

The Situation of the SME Sector in Hungary

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Abstract: Small and medium-sized enterprises (SMEs) may be viewed as important players in the well-being of local and regional communities, with considerable potential for employment creation. As such, they can play an important role in Europe's 2020 strategy, contributing to the economic health of the European economy; this numerous and disparate subpopulation of enterprises is the focus of this special feature. A great part of the problems occurring in micro-, small- and medium-sized enterprises can only be solved by complex economic, regulative, educational and institutional reforms and infrastructural measures.

In our present paper we would like to review the potential problems Hungarian small and medium size enterprises have to face.

1 Aim of the article

The last one-and-a-half decades have been a period of constant reform and transformation for the Hungarian businesses. The transition to a parliamentary democracy and market economy, the preparation for European integration, and the process of joining the European Union have created a previously unfathomable, insecure business environment in Hungary. Members of the domestic business community had expected this instability to decrease after joining the European Union, but on the contrary, all security and predictability had vanished from the Hungarian economic policy. Domestic entrepreneurs desperately need a predictable, functioning state apparatus for the medium term.

Micro, small and medium-sized enterprises play a central role in the European economy. They are a major source of entrepreneurial skills, innovation and employment. However, they are often confronted with market imperfections. SMEs frequently have difficulties in obtaining capital or credit, particularly in the early start-up phase. Their restricted resources may also reduce access to new technologies or innovation. The aim of our article is to find the answers to the following questions: How can we make Hungarian SMEs successful? How can

they create several hundreds of thousands of new jobs? How can a small Hungarian company become multinational?

2 Material and methods

The paper introduces the examined research topic by means of reviewing the specialist literature. During our research work we have used both national and international works. We have carried out the analysis of thorough scientific books and articles. In the article exclusively secondary data were used for the analyses. The issues of the National Statistical Office on Pest County and the regional statistical books served as the basis for quantitative examinations. We have realised that using the data of the NSO can, in many ways be, restricted especially regarding relevance and accuracy. The secondary data may be inaccurate or not totally updated, reliable.

3 Results

In June 2008, a Communication titled the Small Business Act (SBA) for Europe was adopted. This recognised ‘the central role of SMEs in the EU economy’ and aimed to strengthen the role played by SMEs and to promote their growth and job creating potential through alleviating a number of problems which are thought to hamper the development of SMEs. These included: alleviating administrative burdens; facilitating SMEs’ access to finance; supporting SMEs in their bid to access new markets; ensuring fair competition; promoting education and skills for entrepreneurship; protecting intellectual property; encouraging research and development; or supporting SMEs in a regional and environmental context. This ‘mainstreaming’ of SME policy is based upon a premise to ‘think small first’. A review of the SBA was released in February 2011: it highlighted the progress made and set out a range of new actions to respond to challenges resulting from the financial and economic crisis. In doing so, it is hoped that the updated SBA will contribute towards delivering the key objectives of the Europe 2020 strategy—namely, smart, sustainable and inclusive growth. (OECD 2010)

For policy purposes, SMEs in the EU are defined as enterprises with fewer than 250 employees, provided that they are independent (of other enterprises) and do not have sales that exceed EUR 50 million or an annual balance sheet that exceeds EUR 43 million. For statistical purposes, structural business statistics (SBS) may be broken down by enterprise size class according to employment thresholds – to present information on: large (250 or more persons employed); medium-sized (50

to 249); small (10 to 49); and micro enterprises (less than 10). Micro, small and medium-sized enterprises are collectively referred to as SMEs.(BUSINESS EUROPE 2009)

The development of enterprises must aim at realising national objectives, i.e. by spreading entrepreneurial mentality and culture and by domestic capital accumulation it promotes the urbanisation of the country, boosts the possibilities of job creation and increases demand for labour force, primarily in the Hungarian micro-, small-and medium-sized enterprises

