

The Radiography of Microenterprises in Romania



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1. Foreword

When the public sector's capacity to create new jobs is limited, the attention is shifted to the private sector, which may represent the foundations for economic relaunch only through investment and occupancy rate growth on the job market. Generating over two thirds of the number of jobs and over half of the added value in our national economy, the sector of small and medium-sized enterprises is an important engine of the economic development.

The present study focuses on the analysis of microenterprises, the SME segment most affected by problems raised by the financial crisis, and raises a series of questions which it tries to find an answer to: Which is the role of microenterprises in relaunching the economy and supporting long-term development? Which are the business segments in which microenterprises predominantly activate? How do the main financial indexes present themselves for this segment during the post-crisis period? Which are the key challenges regarding credit risk management for these companies? Which was the evolution of insolvencies for this segment of companies and how are these correlated with the registration of new companies? Which is the risk dynamics of the microenterprises assessed by Coface Romania in the last two years and which are the most important predictions for the year 2013?

The answers to these questions are crucial, considering that 9 out of 10 active enterprises in Romania are microenterprises, these companies playing an important role in relaunching the economy on short term and a support factor for medium and long term economic development!

2. Summary

SME – the spine of economy

The sector of small and medium-sized enterprises (SME) generates approximately two thirds of the total number of jobs and over half of the value added in the national economy¹, thus having a crucial role in the economic relaunching perspectives and social balance. The payment discipline of SME has an important impact over the stability of the financial system, under the circumstances in which approximately 70% of the balance of credits given to companies by the banking system, is directed towards the sector of SME.

Microenterprises – the most affected segment within SME. Their liquidity, profitability and solvency is deteriorating

Coface Romania has calculated the main financial indexes for the Romanian companies on different size categories, based on the financial statements submitted to the Ministry of Public Finances for the activity in the year 2011. Based on this analysis, it was noticed that microenterprises:

- register the highest level of debt, respectively 99% (as weight of total debt in assets)
- represent the only sector that registers a negative capitalization
- have the highest loss rate, namely -4.5%
- register the longest days sales outstanding (DSO), namely 172 days, two months longer than the one registered before the financial crisis.
- registers the lowest total debt coverage ratio through turnover, namely 37%

From the point of view of the situation of microenterprises at business segment level, we notice:

- high risk sectors which register a number of insolvencies per 1,000 active enterprises above the national average (metallurgical industry, extractive industry, food and beverage industry)
- low risk ratio sectors which register a number of insolvencies per 1,000 active enterprises below the national average (IT, Health, Other services provided mainly for microenterprises)

¹ http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2012/annual-report_en.pdf

Analyzing the dynamics of financial indexes for the microenterprises that have submitted the financial statements regarding their activity in the years 2010 and 2011, a growth of the liquidity and solvency problems these companies are facing is noticed due to increasing net losses, to the increase of indebtedness, of the negative capitalization ratio and days sales outstanding getting longer.

Index	Microenterprises year 2011	Microenterprises year 2010
Indebtness	99.0%	89.0%
Capitalization ratio	-1.0%	6.0%
Net profit rate	-4.5%	-0.9%
Days sales outstanding	172 days	161 days

The deterioration of profitability indexes for microenterprises for the period 2010-2011 is noticed in the context of a more rapid increase of losses compared to the profit advance, the number of enterprises registering profit being one third lower than the number registering loss. Thus, out of the total number of enterprises registering loss, half have had an increase of loss between 0-25% and a third have registered increasing loss of over 50%. In comparison to these, out of the total number of enterprises registering profit, 73% have registered an increase in profit between 0-25% and only 12% have registered an increase in profit of over 50%.

Microenterprises – faulty commercial credit risk management

In order to appreciate the extent to which microenterprises have appropriately managed the commercial credit risk during the post-crisis period, Coface analyzed the debt variation as a result of the modification of turnover, considering at the same time both the evolution of the average days sales outstanding for microenterprises and all the enterprises active at national level². The analyzed companies have been included in four risk categories (low, average, average to high, high), the detailed financial results being presented in section 6. Hence, considering the numerical weights of the enterprises present in the four frames, we can conclude that only 2 out of 10 microenterprises present a low insolvency risk, 3.5 presenting an average risk and the remaining 4.5 register a high to very high risk.

Microenterprises under Coface magnifying glass – conclusions of the individual analysis of over 20,000 microenterprises

Coface Romania CMS analyzed during 2012 a number of **23,292** microenterprises, with a total turnover of EUR 12.3 billion, representing 50% of the turnover of all active microenterprises at a national scale.

Analyzing the distribution of these enterprises on risk classes, it can be noticed that only 25% of enterprises present a low insolvency risk, a similar result to the one obtained at the end of section 6 regarding the credit risk management in the case of microenterprises (according to that analysis, 21% of all microenterprises at national level present a low insolvency risk, namely the enterprises comprised in quadrant 1).

The consequences of the financial problems microenterprises are facing

In the context of financial problems which the microenterprises are facing being on the increase, Coface draws a warning signal from the perspective of the most important three consequences noticed in the economy:

- **The increase of insolvencies** – the advancement of insolvencies among microenterprises was more

² Within the analysis, all the microenterprises active on the 31.12.2011 were considered, except those that registered modifications (the turnover / debt dynamics) outside the variation band (-500% ; +500%). The elasticities² have been calculated for the 2010-2011 period, based on the financial statements submitted to the Ministry of Finances.

rapid than the one registered for the entire economy. Thus, the number of microenterprises which have entered insolvency in the past two years has registered an annual average increase of 14.5%, while the increase registered for the entire economy, for the same analyzed period has not surpassed 10%. In the context of this dynamic, the numerical weight of the insolvent microenterprises has grown from 78%, level registered in 2010, to 85%, level registered in 2012.

- **The slowdown of the rhythm of economic regeneration** – to be noticed the fact that the year 2012 was the first year after 2008 that registered, during the entire year, a more rapid annual increase of insolvencies than the number of new registered enterprises. Thus, according to the numbers published by the National Trade Register Office during 2012, 66,611 new companies were registered (Registered Sole Traders and Individual Enterprises excluded), representing a growth of 2.70% in comparison with the previous year, when the number of newly registered enterprises was of 64,860. By contrast, according to the preliminary data published by the National Bankruptcy Register, the number of newly opened insolvencies during 2012 has increased by approximately 10% in comparison with the previous year.
- **The increase of bad loans** – during 2012, the small and medium-sized enterprises have registered a credit risk on the increase (the rate of bad loans for the SME was of 23.2% in July 2012, in comparison with 15.1% in December 2010, while in the case of corporations, the bad loan rate was of 4.3% in July 2012).

