

The Hungarian Government's Strategy for Supporting Small- and Medium-sized Enterprises

**MINISTRY OF
ECONOMIC
AFFAIRS**

Entering the New Millennium

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The program of the current civic coalition government, taking office in July 1998, places great importance on improving the operational conditions of small- and medium-sized enterprises (SME). On December 17, 1998 the government passed a resolution regarding the medium-term strategy for the development of SMEs. By enacting the resolution the government has pledged to support the creation of an environment that will encourage these enterprises to play a more applicable role in the dynamic development of the economy and society. The Hungarian government therefore intends to launch a special support scheme, similar to economic policies pursued by advanced nations, to promote the development of enterprises.

As a result of the economic emphasis and increase of SMEs a typical market economy business structure has emerged in Hungary during the last decade. This includes 99.8% of the 770,000 businesses operating in Hungary.

As one of the fundamental conditions for economic growth the issue of the creation of new jobs is high on the government's program agenda. Predominantly, these enterprises are considered most suitable to create jobs lost during the shift in political regime. Consequently, the government gives priority to improving their ability to create employment. Today SMEs generate approximately half of Hungary's gross domestic product (GDP) while accounting for two thirds of workplaces.

As a result macroeconomics procedures and stabilization have created good long-term opportunities to improve SME competitiveness and help the Hungarian economy satisfy European requirements. Hence the government believes in the next few years one of the primary functions of its economic policy will be for these enterprises to contribute considerably to the development of the economy and society by improving their general and specific operational environment.

Based on consistent support schemes the government's objectives can be defined by the size and ownership structures of emerging business patterns. Therefore, one of the most important objectives of the government is to develop its enterprise promotion program. The structure and implementation of these schedules will justify the requirements of individual groups of entrepreneurs harmonizing them with the general economic policy, sectorial, rural development and social programs.

1. Objectives of the Development Policy

In the area of social policy, the government intends to

- offer stability and predictable insight to all SMEs and entrepreneurs,
- ensure entrepreneurs and SMEs proper recognition from society by all possible means and help promote awareness, a spirit of enterprise and cultural development.
- ensure that enterprise becomes a key element along with community values.

In the area of economic policy, it is the government's objective to

- enable strengthening of existing SMEs and in this way improve their performances while promoting further incentives and helping the market entry of newly established small businesses.
- strengthen the proficiency of family businesses believed to be essential in increasing, creating and maintaining a general level of employment and self-employment,
- enable impeded social groups to practice enterprise opportunities,
- increase the market share of SMEs respectively while expanding the domestic market offering them unrestricted economic and social progress while ensuring expansion opportunities to also enter foreign markets.
- support development of supplier schemes suitable for assisting the convergence of SMEs and large enterprises while enabling them to bridge and reinforcing cooperation among businesses;
- support innovation, professional and technical reorganization of businesses;
- increase efficiency of the sector's rehearsal before European Union accession while offering transparent support schemes and engagement in the globalization process,
- monitor and maintain existing values of institutional system along with ensuring conditions for their constant development.

Hence the government desires that SME contributions improve economic growth while increasing employment opportunities. The final objective in the following years is that these enterprises should first reach and then exceed the economic growth rate of the national economy.

2. Support to be Offered is Subject to Size

Classification by size and headcounter is essential for the development of SMEs as this measure best reflects the differences of their circumstances.

Of the 770,000 enterprises currently in operation

- 96.5% are so called micro enterprises employing less than 10 people;
- 2.7% are small enterprises employing 10-49 people;
- 0.6% are medium-sized enterprises employing less than 250 people,
- 0.2% are large enterprises employing at least 250 people.

