

# **Competitiveness, innovation and financing – a trilemma for the Romanian SMEs**

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## **Abstract**

*The development of Romanian economy and the increase of firms' competitiveness are specific requirements generated by the globalization process and the fundamental changes in the world economy. Therefore, the analysis of the needs of Romanian SME sector can reveal the capacity of these enterprises to participate and compete on external market and to face the recent challenges generated by the international financial crisis.*

*At present, not all Romanian SMEs are prepared for acting their role of economy engine. The lack of their competitiveness and innovation is caused mostly by the lack of adaptation to the European standards or their incapacity to attract financing sources for investment in new technologies, new products and implementing the quality and the environment protection systems.*

*In fact, access to financing is one of the most significant obstacles to the survival and growth of SMEs. Moreover, the limited market power, the lack of management skills, the insufficient capitals, all tends to increase the risk profile of SMEs. Uncertainty and informational asymmetries that characterize SMEs are amplified for innovative SMEs making the access to finance even more difficult.*

*The main influencing factors based on which the correlation competitiveness-innovation-financing should be analyzed are the followings: economic achievements of SMEs; their capacity to make investments; their innovation capacity, their capacity to compete both on the local market and international markets.*

Keywords: SMEs, financing, competitiveness, investment, innovation

## **Introduction**

The SME sector represents an important actor in the complex process of developing a modern and dynamic economy. The arguments in favor of this fact consist on the substantial contribution of SMEs to the economic development (Biggs, 2002), (Newberry, 2006) and job creation (Birch, 1987), their ability to respond flexibly in a competitive market and to adapt quickly to the structural changes in the global economy. As well, SMEs are considered main actors for industrial growth (Acs and Audretsch, 1987), a source of considerable innovative activity (Thurik, 1996), (Nooteboom, 1994), they contribute to the development of entrepreneurship (Johnson and Cathcart, 1979) and contribute to the competitiveness' increase (Song and Parry, 1997).

In 2000, the European Union launched the Lisbon Process designed to improve the competitiveness of European SMEs in an increasingly knowledge-based global economy. In 2002, Romania, together with other candidate countries, signed the Maribor Declaration and engaged to harmonize its policies for supporting the competitiveness of local firms to the provisions of the Lisbon Strategy.

Romania has made considerable progress in setting up an extensive policy framework to support the SME sector. Thus, there were developed a range of institutions, policy instruments, programs and resources in order to assist the small and medium enterprise development in Romania accordingly with the regulations on the European Union (Giurca, 2008).

As an expression of Romania's international engagement, the National Development Plan 2007-2013 highlights the importance of restructuring and developing existing SMEs and the creation of new enterprises and in this context, defines the priority measures as improving the business environment, supporting access to financial resources and providing support services to SMEs and entrepreneurs. In the same time, the Ministry for SMEs, Trade and Business Environment (MSMETBE) is responsible for ensuring Romania's compliance with its obligations under the European Charter for Small Enterprises.

Despite the measure taken in order to support the SMEs sector, the main problem they have to face, is the access to finance. In fact, in the economic literature is recognized that these economy actors are in general confronted with the lack of financing sources (Berger and Udell, 2005), (Ayyagari et al, 2006), (Beck, 2007) even there were taken measures in order to fill that gap (Pirvu and Mehedintu, 2008).

The international financial crisis represents another new threat for SMEs financing and development which are related with innovation and competitiveness. There are clear signs about the global credit crunch, with access to external finance becoming much more difficult, as well as expensive. Consequently, the SMEs should get rid off their dependence on banking credits and cover the financing gap through new and modern financing instruments such as mezzanine financing, venture capital or business angels.

### **SMEs sector in Romania: recent evolutions**

The SMEs play an essential role in the Romanian economy having a substantial contribution to the GDP (70% in 2008) and to the job creation. Thus, in 2008 in the SMEs sector were employed 60.7% of active population, the weight of contribution to the budget incomes was about 60% and to the exports of over 50% (MSMETBE, 2008).

On evolution, the number of Romanian SMEs registered an increase in the period 2000-2007 (table nr. 1).

