

## Impact and management of legislative changes in the construction sector with specific reference to the design activity

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**Abstract** – This article examines the financial management of a construction company over a period of nearly two decades (2005-2022). The impact of legislative modifications on small and medium-sized company (SMEs) within the Romanian construction industry was analyzed. The results of the data analysis reveal the susceptibility of a micro-enterprise (SME) in the construction sector to significant events during this period, indicating that both positive and negative effects were influenced and altered by about 50%. The study examines the impact of economic volatility and regulatory changes, including the 2009 global financial crisis and the COVID-19 pandemic, on the financial and development performance of the enterprise. The comparative analysis of construction sector statistics emphasizes the importance of regulatory stability for microenterprises within this domain. This offers valuable insights for the financial management of these enterprises and the development of small businesses during difficult economic conditions.

**Keywords** – construction company, financial management, legislative regulation, vulnerability.

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### 1. INTRODUCTION

The private sector in Romania is marked by resilience. Dex defines resilience as “the capacity to revert to a normal state following the experience of a shock (emotional, economic, etc.).” Data training concluded in October 2023. In construction firms, the notion of organizational resilience pertains to the entity’s capacity to recuperate or adapt to unfavorable circumstances or alterations swiftly and with minimal supplementary expenses.

While private economic entities constitute the foundation of any nation’s economy, in Romania, the private sector has consistently been the first to suffer during crises and the last to get support during development phases. This article examines the circumstances of small and microenterprises in the building industry from the perspective of a microenterprise offering design services as a representative case.

The empirical segment of the study will conduct an economic analysis of the firm in issue for the period from 2005 to 2022. This research highlights both the favorable periods the firm has experienced and the difficult occasions it has faced. In the study's second half, the legislative modifications in the construction sector, implemented between 2005 and 2022, will be temporally correlated with the financial outcomes of the firm in question.

The legislative framework of Romania has undergone numerous alterations. These changes frequently exhibit limited preventive measures and a brief duration for transition and implementation. Consequently, the Romanian private sector has had to develop an ability to swiftly adjust to any alterations. It is important to note that for a building company, the logistical equipment required for operations is considerably costly, resulting in additional adaptation expenses.

From 2005 to 2022, there were fluctuating phases of economic expansion with a financial crisis and a health catastrophe caused by a pandemic. The second part of the study will examine the legislative changes that impacted on micro and small enterprises during this time period, with a focus on the financial implications for the enterprise under investigation, as well as the wider influence on all enterprises the construction sector. Relevant statistical data were collected and analyzed comparatively to validate the acquired results against prevailing patterns for all enterprises in the construction sector.

All these legislative changes led to significant alterations in the financial outcomes of Romanian SMEs. This study aims to identify and evaluate the changes in construction industry enterprises using a technique that incorporates both qualitative and quantitative components.

The financial analysis of a microenterprise engaged in design activities, correlated with market trends across the sector, can enhance the existing knowledge within this scientific community by providing valuable insights.

## 2. DESCRIPTION OF THE RESEARCH METHOD, LEGISLATIVE FRAMEWORK AND COMPANY ANALYZED

The selected methodology for the research incorporates a blend of methods and techniques, focusing on the exploration and synthesis of qualitative and quantitative elements. The economic data was gathered from the accounting and official records of the microenterprise and subsequently examined. Furthermore, the legislative material was obtained from authoritative sources that ensure reliability, including ANAF (National Agency for Fiscal Administration), legal portals, and financial magazines. The employed methodologies included the comparison method and the establishment of financial indicators for benchmarking purposes.

The calculation of pertinent financial indicators is essential for conducting the company's financial analysis. Statistical data, serving as a benchmark, were acquired via the Eurostat site [4] and underwent comparative examination. The Romanian legislative framework for the construction sector was examined, along with statistical data from specialized platforms.

The information undergoes comparison examination to establish a clear understanding. The quantitative aspect of the study involves a financial examination of the microenterprise's economic activity.

The study objectives were organized into three distinct categories. The initial directive was to perform a comprehensive financial analysis for the chosen microenterprise.

The evaluation of its design activities occurred across its whole operational period, from 2005 to 2022.

This study aims to examine and emphasize the legislative changes in recent years that have significantly impacted the financial performance of this microenterprise, whether positively or negatively. Furthermore, the objective was to measure this influence.

The analysis for the third line of inquiry also encompassed the sectoral level. The objective was to analyze statistical data from all construction firms to detect industry trends and assess their alignment with the financial performance of the analyzed microenterprises post-legislative changes.