3. The importance of SMEs. Focus on microenterprises!

In an economy, the positive effects generated by the SME sector, in general, are materialized in:

(+) the improvement of the competitive environment – due to their reduced dimensions and high number, the SME have the capacity to stimulate the competition and to weaken the monopoly positions of big enterprises in general;

(+) the strong individualization of products and services offered by SMEs and of the efficiency of their activity, which contributes to the enhancement of the competitive vibe of the market;

(+) generating the highest number of new jobs – the SMEs create a significantly higher number of new jobs than the number of new jobs created by the large companies already present on the market, with a lower capital cost, acting as a buffer for the fluctuations on the labour market and representing the most important alternative in fighting unemployment;

(+) high perception of the needs of the market due to unmediated contact with the market, thus resulting in a better adaptation of their offer to the clients' needs. Through their specific flexibility, their innovative ability, fast response time, the SMEs are becoming the only enterprises compatible with the forever more complex and dynamic environment.

Despite the major importance held by this sector of enterprises over the economic development, the SMEs in Romania are still dealing with the effects of the crisis, the main problems being the following:

- Low chance for additional loans for the following period
- Lack of a solid guarantee program;
- Low weight of the guarantee institutions;
- Difficulty in accessing European funds, excessive bureaucracy and lack of regulations;
- Late cashing of debts

These problems are reflected in the financial situation of the companies in this segment, as we will see from the analysis of the financial indexes calculated and presented further on. Based on the financial statements submitted to the Ministry of Finance on the activity for 2011, Coface Romania calculated the main financial indexes for the Romanian companies on different size categories. The classification of enterprises by size was performed in accordance with the provisions of Law no. 346/2004 regarding the stimulation of setting up

and developing small and medium-sized enterprises, with subsequent modifications and completions, which establishes the criteria for classifying enterprises on these categories.

Thus:

- **Microenterprises** – have up to 9 employees and have an annual net turnover or hold total assets of up to the equivalent in lei of 2 million Euro
- **Small enterprises** – have between 10 and 49 employees and have an annual net turnover or hold total assets of up to the equivalent in lei of 10 million Euro
- **Medium-sized enterprises** - have between 50 and 249 employees and have an annual net turnover up to the equivalent in lei of 50 million Euro, or hold a total number of assets that do not exceed the equivalent in lei of 43 million Euro
- **Large enterprises** – have between 250 and 999 employees
- **Very large enterprises** – have over 1000 employees

For enterprises with a maximum number of 249 employees, exceeding one of the classification criteria triggers the classification of the enterprise in the next size category.

As it can be seen from the figures below, the SME sector in general, and that of microenterprises in particular, shows the poorest prospects for funding. Thus, as far as the situation of the microenterprises is concerned, they:

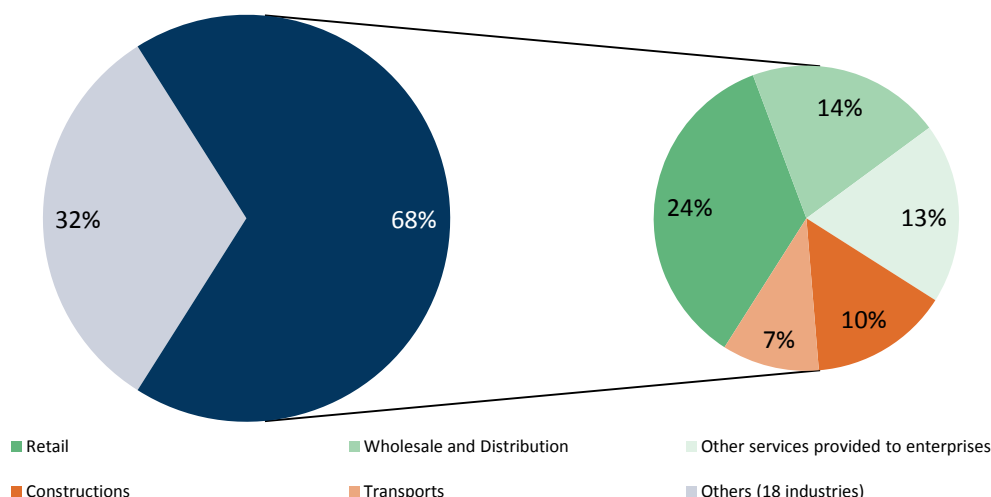
- register the highest debt level, namely 99% (as weight of total debt in assets)
- represent the only sector that registers a negative capitalization
- have the highest loss rate, namely -4.5%
- register the longest days sales outstanding, namely 172 days, two months longer than the one registered before the financial crisis.
- registers the lowest total debt coverage ratio through turnover, namely 37%

Size class	Number enterprises	Weight in total enterprises	Debt ratio	Capitalization ratio	Net Profit/Loss	DSO	Percentage employees
Microenterprises	529,789	89.79%	99%	-1%	-4.50%	172	20%
Small enterprises	49,551	8.40%	86%	13%	-1.60%	134	23%
Medium-sized enterprises	9,030	1.53%	63%	33%	0.43%	105	22%
SMEs	588,370	99.72%	82%	16%	-0.86%	124	65%
Large enterprises	1,388	0.24%	57%	38%	1.40%	87	15%
Very large enterprises	271	0.05%	43%	42%	2.91%	73	20%
Grand Total	590,029	100%	71%	24%	0.53%	104	100%

4. The business segments in which microenterprises activate

The distribution of microenterprises on business segments presents a high degree of concentration, 68% of these activating in five sectors: Retail (24%), Wholesale commerce and distribution (14%), Other services provided mainly for enterprises (13%), Constructions (10%), Transportation (7%).

Distribution of Microenterprises on Industries



Source: the Ministry of Finances, The National Institute of Statistics, Data analyzed by Coface

In the following sections we will present the top 5 business segments (the highest / lowest values) for the most important financial indexes calculated for enterprises classified in the category of microenterprises, for their activity in 2011.

