



Eurofound

Restructuring in SMEs: Slovakia

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Introduction

Restructuring is a process of accommodating a company or a whole sector to permanent changes in the economic environment. The issue of restructuring has been on the agenda of social partners, managers and social workers in Slovakia since the beginning of the economic crisis in Europe, which worsened at the end of 2008. Job losses have been caused by mass dismissals following closures of large companies, layoffs in small and medium-sized enterprises (SMEs), and by termination of fixed-term contracts. Anticipating, managing, limiting and cushioning job losses is increasingly challenging in this difficult context. However, it should be stressed that, even in less challenging times, restructuring had already made its mark as a permanent structural component of the economy.

Restructuring is a common process both at the national economy level as well as in a company lifecycle. There are however distinct differences concerning approaches and outcomes.

This comprises at least two different, although interlinked, processes. The first concerns the practice of mass layoffs. While it is generally accepted that outdated non-competitive activities should be terminated, the choices made by transnational firms over relocating to low-cost plants in low-wage countries and closing or downsizing less competitive, but nonetheless profitable plants in more developed countries are more controversial. One of the main lessons of recent years is that whatever the company's economic situation, restructuring calls for a sharing of the responsibility of anticipation and a shared diagnosis of its situation.

The second issue relates to the management of the entire restructuring process in order to minimise negative effects on workers, companies and territories and finding responses to mass unemployment and the destruction of skills and skilled occupations. Both issues are interconnected when some actors (typically trade unions and/or local authorities) contest the size and/or the necessity of the announced dismissals and try to influence the employer to opt for what they deem less destructive outcomes.

This report outlines restructuring processes in Slovakia at the macro level, providing contextual background to the environment in which SMEs in Slovakia operate.

SMEs in Slovakia

The creation of new enterprises and the liquidation of poorly performing ones suggests that SMEs in Slovakia show the same pattern as the economy in Slovakia as a whole during the economic crisis. General information on the Slovak economy is shown in Table 1.

Table 1: *Slovakia: main economic indicators*

	2009	2010	2011
Real GDP growth (%) ¹⁾	3.52	4.66	11.54
GDP (€millions) ²⁾	42.21	40.14	32.69
GDP per capita (€) ²⁾	42.84	46.24	43.27
Consumer price inflation ²⁾	5.53	7.53	11.54
Unemployment rate (%) ²⁾	2.89	0.72	0.00
Total population (in millions) ³⁾	3.02	0.72	0.96

¹⁾ Source: *National Bank of Slovakia and Statistical Office of the SR, September 2012*

²⁾ Source: *Statistical Office of the SR, March 2012*

³⁾ Source: *Eurostat, population at 1 January*

After the start of the economic crisis, Slovakia faced the largest drop in GDP in 2009, followed by a revitalisation of the economy in 2010. During the period 2009–2011 Slovakia reached 73% of the average GDP of EU Member States (in PPS/person).¹ Significant inflation occurred in 2011 as a result of a combination of problems in the Eurozone as a whole and internal problems related to changes in Slovak economic policy. The high unemployment rate in Slovakia is underlined by a high ratio of long-term unemployed people. It reflects lower employment in SMEs, lower production and sales. After the crisis started in 2009, the number of sole proprietors decreased as a result of decreased purchasing power and insufficient funds for restructuring their production and services. There were only 62 firms which had undergone restructuring, while as many as 33,253 entrepreneurs ceased their activities. They decided to interrupt their activities for a year or terminate them altogether, rather than to restructure. Revival of production and services restarted again in 2012 due to measures introduced in 2010, as mentioned below in the discussion of Table 5.

Enterprises in the Slovak business environment are divided into Physical persons, Sole proprietors, and Legal entities. There are three forms of sole proprietors in Slovakia: small trade licensees, freelancers and independent farmers. The exact numbers of all forms of sole proprietors are outlined in Table 2. The most common form of conducting business in Slovakia is as a small trade licensee. Legislative norms on the one hand and economic conditions on the other hand have reduced the number of entrepreneurs in agriculture by two-thirds over the past 15 years.

Table 2: *Numbers of sole proprietors in Slovakia 1993–2011*

Year	Small trade licensees	Freelancers	Independent farmers
1993	264,090	1,172	17,632
1994	263,733	2,480	20,789
1995	248,204	7,307	19,599
1996	241,199	10,486	21,014
1997	244,419	12,212	20,571
1998	263,733	12,946	19,122
1999	266,903	11,231	17,616
2000	269,323	11,647	15,550
2001	279,597	12,187	11,722
2002	274,630	12,379	11,767
2003	306,356	13,044	10,320
2004	336,640	13,683	10,055
2005	344,870	12,752	9,472
2006	364,185	15,175	8,886
2007	374,382	16,725	8,534
2008	392,841	17,189	8,191
2009	387,876	17,974	8,017
2010	384,202	18,378	7,728
2011	375,722	19,069	7,534

Source: NADSME, Bratislava 2012

¹ <http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tec00114>

Since 1993, there has been an increase in the number of freelancers in Slovakia. Freelancers often have a full-time job as well as their freelance activities. For example, a university professor may also be an auditor, tax advisor and so on. This form of entrepreneurship has a certain social status and enables the freelancer to be constantly in touch with the latest theory and practice. The financial reward for this kind of activity can also be considerable. The number of freelancers has increased from 1,172 in 1993 to 19,069 in 2011. Their share of total number of SMEs has risen from 0.42% to 4.74% during the existence of the Slovak Republic.

On the other hand, there is the opposite situation with regard to independent farmers. The qualification structure of independent farmers is lower, Slovak demand for agricultural products is also lower and their financial situation is unsustainable. The most important problems are regulations related to product quality standards and import and tariff policy open for import of substitutes from abroad, taking into account the Common Agricultural Policy. Since the peak in 1996, the number of independent farmers has been declining year by year as they cannot compete with foreign producers in the area of crop and livestock production.

Development of the second group of SMEs – Legal entities – is outlined in Table 3. The total number of SMEs in Slovakia has been increasing since 1996. The most important is the size category of microenterprises. The share of microenterprises was 89.16% of the total number of SMEs in 2011. The number of small enterprises with 10 to 49 employees reached a maximum of 21,226 in 2008. The number of medium-sized enterprises is stable, but during the past 15 years their share of the economy has been declining. This is because of a sharp rise in the number of microenterprises.

Table 3: *Structure of SMEs – legal entities, by size, since 1996 to 2011*

Year	Microenterprises (0–9 employees)		Small enterprises (10–49 employees)		Medium enterprises (50–249 employees)		SMEs total
	Number of enterprises	% of total SMEs	Number of enterprises	% of total SMEs	Number of enterprises	% of total SMEs	
1996	36,865	78.37%	6,888	14.64%	3,284	6.98%	47,037
1997	41,836	78.94%	7,904	14.91%	3,257	6.15%	52,997
1998	49,172	82.58%	7,030	11.81%	3,343	5.61%	59,545
1999	45,021	78.10%	9,328	16.18%	3,294	5.71%	57,643
2000	48,662	80.69%	8,585	14.23%	3,063	5.08%	60,310
2001	50,867	81.68%	8,585	13.79%	2,825	4.54%	62,277
2002	47,845	81.19%	8,317	14.11%	2,768	4.70%	58,930
2003	51,973	81.42%	9,129	14.30%	2,735	4.28%	63,837
2004	59,761	81.25%	10,657	14.49%	3,136	4.26%	73,554
2005	69,501	83.65%	10,658	12.83%	2,930	3.53%	83,089
2006	76,918	82.90%	12,956	13.96%	2,908	3.13%	92,782
2007	80,899	80.16%	17,212	17.06%	2,805	2.78%	100,916
2008	95,010	79.67%	21,226	17.80%	3,024	2.54%	119,260
2009	102,926	81.20%	20,899	16.49%	2,925	2.31%	126,750
2010	130,144	91.38%	9,549	6.70%	2,724	1.91%	142,417
2011	136,672	89.16%	13,850	9.04%	2,761	1.80%	153,283

Source: NADSME, Bratislava 2012

Table 4: *Share of SMEs in total GDP in Slovakia, 1998–2010 (€ million)*

Year	Microenterprises	Small enterprises	Medium enterprises	Large enterprises	Total GDP	SMEs total	Share of SMEs in total GDP
1998	1,893	1,511	2,291	6,529	12,225	5,695	46.60%
1999	2,315	1,601	2,447	7,058	13,421	6,363	47.40%
2000	2,611	1,773	2,598	8,184	15,166	6,982	46.00%
2001	2,110	2,433	3,117	8,653	16,312	7,659	47.00%
2002	2,080	2,734	3,300	8,364	16,479	8,114	49.20%
2003	2,177	2,381	3,340	9,531	17,428	7,897	45.30%
2004	2,202	2,529	3,618	10,207	18,556	8,349	45.00%
2005	2,328	3,366	4,480	10,632	20,806	10,175	48.90%
2006	2,952	3,857	4,863	12,200	23,872	11,672	48.90%
2007	3,586	4,928	5,611	13,684	27,809	14,125	50.80%
2008	3,870	6,878	6,552	14,017	31,317	17,301	55.20%
2009	2,933	6,622	6,042	12,889	28,486	15,597	54.80%
2010	5,226	5,424	6,754	13,638	31,041	17,403	56.10%

Source: *NADSME, Bratislava 2012*

The share of SMEs in Slovakia's gross domestic product has been increasing since 1998, reaching more than 50% in 2007. The highest share of SMEs in GDP was reached in 2010 with 56.1%. Based on the size structure, micro and small enterprises accounted for almost two-thirds of SMEs' share of GDP (€17,403 million).

