HRM and Knowledge Management in Light of the Present Economic and Financial Crisis in Hungary – Empirical Research 2008-2009 [1]

Péter Fodor

PhD student (University of Pécs)
email: fodorp@ktk.pte.hu

József Poór

Professor of Management (University of Pécs)
email: poorjf@t-online.hu

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1 Introduction

According to Ervin László (2008), a Hungarian member of the Club of Rome, crisis is a natural phenomenon in human society. The present crisis is very different from the previous ones. It has spread very fast to all countries of the world and – he says – we are very close to global collapse. This is the first real global crisis. Our study aims to find out what actions Hungarian companies plan to take concerning the field of human resource management and knowledge management therewith, in the present financial and economic crisis. With brief review of the literature we demonstrate the role of knowledge and human capital in the period of depression. Then we present the findings of our empirical research conducted from November 2008 to February 2009.

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2 Crisis Theories

2.1 The Brief History of the Previous Crises

In order to understand better the present financial and economic crisis, it is necessary to refer briefly to the basic characteristics, principles of crises and the history of previous events. Béla Hamvas (1983: 10) wrote:

> *"Thus, before beginning to discuss the real nature of crisis, we should ask the following question: can we talk about a crisis? […] The world has always favored thoughts that cause panic. People, especially masses like to be in terror. […] But what is the reality in this? Is there a crisis at all? Isn't it a constantly existing thing? There is always a crisis."*

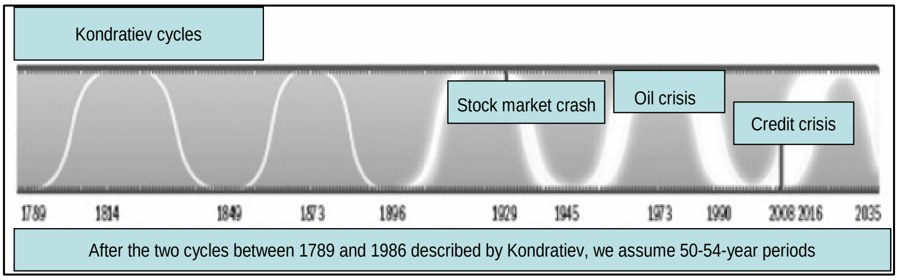
Indeed. The concept and appearance of crisis in public thinking isn't anything new. Apocalyptic mood can be observed early, already in antique civilizations, it appears by Lao-ce, Buddha, Heracleitos. The prophecies of the biblical Joseph can be mentioned as one of the first, when he prognosticated seven-year cycles of good and bad crops for the Egyptians. It is interesting that this observation reappears later in the 7-13-year medium-term cycles of Juglar. Is there really a certain regularable change in the economic-social events?

The development of the capitalist system and the regular provision of data allowed this question to be the examined and justified also from an economic-statistic point of view. Theories show that certain systematic elements of various lengths can be observed in crises. The most important economic theories, regularities concerning periodicity can be summarized as follows;

Kitchin (2009) identified 3-5-year cycles in the economy that are mainly connected to the stockholding and inventories of companies and these cause fluctuations in economic performances in these terms. This research was based on the statistical data published by the financial institutions of the USA and the United Kingdom between 1890 and 1922. Later, Joseph A. Schumpeter (1954) used these results in his studies and it has been proved that the Kitchin theories still persist for example in the analysis of the Dow Jones index.

The researches of Juglar draw attention to a system concerning longer periods. The theory, that mainly refers to sectors and is based on fixed investment cycles, defines 7-11 years long periods. The bottom of this wave is indicated by overproduction and financial market crises. The periodicity of this cycle is easy to be observed in connection with the present stock exchange decreases and e.g. the ones arising from the previous Russian financial crisis. As the return of the major, infrastructural investments of companies can be detected in this length of time, the Juglar cycles can be closely connected with Kuznets's theory on the construction cycles of 15-20 years.

One of the most popular theories is the Kondratiev (1989:291) long wave cycles. The Kondratiev theory, written in 1920 but neglected until the 1929 world crisis, identifies 45-60 years long periods (Exhibit 1). Both the upslopes and downslopes of the wave have their different repetitive characteristics. Before the beginning of the upslopes, significant changes can be observed in the economic conditions. The methods of production and exchange change radically, the utilization of technical inventions multiplies, new money transmission methods are introduced. At the improvement stage the number of social shocks, wars, tensions increase. During downslopes the price gap between agricultural and industrial products increases and the long lasting agricultural depression can be observed.

