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**Small and Medium-sized Firms and the Role of Private Industry in  
Hungary**

**by**

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**PART ONE**

**ECONOMIC AND LEGAL FRAMEWORKS  
OF SMALL ENTERPRISES  
IN HUNGARY**



# 1 PRECONDITIONS FOR PRIVATISATION IN HUNGARY

## 1.1 The question before Hungary

Politicians, executives, managers and other experts want to believe that privatisation can serve as a universal recipe providing favourable and rapid improvements to the Hungarian economy. We wish to clearly state that we don't believe in any omnipotent ability for privatisation's capability to suddenly offer the citizen's of Hungary all of what they have missed for two generations. On the other hand, until privatisation has been substantially instituted, economic growth and the standard of living in Hungary will never achieve it's full potential.

One vivid example is pointed-out by *Márton Tardos*, advisor to the economically-liberal, opposition Free Democratic Party in Hungary. „What we're proposing is the rapid privatisation of an entire economy. It's something unprecedented in size, speed and daring” (*Farlamb, D.*, 1990). Hungary embarked on an ambitious program to privatise even the largest firms as rapidly as possible. But, the merits of this program are rather obvious with a very limited rate of success, particularly with the large firms.

Two additional points are offered by bystanders. *Nankani*, an expert in privatisation techniques states, „...but, the record of those nations that have undertaken privatisation programs during the 1980's is quite mixed, and even for the more successful ones, no blueprint for success emerges. Each privatisation seems to have it's own history and dynamics, arguing the need to adopt a case-by-case approach rather than trying to formulate a simplified model...” (*Nankani, H.*, 1990, p. 43). A second is offered by academics engaged in theoretical base-theory, „The primary goal is to conceptualise the arguments for and against privatisation and to present a conceptual and strategic framework to determine the propensity of a nation to privatise” (*Day, W. – Azmi, M.*, 1990).

Yet, others insist that until privatisation is substantially completed, economic advantages will not result.

„Administratively set prices reflect political, not market needs.” (*Menson, Th.*, 1992, p. 2). Even when a sensible market-decision is developed by government administrators, when it has strong conflict with political goals, the best market solution will be set-aside in favour of political acceptability.

Integrating these various viewpoints brings us to our basic presumption that privatisation must not be considered as a uniform, inflexible goal. In contrast, it must be approached as a means for restructuring an entire economy to create viable business units. Historical experiences, in Europe and

the United States, remind us that many industries require stages of slow and careful development, which should not be abridged for the sake of a goal of rapid privatisation. We must not suffer under the impression that the existing firms, still operating in their outmoded socialist forms, can be successfully converted into healthy, privately-held firms in an instant.

The real situation actually prevents that from occurring. To begin with, the deepest roots of an unsuccessful business operation require identification prior to privatisation.

There is no logic to support the notion that the huge jump from an outmoded, socialist, command-controlled, state owned company into a laissez-faire, market-economy modern corporation would be successful if necessary developmental interim steps are eliminated.

In the recent past, the Hungarian case for ownership rights, in the legal sense, has been heavily emphasised. This paper will explore the question, „Is a longer period of preparation necessary to eliminate the basic shortcomings of a firm’s operations.”

## **1.2 The results of early privatisation**

During the past three years, attempts at privatisation have demonstrated a wide diversity in philosophy, expectations and results. The New Company Act (1988) and The Transformation Act (1989) were issued under the old political regime. Since 1989, several attempts were made vis-a-vis the so-called spontaneous privatisation process. Unfortunately, the deepest tensions and insolvency of many large Hungarian firms were hidden by the politics of a central planned economy. State subsidies, indirect and especially direct, have been reduced in recent years. However, even The Hungarian Bankruptcy Law (1986) has had only a minor result in insolvent businesses declaring bankruptcy.

During the uncertain political climate of 1989, several attempts at the so-called „spontaneous privatisation” were undertaken. To understand this unique phenomenon, a detailed explanation of prior political events is necessary. The former Communist Hungarian Government introduced a new enterprise-management system in 1985. The objective of this reform was to separate the management function from state ownership and regulation. Essentially, all management authority (including that related to investment, organisation and human resource management) was delegated to the firm’s managers; away from the government bureaucracy.

Although this appeared sound in principle, it frequently resulted in chaos for many of the self-managed enterprises, especially those who had several vertically-integrated subsidiaries or were horizontally diversified. This sudden

die legation (of management authority) provided the opportunity for management to develop a position of strength against the government. These managers (sometimes along with the employees) realised they now had an opportunity to direct both financial and human resources vis-a-vis self-governing councils.

As they discovered their new-found power, these councils started to transform themselves into holding companies, placing the assets of the former company into newly created subsidiaries. The original firm was now only a shell, with the assets transferred away from the head office of the state owned firm. Many of these subsidiaries were subsequently re-constituted as joint-stock companies; the ownership of the subsidiary now being shared with the management, their relatives or sometimes the employees. The original firms became known as „mailbox institutions.”

There were some cases of spontaneous privatisation by the manager's outright purchase of these newly created subsidiaries. Since the prices paid to acquire these subsidiaries were ridiculously low, it amounted to confiscation of capital. Even if the subsidiary was formed into a joint-stock company, the price paid for the shares owned by the managers (or their relatives) still amounted to confiscation.

Referring to this process, *László Kecskés*, then Deputy Head Ministry of Justice stated, „The ruling managerial elite of the self-managed state-owned enterprises demanded actions on creating the legal framework of direct corporate transformation. The missing elements were provided by the Transformation Act which came into force on July 1, 1989. The main point of the Transformation Act is to facilitate complete managerial control over the privatisation process. The Transformation Act declares that any transformation of the, self-managed state-owned firms can be initiated only if the enterprise council approves the transformation plan with a two-thirds majority vote. This also means that any outside offer which is not acceptable to the enterprise council could be easily turned down” (*Kecskés L.*, 1990, p. 4).

The end result of these subsequent legal changes was the creation of a situation such that when top management wanted to become the real owner of the company, spontaneous privatisation would occur without any legal restraints or controls on the transaction.

During the second half of 1989, there were neither rules or nor guidelines for standards of minimum asset valuation, disclosure of operations, competitive bidding or even the establishment of a minimum purchase price. In short order, more than one hundred state-owned firms were spontaneously privatised. It was politically and practically unthinkable to consider reversing those situations, even in situations where the most unreasonable transactions were consummated.

In some cases, enterprise councils sold-out to foreigners for the promise of large increases in executive compensation, perquisites or partial ow-

nership. The foreign buyers could afford to pay these costs when considering that Hungarian wage levels are so low as to be highly competitive when exported to Western Europe or North America. The managers were motivated to cooperate with the foreign buyers since this would allow them to retain their executive status. Neither party, executive or buyer, was considering the long-term financial health of the enterprise.

Accordingly, it became apparent with spontaneous privatisation that management decentralisation without ownership reform yielded an unacceptable result. From this lesson, it became necessary to establish a system of controls to ensure societal influence over the property redistribution process. This reform took place via a new control institution: the State Property Agency. This agency was charged with the authority to monitor all privatisation transactions and if necessary, block those which appeared inappropriate.

### **1.3 A revised privatisation program**

The new, freely elected Hungarian Government declared in September, 1990 its National Revival Program: part of this program is a comprehensive privatisation program targeted for a 3–5 year time horizon. This new government is under the pressure of the legacy of the unfavourable performance of the old political and economic system. Its goals are to improve macroeconomic operation and growth and reduce the high rates of unemployment and inflation. Unfortunately, it inherited the legacy of high foreign debt and its attendant debt service.

Strong criticism developed from the perception that many firms had been privatised too cheaply (*National Revival Program*, 1990, p. 3). A new philosophy for privatisation, however, suddenly appeared to provide the opportunity to mitigate two problems: that of the former criticism as well as providing a means for debt reduction. Ergo, privatisation emerged as a goal into itself for debt reduction (as well as being politically correct). The long term economic infrastructure and the well being and improvement of enterprise performance were now surrogated to a new goal of debt reduction.

Hungary embarked on a new, ambitious program to privatise business. The final goal of this program declares that state ownership (currently about 90%) will continue in the majority until the mid-90's. At that point, the goal is to reduce state ownership to about 40%.

This will be accomplished by three different procedures:

- state initiated privatisation,
- enterprise initiated privatisation, and
- entrepreneurial initiated privatisation.

State initiated privatisation will be executed in three phases. Under the first phase, almost 40,000 small business-units in the areas of retail trade, con-

sumer services and catering trade must be privatised. The second phase of the so-called „state privatisation program” included the privatisation of 20–30 firms. Those would have been firms with stable financial condition. The third phase would have been the sale or lease of state owned small and medium-sized firms.

This plan called for three-four auctions each year during the, 1991–1993 period so that 150–200 large firms would be privatised each year during this period. As a result, by the end of 1993, 500–600 large firms – about one-third of the large state owned – would be built-down.

Enterprise initiated privatisation will be tailored to specific firms and controlled by the State Property Agency. During the 1991–1993 period, 300–400 of these state owned firms should be privatised.

The third type of privatisation program would be an entrepreneurial-initiated version. Demand for the purchase of shares, or an entire firm, would come from either Hungarian or foreign buyers. In this phase, privatisation would be initiated by private investors, but the entire procedure would be controlled by the state.

At present, Hungary has external debts of US \$ 21 billion and internal State debt of HUF 1300 billion (almost US \$ 20 billion). The above privatisation process has the potential to achieve cash inflow to the government of an estimated US \$ 30 billion.

It is very important, however, to note the size of Hungary’s internal financial resources is estimated at US \$ 4 billion. This creates a huge disparity of approximately US \$ 26 billion to complete the privatisation process. There is no apparent solution to complete the process other than foreign financing or foreign direct investment (F. D. I.). Either financing or F.D.I. suggests that some 85% of Hungary’s economy would be controlled, or at a minimum, substantially influenced, by foreign interests: a much too high percentage for any country to accept.

#### **1.4 Conceptualisation of Hungarian privatisation program**

These shortfalls require rethinking of a national program of privatisation. Fundamental political and social changes in Hungary have scrapped the old central planned economy in order to achieve a market economic environment. The goal is clear: a laissez-faire, market driven economy. Accepting this goal leaves the remaining question as the means to the goal, which may or may not. be rapid and total privatisation.



We agree with *Wappenhans* views that institutional and behavioural changes are needed. He also points out the „scale of reform is tremendous. Stimulating private sector development, breaking up state owned monopolies, closing non-viable units, restructuring the financial sector, introducing proper accounting systems, dissemination of modern managerial expertise” (*Wappenhans, W.*, 1990). We might add several other aims to facilitate the transformation: rebuilding the old-fashioned system of enterprise, improving economic efficiency, revitalising the factors of production, enhancing competitiveness and encouraging private interest.

We do not dispute that the critical factor is the ownership, since without clear ownership rights, capital cannot move and resources can be reallocated only marginally. Moreover, clear accountability of the management to its owners is a critically important incentive for enhanced efficiency. This is confirmed by another Eastern European overview, „A clear and durable definition of property rights must be established to hold managers responsible for their actions and enforce market discipline, as well as to reward success” (*Eastern Europe. A Long Way to Prosperity*, 1989/90).

The key question to all Eastern European reforms is to provide new functions and rules, new forms and motivations, new identities and ambitions to poorly-managed, low-performing firms and to the masses of people who are existing without clearly defined motivations, self-enlightened interests and role-responsibility for the success or failure of the outcome.

One approach is that of a long-term learning process for both business enterprise and society as a whole. In conjunction, a long-term transition period is also needed to develop and strengthen the new institutions and to disseminate and assimilate new concepts. This societal and political acceptability is unavoidably necessary if the new forms of enterprise are expected to endure. A broad societal involvement is one of the most important conditions. A huge difference can be recognised between the initial and final stage of this historic reform process. The initial stage can be characterised by the lack of private interest, initiatives and incentives, poorly developed market infrastructure and operation, and low management efficiency. At the other extreme, the final stage could operate a workable market system based on highly motivated entrepreneurial behaviour, high performance in company activities, ambition, motivation and enlightened self-interest in personal behaviour.

A rapid selling-out of shares will not eliminate shortcomings of a firm’s operation. We present a list of the necessary stages of development of the entire

economic restructuring process, knowing it is a formal hypotheses without formal testing.

These stages can be summarised as follows:

- individualisation,
- marketisation,
- anti-monopolisation,
- anti-inflationisation,
- corporatisation,
- privatisation.

Each stage requires a careful and detailed analysis and justification in order to precede to the subsequent stage.

### **1.5 Individualisation – stage one**

Individualisation of economic actions appears as an elementary condition for any kind of economic market transition. Under the command rules of a central planned economy, private individuals are denied the freedom to determine economic decisions. For that reason, a comprehensive rehabilitation process is needed to restore the individual's decision-making capabilities as an informed consumer, supplier, saver or entrepreneur. This first step on the way to economic reform is necessary to „activate” the individual into the reformed economic and business functions.

Hungarian economic reforms began after the 1956 revolution, and since 1968, a new type of reform effort was expanded by the New Economic Mechanism. This seemed the only successful way to improve the poorly-run centrally-planned economic performance. Hungary's economic operation has become substantially more flexible and rational in comparison with the pre-reform state of affairs, but has remained far from an effective market economy. In the past few years, the domestic supply of goods and services has improved. This is a direct result of the business firm's reduced dependence upon state authorities decisions.

Western experts express ambivalence concerning these reform efforts. „Hungary has been quietly working toward more open markets for more than two decades. The country has a national identity, a well educated population, a viable farming sector and some tradition of a market economy. But industrial reform, begun in 1968, has proven much less successful. Central planning was progressively relaxed and firms were told to become self-supporting Hungary has been a success story by Eastern standards for personal freedom and con-

sumer choice, but per-capita income remains below that in the poorest parts of Western Europe, and only about average for Eastern Europe itself' (*Eastern Europe. A Long Way to Prosperity*, 1989/90).

The 1968 reform did not result in substantial shifts in the private sectors position. As a consequence of economic individualisation, the semi-private sector proved to be much more successful since the early 80's. At this time, all of the GDP-increase was generated by the private and semi-private sector of the economy. The Hungarian subterranean economy has had a very complicated structure, which includes real private activities and shadow (black) market activities. Much of it consisted of part-time jobs in the areas of domestic services; farming, small private service firms and retail sales. The amazing aspect about this sector is that it owned about 5% of the production assets, but generated one third of GDP. Because of this statistic, this sector was tolerated by the pre-1989 government, but never officially accepted. Nevertheless, those twenty years of reform, including the shadow market activities, have created a basis for the Hungarian market-economy development.

### **1.6 Marketisation – stage two**

The marketisation phase is closely related to the previously described individualisation phase. It is a broad-based process which includes the efforts in building (or re-building) market-related institutions, market infrastructure elements and re-orienting economic legislation and regulation.

Hungary's approach to establish a free market environment has concentrated upon the building of market-related institutions, but of course, this process is not finished. As part of this market system foundation, Hungary created free product markets and fairly free labour markets. During the course of financial reform, an independent central bank was re-established along with banking institutions and financial instruments.

Hungary has reformed her tax system into Western-style taxation by introducing a value added tax, personal income tax and uniform entrepreneurial profit tax. The outmoded state planning bureaucracies were eliminated, private firm starts are permitted and state subsidies (to a great extent) were eliminated.

The development of the legal framework has started. Hungarian Parliament passed several acts to promote deregulation of the economy and the development of a market-led economy. The two most important of them are: The New Company Act created identical conditions for all forms of business, thus facilitating further expansion and growth of small ventures; The Transformation

Act facilitates the transformation of state owned companies into either a joint stock company or corporate form.

In the area of international economic relations, Hungary liberalised numerous aspects of foreign trade activities in addition to encouraging foreign direct investment and joint-venture participation opportunities.

Despite these considerable institutional developments, Hungarian markets, in the broader sense, remain burdened by many distortions. Until the early 1990's, the marketisation process had not even been started. True competitive markets, with many players, had not yet been realised, making a widening and deepening of these newly established markets an unavoidable necessity.

Criticism from Western economists cannot be ignored. Of course, these markets retain many monopoly elements, state and collective enterprises, union barriers and the like. Moreover, capital markets remain heavily controlled, with only about 10% of enterprise capital raised on market terms even in Hungary: „Partially freeing prices without creating a competitive environment and controlling enterprise spending is a prescription for stagflation, not for economic growth” (*Eastern Europe. A Long Way to Prosperity*, 1989/90).

Small and medium size business start-ups are needed to strengthen the Hungarian competitive market environment along with breaking-up some of the large enterprises into smaller, better managed, more viable units.

There must be a proliferation of financial intermediaries to strengthen the competition in the banking industry. This must include more foreign banks. These new banking ventures are needed to heighten the competition by showing how to recruit new clients and win new accounts, spurring the existing Hungarian banks to a market orientation.

During the past two years, direct state subsidies to businesses have been reduced. Despite the decrease of direct subsidies, indirect and hidden assistance to the banking system continues. This significant aspect of restructuring is stumbling along on its way. The reduction or elimination of the redistribution role of the state budget would assist in elimination of distortions in the financial markets. The result would be a more direct connection between consumption and production.

### **1.7 Anti-monopolisation – phase three**

Unfortunately, there is a high degree of monopolisation by the state owned firms. Some dismantling of the large firms began as early as the 1980's, but this move died soon after it was started. As a result of this break-up, 100 new firms were created, but the vast majority of these monopolies remained intact. After the Hungarian political changes by the initiatives of top managers, several trusts

and artificially integrated big firms and other medium level bureaucratic structures were transformed into property-management firms.

As emphasised in one of the author's former papers, „Our most important finding about the period of transition is that the demolition of bureaucratic and market substituting structures is going very slowly, the business venture attitude is a less characteristic factor, but the income sharing endeavour seems to be the most typical feature” (*Bélyácz I.*, 1990).

In the near future these artificially created monopolistic firms must be eliminated by reorganisation, deregulation or import-export liberalisation. Competition policy must be given a concrete anti-monopolistic substance to eliminate this legacy of a centrally planned economy. This will require breaking-up of many vertically integrated industrial structures. A very complicated task since supplier-customer relationships must become re-oriented to a market driven selection process.

The government must work-out the sensitive and intricate legal prohibition of unfair behaviour within the market. The main condition of free market economic competition is the freedom and fairness of the competition. Breaking down the command economy's monopolies by splitting them into smaller parts offers the opportunity to stimulate the economy by increasing the number of competitors in the market. A similar positive effect could also be achieved by a further liberalisation of the foreign trade sector.

Failure to accomplish this anti-monopolisation process would result in one of the worst possible outcomes; privatisation without competition. This unfortunate situation would result in higher costs and lower standards of quality for goods and services.

The most obvious and straightforward method to accomplish anti-monopolisation is the closing of the bureaucratic centres of these large companies and then splitting them apart. This process will need to consider both the vertical and horizontal aspects of the monopoly. In the area of vertical integration, production can be broken-away from the distribution function. There also exists the opportunity to break-apart certain aspects of the production process, so long as the break-up creates no additional in-efficiencies. On the other hand, dismantling horizontally-related products or processes may be much more difficult to accomplish without introducing reduced efficiencies into the economy. Nevertheless, the anti-monopolisation phase will be characterised by smaller units which can be better managed to be more efficient.

## **1.8 Anti-inflationisation – phase four**

„Competitive markets must be created to set wages, prices, interest and exchange rates. Free prices without competitive markets and clearly defined rights and obligations tend to produce inflation rather than higher productivity” (*Eastern Europe. A Long Way to Prosperity*, 1989/90).

Inflation can be measured in the marketplace. The economic risk rating of Hungary is currently 104 out of 129 of the world’s economies (*The Wall Street Journal*, September 20, 1991). This low level of world confidence results from high (30– 40%) annual inflation rates which exist even prior to the privatisation process. The successful fight against inflation will be the condition which establishes both foreign and domestic confidence in the privatisation process.

There are numerous potential inflationary forces present in Hungary. In the absence of a viable anti-inflationisation program, these factors reinforce each other, creating a powerful, geometrically-cumulative effect. The most important of these are: anxiety and anticipation (political uncertainty), macro-economic dis-equilibrium (deficit budget), delays in accounts payable (economic uncertainty), low productivity (inappropriate incentives), inadequate influence of the market (inadequate rewards), domestic price rises to world-class levels (elimination of subsidies), and the reduction of prices in former monopolistic markets (competition).

The elimination of Hungarian double-digit inflation requires installation of rigid disciplinary controls. This discipline begins with structural reforms in budgetary and monetary policy at the State level. Where monopolies remain, supervision of both prices and wages is unavoidable. If the state fails in this task, the private sector will only be encouraged to follow suit. Other areas of action include: a realistic exchange rate policy, a foreign trade policy which stimulates competition, efficient utilisation of external resources, incentives for private savings and development of private property.

### **1.9 Corporatisation – phase five**

The final two stages, corporatisation and privatisation, both theoretically and practically, must be separated from one another. Furthermore, it must be clear that these two significant objectives must not be implemented simultaneously.

To begin with, even the old-style, state-owned companies must be transformed into a modern corporation based upon the division of capital by registering a stated number of shares. This will provide a means for the raising of additional capital, if needed in the future.

*Bélyácz* argued, in a previously quoted paper, „In the present transitional situation, at least two serious controversies are involved. The first is the

unreconcilable logical controversy between the corporate and self-managed form of enterprises, and the other problems are difficulties of transforming the state owned firms into corporate form related to their unprofitability and ineffectiveness. The self-management model in the mid-80's caused many confusions in the functioning of economic actors. (As it was mentioned earlier) at least one half of the means of production was transferred into partial enterprise property, and as a consequence of it, capital users have been authorised with property rights. These misconceptions have to be cancelled, the change of owners in unavoidable both state owned and self managed firms have to be transformed into corporate form" (*Bélyácz I.*, 1990).

