

## An Analysis of the Main Forms of Legal Organization Used in Running Small Businesses in Romania

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### Abstract

*The flexibility of small business lies in their ability to seize the opportunities offered by the market and to adapt quickly to changes in demand. Small business, because of their relatively limited size and productive potential, cannot develop a wide range of products or services, being obliged to concentrate their activity on the production of homogeneous goods or services, within a restricted regulation.*

*In the case of a small business, the character, skills, expertise, attitudes, and behaviour of the entrepreneur exert a decisive influence on the activity of the enterprise.*

*This paper is focussed on analysing the evolution of active number of small businesses in Romania. In this direction we will present statistic research regarding the main forms of legal organization used in running small businesses, registered in the latest years in Romania.*

**Key words:** Sole Proprietorship, Family Business, Authorized Natural Person, Debutante Limited Liability Company

**J.E.L. classification:** L20, M20

### 1. Introduction

In order to legally run a small business, one or more natural persons can organize their activity for this purpose, by opting for one of the legal forms provided by law:

- Sole Proprietorship
- Family Business
- Authorized Natural Person
- Debutante Limited Liability Company

Each of the legal forms of organization presented above offers advantages and disadvantages in terms of mode of operation, taxes due or the conditions for their establishment.

### 2. Theoretical background

In this section we will provide general information regarding the main forms of legal organization used in running small businesses in Romania namely the Sole Proprietorship, Family Business, Authorized Natural Person and Debutante Limited Liability Company. We will make an literature review among the main characteristics of each one of these types of firms, present the most important advantages and disadvantages of them and also we will point out some accounting issues regarding the functioning of these forms of economic organizations.

## 2.1. Sole Proprietorship

### Characteristics of Sole Proprietorship

The Sole Proprietorship, according to Government Emergency Ordinance 44/2008 (on economic activities carried out by Authorized Natural Persons, Sole Proprietorships and Family Businesses) is a type of economic enterprise, without legal personality, organized by a natural person entrepreneur.

Any Sole Proprietorship must have a professional headquarters on the Romanian territory. The registration of a Sole Proprietorship is done at the Trade Register, this being one of the main requirements for its legal operation.

### Advantages of sole proprietorship

The Sole Proprietorship can have as the object of its activity up to 10 classes of activities provided by the NACE code (compared to 5, in the case of Authorized Natural Person), but proof of professional training is required for each of the NACE code chosen.

The Sole Proprietorship can hire up to 8 employees, third parties, with an individual employment contract concluded and registered under the law (compared to 3 in the case of Authorized Natural Person).

The entrepreneur of the Sole Proprietorship can cumulate the quality of also being an employee to a third person. The owner of a Sole Proprietorship is insured in the public system of pensions and other social insurance rights and has the right to be insured in the system of social health insurance and unemployment insurance, under the conditions provided by law.

Setting up a Sole Proprietorship entails lower costs than setting up a Limited Liability Company and the registration of a Sole Proprietorship does not take more than 3 days. In case of death of the owner, the activity of a Sole Proprietorship may be continued by the heirs.

The Sole Proprietorship accounting is simple and entails the establishment of two registers to be archived for 10 years, namely:

- **The Cash Receipts and Payments Journal** - it serves to chronologically record all the amounts of money collected and paid, both in cash and through bank accounts.
- **The Inventory Ledger** – it serves to keep a record of inventoried assets and liabilities. They shall be completed at the beginning of the activity, at least once a year and at the end of the activity.

### Disadvantages of sole proprietorship

The natural person who owns the Sole Proprietorship is responsible for the obligations undertaken in the operation of the respective economic enterprise, with the assets from the patrimony of the enterprise. If these are not sufficient to satisfy the claims, the other assets of the natural person can also be pursued.

A Sole Proprietorship cannot choose any name. The firm of an owner of a Sole Proprietorship consists of his full name or the name and initial of his/her first name, to which the phrase "Sole Proprietorship" is added (ex. Popescu Ion Sole Proprietorship).