Data from the Statistical Office show that comparing year 2010 with 2009, the share of profit before taxation of non-financial corporations for small enterprises was 44.6% (an increase of 2.2%), for medium enterprises it was 12.5% (down 3.4%) and for large enterprises it was 42.9% (an increase of 1.2%). The year-on-year (2010/2009) decline in profit in SMEs was 31.9% while the figure was 28.6% for large enterprises.² These changes affected overall employment in Slovakia. According to the National Agency for Development of SMEs in 2009, on average 1,763,133 people were working in the entrepreneurial sector in Slovakia: 647,500 were small trade licensees, 167,232 employees worked in microenterprises, 193,707 in small enterprises, 265,390 in medium-sized enterprises and 489,304 in large companies.

² According to the methodology of the Statistical Office of the Slovak Republic, non-financial corporations are regarded as profit-oriented enterprises registered in the commercial register in all areas of activity, except financial activities. This also includes organisations receiving state support that covers more than 50% of their expenses with their own revenues.

Table 5: Numbers of employees by business size category since 1997

Year	Small trade licensees	Microenterprises (0–9 employees)	Small enterprises (10–49 employees)	Medium enterprises (50–249 employees)	Large enterprises (+250 employees)
1997	437,000	215,104	157,188	395,698	823,657
1998	442,500	152,646	153,969	410,475	872,519
1999	445,000	131,756	153,043	382,852	875,536
2000	452,500	156,233	177,262	355,027	835,930
2001	476,250	141,725	213,260	355,396	819,534
2002	510,000	126,246	247,182	362,080	763,343
2003	578,500	142,050	243,857	371,650	688,935
2004	610,000	148,465	263,919	388,474	619,490
2005	636,250	140,567	283,843	407,871	606,457
2006	657,500	131,554	200,295	273,745	504,569
2007	666,250	137,377	220,672	276,305	522,454
2008	686,250	121,892	262,637	279,079	536,035
2009	666,250	88,639	258,576	267,128	505,411
2010	647,000	167,232	193,707	265,390	489,304

Source: NADSME, Bratislava 2012

A sharp decline in the total number of employees in microenterprises in 2009 due to the economic crisis was followed by a strong increase in 2010 as a result of the new National Economic Reform Programme. This programme was the first one within the Europe 2020 Strategy. It offered complex services for entrepreneurs – sole proprietors, simplified required administration and formal steps leading to creation of small and micro-businesses and their operations (for example, registration, various standard forms, lower fees for these services, etc.). The rise in microenterprises was positively influenced by the adoption of the euro as the national currency and a 16.4% rise in exports in 2010 compared to 2009, as over 50% of Slovak exports go to Eurozone countries.

It is interesting to note that while the number of employees in large enterprises is declining, the number of small trade licensees is increasing every year.

The Statistical Office survey data for 2009 show a decline in employment in all size categories of non-financial enterprises compared to the previous year. This is considered to be an impact of the global economic crisis.

Over the past few years, there has been an observable shift in the number of enterprises in each size category of SMEs recorded in the official data. This is partially the result of the crisis and economic pressure to streamline operations in individual firms. ‘A decline of the demand, revenue and lower return on investment are creating problems with repayment of loans and payables to employees and suppliers. This is creating a secondary insolvency, which is influencing and threatening other companies’ (Kinčáková, 2011).

However, the main reason is the business environment in Slovakia: ‘Multiple store companies have entered the Slovak market’ (Šúbertová, 2005). Very high administrative and financial burdens relating to employment in SMEs pushes companies into internal restructuring.

SMEs in Slovakia are active in all major industrial branches with different representation. A comparison of employee numbers according to type of industry and type of enterprise is given in Table 6. The table shows a very high representation of SMEs in wholesale and services, and an especially significant number of self-employed physical persons in construction.

Table 6: *Employment by industry and company type, 2011 (%)*

Industry	Type of enterprise			
	Small trade licences	Small enterprise	Medium enterprise	Large enterprise
Manufacturing	14.4	16.1	23.7	45.8
Construction	62.3	19.8	11.1	6.8
Wholesale	23.2	49.9	18.7	8.2
Retail	28.4	31.8	8.0	31.8
Transport	28.7	19.6	20.1	31.6
Services	9.3	40.5	25.6	24.6

Source: *National Agency for Development of Small and Medium Enterprises (NADSME); Status of SMEs in Slovakia, Bratislava, 2012*

Large companies are dominant in manufacturing industry. This is because manufacturing requires large investments and the companies need to keep up with modern technologies, and neither option is usually affordable for smaller entities. SMEs are mostly involved in less investment-demanding activities within this type of industry and employ fewer people.

On the other hand, the construction industry shows a different tendency as a result of a substantial number of skilled workmen – former employees of large construction companies who left these companies, established small enterprises and sole proprietorships, and are now working on a contractual basis for major construction firms.

Wholesale, retail and transport, which all depend on particular conditions (types of products), are adequately represented in both large chains as well as among SMEs.

Services are mostly offered by small enterprises, where owners are at the same time managers and fully involved in actual service work.

Restructuring at national level

Restructuring of the economy in Slovakia has been particularly significant since 1990 – after the change of the previous political and economic system. The main features of this change were:

- Transition from a planned economy to a market one.
- Changes in ownership relations via privatisation.
- Changes in the role of the state in managing the economy.
- New social partner structures for dialogue with the government.

There were also changes caused by the splitting of Czechoslovakia and the foundation of the independent Slovak Republic on 1 January 1993. The latter meant fully taking over the governance of the new state and establishing new state administration bodies. Restructuring shaped the developing private sector (Cziria and Borgula, 2009a).

All those factors and changes had an impact on the structure of the economy, where the importance of individual sectors gradually changed, the importance of the private business sector increased and that of SMEs grew to the detriment of big companies.

Before 1990, the economy in Czechoslovakia was organised mainly in large state-owned enterprises. Privatisation at the beginning of the 1990s helped to develop the SME sector. The private SME sector developed almost from scratch. Either some large enterprises were split into several independent viable companies or there were spinoffs of large companies during their streamlining, with core activities focusing on becoming more competitive. Others were start-ups providing new products and services to final customers or subcontractors for large enterprises.

This type of development had a negative effect on existing trade unions. They have kept their position only in large enterprises. In small spinoffs or newly established SMEs, trade union organisations are very rare. Without protection from trade unions, the position of employees is more vulnerable. A similar situation is also found in many companies established by foreign investors.

The data show that in the last 20 years there have been major changes in the size of enterprises. In 1994, approximately 15% of employees worked for small enterprises, approximately 12% for medium enterprises and nearly 73% for large enterprises. By 1998, more than 19% of employees worked for medium enterprises and fewer than 45% for big enterprises. This trend continued also into 2006, when nearly 22% of all employees worked for small enterprises with up to 49 employees, and 19% for medium enterprises. In contrast, the proportion of employees working for large companies with more than 250 employees had fallen to 31% in the same year. This confirms the rise of SMEs to the detriment of big companies. The data also show the increasing number of self-employed and sole proprietors among the working population after 2000. The most significant drivers of the Slovak economy during the 2000s were foreign direct investments of large multinational companies. It supported the economic development and its significant restructuring. This trend was heavily built up by incentives in the form of state aid.

In addition to lowering unemployment, these changes also contributed to the development of the SME sector through subcontracting opportunities that became the main source of new jobs.

The recent economic crisis was an important impulse for restructuring. Initially, the attitude that the crisis would touch Slovakia only marginally prevailed. In September and October 2008, however, the first signs of the fall in consumer demand abroad were evident. This had an impact upon sales and trade. The growth of Slovak GDP decreased from 10.4% in 2007 to 6.4% in 2008 and -4.7% in 2009. However, the newest revised data indicate reasonable growth at 4.5% in 2010.

At the beginning of 2009, restructuring started to accelerate. The automotive and machine engineering industries were affected the most. The main production companies were not hit by the crisis as much as their subcontractors. Companies often reported to the regional offices of the Central Office of Labour, Social Affairs and Family (Ústredie práce, sociálnych vecí a rodiny, ÚPSVAR) about dismissals, including mass dismissals.

Internal restructuring or closing down of operations cut employment in the enterprises involved. According to the data from ÚPSVAR, from October 2008 to March 2009, more than 83,000 new jobseekers were registered. From January to March 2009, more than 63,000 of them were registered at the ÚPSVAR offices, and the number of unemployed increased to nearly 312,000. While the unemployment rate, according to the Employment Institute (Inštitút zamestnanosti) was 8.7% in the 4th quarter of 2008, in the 3rd quarter of 2009 it had already reached 12.5%.

The following section looks at the different types of restructuring at the company level in the Slovak context.

Relevance of different types of restructuring for SMEs

There are various general definitions of restructuring. What most of them have in common is that it is a process in which a company undergoes substantial change in some or all of its structures and operations. Restructuring is usually carried out to make the company more profitable, or better organised for its present needs, or to accommodate change of ownership or ownership structure, demerger, or in response to a crisis or major change in the business such as bankruptcy, repositioning, or buyout.

When a company is having trouble making payments on its debt, it will often consolidate and adjust the terms of the debt in a debt restructuring. After a debt restructuring, the payments on debt are more manageable for the company and the likelihood of payment to bondholders increases. A company restructures its operations or structure by cutting costs, such as the payroll, or reducing its size through the sale of assets. This is often seen as necessary when the current situation at a company is one that may lead to its collapse.