**Table 1: Number of active SMEs, by size**

Year	Micro		Small		Medium		Total
	Number	%	Number	%	Number	%	
2000	375,804	91.1	29,121	7.1	7,504	1,8	412,429
2001	374,255	90.7	30,340	7.4	7,737	1.9	412,332
2002	377,499	90.9	30,231	7.3	7,761	1.8	415,491
2003	417,366	90.8	33,856	7.4	8,147	1.8	459,369
2004	358,787	88.7	36,392	9.0	9,121	2.3	404,300
2005	386,561	88.9	39,128	9.0	9,158	2.1	434,847
2006	410,763	88.6	43,419	9.4	9,322	2.0	463,504
2007	431,029	88.4	47,022	9.6	9,577	2.0	487,628

*Source: Ministry for SMEs, Trade and Business Environment, Annual Report 2008*

The dynamic for the analyzed period reveals a fluctuate evolution in the period 2000-2005 but starting with 2005, the number of SMEs increased continuously. Therefore at the end of 2007, the SMEs number was 487,628, which represent an increase of 18.2% in comparison to 2000. Despite these positive evolutions, the average of 23 SMEs/1000 habitants in Romania is much lower than EU average of 64 SMEs/1000 habitants (MSMETBE, 2008).

In structure, the micro-enterprises dominate the SME sector (88.4%) while the small firms represent 9.6% and the medium firms represent 2%, in 2007 (table 1). The great share of micro-enterprises should not be interpreted as a feature of underdevelopment for the SME sector or the private sector as a whole. On the contrary, this is an aspect which justifies and consolidates flexibility and adjusting capacity to the continuous changes in the market. Besides, this is a result of several important institutional and legislative factors such as tax facilities and the encouragement of services outsourcing.

Regarding the activity sectors, the number of active SMEs increased in all economy sectors but the evolutions on sectors were very different. Therefore, the fastest dynamic in the analyzed period was registered by the construction sector (32%), while in agriculture the increase was of 9,1% and in industry and services were registered the lowest increase rates, 4,5% and respectively, 2,5% (table 2).

**Table 2: Number of active SMEs, by activity sectors**

Sector	Agriculture	Industry	Constructions	Services	Total
2000	9,925	45,719	11,808	344,977	412,429
2001	10,720	47,693	13,402	340,517	412,332
2002	10,523	52,923	18,842	333,203	415,491
2003	13,704	59,555	24,542	361,568	459,369
2004	11,746	54,993	25,197	312,364	404,300
2005	11,958	55,718	29,265	337,906	434,847
2006	12,859	56,873	34,757	359,015	463,504
2007	14,036	59,492	45,896	368,204	487,628

*Source: Ministry for SMEs, Trade and Business Environment, Annual Report 2008*

In relative terms, the most substantial share is the one of the SMEs belonging to the services sector (75.5%) followed by industry (12.2%) and constructions sector (9.4%) in 2007. The SMEs from the service sector are more flexible; most of them are micro-enterprises involved in trade operations, being market intermediaries and having an additional degree of volatility.

The fact that more and more SMEs are involved in the industrial sector indicates that this sector was undergoing a development stage and this could be correlated to an increased degree of complexity for production processes.

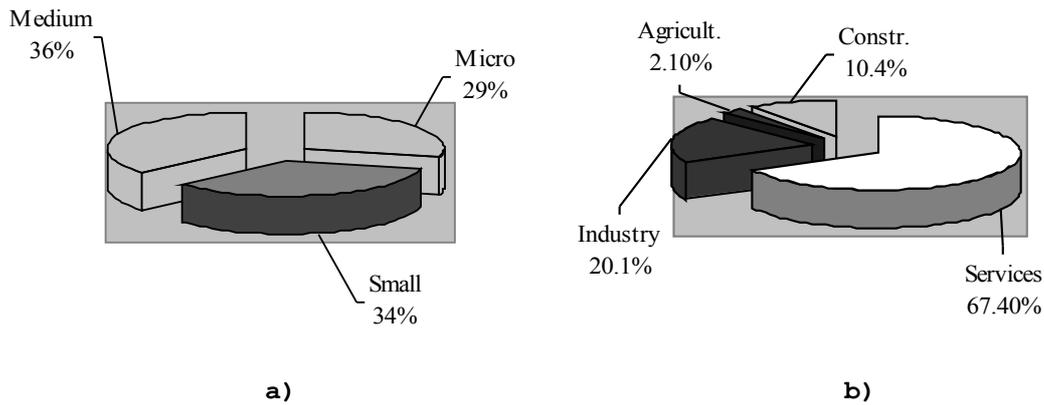
Inevitable, the financial crisis affected the Romanian economy and the SMEs sector in the last months. Therefore, at the beginning of 2009, the number of the SMEs starts to decrease and the forecasts are pessimistic: about 40% is expected to get bankruptcy in this year. In these circumstances, new measures should be taken at the national level to support the SMEs, especially regarding the accession to the financing sources.