The study by Nastac, Isaic-Maniu, and Drăgan (2017) [5], referencing the SME Sector Annual Report 2013-2014 (2014), as well as the work by Drăgan and Isaic-Maniu (2012) [6], discusses notable features of the economic system in Romania.

Following the December 1989 Revolution, which signified a complete transformation of Romania's political government, nearly ten years were required to transition from a centralized economic system to a market-oriented pricing structure, shifting from a price-controlled framework to one governed by supply and demand. In this setting, the private sector, particularly the SME sector, was virtually nonexistent before 1989, as was free enterprise, necessitating comprehensive organization.

In 2019, the European Commission published a manual for aspiring entrepreneurs seeking to establish small or medium-sized enterprises. The manual commences with the assertion, "Ninety percent of enterprises are SMEs, and SMEs account for two-thirds of new job creation." European Commission, 2019.

The former President of the European Commission, Jean-Claude Juncker, stated, "We will achieve jobs, growth, and investment in Europe again only by establishing the appropriate regulatory framework and fostering an environment conducive to entrepreneurship and job creation." We must avoid hindering innovation and competition by excessive and overly comprehensive regulation, particularly for small and medium-sized firms (SMEs). Small and medium-sized enterprises (SMEs) constitute the foundation of our economy, generating over 85% of new employment in Europe, and it is imperative to protect them from onerous regulations. European Commission, 2019 [7].

These assertions underscore the significance of small entrepreneurs and the necessity of recognizing them as the backbone of an economy, warranting support and protection. According to the European Commission, an enterprise is any entity engaged in an economic activity that produces revenue, regardless of its legal structure. [7] The National Agency for Tax Administration has established recommendations (2005, 2021) to aid taxpayers in business establishment and tax compliance.

According to Romanian legislation, the classification of a business as a SME is contingent upon the number of employees and yearly turnover, with distinct criteria for micro, small, and medium-sized enterprises.

In 2005, the ANAF's tax advice for microenterprises stipulated that these firms could opt to pay either corporate tax (16%) or income tax (3%). Tax rates have evolved, and in 2009, a minimal flat-rate tax was instituted, applicable to the turnover concluding in 2008. [8] [9] [10]. Small and medium-sized enterprises were profoundly impacted as 2009 was a year of economic crisis, with taxes often exceeding monthly sales. This resulted in the closure of numerous enterprises, causing significant employment losses as a subsequent effect.

In 2010, the flat-rate minimum tax was eliminated, and the tax framework for microenterprises was temporarily halted (Ascent Group, 2010; Daily Business, 2010; Ziarul Financiar, 2010) Legislative modifications from 2015 to 2018 elevated the income threshold for microenterprises to €1 million in 2018, accompanied by distinct tax rates for organizations with and without employees. [11]

Research conducted by the Fiscal Council [11] indicated a substantial rise in the quantity of microenterprises and their economic impact in 2017.

These tax incentives have favored companies exhibiting substantial profitability and minimal investment, as corroborated by Laslo (2020) [12]. Companies exhibiting low profitability or incurring losses have been adversely affected by these actions; notwithstanding their diminished representation, they remain significant. These disadvantaged enterprises contributed 60% of total revenues in 2015, 41% in 2016, and 44% in 2017 [11]. The introduction of the choice between corporation and income tax has resulted in a decline in budget receipts from corporate income tax, as companies have capitalized on the new tax incentives (Fiscal Council, 2019; Laslo, 2020). [11] [12].

In 2017, modifications were made to the use of the social health insurance contribution (CASS)—a percentage rate—on dividend income, establishing maximum contribution limits that remained constant from 2019 onward. [11]

In 2019, the Tax Council [11] observed that the transition from corporation to income tax resulted in microenterprises reporting markedly increased profits, so indirectly aiding in the diminishment of the shadow economy. Conversely, despite Romania's economic expansion and significant increases in gross profits in 2016 and 2017 [11], budget revenues from income and profit taxes experienced only minor growth. The finding indicated that companies were progressively adept at lawfully maximizing their tax obligations, hence enhancing their level of living. The decision of firms to pay income tax rather than profit tax resulted in a reduction of income tax revenues by 3.3 billion lei [11], while the supplementary income tax revenues only partially offset this decline with an increase of 1.2 billion lei [11], thereby not fulfilling the government's anticipated projections.

In 2020, in reaction to the pandemic and the declared state of emergency, tax refunds were implemented to assist micro-enterprises.

The year 2021 marked the commencement of a new phase of stringent SME legislation.

