

SME: The Hungarian Experience: Situation and Development in Hungary

József Roóz

Budapest Business School, Budapest, Hungary

This paper aims to present the development of the SME sector through the example of a country in East-Central Europe. This country was once a member of the so-called communist block until 1989, but had a market economy in 1989. Hungary joined the EU on May 1, 2004, and displayed numerous interesting features concerning small and medium sized enterprises ever since, complying with a variety of expectations. The research study investigated the East-Central European SME systems, and particularly the Hungarian SME practice. The main methods used in this paper are present European and Hungarian research findings of international relevance. Several data and figures from the European Union, the Central European area and of course from Hungary were used for the characterization of the SME systems. The main results of the research study is a set of characteristics of the SMEs' East-Central European pathway: (1) SMEs as a pillar of the nation in the world and in Hungary; (2) Hungary as the Paradise of small enterprises (numbers versus reality); (3) Domestic small enterprises in an international (European) comparison; (4) How the crisis impacted the domestic SME sector; (5) Misconceptions and dead ends in small enterprises today: What should the state subsidise and how?

Keywords: SME, EU, Hungary, dual crisis, development pathway, misconception, dead-end

Introduction

The author comes from a country in East Central Europe located in the clash zone of earlier East and West. Until 1989, we had been members of the so-called communist block where the Soviet influence was decisive. In 1989, we changed the regime, and converted into a market economy, creating a democratic system with numerous special features.

We count to be a small country expanding on 93,000 square kilometers with 10 million inhabitants. We joined the European Union with a number of other East Central European countries (e.g., Poland) on May 1, 2004.

The theoretical and practical background of this presentation is a research project completed under the Leonardo program that compares SME practice of eight countries: Hungary, Poland, Slovakia, France, Belgium, Germany, Spain, and the United Kingdom.

József Roóz, Ph.D., Rector emeritus, Budapest Business School.

Correspondence concerning this article should be addressed to József Roóz, 11-13. Buzogány Street H-1149 Budapest, Hungary. E-mail: rooz@t-online.hu.

The title of the international comparative study of the project:

“‘Under Pressure’ Exploring New Trajectories of Development in the Context of Globalization An International Comparison of SMEs”;

Leonardo da Vinci reference Material project between 2003 and 2006;

Partners from: Belgium, France, Germany, Hungarian, Spanish, Slovakian, Poland and the UK.

Small and Medium Sized Enterprises as the Force That Supports the Nation

The European Union’s small enterprise development policy is as follows:

The EU keeps SMEs’ situation and role high on its agenda, and emphasizes that they have a central role in economic growth and competitiveness. They form the backbone of the European economy, which is convincingly proven by Table 1.

European SMEs Represent

- Nity nine point eight percent of all European business;
- Sixty seven point one percent of all the workplaces of the private sector;
- Over 80% of all the workplaces in certain sectors (source from Eurostat).

In June 2000, the European Council published its document titled “The European charter for small enterprises” followed by the enactment of the “European Small Business Act”. These, and recently created EU 2020 strategy all attribute high priority to small enterprise development.

EU Strategies

- European Charter for Small Enterprises (2000);
- Small Business Act (2008);
- EU 2020 Strategy (2010).

In its SBA, the EU lays down 10 principles that help the elaboration and implementation of policies at both community, and member state level.

It is commonly known that also the EU finds the continuous improvement of small and medium sized enterprises an important issue partly because it sees them as the pledge of increased competitiveness of the EU, recognizing the role of SMEs beyond their strict economic significance. This was the motivation behind the “European Small Enterprise Action Plan” whose basic principles are shown on the next slide.

The social market economy of the next decade (EU 2020 strategy) is built on 3 mutually related, and mutually reinforcing policy areas.

Building Blocks of the EU 2020 Strategy

- Intelligent growth;
- Sustainable growth;
- Inclusive growth.

Intelligent growth means developing an economy on the basis of knowledge, and innovation.

The strategy of sustainable growth is the objective of creating a more resource-effective, environment friendly and competitive economy.

The objectives of inclusive growth result in social and regional cohesion ensuring high levels of employment.

Table 1

Principles of the Small-Business Act in the EU

Principles of the small-business act in the EU	
1	We have to create an ambience which supports the entrepreneurial readiness.
2	We have to help the resumption of the bankrupted entrepreneurs.
3	We have to strengthen the principle "Do think first on a small scale".
4	The civil-service-systems have to match with the SMEs requisites.
5	We have to help the SMEs' participation in the public procurement procedures, and in the getting of the public-supports.
6	We have to help in simplification the financing of SMEs.
7	We have to ensure the advantages the standard market for the SMEs.
8	We have to facilitate the development of the specialised skills of SMEs.
9	We ought to help SMEs in transforming the challenges of the environmental protection into business opportunities.
10	We have to inspire and patronise SMEs to partake from the advantages of the growing markets.