The implication of these definitions is that ‘restructuring’ in its ‘economic’ meaning is broader than its ‘legislative’ meaning. The economic meaning covers decisions and actions decided and carried out by companies (their owners, managers) themselves (for example development, internal change of organisational structure, technology upgrading), while on the other hand the legal meaning is limited to situations when legislation is involved. In Slovakia, the legislative meaning of ‘restructuring’ – as defined by the Act 7/2005 Coll. on Bankruptcy and Restructuring and its amendments – means that ‘restructuring is a legal process to avoid bankruptcy’. In this process the ‘start of the restructuring process must be decided and approved by the court’. The legislative definition is clearly very narrow and relates only to companies in threat of bankruptcy.

In analysing the restructuring types and processes in Slovak SMEs, this report follows the broader ‘economic’ meaning. However, official data from National Bank and/or from Slovak Statistics Office are based upon the ‘legislative’ definition of restructuring.

Table 7: *Restructuring by company size, 2009–2011*

Number of all restructured companies	Size/Year	2009	2010	2011
All restructured companies	Micro	20	45	37
	Small	21	32	34
	Medium	17	21	29
	Large	4	6	0
	SMEs	58	98	100
	Total	62	104	100
Share of all SMEs out of total restructured companies	%	93.54	94.23	100

Source: *Slovak Information and Marketing Society, Bratislava, 2012, own author's calculations*

The data related to restructuring in Slovakia are presented in Table 7. There are no detailed data available, as entrepreneurs are not required to submit data on restructuring to any official authority – either statistics or tax offices. The majority of large companies are owned by foreign owners and they were granted ‘tax holidays’ (exempt from taxes for 10 years) so they also did not submit any data to tax authorities.

Outsourcing is a widely used form of restructuring among Slovakia SMEs. They use it in cases of insufficient funds, mostly for logistics and those activities which are not core to their business (for example accounting).

If financial resources are available companies prefer internal restructuring, which in most cases takes the form of modernisation of technology and subsequent layoffs, particularly in firms active in information systems and IT.

Bankruptcies are usually solutions for the textile industry, because Slovak producers cannot compete with cheap imported goods, in particular from China and Turkey.

Relocation of SMEs is quite rare, because many SMEs are family-owned. As there are strong family ties in Slovakia, moving for work to different region is seldom an option, and is undertaken mostly only by young people.

Companies with flexible managers were able to utilise functional parts of companies for further development, while abandoning other parts. This is how Novochema Levice (<http://www.novochema.sk/>) transformed its production from chemicals to custom-made gold products and went from a loss-making to a profitable enterprise.

Quite a large portion of SMEs in Slovakia are taking advantage of the country's proximity to five other states – Czech Republic, Poland, Austria, Hungary and Ukraine – and their markets in bordering regions. It helped Slovak companies in these border regions to create conditions for restructuring. Some SMEs in Slovakia are moving companies abroad, if it is more advantageous from a business point of view – mostly to the Czech Republic.

Offshoring to other countries does not play a significant role and if such a situation happens, it is mostly related to medium and large companies owned by foreign nationals, for which the tax exemption (tax holidays) has finished and they are moving to other countries offering the same advantage, for example Romania.

As a percentage of total SMEs in the country, business expansions – as well as mergers and acquisitions – are quite rare in Slovakia.

Some types of restructuring are difficult to identify because they overlap; for example, internal restructuring and outsourcing. Other types of restructuring are quite distinct and have a legally determined form.

The selection of measures a firm adopts depends on the specific situation and available opportunities. Usually for SMEs opportunities are quite restricted compared to large enterprises. For SMEs the most common types are internal restructuring, which is applicable in the majority of circumstances, and bankruptcy/closure in the case of a substantial failure. Entrepreneurs face problems caused by the current world financial crisis. This is also a catalyst for all company processes that motivate restructuring, increase competitiveness, or paralyse activities with an inevitable route to bankruptcy.

Many Slovak undertakings opt for liquidation of the company within the bankruptcy proceeding. Such a proceeding is not a favourable solution for the company or for its business partners or employees. Termination of companies' activity, dismissal of employees, and unsatisfied creditors' claims are just a few results of bankruptcy. Suppliers of a dissolved company lose their customer and customers of a company lose their supplier. Generally it is an unsatisfactory situation.

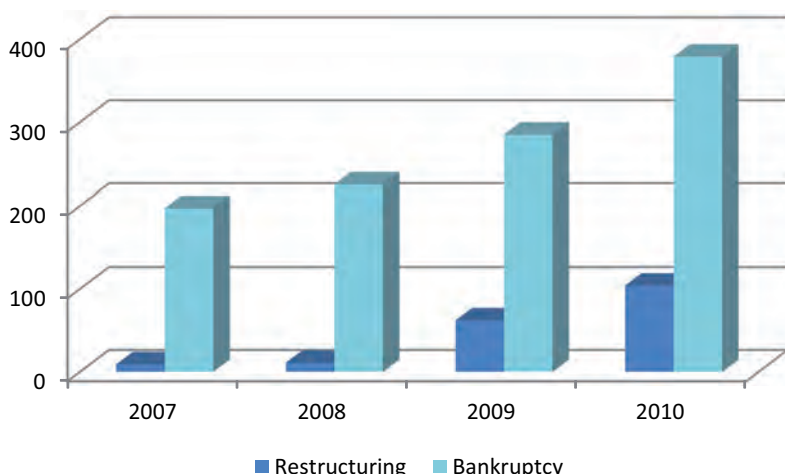
Bankruptcy

Bankruptcy proceedings in Slovakia are defined in the Act on Bankruptcy and Restructuring of 2005. The objective of the Act is the fair distribution of the limited resources of the debtor between the creditors by selling off the assets of the debtor or by gradually satisfying the creditors of the debtor. The Act on Bankruptcy and Restructuring replaced the previous Act on Bankruptcy and Settlement.

Administration of the bankruptcy and restructuring process is carried out by the Ministry of Justice of the Slovak Republic. The court provides the supervision stipulated by the law throughout bankruptcy proceedings, and supervises the activities of receivers.

Entrepreneurs may be able to avoid bankruptcy by anticipating difficulties – if they keep a close eye on the financial situation of their business.

Figure 1: *Bankruptcy and restructuring in Slovakia*



Source: *Slovak Credit Bureau*

Figure 1 shows that there are a very low number of restructured companies. Those which opted for this solution were mostly SMEs (93.5%), because large enterprises were stabilised and sales of their products and services were secure. This figure shows very clearly the ‘definition problem’. The high number of bankruptcies compared to companies entering restructuring processes is due to the fact that the data counts those in restructuring strictly by ‘legislative definition’. Those SMEs which have undergone restructuring in the ‘economic’ sense – meaning companies that were not under immediate threat of bankruptcy – are not accounted for. It is rather a comparison of SMEs (their owners and managers) deciding to take the legislatively easier way to bankruptcy (and, perhaps, create a new entity) than trying to restructure under court supervision.

According to the National Agency for Development of SMEs (NADSME), the proportion of exiting entities as a percentage of the total number of active entities, according to the business demography methodology in selected sectors (OKEČ categories C to K) in Slovakia, was 16.8% in 2007 – an increase of 5.6 percentage points compared to 2006. Within each sector, this indicator ranged in terms of value from 10.8% to 19.8%, with the highest values seen in the trade sector (19.8%), hotels and restaurants (19.7%) and financial intermediation (15.5%). Conversely the lowest percentage values were seen in mining and quarrying (10.8%), the electricity, gas and water sector (11.1%).

In 2007, 64,079 subjects (legal entities and natural persons – entrepreneurs) became defunct. Out of these 64,079 exiting companies 197 went bankrupt, and the rest (63,882) ceased to exist – closed their activities and removed themselves from the Business Registry. Bearing in mind that only nine companies in 2007 went into restructuring and almost 64,000 closed without even attempting restructuring, it is assumed that their owners/managers either did not have confidence in this process or did not know about it. Of the total number of closed enterprises 89.8% entities had 0–4 employees. In terms of sector structure (according the statistical classification of economic activities – SK NACE) most subjects in 2007 had become defunct in the trade (23,054), industry (10,154), real estate (9,570) and construction (8,406).

Restructuring

In Slovakia, the legal processes of restructuring (‘reštrukturalizácia’) are regulated by the Act No. 7/2005 Coll. on Bankruptcy and Restructuring. Restructuring – in its ‘legislative’ meaning as described above – is the way to avoid bankruptcy when a company is temporarily unable to meet its financial obligations. It is feasible only when there is a possibility to design a plan for changes in financial management, production and marketing to revitalise company operations and renew its ability to pay its creditors. In this case there are quite reliable statistical data and very detailed legal procedures. Restructuring in this form keeps the company operating and is directed to its economic stabilisation by measures taken under supervision of a court, and creditors of the company. This procedure maintains the activity of the company, provides conditions for maintaining the relations of the company with business partners, and also satisfies creditors’ claims, unlike bankruptcy. The advantage of restructuring is in higher pay-offs to the creditors compared to bankruptcy proceedings. The most common and most efficient aspect of business restructuring is restructuring of the business’s debts, which means vital involvement of all creditors.

A company that has been restructured effectively will theoretically be leaner, more efficient, better organised, and better focused on its core business with a revised strategic and financial plan. Following are relevant data in synthetic form (Table 7) and analytical form (Table 8) – both tables referring to companies doing restructuring under court supervision. The numbers used the sources indicated below the tables and calculations by the author of this report (Elena Šubertová).