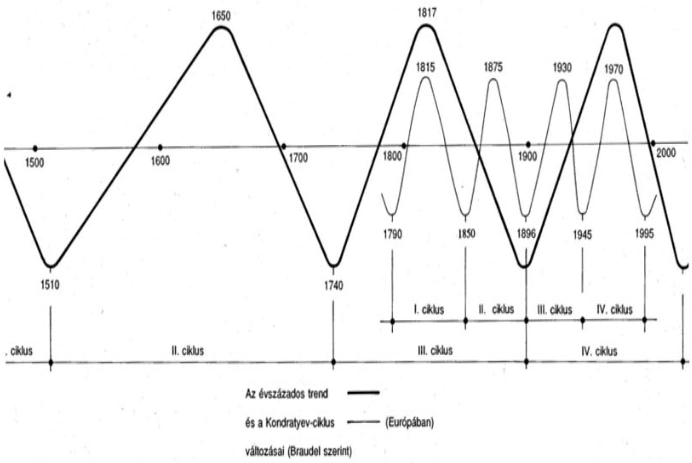


Source: Schweitzer, A. (2008): A gazdasági ciklusok – van-e párhuzam az 1929-es válsággal? (The cycles of economy – is there a parallel with the 1929 crisis?) HVG, Vol. 44

Figure 1
Kondratiev cycles

The so-called secular trend cycle spans even longer period of time than the Kondratiev cycle. The cycles of various lengths described above can enhance or attenuate each other's effect – similar to the wavelike motion known from physics – depending on whether the direction of the meeting waves is the same or opposite (Exhibit 2). Already Kondratiev established in his original piece of work that the medium term cycles (Juglar) string upon the long ones. During the downslope, periods of long and deep depression can be observed in the Juglar cycles whereas in the upslopes of the K-waves the increasing part of the Juglar cycle shows a longer and stronger development.

After reviewing the theoretical approaches it is worth to take a look at previous crises. The effects of the different cycles intensify always in those cases when the two curves enhance each other to the same direction. This was true in 1816-1817 when the peak of the Kondratiev-wave (the end of the war boom) and the peak of the upward secular trend that had started in 1740 met (Szegő, 2008). This K-wave, negative trend ended around 1848, at different times in the different geographical locations. After 1873, the Juglar and Kondratiev cycles met in 1929 in the form of a global crisis.



Source: Kehl, D., Sipos, B. (2009): A bőr és a különböző bőrtermékek termelői árainak hosszú távú tendenciái az Amerikai Egyesült Államokban I. rész (The long-term tendencies of the producer price of leather and the different leather goods in the USA Part I) http://www.bimeo.hu/bor-cipo/2007/070101.htm 2009-02-02

Figure 2
Constructive and destructive interference of the Kondratiev cycles and the secular trend

The overproduction and financial crisis extending from America lasted for four years. The American credits played an important role in the post-war reconstruction in Europe. This was realized primarily in the form of the movement of capital, namely the American investors bought European government securities. However, this source depleted by 1929 since the investors invested their money in the stock exchange due to its higher increase. Liquidity problems occurred in Europe. Due to the previous intensive booming the internal markets gained strength in North-America, the issuance of shares increased due to the source involvement, speculation gaps appeared. At the same time problems arose in the American real economy, the sales of the automotive companies dropped, layoffs began. Due to the fast decline in the stock exchange rates banks failed to satisfy the need for cash, liquidity problems occurred. In order to solve this situation banks tried to withdraw credits but this led to a decrease in investments. Meanwhile, the decline in the rates spread over to the commodity exchange. The governments were unable to solve the crisis by restoring the liquidity of banks and purchasing government securities centrally. The bankruptcies spreading from Europe, Vienna in 1931 caused new problems. In general we can say that the crisis took place in Europe with different features. While we can talk about money transmission and financial crisis characteristically in Western Europe, in Eastern Europe it was about agricultural and sales crisis (Kaposi, 1997).

In Hungary, due to the new geographic situation after World War I, the dependence on the external market was high and the internal demand was insufficient. The country was highly depending on international boom. The previous connections with Vienna were replaced by international loans, the country went deep in debt and interlocked with financial markets ever further in an increasingly complex way. The price gap between agricultural and industrial products gradually increased, the terms of rate deteriorated. Due to the high production costs and the favoritism appearing at a national level, unsaleable goods and great losses accumulated in the agricultural sector. The previous export has dropped drastically. The high level of indebtedness obstructed the automation, modernization begun. Whilst prices decreased in agriculture, production declined in the industry. In three years the number of people employed in the industrial sector fell by 25% and the production value by 35%. The booming caused by the preparation for the war was only a partial solution given the German dependence and the bilateral contracts. The state intervention was realized in establishing an economic protection system (clearing and customs) and an agricultural subsidy of almost 650-700 million pengos[2] (Honvári, 2001).

