

The Analysis of SME Growth Potential in the Northern-Hungarian Region

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SUMMARY

The economic and social tendencies of the last decade's world economy are determined by growth. Challenges like the population explosion, the growth of international enterprises' economic role, increasing pollution, competition in innovation and the info-communicational explosion have to be faced. These tendencies provide great opportunities but also major challenges to economic actors.

The purpose of this study is to summarize the theories of economic growth, to demonstrate the results of research studies that analyse the growth potential of SME and to analyse the opportunities for growth in the case of northern-Hungarian SME-s.

Keywords: theories of economic growth; factors of SME growth; economic power of SMEs in Northern Hungary

Journal of Economic Literature (JEL) code: L26

THEORIES OF CORPORATE GROWTH

Defining resources, i.e. the engine of economic growth is a traditionally open question of economics. In the second half of the 19th century and in the first half of the 20th century, the importance of savings and the leading role of large companies in economic development were acknowledged worldwide. One of the most typical research topics of theoretical economists is the analysis of the relationship between corporate size and economic growth. Robert Gibrat stated that growth does not depend on the size of a firm; the proportionate growth is defined by a certain rule (Gibrat's Rule) (Sutton, 1997). That growth potential is independent from the firm size was first proven by the French engineer in his 1931 doctoral dissertation. He stated that the size and growth of a firm are independent from each other.

We must be careful to define our terms. As Penrose states, Two different meanings of "growth" are generally used in research papers. In some cases it only means quantitative development, e.g. if we talk about the growth of production, export or sales. In other cases, sizeable growth or qualitative development as a result of the development process – similarly to natural biological processes where an interaction-based series of inner changes lead to sizeable growth and consequently to a change in the characteristics of the subject of growth (Penrose, 1959) In her classic book, Edith Penrose emphasized the importance of strategic thinking, entrepreneurial spirit and knowledge as determining growth-stimulating resources. She highlighted that the organizational routine and- the routine-like behaviour of the managers' limits perspective corporate growth.

No less famous or less important is the theory connected to Barney saying that the growth of enterprises depends on the quantity and quality of available resources (Barney, 1997). These days this is the best-known theory of a resource-based approach to corporate growth.

In his famous model, Porter (1980) distinguishes between five factors that affect the intensity of competition, the market potentials and also the growth potentials of the firm. These factors are competitive rivalry within the branch, suppliers, customers, new entries and firms with substitute products.

Drucker (1985) identified the key success factors of SME-s

in the United States and highlighted that during the 1960-s and 1970-s the big companies of the steel, automotive, rubber and consumer electronics industries and the big, maladjusted service providers supported by the government were less able to adjust to the increasing changes than the newly-established innovative SME-s (e.g. Microsoft, Amazon, Yahoo, and later Google). At the same time, several small educational and medical institutes utilized their market potentials, therefore their economic power started to grow explosively.

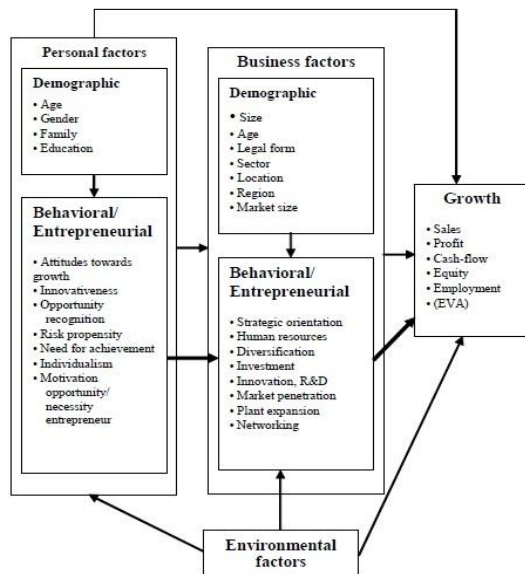
In his study, Perren (2000) stated that besides the market demand and the available resources, the owners' expertise and motivation for growth are also significant in the growth of corporate performance. This is in accordance with Bartlett, Ghoshal's statement (2002) saying that the bases of growth are the competencies of the entrepreneurs (managers) and of the corporate organization.