Table 8: *Structure of restructuring processes by size class SMEs in Slovakia*

Number of all restructured companies	Size /Year	2009	2010	2011
Restructuring company	Micro	3	17	11
	Small	3	11	11
	Medium	2	2	11
	Large	0	0	0
Active after restructuring	Micro	9	13	10
	Small	12	12	13
	Medium	9	10	11
	Large	2	5	0
Bankruptcy after restructuring	Micro	5	10	11
	Small	6	9	9
	Medium	6	9	7
	Large	1	1	0
Deleted from business register after restructuring	Micro	3	5	5
	Small	0	1	1
	Medium	0	0	0
	Large	1	0	0

Source: *Slovak Information and Marketing Society, Bratislava, 2012*

More than one-third of restructured SMEs were microenterprises focused on trade, while small and medium-sized enterprises were mostly part of the engineering and construction industry.

Restructuring occurred mostly in enterprises involved in civil engineering and in mechanical engineering, where changes in technology are quite rapid. Therefore, if they wanted to stay on the market while insolvent, their managements were forced into restructuring despite a temporary fall in production. This process was implemented under court supervision, if a company – otherwise viable – became insolvent, but had the potential to recover and liquidation would be inappropriate.

Table 7 shows that restructuring is mostly used in small and medium companies. Restructuring enterprises significantly reduced the number of workers they employed. On average one-half of the restructured enterprises reduced their workforce by 30%. Most of these enterprises have a negative cash flow. The first group of companies in Table 8, marked as ‘Restructuring company’ refers to those in the first phase, when activities are usually targeted at clarifying the economic situation of the company and its financial data, with the aim of radical cost cutting, decreasing labour cost and cutting jobs, as well as securing liquidity while restructuring debt. In this phase, management of the company is extremely active, and it also uses external crisis management. The second group marked ‘Active after restructuring’ shows companies that are sufficiently active after the restructuring process and which already have positive results from their reaction to problems before restructuring was implemented. Companies have usually changed strategies, changed their communication style, replaced the former management, decreased current costs and laid off part of the workforce. The third category includes those companies which – despite restructuring efforts – did not reach expected results and are in bankruptcy. The fourth category refers to companies which were removed from the Business Register after restructuring. Mostly they are micro-companies which did not have enough resources to pay for external experts (for example crisis management) and were not able to restructure their debt on their own.

Table 9: *Types of restructuring as % of total: main industries in brackets (2008–2009)*

Type of restructuring	2004–2009	Oct 2008–May 2009
Business development	67%	30% (machinery, metals)
Internal restructuring	18%	n/a
Bankruptcy	10%	18% (textile)
Offshoring	3%	9% (textile, auto-parts)
Relocation within Slovakia	1%	2% (food industry)
Mergers and acquisitions	1%	1% (chemical industry)

Source: *Cziria and Borgula, 2009b*

There was a sharp rise in cases of restructuring (legislative meaning – restructuring under court supervision) in 2009 in Slovakia. The number increased more than five times compared to 2008. Unfortunately, in many cases it was opportunistic, with a speculative purpose. A number of ‘speculative’ entrepreneurs used the possibility for restructuring only to buy time and remove assets from distressed companies.

Outsourcing

Outsourcing is a very frequent type of restructuring in Slovakia. Generally, there are two basic trends. Large enterprises outsource some of their activities that are for them not very profitable. To produce more effectively and to streamline their production structure, outsourcing is a good tool to focus on core activities. This gives opportunities for SMEs to serve as subcontractors. This is very important for example in the automotive industry where there are several large car

producers that have many subcontractors for specific parts or services. When such subcontractors deliver the same parts to several large producers, it makes production more effective.

According to a study (Badanova, 2012) completed in 2009–2010 in Slovak SMEs, companies outsource mostly:

- a) Information technologies (44% of respondents) – IT services, IT development, outsourcing of whole IT processes;
- b) Human resources (43%) – payrolls, personnel search
- c) Logistics (23%) – transport, procurement
- d) Financial services (18%)
- e) Production (12%)
- f) Facility management (9%)
- g) Business processes (5%)
- h) Ecology (4%)
- i) Scientific and technology development services (3%).

Note: Each of the responding companies could select multiple answers.

Costs of outsourcing – in the companies which use it – make up on average 20% of their total costs.

The main criteria in selection of suppliers were quality of supplied products/services (53%), ability to keep deadlines (36%) and price (% not available).

The general economic crisis forced only 9% of the respondents to stop outsourcing.

Cooperation between large enterprises and SMEs brings additional benefits to the economy. Long-term subcontracts have stabilising effects on the SME sector and also on employment. Subcontracts allow spillover of new technologies and force SMEs to introduce innovation activities and participate in development and research.

On the other hand, there are many companies, especially SMEs, which instead of using their own employees for some of their core activities sign contracts with sole proprietors for their execution. The reason is to simplify their administration and avoid high payments for social and health insurance. An important reason for SMEs is greater flexibility in matching their workforce to rapid changes of customer demand. Usually these sole proprietor subcontractors are in the position of employees without employees' benefits. This is illegal, but it is very difficult to prove that it is taking place and thus take action.

Offshoring

Offshoring is quite rare for Slovak SMEs because Slovakia has advantageous tax conditions with corporate and personal flat tax rates of 19%. This type of restructuring is relevant only for large companies.

Mergers and acquisitions

SMEs in Slovakia have a relatively small market, therefore mergers and acquisitions help in the export of their goods and services. For example, the Slovak chain of cooperative retail stores Jednota (30 stores, mostly selling food), merged with partners in Hungary and Czech Republic into COOP-EURO, a company with its HQ in Bratislava. Now, instead of a market with approximately 5.6 million residents, they have a market with population of about 25 million.

Internal restructuring

Internal restructuring is common in all sectors and industries, especially in times of economic crisis. Besides innovation, processes most often accompanying internal restructuring of Slovak SMEs are reorganisations, development, mergers and acquisitions, offshoring, relocation and bankruptcies. Private SMEs – including farms – are by far the largest employer in Slovakia, but they have not had very much management experience in market economy conditions. Therefore internal restructuring is a fairly frequent process to adjust organisations to the current economic condition and environment. It is even more important in the case of farms, which were transformed in the first step from large cooperatives into small individually owned farms that needed to modernise their structures and organisation in order to be competitive in the European market. So they provide an excellent example to present internal restructuring in these organisations, not least because they underwent substantial restructuring when Slovakia joined the European Union and accepted the Common Agricultural Policy.

Newly created private farms – limited liability companies – are more efficient as agricultural cooperatives, but with fewer employees and without the burdens of liabilities from transformation process. It is interesting that most of the profitable enterprises are from less productive regions. The reason is their faster optimisation of the production structure (they are not involved too much in losing branches of business, are mostly oriented towards crop production, thus they have lower expenses in feeding livestock, etc.). Newly created private farms are more efficient compared to former agricultural cooperatives, because they have flexible senior management.

This type of restructuring, however, also refers to internal reorganisation that may not necessarily result in the reduction of the number of employees, such as business transfers and succession, reorientation of the business purpose, diversification resulting in redeployment of employees or similar business transformations. Workers do not automatically move from one sector to another. The disappearance of certain particularly dangerous, arduous or polluting jobs can be seen as something positive if they are offset by new ones with less dangerous, safer and better working conditions. However, the new jobs that are created are not necessarily taken up by the people who have been made redundant because the location and the skills required are not necessarily the same in the two cases.

These changes hit the most vulnerable population groups, especially low-skilled workers, particularly hard. The capacity of the Slovak economy to maintain a supply of adequate jobs for these workers is not satisfactory.

Slovak enterprises, in particular those in small towns and in the country, have generally tried not to lay off too many employees when they started facing problems. However, this only delayed the inevitable and resulted in economic problems, which forced managers to implement changes, most often reorganisation of enterprises, and then the first step was to dismiss redundant employees. The government/parliament adopted new legislation Act 311/2011 Coll. related to large-scale layoffs, which came into force on 1 September 2011: the legislation defined a large-scale layoff as a situation when a company dismisses 21 or more employees within a time span of three months. In such a case there has to be notification at least 30 days in advance, so the state can properly assist the employees in question in starting their own businesses, or in requalification or in placement in another company. Kovotvar Kuty (<http://www.kovotvarvd.sk/>) – a producer of custom-made metal products – which downsized from hundreds of employees 10 years ago to 90 today – can be mentioned as a typical example.

Drivers of restructuring

The above-mentioned considerations are very much focused on restructuring at the micro or company level. But, as explained above, virtually every entrepreneurial organisation – including SMEs – is just a part of a very complex economic and social environment, reaching in many cases even beyond the boundaries of the country.

SMEs in Slovakia require restructuring because too many of them are still focused only on the local (or regional) market. If they do not change, they will be replaced sooner or later by expanding competitors, probably by those importing foreign products. One of the problems Slovak entrepreneurs are facing is the low purchasing power of the majority of residents, low demand – leading to low sales, low revenues and lack of resources for investments or for hiring costly experts. That is one of the reasons why companies are not using specialists – for example crisis managers – when problems occur. Instead they try to solve problems on their own, usually by employing the easiest method of cutting costs, which is to lay off personnel. Only if this measure does not help are other methods tried.

As one of the main drivers of restructuring is to decrease costs, outsourcing is also perceived as one of the solutions.

