

9 The Capital-less Capitalism: Review on Hungarian Small Enterprises

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9.1 Introduction

Although private enterprises began to emerge in Hungary prior to the political transformation at the end of the '80s, the structure of micro-and small enterprises did not develop in the organic way customary elsewhere in Europe (EC 2001). While the number of registered enterprises has surpassed one million for over five years, to date more than 96 percent of them are "micro-businesses", employing less than 10. So far the group of medium-sized companies have had a narrow and weak presence.

If we only consider the numerical data of the Statistical Office we might as well be proud of the results: in 13 years more than 1.1 million enterprises were registered in a post-socialist country with a population of 10 million out of which 5.5 million are at working age. However, if we look behind the data we realise that hardly more than three quarters of registered enterprises operate and according to the European statistics the majority belong rather to the category of self-employment or intellectual freelancers than to enterprise.

9.2 Historical roots

In Hungary, already as early as the 1970s, voluntarily created industrial and trade sectors operated extensively, although only on the margin of legality, that were originally organised within the framework of the state-run agricultural co-operatives, and the responsibilities, the direction, and a good deal of the earnings remained with the workers. At that time this sector was called "the second economy," which researchers pointed out was the "self protection of the civil society against a greedy political state." This was legalised by a package of laws in 1982, authorising and regulating the operation of some early enterprises (Szirmai 1984).

When in 1988 the bill on business organisations, on limited companies, joint-stock companies, and other private enterprises, was adopted, there were already 30,000 partnership companies in Hungary. This number is significant, although a considerable percentage of them were not real market-oriented enterprises. The

political transition in 1990 obviously gave impetus to the development of partnership enterprises, so their number doubled to 60,000, by 1991 (Hisrich and Szirmai 1993). The speed of development was unbroken until 1994, with 60,000 new enterprises every year, by which time the number of partnership enterprises grew to 240,000, while that of the single-owner enterprises grew to some 700,000.

The pace of development came to a standstill by the middle of the 1990s, which is understandable if we consider that the population of Hungary is only 10 million, the working population is five million, and nearly one million private enterprises had been registered. A large number of them, due to having been laid off their previous job have become "self-employed by necessity."

There was nothing surprising about the fact that the decisive majority of private enterprises established in these years of fast development were undercapitalised, as people were unable to accumulate capital to set up a company during the 40 years of socialism, and their companies were very small in size, and their founders lacked entrepreneurial skills and business knowledge. Nevertheless, in the middle of the 1990s, it seemed appropriate to optimistically suppose that tiny private enterprises would gradually gain strength, and that the market would select from among them. As a result, half to two-thirds of the new enterprises would go out of business within 4-5 years, as it was common experience in the USA and Western Europe, but the rest would gradually become stronger.

It seems this supposition has so far hardly proven true. Among the specific income and sociological circumstances, the market was not such a radically selecting factor as in the USA or Western Europe (Kállay 2001). Over half of these enterprises survived their eighth or tenth birthday, but the majority of them did not develop dynamically, and out of the 1,202,196 registered enterprises 1,156,854 remained micro-sized (96,2%), employing less than 10 people (Table 9.1).

Table 9.1 Distribution of economic organisations into size categories
(September 2001)

Number of employees	Number of companies	Proportion (%)
> 500	640	-
250-499	803	-
Big concerns, total	1,443	0,1
50-249 (medium-size companies)	8,157	0,7
Medium and big companies, total	9,600	0,8
10-49 (small companies)	35,742	3,0
1-9	293,413	24,4
0 (and unknow)	862,441	71,8
Micro companies, total	1,155,854	96,2
Total	1,202,196	100,0

Source: HCSO (2001: 15)

(a) Definition of businesses

In Hungary in the definition of businesses by size we apply the staff limits defined in the *law on small- and medium-sized businesses* accepted in 1999. According to the law:

1. *Small-and medium-sized* are businesses, in which the total workforce is less than 250, and the net annual revenue is a maximum of 4,000 million Forint, or its balance sheet total is a maximum of 2,700 million Forint, furthermore it meets the conditions set in paragraph (4).
2. *Small enterprises* are businesses in which the total workforce is less than 50, and the annual net revenue is a maximum of 700 million Forint, or its balance sheet total is a maximum of 500 million Forint, furthermore it meets the conditions set in paragraph (4).
3. A *micro-business* is a small business, in which the total workforce is less than 10.
4. An enterprise is considered small-or-medium-sized, if all together the state's, local government's or any large enterprises' *share in the business*, either on the basis of capital or voting rights, does not exceed 25 percent.