Business segment	Capitalization ratio
Generation and distribution of electric and thermic power, water and gas	-37.14%
Fabrication of chemical substances and products	-36.48%
Extractive industry	-31.69%
Metallurgical industry	-31.42%
Food and beverage industry	-26.95%
.....	
Real estate transactions	7.47%
Other services provided mainly for enterprises	18.72%
Health and social assistance	19.96%
Financial brokerage	26.11%
IT	29.56%

Business segment	Profit rate
Generation and distribution of electric and thermic power, water and gas	-25.00%
Hotels and restaurants	-21.00%
Food and beverage industry	-18.20%
Extractive industry	-14.50%
Real estate transactions	-10.60%
.....	
Other services	3.35%
Other services provided mainly for enterprises	5.79%
Health and social assistance	7.21%
Agriculture	7.75%
IT	9.33%

Business segment	Indebtness
Fabrication of chemical substances and products	134.03%
Generation and distribution of electric and thermic power, water and gas	133.95%
Extractive industry	130.44%
Metallurgical industry	129.10%
Food and beverage industry	122.49%
.....	
Agriculture	86.40%
Other services provided mainly for enterprises	78.66%
Health and social assistance	75.26%
Financial brokerage	72.04%
IT	67.73%

Business segment	Average DSO (number days)
Generation and distribution of electric and thermic power, water and gas	360
Real estate transactions	342
Extractive industry	322
Textiles, clothing and footwear manufacturing	275
Financial brokerage	249
.....	
IT	128
Hotels and restaurants	120
Transportation	114
Health and social assistance	98
Retail	71

<p>The business segments with high degree of risk. The numbers are calculated as average for the microenterprises that activate in that respective segment!</p>	<p>The generation and distribution of electric and thermic power, water and gas - is classified in the top five business segments with the lowest ratio of capitalization (-37.14%, 1st position), the highest rate of losses (-25%, 1st position), the highest indebtedness (133.95%, 2nd position) and the longest DSO (360 days, 1st position)</p> <p>The extractive industry – is classified in the top five business segments with the lowest ratio of capitalization (-31.69%, 3rd position), the highest rate of losses (-14.50%, 4th position), the highest indebtedness (130.44%, 3rd position) and the longest DSO (322 days, 3rd position).</p> <p>The metallurgical industry – is classified in the top five business segments with the lowest ratio of capitalization (-31.42%, 4th position), the highest indebtedness (129.10%, 4th position), the business segment registering a negative profitability (-5.50%) and DSO of 208 days, above the average registered by microenterprises at a national level, namely 172 days</p> <p>The food and beverage industry - is classified in the top five business segments with the lowest ratio of capitalization (-26.95%, 5th position), the highest rate of losses (-18.20%, 3rd position) and the highest indebtedness (122.49%, 5th position), the business segment registering an average DSO of 163 days.</p> <p>It is not a surprise that the last three business segments registered during 2012 a number of insolvencies per 1,000 active enterprises above the national average.</p>
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<p>The business segments with low degree of risk. The numbers are calculated as average for the microenterprises that activate in that respective segment!</p>	<p>IT – is classified in the top five business segments with the highest ratio of capitalization (+26.56%, 1st position), the highest profit rate (+9.33%, 1st position), the lowest indebtedness (+67.33%, 1st position) and the shortest DSO (+128 days, 5th position).</p> <p>Health and social assistance - is classified in the top five business segments with the highest ratio of capitalization (+19.96%, 3rd position), the highest profit rate (+7.21%, 3rd position), the lowest indebtedness (+75.26%, 3rd position) and the shortest DSO (+98 days, 2nd position).</p> <p>Other services provided mainly for enterprises - is classified in the top five business segments with the highest ratio of capitalization (+18.72%, 4th position), the highest profit rate (+5.79%, 4th position), the lowest indebtedness (+78.66%, 4th position), the business segment registering an average DSO of 173 days, level compatible with that of microenterprises at national level.</p> <p>All 3 business segments mentioned in this category registered during 2012 a number of insolvencies per 1,000 active enterprises much inferior to the registered national average.</p>
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5. Microenterprises – liquidity, profitability and solvency worsening trend!

Analyzing the dynamics of financial indexes for the microenterprises that submitted financial statements on their activities in 2010 and 2011, an increase in liquidity and solvency problems that these companies face can be noticed in the context of widening net loss, increased indebtedness, of negative capitalization ratio and of longer DSO.

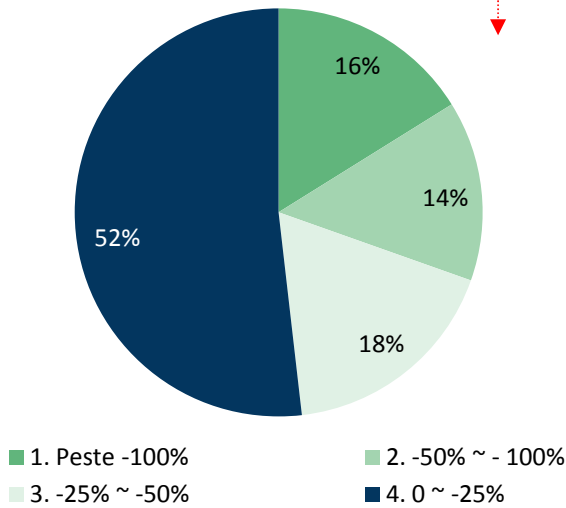
Index	Microenterprises year 2011	Microenterprises year 2010
Indebtness	99.0%	89.0%
Capitalization ratio	-1.0%	6.0%
Net profit rate	-4.5%	-0.9%
DSO	172 days	161 days

The deterioration of profitability indexes for microenterprises in the period 2010-2011 is noticed in the context of the increase of losses which happens in a more rapid pace than profits advance. Thus, from this point of view, one can notice two trends:

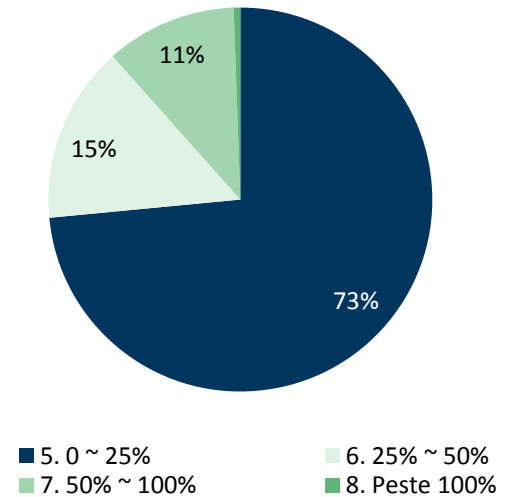
- The migration of microenterprises on sections of profitability: 12.13% of the microenterprises that had registered loss in 2010 registered profit in 2011, while 9.63% of the microenterprises that had registered profit in 2010 registered loss in 2011. Thus, there is an offsetting effect regarding the migration of microenterprises on profitability categories, the size of the companies in the two groups being similar in terms of turnover, namely 250 K RON.
- Half of the microenterprises that had registered losses at the end of 2011 had an increase of loss of between 0-25% in comparison with the previous year, while three quarters of the microenterprises that had registered profits at the end of 2011 had a net profit growth between 0-25% in comparison to the previous year.
- One third of the microenterprises that had registered losses at the end of 2011 had an increase in loss of over 50% in comparison with the previous year, while only 12% of the microenterprises registering profit at the end of 2011 had a net profit growth of over 50% in comparison with the previous year.