Table 10: *Comparison of expectations from outsourcing with actual benefits*

Expected result	Expectation (% of respondents)	Reality (% of respondents)
Cost reduction	59	50
Better concentration on own core business	50	48
Increase in effectiveness	39	41
Decrease in number of employees	28	26
Access to innovations	11	13

Source: *Badanova, 2012*

Table 10 shows that while expectations relating to cost reduction as a result of restructuring were very high (59% of respondents entered restructuring with this goal), in fact 50% of respondents did achieve this goal and only 9% failed, which is quite remarkable. As the table indicates, positive trends included cost reduction, concentration on the core business, and an increase in effectiveness. On the other hand, 28% of SMEs expected layoffs as a result of restructuring, whereas slightly fewer (26%) had to actually lay staff off in reality. Low figures relating to technology innovation – both in expectations and in reality – are generally due to the high cost of modern technologies not affordable to SMEs, particularly to those under stress and even more during economic crisis.

The main drivers of restructuring in Slovakia are: efforts to keep up with competitors by increasing quality of products in retail chains; assuring faster delivery of products to end users; desire to reduce costs; and desire to improve services. These drivers are basically the same for all production industries, but in the case of the agricultural sector they have been more significant due to foreign retail chains entering the Slovak market. This situation required fast and deep changes in the whole agricultural and food sector and its relationship to retail.

Slovak SMEs mostly do not have enough resources to implement new modern technologies or to invest in sophisticated technological product development. This leads to bankruptcies or takeovers by foreign investors in industries with either fast technology development or high costs of research (for example in the pharmaceutical industry).

The most important tasks which enterprises in agriculture are facing are:

- Securing adequate outputs (sales), which depend on economic stability and adequate inputs from industries (chemical industry, engineering, etc.);
- Restructuring the production in relation to market;
- Optimal use of production capacities in accordance to specific conditions in individual regions;
- To improve working conditions of employees with the goal to increase their labour productivity;
- To employ professional managements which are able to make optimal decisions in agricultural enterprises;
- To create vertical cooperation agricultural farms with processing food industry and trade.

There are possibilities for further development of existing forms of farming operations in the Slovak Republic (Šúbertová, 2010).

According to GEM research by Pilkova et al (2012) – data for year 2011 – Slovakia has the highest ‘total entrepreneurial activity’ of the Visegrad Group (V4 Group) of countries (Slovakia, Czech Republic, Poland, Hungary). The percentage of population aged between 18 and 64 years who are either starting their business or investing in ownership, is 14.2% or 525,000 people. This places Slovakia in 15th place among 54 countries surveyed worldwide. The main motivations to start entrepreneurial activity are: increase income, independence, impossibility of finding employment. At the same time, Slovakia is a country with the rate of business discontinuance (7%) and termination of entrepreneurial activities (4.5%), which is the second highest rate of this parameter in Europe (and the highest within the V4 Group).

Table 11: *Reasons for business discontinuations in Slovakia (2011)*

	2011	Rank
Problems getting finance	9.0%	
Personal reasons	13.2%	3
Other job or business opportunity	12.0%	
Business not profitable	36.6%	1
Exit planned in advance	2.1%	
Retirement	4.3%	
Opportunity to sell	3.6%	
Other reasons	19.2%	2

Source: *Pilkova et al, 2012*

The major reason for discontinuing entrepreneurial activities was unprofitability of the business (one-third of respondents). Other reasons included personal (for example disagreement between owners and managers), and also a chance to take up other opportunities. About 20% of respondents did not answer the question. Financial problems were not among the top – they were listed in 5th place – because there were various EU programmes supporting SMEs during the period of the survey. Another reason is that interest rates decreased after Slovakia adopted the euro. Of those who terminated their entrepreneurial activities, 13.9% restarted within 12 months.

Distinctive characteristics of restructuring in SMEs

Legal procedure for restructuring

As in other jurisdictions, the main options available to a Slovak company when it is in financial difficulties are: a private settlement; a court-supervised reorganisation (formal restructuring); or final liquidation. Both private work-outs and judicial restructurings are intended to rescue the company, while a final liquidation (bankruptcy) ultimately terminates the company. One of the common features in Slovakia is the intensive legislative effort to modernise restructuring laws over the past few years. A new and relatively modern restructuring law was adopted in Slovakia in 2005. Further, the debtor-in-possession concept seems to be widely recognised (partly, perhaps, inspired by chapter 11 of the United States' Bankruptcy Code). An expert's opinion on the feasibility of a reorganisation may be required before formal proceedings are entered into. Some other features that can be found in the judicial restructuring statutes are:

- Ease of entry – the restructuring process is available also in the case of an imminent (as well as actual) insolvency;
- The debtor's management is supervised by an independent insolvency practitioner and creditors' committee;
- Creditors vote on the restructuring plan (voting is usually in groups or classes) while the key legislative measure aiming to protect creditors' rights in the process is the requirement that in a restructuring the creditors must get more than they would in a liquidation.

Slovakia recognises final liquidation (bankruptcy) and judicial restructuring as two separate proceedings where the debtor or creditors must decide at the outset which route to take and then make the relevant filing (Allen and Overy, 2009). In the case of concurrent petitions for bankruptcy and restructuring, the law prefers the latter (subject to certain conditions being met). On the other hand, if the court-ordered restructuring is no longer feasible or if the debtor seriously breaches obligations imposed by the law, restructuring proceedings are automatically converted into bankruptcy proceedings. In Slovakia, the law has already been successfully tested and applied to several high-profile cases. Experience in Slovakia shows that the formal (court supervised) stage of restructuring proceedings may take as little as one year (and even less in some cases). Even in the absence of statistical or practical evidence, a good indicator in determining the length of the process could be the statutory deadline for the submission of a restructuring plan to the creditors for voting. In Slovakia, the draft plan must be submitted within 90 days (excluding a possible additional 60-day extension if requested).

Informal settlement

In principle, a private (informal) settlement is feasible in Slovakia based on the doctrine of freedom of contract. Its substance remains the same; that is, a privately agreed reorganisation (restructuring) of the company's debt, agreed between the company and its main creditors (normally banks) and without any formal (judicial) intervention. SMEs can and do hire specialised experts to help with restructuring. The advantages are obvious: avoiding the trauma of insolvency and related negative publicity; preserving confidentiality; control by the most sophisticated and key creditors with limited (or no) involvement of small creditors and courts; and a less formal, less complicated and possibly less costly process. No specific regulation exists at local levels to deal with a private settlement: solutions based upon well-known and the most frequently used standard principles in Europe – for example London Approach and INSOL³ Principles – should work, but there is a varying degree of recognition and market familiarity with them, so they are not used very

³ INSOL Europe is the European organisation of professionals who specialise in insolvency, bankruptcy and business reconstruction & recovery. See <http://www.insol-europe.org/>.

frequently. The situation (especially in terms of market familiarity) in Slovakia shows no legal recognition or specific official guidelines. As a result, the London Approach or INSOL Principles are used very rarely in practice, if at all. Naturally, debtors in difficulties seek as the remedy of first resort the ad hoc extensions of their financial terms and waivers of historic breaches. Perhaps also for historic reasons, key creditors seem to habitually adopt this solution. However, as some observers point out, this may sometimes be at the expense of the possible rewards linked to more timely, coordinated and substance-driven solutions. Therefore, it will be interesting to see how successful market players and advisers prove to be in their efforts to import international experience with work-outs. Slovakia has a specific problem with appraisal of a company's assets, while the company is in process of restructuring. There are different possibilities for doing that – leading to different values.

Pre-packs (or pre-packaged plans) are plans negotiated in advance of a petition and submitted to the court for a confirmation within the judicial restructuring proceedings. In effect, these are the solutions first privately agreed amongst the key creditors (mostly the banks) and then confirmed by a court. The ultimate reason to use a pre-pack is that such a pre-agreed work-out is binding also for other creditors (especially if they tend to behave obstructively). Getting the 'formal' court's approval may be desirable for other reasons, too, for example, to improve the foreign recognition of the plan. Pre-packaged plans may be a useful solution in the scenario where the banks or other institutional creditors need to be involved in tandem with the other creditors (such as significant trade suppliers). The biggest creditors may prefer to agree the deal between themselves first and then make use of the judicial reorganisation which will involve all other creditors and the approval of the plan by a court.

Bankruptcy

As explained above, bankruptcy is a common form of restructuring in Slovakia.

The Act on Bankruptcy and Restructuring defines failure as when a business becomes insolvent and cannot pay creditors, namely where:

- a debtor is more than 30 days late in paying what is owed to more than one creditor;
- a business which is obliged to keep accounts as per Act No 431/2002 on accounting, has more than one creditor, and the value of the amount due exceeds its asset value.

A bankruptcy petition may be filed by a debtor, creditor, the liquidator of a debtor, or another legally appointed person. Petitions are submitted to the relevant court.

The debtor's property is taken over by the creditors, who are represented by an appointed bankruptcy administrator/facilitator. This person is selected randomly by electronic system from the licensed members of Slovak Chamber of Attorneys at Law (Solicitors).

The bankruptcy procedure has two phases: the start of bankruptcy proceedings and the declaration of bankruptcy, where the actual proceedings start. If the court determines that the bankruptcy petition satisfies the particularities required under the law, it will decide on starting bankruptcy proceedings within 15 days of receiving the petition.

Bankruptcy is considered officially declared once the bankruptcy order has been published in the Trade Journal (Obchodný vestník). Creditors must submit an application for claims together with supporting documents to the receiver's office, with one copy also going to the court. The application must be received by both the receiver and the court within 45 days of the bankruptcy declaration.

