

SUMMARY

of the contents of a presentation called “ENTERPRISE DEVELOPMENT IN A NETWORK: INTEGRATED SERVICES” given by Istvan Kovacs at the Budapest Economic Development Conference organized by BVK and MVHK on December 16th 2008

Notes and supplements to the slides of the presentation

1. Enterprise development in a network, integrated services

There is relatively little to say about business development networks and integrated services because provided that the figures, analyses and consequences in this presentation are correct (and that has not been contradicted so far), this can only mean that **really efficient results in enterprise development can exclusively be produced in a specialized network and with integrated services**. For those who can not be convinced by the facts and evidences shown in the presentation, but want to learn further details, I recommend our previously concluded studies.

2. Basic requirements of enterprise development programs

An enterprise development program should meet a number of requirements but I highlighted only one of them because today I consider the most important one to be the good design of the programs. **The programs should be built upon evidences, facts, experience and their cause and effect analysis** as a general rule, but in the days of the financial crisis and recession we must not make any mistakes for it may have disastrous consequences. **During the past decade** sufficient attention was not given to the facts, their cause and effect analysis, the ‘why’s and ‘how’s in the design of enterprise development programs. The contents of my presentation are based on evidences, statistical facts and international experience and include consequences drawn from a cause and effect analysis.

3. Conditions needed for the operation and development of enterprises

Among the external conditions shown in the graph I highlighted the favourable market environment (which is getting worse and worse due to the financial and economic crisis). At the same time we must see **there is still a market of (i.e. demand for) good products, however it can not be accessed by most Hungarian enterprises because they are unable to produce and sell good and inexpensive products**. This is owing to several things but the most relevant ones are the lack of knowledge and the lack of their own and less costly external resources.

In the middle of the graph I put the two most important internal needs of enterprises. **If an enterprise lacks funds and sufficient knowledge, it can not be efficient for the long run**. All other needs can be tracked down to or satisfied by these two. Enterprise development in Hungary should concentrate on these (too), because **a great majority of the Hungarian micro- and small enterprises basically lack the sufficient funds and knowledge**.

4. The entrepreneurial structure of countries that have a developed market economy

In developed economies about 80% of enterprises use bank loans. For the comparatively small number of non-bankworthy enterprises **even the most developed countries run supported enterprise development programs such as counselling, microcredit, business incubation, etc.** Their bank sector can finance the majority of the enterprises, therefore microcredit programs are used to finance enterprises of immigrants, women, minorities, career starters and other disadvantaged people. The governments find it important to support even these small layers of the society! They know that these layers need help, and **it is worth supporting them, for if they start enterprises, the tension in society decreases, the amounts spent on unemployment and social benefits also decrease while employment and tax revenues increase etc.**

Hungary has a totally different situation.

5. Entrepreneurial structure in Hungary and Central Eastern Europe

This graph also speaks for itself and is based on facts.

The main thing is that nearly 80% of micro-enterprises are denied bank loans not because the banks do not wish to lend to more enterprises - and therefore make more money - but **because they can not do so. A great majority of the Hungarian micro-enterprises are so weak financially and professionally that the banks are unable to finance them through bank methods, and in a profitable way (which is a rule for them).**

How big is this micro-entrepreneurial sector? Let's look at the statistics!

6. **Micro-enterprises and the number of their loans**

According to data from the Central Statistical Office (KSH) there were **1.2 - 1.3 million enterprises in existence in Hungary in 2006-2007, while another KSH survey shows 698 000 active enterprises - in 2006 data.** (I ignored the 282 000 licensed traditional small-scale producers who had to register for a tax number at the turn of 2007-2008, which resulted in the increase in the number of entrepreneurs from 1 280 000 to 1 624 000.)

On one hand we must seriously consider every enterprise and private individual that holds a tax number or a traditional small-scale producer license in an enterprise development context, since they all started up to run a business. On the other hand we know that a part of them are not actually active. Considering all this, we are not mistaken when we calculate with 6-700 000 micro-enterprises in the country.

This is supported by the data published by the Ministry of Economy in 2006, which say that only **608 000 out of the 838 000 micro-enterprises** had at least 1 employee.