Profit / Loss 2010	Profit / Loss 2011				
	Number enterprises	Loss	Profit	Zero/ No activity	Total
	Loss	32.78%	12.13%	9.38%	54.29%
	Profit	9.63%	23.92%	1.09%	34.64%
	Zero / No activity	0.85%	0.34%	9.88%	11.07%
	Total	43.25%	36.40%	20.35%	100.00%

Loss index 2011/2010



Profit Index 2011/2010



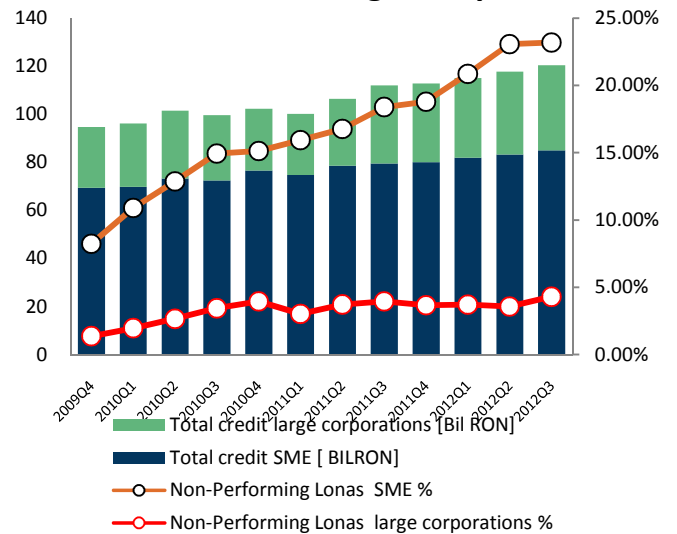
The analysis of enterprises by size criterion shows that small and medium-sized enterprises have indicated a growing loan risk (the SME NPL was 23.2% in July 2012 compared to 15.1% in December 2010, while in the case of corporations the NPL rate was 4.3% in July 2012).

The increase of the risk in the case of SMEs was produced in the context of:

- a subunit rate of coverage of expenses with the interest rate from the profits (0.8 in December 2011³);
- cash flows generated from an activity diminished by 7.3% (December 2011 compared to December 2010)
- the decrease of margin of gross profit

From the balance of the loans granted by the banking system to the companies, approximately 70% is directed to the SME segment. Moreover, the SME segment generates over 90% of non-performing loans granted to the companies by the banking sector.

NPL depending on the dimension of the borrowing enterprise



Source: NBR, data analyzed by Coface

³ According to the Ministry of Finance and the National Bank of Romania

6. Microenterprises – faulty credit risk management!

To assess the extent to which microenterprises properly managed the commercial credit risk in post-crisis period, we analyzed in this section the variation of debts as a consequence of the modification of turnover, while also considering the evolution of the average DSO for microenterprises and for all active enterprises nationwide. From this analysis the companies that recorded changes (dynamic turnover / debts) outside the band of variation (-500%, 500%), which are mainly due to base effect, were eliminated. Only the microenterprises which had activity (turnover greater than zero) were considered and the elasticities⁴ were calculated for the period 2010-2011, based on the financial statements submitted to the Ministry of Finance. The results obtained were summarized in the four quadrants below:

- the microenterprises in quadrant I and IV showed a negative elasticity of debt to the change in turnover (the two variables have evolved in opposite directions)
- the microenterprises in quadrant II and III showed a positive elasticity of debt to the change in turnover (the two variables have evolved in the same direction)

Thus, four categories of microenterprises can be distinguished in terms of how they managed credit risk management in the period 2010-2011

- Microenterprises in quadrant I – represent the businesses with the lowest risk level due to good management of commercial credit risk. In the context of increased turnover, these companies have succeeded to reduce their debts, registering an elasticity of -1.2 (at the increase of turnover by 1% the debts decreased by -1.2%). Thanks to this, the average DSO for these enterprises in 2011 was of 52 days, comparable to that of large and very large enterprises! Moreover, these companies can cover their debts by turnover at a rate of 150%, and register an average profit of 5.62%
- The microenterprises in quadrant II - represent companies with a medium risk level due to a satisfactory credit risk management. In the context of declining turnover these companies have succeeded to reduce their debts faster, registering an elasticity of 1.3 (when turnover decreased by -1% the debts decreased by -1.3%). Thanks to this, the average DSO period of these companies is 94 days, which is a significantly lower compared to that recorded by microenterprises nationwide, of 172 days! Moreover, these companies can cover their debts by turnover at a rate of 119%, and register an average profit of 1.35%
- The microenterprises in quadrant III - represent companies with a medium to high level of risk, due to poor credit risk management. In the context of increased turnover these companies have registered faster growing debts, the elasticity being of 1.65 (when turnover increased by 1% debts increased by 1.65%). Because of this, the average DSO period of these companies is 118 days, which is higher comparable to the level recorded by the enterprises presented in the first two quadrants! Moreover, these companies are able to cover only 64% of their debts with their turnover, registering a high level of indebtedness of nearly 100%. Thus, it is not surprising that these companies registered on average a net loss of -5.2%, although the turnover is increasing.
- The microenterprises in quadrant IV – represent the companies with a high level of risk due to poor credit risk management. In the context of declining turnover these companies have "managed" the counter-performance of registering increasing debts, the elasticity being -1.8 (when turnover decreased by -1% the debts increased by 1.8%). Because of this, the average DSO period for these companies is 153 days! Moreover, these companies are able to cover only 56% of their debts with their turnover registering an over indebtedness of over 100% and negative equity. The average loss is about 12%, and the probability that these companies become insolvent in 2013 is very high.