2.1 Micro enterprises (family businesses)

Families are the fundamental units of civic society. Hundreds of thousands of enterprises have been launched in Hungary relying on families. Due to their specific status micro enterprises (i.e. family businesses providing self-employment) require less complicated rules to promote and sustain them. In addition to agricultural enterprises now established all professions, industrial sectors, commerce and services are based on family units. They rarely have employees or separate business infrastructures and minimum legal and administrative experience. Their lifestyles still run parallel to the employer/employee categories. In certain cases social allowances linked to employment are indispensable to facilitate the survival of this category of enterprise.

Key elements for their development must include the radical reduction of administrative burdens while tax payments and the employment of family members must be simplified. The unemployed and new entrants on the labor market should also be encouraged in addition to the application of the so-called micro credit scheme. They also require regular consulting from expert service which are absolutely familiar with their status and living standards. The government is committed to facilitate the development of mutual support schemes and lending while providing guarantees.

2.2 Small enterprises

An oversupply of small businesses, created as a result of mass redundancies in the 1990s, are nowadays able to manage production and service duties with well defined profiles. Most frequently their problems are resulted by the shortage of available equities and funds. Several businesses in this category of enterprise are involved in training apprentices offering work experience to trade schools pupils.

Reducing and simplifying the administrative and the tax burden is also essential for these businesses. It is essential that these enterprises receive financial support similar to those received by trade education institutes.

To enhance competitiveness the government considers it necessary to maintain a business-oriented, special branch service to provide business with information. The improvement of lending conditions, providing guarantees and maintaining interest support is also desirable. Giving access to risk capital is likewise considered important by the government

for small businesses which are capable of rapidly developing and implementing major investment projects besides strengthening inter-company contacts and development of entrepreneurial networks.

2.3 Medium-sized enterprises

In the government's opinion it is desirable to create an environment for medium-sized enterprises through which this category can be developed and increased, where technical and professional standards can improve and market contacts can be extended with special regard to foreign market opportunities. It is important to reinforce their contact building bonds between multinational corporations and smaller enterprises. Instruments offered by financial institutions and capital market with the existing application schemes are suitable for achieving these objectives and fit for future improvements.

2.4 Additional criteria for support

Whenever providing budgetary support it is appropriate to review priorities in all types of enterprises while designating new support considering economic policy objectives and requirements of entrepreneurs. In order to improve competitiveness the government believes that market instruments and risk capital should play a greater role in the future besides providing finances through credit loans.

Operating conditions for SMEs are also affected by local and regional opportunities and obligations. The government may influence business opportunities in given regions, areas or settlements by implementing regional and rural development instruments. The government's opinion puts an extra emphasis on developing decentralized fund schemes earmarked for specific regions and support systems for enterprise zones, industrial parks and incubator houses.

In view of the fact that the business opportunities of SMEs differ from one another subject to country regional locations and professional activities. Support for regional and industrial development programs are among the government's important intentions. The government intends to invite and encourage local institutions (including decentralized government agencies, local governments, chambers of commerce and industry, interest groups and non-profit organizations) to participate in the economic programs with financial contributions.

Several entrepreneurs suffer disadvantages because of their social status, ethnic background or age therefore the government intends to increase the number of genuine entrepreneurs by assisting groups of unemployed, fresh entrepreneurs, women, members of ethnic communities, young professionals and the disabled.

3. The Aim of Measures and Elements of Instruments

3.1 Improving operating conditions of SMEs

Social welfare and sustained development can be based on an economic policy giving priority to the enhancement of competitiveness, job creation and the criteria for enterprise development.

The development of enterprises consistent with economic policy objectives initially requires economic environment predictability, security in law for entrepreneurs and provision of fair competition rules. The most important instruments in government hands include the provision of favorable regulatory conditions to promote development of small enterprises to brace self-financing capacity with employment roles to suppress the black economy.