## 2.2. Family Business

### Characteristics of the Family Business

Family Business consists of 2 or more members of a family. According to Government Emergency Ordinance 44/2008, which regulates the Family Business, by family we mean the husband, wife, their children who have reached the age of 16 on the date of authorization of the Family Business, relatives and kin up to and including the fourth degree;

Family Business is created by an establishment agreement, concluded by its members. The establishment agreement will stipulate:

- the (sur)name and first name of its members, the representative of the Family Business;
- the date of drawing up the establishment agreement;
- the participation of each member in the enterprise, the conditions of their participation, the percentages in which they will share the net income of the enterprise, the relationships between the members of the Family Business;
- the conditions for the withdrawal of its members, under the nullity sanction of the Family Business.

The representative appointed in the establishment agreement will manage the interests of the Family Business on the basis of a special power of attorney, which will be signed by all the members of the enterprise.

The representative of the Family Business can purchase assets for the activity of the firm without the approval of the other members. However, if the value of the asset exceeds 50% of the value of the assets and of the liquidity of the enterprise, the consent of the other members of the Family Business is required. The purchased assets are in the co-ownership of the members according to their participation quotas.

For the purpose of carrying out the activity for which it has been authorized, the Family Business, through its representative, can collaborate with other natural or legal persons, with other Sole Proprietorships, Family Businesses, Authorized Natural Persons. Family Business cannot hire third parties with an employment contract.

The members of the Family Business are jointly liable for the debts incurred by the representative in the operation of the enterprise, with the patrimony of the enterprise.

The members of a Family Business can also cumulate the status of employee of a third party who works in the same field or in another field of economic activity than the one in which they organized their Family Business.

The members of a Family Business are insured in the public system of pensions and other social insurance rights and have the right to be insured in the system of social health insurance and unemployment insurance, under the conditions provided by law.

### **2.3. Authorized Natural Person**

#### **Characteristics of Authorized Natural Person**

An Authorized Natural Person can carry out any form of economic activity permitted by law, using mainly its own workforce and the professional skills of the representative.

The legal framework for the operation of the Authorized Natural Person is the Government Emergency Ordinance no. 44/2008 on economic activities carried out by Authorized Natural Persons, Sole Proprietorships and Family Businesses, with subsequent amendments.

The firm of an Authorized Natural Person owner consists of his/her name written in full or his name and the initial of his first name, to which the phrase Authorized Natural Person is added - ex. Popescu Ion Authorized Natural Person.

An Authorized Natural Person. can have as the object of its activity at most 5 classes of activities provided by the NACE code. This type of organization can employ a maximum of 3 people in order to carry out its economic activity. The Authorized Natural Person is liable for its obligations with its patrimony and, in addition to this, with its entire patrimony.

The Authorized Natural Person ceases its activity and is dissolved from the trade register in the following cases:

- the will of the owner of the Authorized Natural Person, a procedure that requires the submission of a request for deregistration at the National Trade Register Office and the notification of the National Agency for Fiscal Administration;
- the death of the owner, a situation which requires the start of the deregistration by the heirs and the takeover by the latter, as a result of the probate process, of all rights and obligations deriving from the activity of the P.F.A.

#### **Accounting issues of the Authorized Natural Person**

The mandatory ledgers of the Authorized Natural Person are:

- The Cash Receipts and Payments Journal
- The Inventory Ledger

The Authorized Natural Person doesn't have the obligation to register the ledgers above mentioned with the National Agency for Fiscal Administration and if they are completed in electronic format, they will be printed annually or at the request of the control bodies.

The Authorized Natural Person is an enterprise which does not pay the Value-added Tax as long as the annual turnover, declared or reached does not exceed 300,000 lei; above this value, the Authorized Natural Person will register with the National Agency for Fiscal Administration; as a payer of value-added tax .