The work of Schumacher is outstanding regarding the consideration of economic importance and role of the enterprises. In Europe, the fast-growing SME-s only came into focus after Schumacher's book in 1973. After this, these enterprises raised the attention not only of the researcher but also of the real economic actors.

In Hungary, after the stabilization of the market economy, the SME-s provide a workplace for more than 70% of those employed in the competitive sector, producing almost half of the added value in the economy and one third of the export value. The role of SME-s is also significant in establishing workplaces: in the last years, the SME-sector provided most of the new workplaces.

Therefore it can be seen that it is important to examine the situation, opportunities and problems of the SME sector in every business cycle, but especially in the period of crisis. By developing the operational conditions, the SME-s can be significant engines of further growth – assuming that the decisions of economic policy consider their interests.

Questions of economic growth and growing corporate size had already become determining research topics at the beginning of the political transformation in Hungary. Several analyses, research reports and models have been published. In my opinion, the most meaningful summary of factors examined in these theories and studies is the model created by Szerb (Figure 1).



Source: Szerb, 2008 p.16

Figure 1. The factors of corporate growth

By utilizing the new market potentials, SME-s support the country's competitiveness and are generally receptive and open towards new technologies and innovations which means more and more new business opportunities for the dynamic development of the sectors. Most EU documents that SME-s play an important role in achieving the common goals of integration (see the former Lisbon Strategy, and the current Europe 2020 Strategy). Between 2004 and 2006, Eurostat showed in its corporate performance analysis of the EU27 that the SME-s outperformed the large corporate sector considering their number, employment and the growth of added value produced. The SME-s reached twice as high values in terms of these indicators as their larger competitors, while also increasing their own labour productivity by 8.1% during this period. (Schmiemann 2009) The SME sector produced 56% of the added value in Hungary.

Table 1
Added value production of the corporate sector 2010.

	Added value		
	Hungary		EU27
	Billion €	Rate	Rate
Micro-enterprises	8	17.8%	21.6%
Small enterprises	7	15.6%	18.9%
Medium-sized enterprises	9	20.0%	17.9%
SME-s in total	24	53.3%	58.4%
Large enterprises	21	46.7%	41.6%
Total	45	100.0%	100.0%

Source: Ministry for National Economy, 2011

SME-s play a significant role in employment. In 2008, two out of three (66.7%) of the non-financial workplaces of the EU-27 were established by SME-s (Eurostat, 2011). In Hungary, 71% of the employed were employed by SME-s in 2011. (see table 2.). Considering employment, their presence is favourable also because the cutbacks of large companies are absorbed by smaller companies offering an alternative for making alive. At the sector level - repair services, the construction industry, accommodation and catering, and real estate's are the fields where SME-s reach 80% employment (Eurostat, 2011).

Table 2

Employment rates of SME-s within the EU27 and Hungary 2010

	Hungary (number of firms)	Rate (Hungary) %	Rate (EU27) %
Large enterprises	719,477	28.93%	32.60%
SME-s in total	1,767,120	71.07%	67.40%
Micro	881,142	35.44%	29.70%
Small	479,676	19.29%	20.70%
Medium-sizes	406,302	16.34%	17.00%
Total number of firms	2,486,597	100.00%	100.00%

Source: Eurostat, 2011

Smaller companies have the potential for fast growth. It is a well-known fact that several significant companies of the world economy started as small enterprises and became giant companies as a result of their successful business activities. The development and growth of new fields of information technology is also realized partly through the newly established and fast-growing enterprises. However, we should not forget the probably less visible but still very important organizational adaptability of the traditional sectors, as one of its most important result is the improvement of performance (Kállay 2002).

In a questionnaire survey of the 'Restructuring Forum' (2007) the following structural transforming forces were identified:

- > Globalization, development of value-adding chains, increasing competition,
- > Growing pressure towards knowledge development and education
- > Privatization, liberalization of markets, transformation of the public sector,
- > Challenges of demographic changes (aging employees, lack of knowledge, business transfers).

SME-s are playing an outstanding role in the development of local and global economies. Larger companies are hardly present in smaller regions. Instead smaller firms that mostly produce for and sell to local markets relying on their own resources. Increase the local employment and therefore support the development of the local economy. The joint European resources are trying to support them more. The idea that backward regions should rely on self-sufficiency and local resources has come into prominence in recent years – often parallel with the displacement of financial support – which strengthens the role and growth of local SME-s.