Note. Source: Small Business Act, 2008.

The East-Central European Situation: The Hungarian Case

East-Central European countries such as Hungary use the EU definition for SMEs (Act XXXIV of 2004).

When defining enterprises, EU countries consider three criteria: staff size, annual turnover, and/or annual balance sheet. Table 2 reflects threshold values for enterprises.

Table 2

Classification Criteria of Various Enterprises

Classification criteria of various enterprises		
Type of enterprise	Staff size	Net sales or total sales (Euro/HUF)
Micro-enterprise	max 10	max 2*/0.5**
Small enterprise	max 50	max 10*/2.5**
Medium enterprise	max 250	max 50*, and/or 43*/12,5** and/or 10.75**

Notes. * Million Euro; ** Billion HUF. Source: Act XXXIV of 2004.

The Importance of Small and Medium Sized Enterprises in the Hungarian Economy

In East-Central Europe, the four decades of socialism must not be regarded a fully homogenous period neither for the individual countries nor for the whole "peace camp" (i.e., the Soviet dominated countries). For example, the Hungarian story begins not in 1945 but in 1947, the year of the turn when private plants and other economic operations were nationalised. Small and medium sized enterprises (agricultural operations, family farms) only upgraded from the banned category to tolerate as late as the 1980s. The major boom of business start-ups took place between 1988 and 1994.

The number of Hungarian businesses has been rising continuously for years, currently exceeding 900 thousand.

It is useful to investigate the Hungarian situation in comparison to the EU as suggested by Table 3.

Ninety-nine point eight percent of all businesses operating in the European Union (EU-25) are small and medium sized enterprises, numbering about 23 million, employing about 75 million people, and providing 57% of the EU's GDP. Ninety-one point five percent of all businesses are micro-enterprises with 1-9 employees, 7.3% are small, 1% medium sized, and hardly more than 0.2% are large companies.

Table 3

EU vs. Hungary: A Comparison (%)

	EU vs. Hungary: A comparison (%)			
	Micro	Small	Medium	Σ SMEs
Number of SMEs	1.8	6.9	1.1	99.8
EU/HU	95.6	3.6	0.6	99.9
Number of employers	29.6	20.6	16.8	67.1
EU/HU	42.0	18.1	15.4	75.6
Added value	20.9	18.9	17.8	57.6
EU/HU	20.2	15.6	17.6	53.4

Hungarian business statistics are in many ways similar to the above, but reflect also significant differences in internal structure. Both the share of micro-enterprises employing 1-2, and total employment in micro-enterprises is higher (94.7%, and 35.9% respectively). The share of small and medium sized enterprises is much lower (see Table 4).

Table 4

Hungarian Business Statistics—Small and Medium Sized Enterprises

Indicators	Staff size (%)					
	0-1	2-9	10-49	50-249	SME total	Total
Number of businesses*	76.9	19.0	3.5	0.6	99.9	100.0
Employees*	6.9	21.5	21.7	19.4	69.4	100.0
Sales	7.6	14.6	17.8	21.3	61.3	100.0
Export	4.7	6.7	11.6	14.1	37.0	100.0
Added value	6.1	12.7	17.0	19.6	55.4	100.0

Note. *Including the financial sector. Source: NFGM (Ministry for National Development and Economy), Development Strategy of Small and Medium Sized Enterprises 2007-2013, Annual Interim Monitoring 2009 report.

Based just on the number of businesses, Hungary could even be a paradise for small and medium sized enterprises as 1 of 6 Hungarians out of a total population of 10 million have a business of their own as suggested by most recent official statistics. That astonishing number was calculated based on the 1.7 million registered businesses published by the Central Statistical Office. For a more realistic number, we must take operating companies (deducting dormant ones), which equal just below 1 million, thus one can say that 1 out of 10 Hungarian citizens own a business. If we regard the working population for our basis of calculation, then the 1 million enterprises are owned by about 5 million persons, thus our final number is that 1 out of 5 Hungarians have an enterprise.

General Features Characterizing Hungarian SMEs

Apart from some general features characterizing Hungarian small and medium sized enterprises, we must mention a few specific Hungarian factors that are the direct cause of the problems brought by the crisis.