As the crisis had different characteristics in the certain countries, the methods of handling were also different. The central European countries typically introduced foreign exchange restrictions aimed at preventing gold and foreign currency outflow from the country. Most countries began to protect their internal markets with customs, import restrictions. While trying to reduce the import, the export was stimulated by the (sometimes hidden) devaluation of the national currency due to the overproduction. The transformation of the agriculture was motivated by facilitating investments. It is obvious that the free market was replaced by the obligate intervention of the government. This is evidenced by e.g. the New Deal.

The 1970's oil crisis is probably more interesting.

"Here not only one of the Juglars overlapped another longer cycle but also a Kondratiev and a secular period tumbled upon each other." (Szegő, 2008)

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2 The pengő (sometimes written as pengo or pengoe in English) was the currency of Hungary between 1 January 1927, when it replaced the korona, and 31 July 1946, when it was replaced by the forint.

3 The Present

3.1 "Cash Cows" is Needed

Hugh Courtney (2001), the dean of the University of Maryland's Robert H. Smith School of Business, published a book that gained remarkable attention after 11 September 2001, with the title "20/20 Foresight: Crafting Strategy in an Uncertain World". The author thinks that companies should prepare to scrutinize their financial situations from several points of view. He suggests that they should continually analyze their market opportunities and the steps taken by their competitors. According to the quoted author, those companies will be in easier situation in the present uncertainty that have a number of so-called cash cow products and services. From the companies of the developing world (China, India, Russia, etc.) those will be in a favorable position that have sound financial balance and are relatively cheap to finance. In his opinion, the Indian company, Tata – also known in Hungary – will be in a favorable position because its Western competitors will be forced to carry out significant company reconstructions or they will even end their business presence in certain areas. Thus this company will be likely to retain its previously obtained positions and can intrude to the areas given up by its competitors.

3.2 Many Uncertain Outcomes

Bryan (2008) thinks that the first important thing that the strategic analysts of every companie should do is to raise the two following simple questions: *What do we know about the current situation?* and *What we don't know?* The indicated author gives the following answers to these questions:

- It is a tendency concerning the whole world economy that the financial sector ceased to function normally.
- The different governments have been making remarkable efforts to mitigate the consequences of the crisis but the effects are not at all known today. A long time has to pass before we can see clearly the effects of the government interventions.
- That seems also obvious that the global financial market has weakened significantly and it lacks the efficient coordination and monitoring mechanisms. Instead of the global regulation nationalism and pessimism will go stronger among the economic actors.
- Due to the increase of the role of the government, taxes will likely to be raised and the regulation function of the states will enhance.

- The era of cheap credit is about to end and therefore the main axes of plans have to be reviewed and the concepts previously drawn up should be cut back where it is necessary.
- A new business model is needed in this situation. According to the opinion of the indicated author, the era of the management that is rigid or is based upon large loans is about to end. Significant company reconstructions will become necessary. According to one of the most recent surveys, 54% of the American companies plan to take such steps.

3.3 Possible Scenarios

The previously indicated author, L. Bryan conceives the future of the world economy according to four different scenarios. Several parts of the model described in Exhibit 3 are rather rough but the model may prove useful for strategy makers.

The present crisis is very different from the previous ones. It has spread very fast to all countries of the world and we are very close to global collapse. The markets of the companies are narrowing, sales are decreasing. In such a case different solution proposals come out at international, national and company levels. Many compare the present situation to previous times of depression and their solutions but serious changes have taken place since then. One of the most important differences has occurred in the structures of national economies. Compared to the earlier (e.g. 1929-33) crises the proportion of the service sector has grown remarkably, while the proportions of the agricultural and industrial sectors decreased. This means that such a sector has strengthened substantially where “the connection into the material processes is secondary” but the employment is significant. Here the producing capital can be found embedded into work, in the head of the employees (Sveiby, 2001). Thus, we think that the corporate methods of handling the crisis can’t follow the previous patterns. The old recession scenarios can’t work. This results partly from the character of the crisis. This statement refers especially to those organizations where the intangible assets have an important role, where production is connected to knowledge instead of tangible assets, including also the state sector (Vajkai, 2008).