About 130-140 000 of them are financed by banks and co-operative saving banks. (The statistical basis and the method of calculation will be shown below.)

Looking at these numbers, an analyst must by all means ask the question: **what about more than 75-80% of enterprises, whose number is ca. 450 000?!** These enterprises have at least 1 employee, i.e. we are talking about at least 450 000 employees!!! And we have not considered the licensed traditional small-scale producers, private individuals with tax numbers, and those who are responsible for employing several people.

According to the survey by KSH 60-70 000 new enterprises were started annually (until 2006), while around the same number were terminated. (Surely, the tax number registrations of the licensed traditional small-scale producers around 2007-2008 significantly change that balance.)

A new group of re-starting entrepreneurs has also appeared: they have an entrepreneurial past but they failed at first or nearly did so.

Following the entrepreneurial data of KSH, now let's take a look at the number of loans taken from the database of the Hungarian Financial Supervisory Authority (HFSA)!

7. **HFSA data: number of loans from banks and saving banks (2003-2008)**

(The figure of year 2008 is of the end of September, however it will probably not change significantly till the end of the year due to the financial crisis) Had I created a graph of dispersed amounts, it would have shown an even sharper increase. (A non-expert could even conclude that the economy is boosting...). The graph shows that **the number of short term loans is on the increase, but that is rather misleading.** As you can see, **the number of loans active at the end of year does not increase so dynamically,** because an enterprise can have several loans expiring within the year. The proportion of financed enterprises is under 25% at best, but it is rather around 20% in reality, if we take it into account that an enterprise can have several active loans at the end of the year. Thus the number of 150 000 dispersed loans can relate to ca. 130-140 000 enterprises. In an enterprise development context **the number and trend of loans given for more than a year is a very important indicator,** since an enterprise that is carrying out significant development can only do so with development loans given for more than a year in most cases.

8. **Number of bank loans given to micro-enterprises for more than a year and their composition**

The number of loans given for more than a year was nearly 27 000 in 2003, however after a huge fall then a slow climb, it did not even reach 21 700 in 2007. Due to the financial crisis it will probably not surpass that level in 2008, either.

The proportion of micro-enterprises with at least one employee and financed with a loan for more than a year is less than 4%, and their number is smaller than in 2003! That is food for thought! **The fall in the number of HUF loans is even more significant.** This would not matter if we did not know what risks foreign exchange loans have - which especially surfaced in the current financial crisis! About the number of development loans I must note that **there was a year when the local enterprise agencies of the counties and the capital city (LEAs) provided more enterprises with loans than all the banks did (regarding development loans given for more than a year).** More about that later.

After having introduced the facts, I want to show their possible causes!

9. Analysis: What can be the reason for the financial institutes to finance such a small portion of micro-enterprises?

The low finance level of micro-enterprises is not due to the whim or intent of banks but it has economic reasons! Financing enterprises that lack capital, their own resources and collateral and have relatively little entrepreneurial knowledge is too costly for financial institutes and has high risks. Profit expectations shoot the interest rates so high that micro-enterprises can not afford them. **Therefore I do not think banks should be forced to finance non-bankworthy enterprises but these weak enterprises should be strengthened professionally (with counselling) and financially (with non-profit, supported micro-credits) so that they could become bankworthy!** (Forcing banks to finance micro-enterprises reminds me of an old joke: ‘Can you swim?’ – ‘No, I can’t.’ – ‘And what if I pay you to?’) That is why no commercial banks provide micro-credit anywhere in the world, especially not with government support, only through non-profit micro-finance institutes.

Because of the Basel II regulation this will be even more so, moreover - based on our experience - banks will abandon some of their previously financed enterprises as well, due to the financial crisis! This means that **the line between bank loans and microcredit drawn on graph 5 can be lowered by enhancing the financial and professional standing of micro-enterprises through efficient business development tools and not by suppressing banks in an artificial and expensive way!**

It must be emphasized that banks are NOT business development institutes. As bank representatives said at a „Microcredit” conference sponsored by banks, they would prefer to finance bankworthy enterprises that have already been prepared by other institutes.