Thus, given the weights of the enterprises in the four quadrants, we can conclude that only 2 out of 10 microenterprises present a low risk of insolvency, 3.5 having an average risk and the remaining 4.5 registering a high to very high risk. We will notice that a similar set of conclusions will be obtained by analyzing the

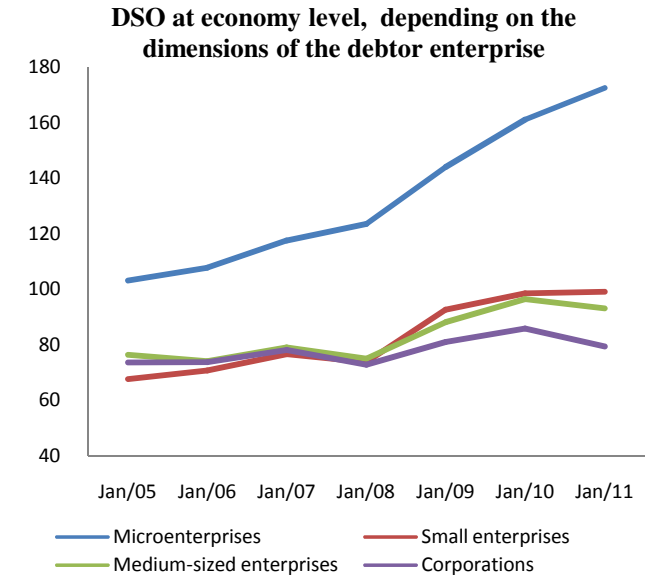
⁴ The modification of debts (percentage increase) as a consequence of the modification of turnover by 1%

sample of microenterprises analyzed individually by Coface Romania in the period 2011-2012 to establish the credit limit (Section 8 "Microenterprises under the magnifying glass of Coface - conclusions from the individual analysis of over 10,000 microenterprises")

	Decrease in turnover	Increase in turnover
Decreasing debts	<p style="text-align: center;">Quadrant II – Medium risk</p> <ul style="list-style-type: none"> • 35% of the total number of analyzed microenterprises • The average turnover of 200 K RON • Average elasticity 1.3 • Average DSO 94 days • Degree of debt coverage through turnover 119% • Net profit rate +1.35% • Indebtness +88% 	<p style="text-align: center;">Quadrant I – Low risk</p> <ul style="list-style-type: none"> • 21% of the total number of analyzed microenterprises • The average turnover of 378 K RON • Average elasticity -1.20 • Average DSO 52 days • Degree of debt coverage through turnover 150% • Net profit rate +5.62% • Indebtness +80%
Increasing debts	<p style="text-align: center;">Quadrant IV – High risk</p> <ul style="list-style-type: none"> • 20% of the total number of analyzed microenterprises • The average turnover of 253 K RON • Average elasticity -1.8 • Average DSO 153 days • Degree of debt coverage through turnover 56% • Net profit rate -11.90% • Indebtness 103% 	<p style="text-align: center;">Quadrant III – Medium to high risk</p> <ul style="list-style-type: none"> • 24% of the total number of analyzed microenterprises • The average turnover of 589 K RON • Average elasticity 1.65 • Average DSO 118 days • Degree of debt coverage through turnover 64% • Net profit rate -5.2% • Indebtness +96%

Commercial credit risk - the second vulnerability generated by companies on the financial stability, it has deteriorated during 2012, according to preliminary figures published by the Payment Incidents Register, the Ministry of Public Finances and The National Institute of Statistics.

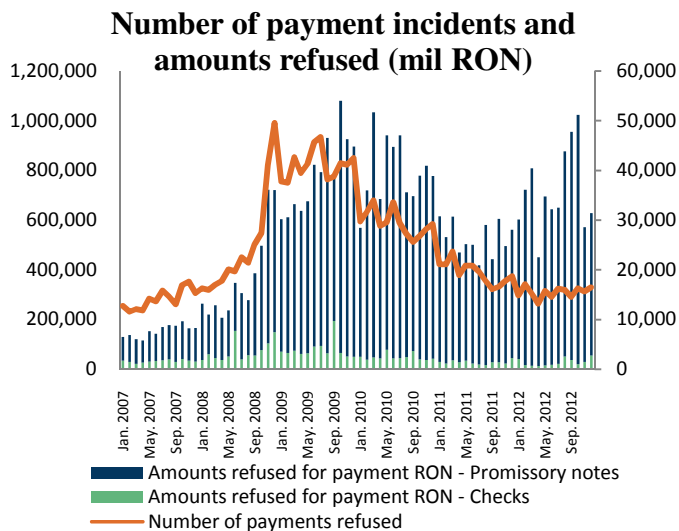
The payment discipline was negatively influenced by the continuation of liquidity constraints for companies, as a result of the tightening of credit conditions offered by banks and maintaining at a high level the DSO period. The greatest difficulty in indentifying financial resources to honour outstanding obligations was registered by small businesses. Thus, the average DSO for microenterprises increased to 172 days, while for small enterprises the level recorded is of 100 days.



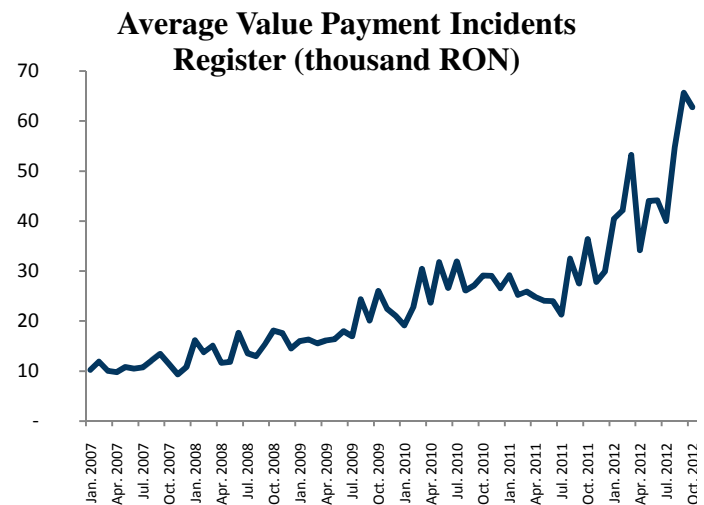
Source: NBR, data analyzed by Coface

Moreover, the microenterprises work in a business environment where payment discipline has widely deteriorated. Thus, according to data published by the Payment Incidents Register, the amounts withheld from payment with debt instruments in 2012 were worth a total of 8.63 billion RON, up by + 36% in comparison with the previous year. The amounts withheld from payment have increased significantly in the second half of 2012, given the advance of payment incidents during January-June 2012 compared to the same period of the previous year which was of 21.27%. Given that the number of payment incidents recorded in 2012 fell by - 21% compared to the same period of the previous year, the average value of payment incidents increased by 70% during the analyzed period. Thus, the average of payment incidents recorded in 2012 was of 46.4 K RON, compared to the level recorded in the previous year, namely 27.2 K RON.

In line with the extension of the recovery of debts in the economy, the trend can indicate a deterioration in payment behaviour regarding honouring debt instruments, which could determine companies to seek partial or full payment in advance to safeguard against credit risk.