Scenario 1: Remarkable improvement in the whole world economy ▪ Recession will turn into improvement in the short term ▪ Effective regulatory regime ▪ Cost of renewal of capital moderates ▪ String trust between economic actors	**Scenario 2: Moderate improvement in the world economy** ▪ Improvement expected within 1-1,5 years ▪ Moderately successful regulatory regime ▪ Significant improvement in some countries ▪ Trust raises between economic actors
Scenario 4: Severe global recession in the world economy ▪ Recession lasts at least 5 years ▪ Significant decline in all geographic locations ▪ Very string defensive and nationalistic attitudes expected in the countries of the world	**Scenario 3: Moderate global recession in the world economy** ▪ Recession lasts for 1-2 years ▪ Rigid regulatory regime ▪ Moderate defensive and nationalistic attitude characteristic of the certain countries

Source: Bryan, L. (2008): Leading through uncertainity. TheMcKinseyQuarterly, December. http://www.mckinseyquarterly.com

Figure 3
Possible scenarios for the future of the world economy

3.4 The Role of Knowledge in Time of Crisis

Layoffs – Wealth Loss

The crisis management solutions of companies are published from time to time in the daily press (Hámori, 2008). This mostly appears by means of reducing the working time or in the form of layoffs. In most cases this is obviously an obliged solution in order to avoid illiquidity and bankruptcy. However, the dismissal of employees causes long term problems besides short term survival.

One of the basic assumptions of knowledge management is that information and human capital have an increasing role on the input side. A large part of company value comes from the human capital, the knowledge latent in people's head and this is the factor that is crucial for competitiveness and high company performance.

However, in a crisis companies don't pay enough attention to retain knowledge (and its holder). They mostly use the lawnmower principle in cost reductions, they try to economize on the highest cost component, the wage. But this can be only of a rather limited efficiency. The train of thought of Boda (2006) helps to understand the background of this. When we talk about costs we sacrifice resources to make profit. Who sees the utilization of resources in this will try to reduce costs at any price. However, this approach can be wrong. Costs occur during operation and not at the time of the investment. We can divide costs into two categories: operational costs and capacity costs (maintaining and preserving the condition of the assets). The assets make the profit and costs have to be assigned to their operation. In knowledge-based companies – purely knowledge-based companies exist but purely not knowledge-based don't – as discussed above, human capital is the most productive asset. Human resource is a special good since its investment value is low (doesn't have to be purchased) but its operation is rather costly. "That cost management can't be efficient that optimizes directly between profits and costs (…) only those can manage costs efficiently who use the most effective assets and operate them in the most efficient way" (Boda, 2006:27). In this sense, dismissing equals scrapping. This can only be effective if the "asset" can't generate a profit that returns investment costs (in case of the human factor it is almost zero) and exceeds operational costs. However, a general layoff is by no means the right solution.

Rumelt (2008:4) also draws the attention to retaining employees and professional communities: "Focus on employees and communities you will keep through the hard times. Good relations with people you have retained and helped will be repaid many times over when good times return."

According to our opinion, the organization can lose the following elements from its knowledge due to the layoffs connected to the crisis:

- Loss is greatest in the fields of human capital, personal competencies, individual knowledge and proficiency of the employees and the relating synergies.
- A certain part of the external structures (client capital) that stems from the individuals' network of connections. The codified elements, such as trademarks, brand name and image, suffer a smaller loss.
- The company loses the least probably from the structural capital since processes and structures are the least connected to "heads", to human resources.

3.4.1 Knowledge Management – Long Term Investment into Success

Knowledge and knowledge sharing becomes one of the most important organizational potential in the fast changing environment due to the unpredictability as it increases competitiveness. (Tomka, 2009)

According to the statements of Salojärvi et al. (2005) in the case of the Finnish SMEs knowledge management maturity is positively correlated with long term growth and sustainability. Companies with a more comprehensive and strategic approach to knowledge management are growing more than those without knowledge management. The study concludes that a conscious approach to knowledge management is not enough in itself as half of the companies in the sample didn't show growth. In the rapidly developing Finnish SMEs knowledge management activities were carried out in a comprehensive and balanced way. The faster growth of knowledge companies was also declared by Sveiby in his book published in 2001.