General principles to improve the regulatory environment:

One of the key disadvantages of doing business is high level of taxes imposed by the central government, the labor related heavy burden of complicated frequently changing rules. Tax, social security and accounting legislation often impose administrative obligations on businesses often insufficiently differentiating the type of businesses affected. Therefore,

- it is essential for the government to continuously evaluate systems of economic regulators and their proposed modifications in conjunction with interest representations, the chambers of commerce, industry and to verify the individual elements impact on small businesses. An important criteria is that regulations should be simple, efficient and practical;
- in order to increase employment and suppress the black economy, reducing taxes on labor and administrative obligations should be targeted. Enhancing the legalization of employment is a priority task besides relieving social security burdens;
- it is the government's objective to continuously monitor possibilities for reducing taxes, social security and administrative burdens of new small businesses while expanding the scope of simplified procedures regarding special obligations connected with social security registration, data provision while softening entrepreneurs' administrative burdens on VAT returns and automobile usage. The government is committed to expand further possibilities of flat rate taxation stretching to promote the general practice of so-called "one-stop-shop" systems providing administrative services;
- in order to enhance economic performance and improve competitiveness the government intends to encourage real investments, research and development efforts by these businesses. During a review of tax preferences in the course of the year 2000 tax reform it will guarantee the average spread of income taxes, on smaller businesses, to be similar to those of large corporations;
- when expanding measures the government will consider to reveal to entrepreneurs the impact of the specific measures;
- in its activities the government emphasizes great importance to service-oriented public administration with simple and easy-to-understand regulations.

3.2 Expanding financing opportunities

The basic principle of government support for enterprises is to finance projects instead of institutions. The criteria and requirements to access government support will be defined by the government to facilitate improving discipline of business management. A requirement of utilization and application of funds will specifically be through appropriate monitoring systems and subject to continuous evaluation of the efficiency of programs.

Suitable transparency, coordination and predictability for budget supported development programs for SMEs will be guaranteed through establishing an independent fund for these enterprises under the auspices of the Ministry of Economic Affairs.

Application areas for the fund will include the following:

- financing micro credit programs;
- development support credits for SMEs;
- promoting and establishing regional risk capital funds for small businesses while contributing to the establishment of risk capital funds that promote innovation;
- support for facilities aimed to development technology of small businesses;
- expanding guarantee schemes, creating decentralized guarantee alliances, backup guarantees and supporting guarantee payments;
- promoting small enterprises access to the international markets;
- promoting access to franchise systems while encouraging the establishment of logistics centers;
- supporting small businesses in the purchase of cooperatives;
- financing tasks related to subcontractors programs;
- supporting the establishment and maintenance of incubator houses;
- supporting infrastructure and other programs of SMEs when preparing them for EU accession while providing financial circumstances for Hungarians participating at SME programs in the EU;
- developing research, business information systems, PR services associated with small business development and
- supporting accredited educational and training programs of SMEs.

Lending to SMEs is the fundamental responsibility of credit institutions therefore it is unnecessary to set up independent SME banks. Improvement of lending terms and conditions to SMEs is supported by the government through differentiated programs in line with special entrepreneurs requirements, application schemes and the financial infrastructure developments.

Reviewing PHARE's Micro Credit Program aimed at improving financial prospects for micro and newly established enterprises while adding modified government funding to facilitate raising the available maximum loan amount from HUF 1 million* to HUF 3 million.

Risk capital funds via investments organized on a regional basis could improve capitalization to ensure rapid development of SMEs. To ensure successful operation of funds capitalization will be improved from resources while also using PHARE programs.

Reducing banking risks while accelerating loan estimates will also be important regarding moderate interest rates on loans for SMEs on an individual basis. SME investment projects

* 1 USD = 218.90 HUF (February 1, 1999)

will be supported by grants linked to special program interests (e.g. subcontractor programs and structural programs).

Backup guarantee should be offered to organizations offering guarantees on a voluntary basis.

The government intends to assist market entry for competitive export products by increasing pre-shipment financing.