Source: NBR, Payment Incidents Register. Data analyzed by Coface



Source: NBR, data analyzed by Coface

7. Microenterprises – fiscal frame

According to the amendments to the Tax Code applicable starting the 1st of February, 2013, there are a series of important changes in terms of categorizing microenterprises (from the Tax Code point of view) and the taxes they have to pay. Thus:

- the limit revenue that defines an enterprise as microenterprise will be of Euro 65,000, instead of Euro 100,000
- the condition to have between one and nine employees disappears
- such enterprises can not choose between corporate tax or income tax, being forced to pay a 3% tax on income earned starting February 1st, 2013

According to the estimates and calculations made by Coface, about half of the companies targeted by the recent legislative changes registered loss in 2011, a quarter have not registered any activity and the rest registered profit. Thus, the modification of the conditions of application for the income tax system will result in a tripling of the number of paying taxpayers and a similar increase in the level of tax burden felt by microenterprises.

Thus, it is possible that the recent tax modifications, in conjunction with the already precarious financial situation of microenterprises, cause an increased risk of insolvency in 2013 for this segment of companies.

8. Microenterprises – insolvencies on the up-rise!

Analyzing the dynamics of insolvencies for the entire economy compared with the dynamics of insolvencies among microenterprises, together with some financial indexes for the latter, we observe the following:

- The increase of insolvencies among microenterprises was faster than that recorded for the whole economy. Thus, the number of microenterprises which became insolvent in the last two years has registered an annual average increase of 14.5%, while the advance registered for the entire economy in the same analyzed period did not exceed 10%. In the context of this dynamics, the numerical weight of insolvent microenterprises increased from 78%, the level recorded in 2010, to 85%, level recorded in 2012
- Due to the higher degree of vulnerability, the microenterprises become insolvent 3 years faster than the national average registered by all insolvent enterprises. Moreover, the average length of activity of an insolvent microenterprise decreased from 9 years, level recorded in 2010, to 7 years, level recorded in 2012
- The degradation of financial indexes for the microenterprises which entered insolvency during the last 3 years – thus, these show a degree of negative capitalization, an increase of indebtedness and increase of losses
- Unlike the situation of microenterprises, the insolvencies registered at national level during 2012 are related to enterprises with a higher degree of sensitivity, which experienced internal and external shocks less significant than the ones in the previous years
- We appreciate that the financial situation of the microenterprises which became insolvent during 2012 is in constant degradation (in the context of weaker financial indexes) while the other companies present a higher degree of sensitivity following the financial crisis of the past three years (due to increased insolvencies among them, although the financial indexes look better).

Index	Total companies			Microenterprises		
	2012	2011	2010	2012	2011	2010
Year insolvency started						
Total insolvencies*	23666	21499	19650	20115	17630	15310
Microenterprises % total insolvencies				85.00%	82.00%	77.91%
Annual increase insolvencies	10.08%	9.41%		14.10%	15.15%	
The average duration of activity for the insolvent enterprises**	10 years	10 years	10 years	7 years	8 years	9 years
Insolvent enterprises with activity for less than three years (%total insolvencies)	11.77%	12.47%	13.01%	13.25%	14.15%	13.14%

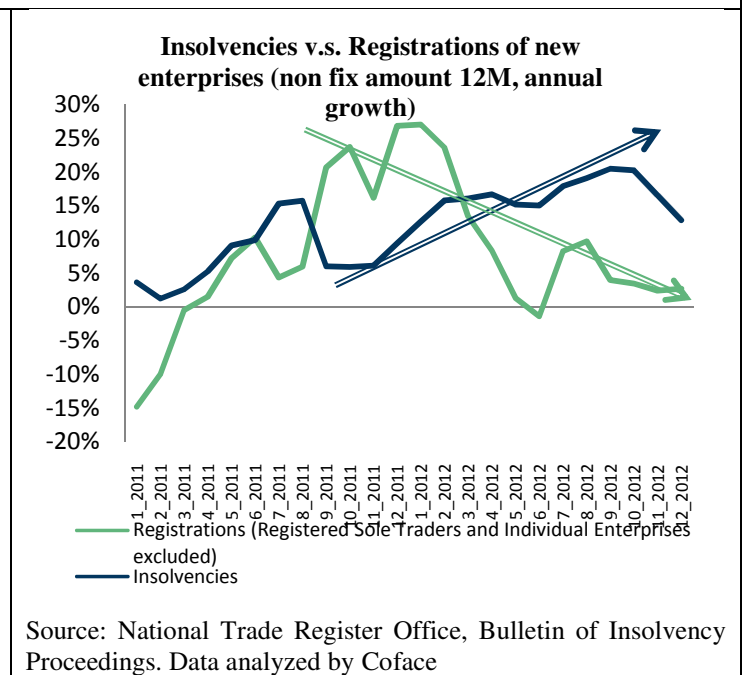
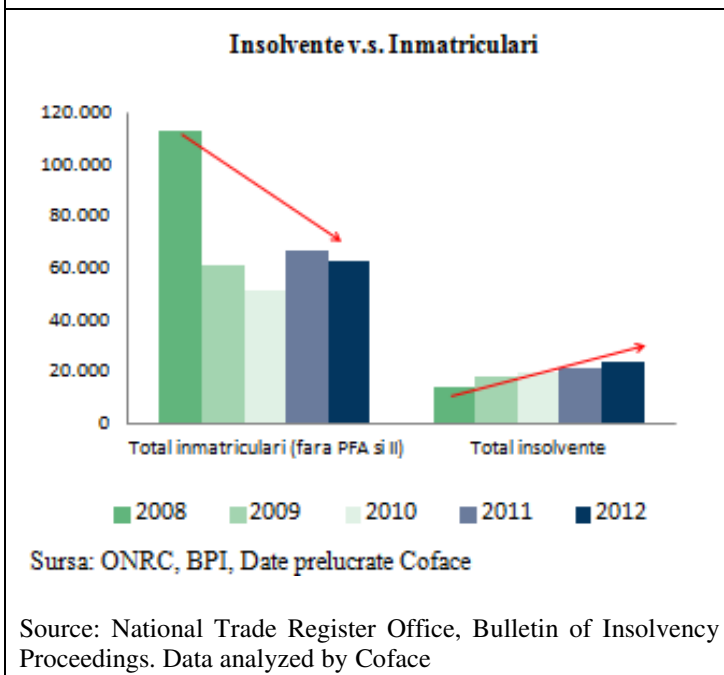
* Preliminary data from the Bulletin of Insolvency Proceedings

**number of years from the year the enterprise was registered until the year of entering insolvency

Indexes for insolvent microenterprises	Insolvency year 2012	Insolvency year 2011	Insolvency year 2010
Average turnover (K RON)	208	294	370
Capitalization ratio	-34.87%	-29.61%	-14.07%