The most difficult question in the corporatisation process concerns the issue of firms with operating losses. General business principles demand unprofitable firms be merged or liquidated. At present, many Hungarian firms cannot achieve profitability without direct subsidies or indirect forms of assistance. This outcome is a result of many causes. Over recent decades, their management practices are incompatible with an open market environment. Most large Hungarian firms are overstuffed and undercapitalised, thus being poorly managed and under-equipped. Successful corporatisation of these firms will be one of the greatest challenges of the transition process.

In addition, the insolvency (or near insolvency) of many companies is an equally challenging problem. Hundreds of companies reached this situation as a result of the actions of less than fifty very large firms. As accounts receivable (for payment of goods shipped to these few, very large firms) grew in proportion, their size transcended the concept of accounts receivable and achieved (in actuality) the status of debt. This debt amounted to HUF 150 billion in 1990, an amount equal to more than half of short term credits extended by all the banks to all the businesses. (Some estimates place the total closer to HUF 200 billion). In these cases, this debt should be classified as „non-performing” and in most, as un-collectable.

This insolvency problem means that many companies cannot meet their payment obligations in due course. Although this practice was abandoned only recently, it had accumulated over years of state ownership in a command economy. However, much of this insolvency is a symptom of more significant problems: high cost levels, lack of competitiveness, and lack of adaptation to changing market conditions.

Initially, these firms became insolvent intermittently; however, later, it became permanent. Nevertheless, bankruptcy procedures were not started

against them (despite the existence of bankruptcy law) because of the paternalism of the state's command economy. In addition, bankruptcy would be interpreted as bad politics. Because these insolvent companies continued to operate, the large state-owned companies started to influence other sectors of the economy. As a result, they received huge subsidies to cover their losses and ensure, not only their survival, but also the survival of their suppliers and other related firms. In this manner, they „survived” and avoided bankruptcy for long periods.

There are presently approximately 400 companies in this category. The majority have not caused the problem, but are the victim of the circumstances, having been caught-up by the large company syndrome. This large company syndrome was brought about by several factors: lack of adapting to market conditions, outdated production methods and state paternalistic politics.

The situation cannot be reversed by a more liberal credit policy; this would simply perpetuate the cause of the problem. Although the companies suffering from chronic insolvency are in the minority, the large company syndrome creates hundreds of subordinate insolvencies. Nevertheless, this syndrome devastates the total payments system and consequently, the circulation of both money and goods. As a result, bankruptcy does not become a threat, since it is not considered a reality.

Today, it is generally accepted that the chronic accounts payable problem can only be settled by implementing a consistent bankruptcy procedure, not by further delaying measures. In addition, this procedure must be implemented simultaneously by all effected companies, not sequentially, so that the initial firms accept all the suffering and the latter firms are declared solvent.

A privatisation process alone is not a panacea for all of these problems of profitability. It will take some time to strengthen and develop unprofitable firms in Hungary, just as it does in other parts of the world. It is primarily for this reason that corporatisation and privatisation must not be mixed in time or space, but rather, must be approached sequentially. Prior to privatisation, the new Hungarian Corporation must demonstrate it's capability to be successful, keep its promises and fulfil its obligations to suppliers, lenders and employees. Until success is apparent in these elements of the business process, privatisation is premature, since investor confidence will only be achieved by these successes. Many large Hungarian firms will not be successfully corporatised with their overmanned, poorly managed, unprofitable operations; restructuring will be required. Dissemination of education and training must be part of the process.

### **1.10 Privatisation – phase six**



As shown in this conceptual framework, privatisation can be regarded as only the final phase of a more complete transitional process. Successful privatisation cannot be implemented without: motivated individuals, a developed market infrastructure, abandoning the rules of artificially created monopolies, controls on inflation and well managed corporatisation. The preconditions to privatisation must be completed satisfactorily. Simply selling-out previously state owned firms to private owners, legal entities or institutional investors would not yield good results because this form of privatisation would not solve the shortcomings and inadequacies that currently exist.

Thus far, the one-sided legal transformation aspects of Hungarian privatisation have been overemphasised to the detriment of the total process. A broad and rapidly implemented privatisation would cause many conflicts. In the short run, the lack of domestic capital would result in a majority of foreign ownership of most Hungarian firms. Only Western investors have the financial strength to buy Hungarian companies at privatisation auctions. If this were to occur, it would not represent the best interests of suppliers, employees, customers, lenders and the citizens of the country.

To establish a sound basis for successful privatisation, potential new owners and shareholders must be developed. Decentralisation of the social insurance fund and pension funds is needed to create financial sources. Insurance companies, broker agencies, investment companies, mutual funds, and other institutional investors will be needed to develop the financial market; infrastructure. The existing Stock Exchange has few transactions, poor trade and a lack of offers. As a result, current prices cannot be considered as real market prices. As is the case with other markets, the capital market also needs widening and deepening to be effective in a successful privatisation process.

### **1.11 Conclusion**

If there is a failure to perform these time-phased-steps to establish the preconditions for privatisation, the process will be only a legal transformation, lacking the reform of the infrastructure necessary for long term business success in Hungary. Our final conclusion is that privatisation cannot be accomplished in one giant-jump from the outmoded, socialist type of state owned company into a market-led, efficient, privately owned economy.

There are no short-cuts. This long (and careful) transition must be implemented to achieve quality and success in Hungary's nation-wide privatisation process.

## **2 MACROPOLICY AND THE DEVELOPMENT OF SMALL ENTERPRISES IN HUNGARY**

### **2.1 Introduction**

Despite the appearance there are many unforeseeable difficulties in examining the position of small and medium-sized enterprises in the national economy. Probably the classification of small, medium-sized and large-scale enterprise in the developed market economies are made according to other criteria and with a different result than in our economy. The fundamental reason for the diversity is the existing difference in productivity. If we want to oversimplify the illustration, it can be said that there is a slip of category in favour of the enterprises of developed economies.

Those named small enterprises there correspond to the medium-sized firms in our case. The differences of output per capita, number of employees, and the technological equipment, all play a role in causing the divergence. Despite the measuring problems the subject and the message of this study are clear-cut since the terminological differentiation of small enterprises has been clear and beyond question in the Hungarian economic literature for long time.

In order to simplify the elaboration we would analyse the business units by drawing them into one circle, and name them by the collective name of small enterprise. We wish to emphasise in the introduction, however, that in reality it includes the examination of three different firm sizes. We include to this circle the private or family businesses operating with one or very few employees, in most of the cases they are not legal entities; secondly we class the small firms working with maximum 50 employees as small enterprises, and thirdly smaller medium-sized firms operating with a few hundreds of employees. During the analysis we will not make a difference between the three groups, and use the collective name of small enterprise for indicating all of them.

In accordance with the request, the analysis covers more than a quarter of a century, in order to understand and to solve the problem of small enterprises we need to go back to the beginning and the middle years of the 1960s. In order to show the importance and the role plaid by the small enterprises we will not break the above mentioned phase into sharply separated internal periods rather we will refer to the most important turn points with a greater emphasis. In the centre of the train of thoughts we examine the growth opportunities of small enterprises in the light of the endeavours of the prevailing economic policy at the given time. In the course of this we are bound to qualify both the possibilities of self development and the effects of the economic policy. By the subject's nature we need to put greater emphasis on the critical analysis of small enterprise's self-development.

During the last three years explosion-like changes are witnessed with respect to all aspects of small enterprise's economy. It, however, should not hinder us in making a balanced, impartial analysis of the problems, since it does not seem feasible to flash back the current conditions to the past.

By doing that the opinions about the processes of the past would be bound to become distorted. The other reason for great caution is that the results of the series of explosion-like changes have not yet become consolidated, there are still significant changes ahead of us in the entrepreneurial sector.

From numerous signs we can come to the conclusion that the spectacular quantity growth has not accompanied by a quality breakthrough beyond doubt, that is enough reason for a circumspect judgement.

## **2.2 A historical retrospect with lots of criticism**

The political and social changes taken place on the turn of the last decade gave a devastating judgement on the economic system, whose leaders never treated the small enterprises as an equal factor. The command economic system most favoured company formation was the large factory, its existence was considered extremely important and backed up by political and economic arguments. The political power treated the small enterprises in an off-hand manner, and it feared from it as an autonomous proprietary and operating formation. The ambivalent relation of the politics was coloured by the political practice that talked about the importance of small enterprise on phraseological level, and in reality it did everything to hold it back.

At the end of the 1940s after the nationalisation and following the introduction of the command economic system the destiny of small enterprises was sealed. The pushing of the large factories overshadowing all the other company forms was based partly on the euphoric overemphasis of the advantages of magnitude, and partly on holding back the private ownership, and initiatives even by prohibition. The fact that the domestic company structure before World War II was not rational in an economic sense worsened the harmful effects of this doctrinaire idea. The two extreme poles of the structure with respect to size (the one-man family-like industry and trade, and the large company) were really developed. At the end of the 1940s such a size distribution of companies was politically attacked and run down by a wave of termination and merger that included only feeble small and medium-sized enterprises. Only a few hundreds of enterprises existed, and more than half of it was merged in within a couple of years. A counter process could be witnessed in this obviously hostile environ-

ment for small enterprises: by forcing the individual craftsmen and retail dealers into co-operatives practically they become part of the small enterprise circle.

The attack against the entrepreneurial small existence, the mergers of numerous firms belonging to the circle of small and medium-sized enterprises turn the pyramid of the companies' size distribution upside down and by that its small business foundation has excessively been weakened. By the years of '50s the prevailing form in the size distribution of companies will be the large company. The proportions can be well demonstrated by indicating that in all the sectors of the national economy the few thousands of large companies stood against only a few hundreds of small firms. This extremely distorted company structure was devoid of any kind of economic rationality, and only the easier way (central) of manageability could be argued in favour of the repeated waves of mergers.

Despite the government's peremptory hostility to small enterprises the claim of smaller sized economic units comes to the front from time to time and the developments following the 1956 revolution give a good example of it. To permit and tolerate small enterprises in small-scale industry and commerce appeared as a compulsive demand. During the last third of 1950s licences for craftsmen and retail dealers are given in great quantity, simultaneously the forced collectivisation sweeps over agriculture gathering hundreds of thousands of small existence into big farms.

The company mergers of the early '60s proved more than anything else how much the formation of the size distribution of companies was governed by political infatuation. From the beginning of the decade the reform forces of the political power concern themselves in radical transformation of the structure of economic policy, meanwhile a centralising wave sweeps over the company structure with a strength exceeding all the previous ones. By the middle of the decade the rest of the small and medium-sized enterprises has been merged in and the country reaches the threshold of the reform in 1968 with a number of state-owned small firms not exceeding 50. This totally centralised company structure is incapable of being the base for a competitive market economy.

The structural reform of the economic policy in 1968 was a milestone in shaping the conditions of small enterprises from all aspects. The reform's ideology emphasised the principled importance of private initiatives, flexible compliance, decrease of production costs, and the small enterprises in general, but it did not draw the institutional conclusions from it. Since the policy system did not change anything about the ownership structure of the given time, thus no possibility existed for mass foundations of small enterprises based on private ownership. Not much after the beginning of the reform the company organisation system is supervised, and it is found „in perfect trim”. Obviously the con-

clusion could be drawn from it, that to form a company structure with many participants according to the requirements of a competitive market is not in the interest of the political power.

Despite that the reform of the economic policy did not start a wave of organisational decentralisation, and did not take the initiative in founding new small enterprises, it did make a breach in the exclusive power of the large companies. Following this we could witness such processes that in some way contributed to the collapse of the command economic system.

After the reform in 1968 the advantages of small enterprises capable of flexible compliance over large companies became clear, it was obvious that to satisfy effectively the market demands without a developed small entrepreneurial sector was inconceivable, it turned out that the smaller sized firms adapted much faster to the circumstances followed the reform than the large companies. We could not hear voices of the ideology and political phraseology against small enterprises from there on, the hidden political endeavours, however, hampered the development of this sector.

A peculiar struggle started in which the small enterprises gained and lost at the same time. It was a gain that the number of craftsmen and retail dealers had definitely grown, new co-operatives were founded, the ancillary branches of large scale farms actually functioned as hidden small scale plants.

Naturally the political attack against the reform did not leave the size distribution of companies untouched. Beside emphasising the 50 largest industrial companies almost an individual company preference was realised by one-sidedly allocating resources to them. In the middle of the 1970s the last wave of organisational centralisation of the command economic regime swept over, by merging dozens of co-operatives in the organisations of large companies.

The above mentioned demonstrates well that the politics and economic policy, treating the small enterprises in a discriminating way, could prevail for three decades from the end of the 1940s. The prohibition with respect to ownership barred the foundation of small private enterprises, and the existing state and co-operative small firms did not receive national economic resources. By the first half of the 1980s one-sided preference of the large companies reached a point where the supervision of the long lasting discrimination became unavoidable. The turn happened around the time when the large company system became entirely incapable of producing significant surplus value.

### **2.3 Turn during the early years of the 1980s**

The growth crises evolving since the end of the 1970s evoked a reaction of economic policy makers that stood out in sharp contrast to their previous ones. In the beginning of the 1980s after several decades of one-sided organisational

centralisation the organisational decentralisation of more than 200 companies was scheduled. 2–3 years passed and the promising decentralisation wave broke and the originally planned of setting independent company units up affected only one-tenth of them. Thus radical changes could not happen, however, more than a hundred new small and medium-sized firms came to existence, and the change in attitude was even more important: after a merging in campaign lasted for decades the previously merger units were rendered independence for the first time. Beside the organisational decentralisation that affected most of the large companies, similarly important processes started to increase the role of small enterprises.

In the beginning and the middle of the 1980s the state economic policy itself helped to remove the barriers by permitting and in some way supporting the foundations of work partnerships in enterprises (pursuant to Decree 28/1981. (IX. 9.) MT), small co-operatives, civil law associations and other forms of small business organisations. The most fundamental mover of the just started permission and incitement of small enterprises was that the political power could not defend itself against the growing losses of the large company system. The legal, semi-legal and illegal small enterprises became increasingly important sources of the national economic output. The power overlooked the contravention of regulations by private initiatives since this sector produced one-third of the gross domestic product before the years of the political change of regime.

The small business prosperity of the 1980s was characterised by the followings: hundreds of embarking on business managed their business with a relatively small capital, in part-time job (half time or quarter time), entwined with the large companies of the state sector. These small ventures were not business organisations in an economic sense since most of them never paid taxes, did not undertake any risk, produced for a secured market, and several of their formations lived in an actual symbiosis with the large companies. The political power took care not to let the small businesses independent, capable of accumulating, and expanding also to become well provided with solid capital. Most of these small ventures could not be privately owned, since according to the law only durable consumer goods were allowed to be kept as personal property.

The hundreds of small ventures of the 1980s were economic organisations tolerated of necessity, without a long term perspective of development and accumulation, they were more interested in running through their incomes than investing them or expanding the business.

The small enterprises constituting the grey economy of the 1980s mitigated the crises of the command economic regime, and demonstrated that the small organisations capable of flexible compliance were more effective than the overfavoured and over subsidised large companies. By this time the indispensability of small ventures and irreplaceability of a dual system with respect to size were

more widely realised. The large companies and the small enterprises instead of excluding each other, they are interdependent and conditional upon one another, necessarily built on each other. Though the discrimination against small enterprises is still loosened with difficulty within the company structure. For decades the decisive part of financial resources was granted to the large companies, thus the most significant characteristic of the small ventures was the scarce capital. The political tolerance towards small ventures did not mean financial promotion as well, so this business form reached the change of regime with possessing only a fragment of the national economic resources.

It needs to be emphasised that in the above mentioned period the political power made a concession out of necessity for using the large companies' capital within the framework of small ventures. Several aspects, both legal and economic, of this peculiar co-operation also its ethics were not made clear, the national economic reserving and preserving role justified the compromise. Despite all the contradictions the small business development proved to be a learning process, and it was an effective precedent of the real capitalisation process taken place later. At about a thousand new small co-operatives were founded and they infiltrated into the economy as real market economic organisations; one-third of the retail shops and restaurants and other places of catering industry began to operate under contractual agreements; communities were formed within the large companies that could be seen as small venture's initiatives. These movements more and more plainly set against the large company system wrestling with the increasing difficulties of efficiency, but the breakdown of the large companies had not yet happen.

In the 1980s according to rough estimation the expanding small business sector of the national economy produced an output equal to the loss of large companies, thus the steadily increasing small business sphere could counterbalance the large companies' deficit, more over it established a minimal growth.

Based on contemporary estimations at about half a million people worked in industry or service industry in some way, in small businesses (private, semi-private or within the state sector), and in agriculture at about one and a half million households worked on household plots. The contemporary analyses emphasised more often that the small enterprises with a few percentages of national economic resources produced one-third of the national output. It was rather the criticism of large company system than the promotion of the small business sector, since it was well known, that the tolerated small ventures were based on self-exploitation of the participants and existed within chaotic legal conditions, without the acceptance of private ownership, thus in insecurity.

The turn of the 1980s brought irrevocable results, after the changes there was no chance to restore the organisational system based on the prevalence of

large company structure. At the threshold of the political changes more than half of the population being in working age had relation with some organisational form of small venture. It seemed that according to all indications there was a straight and short way to a well operating market economic system from the evolved pre-school of market economy. It did not happen quite like that.

#### **2.4 The total freedom of venture and the small enterprise**

Following the free elections the new political forces in power did not consider the small business reform experiments as the means for preparing the market economic system, they wanted to establish a normal, guaranteed legal environment by formulating a new legal system. They made way for founding and transforming companies in accordance with the laws by eliminating all the barriers of free venture, by the statutory guarantee of inviolability of private property, and ensuring sector neutrality. As a result of the new political and legal situation the problem of maintaining the small business sector against the political will lost its meaning, and the political differentiation between small enterprise and large company entirely disappeared after a long time. Following the changes the small business organisational formations of the 1980s have gradually disappeared, however, the semi-business and not business-like attitude established then has not. The most obvious signs of it are demonstrated by the significant decline of tax moral.

At the turn of the 1980s and 1990 there was a radical change in the small business sector in a quantitative sense. Considering the number of enterprises within the space of two years the pyramid of firm distribution was turned over from its head to its feet, and its internal structure could be compared to the companies' size distribution of the developed economies. During the dramatic changes the number of individual small ventures (of the former craftsmen and retail dealers) not having legal personality increased to six hundred thousands, at about ten thousand small enterprises with legal personality were founded in industry, about forty thousand in commerce and service industry. Based on the number of small enterprises the small business sector became the prevailing formation of the national economic company structure, and according to rough estimations in the beginning of the 1990s these enterprises produced more than one-third of the national economic output. The direction and proportion of the previous pyramid of firms' distribution was reasonable changed by the quickly passed off small business revolution. It is obvious that for such a big mass of company foundation free capital could not be available, thus most of the new enterprises were formed either with a minimal capital or with property goods



and capital resources derived from the large companies. By regulating the legal status of business enterprises the semi-market and semi-business conditions disappeared. The managers and employees of small enterprises worked in full-time, under competitive market conditions, they became tax payers, and undertook business risks. The first step of the new government's economic policy to legitimate the small enterprises as an equal form was to declare the sector neutrality. Actually there was no positive discrimination aiming at one-sidedly supporting the small enterprises. The most general means, the means of tax policy affected all the business forms in the same way.

Some peculiar feature of the small business boom requires special attention to be paid. It is a striking fact, that most of the business foundations happened, both in relative and absolute sense, in the fastest capital turnover ensuring sectors. This is the reason for that the majority of small firms, stabilised in a short time, were formed in commerce and in service industry (material and non material). It would be difficult to classify the mass of newly founded small ventures by only a few characteristics, some tendencies, however, are well outlined after such a short time, too. Probably significant proportion of the small enterprises was founded with the objectives to secure employment for the entrepreneurs and employees, to provide gainful employment and a consumption level above average, in addition to get a chance to realise business entrepreneurial ambitions. With a slight simplification we could say that the about one million citizens form the core of the existing small businesses who played an initiative role in the semi-legal, tolerated small ventures of the 1980s. The full-time entrepreneurs can enjoy all the advantages and bear the burdens of business ventures within the new, legal framework of small enterprise.

It may be very important to clarify that what role was played by the autonomous forces of the economy, and by the economic policy, in the development of small business in the past three or four years. Without the intention to abolish the positive results of governmental policy, it is very likely that the major role was played by the initiative of economic actors. In the one or two years preceding the change of the political system the obstacles of independent private ventures were gradually eliminated. The change of system considerably reduced the weight of economic policy as the means of government compared to the previous period. The remaining governmental means became more unanimous and more transparent than the former ones. The main point is rather that the considerations of economic policy have no

longer been obstacles to small business initiative, and the political barriers have disappeared once for all. The source of troubles is that the disappearance of obstacles and barriers alone does not mean automatically incentives and support. The ten and hundred thousands of new small business firms were established not by major entrepreneurs with solid capital but by economic actors with little capital. The shortage of available liquid capital resources is a serious difficulty just like it was in the past decades.

With strongly simplifying the recent development it can be argued that the citizens who endeavoured to be entrepreneurs „escaped into” the framework of small business. In this process the exemption of profit tax meant a definite attractive element. Exemption from one kind of tax, however, did not mean light burdens and a unanimously entrepreneurship supporting environment. The long time well known burdens on the domestic production have not decreased significantly; regarding the payments after labour and employment, social security expenditures, various special taxes and fees, that is, all expenditures that a small business has to bear in any circumstances, even when the output is very low. The same costs that mean a relative small load for large enterprises are unbearable pressure on a starting small business in the stage of market introduction.