An authorized natural person owes the following taxes to the state budget:

- Income tax (10%) – established on a real system basis (10% of the net income calculated as the difference between gross income and deductible expenses) or under a fixed income quota/income norms (10% of the published income quota for the activity for which there is authorization);
- Social Insurance Contribution/CAS (25%) – if the Authorized Natural Person obtains during a year a net income higher than 12 minimum gross salaries per economy (ceiling 2018 - 22,800 lei; ceiling 2019 - 24,960 lei);
- Health Insurance Contribution/CASS (10%) – if the Authorized Natural Person obtains during a year a net income higher than 12 minimum gross salaries per economy (ceiling 2018 - 22,800 lei, ceiling 2019 - 24,960 lei).

#### **Advantages and disadvantages of Authorized Natural Person**

Among the main advantages of the Authorized Natural Person we can mention:

- simplified, therefore cheaper, book-keeping;
- simple method to dissolve the firm from the Trade Register.
- can use the Authorized Natural Person's revenues for personal purposes without justification. Exceptions are the revenues from the bank account.

Among the main disadvantages of the Authorized Natural Person we can mention:

- the Authorized Natural Person is held accountable by the state institutions and third parties with its entire property:
- The Authorized Natural Person has a limited number of employees - 3;
- The Authorized Natural Person has a limited number of economic activities carried out - 5;

## **2.4. Debutante Limited Liability Company**

### **Purpose and benefits**

Debutante Limited Liability Company is a type of business organization created as a result of Emergency Ordinance no. 6 of February 2, 2011. The purpose of this form of organization was to provide facilities for newly established micro-enterprises, run by start-up entrepreneurs, who were carrying out an economic activity for the first time, through a Limited Liability Company.

Among the initial benefits of a Debutante Limited Liability Company we can mention:

- the exemption from the payment of fees for registering the company in the Trade Register;
- receiving guidance, training and support from the authorities in the field of entrepreneurship within the area in which the company has its registered office;
- the exemption from paying the social security contributions owned by the employers;
- the possibility of granting a Non-Reimbursable Financial Allocation of up to 10,000 euros, etc.

### **The current situation regarding Debutante Limited Liability Company in Romania**

Currently, most of the benefits of a Debutante Limited Liability Company have been eliminated or have become irrelevant, given that:

- most of the registration fees in the Trade Register were eliminated by Law no. 1/2017;
- the exemption from paying social security contributions can no longer be granted, as it is now the employee who pays these contributions (and not the employer);
- the non-reimbursable financial allocation is no longer granted, being replaced by the Start-Up Nation program. (Through the Start-Up Nation program, micro- and small enterprises can obtain a non-reimbursable financing of 200,000 lei with a company established after 30.01.2017 carrying out activities in the following areas: production, creative industries, services.)

Basically, although there is still a possibility of setting up a Debutante Limited Liability Company it no longer has real benefits, whereas the restrictions are still valid:

- a limited number of NACE codes (maximum 5),
- the obligation to change the legal form into LLC, after a period of three years, which implies certain costs.

### 3. Research methodology

In this paper we will provide a statistic analysis of the evolution of the Sole Proprietorship, Family Business, Authorized Natural Person and Debutante Limited Liability Company in Romania in the latest 5 years. The main source for this analysis is The National Trade Register of Romania.

Through this paper, we will present statistics regarding the number of registered Sole Proprietorships, Family Businesses, Authorized Natural Person’s and Debutante Limited Liability Company’s at country level, and on two regions of economic development, namely the South-East and the Central areas. Also we will study the structure of this type of companies taking into account the gender and groups of age of the holders/members of the analysed companies.

### 4. Findings

In our research we collected data from the National Trade Register of Romania from December 2017 until November 2021, regarding the registered Sole Proprietorships, Family Businesses, Authorized Natural Persons and Debutante Limited Liability Company’s in Romania.