The McKinsey management consultant company advising on strategy also argues for organizational knowledge and innovation (Barrett et al., 2009). According to their opinion, those companies that cut their R&D costs in a recession in order to economize make a mistake. In fact, R&D doesn't produce revenue and profit directly in the short term so slashing costs in this filed may seem to be a simple solution. Doing this managers feel that they can generate savings in an easy, quick and relatively simple way. Yet such decisions distract resources from those knowledge-based investments that could be solutions to the problem and allow unworthy "zombies" linger. Certainly, here we don't think about the cash cows since we can say, based on Courtney (2001),that those companies will be in easier situation that have a number of so-called cash cow products and services and that are cheap to finance. However, it could be difficult to find a sway out from the crisis without raising question marks and without new, leading solutions.

General cost cuts and the reduction of R&D costs also carry another negative message. The knowledge workers, engineers, who represent the main immaterial wealth of the organization and assure the company's innovativeness, get unfavorable moral impressions from the company. Instead of cutbacks organizations should take a more strategic approach to R&D costs and retaining key employees. The crisis should be considered as some kind of opportunity. (Barrett et al. 2009)

4 The Results of an Empirical Research

After reviewing the literature we sought empirical confirmation from the representatives of the corporate sector. Do they think the same as the authors suggest or do they prefer other ways? Do they use the traditional tools or they react proactively? In order to answer this question we used the results of our questionnaire survey conducted in November 2008 and February 2009 (Note: we have already discussed this topic in a previous issue of the Munkaügyi Szemle). We used web-survey to question Hungarian employers. Twice we sent the questionnaires electronically to more than 3000 companies and we received 253 valid answers altogether in connection with the expected impacts of the penetrating economic and financial events on the fields of company management, wage and HR.

4.1 Characteristics of the Companies Surveyed

The sectoral classification of the respondents is shown by Figure 4.

1.	1. Percentage
2. Industry	2. 28.9
3. Trade	3. 26.9
4. FMCG	4. 1.6
5. Financial sector	5. 4.3
6. IT	6. 3.2
7. Telecommunication	7. 0.8
8. Transport	8. 2.8
9. Energy	9. 1.6
10. Economic services	10. 30.0
11. Total	11. 100.0

Source: Authors' research (2009)

Figure 4
The sectoral classification of the companies surveyed

The great majority (81%) of the respondents operates with less than 100 employees and the proportion of companies having over 500 was 8.2%. Regarding the annual revenues, 71.5% of the companies in the sample gains less than 1 billion forints and 13.2% gains between 1 and 5 billion forints. The remaining 15% earns over 5 billion forint annually. The proportion of the private companies is dominant (over 90%), the distribution of foreign-Hungarian enterprises is 20-80% and most companies (78.9%) are based in Budapest. On the whole, we can say that although the composition and size of the sample are not representative of the Hungarian enterprises in every respect, considering the list of the respondents, we could survey dominant companies that demonstrate well the expected changes.

In our questionnaire we tried to find the answers to several groups of questions from which we use the following in this study:

- Likely impacts of the penetrating economic and financial events
- Actions planned
- Planned rate (%) of salary increase for 2009 by groups of jobs
- Planned changes in HR and knowledge management

4.1.1 Likely Impacts of the Penetrating Economic and Financial Events

It is easy to find out that the respondents are aware of the crisis. More than 75% stated that the crisis reduced their growth. 80% expects that the crisis will have negative impacts on the Hungarian markets, 40% expects on the EU markets. The majority assumes the inflation to be relatively low, under 7%.

4.1.2 Actions Planned

68.2% agreed that actions need to be taken in order to avoid the negative impacts of the crisis and it is not enough to continue the regular running of business.

Our questions can be categorized into two groups, answers 2 to 5 compose the group of reactive, defensive steps. Here we refer to traditional, belt-tightening activities that approach the already occurring impacts basically from a cost rationalization point of view. The second group of questions (from 6 to 9) refers to the possible proactive, offensive options. The answers we collected here see the solution in finding new ways, while adapting to the change, by increasing sales, capturing new areas and markets, enhancing efficiency or creating new strategy instead of suggesting the preservation of old practice (Exhibits 6 and 7). The respondents' willingness to answer this question was below the foregoing. We got the least (176) answers for the possibility of "No action needed" and most (240) companies pointed out the possibility of cost reduction.