Within the problems of small business firms financing is of outstanding importance. No doubt about that the government and certain specified organisations and foundations took some steps to make favourable loans and credits available, however, the total volume of these remained so small that it could not have serious effect on a wide range of small firms. The conditions of ordinary bank loans are so hard that the majority of small firms cannot even come into consideration as potential partners for lending. Under these circumstances the small entrepreneur can obtain resources of neither the capital market nor the banks, and in this way the shortage of resources hinders the development of small business units. The government, according to traditional routines, has primarily established organisations and bureaucratic institutions that help enterprise development; and did not bring new financial institutions into life that could have served small business development.

With a little overstatement it could be argued that hundreds of thousands of small private ventures and tens of thousands of small firms with legal personality were born hoping the future support of economic policy, but did not receive really substantial assistance to their survival and development. The overwhelming majority of new firms was established in the form of small enterprises because the minimum required initial capital meant the upper limit of the fi-

nancing capability of their founders. Most of the new small business firms began to operate on a very unstable financial basis, and they were hardly able to take on a significant load. It is a serious danger that a considerable number of small firms will financially overload themselves and this would mean a chain of crisis for thousands of enterprises. Because of the uncertainty of the market, the counter interests of banks, the unstable position of large enterprises, there can hardly be found a solid base that could offer support for small firms either in the market or in the financial sense. The economic policy of the government is not able to offer assurance that could mean support, in long term, to small business ventures that endeavour to establish themselves firmly in a straight way.

Currently it could be hardly doubted that small business is the most dynamic area of the national economy. The most intensive mobility, and the actually progressive development can be observed in this area. However, while pointing out that these movements have not yet calmed down, it must be remembered that in this spectacular whirling there are several thousands of firms present, which have little chance for lasting survival.

The field of small business is extremely heterogeneous regarding the involved attitudes and motivations. There can be found a lot of such types of entrepreneurs whose primary objective is not smooth operation, decent profit, market reputation, but the utilisation of the boom of entrepreneurship. It can be worrying that numerous small firms do not undertake a continuous real economic operation satisfying market needs beyond illegally reclaiming value added tax, using tax allowances, legalising illegally obtained productive assets. Perhaps, there are much more shadow, sleeping, and pseudo-enterprises than it would be unavoidable.

The long time anticipated revolution of small enterprises came true in a period when business morale had dropped to a very low point, for unclear reasons from many aspects. In the circumstances of developed market economy the small business is a solid basis of the pyramid of the size distribution of enterprises. They represent the largest number, but they cannot turn to be a determinant power regarding output or capital, neither alone nor together. In spite of their small size and moderate capacity, small firms are the symbols of flexibility, rapid adaptation, and reliability. Although it is always the small enterprise that has the highest mortality rate, this segment of size has been representing a constant ratio within the totality of business for a long time. Since the Hungarian pyramid of the size distribution of firms has turned round extremely fast, it is a well-grounded question that whether this suddenly established base of the pyramid will be solid enough. After many decades of

severe policy restraints the size structure of business was restored so sudden that serious doubts may emerge regarding the fast stabilisation of it.

When talking about business, contractual, tax and morale confusion and their crisis the chain of phenomena includes small enterprises, too. There must be a reason for that the most positive morals of market economy and business did not really established in the small business sphere. The fear from risk, bankruptcy, market impossibility does not function as a retarding force in due measure and create dependency in a positive sense. We can find several business units among the new small ventures that stand out rather by irresponsibility and perfidy than by their promises and fulfilment of obligations. Before anyone started to wonder why it is that we attach such an importance to these moral problems, it must be seen, that because of the statutory gaps, and the less developed business ethics, small business might become such a hunting field, where the misuse of business confidence and good faith, also the tolerance of the society might happen without any consequence.

All of these shows that we do not find the spectacular growth in the number of small firms as events free from difficulties.

The impressive quantity does not mean a quality jump beyond doubt. Everything that happened can rather be considered as an answer reaction aiming at pressing the previous back, than an organic evolution. During a transit period small enterprises must become part of the comprehensive division of labour of macro economy, and assume the typical roles and features characterising this business form. In all sector of the national economy the small sized ventures have special features and functions. Obviously two-three years were not enough for developing an organic co-operation between small enterprises and large firms. The significant instability of the producing, market and financing position of the large enterprises is only one reason of that, there was not enough for the small ventures to find effectively their way either. Beside the stabilisation of the large companies the target orientation of small firms would be needed for an effective co-operation between enterprises of different size.

## **2.5 About the importance of small enterprise's promotion**

The government and the parliament made significant steps to reinforce the sphere of small enterprises by creating the legal framework during the last years. The Act on Business Associations (Companies Act) was passed before the political change of regime. The most preferred business forms by small businesses are the limited partnership (*betéti társaság*) and the limited liability company (*korlátolt felelősségű társaság*). The number of small shops managed by individual entrepreneurs increased above half a million. The scope of the Act

on Business Associations does not extend to their foundation. The striking characteristic of the new foundations is that while only some hundreds of businesses were created according to the simplest business form (partnership, *közkezeseti társaság, kkt*) included in the Companies Act, during the last three years 25 thousand of limited partnerships and at about 50 thousand limited liability companies were established. The partnership and limited partnership based on the principle of liability without limitation are in harmony with the size of the firm, its capital, risk. The same, however, cannot be said about the limited liability companies established in a great number.

A significant proportion of the limited liability companies, founded during the last years, was formed with minimal capital.

Lots of them are one-man companies (formed by one member) thus there are too many of those limited liability companies where the unlimited liability would have been better. Obviously the basic problem is the measure of risk, liability and load bearing capability. Since most of the limited liability companies' objective is not to join capital but activities, there is no reason for limiting liability and it is not understandable either. We only pay attention to this form choosing confusion because by this way several firms can be founded aiming at not functioning as a small enterprise but rather with an objective of border on legal and illegal speculations. If thousands of business units are formed with an objective of not producing goods to the market but rather for prime capital manipulation, the doubt arises whether the influence of legal framework on entrepreneurial scope is fortunate.

In an economy where the discipline of payments has got loose to an extreme and in order to avoid the fulfilment of obligations the prime capital can be moved to another venture of the owners-top executives with impunity, there the efficiency of legal regulations is of special importance. By mentioning these negative examples we do not wish other than to draw the attention to the fact that these ventures can in no way reinforce the establishment of the size distribution of firms.

If as a result of the radical boom of small enterprises a great number of dubious small firms come to existence, it is to be feared that small ventures will be accompanied by not desirable associations. The peculiar looseness created by the organisational forms that can be chosen from, cannot be considered the positive example of small business development without criticism. Despite the appearance, we do not think that the economic policy makers and leaders have done everything in order to help small ventures by creating a loose organisational framework.

The financial basis of business enterprises formed not for market production and service output will be destroyed at the moment when it becomes impossible to live by taking advantages of tax allowances, the short-term exploitation of capital, and manipulation. Unfortunately the small business boom made

way for such entrepreneurial behaviour patterns that do not serve the long term interest of the national economy.

We should not forget that during the last three years the small firms with legal personality were not founded by risking their own capital resources, but decisively by the conversion of the pieces of public property. Under these circumstances we should not be surprised that the new owners and top executives do not always manage the easily obtained entrepreneurial capital with the care a conscientious businessman uses, but rather use it for prestige consumption. The market economic attitude does not include these behaviour patterns, it is rather a late appearance of „the soft budget constraints”. In this light it would be more correct to speak about some kind of over preference, and admit that the small business form is over supported. Obviously this conclusion is in a contradiction with the above mentioned, thus it needs some explanation.

The lack of small business promotion and the formal legal over support of them exist together in a way, that the small enterprises functioning in the real economy are lacking the promotion and at the same time the scope of business units with a dubious background and objectives is unreasonable big. The owners and top executives of small firms formed for product and service output can count on low percentage of net profit, and significant burden, too, which keep the firm's realised return low. The economic policy makers have not realised yet that the load bearing capability of the small firm is significantly lower than of a large company, and the small enterprises cannot be levied a contribution on to fill up the state budget without disastrous consequences. The domestic practice demonstrates that in a relative sense the small enterprises do not bear less burden than the large companies. The most important characteristic of the small enterprise is that its result is based either on private work or the joint activity of small community, thus *ab ovo* it means limited profitability and load bearing capability. The owners and top executives of these enterprises (with scarce capital) are aware of the constraints, and adjust the measure of their undertaking to it.

The monetary restriction applied in the economy during the one and a half years is not the environment in which the small enterprise can operate and develop undisturbed. Thus we should not think that the ten thousands of small enterprises were formed because of favourable financing conditions created by the government, the financial institutional system and other organisations with an objective of it. Just it proves the contrary to be true. The overwhelming majority of small firms is in a very difficult financial situation, the normal undisturbed operating conditions are not ensured. Despite the fact that the capital circulation in small enterprises capable of market realisation can be viewed sufficient, as a result of organic capital scarcity they cannot obtain the capital resources minimal needed. The monetary restriction raised

the „threshold of dealing with someone” so high that the majority of small firms does not qualify as potential borrowers.

Contrary to the appearance we need to say, that the vegetating of small enterprises with scarce capital without resources is not really a virtue, but rather a forced adjustment that should be avoided. We do not think, however, that a mass exemption from the undifferentiated rigidity of monetary restrictions should be granted in favour of small firms. The discrimination in favour of small enterprises does not mean that the large companies should be discriminated against. We do not wish the relatively high burden on small enterprises to be compensated by using the large companies’ resources. The small firms would not need to compete with the larger companies on the free ways of bank credits and money market. It does not work like that in the whole World. We should think, however, there are known institutions and methods that prefers the capital supply to small firms, that are capable of compensating the natural disadvantages of small ventures. After decades of discriminatory treatment it would be a mistake to consider the small enterprises as the economy maintaining sector that will take over the place from the prevailing large companies. In all over the World the small enterprise enjoys allowances in conformity with the market through interest reduction, tax allowances, and other exemptions from social costs. An important condition to gain the above listed allowances is that the business unit must be a small enterprise in the real sense of the word. There is still ahead of us a clearing and settling process in our economy, and as a result only such a circle of small business firms will survive that have the classical features of small enterprise. Thousands and ten thousands of newly formed small business units have to integrate organically with the market processes, and find fix buyers and partners to co-operate with, and take their place in the market.

We think that it is important to make easier to found and to start a new venture. This undoubted help, however, should not be mistaken for a definite easement of stepping on the market.

Because of the short time, the prevalence of closed forced markets and the limited entrepreneurial knowledge a great number of small enterprises has not yet integrated with the market organically. By market integration we mean great number of buyers and sellers in relation to one small enterprise, the extensiveness of market relations, the multiple threaded integration with the division of labour. Considering all these lots of difficulties need to be overcome. Small enterprises demand much more help for creating the business infrastructure surrounding them. Several business and top executive functions are known that are luxury to operate in each firm and put unreasonable burden on entrepreneur. Masses of small business units have to be provided with these services, and the state assistance would be indispensable in it.

When the owners and top executives of small enterprises with an objective of manufacturing and service are complaining about the lack of a business supportive environment, they harp on the unreasonableness of some of the burdens. They think that the revenue, coming from levy, will be used for financing the maintenance of the inactive bureaucracy. The small business burdens that are hard to bear not only suggest that the business organisations with scarce capital „need to provide for” others but also that the achievement of a small entrepreneur does not meet with fair social recognition. When mentioning the importance of promotion we never mean subsidy by it. Only the small enterprise belonged to the size category of which some business units had never got even minimal state resource in the vanished state economic system. The lack of promotions, capital grant and any kinds of financial assistance also meant that the state drew resources (in net sense) from the tolerated small business sector. In a situation like that the enterprise sphere would never be capable of significant accumulation. After the radically changed situation the small enterprises would not demand subsidies and investment promotions, but the decrease of the general taxation to a level that would be in conformity with the real load bearing capability of small-sized business units. We should avoid that the small business sector, increased in number and output, would become the subject of the well-known state capitalist exploitation. If we put too much burden on enterprises with low load bearing capabilities we push them (against our intention) to a direction that they will become interested in using evasions. If the large companies’ successful transformation into business associations, turning them round onto their feet, their restructuring based on the principle of efficiency will be accomplished then we can count on the development and stabilisation of manufacturing, co-operating, market, financing relations and the relation of division of revenue between the small and large enterprises. The small enterprises cannot be put into a position by increased state exploitation that makes them to become someone using tax evasions, negligent, and incapable of market co-operation. In a region where the smaller-sized ventures are of great importance, there the economic policy cannot become a paralysing burden on small enterprises.

The managerial competence, the right risk undertaking, the capital, and the characteristic of the market make small enterprises the proper business size where the knowledge of top executives operating the capital offers the best result. When in a short period hundreds of thousands of individual enterprises, and ten thousands of smaller business associations were formed, then the owners and the ventures had just recognised that they could expect the well-founded success for their efforts only at the given size, risk and liability undertaking. The economic policy makers are bound to realise that this radical development reformed the size distribution of firms in a spontaneous and very progressive way. The government’s interest can only be to stabilise this extended



entrepreneurial circle and to integrate them with the operation of the national economy. The role of governmental economic policy in the evolving market economic system will profoundly be transformed compared to the previous one's and it will rather become an indirect factor of orientation. The transition is very complex, and in the middle of a crisis we ought not to make a mistake by compensating the losses of the large company system (being in a deep crisis) with the revenue levied from the small enterprises. Since the current situation is not without these kinds of dangers, it is to be feared that the small enterprises will take a growing proportion of their activities, business transactions, financial relations to the informal economy. A rational burden is the foundation of trust between the state and the entrepreneur, the lack of it might be a source of a wide range of far-reaching problems.

## **2.6 The small enterprise as market competitive factor**

After several decades of partly successful economic reform experiment, at the turn of the last decade the creation of competitive market economy's institutions began according to a definite concept. The old size distribution of firms was not only causing problems because the large companies were predominant but also because it was the inflexible system of the monopoly of firms distribution. The greatly monopolised institutional system of the companies excluded the smallest chance for competition. After the size distribution of firms had turned round, there was a hope that the monopolistic structure would get looser, and that a competitive situation would evolve. The results of the last three years show that the chance for market competition has definitely become better and lots of monopolies have disappeared. The segment markets with many actors appeared particularly in the trade and service industry, the consumers' choices increased significantly.

Despite these undoubtedly favourable developments the monopolistic characteristic of the firms distribution of the national economy has not yet disappeared entirely, and the exclusive effect of several monopolies prevails undisturbed.

In spite of the radical increase in the number of firms the considerable segmentation of markets, and the monopolistic conditioning often characterising small entrepreneurs are causing problems. A wide circle shows inclination for cartelising, to sign agreements excluding competition, that is the remains of monopolistic behaviour are still haunting.

Despite the welcome increase of small enterprises we should not think that the small shops' dependency from the consumers, and the market increased to such a high level that its effect would be felt in quality, price or in a more accurate performance. Up till now the quantitative conditions of the competitive market have appeared by the fast increase of firms in number, but the com-

pulsion for competition causing qualitative improvement has not yet evolved. The newly formed small enterprises improved the market supply so significantly that the shortage of goods and services has disappeared in most of the cases, and more over a significant surplus of them appeared on numerous market segments. The source of problems might be that a surprisingly large proportion of small firms concentrate its activity on intermediate trade and within it, on distributing import goods that does not generate to much of surplus value. The market competition situation could be reinforced in the best way by the operation of more and more small firms that are capable of producing significant value added. There would be a need for numerous small enterprises that plan their activities for the long-run, establish it gradually, and endeavour to find solid market positions.

Probably the government will not be interested in winding up the remained large monopolies, since they (except for those in deficit) can be considered more reliable as tax payers and resources of revenues than the other forms of ventures. The small enterprises as the most responsive points of the market surface fill in functions, from which the consumer, the partners of co-operation and the market in general benefit, but less direct budgetary advantage derives from them. The whole market becomes more responsive, flexible, and capable of better complying by filling the gaps of the size pyramid. The social benefit derived from it is less palpable for the economic policy makers and they appreciate it to a less extent. They consider the small firms as the most unreliable tax base, and they rarely pay attention to the fact that the domestic small enterprises need to create the minimal conditions of financing capability without any help of external resource. In a situation like that we should not be surprised that the income exhaustion of small firms would be definitely disadvantageous during the first couple of years after foundation.

In what will these constantly growing small enterprises compete? They will compete with each other for the fulfilment of the consumers' demand, also to fill the position in co-operation and home industry. The small enterprises becoming solid in capital, and market position, gaining reputation will become the solid bricks of the dual firm structure based on the size relations if they could maintain, beside producing on low expenditures, their capability of flexible responsiveness. Soon it needs to be realised that the small and large enterprises are not the problem of choice but they are precondition one another, built on and complementary of each other. A well operating competitive market economy is inconceivable without an extended small entrepreneurial sector consisted of units capable of competition individually. They are counted on as competition promoting (directly and indirectly) factors. The expenditure level, the productivity and the competitive capability of large companies' sector can be favourable modified through some transmission, based on wide ranged co-operation with the small entrepreneurial sector. Thus the only way to reinforce

the competitive economy is to integrate organically the numerous new small enterprises with the division of labour of the macro economy.

## **3 THE LEGAL FRAMEWORK CONCERNING SMALL AND MEDIUM-SIZED ENTERPRISES**

### **3.1 Introduction**

According to statistical data almost ninety thousand registered firms are operating in Hungary. The overwhelming majority of them belongs to small and medium-sized enterprises. Slightly more than ten percent of the registered firms is state-owned companies together with the co-operatives and companies limited by shares. Considering output, sales, number of employees some of them belong to the category of medium-sized enterprises, and some to the large enterprises. With respect to such criteria ninety percent of the registered firms can be considered small and medium-sized enterprise.

This study gives an overview of the rules regarding the operation, the self-government, the possible transformation and the termination of small and medium-sized enterprises including insolvency (bankruptcy, liquidation, winding up) and the laws related to market behaviour.

The study put an emphasis on introducing the forms of business associations separately with respect to the fact that most small and medium-sized ventures choose one of the forms of business associations for their organisation and operation. Beside that the reason for the particular attention given to business associations is that most of the state-owned companies are mandated to transform into a business association. This possibility is also given to co-operatives.

Considering all of these, the study will analyse the most important provisions of the following statutes: the Act on Business Associations<sup>1</sup>, the Act on State-Owned Companies<sup>2</sup>, the Act on Co-operatives<sup>3</sup>, the Act on Individual Enterprise<sup>4</sup>, the Act on the Transformation of Business Organisations and Business Associations<sup>5</sup>, the Act on Court Registration and the Legal Supervision of Firms<sup>6</sup>, the Act on Bankruptcy, Liquidation and Winding up Procedure<sup>7</sup>, the Act on the Prohibition of Unfair Market Behaviour<sup>8</sup>.

### **3.2 The business associations as the general forms of small and medium-sized enterprises**

The modified Act VI of 1988 on Business Associations (hereinafter: Companies Act) regulates the foundation, the organisation, the operation of organs of business associations, the rights, the obligations and the liability of their members,

and the termination of the business associations. Besides determining each form of business association the act covers a significant proportion of joint business ventures, including the business activities of citizens and business organisations, also Hungarian and foreign joint business activities.

Before the enactment of the Companies Act state-owned companies and co-operatives were the prevailing forms in the Hungarian economy. In 1984–1986 the state-owned companies went through a major organisational reform. At about 25 percent of them remained under state supervision and control, 75 percent was transformed into either a self-governing company under the general management of a Company Council, or a self-managing company operating under the general management of the general assembly of the employees (or the assembly of their representatives). The self-governing and self-managing form became prevalent among the small and medium-sized state-owned companies.<sup>9</sup>

The Companies Act considerably extended the possibilities of citizens to association. It increased the freedom to form an association according to the principles of indifference in competition and sector. The business opportunities of small-scale industry and retail significantly increased following the enactment of the Companies Act.

Most of the organisational barriers that previously stopped the foreign working capital in appearing in Hungary were abolished by the Companies Act. It became possible to form a business association with a majority or even with a 100 percent of foreign interest in it. It is an important fact with respect to study's subject, since most of the business associations established with foreign participation or exclusively with foreign capital by a foreigner belong to the category of medium-sized enterprises. Simultaneously with and jointly to the Companies Act's entry into force the Act XXIV Regarding Investments by Foreigners in Hungary was passed, too.

The Companies Act is not only significant with respect to its content but also to its volume. It consists of more than three hundred paragraphs, three major parts and seven chapters. In the first part the fundamental rules related to business associations are formulated in a principled manner and it contains general provisions that apply in part or in full to each form of business associations. The second part gives detailed rules of the business associations separately. The third part contains the closing provisions. The followings can be stated about the above mentioned.

Among the general provisions on business associations the provisions concerning the foundation of business association are of importance. The le-

gislator started from that the business association is a contractual relationship between the members that comes to existence by unanimously and mutually expressing the will of the partners. In accordance with that, the Companies Act provides that a contract of association is needed for the foundation of a business association. The basic document of the one-man limited liability company is called the instrument of foundation, while in case of the company limited by share it is called the articles of association. The contract of association regulates the relationship of the partners for a long period, but it has important provisions related to third persons, too. Thus the Companies Act stipulates the written form as a validity condition, the breaching it makes the agreement null and void.

Though the contract of association need not to be embodied in a public document or in a private document of full probative effect – signed by two witnesses –, it is essential, that it would be signed by all members and counter-signed by an attorney (legal adviser).