In 2021, effective from 2023, a decision was made to reduce the income threshold for tax classification as a micro-enterprise. [3] Simultaneously, until 2022, the tax rate was 1% for microenterprises with at least one employee and 3% for those without employees. However, by Ordinance 16/2022, effective January 1, 2023, the tax concession allowing firms without employees to pay a 3% income tax was abolished. Consequently, numerous SMEs were compelled to transition to corporate income tax payments. 13

The design-focused construction company commenced operations in 2005. The corporation has a single administrator and its operational nature does not incur significant administrative costs. The company's headquarters is situated on the manager's land, adjacent to his residence, thereby alleviating early expenses related to establishing the premises and paying rent.

To qualify as a micro-enterprise (SME), the management was employed part-time in his own firm till 2012.

This legislative duty was in effect until 2012. Consequently, from 2005 to 2022, the company achieved the following values (Fig. 1).

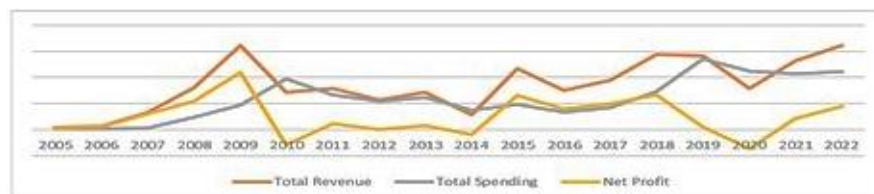


Fig. 1 Evolution of revenues, expenses and net profit, 2005 - 2022

The data in Fig. 1 were derived from the annual reports recorded in the yearly balance sheets and consolidated income statements.

Figure 1 demonstrates that the company's actions have displayed a turbulent and occasionally abrupt propensity. In the first three years, expenses were consistent, although revenues saw significant rise. From 2005 to 2009, the company experienced a significant increase in turnover and total revenues, especially between 2007 and 2009, reaching a maximum of RON 161,856. This phenomena can be ascribed to the expansion of the construction sector in Romania, supported by pre-crisis economic growth and market liberalization. In 2009, the global financial crisis commenced its substantial influence on the local economy.

The tax policy in this time initially favored micro-enterprises, with income tax reduced to 2% in 2007; however, the implementation of a minimum tax in 2009 began to impose a burden on small firms. Concurrently, preliminary signs of difficulties surfaced, marked by an increase in business debts.

In 2010, overall receipts declined by 56%, whilst expenditures increased by 105% compared to the previous year. In this year, the Romanian government instituted stringent austerity measures, including the abolition of the special tax regime for micro-enterprises and the increase of VAT to 24%. [14] The corporation faced a decision between the flat-rate minimum tax and the corporate income tax, leading to increased overall expenses and substantial losses. The impact was observed in diminishing revenue and escalating total liabilities.

Subsequent to the economic crisis from 2011 to 2015, the firm sought to stabilize amid fluctuating profitability. Post-2010, total expenses decreased, however turnover shown volatility. This signifies a difficult landscape for small businesses concerning resource and finance availability. It also demonstrates the extended time necessary for a microenterprise to recover after a major economic disruption exacerbated by governmental incompetence.

During this period, tax legislation has undergone numerous amendments. In 2013, the threshold for micro-enterprises was reduced to €65,000 (Perți, 2014) [15], and in 2016, dividend taxation was increased. This legal instability required constant adjustments by businesses, negatively affecting profitability.

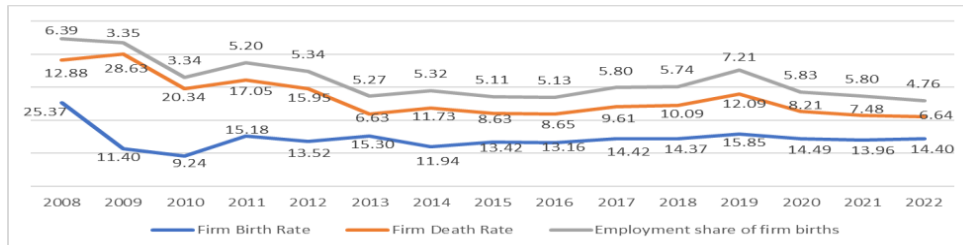
In 2016, the barrier for micro-enterprises was elevated again, and the company underwent a period of stability throughout this interval. The corporation entered the flourishing period mentioned by the Tax Council in its 2019 report [11]. Debts were resolved, revenues increased threefold compared to the 2014 benchmark, and expenses were maintained at 45% of total sales, barely exceeding 50% in 2018.