**Economic performance of Romanian SMEs**

**Performance indicators of the Romanian SMEs**

The economic performances of Romanian SMEs can be reflected by indicators such as turnover and labor productivity.

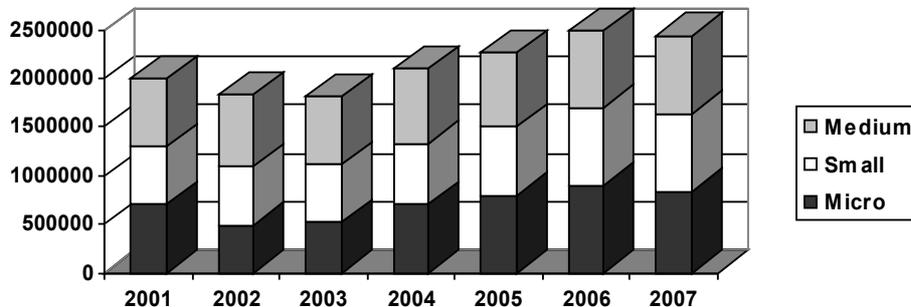
In 2007, the total turnover for Romanian SMEs was 139,132 million Euro, 36% being achieved by the medium firm, 34% by the small firms and 29% by the micro enterprises. On average, the turnover registered an increase at all size categories of SMEs (figure 1 a).



**Figure 1: SMEs' turnover by size (a) and activity sector (b)- 2007**  
 Source: Ministry for SMEs, Trade and Business Environment, Annual Report 2008

On activity, sectors, the SMEs from the services sector has a major contribution to the total turnover for SMEs (67,4%) while the industry and energy sector contribute with 20.1% and constructions with 10.4%. The SMEs from agriculture registered the lowest level with 2.1.% (figure 1 b).

The efficiency and profitability of the SMEs can be measured also by the productivity defined as the report between the turnover and the number of employees or as productivity per employee. The size of the productivity ratio depends on the price policy but also on the human resources policy. In fact, the number of SMEs' employees increased continuously since 2002 and registered 2,764,768 persons in 2007, which represents 16% more than in 2004 (figure 2).



**Figure 2: Number of employees in the SMEs by firm size**  
 Source: Ministry for SMEs, Trade and Business Environment, Annual Report 2008

The structure of the average number of employees in 2007 indicate that 32,5% worked in micro enterprises while 33,5% and 34.0% worked in small firms, respectively, medium firms (MSMETBE, 2008).

Taking into consideration the number of employees, the average productivity expressed as turnover per employee was 41,183 Euro, being 39,500 Euro for micro-enterprises, 50,786 Euro for small firms 54,136 Euro for medium firms (table 3).

**Table 3: Productivity per employee-on size and activity sectors (Euro)**

Year	Type of SME			Activity sectors			
	Micro	Small	Medium	Agriculture	Industry	Construction	Services
2005	26592	32304	39500	18445	17303	18964	36863
2006	30984	42051	41685	24657	26902	27225	35348
2007	39500	50786	54136	33465	32000	32581	44232

*Source: Ministry for SMEs, Trade and Business Environment, Annual Report 2008*

Considering the firms' size, the highest level of work productivity was registered by the medium firms. The micro-enterprises registered lower labor productivity, under the sector average and the main reasons are the followings:

- the low salary level on the labor market discourage the labor rationalization trends and determine a number of employees larger than necessary, instead of stimulating internal competitiveness;
- the medium enterprises are overstaffed taking into consideration that many such enterprises have not been set up as new companies through a privatization process or property transfer which forced them to keep their staff despite the low financial ratios.