The general rule of the Companies Act with respect to the contents of the contract of association declares the freedom of contract, that is the members can freely determine the content of the contract within the limits of the law. It means that the majority of the provisions laid down in the Companies Act is permissive in nature, that is they are applied only if the members do not agree otherwise regarding the matters in question. In other words, the contracting partners can formulate the content of the contract of association according to their ideas and interests within the limits of the laws.

The provisions on the company limited by shares, however, are mandatory, and the partners have less contractual freedom. By establishing this form of business association the partners may depart from the provisions of the act only if it is expressly allowed to.

We could consider Section 21 of the Companies Act as a safeguard provision. It stipulates those content elements of the contract of association that should be included by the associating partners. These are the followings:

- the firm-name and registered address of the business association,
- the names of the members (and the firms) and their address (registered address),
- the activities of the business association,
- the assets of the business association and the time and the manner in which they will be made available,
- all the provisions specified as obligatory by the Companies Act for each form of business association.

The contractual freedom does not mean that there are no other legal restrictions concerning for example the determination of the firm's name. The already cited Act on Court Registration and Legal Supervision of Firms defines the principles (exclusiveness, reality, particularity) that have to be taken into account by the associating partners.

The Companies Act makes the foundation of business association and the participation in existing business associations wide open for all natural or legal persons. In principle this possibility is existing for the state, legal persons, partnerships without legal personality and natural persons (Hungarian and foreigner), too.

It does not mean the restriction of contractual freedom that some activities (financial institutions') may be conducted only in the prescribed form of business association, other activities may be engaged in only under a concession contract, or sometimes certified qualifications or licence by an authority are required.

When establishing a membership relation the provision on the prohibition of accumulating unlimited liabilities as a creditor protecting provision has to be considered by the associating partners. Thus a natural person may be a member with unlimited liability at any one time of only one business association.

Since 1992 the requirements of the related international recommendations (ISIC Rev. 3 and NACE Rev. 1) have been in effect for formulating the activity of a business association in the contract, because the harmonisation of national sectoral categories is greatly emphasised at the international level.

The assets of a business association are made available by the members. At the time of foundation, the assets of the business association consist of cash contribution and non-cash contributions. The member supplying the non-cash contribution is liable to the business association for a period of five years from the date of the contribution with regard to that the value of the contribution at the time of making it is as indicated in the contract of association. If it is proved within that time that the value of the non-cash contribution was less at the time of supplying it than the amount indicated in the contract of association, then the person who supplied the non-cash contribution is obliged to round off his contribution with cash or an additional non-cash contribution to that amount.

The members have financial interest in the operation of the business association. It is not limited to the obligation of supplying the financial contribution, it manifests in that the members jointly share in the net earnings and the losses during operation. Within that the measure of share of each member may be free-

ly determined according to the provisions regarding the different forms of business associations.

The market stability and the public interest demand that only business associations formed in accordance with the laws would participate in the business life. Because of that the foundation has to be notified to the court of registration and all the related important documents need to be filed, too. The registration procedure starts on request, it is not based on the court's own initiative.

To prepare and to obtain the documents needed for registration take time, thus the Companies Act stipulate a thirty day period for filing the notification for the purpose of registration. The omission or delaying in sending the notification may be sanctioned by levying a fine.

Following the filing of the notification for registration the court of registration examines the legality of foundation on its merits, and after verification it registers the firm. The business association comes into existence by its registration in the firm register. The writ of the court of registration ordering registration has retroactive effect, that is a business association as an independent subject of law can be considered existing by the registration in the firm register.

For practical purposes the Companies Act links the existence of the business association not to the registration in the firm register but to the time of the conclusion of the contract of association or the adoption of the articles of association.

The business associations are market actors, they enter into contractual relations with different business partners. Following registration, that is why is it necessary to publish the most important data of the existing business associations. The court of registration publishes them in the Firm Registry Gazette.

If the court of registration refuses to register a business association it has to cease its activities after the receipt of the final decision. The interest protection of creditors of a business association under registration procedure is secured by the provision that stipulates that the persons acting in the name of a business before its registration are jointly and severally liable without limitation for obligations undertaken in the joint name.

Among the general provisions regarding business associations separate titles are dealing with executive officers, supervisory board and auditors.

Since most of the times the business associations are work organisations, it is reasonable to appoint a person or a board to manage the organisation and to fulfil the legal representation of the business association.



According to the act in effect the executive officers are: the general manager at the business union and at the joint enterprise; managing directors at the limited liability company and members of the board of directors in a company limited by shares. A person convicted for a crime and sentenced to enforceable imprisonment in a final judgement may not be an executive officer of a business association as long as he is not relieved from the detrimental legal consequences.

The executive officers, members of the supervisory board, and auditors may be elected for a definite period not exceeding five years. The business association is obliged to notify the court of registration in case of any changes concerning the registered persons.

The executive officers, members of the supervisory board and auditors have to act with such a care as may generally be expected of persons holding such office. They are liable according to the general rules of civil law for the damage caused to the business association through a breach of their duties.

Executive officers, members of the supervisory board, auditors often come to information during the regular course of conducting business that may qualify confidential. Executive officers are obliged to treat as confidential all knowledge, information, data, facts related to the proper operation and needed for its promotion if it is possible to keep them as confidential. If the executive officer breaches the obligation of confidentiality, the provisions of the Civil Code concerning the violation of rights pertaining to persons are to be applied against him.

The duty of the supervisory board of a business association is to oversee the management of the association. Pursuant to this it may require reports or information from the executive officers and leading employees of the business association, it may itself inspect or have inspected by an expert, the books and records of the business association. The supervisory board has to inspect all reports of importance brought before the supreme body of the business association, the balance sheet and the statement of assets and liabilities. The chairperson of the supervisory board announces the results of the inspection. Without that, no resolution may be validly adopted regarding the reports, the balance sheet and the distribution of earnings.

At concluding the contract of association the members of the business association may stipulate that the supervision over the management has to be carried out by an auditor instead of, or together with a supervisory board. It shows that the legislator endeavoured to make possible the participation of

impartial experts from outside in supervising the operation of a business association in any case. The election of an auditor is mandatory for companies limited by shares for the purpose of protecting creditors and minorities. Similarly the operation of an auditor is mandatory for one-man limited liability companies of which initial capital exceeds fifty million forints. The auditor may inspect the books of the business association, and require information from its executive officers and employees. It may examine the cash-in-hand, the portfolio of securities, the stock of goods, the contracts and the bank accounts of the business association. The auditor may attend meetings of the supreme organ of the business association and the supervisory board. He has to attend to the general meeting of a company limited by shares. If an auditor finds that a significant decrease in the assets of the business association may be expected he has to inform the supervisory board, in the absence of such board, the business association and has to request the calling of a meeting of the supreme organ of the business association.

The second and most extended part of the Company Act deals with each formation of business associations. The Company Act accepts the following forms of business associations:

- partnerships,
- business union,
- joint enterprise,
- limited liability company,
- company limited by shares.

From our study's point of view great attention should be given to partnerships and limited liability companies, since major proportion of the small and medium-sized enterprises belong to these two categories.

The Company Act defines the partnership as a basic form of business association without legal personality.

The partnership is a typical form of the individuals joining business associations. It is a wide spread and applied form in most of the legal systems. Primarily the partnership is a form of business association that is suitable for satisfying the needs of a business firm with small number of employees or often family business.

Their basic feature is the unlimited joint and several liability of the members and the obligation of the natural persons for personally taking part in the activities.

The legal formulation includes the above mentioned criteria when it provides that „by the contract of association aimed at forming a partnership, the members of the association undertake, with unlimited joint and several liability, to carry on common economic activities and to place the necessary assets at the disposal of the association”.

By examining the internal legal relations of partnership we can state that the contribution of the partner in cash and in expendable or replaceable things passes into the ownership of the business association, his other property contribution, in accordance with the provisions of the contract of association, passes either into the ownership or the use of the partnership.

In the contract of association the partners may entrust one or more partners with the management. Except for exceptions included in the Companies Act the partners make decisions related to the affairs of the partnership by a majority of votes, each partner has one vote. For making the most important decisions (e.g., to expel a partner) a majority decision of at least two-third is required. In fundamental matters the unanimous decision of the partners is required in partnerships.

Though the operation of a partnership is mainly based on the personal participation of the members, the Companies Act makes possible for the partnership to employ employees, contract labour, family member helpers and vocational trainees.

A partner is entitled for remuneration for his personal participation. The earnings and losses stated in the balance sheet are distributed among the partners in proportion to their property contribution.

For the obligations of the partnership the partnership is primarily liable with its own property. If it does not cover the claims, the partners are jointly and severally liable without limitation with their own property.

The Companies Act gives the itemised list of the termination of the business association.

The Companies Act defined the work partnership and the work partnership operating under the liability of a legal person as subtypes of the partnership. The provisions of the Companies Act previously in effect need to be applied to the work partnerships and work partnerships operating under the liability of a legal person that have been registered in the firm registry. This two forms of business association represent a significant proportion in the circle of small and medium-sized enterprises. It has to be mentioned that these forms may have been founded since 1981, and they helped to demolish gradually the prevalence of state companies and co-operatives. Probably a signi-

ficant proportion of them will continue to pursue their activities in the form of a partnership.

The Companies Act defines the limited partnership as a simple form of business association without legal personality. This form of business association is also considered as a subtype of partnership. It is one of the most often chosen form. Through this formation of business association it became possible to invest in business ventures under limited liability without personally participating in them for both natural persons and business organisations.

According to the Companies Act by the contract of association aiming at forming a limited partnership the members of the association undertake to carry on common activity, with the liability of at least one of the partners (general partner) for the obligations of the partnership being unlimited jointly and severally with the other full partners, while the liability at least one of the partners (limited partner) being limited to the extent of the property investment the partner made.

Since there is no mandatory minimum property contribution for establishing a limited partnership in the Companies Act, it became the favourite and often chosen form of business associations by those having smaller capital.

Limited liability company is the most often founded form of business association all over the world. This good position among the business associations is kept in the Hungarian economy, too. The statistical data shows that forty percent of the registered firms belongs to this type of business form. It is worth to scrutinise whether what makes this business form so attractive world wide and in Hungary.

The limited liability company is situated between the partnership and the company limited by shares. We could argue that it is mixed type of business association it is a fortunate mixture of the partnership with its personal participation and the impersonality, and the capital joining character of the company limited by shares.

The flexible organisational and operational rules regarding it makes this formation suitable for family type ventures or enterprises with few employees, and at the same time for a business venture established by several members with solid capital, too.

The limited liability company mainly differs from the partnership and the company limited by shares in its size. The partnership is a business association with few members. In the case of a company limited by shares the relatively high authorised capital is composed of the cash contribution paid up by numerous shareholders.

Considering this approach the partnership can be classified as a small enterprise and the company limited by shares definitely as large enterprise. In this

respect the limited liability company is situated somewhere between the two of them.

Because of the personal character of the rules regarding limited liability company it is not really suitable for the co-operation of more than thirty or even fifty members. Contrary to the regulations in some foreign laws, the Companies Act does not determine an upper limit in the number of members of a limited liability company. The experience shows that a significant proportion of the limited liability companies was formed by and operates with two-ten members.

In the case of limited liability company there is not much difference between the authorisation of the person practising the rights regarding ownership and the person managing business affairs. The members themselves may participate in the management of the business association or may pursue other kinds of business activities.

It seems that this form is good for making the members to consider the venture as their own, in contrast to the company limited by shares where the impersonal character of the business association is prevalent.

The limited liability company also differs from the partnership in that it is a legal person, and the liability of its members is limited to their furnished property contribution.

The other important characteristic of the limited liability company compared to the partnership is that the members are not obliged for personally participating in the activities of the association.

Besides some similarities there are major differences between the limited liability company and the company limited by shares. The following characteristics are worth to accentuate:

- it is prohibited to issue securities evidencing membership rights, more precisely property rights in limited liability company;
- there is a fundamental difference in the way the two forms of business associations are regulated. There are safeguard provisions built in the Companies Act, when the provisions regarding the company limited by shares are stipulated as mandatory. It means that the members may not deviate from the provisions of the act unless permitted by law. Contrary to those, the provisions on limited liability company are permissive, thus the members can freely deviate from the provisions of the Companies Act in the contract of association, except for the few cases when it is expressly prohibited. That is the contractual freedom is much more „extensive” in respect to limited liability companies than companies limited by shares;

- the organisation and the operation of the organs of the limited liability company are much simpler than the organisation and the operation of the company limited by shares.

The Companies Act gives the following definition for limited liability company: „A limited liability company is a business association formed with a prime capital made up of quotas of predetermined amounts, toward which the liability of a quota holder is limited to supplying his quota and other possible property contributions determined by the contract of association. A quota holder shall not be liable for the obligations of the company.”

It appears from the statutory definition that the member's liability towards the association primarily is to furnish his quota. Thus the characterising rule of liability is that the member's liability does not extend to his private property, thus it may not be counted on when paying off losses. Maybe it is not an overstatement that possible this peculiar liability makes the limited liability company so attractive to entrepreneurs. At the same time the Companies Act has several creditor protecting provisions since only the property of the association can be considered as a base to cover their claims.

The possibility needs to be mentioned here, that a limited liability company may be formed also by one man (one-man company). By this the legislator made it possible for the entrepreneur to start a business by himself where his liability towards the association is limited to his property invested in it. This is the only organisational form in Hungary that allows it.

The business union is one of the forms for small and medium-sized ventures. Their number is insignificant, the number of the operating business unions hardly reaches one percent of the registered firms. Through the regulation related to it, it became possible for the members with legal personality in the business union to supplement their main activities, and to operate such organisational units that would not be efficient to operate in other organisational conditions. In this form of business association the conditions of the organised flow of market information, common marketing activities, research and development can be favourable established. Usually the business unions are small in size and do not require significant capital investments. Contrary to the other types of business associations the business union does not aim at gaining profit for itself in the course of its business activities. The actual result of the activities conducted in the union appear in the members own management. The co-ordination, organisation of the management of the business union's members inevi-

tably brought about the demand for the interest representation of the business union's members in certain professional questions.

The Companies Act defines the business union in the following way: „A business union is a business association established by legal persons to promote the efficiency of their own management, to harmonise their business activity, and to represent their business interests. A business union shall not aim to make profit for itself, its members shall jointly and severally liable for the obligations of the business union exceeding its assets.”.

The joint enterprise is one of a peculiar organisational and operational form of the business associations that may be established exclusively by legal persons. It is a possible formation for property joining business associations. The joint enterprise conducts its business activities based on the furnished property contribution of the members. The members providing property contribution can influence the operation of the enterprise through the board of managers.

According to the definition of the Companies Act: „The joint enterprise is a business association founded by legal persons, which shall be liable for its obligation with its stock capital contributed by its members, and with its property other than the stock capital. If the property of the enterprise does not cover the liabilities, the members shall be liable jointly as guarantors in proportion to their contribution.”

The provisions relating the joint enterprise are similar to the stipulations regarding business unions in several aspects. The difference, however is significant in respect to liability and bearing risks. While the liability of the business union's members is unlimited, joint and several for the obligation of the union, the members of the joint enterprise are liable for the enterprise's obligation jointly as guarantors in proportion to their contribution provided for the common economic activity.

The joint enterprises similarly to the business unions do not represent a great number. The number of both business formations (business union, joint enterprise) is slowly decreasing, there are no new foundations. All of this indicates that we need not to count with this two types of business forms for the long run.

The Companies Act defines the company limited by shares as the most developed form of business association. Though this form of business association can hardly be put in the category of small and medium-sized enterprises, in practice some of the company limited by shares can be considered rather medium-sized enterprises than large business ventures. It is well demonstrated

by the definition given in the Companies Act on the authorised capital of the company limited by shares. In comparison with the limited liability company the followings can be stated:

- the amount of the prime capital of the limited liability company may not be less than one million forints, the sum of the contributions in cash at the time of formation may not be less than thirty percent of the prime capital and five hundred thousand forints;
- the authorised capital of the company limited by shares may not be less than ten million forints, the amount of cash contribution at the time of foundation may not be less than thirty percent of the authorised capital and five million forints.

Since part of the companies limited by shares are founded with the minimum authorised capital (ten million forints), consequently we could classify a certain number of the companies limited by shares as medium-sized enterprises. Thus within the framework of this study, the company limited by shares should be dealt with as a business form belonging to the category of medium-sized enterprises at least by examining its statutory definition.

The Hungarian and foreign legal traditions regarding business associations were taken into account in formulating the Hungarian legal definition of the company limited by shares. The such principle requirements prevail in the legal regulation regarding the company limited by shares like:

- impersonality,
- possibility for quick return on the invested capital,
- risk undertaking but with limited liability for the risk taking,
- complex internal organisation.

According to the Companies Act: „The company limited by shares is a business association formed with an authorised capital composed of shares of a predetermined amount and par value, the liability of the members of which is limited to supplying the amount of the par value or issue value of the shares. Otherwise the shareholders shall not be liable for the obligations of the corporation.”

The number of companies limited by shares shows an increasing trend, thus this form of business association, business venture should be accounted with for the long run.

### **3.3 Co-operations as possible forms of small and medium-sized enterprises**



A small proportion (6,616) of the registered firms (89,612) is operating in a co-operative form. Not counting the 1,300 agricultural co-operatives, the majority of the co-operatives can be classified as medium-sized enterprise. The known forms of the co-operatives (besides the agricultural co-operatives) are the industrial co-operatives, the consumers', sale and purchasing co-operatives, the savings co-operatives, and the other co-operatives (housing co-operatives, boarding-house co-operatives, etc.).

The new act on co-operatives undertook the democratic civil traditions of the when the following definition was formulated: „the co-operative is a community established in accordance with the freedom to assemble and the principle of self-help, it conducts business and other activities serving the interest of the members by the personal participation and the property contribution of the members within the framework of a democratic self-management”.

We need to pay attention to the conceptual element of the definition according to which the co-operative is a venture of the members. Since minimum five members are required for the formation of a co-operative, the given co-operative can be both small or medium-sized enterprise.

The new legal regulations concerning the co-operatives operating as legal persons show significant approach to the regulations regarding business associations. There was a time when the co-operatives were regulated (the Commercial Act of 1875) as a form of commercial association in Hungary. There is a separate act on co-operatives. The approach of the professional literature should be agreed with when the co-operative is considered such a business association to which the scope of the Companies Act does not extend.

The Act on Co-operatives starts from that the members of the co-operative are natural persons, though the articles of foundation may allow the membership of legal persons as well.

The provisions on foundation of co-operatives (the calling of the constitutive meeting of the general assembly, the approval of the articles of foundation, the election of the executive officers, the firm registration, etc.) hardly differ in principle from the legal regulations regarding the formation of business associations. The approaching similarity in the regulations is the result of the laws on firms that consider this formation as a firm, besides that the co-operative is classified as a business association.

Similarly to business association the co-operative comes to existence by the registration of the court of registration.

A peculiar characteristic of the co-operative is that it is operating within the frame of a democratic self-management. The content features of it are as follows:

- the members themselves decide on all the matters related to the operation and the management of the co-operative and other activities serving the interest of the members,
- the members establish through election the mandatory bodies and those required by their own need,
- the members themselves formulate the by-laws of the co-operative and first of all the articles of foundation,
- the members supervise the operation of the co-operative and the activity of the executive officers, and finally
- the members order the executive officers and managers to render account of their work.

The legislator follows the so-called classical co-operative principles in establishing co-operative membership relation (open membership), and in the statutory declaration of the members' basic rights and obligations. The member's interest is accentuated not only in the definition of the co-operative but also in the provisions on the property relationship between members and co-operative. The co-operative business share, which mostly emphasises the interest of the members, establishes the rights for sharing the realised profit according to the resolution of the general assembly on its distribution. A registered share for the member has to be issued about the distributed amount. The business share may be transferred or inherited.

A separate chapter of the Act on Co-operatives deals with the rules of mergers, disunions, transformations and terminations of co-operatives. Based on the resolution of the members the co-operative may transform into a limited liability company or a company limited by shares.

It needs to be mentioned that 1992 is a turning point for the co-operatives. In this year the co-operatives accomplished the so-called property identification, renewed the mandates of the executive officers, and decide on the approval of the new articles of foundation. The co-operative had to decide whether to continue its operation in a co-operative form or to transform into a limited liability company or a company limited by shares. The legal regulations made it possible for the member to leave the co-operative with his property.

Only two percent (1,968) of the registered firms (89,612) belongs to the category of state-owned company. Presently the several times modified and supplemented Act on State-owned Companies is still in effect. It regulates the foundations, organisations, management, etc. of the state-owned companies. We need to disregard it for two reasons. On the one hand the overwhelming majority of the state-owned companies cannot be considered small or medium-sized enterprise. On the other hand the different legal rules promoting the crea-

tion of the market economy based on private ownership induce the state-owned companies to transform into business associations, practically it means transformation into a company limited by shares in most of the cases.

To indicate the connections it needs to be pointed out that the Parliament passed an Act LIII of 1992 on the Management and Utilisation of the Entrepreneurial Property Remaining Permanently in State Ownership. The Decree of the Government No. 126/1992. (VIII. 28.) Korm. rend. determined the business organisations falling under the scope of the cited act and belonging to the State Assets Managing Corporation (*Állami Vagyonkezelő Részvénytársaság*):

- remaining permanently in part or as a whole in state ownership,
- conducting activities stipulated in the Act XVI of 1991 on Concession with state majority share.