The bankruptcy administrator prepares a schedule of assets for liquidation. Proceeds from liquidation of the assets subject to bankruptcy proceedings are allocated to creditors who have registered their liabilities.

The court may halt or suspend bankruptcy proceedings.

Liquidation

Liquidation is generally governed by the Civil Code, which at the same time makes reference to Commercial Code provisions on liquidating companies.

In this approach the assets of the company are liquidated and its liabilities are discharged. The process takes place out of court. The result is the winding-up of a company and its subsequent dissolution through removal from the Commercial Register.

The liquidator may be an individual or a legal entity registered in the Commercial Register.

The liquidator has an obligation to notify in respect of the following:

- Commercial Register
- all known creditors
- the relevant tax administrator
- Trade Licensing Office.

Mergers

The amalgamation or merger of companies requires a draft amalgamation agreement or merger agreement for the companies, which contains in particular:

- trade name, registered address and identification number of the amalgamating or merging companies; also their legal form, where appropriate;
- the shares of the company partners in the successor company, or the size of the contribution made by the partners in the successor company;
- draft Articles of Association or Deed of Establishment, and the articles of the company being created through the merger;
- the date from which the acts of the company being wound up shall be considered from an accounting perspective to be acts performed on the account of the successor company;
- the time when the partners in the company being wound up will acquire rights to a share of profits as partners in the successor company;
- members of the statutory body or supervisory board.

The consent of all partners in the companies being wound up shall be required for the draft agreement, and in the case of a merger the partners in the successor company as well.

Cross-border mergers or cross-border amalgamations are understood as follows:

- EU Member State or member of the European Economic Area;
- a ‘Slovak company’ means a company with a registered address in the Slovak Republic;
- ‘foreign participant company’ means a company with a registered office in another Member State;
- a Slovak company or a company with foreign ownership;
- of one or more Slovak companies with one or more foreign companies; all of the companies being wound up and the successor companies must have the same legal form.

To expand a business, a good way can be buying an existing company, with the already established structure.

The Anti-monopoly Office authorises company mergers by monitoring market concentrations. This concerns mainly companies with larger market share. In the interests of maintaining competition, the office implements corrections on the basis of the Competition Act.

Mergers, amalgamations or divisions of companies shall become effective through an entry in the Commercial Register, by which:

- the assets of the company being wound up are transferred to the successor company;
- the partners in the company being wound up become partners in the successor company;
- the companies being wound up through a merger, amalgamation or break-up cease to exist;
- in the case of merger or division, the successor companies come into existence.

The process of takeover is regulated under the provisions of the Commercial Code.

If a person or a company decides to take over another company, they may do it in two ways:

- through a contract on selling a company – the seller transfers right of ownership and other rights and assets to the buyer. The buyer takes on the liabilities and obligations of the seller and pays a purchase price;
- through the transfer of a business share in the legal entity or through the merger of one company with another. This method applies only to legal entities.

Parties involved

For a number of years, companies and their management, workers and their representatives have been deemed as the only parties concerned and affected by restructuring processes. Although they are the main stakeholders, it is clear that regions have slowly emerged as a first-rank player.

Regional authorities specifically bring in an overall perspective to the management of the restructuring process. Regions are able to combine both an economic and social approach (especially with regard to the consequences of restructuring), and to overcome the limits of the company role, extending management mechanisms to a set of companies as well as to a wider group of employees than those made redundant by one (big) company. SMEs revive historic centres, they offer

a wide range of typical local products and services, which attracting not only local consumers but also visitors and foreign customers. Revitalisation is region-specific – for example in Slovakia it is renovation of castles by construction companies, restoration of parks by various types of SMEs, or even reconstruction of local roads. These activities are carried on in cooperation with government authorities – local, and/or regional, and/or central – which provide opportunities and funds enabling distressed companies to change their lines of business and in such a way enable their turnaround.

Government can indirectly influence restructuring through certain economic tools. For example the Slovak Ministry of Culture funds supported the activities of small and medium-sized construction companies which were restoring old castles, because the construction sector was the most hurt by crises due to lack of interest – and money – to build new company premises, houses or apartments. These funds helped some SMEs and after restructuring they were able to decrease (to some extent) unemployment on local/regional level. Large construction companies involved in infrastructure projects (for example highways), usually worked on government contracts and were not strongly affected.

As trade unions are present only in large and some medium-sized companies, their influence on activities in SMEs is not strong.

Main challenges and constraints facing SMEs in restructuring

SMEs in Slovakia are an important part of the economy, both as a stabilising element in the economic system and as the sector with the greatest potential for growth. The role played by SMEs is irreplaceable, especially in the areas of job creation, balancing regional development and the introduction of innovations into standard business practices. SMEs provide jobs for more than two-thirds of the active labour force and contribute more than half to the value added. However, they are increasingly sensitive to the quality of the business environment. Systematically improving the environment for business is therefore an important task for the government, which is subsequently reflected in improved competitiveness in domestic and European markets.

Major features in the Slovak entrepreneurial environment that favour company restructuring include:

- a) High level of savings before the global crisis, openness to foreign influence, very good conditions for influx of foreign investments;
- b) Low expenditures by SMEs on research and technology development, a relatively high level of informal relations, high interest rates, and especially very high guarantee requirements set by the banks on loans.

The main problems the SMEs are facing can be divided into three parts: financial problems, administrative problems and other problems.

Financial problems include the deterioration of payment discipline of customers due to insolvency, and a deterioration in the availability of financial resources. The price of labour is high in Slovakia – every entrepreneur pays a sum equal to more than one-third of a worker's wages on health and social insurance. Also, high loan guarantees are required and SMEs do not have resources for innovation of production. There are frequent changes to rules governing taxes and charges, but it is relatively expensive for SMEs to retain accountants (or auditors) and tax advisors.

SMEs face problems in restructuring processes related to the high level of guarantees required by the banks, which restrict many SMEs – especially small ones – in drawing credits. The situation is even worse with micro-companies, owned by sole proprietors, as they are liable by their whole property (assets of their family) in case of failure. In the first stages of restructuring, owners avoid layoffs due to strong informal relations with employees.

Administrative and legal challenges

SME restructuring in Slovakia is widely discussed not only among entrepreneurs and economists, but also among legal experts (Durica, 2010; Havlat, 2011). While in theory there are clear advantages of this process, in practice some problems accompanying restructuring make it unpopular:

- extensive documentation – small entrepreneurs require the same accounting and other documentation as in the case of large businesses, which creates problems for micro-entrepreneurs and SMEs;
- frequent changes of legislation – changes and amendments of relevant legislation, including norms related to restructuring and bankruptcy, in Slovakia are way too frequent. There were 698 changes (amendments) in legislation in 2006, another 669 changes in 2007, another 650 changes in 2009 and 'only' 560 in 2010 (the first time the number was under 600). For example, Act 455/1991 on the Business Code has been amended approximately 20 times since 1991. Therefore SMEs are more likely to face legal problems than companies with their own legal departments (Šúbertová, 2009).

Other problems

One problem SMEs face is the enforcement of their legal rights, which is difficult because the legal system is characterised by lengthy processes that are ineffective for the plaintiff. The judicial system is under stress – for example in Bratislava one judge has 800 to 900 cases, which means that cases are decided many years after they were filed. Another problem is that large companies often impose onerous contract conditions, which SMEs comply with simply because otherwise they will go out of business. Further hurdles for SMEs are occasional practices of favouritism and corruption, rising prices of inputs (energy, raw materials), which increases costs of products and services and threatens the competitiveness of companies, lack of resources for start-ups, and non-functioning capital markets.

The other side of the coin is the current perception of judicial restructurings by the market as a whole, and especially by key players in the market. In some jurisdictions, it is common for some local players (and especially those on the credit side) to overlook the benefits of a formal restructuring or over-emphasise its drawbacks at the expense of potential rewards. Historically, the insolvency of a company was almost invariably viewed as leading inevitably to liquidation (bankruptcy) and little attention was paid to a possible rescue solution through a private settlement or formal restructuring. However, now that the credit crunch and current global recession has severely hit local economies, it is clear that a new wave of restructuring cases will take place in Slovakia. It is not difficult to envisage the response that battered debtors are likely to adopt, especially where the formal restructuring may be viewed as the very last chance to survive and come up with a rescue plan while sheltered under the court's protective wings. However, how the rest of the market and especially those who have the power and position to shape local practices respond (and to what extent any potential opportunities may be realised) remains to be seen.

While restructuring should be a revival and revitalisation of a distressed company, Slovakia is lagging behind other European Union countries in using the process effectively. While restructuring efficiency in the EU is about 40%, it is only about 10% in Slovakia – about the same level of efficiency as debt recovery in bankruptcy (Jurik, 2010). Therefore in Slovakia restructuring is often looked at with suspicion, as it usually brings in practice more negatives than positives to debtors and employees.

The European common market affects Slovak SMEs in two opposite ways: on one hand it opened foreign markets, on the other it opened Slovak markets to foreign products (which quite often are – without VAT – cheaper than comparable Slovak products). Exports of Slovak SMEs in 2011 amounted to €15,947.3 million or 31% of total Slovak export. Slovak SMEs imported in 2011 goods in value of € 21,941.8 million (44% of total Slovak imports).

Slovak SMEs mostly do not have enough resources for implementing new modern technologies or investing in sophisticated technological product development. This leads to bankruptcies or takeovers by foreign investors in industries with either fast technology development or high costs of research (for example in the pharmaceutical industry).