Hungary's SME sector is dominated by micro firms (and the self-employed) (Figure 1). They account for considerably higher shares in terms of the number of enterprises, employment and value-added compared to the EU average. Consequently, the average Hungarian SME is smaller — at least in employment terms — than those in the rest of the EU: Hungarian SMEs employ one employee fewer on average than their EU peers (3.3 against EU average 4.3). Despite this low average, Hungarian SMEs make an important contribution to the domestic labour market. Between 2002-2008 they created an additional 25 000 jobs to provide a total of almost 435 000 new jobs. The increase during that period was remarkable as it was set against a rather challenging overall economic climate with an overall increase in unemployment. This puts into perspective the fact that the growth of Hungarian SMEs during that period and for all size-classes trailed the EU average. However, during the majority of the last decade, the net number of SMEs did not increase, and this merits closer monitoring, as this is an almost unique phenomenon in the EU. Moreover, it affected the micro firm segment especially, which is particularly important due to its size and to the fact that it typically includes most of the newly founded start-ups. (EC 2011)

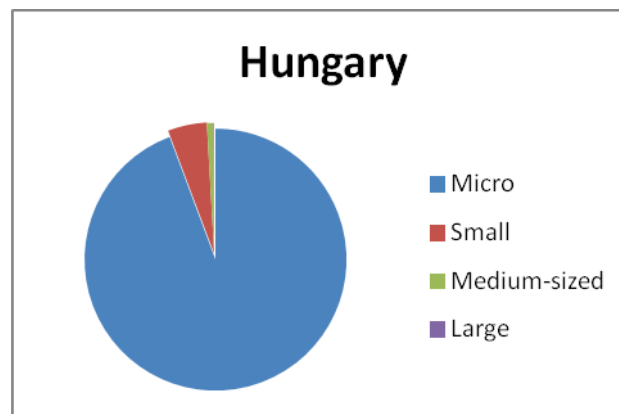


Figure 1
The proportion of enterprises in Hungary in 2011

According to international comparisons, the operation of the Hungarian economy is more and more similar to that of the countries lying South and East. People feel that it is not possible to get on by the appreciated knowledge and hard work in our country. Entrepreneurs state that the taxation system has so far punished those who were doing fair business and the budget did not make good use of the taxes paid by the enterprises.

The cost of state regulation is high and constantly rising. The burdens of the state administration are estimated to be around 4.5-6.8 % of the gross national product. Table 1 illustrates the most significant administrative burdens.

Rank	Name of administrative burden	Admin. burden (billion Ft)
1.	bookkeeping	135,1
2.	invoice burdens	31,2
3.	VAT burdens	30,4
4.	advanced tax payments	28,8
5.	burdens of employers	28,5
6.	tax records burdens	28,0
7.	detailed tax registry	26,4
8.	keeping record of invoices	24,0
9.	administration in connection with employment	20,6
10.	employment registration obligations	19,2

Table 1
 Most significant burdens on enterprises

According to the competitiveness survey our country is one of the last ones of the international ranking when taking the expenditure of obeying rules, their administrative costs and opportunism of the officials into account.

Rank	Name of the Country	estimated administrative burdens as of GDP (%)
1.	Finland	1,5
2.	Sweden	1,5
3.	UK	1,5
4.	Denmark	1,9
5.	Ireland	2,4
6.	Belgium	2,8
7.	Check Republic	3,3
8.	France	3,7
9.	Germany	3,7
10.	Holland	3,7
11.	Slovenia	4,2
12.	Austria	4,6
13.	Italy	4,6
14.	Portugal	4,6
15.	Slovakia	4,6
16.	Spain	4,6
17.	Poland	5,0
18.	Greece	6,8
19.	Hungary	6,8

Table 2
Hungary's estimated burdens as of GDP in comparison with other countries (KOX 2005)

Based on the impact of the taxation system on employment and investment, we also rank among one of the last ones on these comparative lists of competitiveness. The administrative costs of the operation of the Hungarian taxation system are primarily shifted to small and medium-sized enterprises, which accounts for approximately 10 % of the net income of the small enterprises.

One of the main problems of the taxation system is unpredictability and the fact that the rules are not properly formulated, worked out or considered. Since 2006 it has become a practice that the rules of the taxation system have been modified even several times during the year. A significant part of the taxation rules are thought not to be implementable and practice-oriented enough by the entrepreneurs while in the opinion of accountants several rules are contradictory so it is impossible to obey them.

Recently, private companies and their associations have been increasingly critical about municipal governments. The local taxes and duties are high, the tax on the practice of trade they regard as a ransom denting their competitiveness, and simultaneously they receive poor economic infrastructure and encounter much red-tape bureaucracy.