The findings suggest a favorable economic environment, supported by the increase of the tax threshold to €1 million for micro-enterprises in 2018 and the decrease in dividend tax rates. The previously mentioned tax reforms and their consequent implications have prompted entrepreneurs to raise investments in business development, leading to an 86% rise in 2019.

The year 2020 encountered an additional economic disruption due to the COVID-19 pandemic, which profoundly affected corporate operations in Romania. The examined company recorded financial losses of RON 36,043 in 2020, reflecting the difficulties encountered in maintaining operations and achieving anticipated growth during pandemic conditions. Expenditures continued to increase while revenue drastically declined. There was no motivation for design initiatives about new investment. Restrictive rules and economic impediments were clearly affecting the firm's revenues.

Between 2021 and 2022, the dominant economic conditions generated significant demand for project development, allowing the company to realize a net profit gain of 156% in 2022 compared to 2021.

From 2005 to 2022, the statistical data revealed the following aspects (Fig. 2).



**Fig. 2** Evolution of start-up and closure rates and the share of employees in start-ups in total net employees, 2005 - 2022, Eurostat[4]

In 2009, the start-up rate decreased by roughly 14 percentage points, whilst the firm closure rate rose by approximately 16 percentage points, reflecting a difficult economic climate and legislative uncertainties. This corresponds with significant losses claimed by the analyzed firm, highlighting the difficulties faced by small business proprietors. Since 2013, statistical data indicate a stability of trends. This signifies a revival of entrepreneurs' trust in Romania's economic conditions and an improvement in their ability to manage businesses effectively, despite the pandemic and following legislative changes. Newly established businesses have consistently facilitated job creation in the construction industry, sustaining rates exceeding 5% for most of the examined timeframe.

### 3. RESULTS AND SIGNIFICANCES

A corporation focused on both the construction sector and the private domain, particularly regarding liberal professions, might serve as a case study for inclusion in a best practice manual for fiscal and legislative forecasting and planning in construction design activities.

From 2005 to 2022, the firm's management fluctuated between employment with his own company and unemployment. This decision was predicated on the tax legislation of the separate periods and his intention to optimize tax expenditures, culminating in a decrease in tax liabilities by approximately 20-30%. This occurred due to salary expenses and social security contributions being less than the 16% corporate income tax imposed on the corporation liable for corporate income tax.

From a legislative perspective, new rules must be accompanied by comprehensive and considerable impact assessments, as every legislative alteration (whether beneficial or detrimental) can drastically affect the financial outcomes of a SME by over 50%.

Simultaneously, upon comparing the analysis results with the sectoral statistical data of construction enterprises in Romania, we can affirm analogous evolutionary trends to those observed in the analyzed firm.

The following abbreviations have been defined in this article:

SME - small and medium-sized enterprises, defined according to turnover and number of employees, in specific Romanian legislation

CASS - social health insurance contribution - percentage share

ANAF - National Agency for Tax Administration



#### 4. CONCLUSIONS

The financial analysis conducted on the construction design firm, emblematic of the SME sector within the Romanian construction industry, demonstrates the capacity of these small enterprises to adjust to a markedly unstable economic and regulatory landscape. Economic fluctuations—expansions and contractions—have been intricately associated with legislative alterations and the overarching economic milieu, including the global financial crisis of 2009 and the COVID-19 pandemic. Notwithstanding the challenges, the company has demonstrated significant resilience, successfully recuperating from several external shocks, partially aided by tax legislation favorable to SMEs. Nonetheless, this adaptability incurred a cost, revealing susceptibility to significant alterations.

The Construction Sector is a specialized area within the technical engineering discipline, characterized by distinct activities that are explicitly governed by prevailing technical standards and regulations. This is one of the factors that contribute to logistical equipment expenses necessary for conducting activities in the construction business.

The comparative study of statistical data validates the trends identified among the examined enterprises, highlighting the significance of legislative stability for the survival and success of SMEs.

Fiscal and legislative initiatives that have bolstered small enterprises have positively influenced their establishment and sustainability rates, hence fostering job creation and economic stability. Nevertheless, further legislative attention is essential to avert additional volatility that could endanger these specialized, technological engineering enterprises vital to the national economy.

The aims of this investigation were completely achieved. The comprehensive financial study of the company has elucidated the economic and legislative effects on its performance, while the assessment of sectoral statistical data has revealed analogous tendencies throughout the construction sector.

The research demonstrated a direct correlation between legislative changes and the financial performance of small enterprises, affirming the significance of legislative assistance for their survival and growth.

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