We first have to stress that Hungarian SMEs are undercapitalized. It is commonly known that SMEs have essentially low creditworthiness, only 20%-22% is creditworthy vs. the EU average of 70%-85%. One of the major problems is that the performance, equity, and total assets of Hungarian microenterprises lag far behind the average of EU-15.

The distrust between SMEs and the state and the public administration system is, in a certain sense, mutual.

Administrative burdens, excessively complex administrative processes place especially micro-enterprises in a really difficult position. Society and the state look at SMEs with suspicion often assuming their activity to be a form of tax evasion.

An important feature of SMEs is the phenomenon called chain-debt or circular debt.

More than one third of clients regularly pay late, thereby causing insuperable difficulties to those queuing up for their money. That phenomenon mostly hits the construction industry, where each second company is victim to that problem. The smaller the business, the more exposed it is; half of the businesses employing less than 50 paid late because they were paid late themselves.

Last but not least a sad feature of small and medium sized enterprises is the poor willingness to cooperate. Fast spreading new methods of joining forces (e.g., clustering) have just recently been adopted by domestic SMEs.

The Environment of Small and Medium Sized Enterprises: The East-Central European Perspective

When evaluating the East-Central European, and the domestic SME sector, it is important to analyse competitiveness, and perform an international comparison. Various evaluations—by Management Training and Economic Research Institute (IMD Lausanne), World Economy Forum (WEF), World Bank, etc.—state that Hungary lags behind the major competitors in the region.

The World Bank's annual publication "Doing Business" ranks 183 countries based on their business environment. We have prepared a comparison of East-Central European countries and Hungary based on the environment of their SMEs (see Table 5).

Table 5

The World Bank's Business Environment Ranking (2010)

	The World Bank's business environment ranking (2010)				
	Czech	Hungarian	Polish	Slovak	Slovene
Business environment	74/66	47/41	72/72	42/35	53/58
Business launch	113	39	117	66	26
Licence issues	76	88	164	56	59
Employment	25	77	76	81	162
Registering ownership	62	61	88	11	108
Access to credit	43	30	15	15	87
Protecting investment	93	119	41	109	20
Taxation	121	122	151	119	84
Foreign trade	53	70	42	113	84
Compliance with contracts	82	14	75	61	60
Liquidating the business	116	58	85	39	40

Note. Source: Retrieved from <http://www.doingbusiness.org/>.

Table 6 provides a ranking of factors inhibiting the growth of SMEs and their order of importance. It is based on a survey involving over 300 entrepreneurs.

There have been important changes in the ranking of the factors hindering the growth of businesses as seen by entrepreneurs since 2007. Domestic small and medium sized enterprises regard high public contributions, and

increased administrative burdens as the factor that most hinders their growth (6%). Equally important is that the factor unpredictable economic regulations are now higher in the ranking than the factor competition.

Table 6

Factors Hamper the Growth of SMEs in Hungary

Factors hamper the growth of SMEs in Hungary	
1	Extremely high tax burdens and state insurances
2	Incalculable economical regulation
3	Strong competition
4	Not sufficient order for growth
5	Unprincipled competition
6	Shortage of sufficient capital
7	Default in paying from consumers
8	Lack of credit
9	Difficulties in procurement
10	Lack of skilled workforce

Small and Medium Sized Enterprises in the Crisis

Why are we saying that a dual crisis has hit Hungary?

- The effect of the international crisis;
- The effects of poor economic policy.

The Effect of the Crisis in Numbers

However, the low-flight of the GDP has several other reasons as well. Thus:

- Hungarian GDP is only 60% of the average of the EU-15;
- In Hungary revenue centralization is one of the highest in Europe (in excess of 50% of GDP);
- Government debt is high (about 70% of GDP);
- High public finance deficit (over 3% of GDP);
- High balance of payment deficit (over 3% of GDP).

How the Crisis Influenced the SMEs?

The crisis has affected SMEs to varying degrees. The first phase of the international financial crisis mostly only affected the banking sector, the Hungarian small and medium sized enterprise sector was affected only to a lesser extent.

The second phase of the crisis (international economic recession) is hitting the Hungarian SME sector just these days. Forty percent of all jobs lost are in the SME sector.

In the third phase of the crisis, the social crisis is still ahead of us, and its effects are difficult to quantify. With strict economic policy measures (radical restrictions on revenue owners)—resulting from the necessity of complying with the World Bank's loan terms—the crisis has been successfully avoided, and the country's economic situation has stabilized today. The greatest difficulty facing SMEs is a major setback in demand.