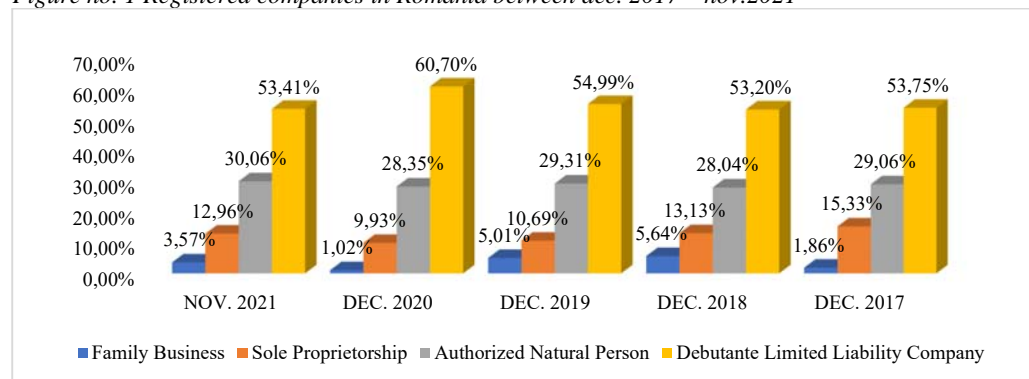
Table no. 1 Registered companies in Romania between dec. 2017 – nov. 2021

| FORM OF LEGAL ORGANIZATION |                 |                     |                           |                                     |        |
|----------------------------|-----------------|---------------------|---------------------------|-------------------------------------|--------|
| Year                       | Family Business | Sole Proprietorship | Authorized Natural Person | Debutante Limited Liability Company | TOTAL  |
| NOV. 2021                  | 3,247           | 11,803              | 27,377                    | 48,633                              | 91,060 |
| DEC. 2020                  | 813             | 7,899               | 22,554                    | 48,290                              | 79,556 |
| DEC. 2019                  | 4,347           | 9,278               | 25,423                    | 47,705                              | 86,753 |
| DEC. 2018                  | 4,924           | 11,474              | 24,495                    | 46,479                              | 87,372 |
| DEC. 2017                  | 1,532           | 12,597              | 23,888                    | 44,175                              | 82,192 |

Source: Own processing from the statistics provided by the National Trade Register of Romania, (<https://www.onrc.ro/index.php/ro/statistici>)

As we can see from table no. 1 and figure no. 1 in the latest 5 years the most popular type of legal form of organization among small businesses is the Debutante Limited Liability Company. Between 53% and 60% of small businesses running in Romania are Debutante Limited Liability Company. The Family Business is the less preferred type of legal organization, registering percentages between 1% and 5,6% of small business. The second option for small businesses is The Authorized Natural Person, registering like 30% among the preferences of entrepreneurs.

Figure no. 1 Registered companies in Romania between dec. 2017 – nov.2021



Source: Own processing from the statistics provided by the National Trade Register of Romania, (<https://www.onrc.ro/index.php/ro/statistici>)

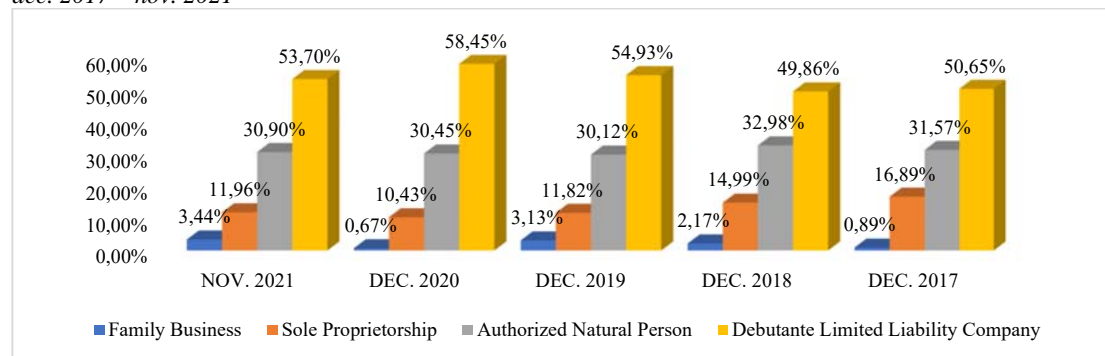
Table no. 2 Registered companies in Romania in the South-East Economic Development Region between dec. 2017 – nov. 2021