On the activity sectors, the highest productivity (about 50% more than the other sectors) was registered by the service sector which is characterized by a wide range of service and commerce activities and by the preponderance of micro enterprises in this field that influenced the final result. The performance of the construction field (32,581 Euro) is also important as it surpasses the one in industry (31,000 Euro).

#### **Accessing financial sources for the Romanian SMEs**

In order to record economic performances that would ensure competitiveness and longevity on the EU market, the firms should benefit of financial resources for investments with the purpose of modernization and innovation or for training their staff. Therefore, the access to finances sources represents a major factor of development for the SMEs sector because it can influences their capacity to invest.

Despite the Government's measures to generate a favorable background for the SMEs development and to improve their access to financing sources, there are still many deficiencies on the financial market. Hereby, the largest part of financial resources is based on their own

funds followed by the banking credit and other non-reimbursing sources as budget allocation or EU funds (table 4).

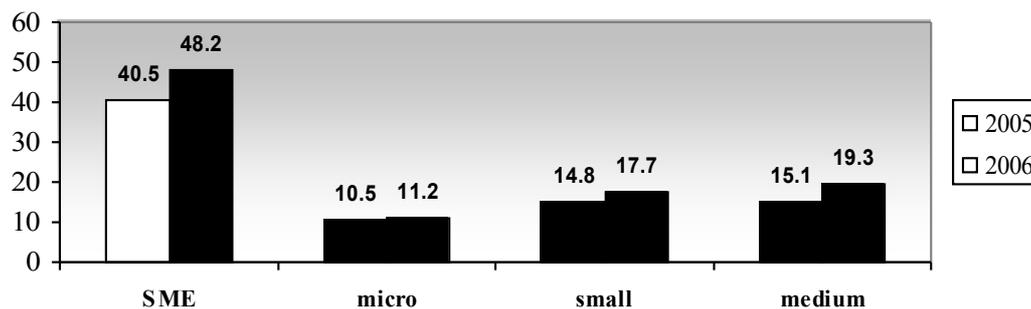
**Table 4: The financing sources for Romanian SMEs (%)**

Financing sources	Total SME		Micro		Small		Medium	
	2005	2006	2005	2006	2005	2006	2005	2006
Equity	18.7	21	13.9	15.5	16.3	21.7	27.9	27.3
Banking debts	6.4	7.7	4.2	5.1	7.6	9.2	8.3	9.5
Non-banking debts	65.7	65.6	69.6	74.5	69.0	64.9	56.7	59.7
Self financing capacity	9.2	5.7	12.3	4.9	7.1	4.2	7.1	3.5

Source: Ministry of Public Finance, National Bank of Romania –Financial Stability Report 2008

The capacity of the SMEs to use more diversified financing sources is still very low (4.9%) and there are not financed investments from the capital market (Popa and Giurca, 2006).

Accordingly with the increasing financing needs of SMEs, the banks' attitude towards SMEs changed considerably in the last years, evolving from hesitation and even rejection to a real interest in financing this sector. Although the weight of the banking credits for SMEs increased in the last years from 40.5% in 2005 to 48.2% in 2006 the percent of financing by bank loans is still low (fig 3).