However, root causes, as well as solutions, originate less from local governments than from the state. The state has been swallowing most of local tax revenues, for example 90% of personal income tax, and after that it redistributes this sum according to a per-capita quota system to fund various public services, education, healthcare or social provisions. Nonetheless, the state can legally oblige settlements to provide public services without sufficient or zero central financial contribution. Logically, a settlement must then try to choose the less of two evils, it either taxes local businesses or it reduces expenditure on development or investment projects to make bridge the gap. The end results, in any case, are high local taxes and poor local economic infrastructure.

According to some examinations there are only slight differences in the motivations of entrepreneurs and managers of enterprises and they conform to the attitudes of international entrepreneurs. Professional acknowledgement, the safety of families and the satisfaction of employees are of such strategic importance that influences the operation of all the Hungarian enterprises. At the same time, the basic structural characteristics of the small and medium-sized enterprises have changed to a slight extent since the turn of the millennium as they typically perform labour-intensive activities whose capital requirements are low. One of the principal weaknesses of the domestic SMEs is low innovation ability and performance. The professional consensus declares the low dynamism of the nationally owned micro-enterprises that supply the Hungarian market with low efficiency and struggling for a day-to-day survival as one of the biggest problems of the Hungarian economy. The most successful enterprises are the well-prepared companies motivated by business opportunities that also produce for foreign markets, are diversified, invest huge sums of money simultaneously and carry out own innovation. Therefore, the greatest barriers to the prosperity of the domestic enterprises are of internal, managerial nature on the one hand, and external ones related to the running of the state (high taxes and administrative costs, unpredictable regulation).

Hungarian entrepreneurs have been compelled to put up with the extremely high interest rates for a long time that takes most of the profits made in their enterprises away if they have debits. However, multinational companies are affected by the domestic rates of interest to a smaller extent as they typically finance their operation from foreign resources of low interest rate.

Another serious financing problem of Hungarian enterprises is circular debt and the chain of debt. Circular debt does not only destroy business confidence, accuracy in payment and the predictability of the business environment but also causes enterprises, especially SMEs, very difficult liquidity problems so this situation can result in the termination of many viable enterprises and the loss of entrepreneurs.

The special feature of circular debt, namely, that it is always the last one who has to bear everything, principally hits the small enterprises that stand at the end of the chain. For them outstanding debt or an unsettled invoice can often mean winding up their business.

The reasons are many -folded. The lack of proactive business behaviour, tracking down clients or the market-based insurance against expected business risks can play a role in some companies. Another influential fact is that the contractors often agree to perform tasks for unrealistically little sums of money due to tight competition and finally the smallest and weakest subcontractors are paid late or not at all. In Hungary main part of circular debt originates from one of the biggest procurers, i.e. the state (and the sector of local governments) so they have to find solutions, primarily by taking regulative steps (e.g. by postponing VAT payments on jobs performed by the contractor but not paid for or by protecting the interests of small enterprises that are in a weak position in the state regulation of inter- corporate connections that are based on a dominant position. The state as a procurer also has a significant role, i.e. it should make all payments justified in all cases and immediately as well as it should protect strengthening the institutions ensuring guarantees for entrepreneurs.

The better wins in a competition if there is a competition, at all. If we succeed in controlling or excluding it, it is the stronger, and not the better, who wins. In the present Hungarian economy there are too many monopolies or cartel-like market situations based on dominance not only in commerce but also in other industries that distort and control competition, and, thus, make the situation of other enterprises and consumers worse. The malfunctioning privatisation policy even strengthened it by transforming public monopolies into private ones. Due to this fact, e.g. the energy prices for consumers apparently exceed the prices in the neighbouring countries, which also weakens the competitiveness of the Hungarian enterprises. The high interest margins of banks and other fees outstanding in Europe also suggest the existence of monopolies in spite of the apparent competition. It is an important task of the state to take measures against it. It should break up the cartel-like operations where possible even if it means bringing in new competitors. Where monopolies are natural, a stronger and stricter regulation or the possible transformation of ownership should be the instruments of strengthening competition.

The system of distributing Union funds does not accept or reject enterprises on the basis of their contribution to an objective of development, rather, either on the ability of writing applications or compliance with a criterion independent of its original objective (e.g. if the applicant wishes to develop a project on a settlement with more than 5000 inhabitants). All this forces the local governments to enter a meaningless competition while developing their basic tasks in which their autonomy is significantly reduced and instead of their development strategy, it is often pure luck in application that decides what to build and what not for the citizens of the given local government.