| FORM OF LEGAL ORGANIZATION |                 |                     |                           |                                     |       |
|----------------------------|-----------------|---------------------|---------------------------|-------------------------------------|-------|
| Year                       | Family Business | Sole Proprietorship | Authorized Natural Person | Debutante Limited Liability Company | TOTAL |
| NOV. 2021                  | 299             | 1,040               | 2,687                     | 4,670                               | 8,696 |
| DEC. 2020                  | 53              | 830                 | 2,422                     | 4,650                               | 7,955 |
| DEC. 2019                  | 263             | 992                 | 2,528                     | 4,611                               | 8,394 |
| DEC. 2018                  | 196             | 1,351               | 2,973                     | 4,494                               | 9,014 |
| DEC. 2017                  | 76              | 1,437               | 2,686                     | 4,309                               | 8,508 |

Source: Own processing from the statistics provided by the National Trade Register of Romania, (<https://www.onrc.ro/index.php/ro/statistici>)

In the South- East Region of Romania the situation is similar to the numbers recorded in the whole country between 2017 and 2021. So we can affirm that cities like Constanța, Tulcea, Galați, Brăila, Vrancea and Buzău has a small business environment based on two types of legal form of organization, namely the Authorized Natural Persons and Debutante Limited Liability Company.

Figure no. 2 Registered companies in Romania in the South-East Economic Development Region between dec. 2017 – nov. 2021



Source: Own processing from the statistics provided by the National Trade Register of Romania, (<https://www.onrc.ro/index.php/ro/statistici>)

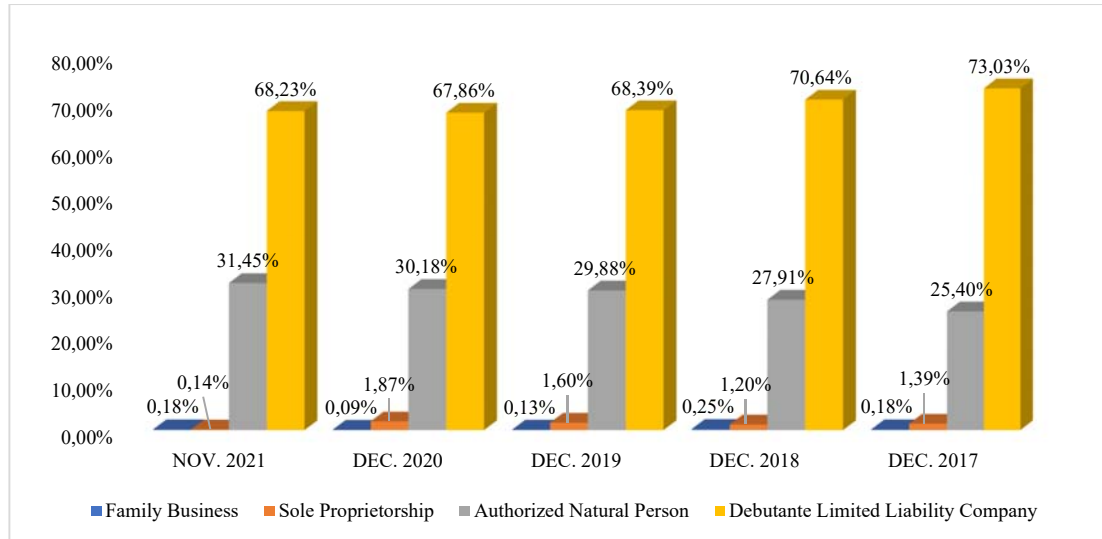
Table no. 3 Registered companies in Romania in the Central Economic Development Region between dec. 2017 – nov. 2021