Lessons and Dead Ends in Current Hungarian Practice

Finally, we would like to present the driving forces behind the operation of Hungarian small and medium

sized enterprises, the possible motives of their development, and related misconceptions, and dead ends present in the SME sector. These difficulties must be cleared from the way of the SMEs following the recent elections in order to ensure more harmonised development.

Our history and entrepreneurial culture in the East Central European region carry numerous elements that call for a change of concept and of mentality before European entrepreneurial culture can strike root in Hungary.

One of the Major Virtues of the Small Business Sector Is Flexibility

The statement in the above sub-title is a misbelief widespread in both Hungarian and international technical literature. The error about the statement is that flexibility of the sector is often mistaken for the flexibility of the individual businesses. The two, however, are not at all the same. An entrepreneur usually spasmodically clings on to the activity that he has always performed, that he has experience in, and where he has his relationship capital. He will only change he clearly sees that all other options are gone. Most frequently, however, in such a case the business goes bankrupt, and the entrepreneur will be forced to roll the curtain down, and somewhere a new business will be launched whose services or products are then in demand in the market.

The Essential Attribute of a Small Business Is Innovation

That statement, which sounds quite a commonplace, has been common knowledge since Schumpeter, who wrote a volume titled *Small is beautiful*, and who has been regarded the pope of small entrepreneurs ever since the 1950s. There is some truth in this statement if we interpret innovation in the widest possible sense; innovation could be also if someone refuses employment in a state owned confectionery, and launches his own ice cream parlour, and continues to operate as an independent ice cream business. In reality, however, innovation characterizes only a small fraction of Hungarian entrepreneurs. One reason is that real innovation is mostly cost and investment intensive, while the majority of Hungarian enterprises operate in such sectors, and perform such activities as require no or hardly any initial capital. It is not by chance that initially they were most often established in trade, and retail sector services. Initially small businesses used to be market leaders in real estate and general trade, and consulting, and up until today only a smaller ratio is involved in the production sector, industry, etc..

The Situation of Businesses Is Well Reflected by Entrepreneurs' Opinions

The culture of ceaseless complaining is characteristic among the author's entrepreneur friends. They have been saying for 20 years that they will close the business down next year, and the tax office is asking for too much, the crisis has hit Hungary too hard, etc.. And of course they are not closing down, moreover, they manage to cater not only for their owners, but also their families, friends, and partners.

Being Small and Staying Small

Entrepreneurs who were brought up in the culture of the second economy of the 1970s and the 1980s got used to being ashamed of, and conceal success. Meanwhile, their Western European counterparts are proud if they are the largest tax payer of the community, or if they themselves earn good profit, and can even afford spending on charitable purposes, or if the market awards their activity by outstanding profit. In Hungary the average citizen—including of course entrepreneurs—has got used to “not being able to make a decent living just through decent work”, i.e., if someone earns a great deal, he surely does so through non-decent work. Thus, the

Hungarian entrepreneur hides if he can, and that does not only mean that he tries to hide his profit from the tax authority, but also that even if the opportunity arises, he is unwilling to undertake a larger assignment if it involves a spectacular increase of his business or his capacities.

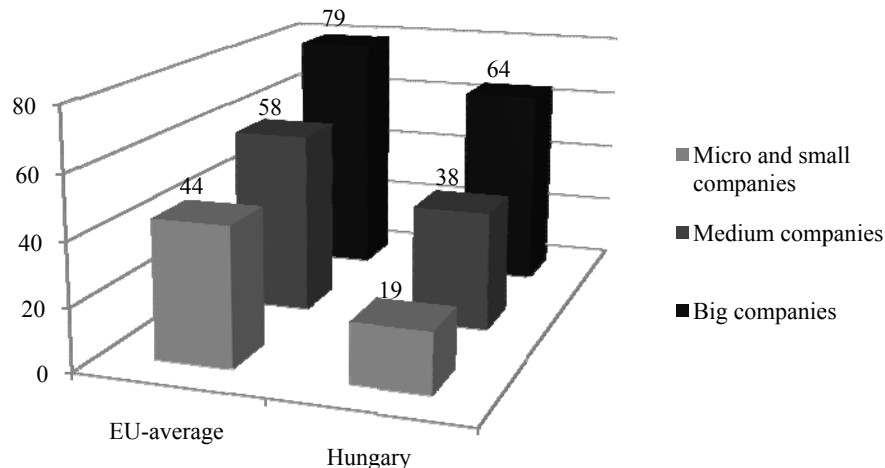


Figure 1. The ratio of companies introducing innovative products (%) by company size 2008. Source: KSH.