It seems obvious that cost reduction has a priority beyond dispute among the companies. Yet, opinions differ on the way it has to be realized. While the necessity to delay investments is pronounced, companies prove more cautious in connection with redundancies. Less than the third of the companies stated that it will be extremely necessary to take this step. (Note: We mention by digression that the impacts of the partial employment (4+0 or 4+1) programs already being started may be included in these answers.) Companies prefer to freeze salaries even more than that. Here the most frequent answer (modus) was the "Extremely typical" and in the case of redundancies it was the "Not at all typical". However, while the answers "Not at all typical" and "Not very typical" were dominant in the case of redundancies, in connection with the delay of investments and the freezing of salaries the other three answers got more attention. So, to return to the reasoning of Boda (2006), companies try to avoid "asset scrapping" rather by freezing salaries.

It would be unreasonable to examine such behavior of companies only from a knowledge management point of view. It is obvious that social interactions, emotions and the social assessment of the companies have a strong influence on decision-making. Thus, it cannot be stated about the answers given in the sample that companies shun from layoffs only on these grounds. However, even if we investigate this issue from the knowledge management side, it is not true that it is practical for the company to retain all employees. In the era of knowledge – as Sveiby (2001) put it – it is reasonable to mechanize or outsource the repetitive, mechanic tasks and keep the expensive human resource for the constantly changing tasks. On the contrary, our survey revealed that companies don't make such distinctions. It is also not true that labor force is handled differently in the more knowledge-intensive sectors. We cannot show any correlation between the certain industries, the dismissals and the later occurring question of labor force development. In our opinion, this means that even those companies are not aware of the importance of knowledge management which employ knowledge workers and are largely based on intangible assets and also they follow the traditional strategies of crisis management; and they don't make their dismissals dependent on knowledge management as it is an obvious fact, which is independent from knowledge management, that the different industries are affected by the crisis at different extents.

	Not at all typical	Not very typical	Somewhat typical	Very typical	Extremely typical
1.No action needed	68,2	5,7	15,3	5,7	5,1
2.Redundancies necessary	34,0	14,8	22,0	12,9	16,3
3.Investments have to be delayed	16,1	13,9	22,0	17,5	30,5
4.Cost reduction necessary	3,3	3,8	17,1	23,3	52,5
5.Salaries have to be frozen	17,4	10,1	20,2	20,6	31,7
6.Marketing budget has to be increased	35,4	16,3	25,8	9,1	13,4
7.Need to enter new markets	19,4	12,2	24,3	19,4	24,8
8.Strategy has to be revised	7,8	7,8	27,5	20,2	36,7
9.Company efficiency has to be increased	8,8	3,9	21,9	24,1	41,2

Figure 5
Actions planned to reduce the impacts of the crisis

4.2 Planned Changes in HR

In case of every question more than half of the respondents don't plan to take steps in this field. The hiring freeze got the highest percentage (44.2%) – it is not surprising, given the foregoing – and layoffs and the transformation of performance management were also mentioned frequently. The ratio of the companies naming layoffs roughly equals to the number of respondents who classified redundancies as "Extremely typical" in question 5. A total of 18.6% plans changes in the field of knowledge management, this suggests that companies don't see any relationship between this field and the solution for the crisis. The problem that previously appeared several times in the 2005-2006 surveys of the KPMG comes up again in this and in the previous question, namely that companies don't know about the advantages of knowledge management, they can't identify how this tool can profit them. Although they have the proper IT background and the willingness to share knowledge is increasing, companies don't see a future in this method. (Lengyel et al., 2006)

The transformation of performance management showed a significant correlation with the salary increase of the salespeople, which group got the – not outstandingly – highest value from the job categories (either this was, in average, not higher than 3%). Based on the foregoing described, we see that companies try to solve their difficult situations by encouraging sales. Same product in the same way but more. Regarding both the actions planned and the changes in HR copying the old methods is dominant.

Summary, Conclusions

In times of a crisis companies apply different methods to ride out the storm. The underlying reason is often the short-term survival and to avoid being nearly bankrupt. However, they put the future at risk in several ways with layoffs and the neglectful handling of assets. By losing human capital they jeopardize the innovativeness that ensures flexibility and they lose the driving force of growth: the intangible assets. The comprehensive, strategic level management of knowledge leads to faster growth and to finding a way out. The previous crisis management solutions work with little success in the changed economic environment. However, our questionnaire survey revealed that companies still tend to prefer the old solutions. They try to avoid layoffs but the underlying reasons are rather social than connected to knowledge management as no difference could be shown between the companies applying this method regarding the different industries. The majority of the companies doesn't plan innovations in the HR field, they don't think that this is the way out. The underlying reason may be the lack of knowing the advantages of knowledge management.

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