(b) Market zoology: the good balance in the jungle of market

A Hungarian researcher, János Vecsenyi in a book that attempts to make useful analogies, differentiates four different animal species in the jungle of the market (Vecsenyi 2002). The smallest players are the *ants*, who are unable and unwilling to develop, for whom continuous survival and possible stability are the centre of their strategy (Figure 9.1). Their number is great, and naturally their fluctuation is also significant, as many ants are born each year, and many fall out of the market as they had incorrectly calculated their abilities and possibilities. This is a natural concomitant of a healthy economy.

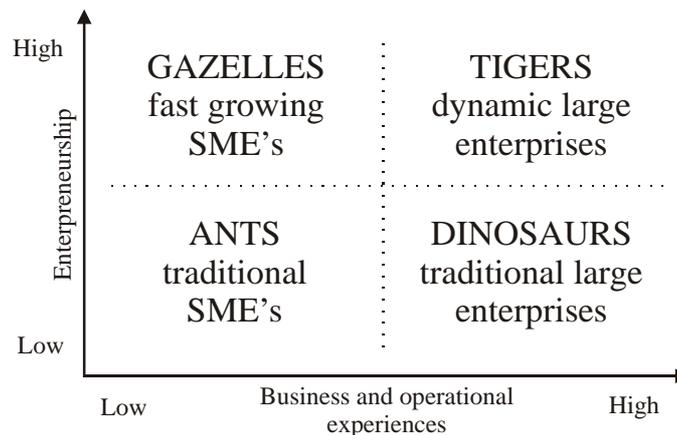
The *gazelles* are the dynamic, fast-growing, small-and medium-size businesses, which frequently achieve spectacular results, instantly utilising market possibilities, whose vulnerability is exactly that they grow too fast, but they are the ones who bring innovation and dynamism into a healthy economy.

The big game animals of the economy are the *tigers*, who often gobble up (buy up or incorporate) the gazelles, and either carelessly or deliberately crush the ants. The tigers mostly hunt on the international markets, with enormous strength and the necessary speed, with a willingness to change place or profile.

The *dinosaur* was big game for a long time, especially in the East-Central European economies, just emerging from the command economy. One of the most important positive feature of the economic growth in Hungary in the past decade is

the gradual extinction of dinosaurs, the immobile, less innovative, mostly state-owned big concerns, which operated with low productivity.

Figure 9.1 Four types of businesses



Source: Vecsenyi (2002: 54)

They went extinct either by having cut off and privatised their viable parts, which now operate as gazelles (obviously also giving room for ants to eat from them), or by going out of business by not finding their place on the market. Some of them were able to renew themselves, at enormous cost and effort, and today are trying to find their role in the market economy as tigers.

There's no overall recipe for a healthy ratio of different company types. One thing is for sure, though, that it is an unhealthy trend if one or another species is missing. It was unhealthy and blocked the development of the when there were no ants in the time of the command economy, and it is unhealthy these days that the gazelles are very rare, and in some lines of business, completely absent.

9.3 Ideas and circumstances

For a long time, small businesses have been at the focus of attention of Hungary's economic policy as, just like in the advanced European countries, small businesses create the most significant share of new jobs. In crises, as was in Hungary in the early and the mid-1990s, the big businesses were net losers of workforce, increasing unemployment. A significant part of that workforce was absorbed by small businesses. It seemed that the trends in Hungary's development, with certain

differences and time-lag, are similar to those of the European Union's, so in Hungary small enterprises will also achieve a leading role.

However, relatively few real small businesses, employing 10-49 workers, have been established, their number at present hardly surpasses that of 1988's 30,000 figure. The latest such statistical register put their number at 35,742, and the decisive portion of the growth is still micro-business. It is worth noting that 862,441 businesses have no employee at all, so they can fairly be called self-employed. The comparison with western Europe is already inappropriate at this point, as in Hungarian statistics such categories are also regarded businesses which e. g., in Germany are called freelance intellectual worker, or some other type of self-employment (Laky 2001).

In Hungarian practice, entrepreneurs by necessity are often talked about disdainfully, although, their majority should rather be regarded as heroic, as it means that the person does not accept being unemployed, does not want to live on welfare, but tries to get some income by doing some socially useful, accepted activity, mostly amongst severe difficulties.