The regulation indicates beside the name of the business organisation the proportion of the business organisation's registered capital to the permanent state property, and the business shares ensuring the state's permanent membership (shareholder) rights; in the case of minority permanent state ownership the minimum measure of state ownership; the fact that the business organisation undertakes national public utility services. The number of these business organisations slightly exceeds the two hundred.

The increase of the individual enterprises' (based on private ownership) share in the economy, and to become one of the significant factors of the economy are essential prerequisite conditions for building up the market economy based on mixed ownership.

The Act V of 1990 on Individual Enterprises creates the conditions for establishing a one-man business venture with unlimited liability that may conduct firm-like activities not just through personal participation.

The cited act regulates the conditions of founding, operating and terminating an individual enterprise. It defines the individual enterprise as a private enterprise in which a natural person conducts his business in his own name, and to his own risks, in a regular manner in order to gain profit.

A private enterprise can be exercised on the basis of notification and in the possession of an entrepreneurial card. The entrepreneurial card is a notification with a clause inserted by the authorised administration.

All entrepreneurs may be given only one entrepreneurial card, but it may conduct several business activities based on that card. The individual entrepreneur is obliged to participate personally in conducting the activity, though he may employ employees, contractual labour, helping family members.

Private enterprise may pursue activity only if it meets the required qualifications stipulated in the relevant legislative rules.

The individual entrepreneur is liable for the obligations originating from his activity without any limitation with his own property. Because of this a natural person may found only one private enterprise and may not be simultaneously a member with unlimited liability of a business association.

An individual entrepreneur may be registered in the trade registration kept by the court of registration, on his own request. In that case he will conduct his activity as a private enterprise.

Now the entrepreneurs still prefer business associations to private enterprises, it seems that there are financial and other reasons appearing in attitude for that.

The individual enterprises (private enterprises) almost all, without exception belong to small and medium-sized enterprises examined in this study.

The foundation of an individual enterprise is the right of all natural persons by the virtue of law. The act stipulates two conditions:

- unlimited capability of action, and
- permanent place of dwelling.

In case of meeting the above mentioned conditions only those may not start a business who are excluded from the circle of individual entrepreneurs by the itemised list of the act. Thus a person may not obtain an entrepreneurial card or certificate, if he committed one of the crimes against the purity of economic life, and has not yet been exempted from the detrimental legal consequences.

### **3.4 The common rules related to small and medium-sized enterprises**

The building up and the operation of the market economy require an authentic register that certifies the most important data (firm register) of the organisations operating in the economy, that makes it possible for the actors of the economy to transform their previous formation (transformation), that regulates the situation with respect to the insolvency of business associations (bankruptcy, liquidation, winding up), and finally that enforces the prevalence of the fundamental conditions of market competition, the freedom and the purity of market competition (prohibition of unfair market behaviour). Before analysing the major characteristics of the legal regulations belonging to this subject, we have to point out that naturally these regulations are applicable not only to small and medium-sized enterprises but to all actors of the economy.

The Act on Court Registration and the Legal Supervision of Firms covers the following subjects.

It gives the definition of the firm, according to which „a firm is a legal or natural person or their association registered in the firm register, that (who) conducts business activities under its own firm name in a regular manner, may acquire rights and undertake obligations and uses the firm name for its (his) signature”. In this place we can find the provisions on the authenticity of firm registration, publicity, rules related to firm name, definitions of the courts of registration obliged to keep firm records:

- the act deals with the firm registers, the data, rights, facts, included in them, the rules regarding firm registration, the rulings of the court of registration at the time of liquidating or winding up the firm under a separate title,
- in the general provisions on the firm registration proceedings the legislator stipulates that generally the registration happens on request. The provision serves the publicity and the safety of the market when mandating the publication of data, rights, facts registered in the firm register, in the Firm Registry Gazette,
- the act gives the objectives of the supervision of legality by the court of registration in a separate part, it provides detailed rules on the types and conditions of rulings regarding supervision that are applicable by the court of registration. Within this frame the court of registration may warn the person representing the firm to restore legal operation, it may levy fine on the firm, supervise the resolutions of the firm from the aspect of legality, may call the governing body of the firm, suspend the operation of the firm for a definite period, and finally strike the firm off the register and simultaneously declare its termination.

The declared aim of the Act on Transformation of Business Organisations and Business Associations is to present rules, by the statement of general succession, on the transformation of the business organisations into business associations and the transformation of the business associations from one into another, including their merger and disunion as well. According to the Act the organisation under transformation is obliged on the one hand to prepare a plan of transformation, on the other hand to prepare the balance sheet and to make it supervised by an auditor. It has to be ensured that the property of the organisation aiming at transforming would be transferred to the new organisation on its real value. At the same time the newly founded organisation needs to be protected from that the property recorded in an unrealistic value would not become a burden later on. There are several creditor protecting provisions built in the act (e.g., the publication of the transformation) in order to give guaranty for the creditors of the organisation aiming at transforming, and to avoid getting into a disadvantageous position because of the transformation. The proper exe-

cution of the transformation without any difficulty is helped by the stipulations regarding each form of business organisations.

The Act on the Procedure of Bankruptcy, Liquidation and Final Accounting is a new „product” of the economic legislation in order to give assistance, based on international and domestic experiences, in reorganising insolvent business organisations, through bankruptcy proceedings, and if it is not possible, in terminating them through liquidation procedure, and in „managing” the final settlement of solvent business associations about to terminate their business activities<sup>10</sup>.

The act affects all the actors of the economy being in a creditor or a debtor position. Its basic characteristics are the followings.

The act regulates three forms of the procedure, the bankruptcy, the liquidation and the winding up procedures.

The debtor may start bankruptcy proceeding against itself if it is probably that it cannot pay off its debts or it is already insolvent. Liquidation procedure may be conducted on the initiative of both the debtor and the creditor. In all three proceedings the main actors are the debtor, the creditor and the courts that follow the settlement proceedings regarding insolvency, and the final accounting settlement.

The act stipulates that in certain cases the head of a business association is obligated to declare bankruptcy, namely, if the business association is incapable to pay its debts back within a 90 day period following maturation. The head of the company is held to be liable without limitation with his own property for omitting to make the required announcements according to the general provisions of civil law.

The objective of the bankruptcy procedure is to allow a three month respite for settling the financial problems, and to prepare a plan for getting out of the deep crisis.

The liquidation procedure may be conducted at the request of the debtor, creditor, or the person responsible for the final settlement. In the case of an unsuccessful bankruptcy procedure the court starts the liquidation procedure. During the procedure due publicity must be ensured in order to protect the interest of the creditors.

From the beginning of the liquidation process on only the liquidator is empowered to make legal statements regarding the assets of the business organisation. It is a fundamental objective to reach an agreement between the debtor business organisation and the creditor thus the possibility is always left open in the course of the liquidation procedure to conclude a settlement.

On the basis of the final balance sheet and the proposal for property distribution, the court issues a writ on the termination of the business association.

In the event of a business association going out of business without a legal successor a final settlement of accounts is called for. On the basis of the notification of the top executive of the business organisation the court of registration announces the starting of the final accounting procedure in the Firm Registry Gazette. From that on the creditors may announce their claims to the accountant in charge of the final accounting within a period of sixty days. Following the preparation and approval of the required papers the court orders the striking off of the business organisation from the firm register.

Finally the most important provisions of the Act on the Prohibition of Unfair Market Behaviour need to be outlined.

The freedom and integrity of economic competition are basic preconditions of market competition that is causing economic efficiency. In order to protect the freedom and purity of economic competition forms of conduct that are contrary to fair market practices must be banned and supervision over the structural merger of enterprises must be introduced by creating the necessary organisational forms. Accordingly, public interest linked to economic competition, the interest of the competitors and in connection with fair market behaviour the interest of consumers must be protected by the law.

As a summary we can argue that the legal institutions of the market economy based on private ownership can be considered established. Their proper function can successfully serve the efficient operation of small and medium-sized enterprises.

### Notes

- <sup>1</sup> Act VI of 1988 on Business Associations
- <sup>2</sup> Act VI of 1977 on State-Owned Companies
- <sup>3</sup> Act I of 1992 on Co-operatives
- <sup>4</sup> Act V of 1990 on Individual Enterprise
- <sup>5</sup> Act XIII of 1989 on the Transformation of Business Organisations and Business Associations
- <sup>6</sup> Statutory Rule 23 of 1989 on Court Registration and Supervision regarding Legality of Firms
- <sup>7</sup> Act IL of 1991 on Bankruptcy, Liquidation and Winding up Procedure
- <sup>8</sup> Act LXXXVI of 1990 on Prohibition of Unfair Market Behaviour
- <sup>9</sup> More about it in *Sárközy T.*, 1989.
- <sup>10</sup> More about it in *Dancs M.*, 1992.

## **4 NATIONAL, REGIONAL AND LOCAL INSTITUTIONAL AND FINANCIAL SYSTEM OF ENTREPRENEURSHIP PROMOTION IN HUNGARY**

In the second half of the 1980s there were several institutional changes in Hungary that could definitely be seen as the institutional framework related to the market economy.

The development of the institutional system and its operation within the legal framework began in 1987–1988. In 1987 the two-tier banking system was created. In 1988 the multiple phase net sales taxation and the personal income taxation came into force, and in 1989 the comprehensive laws of founding and operating business associations were passed. The government economic policy programme published in 1990 requires the expansion of small and medium-sized enterprises in several areas and the extension of the private ownership's sector, and it promises numerous measures to be taken for their development. There has been a significant progress in the market economy and by it in the field of promoting entrepreneurship, though the measures concerning explicitly the small and medium-sized enterprises and the efficiency of building up the institutions do not correspond to the present and growing importance and role of the small ventures. Up till now the privatisation has not linked up with the development of small private ownership and small enterprises. The unpredictability of the economic conditions and the great uncertainty incline the stratum of the small enterprises to think in short run. Unfortunately the already existing different business developing programmes, measures, their institutions, the privatisation, and the decentralising measures taken to disintegrate the state ownership do not create a consistent system, so their efficiency is not adequate. The new Act on Accounting, the Act on Bankruptcy, Act on Financial Institutions coming into force from 1992 try to establish economic perspicacity, and unambiguously appreciable conditions for business environment. We see that among the most fundamental problems related to small and medium-sized enterprises are that the different supporting and allowance making measures and institutions do not integrate to a programme of comprehensive economic policy, so these measures are not efficient and predictable enough and inconsistent. The government's declaration and programme concerning small and medium-sized enterprises are missing. There is a need for establishing a governmental organisation that would effectively take part in forming the economic policy by its co-



ordinating role while taking the special requirements of small enterprises into account, by its resource allocating and advising role.

#### **4.1 Organisation and efficiency of the institution system**

Next we will examine how the institution system of politics and economic policy concerning small and medium-sized enterprises is built up, and how much it is effective in promoting. The extent of this study does not allow to examine the institutional system of the economic policy related to the enterprises in full width and details, so we concentrate those areas that are determinant in developing and supporting small and medium-sized enterprises in Hungary now.

##### **4.1.1 National institutions**

Despite lots of problems the national network of institutional system supporting small and medium-sized enterprises is building up. These institutions either indirectly as the institutions of the economic policy, or directly help in establishing and operating ventures. The institutional system that is able to guarantee the indirect promotion infiltrates to the institutions of economic policy. These can effectively serve the ventures in the following areas:

- insuring adequate and predictable legal conditions,
- by a system of money market and finance that capable of serving small enterprises, and a related scheme of promotions and subsidies,
- by a taxation system and social security that are calculable with a high level of certainty, and impose reasonable burdens on,
- elaborating a concept of privatisation considering small and medium-sized enterprises, and elaborating a sectoral and development concept relying on enterprises,
- by an institutional system of foreign trade policy relying on small and medium-sized enterprises, too.

The institutions of the following areas directly support, or at least they declare to undertake to develop and to promote small enterprises:

- the organisations of business federation of entrepreneur,
- banks, financial institutions and other financial funds dealing explicitly with financing small and medium-sized enterprises,
- business development foundations and agencies,
- consultant firms and agencies that give advice, furnish with information, and with operational promotions, institutions dealing with training entrepreneurs.

A contradictory picture not free of problems can be outlined about the national institutional system promoting ventures. The system of legal conditions for establishing and operating the small entrepreneurial sphere based on private ownership has practically been laid down. The freedom of venture is guaranteed on a statutory level. From now on the emphasis can be put on to eliminate the still existing legal and regulatory barriers, the legal conditions inherited from the previous regime. At the same time, however, the lack of a comprehensive reform of ownership and of the statute on privatisation without which there is a feeling of the economic government's in determination towards small enterprises, indicates problems.

The place and the role of the small and medium-sized enterprises within the process of privatisation is not clear-cut. It is to be feared that if the organisation of the Hungarian private capital into enterprises will be channelled on a different route than the one of the privatisation of the state ownership, then the domestic entrepreneurs that the government aspires to (GDP growth, employment, restructuring, etc.) will be left out from solving the nations' biggest problems. That situation would be helped on and the efficiency of privatisation probably would be increased, and its pace speeded up by the application and the propagation of the followings: to increase the demand of privatisation by such a credit construction within which both smaller ventures or private persons could buy state-owned properties under relatively favourable conditions. It also means that it would be possible not to buy the company only as a whole but shares of it. For that reason the supply structure of the privatisation must be altered, since the plant sizes of the previous, socialist companies do not suit the Hungarian entrepreneurs. It could be a further effective instrument if the institutions of new, flexible technics of privatisation will develop, the leasing, rent option, managerial buy out, etc.

The institutional framework of the financial system has developed. Though their role played in promoting, developing small enterprises are limited by the burdens as a result of and inherited from the previous regime, and also by the lack of domestic savings. Since getting hold of resources is one of the major problems of establishing and operating small enterprises in Hungary we deal with this problem separately, too.

The elements of the taxation system and the obligation for paying allowances lay a major burden on ventures. It is not the task of this study to elaborate it, but the elements related to the promotion and the restriction of small enterprises should not be neglected. Now the company tax is levied on every company, both on private company or state-owned company. It is indifferent with respect to ownership, size or area of activity. The average amount of the company tax is 40 percent, considering the different bonuses, exemptions the actual

curtailment is only 30–34 percent. The range of bonuses is quite wide. The problem, however, is that the circle of favoured ventures relatively often fluctuates and the preferred activities and areas often change. An additional problem is that the local governments do not receive anything from the company tax so they lose an important source for promoting ventures. The personal income tax component of the taxation system affects only those small entrepreneurs who do their business as individual entrepreneurs.

In 1991 the private ventures could choose between paying tax on their income according to rules of the entrepreneur's profit tax or the personal income tax. From 1992 this possibility was abolished. After that every individual entrepreneur will be obliged to pay tax on all of their income according to the rules of personal income tax. To avoid it probably a lot of them will form simple type of business organisation where the burden to pay tax is partly avoidable or can considerably be reduced. The third component of the taxation system is the general turnover tax (GTT) that is similar in its fundamental principle to the system used in the states of the European Community (Mehrwertsteuer, TVA, VAT). The GTT system does not have promoting or restrictive elements related to the small enterprises since it is prevalent in the sales sphere. The most important tax burden imposed on ventures is the social security contribution. Social security contribution is fully superimposed on wages and incomes. The burden of the obligation to pay the contribution is extremely high. The employee is liable to pay 44 percent of the wages or similar forms of compensation as social security contribution and beyond that 5 percent of the above mentioned incomes to the Solidarity Fund of Unemployed. The employees pay 10 percent of their gross income as contribution and 1.5 percent to the Solidarity Fund.

Similarly the individual entrepreneurs are liable to pay 44 percent under the pretext of social security, 6 percent as pension contribution, and 4 percent as health insurance. The current system of social security in effect means unbearable burdens particularly to those entrepreneurs who come under the ruling of personal income taxation. For that circle of entrepreneurs the two liabilities together mean 70 percent measures on the average. Payment obligation of entrepreneurs being on the personal income tax margin is close to 90 percent.

It also means that the entrepreneurs can freely use 30 percent of their income on the average, and scarcely 10 percent on the margin for their own existence and developing the firm. Since social security contribution is not imposed on dividends and interest-like incomes in Hungary, only 20 percent tax at source is imposed on them, thus it is more beneficial to the entrepreneurs not to reinvest into their own businesses. It can be said that the elements of the tax system related to incomes, particularly the payment obligation of social security

contribution keep back entrepreneurial investments into the real sphere, and decrease the propensity to save.

The foreign trade activity of the companies and firms are co-ordinated by the Ministry of International Economic Relations (*Nemzetközi Gazdasági Kapcsolatok Minisztériuma*). In 1991 the Investment and Trade Development Agency (*Befektetési és Kereskedelemfejlesztési Alap*) was organised with the objective to promote export activities and foreign investments. This institute is the trustee of the resources of the Trade Development Fund (*Kereskedelemfejlesztési Alap*) and the Investment Inciting Fund (*Befektetésösztönzési Alap*). Beyond that it assists the entrepreneurs in finding foreign partners, furnishes investors and trade partners with information. The current government policy tries to support the export activities, particularly the convertible export through different institutions.

The most important institute in supporting foreign trade development is the Trade Development Fund. In 1991 its resource was 5 thousand million forints. The Fund's promotion can be applied for by any company or firm through an export developing tender system with no restriction as to ownership or form of business organisation. It also means that there is no such institute that expressly supports the foreign trade activities of small and medium-sized enterprises in Hungary. At present the Fund is not available for export developing investments any longer. The other important institute of promotion is the Investment Inciting Fund. The resources of the Fund can be applied for infrastructure investment and participation in privatisation by limited liability companies and companies limited by shares if they are joint ventures with a capital exceeding 50 million forints out of which the contribution of the foreign investor is 30 percent and its 50 percent is cash.

The other important area of promoting foreign trade is the 10–35 percent export subsidy granted with respect to a defined circle of agricultural products. The current domestic business federations also help ventures to find foreign partners in their activities. Particularly the Chamber of Commerce (*Gazdasági Kamara*), the National Association of Entrepreneurs (*Vállalkozók Országos Szövetsége*, VOSZ) and the National Unions of Industrial Guilds (*Ipartestületek Országos Szövetsége*) endeavour to furnish entrepreneurs with information on foreign trade and to mediate their interest to the government organisations. In summary the institutional system supporting foreign trade serves small and medium-sized enterprises without differentiation. At the same time there is a need for founding an institution that expressly takes the characteristics of small enterprises into account and gives assistance particularly in the area of co-ordination and information flows.

#### **4.1.2 Directly supporting institutions**

Despite the problems and contradictions the development of the institutional system that directly supports small enterprises is continuous. Almost every day institutions are established with a declared objective of supporting small and medium-sized enterprises in some ways. Among the directly supporting institutions there can be found that is explicitly oriented to small enterprises, and some others, whose main profile is not supporting the small organisations, though related to founding and operating them. In the following we will be focusing on the institutions explicitly dealing with small enterprises.

#### **4.1.3 Business federations**

National Association of Entrepreneurs (*Vállalkozók Országos Szövetsége*, VOSZ) was founded in 1988 when it separated from the Small Entrepreneurs' Section of the Hungarian Economic Chamber (*Magyar Gazdasági Kamara Kisvállalkozói Tagozata*).

Presently it has a substantial membership: more than 5,000 members. Its membership is heterogeneous, including near 2,000 work partnerships (*gazdasági munkaközösség*) 1,300 limited liability companies (*korlátolt felelősségű társaság*, Kft) private entrepreneurs, craftsmen, and other forms of business associations. The main goal of the VOSZ is to represent the interests of entrepreneurs, to help in forming an entrepreneurship promoting economic policy through all possible channels. It gives professional assistance to new ventures. Now VOSZ operates 13 regional organisations and 14 professional sections. Its activity beyond representing and enforcing interests includes financing ventures, giving professional advice, and areas serving partner relations. For that reason they organised an Entrepreneurial Credit Club (*Vállalkozói Hitel Klub*) whose members, given the existence of normal credit conditions, can get credit from the Post Bank within 24 hours.

According to the agreement concluded with the National Insurance Company, members of VOSZ are preferred and receive a faster administration at the insurance company. Presently the VOSZ represents the interest of both small and large organisations, though considering its current activity it is rather an institution representing the interest of larger organisations.

The National Union of Industrial Guilds (*Ipartestületek Országos Szövetsége*, IPOSZ) was founded in 1990, partly based on the previous interest protecting organisations. IPOSZ is an economic, professional, interest protecting and representing union of professional Guilds founded by individual and joint private ventures. In the first half of 1992 135,000 members of 286 Guilds join

to the Union. IPOSZ is a full member of the International Industrial Union (*Nemzetközi Iparunió*), the International Association of Small and Medium-sized Enterprises and the International Union of Craftsmen. The fundamental objectives of the IPOSZ are to represent and to protect the economic and professional interest of the individual and joint private ventures. Its basic tasks include to propose state promotion for education and retraining, and to help to ensure professional replacement. It endeavours to serve small enterprises with business information. The regional organisations of IPOSZ endeavour to enforce the interest of small enterprises and to strengthen the economic policy suit to small enterprises at local governments.

Informational agencies of the IPOSZ were organised at local governments. In the area of international relation they use foreign promotion mainly for education and to renew professional training. To accomplish it the Intermerkant Educational Centre (*Intermerkant Oktatási Központ*) was founded by IPOSZ that educates, trains, retrains and gives information for craftsmen in several fields of business through its national network. IPOSZ also helps to finance small enterprises. According to the agreement concluded with Budapest Bank (*Budapest Bank*) the members of IPOSZ can receive credit on favourable conditions at this bank.