The former system favoured the organisations of the civil participants and autonomous institutions of higher education that have strong capital and those who regard writing applications as a regular task of life. The weak applicants or those inexperienced in Union applications were either not given funds or taken close to bankruptcy by constant delays.

Development funds and sectoral regulations were sometimes in confrontation and neutralised their impacts as they relied on parallel capacities instead of each other and intensified the mistakes made.

The exclusion of the small entrepreneurs in the rural areas was the consequence of the distinction between structural funds and those of rural development, which made doing business other than of agricultural nature impossible in tiny settlements. However, it is one of the great advantages of small enterprises that they could create jobs at locations where it would not worth it for the big ones.

The costs of utilising resources often exceeded the returns on the otherwise sensible projects. The institution system spent 4 % of the resources on its own running, which was a smaller part of expenditures.

Main parts of the costs were set off to the applicants. The costs of application debited on the applicants were further 4-9 % according to a survey in 2008. Moreover, the administrative tasks in the process of execution and late payments are also estimated to have been a similar amount for the applicants. As a significant part of the costs does not depend on the volume of the project, for the smaller applicants this amount is more prominent regarding the volume of their projects, which prevents them for further prosperity despite the fact that originally the introduction of the normative application system tried to favour them by easing administrative burdens.

This grave situation was not the result of conscious policy. On the contrary, it was the consequence of the lack of conscious policy. The distributors of development funds were not personally responsible for the objectives to which the government announced Union support.

The branches, although they could have felt responsibility for the targets, were not given enough access to funds. The separation of development policy from the other parts of governmental policy was more intense after 2007.

Another way of supporting the domestic market could be to make a change in the system of public procurements. In most European Union countries the proportion of domestic and foreign companies in the overall number of public procurement competitions obtained is exactly the opposite of the Hungarian figures. While in EU member states the proportion of procurement contracts obtained by domestic companies is about 70 %, in Hungary its maximum reaches about 40 %.

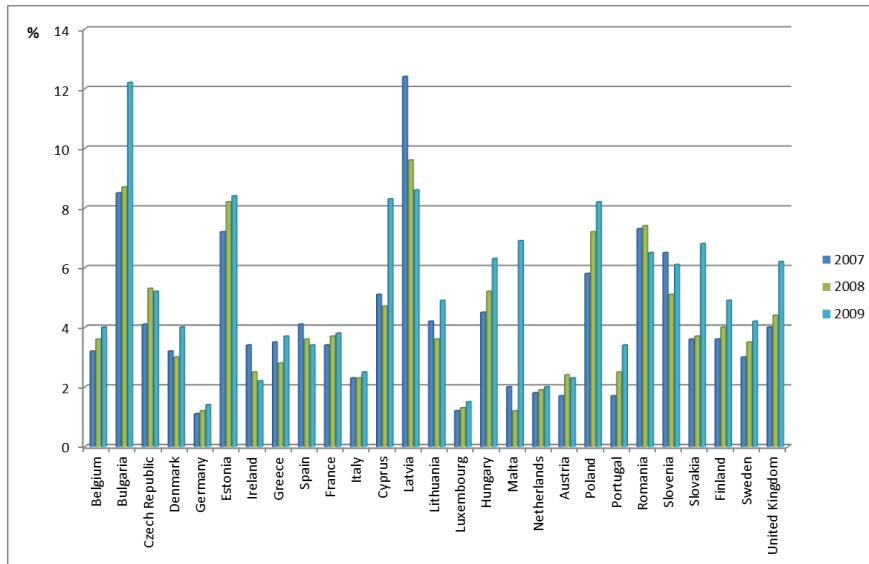


Figure 2

Value of public procurement which is openly advertised, as a percentage of GDP

Considering these figures, allocating EU funds according to European standards would suggest that at least 70 % of Hungarian public procurement contracts should be directed to domestic companies. An action plan of the state should make this goal feasible through some direct and indirect measures, for example by ordaining the proportion of suppliers to be involved.