| FORM OF LEGAL ORGANIZATION |                 |                     |                           |                                     |        |
|----------------------------|-----------------|---------------------|---------------------------|-------------------------------------|--------|
| Year                       | Family Business | Sole Proprietorship | Authorized Natural Person | Debutante Limited Liability Company | TOTAL  |
| NOV. 2021                  | 21              | 17                  | 3,733                     | 8,097                               | 11,868 |
| DEC. 2020                  | 11              | 221                 | 3,570                     | 8,026                               | 11,828 |
| DEC. 2019                  | 15              | 185                 | 3,464                     | 7,928                               | 11,592 |
| DEC. 2018                  | 28              | 132                 | 3,069                     | 7,769                               | 10,998 |
| DEC. 2017                  | 18              | 142                 | 2,596                     | 7,463                               | 10,219 |

Source: Own processing from the statistics provided by the National Trade Register of Romania, (<https://www.onrc.ro/index.php/ro/statistici>)

In the Central Economic Development Region of Romania the young and new entrepreneurs prefer in a overwhelming proportion the Debutante Limited Liability Company in order to run their businesses. In Bucharest and Ilfov county the small businesses are in proportion of 70% - Debutante Limited Liability Company. The centre of the Country registered between 2017 and 2021 only 93 active Family Businesses.

Figure no. 3 Registered companies in Romania in the Central Economic Development Region between dec. 2017 – nov. 2021



Source: Own processing from the statistics provided by the National Trade Register of Romania, (<https://www.onrc.ro/index.php/ro/statistici>)

Regarding the age of the holders/ members of the studied legal form of organizations, we can see that small business are run especially by entrepreneurs aged between 39 and 49 years old. Also, we can remark that small businesses are rather run by persons over 50 years old than by young people aged under 29.

Table no. 4 - Active Sole Proprietorship/Authorized Natural Person/Family Business by holders /members age between dec. 2017 – nov. 2021 (no.)

| Year   | No. of active Sole Proprietors hip/Authori zed Natural Person/Fam ily Business | No. of holders /members of active Sole Proprietorshi ps/Authoriz ed Natural Persons/Fami ly Business | Holders / members up to the age of 29 yrs. | Holders / members with the age between 30-39 yrs. | Holders / member s with the age between 40-49 yrs. | Holders / member s with the age between 50-59 yrs. | Holder s / membe rs with the age over 60 yrs. |
|--------|--|--|--|---|--|--|---|
| Nov-21 | 416,810  | 454,832  | 10.71%                                     | 24.02%  | 28.17%   | 20.46%   | 16.64%  |
| Dec-20 | 393,586  | 429,464  | 10.31%                                     | 24.50%  | 28.56%   | 20.21%   | 16.42%  |
| Dec-19 | 378,742  | 414,678  | 10.81%                                     | 25.09%  | 28.57%   | 19.70%   | 15.83%  |
| Dec-18 | 392,548  | 425,770  | 11.83%                                     | 25.70%  | 28.66%   | 18.81%   | 15.00%  |
| Dec-17 | 388,128  | 418,830  | 12.64%                                     | 26.20%  | 29.24%   | 17.78%   | 14.14%  |

Source: Own processing from the statistics provided by the National Trade Register of Romania, (<https://www.onrc.ro/index.php/ro/statistici>)