The National Association of Retailers (*Kiskereskedők Országos Szövetsége*, KISOSZ) is an old interest representing organisation, its legal predecessor operated in the previous regime, too. According to its objectives and activity it is a traditional interest protecting organisation. The organisation and the activity of the KISOSZ is similar to the ones of the IPOSZ from many aspects. KISOSZ gathers entrepreneurs being in catering and retail industry, while the IPOSZ is the organisation of craftsmen and artisans. The membership of the KISOSZ is not compulsory any longer, at present it has about 40,000 small ventures in its 21 member organisation on a volunteer base. Beyond representing the interests at the local level similarly to the IPOSZ it endeavours to represent the interest at the national level, too.

The Chamber of Entrepreneurs (*Vállalkozói Kamara*) was organised in 1990 mainly by associating smaller ventures. It does not have a legal predecessor, it is an entirely new organisation.

There is ambiguous information about the number of its members.

Considering its activity the main function of the chamber is to protect the interest of small enterprises now.

The National Association of the Hungarian Manufacturers (*Magyar Gyáriparosok Országos Szövetsége*, MGYOSZ) left VOSZ and has been ope-

rating as an individual organisation since 1991. The number of its members is not too high, it hardly exceeds 100.

This organisation has a long standing tradition in Hungary, it already operated before World War II. Presently it was again reorganised as the interest representing organisation of private manufacturers.

The National Council of Industrial Co-operatives (*Ipari Szövetkezetek Országos Tanácsa*, OKISZ) operated in the state socialist regime, the industrial type co-operatives belonged to it. It follows the objectives and tasks of its previous practice, it has lost a lot of its importance. Currently 19 regional organisations and professional unions belong to OKISZ.

The number of its members is about 2,000 co-operatives.

The Hungarian Agricultural Chamber (*Magyar Agrárkamara*) was founded in 1989 it is one of the most important interest representing organisation of the individual and joint business enterprises working in agriculture. Presently the Hungarian Agricultural Chamber has 40,000 individual members and about 1,000 joint business organisation having legal personality. It has several regional and 11 professional organisations.

The National Association of Agricultural Producers and Co-operatives (*Mezőgazdasági Termelők és Szövetkezetek Országos Szövetsége*) was organised as the legal predecessor of the National Council of the Producers' Co-operatives. It has a long standing tradition, it took partly over the previous regionally built organisational network, and has 22 member organisations. About 1 million agricultural producers and 10–12,000 agricultural producers' co-operatives belong to it.

The National Council of General Consumers' Co-operatives (*Általános Fogyasztási Szövetkezetek Országos Tanácsa*, ÁFSZOT) assembles the old General Consumers' and Marketing Co-operatives (*Általános Fogyasztási és Értékesítési Szövetkezetek*, ÁFÉSZ). It has a major, nation-wide organised network. Presently it assembles about 300 co-operatives, though the number of ventures linked to ÁFSZOT is substantially higher since close to 30 percent of the national retail and catering industry, and about 40 percent of the rural area link to ÁFÉSZ.

The National Union of Farmers Associations (*Gazdakörök Országos Szövetsége*) was organised as a new organisation undertaking agricultural interests. Building up its network is under process. Similarly the Society of the Agricultural Small Producers and Entrepreneurs (*Mezőgazdasági Kistermelők és Vállalkozók Egyesülete*) and the Association of Agricultural Small Producers and Co-operatives (*Mezőgazdasági Kistermelők és Szövetkezetek Országos Szövetsége*) are new organisations.

Beside these new organisations other associations and unions are continuously being formed with similar objectives undertaking the representation of small enterprises, too. We do not have reliable information on their national network-system and their membership.

The interest representation and protection was the privilege of some national organisations in monopolistic position basically organised at the sectoral level in the state socialist regime.

Most of the time it was compulsory to join to them. Parallel with the legalisation of the Hungarian private capital, the appearance of the new entrepreneurs and ventures, their spreading, and the differentiation of their interests, most of the old interest protecting organisations transformed and numerous new ones were founded beside them. Today the interest protecting organisations are formed partly on sectoral, and regional base. Since some of them undertake the general representation of the entrepreneurs' society as a whole, today we witness lots of overlap in many areas.

#### **4.1.4 National business development funds and agencies**

Almost every day funds and agencies dealing with different business development are being formed in Hungary. So we cannot undertake to consider all of them, only those of which activity is important on the national level.

The National Small Enterprise Developing Agency (*Országos Kisvállalkozás-fejlesztési Iroda*, OKFI) was founded as a government institution with national scope of authority in 1990. Its function is to hold together and to manage the business development and vitalisation at the national level.

Its objectives include to do research, to prepare surveys and case studies related to small enterprises. The Agency makes a proposal for the current objectives for long- and short-term policy promoting small enterprises, and it gives opinion on Bills. It should be mentioned that with the lack of a comprehensive business developing concept this type of work done by the agency is less effective. The Agency also makes proposals on the utilisation of financial funds separated for financing small enterprises. It organises the information system supporting businesses and gives assistance to business promoting foundations, banks and financial institutions in their co-operation. It regularly prepares and publishes different kinds of publications for entrepreneurs and ventures.

The OKFI organises the Club of Entrepreneur Houses (*Vállalkozóházak Klubja*) aiming at assembling the organisations dealing with business management and entrepreneurial consultancy into a Union. Currently the Agency is working on to build up a National Entrepreneurial Information and Service Network (*Országos Vállalkozói Információs és Szolgáltató Hálózat*). Organising



and implementing the tasks related to the Existence Credit belong to OKFI. It accepts foreign government loans and elaborates the credit granting conditions. The joining in the Working Group of Small Enterprises of the Pentagonale (*Pentagonale Kisvállalkozási Munkacsoportja*) is of high priority within the international relations of OKFI. The Council of Business Development (*Vállalkozásfejlesztési Tanács*) works by OKFI. The Council mainly assembles the organisations representing entrepreneurial interests, although numerous other organisations can be found among its members whose activity are related to promoting enterprises. The major objective of the Council is to formulate a unified standpoint with respect to ventures.

The last government of the previous regime founded the Hungarian Foundation for Enterprise Promotion (*Magyar Vállalkozásfejlesztési Alapítvány*, MVFA) for the expansion of small and medium-sized enterprises. Its initial capital was 4.2 thousand million forints. Additional financial resources were granted to it within the framework of the PHARE programme. In 1991 the amount was 18 million ECU, and till the end of 1992 an additional 5.5 million ECU can be expected. The areas of activity of MVFA are as follows: it manages the credit programmes for small and medium-sized enterprises, within its framework it grants not recoverable credits. It also actively participates in managing other credit constructions. It organises the foundation of Local Entrepreneurial Centres (*Helyi Vállalkozási Központok*) at the national level. Also the intention is that the centres will deal with credit placing. It proposes and promotes manager training and educational programmes, and consulting services. It organises the foundation of incubator houses for the inexperienced entrepreneurs. The SEED Foundation (*SEED Alapítvány*) was founded in 1990 with an initial capital of 20.9 million forints. With the promotion of the American Government (100 thousand USD), the *Soros Foundation* and the *Mellow Foundation*, it mainly helps the entrepreneurs just beginning. It offers an effective help for the unemployed who tries to establish his existence in the business sphere. The individuals, becoming entrepreneurs from being unemployed, are financially promoted in their starting for 6 months by a not repayable contribution that is equal to the amount of the unemployment benefit. The inexperienced entrepreneurs are helped by training courses, free consultancy, and information. The first incubator house was organised by the SEED Foundation and it helps to build up the national network of incubator houses.

#### **4.1.5 Entrepreneurs training supports**

Education and training should be mentioned within the institutional system of promoting entrepreneurship. At the beginning of the transition to market econo-

my the first curriculums and entrepreneurs training programmes came from western countries. They are mainly used in training courses and retraining programmes. Together with the change of regime the demand for teaching entrepreneurial knowledge and training entrepreneurs within the framework of the formal educational system appeared. It is still entirely absent from the basic educational system. One can find attempts and experiments in some of the secondary schools. The four years of secondary school are amplified by entrepreneur training courses after graduation at many places. These are qualification giving courses, after graduation they earn a diploma as managing assistant or clerk at banks. The current Hungarian system of vocational education is in a critical situation, the development of the new education system is in progress. The interest protecting organisations (IPOSZ) try to help on the problems of vocational education. Several local organisations of the IPOSZ support the regional educational institutions, in order to help their student to participate in foreign professional training programmes. Presently the higher education tries to find its possibilities for renewal. There have been successful initiatives in entrepreneurs training programmes at the universities and colleges. With the help of foreign universities the MBA training, the programmes of the Open University, and other manager training courses enjoying the promotion of foundations on different level started at several places. Different kinds of retraining programmes have been started with the support of the Ministry of Labour. There is a constant demand on the part of companies for manager training courses organised at universities.

The entrepreneurs' training is currently promoted by the following foundations.

Fund for Vocational Training (*Szakképzési Alap*) was founded through 1.5 percent compulsory contribution of companies and 1 percent of agricultural co-operatives for the promotion of professional training.

The Employment Fund (*Foglalkoztatási Alap*) serves extension training and retraining. Its resources from the state budget are supplemented by the compulsory contribution of the employers by 1.5 percent and the employees by 0.5 percent. The promotion of the Employment Fund can be won through a tender.

The 40 percent of the Funds' resources is centrally used and 60 percent is used in a decentralised way. There are no separate financial funds for training and education related to developing small and medium-sized enterprises.

The entrepreneurs' training is also promoted by foreign financial funds and foundations. The most important of them are the promotions of the World Bank in that area, the promotion that is realised within the framework of the PHARE programme, and the training and educational promotions given by foreign governments.

#### **4.1.6 Regional and local institutions**

Most of the above mentioned national institutions helping small enterprises have regional network. These institutions mainly have operating centres in the capitals of the counties or in larger cities. The regional and local small enterprise development shows quite a significant disproportion. The main reason for that is that the distribution of the small and medium-sized enterprises is disproportionate, too. At about 60 percent of the small firms are concentrated in the Capital and the County of Pest, the others' distribution between Western and Eastern Hungary is relatively balanced. Considering the distribution, however, at the counties level significant disproportion can be found.

The Act on Local Governments does not make it obligatory on the local governments to support ventures, at the same time the local governments have to undertake this activity in the long run. The initial steps and directions are currently taking shape. Presently the local governments rather concentrate on furnishing them with local information and building up its network. It includes from information on settlement development, and the practical questions of founding business organisations to almost every problem of entrepreneurs.

Presently the task is incumbent on the administration. The promotions and progression of small and medium-sized enterprises are of high priority in the programmes of regional development. It appears in both the developing projects made for small regions, and the so-called crises managing programmes of the larger regions in crises. The entrepreneurship promoting and serving local institutional system, however, has just started to evolve in most of the small regions. The local tax allowances can be considered as indirect entrepreneurial support. In 1991 there were about 1,500 regulations levying local taxes, but only one-third of it affected the entrepreneurs. Although the taxes were levied rather considering the fiscal aspects of local governments than by the motivation of progressing entrepreneurship. The local governments do not place enough orders to the entrepreneurs on market terms yet. This area of development depends on central political decisions, since it is not yet decided whether the local conditions of ensuring public utility services and public supply can be privatised or not.

The entrepreneurs' profit tax allowance is due to firms operating in backward areas, although it is 60 percent, it has proved to be insufficient. Considering the other items of taxation and the financing problems it does not speed up both the expansion of ventures and the investments aiming at crises solutions as it was expected.

The most often mentioned problem with respect to small and medium-sized enterprises is the insufficiency or the lack of local infrastructure. The scarcity of local resources does not allow to solve the problems at the given area.

Favourable results can only be found in developing telecommunication network, however, it is still not enough to attract investors.

The local governments have the opportunity to gain financial resources for developing enterprises by joining in the national tender system. Though this opportunity is given primarily for communal and infrastructure development. Arising from the economic reduction there are fewer resources available for developing enterprises. It is almost impossible to bring into being the local incubator houses, the entrepreneurial houses, the industrial innovation parks from local resources.

There are only a limited number of local financial funds in finance, the regional and local foundations (their number is significant) are unable to help to finance the enterprises because of the lack of resources. The local small enterprises do not know about the foreign credit opportunities, and promotions. Most of the related information can only be found in Budapest. The regional small banks and the local investment funds are missing, though they could be a great help in expanding enterprises in accordance with the local objectives and in partly undertaking the problems of credit. The local governments are allowed to promote the enterprises with real property or part of a house-property, but this type of help is very rare. Founding the credit bank co-operatives of small savers is still only a possibility since the legal conditions of it is given from this year.

#### **4.2 The financing system of small and medium-sized enterprises**

The currently operating institutional system of the money market, the two-tier bank system was organised in 1987 in Hungary. The aspects of financing requirements of the state and co-operative sphere were decisive in its shaping. During the last years the bank system developed a lot, its organisation, operation and services became more differentiated. Despite all of that, its structure is still not suitable for serving the private business sphere that requires special money and capital market conditions. Basically small enterprises primarily need initial and starting capital. This would require such a financing system that considering the small savings could provide the enterprises with initial capital, supply for later demands of expanding, and would be suitable for continuous financing of working capital. The financing system does not yet meet these requirements. The sphere of small enterprise has not yet become part of the banking activity on business grounds. The above mentioned types of financing require different credit devices and postulate the existence of lots of small banks and financial institutions serving special needs, too. The current commercial banks cannot carry

out the differentiated services, and a well proportioned financial system and the establishment of its structured institutions are still waited for.

So far according to the experiences it can be said that the smaller banks meet the financing demands of small enterprises on a higher level, and they try to take the special needs into account. The smaller banks are more flexible, can easily recognise the local demands, and try to adjust their offer of credit to them. Though it pertains to this that the claims of these banks include only a negligible stock of doubtful and irrecoverable debts inherited from the old state sector, thus the inherited burdens do not make their business policy rigid.

The position of the larger banks is less favourable. They have lots of irrecoverable and doubtful debts, their structure is inflexible, they were typically founded with an orientation to large enterprises. The large banks do not have experiences related to small enterprises, they often treat them with reservations.

The feature of the Hungarian financing system of enterprises is bank-oriented. It is particularly true for small and medium-sized enterprises. Virtually the only way to obtain initial and additional resources for this sphere is to ask for bank loans.

The sector of current private entrepreneurs and potential entrepreneurs do not own significant properties that could be considered as capital, their savings are negligible and as a result their own resource supply is on a low level. It became typical (and probably stays in that way for a while) to finance enterprises by credits in Hungary.

Currently the greatest problem of the entrepreneurial sphere is to launch the business and to finance the first years of operation. The most urging financial problem is to find the investment resources for founding, and launching the venture, and to ensure the initial working capital needs, later to maintain the continuous liquidity and to find the resources for market creation and expansion. It is particularly a major constraint for those enterprises that were organised for riskier activities ensuring later return in the manufacturing and processing industry. This also plays a role in that up till now the small and medium-sized enterprises were founded mostly in commercial and service industry that require relatively small capital investment and ensure fast return. It can be said that today the creditors are dominating on the Hungarian money market. There are numerous credit constructions available for enterprises including smaller units, too. The significant number of constructions, the excess of credit supply suggest that the business financing has been solved from the money market side. After analysing the actual opportunities, however, the situation is very

contradictory. The small enterprise financing is not at all solved, though the competition is a bit more vivid now in placing entrepreneurial credits.

The credit supply available for enterprises can be sorted according to the followings: credits from the World Bank, and other foreign credit construction based mainly on government agreements, privatisation credits promoted by the Hungarian government, and other domestic credits.

The conditions of granting and applying for credits were determined with respect to the credits and loans of the World Bank and other foreign credits by the giving financial institutions, with respect to the privatisation credit by the Hungarian government. To determine the conditions of normal small and medium-sized entrepreneurial credit placing is the task of commercial banks. The credit placing are generally characterised by the followings. Most of the time the banks grant the maximum days of grace, the determination of the term and the concrete conditions depend on the agreement concluded between the credit grantor and the grantee. The rate of interest varies according to the credit construction. The interest rate on credits that can be granted in foreign currency is fixed to the interest rate developed in the practice of the national money market, with respect to the forint credits it depends on the actual basic interest of the bank of issue, it follows the inflation rate. It depends on the type of credit construction that what is the required rate of entrepreneurial share. It may range between 15–50 percent. The entrepreneur has to provide collateral security for the applied credit, the measure of it may be 100–200 percent. Currently to depart from it is very rarely allowed. One of the major problems is to provide the collateral security and the question of undertaking guarantee. The banks require differently detailed business plan depended on the characteristics of the construction, and in some cases the presentation of the study of feasibility from those applying for credits. It is still difficult to draft them for entrepreneurs. We shall examine the most important credit constructions and their problems in the following chapter.

#### **4.2.1 Foreign credits**

The general feature of the foreign credits is that they are business like, organised charities are out of question. The number of credit opportunities and the amount that can be granted are relatively high, the commercial banks cannot place them all. Their basic characteristic is that they are firm-type, can be applied for both in forint and foreign currency.

Generally these credits cover 85 percent of the value of goods, thus the Hungarian importer has to have 15 percent own share at disposal. Promotion type of construction can be hardly found among the foreign credits. The western financial institutions effectuating the credit do not sign the contracts with the Hungarian commercial banks, they do not consider them „appropriate” yet. They enter into a contract with the National Bank of Hungary (*Magyar Nemzeti Bank*, MNB), this means negligible risk for the foreign governments. This activity, however, does not belong to the MNB, since this activity is not included in the activities of the bank of issue. These credit constructions are most favourable for the commercial banks, since there is no need for mobilising internal bank resources.

They can obtain liquid capital by calling it from the bank of issue without actually lending them out. These constructions are not really attractive for the enterprises since most of it could be used only for purchasing in the given foreign country.

The other obstacle is that the minimum amount that can be applied for is too high for the Hungarian entrepreneurs, audits scope of use is very limited. Practically there is no chance to obtain a medium-term foreign credit today. The new-comer entrepreneurs cannot use the credits for building their company seat or to finance the current assets. Another peculiarity of the credit is that the charged interest together with the other costs and fees superimposed on it, makes it more expensive to obtain it in Hungary than in the country of origin. It can be said that only few Hungarian entrepreneurs are interested in these constructions as a result of the numerous limitations and restricting factors. At the termination of the foreign general contract only part of the available resources could be lent out in the entrepreneurial sphere. In the near past they either prolonged the dead-lines or the negotiations are being carried on. Only 9–30 percent of the import promoting amount was granted. Till the beginning of 1992 only 47 million DM were called in from the Bayern 250 million DM credit by the commercial banks. The commercial banks called only 70 million DM from the 250 million DM credit construction of the province of Baden-Württemberg. The actual amount of placing is much less than that. An additional problem is that the entrepreneurs have only limited information about these constructions. The transit time of the credit construction is too long (3–4 months) for the small enterprises. One of the fundamental reasons for the negligible interest is that the credits are target oriented, they are linked to purchasing foreign investment goods, meanwhile the potential entrepreneurs want to operate in the commercial and the service industry. The most significant foreign credit opportunities are

the followings: the export stimulating credit granted within the framework of the III Structural Adjustment Programme provided by the World Bank. This can be applied for by those business associations whose 30 percent of sales revenue comes from convertible export. The maximum amount is 776 million forints, and it requires 25 percent of own share. The credit can be used at the expense of the basic interest of the bank of issue and banking costs for 12 years with a 3 year grace period.

The credits of the Inter Europe Bank-European Investment Bank can be applied for practically any of the entrepreneurs, however, the joint ventures with participation of Common Market partners are favoured. Minimum 20 million HUF maximum 200 million HUF can be applied for with a 50 percent own share, for seven years, with 1–2 year grace period, at 26–28 percent interest.

The Budapest Bank–IFC loans and quasi-equity construction is available for private companies with majority share and co-operatives if they are not operating in the area of commerce, finance or real-estate business. It can be called in forints or foreign currency with a 25 percent of own share, for 3–9 year term, with a 4 year grace period, at the basic interest rate of the bank of issue plus 1.5–3.5 percent costs. The minimum amount in foreign currency is 100 thousand DM, the maximum is 8 million DM.

Special employment promoting credit construction is available for the country's four counties in crises, practically all ventures pursuing industrial activities can apply for it. The own share is 25 percent. It can be granted for maximum 10 years, with 3 year grace period at the basic interest rate of the bank of issue plus 6–7 percent commission.

The special small entrepreneurial foreign credit construction is available for small enterprises with less than 60 employees.

It is fortunate that in this case there is no minimum figure given. Maximum 11.7 million forints credit can be granted by 25 percent of own share, for 10 years with a 2 year grace period, at basic interest plus 6–7 percent commission.

The entrepreneurial credit of the DG Bank Frankfurt „UNICBANK Founds” is a special credit, only the Union of Confidence Guaranty can apply for it. Only those enterprises can apply for it that can show two successful years in business. Own share is not required, it can be granted for maximum 2 years. There is no interest charge on it, only the charge of undertaking guaranty and a minimal commission have to be paid. The available amount is 1 million forints.



The other major group of foreign credits can be used basically for purchasing investment goods in the given country in accordance with the government agreements. They function as import credits. The itemised presentation of them is not possible within the framework of this study, thus we mention only the important ones and concentrate on their common features. The most important of the import credits based on bilateral agreements are the Finnish, Sweden, Italian, Japan, Bayern, Canadian, French, British credit construction and of Baden-Württemberg. The other group of import credits is provided by foreign banks. The most important form these are the Swiss and the Belgian construction. The common feature of them is that it can be drawn on only to purchase foreign investment goods by already operating enterprises. The joint ventures formed with the participation of the investors of the given country are always preferred. The available minimum amount is very high in all constructions, the maturity is only a few years, ranges from 2 to 9 years, in many cases the grace period is only a few months, the interest conditions follow the foreign interests. These credits are also characterised that the foreign partner hardly ever undertakes guarantee, the entire rate and business risk rest on the Hungarian entrepreneurs.