**Figure 3: The banking credits for SMEs (%)**

Source: National Bank of Romania, Financial Stability Report 2008

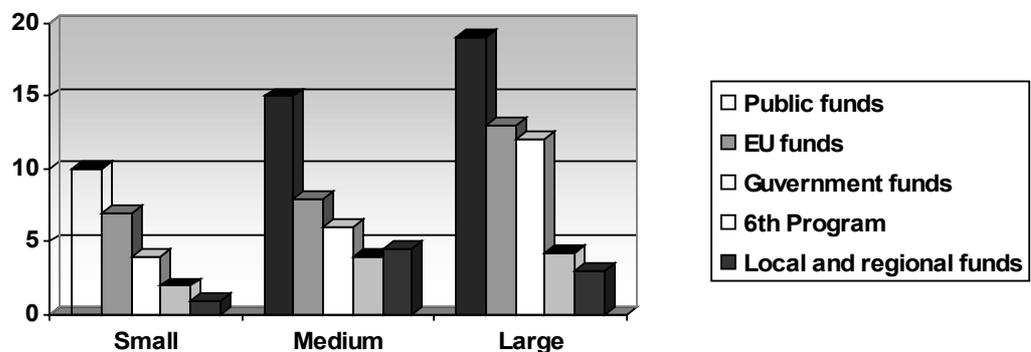
The need for development of the SMEs imposes financing sources but there are different factors which affect the access of firms to the banking credits such as: the lack of guarantees, the limited experience in the business field, the poor managerial experience, the lack of information. Moreover, the recent financial crisis affected the financing capacity of the SMEs and increased the prudential measures imposed by the financial institutions.

Despite these new challenges, improving the access of the SMEs to financing represents a priority in order to develop this sector of economy. The main ways to ease the access to financing are the followings:

- the participation of the enterprises in non-refundable programs;
- the development of the micro financing schemes;
- facilitation of the access to investment funds;
- improving the access to bank loans;

- the development of some guarantee system for the loans on a national, regional and local level;
- the introduction of some new financing means such as venture capital, business angels or mezzanine finance;
- the development of business incubators and clusters.

The financing sources for innovation from public funds (national and European) are related to the firm size which determine the increase of the innovation gap between the SMES and the large enterprises. The small firms get about 10% from the public funds, while the medium firms get 15% and the large ones, 20%. Only the funds from local and regional authorities are addressed in a higher proportion to the medium firms. In total, the percentage of firms that got public funds for innovation represent 2.8% from the total firms (figure 4).



**Figure 4: Innovation firms which received public funds (%)**

*Source: National Institute of Statistics: Report Innovation in industry and services in the period 2004-2006, 2008*

### **Romanian SMEs' competitiveness - facing new challenges**

The main influencing factors for SMEs competitiveness level and which represents in the same time new challenges are as follows: SMEs capacity to make investments; SMEs capacity to bring new products onto the market; SMEs capacity to compete on the local and international markets.

#### **Romanian SMEs investments**

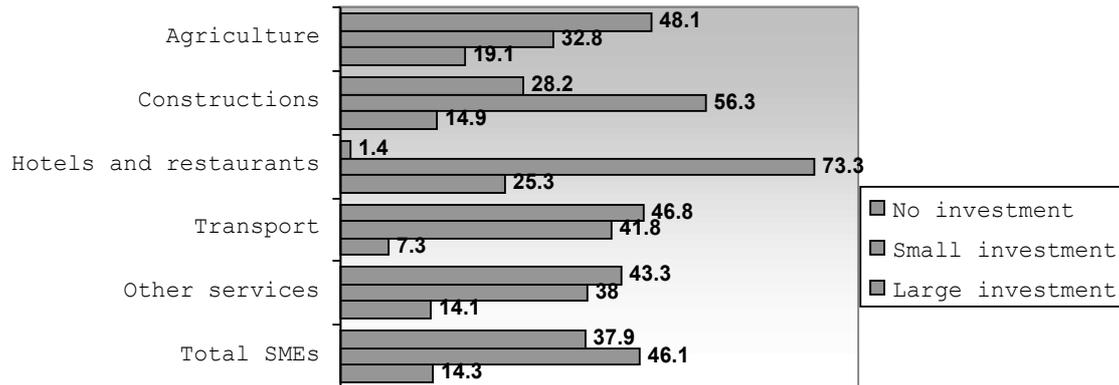
The investments are factors of economic growth that create new resources for enterprises and can stimulate the employment. Regarding the SMEs investment, it should be analyzed the SMEs capacity to make investments as an expression of their competitiveness (to get new technologies or to create new products).