3.3 Reinforcing innovating abilities of SMEs

Reinforcing innovating abilities of SMEs has become a constant obvious requirement in advanced countries. This is now a global economic trend where the sector plays a distinctive role in the technological development of national economies. It is particularly important that technology transfer institutions, innovation centers, innovation parks, technological incubator centers and demonstration centers be created for the development of technology-oriented businesses handling regional development activities. These can be created with the initiative of chambers of commerce and industry, local governments and institutions of higher education. However establishment of these should be assisted by publishing methodological aids, creating conditions for international cooperation, the innovation-oriented mobilization of funds earmarked for the purposes of regional development while also operating characterized applications schemes.

One of the fundamental issues of research and development is the cooperation between businesses, joint maintenance and financing of certain R&D infrastructures and capacities to cut unit costs. This would also lead to more efficient practice of support received from the central and local governments.

3.4 Developing business information systems

Unrecognized demands for information make it impossible to satisfy support for SMEs. When utilizing educational and training systems methods and means must be available for all to acquire important legal, financial and technical know-how. Basically inadequate business information creates just as severe problems for small businesses as does the shortage of capital.

To enable businesses to become decision makers based on statistics surveys and economic analysis to enable them adaptable changes in their environments they must receive assistance for obtaining required economic information.

Regarding, these

- updated information materials on market trends and opportunities will be compiled for specific sectors and made available. SMEs decision-makers will be constantly provided with the latest knowledge about absorbing markets hungry for their products and services;
- in order to "draft a map" of business opportunities and possible research catalogues, company publications, regulatory issues, information on competitors and suppliers will be accessible with the use of fast and modern methods;
- an information center will be set up to facilitate increasing activities of SMEs in public procurement thus providing support in various cooperations created in these areas.

The "Resource Chart" developed by the Ministry of Economic Affairs offers comprehensive information on programs supported by government funds and applications (available on the net home page of the Ministry of Economic Affairs at <http://www.gm.hu>). The content of the data base requires continuous updating and expansion with added indispensable information for establishing and managing businesses by offering data links of SMEs operating on the international market.

Promoting electronic-based modern technologies and means (e.g. the Internet, CD-Roms, electronic commerce) to facilitate the efficient flow of information among SMEs. Providing information to entrepreneurs in government supported areas is the prime responsibility of commerce and industry chambers.

3.5 Developing entrepreneurial culture

Embracing an entrepreneurial culture focusing on technical know-how has become a key issue. Therefore undoubtedly all efforts aiming for more effective action against violating codes of behavior concerning consumers and entrepreneurs will be encouraged. It is necessary to guarantee and encourage the flow of special know-how and fundamental market economy rules of SMEs from primary school to higher education. Typically basic know-how will be supplied through primary, secondary and higher education institutions supplemented by appropriate postgraduate training. The government intends to encourage in-services and retraining of entrepreneurs to guarantee a high-quality professional culture. Tightening qualification criteria and expectations concerning trade institutional training is required in several areas.

It is important to involve entrepreneurs in more extensive training of new future specialists offering them support conditions identical with those granted to state institutions. The government intends to pay attention to continuous employment of new entrants on the labor market.

In order to enhance the efficiency of the labor market while reducing structural unemployment government supported funds for vocational training institutes may be provided only for trades meeting market requirements. Commerce and industry chambers will play a greater role when harmonizing the requirements of the markets and institutions.

Enhancement programs with special training constitute an important element for SMEs. Institutions supporting local businesses will offer special training to improve efficiency of custom made training programs.

The government wishes to shed the negative judgment of businesses and also reinforce mechanisms of self-control through voluntary organizations and public enterprise groups.

The government sees it desirable to support products of educational and information materials, press publications and cultural productions covering the evolution of entrepreneur lifestyles and attitudes.

3.6 Preparation for European Union accession

Accession to the European Union (EU) to a large extent will have an impact on Hungary's SMEs depending on how they are able to respond to market challenges. Integration is a serious challenge for enterprises having the fundamental task of preparing themselves appropriately in the period before accession.