Public procurements are one of the biggest markets in Hungary, and it is even more so in the EU. However, the reputation of the public procurements system by the Hungarian society, as well as entrepreneurs, is quite unfavourable. The opinion of the public has been aggravated by the negative publicity about the misuse of power, the predominance of political interests and the corruption-induced high prices disclosed by the media or entrepreneurs. At the same time, the procurement procedure is wearisome and complicated to such an extent that it can prevent several entrepreneurs considering bidding from eventually doing so.

One of the causes of these problems is that politics and the central apparatus have tried to regulate this issue independent of the private sector. There have been expectations incompatible with business mentality integrated into the system. At the same time, it has not been in the interest of the most influential and most frequently successful big companies to have a transparent and sustainable public procurement system capable of generating competition. Therefore, the community of domestic private companies must be given a greater role in the formation and operation of the system.

Conclusions

With the disproportionate burden of many meaningless state regulations and obligations, the state bureaucracy and administration in their current forms paralyze domestic private companies. The rationalization of bureaucratic burden would bring down the size of administrative staff too, as a smaller number of procedures would need a smaller apparatus, which in turn could save money for the budget. Indirectly, from such a move private companies could profit too, because if the state spends less on bureaucracy then it requires less in revenues; taxes can be cut and businesses can keep more resources.

According to international statistics, the administrative costs of businesses in Hungary are twice as high as for private companies in countries of reasonable administrative mechanisms; additionally, the time devoted to office work is also double the average. It creates an invisible, but genuine competitive disadvantage for domestic businesses relative to their global competitors. The expensive and slow administrative procedures affect every aspect of the business environment, from real estate registration, establishment of a company and tax declaration to the analysis of statistical data. Although multinational companies operating in Hungary are better prepared to bear the high administrative costs than domestic SMEs, this bureaucratic situation has become truly worrisome. The impact of these costs substantially weakens the country's attractiveness for foreign capital to invest here.

The ultimate goal is to cut the expenses by half, in both money and time, that business administration demands. The system of taxation, regulation, licensing and competitions must be simplified and stabilized, or in other words, they must be made transparent. To achieve this objective, a stable legal environment must be created by the issuance of lasting and competent rules. Tax declarations must be simplified and digitalized, and their drafting must be assisted by an agile electronic customer service.

Competitive businesses can only operate in competitive settlements. So the solution could be to decrease the proportion of revenues the state draws from local governments, instead of further suffocating them. However, if the goal is to spend more on the local economic environment as private companies wish, the stimulating role of the market must be restored in the financing policy of settlements. The policy to provide local private companies and investors with an optimal place of business, for example by developing infrastructure, is very expensive. If local governments cannot recover these costs from the higher taxes on businesses and from the personal income tax of their workers, they cannot be motivated to improve the local economic environment.

Unless there is a system for the fair allocation of local and central taxes, which could secure a direct relationship between the economic development efforts of a

settlement and its revenues (or between the expenses and the wealth of a settlement), there is nothing to motivate local governments to improve the economic environment.

Nowadays the actual impact of EU resources is so low because their utilization works by the watering-can principle: there are many small sums spent on many small projects, and a lot of these funds have been allocated without having a concrete goal. Because of this, EU resources must be rearranged according to the principles of the New Széchenyi Plan for growth-oriented and employment-focused sectors. Such a system must be built for the allocation of EU funds which can ensure prompt utilization.

With the decision made by the European Commission Hungary received special permission to extend its SME venture capital programme financed from EU funds. In the future the Széchenyi Capital Fund will be able to realize larger value investments; by involving partner investors the individual limit value for investments can increase to as much as EUR 750 thousand. EU funds need to be involved in order to strengthen the capital position of the Hungarian SME circle since some enterprises have no other alternatives for raising capital for their capital requirements ranging from HUF 75 million to 200 million. With the permission the Széchenyi Capital Fund is even allowed to involve a financier for certain investments. (SZTA, 2013)

The positive social values related to enterprises cannot be regarded well-established ones and the social appreciation of entrepreneurs is contradictory. According to comparative European studies the social status of entrepreneurs is regarded low by the Hungarian adult population. The low esteem of the social entrepreneurial status is partly due to the fact that the number of those who do not obey the law, ethics and expected forms of behaviour is high. Part of the Hungarian entrepreneurs see the only possibility of effective management and individual prosperity and progress in violating market-conform patterns of behaviour. There would be a need for positive entrepreneurial models and patterns to be followed in the media.

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