#### **4.2.2 Domestic credit opportunities**

The commercial banks as a result of lack of internal resources grant entrepreneurial loans only for a year period for their own clients. This is included in almost all of the financial institutions' activity, on condition that the client is solvent, possesses the required collateral security, and is capable to pay off according to market conditions. These normal loans are almost unattainable for a newcomer entrepreneur. The most favourable forms of domestic credits are the constructions provided by government funds.

The Existence Credit (*Egzisztencia Hitel*) and the allowance of paying by instalment should be mentioned on the first place among the domestic credits. This privatisation promoting credit can be applied for by native private person and their associations, co-operatives, and in addition the organisations founded for the realisation of the Employees' Share Ownership Programme (*Munkavállalói Rész tulajdonosi Program*). The conditions to obtain the credit are favourable, the interest rate is 60 percent of the given basic interest of the bank of issue plus 4 percentage point. The required own share, the maturity and the grace period are differentiated with respect to the amount of the credit. By this time the conditions of applications are loosened but still the conditions of obtaining and payment are hard on the entrepreneurs. It is favourable that by now state shares

can be purchased from E-credit, and the credit can be used for acquiring right of tenancy, and the 50 million forints upper limit of credit application is abolished. The restriction is, however, that the entrepreneur has to cover the costs and expenditures of privatisation, additionally to insure the credit rest on the private individual and not on the venture. An additional restriction is that the instalment payment has to be paid from the after tax income.

The START Credit (*Start Hitel*) provides loans minimum 500 thousand forints, maximum 10 million forints for new private entrepreneurs and firms operating not longer than 3 years.

Extremely strict conditions are prescribed for obtaining the credit. Often 150–200 percent collateral security is required, a beginning entrepreneur can hardly ensure it. The interest conditions are favourable, it is 75 percent of the interest rate of the bank of issue, together with the granting commercial bank's interest margin. This construction came into existence with the 100 million DM promotion of the German Government with the addition of the same amount of resources from the MNB in 1991. Last year they could place only 3.8 thousand million forints. The reason for this is probably the high at about 30 percent own share for the beginners, and the intolerable instalment payments. In the second half of this year the demand for this credit construction has increased.

The reorganisation promoting credit and the interest subsidy can be applied for by transformed state companies or for purchasing the co-operatives' properties being under bankruptcy- or winding-up procedure. Native private persons and business associations with Hungarian majority can apply for it. The structure of the construction is similar to the credit placing on money market. The financial institution determines the maturity, the interest charges, the measure of own share. The credit can be obtained on competition, the entrepreneur can choose from different conditions at formulating the measure of the interest subsidy.

The National Technological and Development Council (*Országos Műszaki és Fejlesztési Bizottság*, OMFB) grants promotions aiming at innovation to entrepreneurs qualified solvent by commercial banks from the central financial fund on normal money market conditions. The OMFB undertakes 50 percent of the interest charges in this construction.

The commercial banks grant credit aiming at export stimulation for the solvent clients within the framework of Export Stimulating Tender System. The 70 percent of the resources needed for the credits are refinanced by the MNB. This credit granting is oriented around a limited circle of entrepreneurs.

Only export is accepted as performance, it is a condition that the return on investment should be realised within 5–10 years.

Other promotions can be obtained beside this credit, thus promotion for R+D activity from the Technological Development Fund, also exemption from

paying given interest charges can be applied for, and tax allowance can accompany this form of credit.

The micro credit programme of the Hungarian Business Development Foundation (*Magyar Vállalkozásfejlesztési Alapítvány mikrohitel programja*) is a typical small enterprise promoting construction. This credit can be obtained by enterprises founded not earlier than 2 years, with less than 10 employees and if the initial capital of the firm does not exceed 1.5 million forints. Maybe this is the only construction that helps to finance the operational problems of small enterprises, since it can be applied for without own share for a relatively short maturity (minimum 6 months, maximum 3 years). It is a complex credit form since it includes loans and subsidies simultaneously. Currently it can be only applied for in the six Regional Entrepreneurial Centres of the country.

We should mention among the domestic credits the credit opportunities linked to the membership of interest representing organisations. Unfortunately up till now there are only two favourable constructions like that in Hungary. One of them is linked to the membership of VOSZ. VOSZ members can gain credits within the framework of the Post Bank and VOSZ Entrepreneurial Credit Club construction. The credit conditions follow the actual money market conditions of short term placing. The other similar construction is the joint credit of the Budapest Bank and IPOSZ. The members of IPOSZ can quickly get credit for 6 months on the terms of the interest conditions prescribed for short-term credits.

Considering the previous things it can be seen that the financial promotion of the ventures is not yet solved in Hungary, only the framework of the institutional system is suitable to serve effectively the money market financing of private capital. The fundamental operational conditions of the two-tier bank system and its institutions are given, but the other financial institutions are missing. There are deficiencies in numerous areas. There are only a few offers of credit that would effectively serve the short-, the medium-, long-term financing of small and medium-sized enterprises. The money market financing of starting a business imposes unbearable burdens on entrepreneurs. All the credit expenditures, the risk, the undertaking a guarantee to ensure the collateral security are all on the entrepreneurs. There is a need for more institutions, financial funds, that provide interest promotions and would undertake the interest and the rate risk. There is also a need for longer grace period, and more favourable payment instalment accounting. At most of the credit construction the financing expenditures can set against the after tax income. The government is working on the elaboration of the credit guaranty system. This year the General Guaranty Fund and the Small Entrepreneurial Guaranty Fund will come to existence, and their

central institution, the Entrepreneurial Credit Guaranty Corporation is being organised.

According to the plans the institution would undertake guarantee for 80 percent of the granted credit with objectives determined by the banks.

An additional problem is that the financial institutions in charge of the entrepreneurial capital fund and the ones dealing with small investments are absent from the money market. The Hungarian Investment and Development Corporation as a centralised institution is not capable of effectively financing enterprises. The regional and locally organised small banks and financial institutions are also missing. The local governments do not play almost any role in financing local enterprises. It needs to be mentioned that some of the sectoral ministries have not yet built their regional network, their business, service and information system. These, however, could effectively help the local enterprise development by furnishing them with information, and granting and distributing credits for investments, developments related to local programmes. The regulatory system is also a barrier of effective financing. The transit time of an actual development credit is so long that by the time it is used and the payments are made the regulations mainly the stipulations of taxation might have changed more than once.

## **5 ENTREPRENEURSHIP AND REGIONAL POLICY IN HUNGARY**

### **5.1 The regional dimensions of the crisis**

The effects of the economic and social crisis in Hungary can be detected in all parts of the country; they force a modification and revaluation of the development fundamentals. The consequences of the crisis manifest themselves in different ways in different structures. In regions with weak structures and in monocultural settlements, new types of regional phenomena – like unemployment and impoverishment – are the results of economic stagnation or decline. Depressive processes – showing social and economic decay – have emerged owing to developmental problems in certain sectors and management deficiencies in industrial regions traditionally considered to be developed. The worsening of the economic conditions within the agricultural sphere has led to the development of stagnant agricultural regions. The income-producing ability of the productive sectors has gradually decreased, occupational forms like these have lost their former potential to develop the region and the settlement. Lacking resources and a consistent conception economic policy, developmental projects for the underdeveloped areas are of little effect.

The growth of problematic regions of the country has come to a turning-point. The course of regional and settlement development has arrived at a dead-end. The answer to this crisis situation is to establish a modern economy to transform the economic structure. In the last decades, it was typical for the policy of regional development in Hungary to try to restrain the inequalities to an extreme extent. The level above which inequalities were considered to be undesirable, excessive, unjustified, politically inequitable, etc. was determined differently from time to time and a gradual moderation and suppression of the inequalities was aimed for. The regional cross-section or level where the regional policy thinking and activity were conscious of the inequalities and tried to moderate them was similarly changing. There was a constant striving after the reduction of the differences between the various counties, once embedded in the system of large territories (regions), at other times the base of comparison was made up by the diverse development of capital–country, village–town, and industrial and agricultural regions.

Apart from partial transitory results, none of these efforts achieved overall success and, with the decline of the socio-economic environment and the development of the crisis, enforcing a structural change in the economy and the reor-

ganisation of the political system, the inequalities increased to a great extent and a territorial polarisation could be observed.

There were four basic processes – each one creating regional crisis in its own right – intertwined and having their effects at the same time:

- the problem of the historical expansion of disadvantaged regions, the ever increasing backwardness of rural areas and finally their falling behind, and the inability to develop in rural and agricultural regions without centres;
- the transformation of the role and market conditions of certain productive sectors especially in those cases when these sectors played an important role in the economic structure of a region and there was a need for radical changes in the regional economic structure; a good example of that are regions with the dominance of heavy industry, the crisis of classically depressed regions;
- the rapid collapse of the economic systems of Eastern Europe and the new economic orientation to the world along with the extension of market relations have plunged the whole Hungarian economy, and within that the various regions, in different ways into a critical state;
- the change of the organisational and functional structure of the economy as a result of the change in the social-economic system, which, on the one hand, is determined by the change in the ownership (privatisation), on the other hand, by the reorganisation of the economic organisational system, the selective disintegration of the formerly dominant large industrial system, the establishment of small and medium-sized companies at a rapid pace, and the spreading of enterprises.

The most obvious outward form of regional crisis is unemployment, with the necessary contraction of the state sector as its determining cause. As a result of the regional division of large state industry and the regional unevenness in the progress of the economic structure, sharp social tensions caused by unemployment can be observed mainly in the eastern parts of the country (the Great Hungarian Plain having low-level technologies and industrialised through factory resettlements from Budapest in the sixties) and in the north-eastern centres of heavy and extractive industry (Miskolc and surroundings). In November 1991, the national unemployment rate came to 7.3% (351,000 unemployed), in the eastern regions of the country it was 10–14%, in the western areas it was 4–7%, and in Budapest it amounted to 2.4%. (Unemployment has spread quickly: in January 1990 there were 23,000; in January 1991, 100,000; and in June 1991, there were 186,000 registered unemployed in Hungary. The pace of the increase was seventeen times higher at the end of 1991 than at the beginning of 1990.)

The general crisis of the state sector meant a basic alteration of the state labour market in Hungary. As a result of the decrease in the production and the number of workers in industry (and the spreading of small and medium-sized

companies to be dealt with later on), there have been three regional types to be outlined.

In the central regions (Budapest and the counties around the capital), state industry has contracted and the private economy shows a strong development, there is deep organisational slump in the eastern parts of the Great Hungarian Plain and in north-eastern Hungary, while other regions of the country find themselves in a transitory situation (which of the previous two groups they are going to join is not clear yet).

In Eastern and Central Europe – owing to historical misfortune – the demand for three basic changes has accumulated in the past one and a half decades (*Enyedi Gy.*, 1990). *Firstly*: with the completion of the industrialisation, there is, a transition into the post-industrial phase, which took place in the sixties in Western Europe, at the time of the prosperity of world-economy. *Secondly*: there are changing structures and technologies, which the economy proved to be absolutely incapable of. *Thirdly*: the socio-political change in the system in the former socialist socio-economic model repressed the development of the forces of production.

The economic reorganisation is made difficult, however, by the fact that all these significant changes have to be carried out simultaneously. The macro-structural change of the economy has to take place at the same time as the technical-technological and organisational modernisation of the industry. All these are to be realised in a period of time when:

- the growth rate of the economy has decreased, there is a continuous decline in the economy,
- the effectiveness is extremely low, there is a wasting of economic resources,
- a big part of the population has become poor, the social polarisation exceeds the degree typical for market economies,
- there is open inflation,
- unemployment and the external and internal debt have increased,
- regional disparities are growing rapidly.

Although there have been several concepts formulated on the modernisation of the Hungarian economy and society, and they show essential differences as to their political or economic-philosophical affiliation, they still have something in common, namely that they all assign an honoured role to the small and medium-sized companies in the process of the structural change of economy and the creation of the property relations in Hungary.

In the countries of Eastern and Central Europe fundamentals necessary to the economic development of small and medium-sized companies – and to the framing the market conditions – differ from each other to a great extent. The

course of development is different from those of Western-European countries because of peculiarities of the historical background, while Hungary's special position within the East European bloc is due to the heterogeneous effects to the reforms started more than twenty years ago. The experiences of the semi-market solutions facilitate the transition of the market economy in Hungary; however, the shortage of capital, the accumulated tasks of modernisation, and the flexible political conditions show various alternatives for development. The fast development of the small and medium-sized company sector will probably lead to economic, regional, and political decentralisation.

## **5.2 The development of the economic organisational system**

In the history of the modern Hungarian economy over the past one hundred years, a particular dichotomy of the big industry and the small-scale production can be observed. At the end of the 19th century, the manufacturing industry started from a weak basis and then developed rapidly. This process led to the success of heavy engineering. While in 1880 only 21% of all industrial workers worked in big industry, at the turn of the century this figure was 40%, and in the 1910s more than 50% of the 563,000 industrial employees were involved in it. A high level of concentration was typical for the manufacturing industry. More than one third of all employees were to be found in 4% of all the factories. More than half of the workers in big industry were employed in factories with 21–100 and above 1,000 workers. The category of the medium-sized company was missing. Besides the organic development of industry, there was a great need for industry to produce consumer goods.

In the new situation after World War I – the territory of Hungary was reduced by two thirds, its population was decreased by 60% – the level of concentration reached at the beginning of the century was basically not changed. The number of medium-sized factories, missing at the beginning of the century, had increased in this period through the establishment of several textile, paper, and other kinds of factories. Forty-five percent of industrial workers were employed in small-industry and they produced 28% of industrial output. Seventy percent of small industry production came from the clothing, food, and building industries and the catering trade.

The preparation for World War II – the war-boom – extended not only to the manufacturing industry but to small industry as well. The war production meant economic strengthening for small industry, too; its share in the industrial production, however, decreased in 1940 to 25%.



In 1945, the level of production of the manufacturing industry was about one fifth of that before the war; in 1946, it was little more than one third; and in 1948, it had attained again the level of in last year, before war. In the very same year the fundamental transformation of the Hungarian organisational system of the economy was started: ownership competence. This process went on for two years and sealed the further development of the Hungarian economy, for four decades Hungary was separated from the modern European trend.

The establishment of the socialist sector was started with the Act XXV of 1948, according to which all industrial, transport, mining and smelting companies, and power stations with more than 100 workers that were privately owned, during the time preceding the existence of the act went over to state ownership. Six hundred companies were involved in the nationalisation, 83.5% of all workers of the manufacturing industry became employed in the state sector. All heavy industry companies were nationalised but only 25% of the workers in the textile industry (13% of them in the leather industry), and 55% of the employees of the food industry stayed within private companies. At the end of 1949, industrial companies having more than 10 workers went over to state ownership and some industrial branches were fully nationalised. Two thirds of the foreign trade, the whole branch of wholesale trade, and the retail trade for its main part went over to state ownership.

One of the most significant changes of the economic organisation system was the increase in the concentration of the production. In 1950 there were 1,427 industrial companies and in 1965 only 839. The average staff number increased from 336 to 1,183 in 1950. Less than 30% of all workers were employed in industrial companies with less than 500 workers in 1950, while in 1965 only 10%. At the same time, large companies with more than 5,000 workers employed 35% of all workers compared to 17% formerly. This kind of concentration – coupled with regional concentration (even at the end of the sixties, 44% of all industrial workers were employed in the agglomeration of Budapest) – was for the most part only the result of organisational changes and the steps of centralisation, and not of real concentration processes.

The economic reform introduced in 1968, the moderation of the central planning system, and the growing importance of company independence in Hungary put an end to the growth of factory and company size, and it even started the process of decreasing size. Although in the mid-seventies – due to the pressure of the Stalinist groups in the state party – there was additional growth in the size of firms in the manufacturing industry, at the end of the seventies with the strengthening of the Hungarian economic reform, a slow and gradual process of the decrease in the proportions of companies and factories occurred. Through government measurements, following the demands for realism, some monopolistic organisational blocks were abandoned. Decentralisation first took place in the food processing industry, then in some other

branches of industry, too. The new perspective gained more and more importance in the modernisation of organisational system as they gradually tried to do away with the conservative traditions of the past and align the system to a market economy. The decentralisation measurements of the government, however, reflected the viewpoints of the company proportions in the late seventies and early eighties. Economic autonomy and the development of entrepreneurial ability were neglected issues.

It was those years when the so called second economy, a working activity not socially organised, had started to spread in the deeper streams of the economy of the open society. In this process, the Hungarian agrarian model played the leading role.

The Hungarian network of agricultural co-operatives was basically different from the East-European *kolhoz*-type system in that – and this being so the Hungarian system found itself in the cross-fire of ideological-political attacks – there was a particular division of labour between the big agricultural companies and the household farming and auxiliary economies (activity carried out on a piece of land in private ownership, or rented). At the beginning of the eighties, 70% of the vegetable production (horticulture), 51% of the fruit production, 21% of the cattle population, 52% of the pig population, and 40% of the poultry population came from household farming and auxiliary economies. More than the half of small-scale producers were integrated in agricultural co-operatives and two thirds of the commodity production of the small-scale producers got to the consumers and reprocesses in an organised form.

The demand-increasing role of the second economy, along with the rise in living standards, also became obvious in other sectors of the economy (services, trade, construction industry): at the end of the seventies, only 30% of the repair services were „socialist” organisations. The judgement of the second economy was to be characterised by the sense of reality and the comparison with international tendencies.

### **5.3 Enterprises immediately prior to the change of the political system**

There were certain traditions of enterprising – economic activity performed out of the framework of socialist organisations – at least in „buds” that were developed by creating suitable legal rules.

Setting up a legal framework for the collective forms of small ventures, the political leadership of that time was trying to create an escape (unsuccessfully) that would release the expected social tensions. In this way, they intended to provide opportunities for almost every strata with political importance to find some compensation for the unavoidable decrease in the living standard through having secondary employment in some kind of enterprise form. There was nei-

ther time nor energy to establish the ideological basis for these major changes and to reveal their long term consequences.

The package of decrees, announced in the autumn of 1981, performed the legal regulation of the forms of collective enterprising listed below. They were free to operate from the 1st of January, 1982.

- *Economic working community*: they could be formed as specialised entities of civil partnership, on the basis of registration with the Court of Registration, followed by a council-licensing procedure. There had to be at least two and not more than thirty members of the venture. They had social insurance and worked as full- or part-time workers. The co-operative could give work to employees, too, but their number was not to be more than 50% of all members. The co-operative paid 3% company tax.
- *Enterprise-sponsored working community*. In addition to the regulations for the work team associations, they were subject to the joint and several liability of companies.
- *Small co-operatives*. They were formed on a voluntary basis, willingly, as ventures organised „from below” with at least 10 and a maximum of 100 members. They had some advantages as to the regulation (for example exempt from the wage-regulation) when compared to traditional co-operatives.
- *Specialised group of a co-operative for industrial activities and services*. It could be formed on the basis of a resolution of the general assembly of the „mother-co-operative”. It had to have at least five members, but there was no limited maximum number of associates. The main purpose of creating this kind of venture was to provide opportunities for the agricultural co-operatives with disadvantageous conditions. The industrial production had a higher profit-rate this way.

The companies were free to create subsidiaries and small companies besides the working-pools in order to unbind the overcentralised structure. They never became general, however, in spite of granted favours in wage-control, taxation, and registration because of the weak motivation of large companies.

In short, we can say that these forms of collective enterprising caused important changes considering the Stalinist kind of economies of the East-European countries. The process of decreasing the economic role of the state, however, had no real success, not even in Hungary, which was due to the following.

- The conservative left-wing political-ideological pressure against the small ventures remained effective as late as 1989: they were still afflicted by many administrative restrictions, and got only a small amount of real support from the economic policy.

- The privileges of state-ownership were not decreased significantly and state ownership had a paralysing influence on the non-state-owned companies, too. The new period of the enterprise-boom in Hungary started in 1988 when the demolition of the constitutional and legal obstacles to the private sector began. The Company Act of 1988 opened the way to Hungarian civil progress. This Act:
  - helped smaller ventures to become middle-sized plants because the maximum number of employees (in the private sector) was raised from 30 to 500,
  - provided an opportunity for private individuals and legal entities to form joint ventures in certain enterprise forms,
  - initiated the new institutions of the limited liability company and the company limited by shares, in which the responsibility of the owner was restricted to the invested property,
  - legalised the institution of silent partners, in this way, joining a company with capital only had become legal.

The Act on Foreign Investments of 1988 facilitated foreign investments in Hungary. The former concession system was terminated, 100 percent foreign ownership became possible and tax preferences were offered to joint-ventures.

The Act on Transformation, which came into operation in the middle of 1989 made it possible for certain small ventures to choose a more up-to-date company form and solved the problem of the expansion and transformation of small ventures (e.g., working communities could be transformed to limited companies flexibly, fast, free of charge, and with no liquidation, without paying taxes or dues). The Individual Entrepreneur Act of 1990 terminated most restrictions concerning small-industry and private trade, and used the principle of the activity-importance: the rules of the official and qualification licensing were connected with the activity and not the enterprise form. The Act on Issuing Securities and the Act on Exchange, both in 1990, terminated the minimum value of the shares and legalised the operation of private individuals at the Stock Exchange Market in Budapest.

Although the advantageous legal changes were not accompanied by an adequate decrease in state tax-payments, a new wave of company formation emerged in Hungary. The number of companies almost doubled between 1989–1990 (*Table 1*). The most dynamic increase took place in the field of limited companies, their number quadrupled.