THE OPERATIONAL PROBLEMS OF SME-S

The Development Strategy (2007) issued by the Ministry of Economy and Transport (GKM) highlights the following three areas as focus of development. These globally refer to the necessity of the development of the most problematic areas that would be crucial in the development of SME performance.

- > Development of regulatory environment;
- > Increasing the availability of financial support;
- > Development of knowledge and entrepreneurial infrastructure.

A survey made by the Ministry of Economy and Transport (GKM) in 2007 included a ranking of problems the executives considered the most serious. Several factors refer to financial difficulties. For the domestic SME-s, resources, - i.e. financing - mean a general problem that has become even more serious with the economic crisis. Besides this, the national economic policy indirectly or directly also affects the opportunities of SME-s to attract capital. We can see in Table 3 that these two

hindering factors – even if with decreasing weight – are still the most determining, even after 10 years' time.

Table 3
Hierarchy of hindering factors of SME growth

Hierarchy of hindering factors of SME growth (on a scale of 1 to 100)						
Hindering factors of growth	Significance index (%)					
	1997	1998	1999	2003	2005	2007
High tax and social insurance burdens	84	78	73	74	72	77
Ever-changing economic regulations	62	58	53	58	55	63
Strong competition	53	57	61	61	61	56
Not enough orders	48	45	52	45	48	45
Unfair competition	46	44	44	47	48	45
Customer payment delays	30	31	30	32	34	35
Capital shortage	40	37	37	34	32	31
Other hindering factors	19	20	17	16	13	19
Purchasing difficulties	14	16	16	17	16	13
Outdated existing capacities	17	19	17	17	13	12
Credit shortage	27	26	26	20	15	12
Manpower shortage	9	9	9	12	8	9

Source: Ministry of Economy and Transport (GKM), 2007

The majority of problems related to the development of small enterprises are caused by the fact that – due to the economy of scale – the relative transactional costs of resources and services they wish to use are too high. This is valid for financial services, more precisely for credit and for the potential for capital-involvement, for a significant part of technical business services and for services connected to the fulfilment of obligations prescribed by the state (taxation, accountancy, payment of contribution, information supply)” (Kállay 2002, p.557)

I try here to collect the typical problems and characteristics of the Hungarian SME sector. SME-s are more exposed than the large, well-funded but often foreign-owned companies: having a relatively small size compared to the market, they have little influence on the market therefore they have to follow price-taker behaviour. They are in contact with only a few customers, and so the non-payment of even a single customer can cause quasi-insolvency even for a successful firm. In the period of crisis and circular debt this particularly has affected SME-s (especially in the construction industry). A large number of firms have low capital adequacy and high intensity of the labour-force. The SME-s suffer from high liquidity risk and long-lasting lack of funds compounded by the existing crisis of credit supply. In other words, due to their size, granting credit to SME-s is risky, since they cannot guarantee security for the loan. Their technical state of supply is not satisfactory, and their profitability and efficiency is also low. They are not active in R&D and innovation, which makes joining to foreign production or distribution chains and suitability for competition even more difficult. Their sales and marketing view is incomplete and their qualitative view is conservative, which makes it difficult for them to measure up to the large companies and to hold their ground in competition. Their dependence on multinational companies is strong and they cannot or can hardly compete with them. The lack of qualifications and competence reflects the insufficient economic and financial knowledge; accessing a qualified labour force is limited and difficult. They strongly depend on support that is often difficult to obtain. Corruption makes obtaining government support even more difficult. Their project activities are low: they suffer disadvantages in public procurements; their tendering knowledge is weak as they hardly get information about tendering opportunities and even if they win tenders, the

fundraising for pre-financing is difficult. They heavily depend on political-economic regulations and their changes; they are operating in a constantly changing business environment with intensively changing regulations and high taxes. The enterprises cannot utilize the possibilities of positive changes and cannot react quickly. These are mostly consequences of a dysfunctional management system and the lack of efficient management. Obtaining market information is expensive and asymmetric, e.g. incomplete information on partners (circular debts), or being hindered from entering foreign markets (unpreparedness). Weak financial morals and distrust surroundings the domestic market hinders their concentration into networks and clusters, although in this way they could reduce the problems originating from their sizes.