SMEs quite often face problems with time delays and financing transport of unique spare parts from abroad (for example small and medium print-shops using state-of-the-art Japanese technology depend upon large importers with warehouses in other countries – mostly in Germany), and in the event of problems with machinery these delays can result in missed deadlines, leading to loss of customers' satisfaction.

Business support from public and private sources

Policy and business support

An important precondition for the development of the SME sector is to create a healthy business environment. SMEs are particularly sensitive to the quality of the business environment, and they play an important role in the Slovak economy – creating jobs, adding value and developing the regions. Currently Structural Funds are the most important contribution for improving the business environment, especially in terms of providing resources for financing entrepreneurial activities. Focusing on innovation, they influence restructuring in individual companies as well as at the level of whole economy.

In 2007–2013, the basis for the use of the EU Structural Funds and the Cohesion Fund is the National Strategic Reference Framework. The Ministry of Construction and Regional Development of the Slovak Republic (MVRR SR) assists with coordination of regional strategies by providing support to regional development agencies. Structural Funds are the only relevant source for supporting restructuring in SMEs. Particularly the Operation Programme ‘Operational Programme Competitiveness and Economic Growth for 2007–13 (OP CEG)’ that was prepared by the Ministry of Economy of the Slovak Republic. The goal of support through OP CEG is to maintain and foster the competitiveness and effectiveness of the manufacturing potential of industrial production and of the energy sectors, as well as the potential of tourism and other selected services. OP CEG respects the conditions of sustainable development, and thereby effectively contributes to enhancing the economic performance of Slovakia as a whole, and reduces the existing disparities in the economic performance of individual regions of Slovakia. Attention is also paid to supporting those activities that have a positive impact on employment and development of innovation.

While there is strong public support for implementation of information technologies, the year 2012 started with some problems with the electronic tax system.

Public support is realised either directly by grants, subsidies, repayment of loan interests, or indirectly by free of charge consulting services, tax deferrals, taking over guarantees.

Organisations supporting SMEs (for example the National Agency for Development of SMEs; Slovak Association for Small Enterprises, Slovak Business and Industry Society, etc.) continue their consultations and advisory activities regarding use of funds from European Union.

Slovak micro-companies can use the Micro-Credit Programme (loans up to €25,000); fast-growing companies can use Seed Fund (loans €10,000 to €100,000 with five years; maturity). There is also a network of so-called ‘business angels’ – investors who also provide managerial services.

There are more than 400,000 SMEs in Slovakia, so it is difficult to generalise about the management situation in the sector as a whole. A number of organisations provide management training in different forms – from seminars and workshops to full-time study; other organisations are focused on lifelong learning activities. All these forms – general as well as narrowly specific (for example crisis management, change management) – serve to increase management abilities. Slovakia has 10 Regional Advisory Centres which serve SMEs specifically, three Centres of First Contact and two entrepreneurial incubators. Management studies are offered by the majority of Slovak universities – there are 15 management faculties at these universities.

One of the forms of support for SMEs are consulting and advisory services of different organisations (for example, SARIO, NADSME), particularly when companies are planning to enter foreign markets. Globalisation is substantially

influencing the competitiveness of Slovak SMEs. However, only 16% of respondents are currently using these services. One of the reasons for low trust in these institutions has its roots in lack of information – 23.1% of entrepreneurs either did not know about these organisations or they considered them as obsolete (Šúbertová, 2009).

Tools and measures for managing restructuring

The basis for the use of the EU Structural Funds and the Cohesion Fund is the National Strategic Reference Framework 2007–2013. The Ministry of Construction and Regional Development of the Slovak Republic (MVRR SR) assists with coordination of regional strategies by providing support to regional development agencies. New investment and new companies, which would create new jobs, are crucial to the development of many regions. Systematic rational selection of investors, however, has not been one of the strengths of the implementation of regional development policies in Slovakia so far. Some investors coming to Slovakia, especially those operating in regions with high unemployment, have obtained financial incentives. However, the total amount of financial resources available from the state for such support is limited. Some of these resources are also allocated to developing infrastructure (for example, roads) linked to the new investment, and to the establishment of new industrial and technological parks, which play an important role in attracting new investors. Strategies for regional and local development and for restructuring of enterprises were usually not coordinated in the most efficient way with labour market policies or with social policy, which aimed at employment of the available labour force of productive age. Recently, there has been a real lack of qualified labour, for example, in the automotive and electrical industries and in construction. However, the most effective steps towards the reconciliation of labour supply and demand have only been taken recently. The system of lifelong learning, which would boost the employability of workers, including elderly workers, has not yet been properly developed. However, in May 2009 the Slovak Government adopted measures to improve the programme to establish a lifelong learning system, financially supported by EU resources. At present, there are no specific measures or tools for the early prediction of changes. These are needed for more efficient restructuring.

Active measures include the following:

- Public employment services are directly involved in restructuring in cases of mass lay-offs. The labour offices help laid-off employees – most of them from the SME sector – to find an alternative job, mainly by channelling them to another employer or through education and retraining. An individual action plan for jobseekers plays an important role here. There is also support for the jobseekers in starting their own business, help with geographic mobility and support for handicapped jobseekers.

However, mainly passive measures have been adopted:

- Redundancy pay, which is regulated by the Labour Code, is paid by the employer. It does not depend on the scale of restructuring, and dismissed employees are entitled to redundancy pay by law. An employee can receive higher redundancy pay if it is agreed upon in the collective agreement;
- Unemployment benefit is paid to jobseekers, in accordance with the Act on employment services – at present for a maximum of six months;
- A redundant employee can ask for early retirement if he or she fulfils conditions set by the Act on social insurance. At present, legislation regulates early retirement more strictly.

Legal support and legislation

Issues related to restructuring in Slovakia are regulated by several laws, including the following:

- Act No. 2/1991 Coll. on collective bargaining, as amended, regulates collective bargaining, social partner involvement, the extension of collective agreements, collective labour disputes and procedures for their settlement. Social partners can negotiate and agree on higher redundancy payments than the Labour Code sets as the minimum. (For instance, when firms close or move to other countries.) The ability of social partners to negotiate is based almost exclusively on support they receive from the highest levels of the labour unions and even if this support is in place, negotiations are usually not successful. Labour unions may become active in collective bargaining, when they represent at least 30% of employees. The fact that the labour union organises at least 30% of employees has to be declared to the employer when the union is created. After that, the union may act in the name of all employees.
- Act No. 231/1999 Coll. on state aid allows state assistance to enterprises in difficulties. However, it is still not working properly and financial resources available are not nearly enough to meet demand during the present economic crisis.
- Act No. 311/2001 Coll. on the Labour Code, as amended, regulates dismissal of employees: termination of employment contracts, collective dismissals, redundancy pay, employees right to wages, taking care of employees in case of transfer of undertakings, etc. A new provision allowing flexible working hours for a specific period was introduced in the year 2009. There is no size class differentiation in the Labour Code concerning any of the stated regulations.
- Act No. 461/2003 Coll. on social insurance, as amended, set up a guarantee fund to cover wages and redundancy money when firms go bankrupt.
- Act No. 5/2004 Coll. on employment services, as amended, specifies the duties of employers in cases of large-scale dismissals.

Specific measures are taken by the Central Office of Labour, Social Affairs and Family (Ústredie práce, sociálnych vecí a rodiny, ÚPSVAR) to promote the re-employment of dismissed workers who are registered as jobseekers, for example through training.

Act No. 328/1991 on bankruptcy and settlement was amended by Act No. 122/1993. However, due to fear of a ‘domino effect’, this act only came into force in 1995. The act did not allow for enterprises to be restructured (in the legislative sense – meaning under court order and supervision). It usually led to their closure, with a damaging loss of know-how and employment. Act No.7/2005 Coll. on bankruptcy and restructuring, which came into force in 2006, offers the company restructuring under the custody of a court as an alternative to bankruptcy. The procedure is practically identical to that set out in chapter 11 of the United States’ Bankruptcy Code. During restructuring, the company is protected against individual creditors and may agree upon a legal reduction in its liabilities as part of a project approved by the creditors and confirmed by the court. According to the Act, an enterprise is insolvent when it is not able to pay back its liabilities for more than 30 days and has more than one creditor.

It has allowed many companies to come through the current recession, even with a big fall in their sales, without searching for escapes like tricky bankruptcy or ‘tunnelling’ before bankruptcy. It helps maintain the know-how of companies and to restart the economy after a recession, as well as making job creation easier.

Outcome of restructuring events

Organisational effects

Organisational changes come about for example a result of layoffs, mostly of administrative staff and workers from production lines which were closed down. On the other hand, SMEs are hiring new qualified workforce and managers needed for innovation, as well as purchasing and operating new sophisticated technologies, introducing new materials and new production processes. If restructuring requires expensive purchases, SMEs – considering price and services – usually turn first to domestic suppliers. However, modern machinery and equipment is quite often accessible only from international sources. In such a situation, the advantage of clusters in dealing with foreign partners – be it arrangement of imports, exports and any other form of international cooperation – is substantial.

Slovakia has strong international business ties, with most of exports/imports within the European Union, and has a positive foreign trade balance of €975.1 million, the highest balances being with Austria (€2,663.9 million, Germany €2,560 million, Czech Republic €2,217.5 million, and Hungary €1,858 million) (source: **Statistics Office of the Slovak Republic**). SMEs (including micro-companies) account for about 46% of exports and for about 44% of imports.