Indebtness	132.71%	127.87%	111.91%
Net Profit/Loss Rate	-28.49%	-26.07%	-24.39%
DSO	225	251	212
Indexes for total insolvencies nation-wide	Insolvency year 2012	Insolvency year 2011	Insolvency year 2010
Capitalization ratio	36%	-14%	-2%
Indebtness	57.00%	112.00%	97.00%
Net Profit/Loss Rate	-14.00%	-18.00%	-17.00%
DSO	145	182	185

Note that 2012 was the first year after 2008 which recorded, throughout the year, an annual increase of insolvency higher than the number of newly registered enterprises. Thus, according to the numbers published by the National Trade Register Office, during 2012 66,611 new companies were registered (Registered Sole Traders and Individual Enterprises excluded), representing a growth of 2.70% in comparison with the previous year, when the number of newly registered enterprises was of 64,860. By contrast, according to the preliminary data published by the National Bankruptcy Register, the number of newly opened insolvencies during 2012 has increased by approximately 10% in comparison with the previous year.



Analyzing the territorial distribution of microenterprises which became insolvent during 2012 alongside the registrations of new enterprises in 2012 (Registered Sole Traders and Individual Enterprises excluded), we notice the following:

- The negative correlation between the number of insolvencies per 1,000 active enterprises and number of registrations in relation to the number of insolvencies, in the context of timid advancement of registrations of new businesses in 2012
- Bucharest registers the lowest number of insolvent microenterprises reported to 1,000 active enterprises

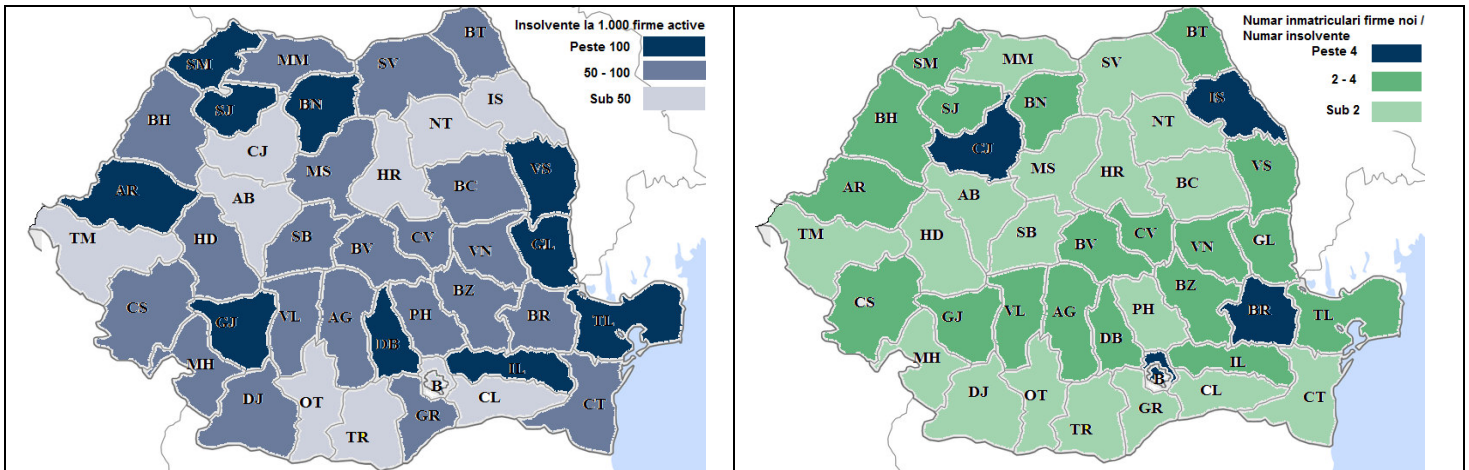
- Brasov is the only county where the number of newly registered enterprises in 2012 does not exceed the number of insolvencies opened the same year, the ratio being of 0.6

Judet	Insolvente la 1000 firme active	Inmatriculari / insolvente
Gorj	138,75	1,00
Bistrita-Nasaud	133,88	1,35
Galati	132,71	1,46
Ialomita	118,98	1,50
Arad	118,36	1,51
.....		
Iasi	42,13	4,40
Ilfov	39,46	4,98
Cluj	38,65	4,11
Neamt	38,41	3,94
Bucuresti	24,16	6,34

Judet	Inmatriculari / insolvente	Insolvente la 1000 firme active
Bucuresti	6,34	24,16
Ilfov	4,98	39,46
Braila	4,53	86,55
Iasi	4,40	42,13
Cluj	4,11	38,65
.....		
Bistrita-Nasaud	1,35	133,88
Dambovita	1,31	117,43
Vaslui	1,27	114,14
Gorj	1,00	138,75
Brasov	0,60	98,50

County	Insolvencies per 1,000 active enterprises	Registrations / insolvencies
Gorj	138.75	1.00
Bistrita-Nasaud	133.88	1.35
Galati	132.71	1.46
Ialomita	118.98	1.50
Arad	118.36	1.51
.....		
Iasi	42.13	4.40
Ilfov	39.46	4.98
Cluj	38.65	4.11
Neamt	38.41	3.94
Bucharest	24.16	6.43

County	Registrations / insolvencies	Insolvencies per 1,000 active enterprises
Bucharest	6.34	24.16
Ilfov	4.98	39.46
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.....		
Bistrita-Nasaud	1.35	133.88
Dambovita	1.31	117.43
Vaslui	1.27	114.14
Gorj	1.00	138.75
Brasov	0.60	98.50



9. Microenterprises under the magnifying glass of Coface - conclusions from the individual analysis of over 20,000 microenterprises

Coface has developed a rating model (named @rating score) for the countries in Central Eastern Europe, with variables calibrated to the macroeconomic specificity and depending on data availability in each country.

@rating score:

- Indicates the probability of the analyzed company to enter bankruptcy in for the following 12 months
- All relevant variables are combined into a single risk indicator, which is displayed on a scale from 0 (open insolvency) - 10 (minimum insolvency risk), each class being correlated with a specific insolvency probability
- Uses econometric models calibrated differently for each country
- Combines variables regarding financial information with the ones referring to payment behaviour
- Differentiates between SME and large and very large enterprises

Calculating the probability the analyzed enterprise would enter insolvency in the next 12 months involves the use of 218 soft variables (referring to payment behaviour and company description) and 299 financial variables. The results obtained by the two categories of variables are then consolidated to create a single risk index. Examples of variables used:

- **Qualitative (Soft):** the date of registration of the enterprise, the form of organization, location, development, activity (business segment membership for systemic risk assessment), information about shareholders and business relationships with other enterprises, information on payment behaviour, the existence of recovery cases (access and interconnection to/with database of the recovery department within the enterprise, which gives us information about the payment behaviour of the investigated enterprises), etc.
- **Financial:** is calculated based on the available financial data (both the dynamics of balance, the absolute values, and the calculated indexes), e.g. the dynamics of turnover, of fixed assets, of equity and their components, liquidity, solvency, profitability or activity indexes.