THE EFFECTS OF INTERNATIONAL COMPETITION AND GLOBALIZATION ON HUNGARIAN SME-S

A determining phenomenon of the 21st century is globalization and the varied world economy it has formed. The competitiveness of the national economy is basically determined by the performance and adaptability of firms operating within that certain economy. Therefore it is important how prepared the national corporate and SME sector is to adopt well-known and widespread corporate management methods (Buzás et al 2003)

Based on the level of its extension, we can talk about national, international, regional and global competition. In case of Hungary, the strengthening of regional competition became perceptible in the 1990-s as its economic relationships with the European Union became dominant and the Central and Eastern-European economic relationships were reorganized. Global competition was also present in a number of industries due to the investment of working capital and globalized industries. During this period and even later on, Hungary has had to perform in a dominantly resource- and investment-based competition and had to compete for working capital investments and in establishing relationships with developed companies. (Chikán et al 2002)

The extension of competition is determined by the size of the given economy: the smaller a country is, the more it is forced to join the international trade and to extend its markets. As Hungary is – in every aspect - an open economy, the international prosperity has a stronger effect on its conditions of competition. In addition, the global conjuncture has not only a direct effect but also an indirect one, through the movements of the domestic investors, who have a significant role in several aspects within the national economy and even in economic policy (Chikán & Czakó 2009). In this way, the international crises influences the performance of the national economy and also has a strong effect on the potential of the corporate sector where the SME-s are especially vulnerable. The hectic economic policy is increasing in the crisis and might decrease their potential and adaptability.

ECONOMIC PERFORMANCE OF BORSOD-ABAÚJ-ZEMPLÉN COUNTY FROM THE ASPECT OF MACROECONOMIC TRENDS

The analysis of the economic-demographic-social processes within Borsod-Abaúj-Zemplén County (B.A.Z. County) demonstrates the serious problems of a region that is lagging behind the European Union. B.A.Z. County with an area of 7247 square kilometres and a population of 684,793

(Hungarian Central Statistical Office - KSH, 2011) is the second largest county of the country. Its centre is Miskolc, which is also the centre of the North Hungary region. It has 15 administrative micro-regions. The economic geographic conditions of the county are favourable; the county has the largest economic weight of the North Hungary region.

A fact that reflects the situation of the county is that based on a classification made by the government, three of its micro-regions are underprivileged, and another 10 (one-third of the Hungarian micro-regions) are so underprivileged that they should be supported with a complex program. In its sectorial structure, the chemical industry and mechanical industry play a crucial role. Its settlement structure is characterized by small villages which makes retaining the population very difficult while the population of the county seat is also decreasing.

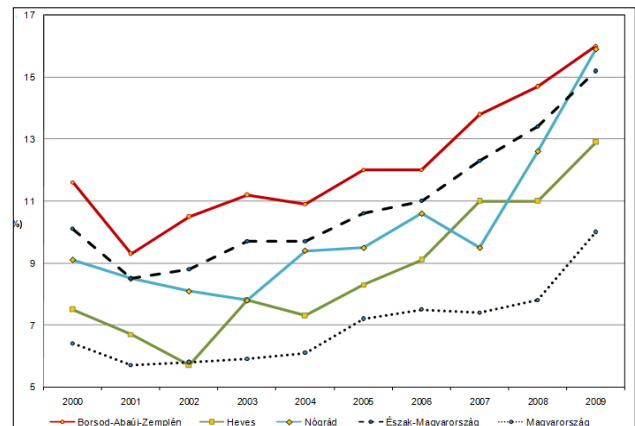
One of the most important measures of the development of an emerging economy like Hungary is its growth potential and catching-up pace. In the beginning of the 21st century, the Hungarian economy used to be the leading champion of the region with an annual growth rate of 4%. However from the second half of the first decade Hungary showed the most modest growth of the Visegrád countries. In 2009, the national GDP was hardly higher than 6 years earlier – compared to the EU-15 average. Today, Hungary is one of the economies with the worst performance and growth potential within Europe.