A general characteristic, available for Romanian SMEs from all sectors and all size categories, is the low level of investments. There are some essential aspects which can explain this trend, such as:

- the reticence attitude towards investments, many SMEs taking into consideration only short term loans;
- the investments are mostly directed to infrastructure elements (buildings, industrial offices and others);

- ignoring the investments for environment protection and for staff training;
- the correlation of the "vicious circle" between the level of the business and the investment activity because accessing the investment resources depends of the stage of the businesses, and small businesses can access funds with great difficulty.

By activity sectors, there are big differences regarding the SMEs investment: the hotels and restaurants sector registered a high percentage (73.3%) in comparison with the other sectors, such as constructions, transport or other services (figure 5).



**Figure 5: SME investments by size and activity sectors**

Source: National Agency of SMEs and Cooperatives, Annual Report on the SME Sector in Romania 2005

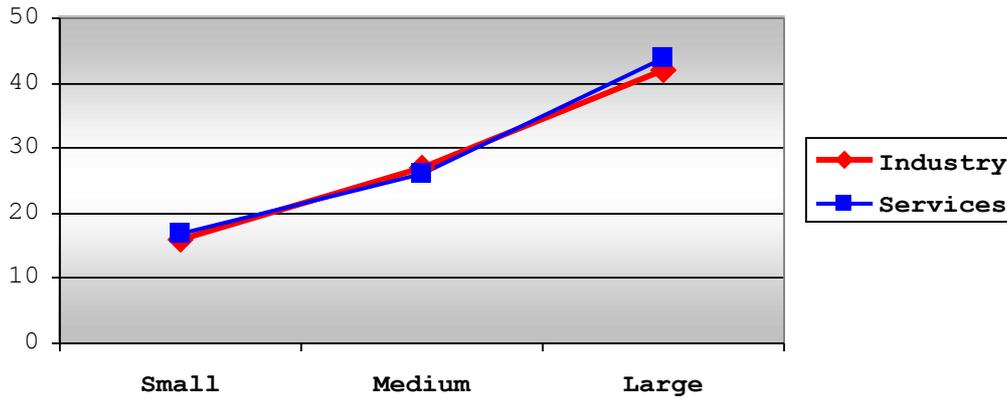
A particular negative situation was registered in agriculture, where a part of entrepreneurs made small investments (32.8%), a part made large investments (19.1%) and 48.1% did not make any investment.

The micro-enterprises had the lowest percentage regarding large investments (13.0%) and the highest share of enterprises that did not make any investment (39.4%) while the percentage of medium-sized enterprises that made large investments was 35.1% (Popa and Giurca, 2006). These evolutions indicate that the SMEs are not financially able to make long-term investments that make them able to develop and remain in the market. Besides, the present day financial crisis affects the investment capacity of the firms which focus on short time planning and finding new financing sources for survival.

**Innovation capacity of SMEs**

The SMEs innovation capacity is one of the specific features of this sector, related to flexibility and market-driven activity. The success of the innovative activities carried out by SMEs can be described through market development, by introducing new or improved products, and by improving and innovating organizational and technological processes.

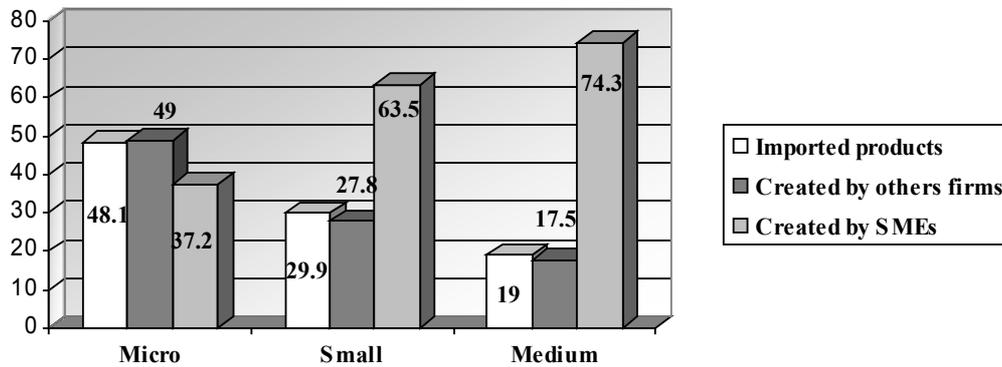
The proportion of the small firms which make innovations is reduced (18%) but this proportion increase till 25% for the medium firms and till 44% for the large firms. In general, there are not significant differences between services and industry (figure 6).