The final score (the company's @rating) is obtained as a linear combination of the two scores, the financial with a weight of 0.7, and the quality with a weight of 0.3. Coface @rating score also benefits from the information obtained by the Commercial Insurance Department within Coface, which provides additional information to our analysts (most of the times confidential information that can not appear in the report) about

the investigated enterprises.

Scoring @rating: 1-3 (NIGA – Non Investment Grade Agrivated)

For companies that are in this risk category (NIGA) investment, commercial insurance or commercial credit granting are not recommended. For this reason the maximum recommended exposure for these companies will always be zero.

In general, the companies in this risk category (NIGA) have a decreasing evolution (plummeting) for several years in a row, risky payment behaviour (very recent payment incidents, they are in suspension of check writing privileges, have outstanding debts registered in our database), negative or very small equity (<5% of total assets), very low, liquidity very low or negative information on commercial insurance (confidential information that can not be provided in credit reports).

Scoring @rating 4-5 (NIG – Non Investment Grade)

For companies in this risk category investment is not recommended, but may be subject to a commercial insurance or a commercial loan (with caution).

@rating companies scoring 4 and 5 have both negative and positive aspects: decreasing trend, but good financial structure, debt to the budget, old incidents, recent recovery cases positively closed (the company paid the debt), negative equity, but good development on the Profit and Loss Account

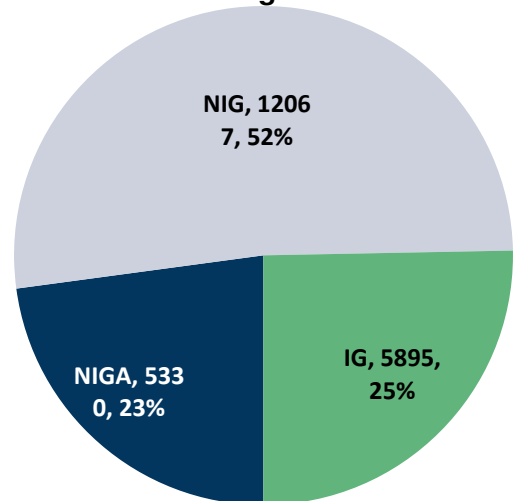
Scoring @rating 6-10 (IG – Investment Grade)

For companies in this category the risk is considered to be low. There will always be a recommended commercial exposure for scorings in this risk category.

Coface Romania CMS individually analyzed during 2012, at the request of the business partners or for direct exposure monitoring within the insurance department, a total of **23,292** microenterprises, with a total turnover of EUR 12.3 billion, representing 50 % of the turnover of all active microenterprises nationwide.

Analyzing the distribution of these enterprises on risk categories, it is observed that only 25% of the microenterprises present a low insolvency risk, a result similar to that obtained at the end of Section 6 on credit risk management for microenterprises (according to that analysis, 21% of all microenterprises nationwide show a low insolvency risk, namely the enterprises in quadrant I).

Distribution of microenterprises analyzed by Coface in 2012 on risk categories



Of the 23,292 microenterprises individually analyzed by Coface during 2012, a total of 9,716 companies were analyzed in 2011, representing about 20% of the turnover of all microenterprises active nationwide. Analyzing how these companies have moved from one risk category to another during the two analyzed years we observe the following:

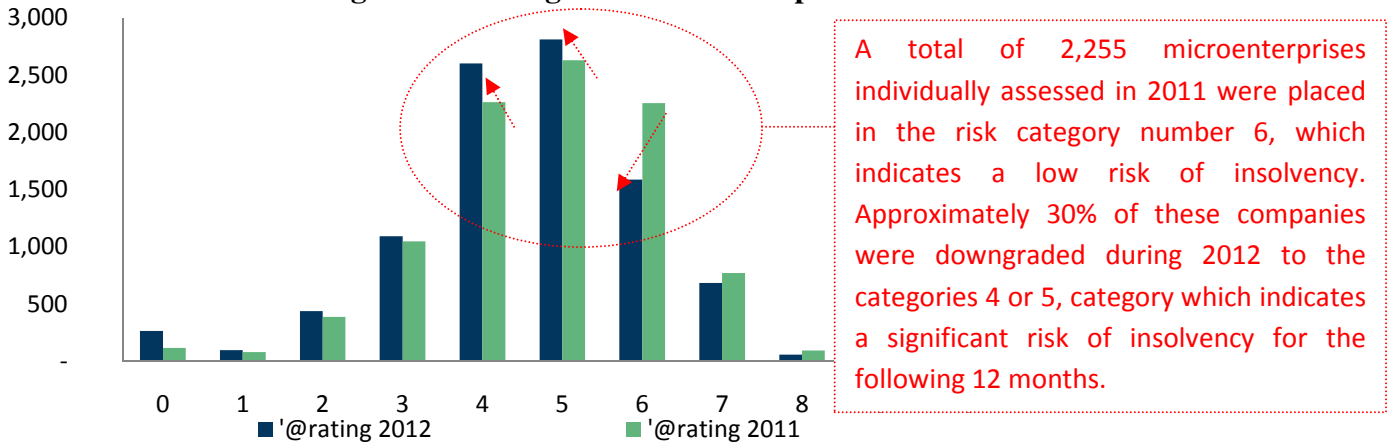
- A total of 4,546 microenterprises were placed in the same risk category, representing about 47% of the analyzed sample
- A total of 2,854 microenterprises were placed in a higher insolvency risk category, representing about

30% of the analyzed sample

- A total of 2,316 microenterprises were placed in a lower insolvency risk category, representing about 23% of the analyzed sample

	Number enterprises	Average turnover MIL RON
Total number of enterprises analyzed in both years 2011 - 2012	9,716	2.20
and which represent 20% of the turnover of all active microenterprises		
out of which:		
identical @rating	4,546	2.81
	Downgrade 1 class	1,851
	Downgrade 2 classes	674
	Downgrade more than 2 classes	329
	Upgrade 1 class	1,473
	Upgrade 2 classes	658
	Upgrade more than 2 classes	185

Evolution @rating 2011-@rating 2012 Microenterprises



Thus, following the analysis presented in this section in particular, and in the other sections in general, the segment of microenterprises shows a growing insolvency risk.

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