According to the situation of competitiveness in 2011, the reason for the trend-like decay of the performance of the Hungarian economy seen in the last decade was not external prosperity, nor was the slowing effect of the cycle of fiscal restrictions that characterized only the second half of the decade the primary reason was structural problems which mean a permanent decrease in competitiveness.

B.A.Z. County produces 4.5% of Hungary's and 60% of the North Hungary region's GDP. Since the beginning of the 21st century, the county showed an average GDP growth of over 4%. In case of this region, we can talk about catching up to the national performance only since the first decade of the 21st century. The years of 1995-2000 were characterized by the long-lasting processes of crisis but an economic change in trends appeared afterwards. This can also be seen in the added value production of the county: its 2007/2000 index is 241.7% while the national index is 215.1% (Borsodi TOP 100, 2008). Until 2007, we can say that the economic performance indicators calculated at current price also increased at real price, and the development of most indicators of the county reached or surpassed the development of the national indicators.

By today, the machine industry and energy industry have become the priority sectors but service activities are also becoming more and more important. This is reflected in the employment and investment data of B.A.Z. County.

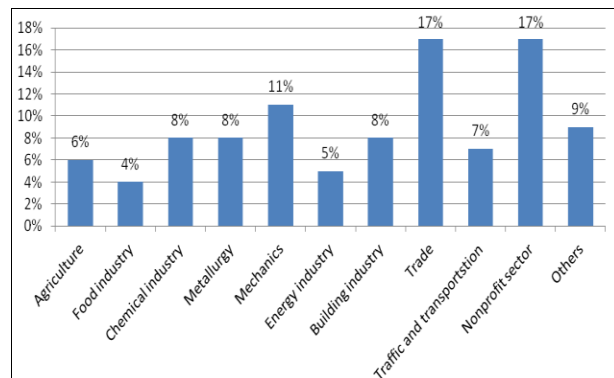
In B.A.Z. County, the economic problems of the previous years are sharply reflected in the labour market conditions – the employment rate has lagged far behind the national indicators since the systemic changes. The reasons behind the problems of unemployment are the inequality of the supply of and demand for labour (because of the lack of qualifications and general knowledge) and the high and in the last decade several times increased charges of labour. At a regional level, based on the 2008 data, the activity rate was 50.4% (national average 54.6 %) and the employment rate was 43.7% (national average 50.3%). By 2009, the unemployment rate of the region had reached 16%, while the national average was slightly below 12% (Borsod Top 100, 2009)(BVKI, 2010)



Source: Hungarian Central Statistical Office (KSH)

Figure 4. Unemployment rate in the North Hungary region (2000-2009)

Considering employment, the contribution of trade and the non-material branches is outstanding with 17% (2009), while the machine industry (11%), chemical industry (8%) and metallurgy (8%) also provide a significant number of workplaces. A special characteristic of the county is the outstanding employer role of the energy sector (5% compared to the national average of 1%).

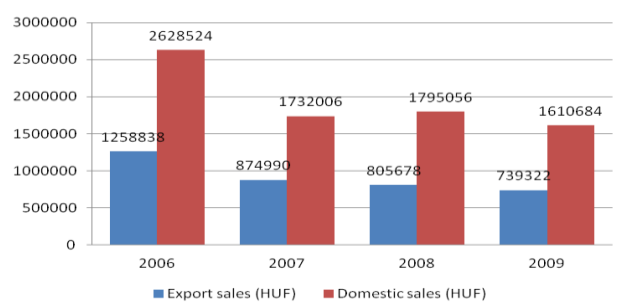


Source: TOP 100 Borsod, 2011

Figure 5. Distribution of employees by sectors B.A.Z. County 2009.

Hungary is one of the most open economies of the European Union. In the last decade, the country was able to continuously increase its exports – with the exception of 2009 when a decline in world trade occurred due to the global crisis. Since 2005, net exports had definitely been the engine of the development of the Hungarian economy. Exports that were permanently higher than imports were a result of the favorable conditions in the foreign markets. In 2006-2007, the decrease in investment continued: its volume has continuously decreased since 2006; in 2009 it was even smaller than the rather low 2008 basis.

In B.A.Z. County, the income from export sales has been decreasing since 2006 proportionally with the decrease in net turnover. Taking into consideration the changing HUF exchange rate of key currencies makes the above tendency even worse. In the mentioned years, the machine industry (41.6%), chemical industry (41.9%), metallurgy (10.1%) and food industry (1.7%) provided a permanent and significant basis of export.