Escaping Red Tape (Bureaucracy)

Against the above background, a significant part of Hungarian entrepreneurs launched their private businesses after many years working in the public sector, and so this is where they had acquired their experience, business relations, and their entrepreneurial skills in general. For a major part, the motivation to become independent was exactly to escape the bureaucracy of the public sector, often stupid and overly a complex decision making mechanisms, and irrational operation. The major motivation behind a private enterprise most often was not so much higher revenue but, at least as much the “flat pyramid (of hierarchy)”, i.e., the fact that they could be their own bosses, making their own decisions concerning important issues of the business. An entrepreneur often prefers maintaining the initial idyllic state to growing his business, and experiences all bureaucratic requirements as a huge administrative burden, even if these actually serve his own interests.

Using state-of-the-art IT equipment, taking advantage of e-government, relying on electronic filing systems, and electronic tax returns, etc., could be a solution to the problem, if that did not require a characteristic shift of generations. Figure 1 shows the ratio of innovative companies by company size.

The More Subsidy the More... What?

Especially in response to entrepreneurs' requirements, it has become a more or less accepted misunderstanding that good government means providing as much subsidy as possible to the small entrepreneurial sector, because subsidies promote the number of enterprises, and also help them become more successful, etc.. When people are lured to start a business by the promise of direct subsidies, the strongest argument is inevitably the availability of subsidies rather than the satisfaction of market demand, and being the best in producing a product or providing a service. Thus, it is similarly a misbelief that a weak state is good because it lets private enterprise thrive.

The opposite is true: It is in fact a strong state that is able to create, comply with, and gain effect to good and transparent rules.

It is also the feature of a strong state that it complies with its own laws. It is very difficult to explain this to Hungarians where the state so often ignores its own laws. So what entrepreneurs must require in the current crisis situation is a strong, effective, stable, predictable state operating, preferably, along good rules.

Future of Hungarian SMEs

The most important priorities of developing Hungarian small and medium sized enterprises are laid down in the government's SME development strategy for 2007-2013. The document sets out the following main priorities:

- Promoting, helping the funding of enterprises;
- Reducing the administrative burdens of entrepreneurs;
- Competitiveness: promoting real European economic integration.

That appears in the New Széchenyi Enterprise Development Programme, currently being fine tuned in a social dialogue process contains the following main priorities for the future development of businesses.

Table 7

New Objectives of the Széchenyi Enterprise Development Programme

Széchenyi enterprise development programme	
New objectives	
1	Improving SMEs' competitiveness
2	Integrating efficiency in enterprises
3	Supporting/subsidising exports
4	Limiting the amount of non-repayable subsidies
5	Creating an enterprise friendly environment that sets a limit to bureaucracy
6	Using funds from the EU to promote modernisation among Hungarian businesses

The most important among these is encouraging export-orientation, and reducing non-repayable subsidies, and simultaneously, re-grouping EU funding resources, simplifying entrepreneurs' access to them.

References

- Makó, C. (2010). New growth potentials for the SMEs: Stronger involvement in the KIBS economy (The Case of the Hungarian vs. Slovakian business service firms). Conference presentation (134350-LLP-1-2007-1-HU-ERASMUS-EVC Erasmus project) Budapest: Budapest Business School.
- Makó, C., & Szirmai, P. (2006). Comparative report on SMEs. conference presentation (2003-3448/001-001-LE2-510REF Leonardo da Vinci project). Budapest: Institute of Sociology, Hungarian Academy of Sciences, Budapest Business School.
- Makó, C., Szirmai, P., & Illéssy, M. (2005). National report on SMEs. Hungary (2003-3448/001-001-LE2-510REF Leonardo da Vinci project), Budapest: Institute of Sociology, Hungarian Academy of Sciences, Budapest Business School.
- Makó, C., Szirmai, P., & Illéssy, M. (2006). Under pressure: Exploring new trajectories of development in the context of globalisation—An international comparison of SMEs (2003-3448/001-001-LE2-510REF Leonardo da Vinci project). Budapest: Institute of Sociology, Hungarian Academy of Sciences, Budapest Business School.
- Ministry for National Development and Economy (NFGM). (2009). Development strategy of small and medium sized enterprises 2007-2013. Annual Interim Monitoring 2009 report.
- Ministry for National Economy (MNE). (2010). New Széchenyi programme. Retrieved from http://www.ngm.gov.hu/data/cms2068241/uj_szechenyi_terv.pdf
- Szirmai, P. (2010). Kisvállalkozás, mint nemzetfenntartó erő. Győr.