Table 12: *Slovak exports by size of exporter, 2011 (€ million)*

Territory	Category of exporter			
	Microenterprise 0–9 employees	Small enterprise 10–49 employees	Medium enterprise 10–249 employees	Large enterprise 250+ employees
EU15	1,604	1,331	3,671	19,895
EU12 (new EU members)	3,246	1,876	2,501	9,133
Not EU	594	406	719	6,450
Total	5,944	3,613	6,891	35,498

Source: *National Agency for Development of Small and Medium Enterprises (NADSME); Report on SMEs in Slovakia, Bratislava, 2012*

Table 13: *Slovak imports by size of importer, 2011 (€ million)*

Territory	Category of importer			
	Microenterprise 0–9 employees	Small enterprise 10–49 employees	Medium enterprise 10–249 employees	Large enterprise 250+ employees
EU15	2,593	2,400	3,924	18,430
EU12 (new EU members)	4,369	2,107	2,204	14,135
Not EU	1,315	1,270	1,761	17,265
Total	8,277	5,777	7,889	49,830

Source: *National Agency for Development of Small and Medium Enterprises (NADSME); Report on SMEs in Slovakia, Bratislava, 2012*

The data show that micro and small enterprises involved in foreign trade are oriented more towards the new EU Member States (those which entered the EU after April 2004), while medium and large companies are mostly active in international trade with countries that were members before 2004. The numbers for large companies are significantly influenced by the unique Slovak position due to large automotive industry production (Volkswagen, Citroen/Peugeot, Kia) and the resulting export of cars.

Employment effects

The word ‘restructuring’ has several meanings and some definitions of restructuring might include events that do not have any impact on employment levels or that, through a reorganisation of work, may have an impact on the workforce in some other way. Similarly, the relationships between restructuring and employment are neither simple nor straightforward (European Commission, 2011).

Table 14: *Breakdown of employment effects by type of large-scale restructuring 2007–2011*

Type of restructuring	No. of planned job reductions	% planned job reductions	No. of planned jobs created	% planned jobs created	No. of cases	% Cases
Business expansion		0%	69,635	99.64%	156	57.78%
Internal restructuring	21,224	56.29%		0%	67	24.81%
Closure	5,214	13.83%		0%	14	5.19%
Bankruptcy/Closure	3,895	10.33%		0%	10	3.7%
Bankruptcy	2,733	7.25%		0%	9	3.33%
Offshoring/Delocalisation	3,661	9.71%	150	0.21%	8	2.96%
Relocation	342	0.91%	100	0.14%	3	1.11%
Outsourcing	150	0.4%		0%	1	0.37%
Other	200	0.53%		0%	1	0.37%
Merger and acquisition	285	0.76%		0%	1	0.37%
Total	37,704	100%	69,885	100%	270	100%

Source: <http://www.eurofound.europa.eu/emcc/erm/index.php?template=stats>

Slovakia recorded 270 cases of large-scale restructuring in the period from 1 January 2007 to 31 December 2011. Out of this number 156 enterprises – this is 57.78% – planned to create a total of 69,636 new jobs.

On the other hand, job reductions were planned as a part of internal restructuring in 67 enterprises (24.81% of all restructured enterprises), with 21,224 affected workers.

Other types of restructuring were represented significantly lower in expected outcomes: closure was expected in 5.19% of cases, bankruptcy/closure in 3.7% and bankruptcy in 3.3%.⁴

These numbers require a few brief comments.

- ERM does not distinguish size of the companies, so the numbers clearly indicate that the huge majority of enterprises in the ERM are large companies, not SMEs. (It is difficult to imagine an SME which will hire approximately 450 new employees or lay off 317 employees as a result of restructuring, which are averages calculated from the data above).

⁴ <http://www.eurofound.europa.eu/emcc/erm/index.php?template=stats>

- High numbers are due to large international companies and corporations moving/creating their branches and subsidiaries in Slovakia, taking advantage of a 10-year tax-free period, qualified and relatively cheap workforce, low prices of real estate (land, buildings) and utilities (electricity).
- The same applies to those enterprises which were expecting lay-offs. A number of the international companies which have already used 10-year tax-free period, moved their operations to other 'advantageous' countries (for example Ukraine, but mostly farther to Asia – China and Thailand being most popular).

Frequently, the impact of restructuring is negative. Whatever the short-term gains in profitability, they are often achieved through job losses, wage reductions, worsening of labour conditions and enormous social costs.

The net outcome of restructuring on employees and on workforce in almost all cases and with only a few exceptions is increased unemployment (which in Slovakia is among highest in European Union).

Entrepreneurs are lowering the number of employees and outsourcing some of those activities that are labour intensive. Very often workers who leave the company become self-employed and act as subcontractors for their former employers. This has sometimes positive effects when these subcontractors specialise in particular activities and are able to serve several customers.

The unemployment in SMEs is mainly of structural nature. For example in information technologies and information services (IT/IS) the demand for skilled professionals is higher than is their supply of graduates from universities. The same situation is in private hospitals, which became SMEs because too many physicians left Slovakia and went to work in the western EU countries. On the other hand in some industries – especially in construction, Slovakia has many specialists without employment possibilities in their profession.

The unemployment is highest in two groups: (1) among young people – fresh graduates, who do not possess skills and experiences required on the labour market, and (2) among people 50+ years old, who have experience and skills, but are not interesting for entrepreneurs who use new techniques and technologies. One of the consequences of this situation in restructuring is that Slovak SMEs started to use experienced unemployed people, 50+ years old, who are now – during the global crisis – willing to work for wages below usual rates. There is a similar situation – decrease of wages below usual rates – in the case of hiring fresh graduates. However, restructuring should not be only about decreasing wages and crosscutting lay-offs, but also about selection of the best employees to ensure the future viability of the company.

Conclusions and policy issues

Structural change is a general characteristic of economic development, driven by shifts in relative productivity and demand, technological or socioeconomic changes. To adapt to altered framework conditions – either in an anticipatory way or when they are already confronted with them – companies undergo restructuring to maintain or improve their competitiveness and, hence, sustainability. This not only contributes to economic growth, but also to the maintenance and improvement of the living standards of the population. Consequently, restructuring should not always have the negative connotation it often takes on in public discussion and media coverage. Not all restructuring events lead to a large number of job losses or a deterioration of working conditions of the affected employees. Nevertheless, it has to be borne in mind that even if the outcome is beneficial for both the company and the workforce, restructuring is seldom a smooth and painless process.

The Slovak market is not a large one, but it is still interesting for all suppliers. It would be appropriate for Slovak entrepreneurs – SMEs in particular – to turn their attention more to the export of products; in doing so they would do well to utilise the assistance available to them: a well-built infrastructure of various entrepreneurial associations and their advisory and consulting capacities.

There are strong reasons for public authorities and social partners to support both the company and the employees. For the company, restructuring is an extraordinary event and the lack of experience and expertise of restructuring underlines the usefulness of external expertise and instruments for the restructuring process. Moreover, as job losses can imply significant social costs, there is an economic case for public intervention. This makes external support not only from public authorities, but also from social partners, desirable in order to improve the outcome for both parties to the restructuring event.

Restructuring always directly affects labour issues and the interests of employees and their families as well as local communities: whether or not restructuring results in dismissals, unemployment, distress, regional crisis or leads to improved living and working conditions, better jobs and enhanced individual career prospects for employees is not predetermined. It very much depends on the way restructuring operations are carried out and the specific frameworks within which they are implemented at the level of companies, regions, national and sector environments and beyond. In Slovakia, the National Agency for Development of SMEs has played an important role in providing loans for entrepreneurs, addressing the issue of access to capital since 1997. Between 1997 and 2012, the minimum loan was €1,659.70 and maximum was €49,790.88. The purpose of these loans is to enable businesses to acquire property or to finance its reconstruction. Overall, since the beginning of the Micro-loan Programme, NADSME has provided 1,827 loans for SMEs in Slovakia to the amount of €31,195 million. The interest rate was on average 3.00% and time of maturity from six months to four years.

While restructuring economic and human resources towards more productive and profitable activities is fundamental to the dynamism of a company, it can entail difficulties for employees. It is therefore essential not only to facilitate necessary structural change but also to mitigate the negative effects for both the company and employees. To achieve this many types of instruments can be used for restructuring. Procedures should include both the anticipation and management of change, and address the needs of both employees and employers.

Promoting innovation and entrepreneurship is likely to produce faster results in employment. Getting the ‘innovation engine’ going is essential to reducing the structural rate of unemployment. There are views that innovation might actually destroy jobs by making production more efficient. However, virtually all innovations require people to conceive new products, to develop a way to produce them, market them and evaluate them. This suggests that innovation has expanded the number of jobs. Big firms destroy jobs to become more productive. Small firms need people to find opportunities to scale.

The mismatch between the skills demanded by employers and those available in the market is a reflection both of bad choices by students, who have not thought hard enough about what will help them find a good job, and of education systems that are too often indifferent to the needs of the labour market and too slow to change even if they try.

A challenge for governments is to establish the right conditions for businesses to create more jobs. That means running sustainable macroeconomic policies, so that firms need not fear that their investments will be undermined by another economic crisis; sensible regulation; and a tax system that is competitive, with low marginal rates, but does not distort business decisions in arbitrary ways. Given the importance of job creation, it would make sense to shift some of the burden of taxation permanently away from employment towards consumption or carbon emissions. And since entrepreneurship plays a big part in creating jobs, especially in the phase when young businesses expand rapidly, government should do all it can to encourage more of it – though in view of its poor track record in this area, that should be mainly a matter of supporting (rather than obstructing) private-sector-led initiatives.

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