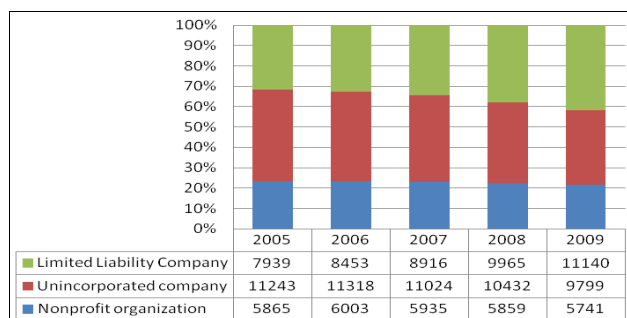


Source: TOP 10, Borsod, 2010

Figure 6. Export and domestic sales in B.A.Z. County

CORPORATE ACTIVITY OF BORSOD-ÁBAÚJ-ZEMPLÉN COUNTY

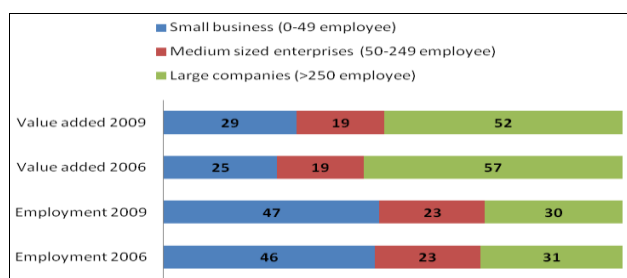
Until 2009, the number of active firms based in B.A.Z. County followed certain trends. The number of joint ventures tends to grow slightly—within this, the growth of non-liability company with legal personality is higher than the average. The most common form of enterprise is still the Limited Liability Company. The number of firms without limited liability is decreasing, mostly in case of Limited Partnerships. Because of the lower risk of business liability, more and more firms without legal personality have decided to be transform themselves into limited liability companies. The number of non-profit organizations is also decreasing year by year.



Source: TOP 100 Borsod, 2010

Figure 7. Distribution of joint ventures in B.A.Z. county

In addition to the determining economic weight of the few large firms in the county, SME-s (98.4%) play a major role. SME-s provide 47% of the county's workplaces, by 2009, their role in employment had increased by 1%. Considering added value creation, they increased their market share from 25% to 29% in the county from 2006 to 2009.



Source: Borsod TOP 100, 2006, 2010

Figure 8. Performance of entrepreneurship in B.A.Z. County by corporate size

HINDERING FACTORS OF ENTERPRISES IN B.A.Z. COUNTY

In 2008, the economic situation, market relations, economic performance and future plans of enterprises within B.A.Z. County were examined using a questionnaire survey. The survey was executed with the involvement of interviewers in the period of March to May 2008.

The analysis was made based on a sample consisting of 535 enterprises. This means that 0.723% of the enterprises operating in B.A.Z. County in 2008. Representativity was more or less ensured considering micro-regions and sectors. The sample contained small and medium sized operating joint ventures (SME-s) with at least two closed financial years.

Considering that our basic aim was to discover the factors and barriers of growth in the case of the enterprises that showed some potential for growth, we excluded the smallest enterprises with 0-1 employees and sole proprietorships from our list.

Table 4

The number of economic players in B.A.Z. County (2005-2009)

	2005	2006	2007	2008	2009
Joint ventures	25047	25774	25875	26256	26680
Sole proprietorships	23900	22272	21649	20864	19638
VAT-affected private persons	9030	8806	10280	26884	28271
Active taxpayers in total	57977	56852	57804	74004	74589

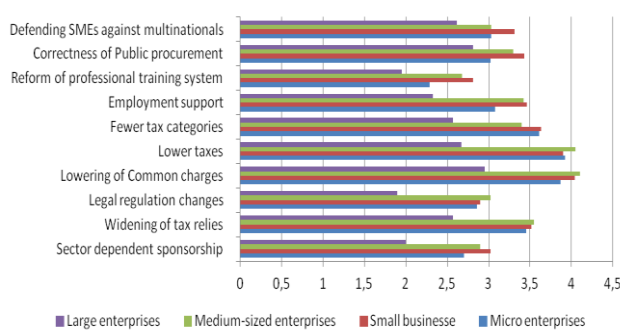
Source: own edition based on the data of Hungarian Central Statistical Office (KSH) and Tax and Financial Control Administration (APEH)