Since the middle of the 1990s, positive trends have been observable, as the number of partnership enterprises have increased from 240,000 to 400,000. However, the majority of these businesses are still micro-size, as most of them, even if there are two or more owners, operate without employees, as self-employed.

(a) The missing middle

It is characteristic of most European economies that while having a relatively small number of big concerns there are a large number of small businesses, but these would be considered medium-sized businesses by Hungarian standards, on the basis of their size and turnover (Szirmai 2002). But it is an unknown phenomenon in Europe that the number of real medium-size businesses is well under one percent (0.68 percent). A medium-size company sector is strikingly missing from the structure of the Hungarian economy. There are only 8,157 companies employing 50-249 workers.

Sailing boats are equipped with a keel so that they don't capsize even in harder winds. This keel secures stability, an ability to manoeuvre. Such a keel in a market economy is the medium-size companies sector, if such companies exist. In Hungary it is badly missing, and it is an obstacle to both the stable development of the economy and to its manoeuvring ability. Most German authors call the attention to the importance of the middle class, called *mittelstand* in German, and assert that this layer could be the token of political stability as well.

(b) Thirsty for financial sources

It is worth demonstrating the possible negative effects of the lack of medium-sized businesses on the economy. There were great expectations, some of them probably only illusions, concerning the increasing activities of risk capital companies in the prosperity of Hungarian small enterprises. One of the reasons for disappointment was that the risk capitalist, for whom gauging the situation of a business is highly costly, cannot deal with either a self-employed or a micro-enterprise, employing less than 10 people. Such a company, from an investor's point of view, has no capital-accumulating capacity. The risk caused by market powers is calculable and assumable in many cases for the investor. But the risk that a simple flu epidemic can reduce the output of a company to zero, as all three owners-employees are sick, is a non-assumable risk for an investor.

But we face similar problems looking at the oft-cited subcontractor relations, which the government's economic policy so desires. For a big company it is too big a risk to deal with a micro-enterprise in which there is no stable professional management, where the owners are the foremen and also the workforce, where the size of the company and their lack of capital do not allow for the creation of a structure necessary to secure the contracted quality, or the employment of the necessary technology. The ideal subcontractor for a big company is a stable, reliable medium-sized business, which has the necessary financial underpinnings to survive the liquidity crisis even if the buyer does not pay in time, which has the necessary machinery, which has reserve capacity if necessary, and reliable, well-trained workers and management. There are only some 8,000 such companies in Hungary.

The economic figures of the past two years show that a healthy strengthening process has started among micro-businesses, the majority of them have stabilised, and moreover, there is hope for further development. An ever growing number of micro- and small businesses take advantages of resources at their disposal for extension and modernisation investments. Over 100,000 enterprises have already signalled their intention to take those subsidies, and there will be tens of thousands of them who will actually do it as well. (GEM 2001, 2002)

Analysing the processes of the past two years, the government has found means to support and stimulate small enterprises. However, the means to strengthen medium-sized businesses have not been satisfactory thus far. As a report by the institute to support small businesses on the year 2001 stated: "A spectacular move in the restructuring of company revenue positions did not take place in 1998-1999, but among the micro- and medium-sized businesses in the year 2000 it did. The share of micro-businesses grew by five percent, and that of the medium-sized companies dropped by eight percent, as compared to the previous year" (Kállay 2001).

It is to be considered, though, that the processes within the economy have their "maturing time," which is difficult to make shorter (BDSSE 2001). This is likely that the business-boosting measures of the Széchenyi Plan, the government's national

economy development program, like credit supports, investment tax benefits, will be evident only in the statistical figures of the coming years. So it is probable that the development of the economy will be corrected and will bring into balance internal economy's presently still disproportionate and unhealthy structure, only one manifestation of which is the 82 percent share of big enterprises in the country's total exports (Csaba et al 1998).

9.4 Summary

As we can see, the recent challenge of the Hungarian economic policy, more precisely the enterprise-development policy, has not been financing the foundation of new enterprises but preparing operating companies for the intensifying competition due to our joining the EU. Hungarian enterprises and entrepreneurs do have the potential to turn the intensifying competition to their own advantage. In order to achieve it, the support of governmental issues and mergers and acquisition processes, infrastructural development, well-set priorities of economic policies and the help of taxation, fiscal policy and legal regulation are of great importance.

It is also pointed out in the article that contrary to the fact that financial matters and the lack of capital and sources are the most often blamed factors, in reality, market, human, organisational and subcontractor problems have to be handled in the course of the development into a medium-sized company.

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