Ways of strengthening micro-enterprises are known in professional circles:

The entrepreneurs’ lack of knowledge can be improved by a good counselling program in the short term, while their lack of resources can be eased by a microcredit program.

10. What is the reason for the absence of counselling networks?

The entrepreneurs’ **lack of knowledge** can be tackled the most efficiently by a good counselling program **in the short run.** Certainly training in entrepreneurial knowledge ought to be enhanced at schools and out of schools as well, but that will have an impact in the long run. An entrepreneur employing one or two people can neither afford to hire a professional to tackle each incurring problem nor have the time to attend courses. Besides, that is not an efficient way when there is a chance to get the necessary knowledge from consultants inexpensively. **The Hungarian counselling network however has not been established, because the professional apparatus at the ministry**

of economy has considered it to be unnecessary for a decade. (Though even the most developed countries have been running counselling programs.)

That is why it is a crime committed against the entrepreneurs that the new counselling programs have not been started since 2007 either in the framework of the Regional Development Operative Program (ROP) or the Economic Operative Program (GOP4). Furthermore the counselling program of the 2004-2006 GVOP 2.2.1 (Economic Competitiveness Operative Program) was started late and ill-prepared with weak finance and monitoring.

In the viewpoint of enterprises the slide gives an answer to the question. The **efficient long-term counselling network based on fundamental consultancy**, which we have been recommending for a long time, is needed in order to tackle the problems shown in the slide. **The network must be established, which is time-consuming**, but the wasted time must be made up soon! **Fortunately it does not need to be done from scratch**, as the LEA network has great experience in this field too, particularly in 1991-2000 and 2005-2007.

11. What is the reason for the lack of capital and resources?

Surely, several reasons could be mentioned, however I have made a list of the most important ones. Among these I would like to highlight the first one and the last two. Even on the domestic market the Hungarian enterprises have to compete with **the Western European enterprises, which have been able to increase their assets for decades or centuries**, therefore a greater proportion of them have their necessary own capital, material collateral and liquid funds. Furthermore, they are granted cheaper bank loans. **The majority of the Hungarian enterprises can not accelerate capital increase by means of grants**: that is only a privilege of the few.

For the majority the only solution could be their own resources gained from their profit but the profit margin of their activities is generally not very high, and it is even lowered by high taxes and contributions. In order to increase profit, they should develop **to become more up-to-date, however due to the lack of sufficient resources they have to use bank loans, and the high interest rates** also reduce the possibility to accumulate profit. Non-bankworthy micro-entrepreneurs' lack of resources can be eased with **a good microcredit program**. A good microcredit program is such that **can provide many tens of thousands of entrepreneurs with resources at a very low (even 0%) interest rate for a long period, so that they can develop, update and get a chance to increase capital from their profits.**

Thus for many of them microcredit is **the only chance for development and/or survival.**

Now let's look into microcredit!

12. Why is the number of enterprises provided with microcredit not higher?

As the previously displayed statistical data show, there is a potentially high number of micro-enterprises that are really active, have at least one employee, have the intention to develop nevertheless financial institutes can not finance them owing to their weak financial and professional standing. In order to determine the size of the potential target group, let's take the **608 000 enterprises, which have at least 1 employee each.** Another survey conducted by the ministry says that 59% of the micro-enterprises do not intend to grow. These surely include most of the one-man trading businesses, agents, traditional small-scale producers. If we exclude them, there are still **250 000 enterprises** remaining. If the banks doubled the number of their loans provided for more than a year (which seems very unlikely at the moment), there are still **210 000 enterprises** remaining without such a loan.

Considering that not all of the enterprises want to develop every year, even if we take one third or fourth of the enterprises, there remain many tens of thousands of micro-enterprises that can be actually assisted in their development with microcredit instead of only a couple of thousands.

The New Hungary Microcredit Program (NHMC) has 10-20 times as much resources as in the previous years, therefore we can not speak about a lack of resources anymore.

Apart from the 20 members of the LEA network, which has sixteen years' excellent experience in microlending even on all-European standards, there have appeared some new actors, thus we can not speak about a lack of providers. Nonetheless the number of entrepreneurs financed with microcredit did not increase. On the contrary: it even decreased.