**Figure 6: Innovation firms by size and sector activity**

Source: National Institute of Statistics, 2008, Report Innovation in industry and services in the period 2004-2006

Although only a third of SMEs managed to introduce new products onto the market, the firms that did this equally approached three main sources: new imported products (45.5%), products created by other companies in Romania (46.0%) and the last place is held by products created by the SMEs themselves (40.8%). The capacity to bring in their own products increases along with the size of the companies (figure 7).

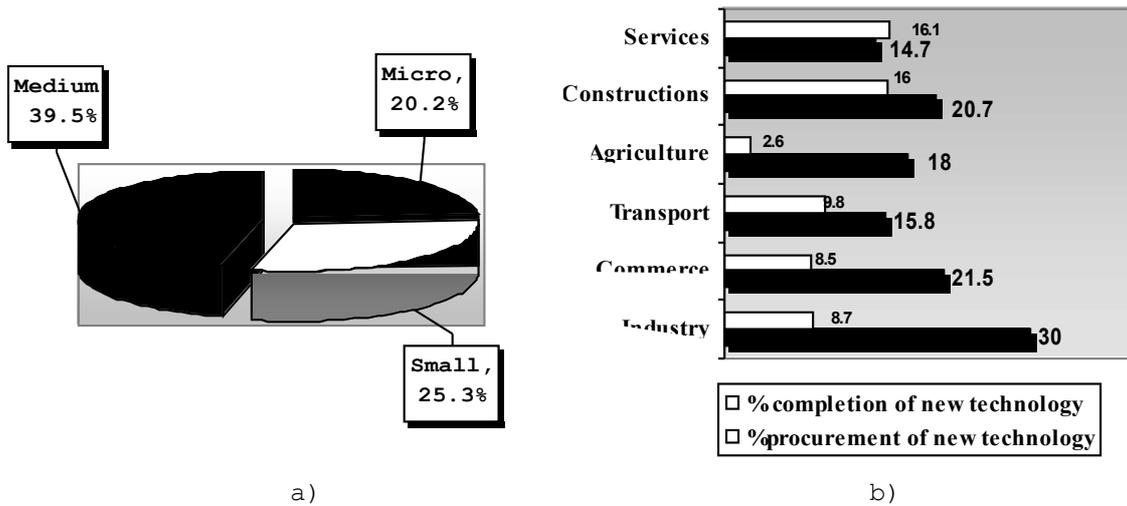


**Figure 7: Origin of the new products introduced on the market by SMEs (%)**

Source: National Agency of SMEs and Cooperatives, Annual Report on the SME Sector in Romania 2005

Also the procurement level of new technology among SMEs is low: 68.1% of SMEs did not procure any new technology in 2005, only 21.2 % purchased new technology, while 9.7% completed their acquisitions of new technology.

Taking into consideration the size of the SMEs, 39.5% of medium enterprises procured new technology, which is almost double than the micro-enterprises (20.2%) and far ahead than small enterprises (25.3%) (figure 8a).



**Figure 8: Procurement of technology - SMEs by size and activity sector (%)**

Source: National Agency of SMEs and Cooperatives, Annual Report on the SME Sector in Romania 2005

Regarding the main sector of activity, the largest number of SMEs that procured new technology is found in industry sector (30.0%) followed by SMEs in commerce sector (21.5%) (figure 8b).

**SMEs participation on international market**

The Romanian SMEs have a low participation on the international market: 10% of SMEs took part in the international market as importers, only 6% of them as exporters and 6.9% as sub-contractors of a foreign company (table 5).