Table 5

Enterprises in the sample by branch

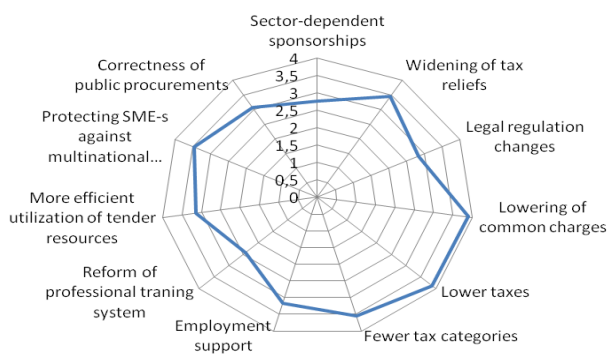
Principal activity	Number of samples
A Agriculture, farming, forestry	17
C Mining	4
D Processing industry	70
E Electricity, gas, steam and water supply	11
F Construction industry	73
G Commerce, repair	198
H Accommodation, catering	29
I Transport, warehousing, post, telecommunication	22
J Financial brokerage	10
K Real estate brokerage, economic services	52
L Public administration, defence, social security	2
M Education	8
N Healthcare, social benefits	8
O Other community and personal services	25
P Households	6
Q Other organizations	0
Total	535

The executives of the enterprises involved in this research all consider the high taxes, the difficulties of borrowing and tendering resources serious problems – regardless of the size of the enterprise. On a 5 point Likert scale, the scores were higher in case of the micro, small and medium-sized enterprises, while in case of the large firms these hindering factors of growth received only medium scores (Figure 9).



Source: own research

Figure 9. Hindering factors of growth in case of enterprises of B.A.Z. County (2008)



Source: own research

Figure 10. Average scores of growth factors, according to the responding enterprises

According to the theories of growth, in the less developed economies and sectors, resource-driven growth is determining, while in the developed, so-called propulsive industries R&D and innovation are the engine of growth. In modern economics development can be supported mostly by credit. Examining the difficulties of borrowing, the respondents highlighted the high interest rates, the high cover expectations of financial institutes and the too bureaucratic credit administration. However, we have to emphasize that the research was done

before the outbreak of the financial crisis. Now these difficulties influence the enterprises even more seriously due to the stricter credit policy of commercial banks.

Table 6
Difficulties of borrowing according to the enterprises included in the sample

Size of the enterprise	micro	small	medium	large
High interest rates	24.04%	21.72%	29.66%	28.13%
High requirements	18.59%	25.09%	25.42%	9.38%
Time-consuming procedure	13.78%	14.61%	10.17%	18.75%
Complicated application method	12.18%	10.49%	9.32%	3.13%
Short period of grace in loan	1.60%	1.12%	3.39%	3.13%
Too bureaucratic administration	13.94%	16.10%	13.56%	21.88%
Low creditability	5.29%	1.12%	1.69%	0.00%
No borrowing	3.69%	3.75%	2.54%	0.00%
No answer	6.89%	5.99%	4.24%	15.63%

Source: own research

The results of this research show that increasing entrepreneurial willingness and strengthening the development aspirations of the gazelles (i.e. dynamically developing enterprises) mean the most important possibilities to support the development of the fast-developing SME-sector. Entrepreneurial willingness can be significantly increased by increasing the preparedness of employees by developing their education, foreign language knowledge and by organizing professional training courses for them. However, the operation of already existing enterprises can be supported by increasing the expenditure on R&D and innovation, by encouraging the practical usage of new knowledge and by decreasing the deductions.

The enterprises of B.A.Z. County typically serve the domestic markets and their foreign market activity is very low. In this way, they lagging ever more behind in the international competition. In an economic region that is becoming poorer and is lagging behind, the role of enterprises in employment and in paying local taxes could be determining, but to enable these enterprises to thrive a complex economic development strategy and economy activating instruments are needed.

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