Let's see to what extent and why!

13. Microlending activities of the LEAs between 1992 and 2008

As the previously displayed statistical data show, there is a potentially high number of micro-enterprises that do not get access to bank loans. This diagram shows the portion of the potential layer that is financed by microcredit programs. The fluctuation of the figures is very meaningful to experts. Especially when we look at and examine WHAT CAUSES the great fluctuation: when there were sufficient funds to disperse microcredit, and the conditions were acceptable for the entrepreneurs, the program was running well; however when the funds were exhausted, or the conditions deteriorated, dispersion started to decline.

The last two columns are very meaningful as well. On display you can see dispersions by the LEAs as of late 2008 together with the data of New Hungary Microcredit dispersed by non-LEA providers in pale colour (as of December 15th 2008)

This proves two things.

Firstly, new non-LEA actors were also unable to produce quite outstanding results, though they could afford to spend large sums on promotion and the involvement of an agent network, which has always been out of the question for LEAs!

Secondly, it indicates that the terms laid down in the NHMC were not adequate since if we add up the dispersion data of both the new actors and the LEAs, the results fall far behind the 2002 performance of the LEAs and they are at the level of the output in 2005-2006. That concludes that the extra funds of the NHMC did not entail the dynamic increase in the number of enterprises financed by microcredit.

Upon considering the arguments in the previous chapter, one may ask: If there can be a potential demand from several tens of thousands of entrepreneurs, and the funds have increased at least tenfold, moreover, there are more providers now, then **WHAT IS THE REASON for such a low level of only a couple of thousand microcredit dispersions instead of ten thousand in 2008?**

I will quote the wisdom of a professor of mine: "if the majority of companies fail to react to a legal regulation as expected, then the flaw is not in the companies but in the regulation!"

Regarding the terms of the NHMC we have been saying our criticism since the start, submitting our proposals.

In November some - unfortunately not all - of our recommendations were included in the new regulation, and their positive effects were immediately felt.

This is proved by the next diagram, which due to the short time of preparation only includes the data of our own county.

14. PRIMOM microlending data

First of all I would like to emphasize that the diagram shows the trend of microcredit provided exclusively from the New Hungary Microcredit funds. In 2008 the Microcredit Board of PRIMOM approved of 103 microcredits totalling HUF 538 million in several packages, however the graph shows only the NHMC package.

PRIMOM from Sz-Sz-B county could actively join the New Hungary Microcredit Program only in April 2008. In the first 7 months due to the lack of interest from entrepreneurs PRIMOM could approve only 8 microcredits within that program. However, as an effect of the positive change in the regulation, starting from November, the number of approved applications for the same package was 15 in one month, which shows a quite dynamic increase in the interest as a result of the change. This is the experience of our colleagues in other counties as well.

15. Summary and conclusion

Some conclusions:

- 80% of active micro-enterprises that have at least one employee but generally lack funding and knowledge are too weak even to get bank loans. Only a very small proportion of them receive grants for development or capital increase; and only 3.6% of them are provided with bank loans for more than a year,
- for this group of enterprises it is of vital importance and urgent to have access to an efficient counselling and microcredit program in a system of integrated services. The bridging, **service providing network (of LEAs)** shown in the slide provides a good base for that, which was originally created for this very purpose by the European Union, and which already has an outstanding experience of sixteen years in microfinance (considerable even on all-European standards),
- if the thoughts, trends and conclusions shown are correct - and I believe they are -, we must quickly find the answer to the questions: what are the reasons for the lack of counselling networks and why have microcredit programs been unable to outreach to more enterprises?
- the lessons learnt from our experience and the 'Microcredit' conference held by banks are the following. The banks would like to have micro-enterprises as their clients if they were previously strengthened financially and professionally! In other countries banks do not compete with microfinance institutions but cooperate with them and support them. MVHK and its members, the LEAs are ready to make this cooperation work effectively thus promoting the development of many tens of thousands of micro-enterprises. **MVHK has the expertise needed for effective operation as well as development plans**; the LEA network can be prepared in a short period of time to run the necessary technical programs at a homogeneous and high level once again!

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