**Table 5: Romanian SMEs participation on international market**

Nr. crt.	Type of participation on international markets	SMEs		
		Micro enterprises	Small firms	Medium firms
1.	Sub-contractors	9.5	5.6	7.0
2.	Exporter	27.9	14.1	4.5
3.	Importers	21.7	15.4	9.1

Source: National Agency of SMEs and Cooperatives, Annual Report on the SME Sector in Romania 2005

Per size category, the participation on international markets shows large differences between micro-enterprises and small ones, and especially medium ones. The micro-enterprises in Romania are not trained, prepared and capable to capitalize the advantages of global economy, thus conducting their business mainly on the Romanian goods and service market. Again, should be underlined the direct correlation between the SMEs size category and their extent of participation in international markets. Thus, only 4.5% of micro-enterprises played the role of exporter in this process, while this number increased to 14.1% for small enterprises and to 27.9% for medium ones. The same trend is noticed when analyzing the degree of participation as importer, per SMEs size categories. Very few SMEs played both roles, as exporter and importer, on the international market. This shows the market is made up of certain players, which means that large companies tend to externalize certain activities to micro and small enterprises.

## Conclusions

The recent trends revealed that the SME are sensible to the evolutions of the economic cycle. It is obvious that the small and medium sized enterprises are not a lonely island but a vivid ensemble which function in direct connection with what is happening at national, European and international economy level. Thus, the SMEs are the first developing entities when the economy is on the right path but also the first ones to pay the price of economic recession. That is why the governmental policy toward this sector has to be an integrant part of a general policy: fiscal, commercial and industrial.

At present, not all Romanian SMEs are prepared for acting their role of economy engine. The lack of their competitiveness is caused mostly by the lack of adaptation to the European standards or their incapacity to attract financing sources for investment in new technologies, new products and implementing the quality and the environment protection systems. Moreover, the financial crisis induced new worries regarding the capacity of SMEs to survive in the conditions of scarcity of financial resources.

For the SMEs financial stability, the efficient allocation of the resources in the economy plays an important role. The Romanian companies are mostly financed by other credits than the banking ones. This high percent rise on one side, the problem for companies to have the capacity to build realistic project and on the other side, the capacity of the financial sector to allocate efficiently the available resources for these companies.

Despite the effort to support the SMEs and the progresses in implementing the European Charter for Small Enterprises in Romania, there still are difficulties the SMEs have to confront which are related to the limited financial resources and the cyclical and structural changes of global economy. In this way, the strategic development and cooperation objectives for the SMEs in the period 2007 - 2013 are the followings:

- Increasing the international competitiveness of the SMEs by offering support for the modernization investments, the development of their own innovative activities, the alignment of their product and services to the quality requests imposed by the European Union;
- The development of the business infrastructure through creation of an adequate business environment for the integration in the economic circuit of all the geographic areas and the premises in order to promote successful investments;
- The development of highly qualified counseling services for the SMEs which represents a measure to connect the entrepreneur to the competitiveness and economic growth;
- Facilitate the access to finance by promoting new financial instruments adequate to the SMEs needs through: innovative financial instruments; increasing the institutional and human resources' capacities among the micro lending institutions; establishing a micro-lending scheme for the start-ups.

Therefore, at the national level it should be elaborated and implemented an integrated and transparent strategy in order to valorize the whole factors which have impact on the Romanian firms' capacity to compete on the internal and international markets. In that

sense, it should be elaborated procompetitive reforms, should be simplified and improved the legislative and administrative framework, diminished the bureaucracy and tax burden, promoted a correct competition environment, prevented and limited the anticompetition practices, stimulated the exports and the access of SMEs to the external markets; offered support for the capital market development.

Also, as part of the European Union market, the Romanian SMEs are the beneficiary of the "Small Business Act" (SBA) for Europe, adopted by the European Commission in June 2008 in order to further strengthen SMEs' sustainable growth and competitiveness. Therefore, the EU and Member States should facilitate SMEs' access to finance, in particular to risk capital, micro-credit and mezzanine finance and develop a legal and business environment supportive to timely payment in commercial transactions. Also, should be promoted the upgrading of skills in SMEs and all forms of innovation through the encouragement of investment in research and their participation in R&D support programs, transnational research, clustering and active intellectual property management.

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