Under the auspices of the EU's third program for SMEs during the 1997-2000 period the EU provides legal grounds and budgetary funds for actions designed to develop SMEs.

The program specifies five objectives:

- simplifying and improving the administrative and business environment of enterprises;
- expanding financial opportunities;
- facilitating entry to international markets through developing information services;
- easing access to research results and training; and
- reinforcing entrepreneurial spirit.

Hungary's preparation is assisted by the fact that the European Union has opened SME programs for the associated countries from 1998.

3.7 Revamping the institutional system

In recent years an institutional system has been developed adapting to implementations of the government's program with minor changes. In future the government intends to offer organizations a greater role which provide special technical know-how and assistance while resolving certain tasks.

On behalf of the government the Ministry of Economic Affairs has been commissioned to coordinate SME developments. In the course of its strategic and regulatory work the Ministry will rely on cooperation with commerce and industry chambers, interest representations, the Hungarian Enterprise Development Fund (HEDF) and the Hungarian Development Bank (HDB) to coordinate financial and professional developments. The government intends to implement its business development program and measures primarily through these organizations. The Enterprise Development Board is to function as a forum for the development and interest representation of strategies. The Board's technical committees will be responsible for specific partial tasks through a consensus.

The HEDF will operate as a foundation to pursue specific public activities. Closer control implementation is required over the utilization of government funds through modifying government cooperation. Local enterprise centers may become involved in small credit loans and guarantees besides other support programs and individual agreements.

The State's role will decrease as the public bodies and other functions of commerce and industry chambers line up with economic requirements resulting in a more efficient market regulatory system. A major element connected to this is the professional qualification of enterprise activities, the refining of one-shop-stop administration procedures and providing higher-level consultant and information services for SMEs. Future priority task of commerce and industry chambers will include cooperation while preparing SMEs for the EU accession. Besides receiving a supply of information they can be directly involved in macro-economic interest coordination processes along with programs aimed at expanding financing (risk capital) and promoting line-up processes.

Trade and interest organizations will play a greater role in the establishing, coordinating and running of specific programs while social and trade interests achieve more attention.

Financial institutes, credit institutions and guarantee funds will remain independent State sources. Regional development groups belonging to the HDB will play a critical role in financing line-up programs designed to promote risk capital funds. Voluntary based credit and guarantee systems must also receive instruments of legal and financial aid. Their activi-

ties must be supported by counter-guarantee schemes provided by chambers, interest groups and guarantee institutions.

3.8. Codification of the SME act

The Government considers it a priority to help develop enterprise-friendly environments by passing the SME act to regulate basic SME support systems. The act will define SME categories and fine tune the government's economic strategy identifying national support policy priorities. This is expected to serve as an operational source for funds in supporting SMEs and establish measures affecting them. While preparing the government's decision the impact of the modifications of regulations effecting enterprises should also be taken into account the modification of regulations exercise on these enterprises. The government wishes harmonize its regulations.

Basic problems concerning fair competition arise from property and contract related legislation. The assertion of rights is most hindered by the unreliable and outdated real estate recording system, out stretched economic lawsuits and delayed court rulings. Determined steps are required in this area to ensure more efficient judicial enforcement. Introducing more simple rules while eliminating existing exaggerated or over complicated ones is inevitable.

3.9. Coordinating the SME program

The Ministry of Economic Affairs must ensure the effective coordination of SME development programs.

To ensure budgetary resources aimed at developing SMEs the Ministry of Economic Affairs has set up a so called "Resource Chart" covering update information (on supported programs, applications schemes, grants and operational funds available from the budget) alongside a Treasury based monitoring system.

To improve coordination it is desirable that the government's SME development program should be conceived by existing sector, infrastructure, regional development, line-up, trade education and social programs. The government has requested the ministries and national organizations to develop programs in coordination with the Ministry of Economic Affairs and constantly evaluate these to ensure accomplishing goals set up in the strategy.

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