costs of the investment created.

(3) the risks versus the benefits of resorting to structural funds

While benefits for the SMEs to access structural funds are undoubtfull, companies should also be aware of possible risks incurred. Thus, they may:
- enter a market where new competitors may arise, particularly foreign firms may have technical advantage, and thus be more effective;
- have serious problems with the cash flow;
- be confronted with serious delays in implementing the investment as compared to the alternative of financing the investment by their own resources. This can be particularly triggered by the delays in public procurements and the delays in receiving the reimbursement for the expenditure made in the project;
- modernization of the company, including changes in the production process of an existing site (eg. upgrading facilities, equipment and high tech equipment, automation of the manufacturing process, introducing new production technologies) can lead to drastic changes in the company structure which can adversely affect business and the make it impossible to return to the old system of work;
- some of the jobs may be lost because of the increased level of automation when manual labor is replaced with the technical or electronic processes supported by the project;
- for human resources development projects, training for only part of the employees within a SME can bring some divergence in terms of equal opportunities for the other employees of the enterprise; moreover, involving staff in the training programmes can lead to suspension for a period of activity and to a loss of productivity.

(4) the structural versus volatile effect at macroeconomic level in terms of economic growth and job creation

Even for projects which have job creation as a target imposed by the financing programme, the sustainability of the jobs created is questionable. Mechanisms to assess the structural effects of these projects in the medium and long run are not sufficiently put in place.

**References**

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