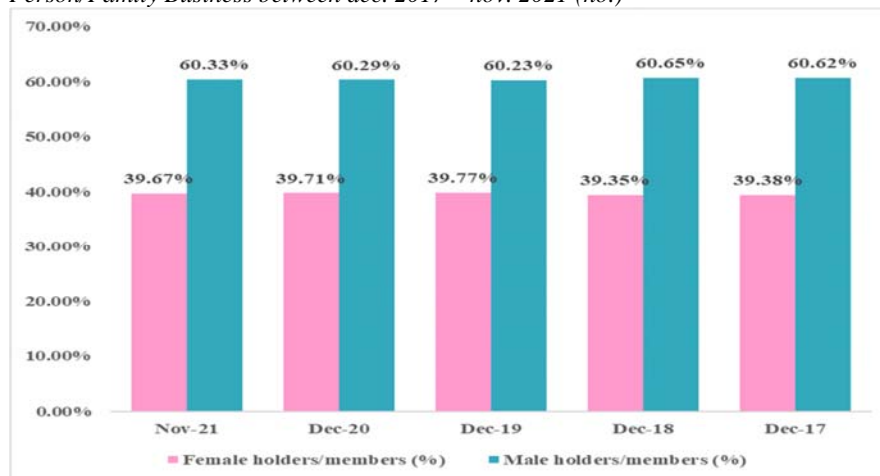
Table no. 5 Gender distribution of holders /members of active Sole Proprietorship/Authorized Natural Person/Family Business between dec. 2017 – nov. 2021 (no.)

| Year   | No. of active Sole Proprietorships/ Authorized Natural Persons/Family Business | No. of holders /members of active Sole Proprietorships/ Authorized Natural Persons/Family Business | Female holders/members (no.) | Male holders/members (no.) |
|--------|--|--|------------------------------|----------------------------|
| Nov-21 | 416,810  | 454,832  | 180,440                      | 274,392                    |
| Dec-20 | 393,586  | 429,464  | 170,554                      | 258,910                    |
| Dec-19 | 378,742  | 414,678  | 164,929                      | 249,749                    |
| Dec-18 | 392,548  | 425,770  | 167,555                      | 258,215                    |
| Dec-17 | 388,128  | 418,830  | 164,924                      | 253,906                    |

Source: Own processing from the statistics provided by the National Trade Register of Romania, (<https://www.onrc.ro/index.php/ro/statistici>)

Table no.4 and Figure no. 5 show us the proportion of the small businesses run by female and male. So, we can remark among the analysed period that 60% of small business are managed by males and 40% by females. The percentages are very encouraging for the development of the business sector run by females.

Figure no. 4 - Gender distribution of holders /members of active Sole Proprietorship/Authorized Natural Person/Family Business between dec. 2017 – nov. 2021 (no.)



Source: Own processing from the statistics provided by the National Trade Register of Romania, (<https://www.onrc.ro/index.php/ro/statistici>)

## 5. Conclusions

The choice of the best legal form of organization must take into account, first of all, the type of activity carried out and the income generated: if independent activities are rather occasional and creative (being related to intellectual property), usually copyright contracts are concluded.

In order to legally run a small business, one or more natural persons can organize their activity for this purpose, by opting for one of the legal forms provided by law: Sole Proprietorship, Family Business, Authorized Natural Person, Debutante Limited Liability Company.

The legal framework for the operation of Sole Proprietorship, Family Business and Authorized Natural Person is the Government Emergency Ordinance no. 44/2008 on economic activities carried out by Authorized Natural Persons, Sole Proprietorships and Family Businesses, with subsequent amendments. Debutante Limited Liability Company is a type of business organization created as a result of Emergency Ordinance no. 6 of February 2, 2011.



The registration as a Authorized Natural Person and Debutante Limited Liability Company remains one of the most common forms of organization for running a small business.

Between 53% and 60% of small businesses running in Romania are Debutante Limited Liability Company, and 30% are Authorized Natural Persons. Most of the small businesses are run by entrepreneurs aged between 39 and 49 years old, in proportion of 60% males and 40% females.

## 6. References

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