It was characteristic of the great „establishing fever” that 42% of the companies functioning in 1990 were formed in 1989–90, 32.1% of them were 2–5 years old, and only 25.9% of them were older than 5 years.

In this sudden increase of new ventures, it was the small organisations which played the most significant role. They kept a simplified double-entry book-keeping system, and their yearly income mounted from 25 to 250 million Ft (300,000 – 3 million USD). At the end of 1990, more than three-quarters of all ventures were small companies. In the material respect, a small company had 23 employees on average, a capital of 9 million Ft (120,000 USD), and a profit



of 28 million Ft (380,000 USD). The increase of the importance of the small companies is also indicated by the fact that at the end of 1990, 45% of industrial companies had less than 20 employees (this number was 55% in the construction industry, 77% in internal trade, and 88% in foreign trade). Two thirds of the industrial companies had less than 50 employees.

The Hungarian economy had this kind of organisational structure as described above when it stepped on the path of changing the political and economic system. The liberalisation of the economy, the evolution of the economic background (advantageous to the private sector), the rearranging of the organisational structure (in accordance with the market-economy) the strengthening of private companies, and the disintegration of the state-owned sector were just about to begin. At this stage of transforming the system, quick economic growth is not to be expected because the development of the new ventures is balanced by the loss in the national economy. The leading branches of the economy are depreciated almost to zero because of the change to the market economy and the pressure to integrate into the western type of economic system. Some of the large-scale industry has lost its values, the large-scale forming system has been shocked, and the neglected information and communication infrastructure is an obstacle to the spreading of new enterprises.

#### **5.4 The regional location and diffusion of new enterprises**

As already mentioned in the first chapter, there are two new factors determining the territorial structure of the Hungarian economy: company size and form of ownership. The former factors, such as sectoral-structure, export-ability, organisational dependence, and the state of technology still have their influence. The capital-provincial dualism appeared in the mid-eighties: 50% of the enterprises operated in the capital (but only 19.4% of the national population and 21% of the industrial employees are to be found in Budapest).

The strong territorial concentration lessened a little in the late eighties, but even in 1990 almost half of the most dynamic companies were located in Budapest and one tenth of them were to be found in the agglomeration of the capital (Pest county). Only the number of the individual enterprises was in proportion to the population structure because many agricultural ventures were settled in the country (*Table 2*).

Examining the company density factor we can establish that Budapest and its agglomeration has similar importance. Regarding the number of economic

associations per 10,000 inhabitants, the country average is 18.7, in the agglomeration of the capital city it is 18, and in Budapest it is 46.4.



Table 2

Share of the economic organisations by counties, 1990

County	State enterprises and co-operatives	Economic associations	Unlimited and deposit partnerships	Individual entrepreneurs	Total
Budapest	32.4	48.2	32.6	22.7	24.1
Baranya	4.7	2.7	3.2	5.2	4.9
Bács-Kiskun	4.4	3.7	4.7	5.4	5.3
Békés	3.1	2.1	2.4	3.9	3.7
Borsod-Abaúj-Zemplén	5.3	3.8	5.8	5.2	5.3
Csongrád	3.6	3.2	3.7	5.2	5.0
Fejér	3.2	2.7	3.2	4.6	4.5
Győr-Moson-Sopron	4.5	3.2	3.8	4.5	4.4
Hajdú-Bihar	3.3	2.6	3.6	4.6	4.5
Heves	2.4	1.9	2.8	2.9	3.0
Jász-Nagykun-Szolnok	2.7	1.7	2.5	3.7	3.4
Komárom-Esztergom	2.3	2.9	2.8	3.2	3.3
Nógrád	2.0	1.3	2.1	1.9	1.9
Pest	6.7	8.8	8.5	10.3	10.0
Somogy	3.6	2.3	3.0	6.7	6.3
Szabolcs-Szatmár-Bereg	3.6	2.4	4.4	4.4	4.5
Tolna	2.1	1.4	2.6	0.9	1.0
Vas	3.6	1.5	1.8	0.8	0.9
Veszprém	3.7	2.1	3.4	2.1	2.2
Zala	2.8	1.5	3.1	1.8	1.8
Total	100.0	100.0	100.0	100.0	100.0

Source: Gazdaságstatisztikai Évkönyv. 1990. pp. 32–35.

The dominance of Budapest comes from different factors. The city has always pioneered types of social innovation in the country. Forty percent of state industry has its headquarters in the capital city, and state industrial enterprises have attracted the workers' business associations. The city offers the largest and most affluent consumer market in the country. The city almost monopolised the economic and political information which was necessary for getting into business. Finally, partly because of the size of city, the control of the political leadership over its economy has been less direct than in any other settlement.

Simultaneously, the spreading of private companies has begun, imitating the classical model of expansive diffusion, and the number of enterprises has in-

creased in the western counties significantly. According to certain data, however, the main directions of the expansion are the Vienna–Gyôr–Budapest and the (Trieste)–Lake Balaton–Budapest axes. The central and the southern part of the country is less affected by this change. In the north-eastern peripheral regions of Hungary, the company-density is rather low. (The density index in the most underdeveloped counties is: 8.4 in Szabolcs-Szatmár-Bereg, 7.7 in Jász-Nagykun-Szolnok, and 9.7 in Borsod-Abaúj-Zemplén, which used to be the centre of the former heavy industry.)

The counties situated west of the Danube river find themselves in an advantageous geopolitical situation. They joined the European regional co-operation in the mid-eighties (Alps-Adria Working Community, Co-operation of Regions along the Danube). The numerous small and medium-sized towns of this region make it an excellent target for foreign joint-ventures, while the eastern part of Hungary has been afflicted by the collapse of the Comecom market.

The present regional rearranging of the economy draws attention to several problems, mostly overshadowed nowadays. Above all, the market-economy should be developed on the regional level, too. The capital, manpower, goods, and information market exist only in the capital city, the market institutions are underdeveloped in the country (even in the six large cities of Hungary). Consequently, the country needs a regional policy which is based on the drawing force of the diversified market and not on the unified model of extensive growth. This policy should help the organisation of regional and local money-markets and use the various implements of „enterprise intensification”.

The present tendencies suggest that in some western counties certain regional progress is to start in the near future. This means a western-type development based on small and medium-sized companies and changing the technology and the production structure, aiming at the third sector of the economy. This process, however, requires an economic policy advantageous for entrepreneurs, a decentralised power structure, and developmental conceptions initiated regionally.

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**Small and Medium-sized Firms and the Role of Private Industry in  
Hungary**

**by**

**HRUBI, László and KRAFTNÉ SOMOGYI, Gabriella**

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## **PART TWO**

### **SMALL AND MEDIUM-SIZED ENTERPRISES IN BARANYA COUNTY**

## **6 REGIONAL STRUCTURE AND RESTRUCTURING PROCESSES IN BARANYA COUNTY**

The socio-economic model that prevailed until recently in Hungary and the other East European countries was characterised by a policy of extensive development focusing on quantitative growth. The structural concentration and central, state control of both the society and the economy was very strong. Consequently the system of political and economic decision-making was also centralised while the production and redistribution of incomes depended on central (state level) distribution. The development policy of this concentrated structure and centralised decision-making system had a unified and strong set of priorities mainly representing macro-level and sectoral interests and paid very little attention to regional expectations and characteristics. This kind of policy quite naturally resulted in a polarised regional structure with advantages accumulating in some areas (primarily in the towns, industrial centres and particularly in the capital) and increasing disadvantages in others (like rural, agrarian areas). It must be pointed out, however, that most of the accumulating advantages were strongly relative, deriving from and serving, at the same time, the prevailing structure and mechanism.

As it turned out later, the existence of the more highly developed areas also depended on a very frail foundation; the key element of our development policy was industrial growth concentrated in some priority towns or regions which acted as poles, also determining the development of the third sector. As a result, we have several regions in the country with significant industrial bases. At the same time, industrial development in some areas was uneven, one-sided or restricted to a couple of large companies, in this way making the region and the development of industrial potentials too strongly dependent on them. Therefore these „poles” of development are best described by uneven regional structure, exaggerated concentration of capital and organisations, lack of market forces and relations, low adaptiveness to and interest in changes.

There can be no doubt that all this was not only and primarily the result of a distorted regional policy but the materialisation of the general economic mechanism (model).

The relativity of regional advantages and the seriousness of disadvantages suddenly came to light in the mid-80s; both external and internal factors played a part in the revelation of the socio-economic crisis. This new situation was created by factors like the second wave of the Hungarian economic reform, the

enforcement and real operation of market relation (strict monetary policy, the introduction of the new tax system, a more active exchange-rate policy and a series of restrictive measures), as well as the recognition that the change of the economic system was inevitable. When mining, metallurgy and the heavy industry in general got into a crisis, the areas previously acting as „poles” of development suddenly became depressed areas.

The decrease of production could not be avoided and opening new jobs for the unemployed became a dramatic regional and sectoral issue: sectoral, because capital and labour should be streamed into new or already efficient sectors, industries and regional, because the elimination of loss-producing activities takes place at different rate in the various regions and the mobility of the population is very limited (housing problems, lack of infrastructure in areas that, in principle, could take up more people).

The present study focuses on structural changes in the economy taking as an example Baranya county and the determinant region (core area) in it located around the towns *Pécs* and *Komló*.

### **6.1 Regional economic structure of Baranya county: signs of depression**

When giving an overall picture of the economy of Baranya three characteristic sectoral features of the structure can be pointed out:

- the mining industry has a determinant role,
- it is a traditionally agricultural area,
- light industries and food processing are significant beside the mining industry.

With knowledge of the present economic and market conditions these three characteristics themselves make it evident that the economic potential of the area may get into a critical position. If to the above mentioned things we add that the agricultural sector is a dominant economic base in an area where conditions of productivity are unfavourable on the two third of the county's territory, and industry is considerably concentrated in the Pécs–Komló area, which is the „core area” of the county, then we get a relatively precise picture of the problem in the county's economic structure, and the pressing necessity of the structural change.

As a result of prevailing economic policy priorities, plans for regional and urban development have so far regarded Pécs and Komló, as well as the sur-

rounding settlements, that is the conurbation of Pécs as the engine of the county's development, because of concentration of economic resources and income deriving capacity of the productive sectors, and that the diffusion of these productive forces can kick-start the economies of the county's microregions. Economic policy courses in the four decades of socialist development encouraged these efforts, even justified them, inasmuch, that the average income of people living here far exceeded the national average. These facts, as well as other statistical data could cause it to be forgotten that there was a danger in the foreseeable future of collapse of the regional development based on the mining industry and declining sectors of world economy and that a well-considered structural change is necessary. This danger, otherwise, was pointed out by researchers in the mid-seventies when they saw the social and economic decline of the depressed areas in Western Europe.

At the beginning of the eighties indications of the regional crisis increased. The radical falloff in the dynamics of the productive sectors, and the slowing down of economic growth became a characteristic trend, particularly in the county of Baranya. Whereas in the period between 1973–1978 the productivity dynamics in Baranya was 116.3% (lowest among the counties), at the beginning of the eighties between 1979–1984 a fall-off in production was noticed. The 94.7% index was second in the counties' league behind the production fall-off in Budapest's industry. The 2.7% uplift in 1987 proved to be only a passing tendency of the decade, in 1988 a 4.3% slump took place, and at present the production volume of the industry is by one sixth less than in 1980.

Different indices of the industrial net output also foreshadowed the unfavourable positions of the county's industrial potential. These indices were below the national average. (2.8% of the national income was produced by Baranya county in that time.) The index of industrial development (net output value per person) was 69% of the national average, the index of living labour productivity (net output per industrial employee) was 66%. Among the 19 counties of Hungary Baranya was fifteenth in the first index, in the latter one it became last.

Only the level of industrialisation (rate of industrial employees in the population) exceeded the national average. A misconception regarding the condition of regional development is revealed very clearly in the case of the county, that is the industrialisation (as a quantity index) and the state of industrial development (as an index representing quality indices as well) run into one another. Industrialisation was generally used as a development indicator, and in using this structural problems for example were not even revealed.

A claim for reshaping the development track has also been outlined from the structure of industrial net production in each industrial sector. 29% of industrial output came from mining and electric energy industry, 14% from raw material industry (chemical and building material industry), also 14% from machine industry, 43% from food processing, light and other industries. The cause for the industrialisation index to be the only one above the national average is the mining orientation of the county. At the same time there was a word of warning, namely that the rate of net output in the machine industry was just half the national average, and that the production of food processing and the light industry exceeded the rate of the sectors in the national economy by two third.

We get a similarly gloomy picture of the industrial structure with regard to the number of employees (*Table 1*).

*Table 1*

**The structure of industry in Baranya county by the number of employees in 1980 and 1990**

Industries	1980		1990		Change 1990/1980 %
	Number of employees	%	Number of employees	%	
Mining	21,313	29.7	13,422	25.9	63.0
Electric energy industry	2,418	3.4	2,432	4.7	100.6
Metallurgy	729	1.0	546	1.1	74.9
Machine industry	8,968	12.5	6,518	12.6	72.7
Building material industry	5,463	7.6	3,979	7.7	72.8
Chemical industry	1,437	2.0	1,625	3.1	113.1
Light industry	17,953	25.0	13,606	26.3	75.8
Other industries	3,721	5.2	260	0.5	7.0
Food industry	9,784	13.6	9,399	18.1	96.0
<b>Total</b>	<b>71,786</b>	<b>100.0</b>	<b>51,787</b>	<b>100.0</b>	<b>72.1</b>

*Source: Baranya megye statisztikai évkönyve. 1980. 1990. (Statistical Yearbook of Baranya County. 1980. 1990). Pécs: Központi Statisztikai Hivatal.*

There was hardly any visible change in the industrial structure of the county in the eighties. Beside the falloff in mining and the coming up of food industry, there was not much of a reorganisation. The industrial structure has essentially been preserved in a condition which was different from the national one and in a less developed one taking the economic and market conditions into account (*Table 2*).



The difference itself does not represent a problem of course, since the specialisation of regional economies, adaptation to local circumstances, is a necessity and provides a resource for regional economic growth. The structural problem is characterised by the lack of one or two tracks of adaptation when structures and basic elements survive, despite the fact that the evoking economic and market conditions have already changed or become disadvantageous.

With regard to our topic it makes no difference actually whether the cause of it can be found in the centralised economic policy, the simulated market, distorted prices, that is in the characteristics of macro economy as a whole or in the companies' organisational, management or local, in some respect subjective elements. The structural problem, as starting position is a given thing.

*Table 2*

**The structure of industry in Baranya county and in Hungary by the number of employees in 1980 and 1990 (%)**

Industries	Baranya county		Hungary	
	1980	1990	1980	1990
Mining	30.9	25.9	7.1	6.1
Electric energy industry	3.3	4.7	2.2	3.4
Metallurgy	1.1	1.1	6.0	4.9
Machine industry	11.5	12.6	32.0	32.9
Building material industry	7.4	7.7	4.9	4.6
Chemical industry	2.2	3.1	6.9	8.6
Light industry	28.3	26.3	25.3	22.1
Other industries	1.4	0.5	3.4	1.9
Food industry	13.9	18.1	12.2	15.5
Total	100.0	100.0	100.0	100.0

*Source: Baranya megye statisztikai évkönyve. 1980. 1990. (Statistical Yearbook of Baranya County. 1980. 1990.) Pécs: Központi Statisztikai Hivatal*

The industrial structure of Pécs city, the county centre is not much more advantageous, however, the trends of structural change characteristic of the whole county here are more striking (*Table 3*).

*Table 3*

**The structure of industry in Pécs city by the number of employees in 1980 and 1990**

Industries	Number of employees		%		Percentage in the same industries of Baranya county total	
	1980	1990	1980	1990	1980	1990

Mining	13,133	4,260	34.2	16.9	62.6	31.7
Electric energy industry	1,761	1,849	4.6	7.3	78.2	76.0
Metallurgy	283	191	0.8	0.7	37.0	35.0
Machine industry	4,507	3,637	11.7	14.4	57.5	55.8
Building material industry	2,345	1,795	6.1	7.1	46.5	45.1
Chemical industry	883	1,038	2.3	4.1	61.9	63.9
Light industry	9,340	6,456	24.3	25.6	48.7	47.5
Other industries	739	170	1.9	0.7	73.8	65.4
Food industry	5,433	5,849	14.1	23.2	57.6	62.2
<b>Total</b>	<b>38,424</b>	<b>25,245</b>	<b>100.0</b>	<b>100.0</b>	<b>56.6</b>	<b>48.8</b>

Source: *Baranya megye statisztikai évkönyve. 1980. 1990.* (Statistical Yearbook of Baranya County. 1980. 1990.) Pécs: Központi Statisztikai Hivatal

The significance of the town in the county's employment rate has lessened. Decrease in mining is considerable but its counterpoint is the leap forward of the rate of food processing. Compared on a nation-wide scale, the town's industry, however, presents quite a gloomy picture in 1990 as well.

Structural weaknesses of the industry in Baranya county are reflected in the development of income producing capacity as well. The profit of the enterprises in the county rose from 1,850 million Ft in 1986 to 2,619 million Ft in 1987, then in 1988 it went down to 1,797 million Ft and even in 1989 it was only 2,117 million Ft calculated at current price. The profit per employee in industry in 1989 is 36,500 Ft, and it is equivalent to 3.4% rate in proportion to net returns.

Additional document to the permanent character of the structural problem and to the fact that it is still not changing is given by an analysis of the 1986 figures made by Baranya County's Territorial Organisation of the Central Statistics Office.

According to it 7% of industrial employees in Baranya work for an economic organisation with low profit-yielding, 13% for organisations which are in a bad financial shape, and 23% work for organisations which produce low profit and are in a bad financial shape. It is true that economic problems are cumulatively present in mining and building material industry (the last group), but these companies employ 23% of the industrial workers. The companies which are in a bad economic position employ 41% in light industry and 15% in machine industry.

Finally we must point out that among the factors representing the growth capability of the industry, the background for research and development are rather weak in the county, though they are essential in the secure market diversification to come. 0.96% of active wage-earners in Baranya (1,944 persons) worked in jobs connected with research and development (the national rate is

1.6%). From the figures of *Table 4* a general survey is drawn up which proves the disadvantageous conditions of research base in the county.

According to R+D inputs Baranya is the twelfth among the 19 counties, whereas it is last according to inputs per researcher which is only 25.9% of the national average. The fact that only 4 company research units are registered by research and development statistics from the 81 R+D centres of the county gives food for thought, and at the same time reveals a whole range of things to be done.

Characteristic additional fact is that only 4 of the 700 development projects supported by the Central Technical Development Fund and 30 million of the 6 billion Ft financial support were allocated to Baranya in 1991.

*Table 4*

**Data for the research-development centres in 1986**

Counties	Total number of staff	Expenditures		Input by researcher	
		input million Ft	order	(thousand Ft)	order
Budapest capital	50,839	18,792.8	1	741.4	9
<i>Baranya</i>	<i>1,944</i>	<i>223.0</i>	<i>12</i>	<i>184.6</i>	<i>20</i>
Bács-Kiskun	678	132.8	13	421.5	11
Békés	756	245.5	10	1,319.8	4
Borsod-Abaúj-Zemplén	2,322	720.1	6	725.2	10
Csongrád	3,656	747.0	5	412.3	13
Fejér	2,455	1,250.4	2	1,576.5	2
Győr-Sopron	1,449	578.8	8	808.4	8
Hajdú-Bihar	3,225	630.9	7	361.5	16
Heves	570	72.7	16	225.8	19
Komárom	624	233.1	11	1,137.1	6
Nógrád	241	37.5	19	421.3	12
Pest	4,050	1,225.7	3	899.3	7
Somogy	220	43.8	18	339.5	17
Szabolcs-Szatmár	745	119.9	14	368.9	15
Szolnok	711	260.2	9	1,227.4	5
Tolna	247	87.7	15	1,654.7	1
Vas	162	19.4	20	242.5	18
Veszprém	2,414	1,150.2	4	1,345.3	3
Zala	355	64.6	17	408.9	14

Source: *Tudományos kutatás és fejlesztés. 1986.* (Research and Development. 1986.) Budapest: Központi Statisztikai Hivatal

It is difficult to show with synthetic indices the economic potential of Baranya's industry on the whole. The position according to value added may be the fixed point to hold on when giving a rough characterisation (*Table 5*).

*Table 5*

**Distribution of the added value of industry in 1990**

Distribution (%)	Added value per employee
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Industries	(thousand Ft)			
	Baranya county	Hungary total	Baranya county	Hungary total
Mining	27.2	11.9	303	789
Electric energy industry	12.2	11.8	748	1,374
Metallurgy	1.0	6.6	277	533
Machine industry	9.2	24.4	211	298
Building material industry	12.3	4.3	461	373
Chemical industry	7.5	16.6	686	778
Light industry	16.6	13.3	182	242
Other industries	0.3	1.0	154	224
Food industry	13.7	10.1	217	259
Total	100.0	100.0	288	401

Source: *Baranya megye statisztikai évkönyve. 1990.* (Statistical Yearbook of Baranya County. 1990.) Pécs: Központi Statisztikai Hivatal. (Calculation by author.)

The appropriate data for statistics are collated from the companies' balance sheet reports, from the field observed in it, that is reservations must be pointed out mainly in relation to a given region. It arises mainly from the fact that performance is sometimes taken into account in another region or can't be revealed. All this is caused by the organisational system of the economic units, and it happens more often in the case of significant extraterritorial dependence. On the whole statistics underestimate the value added in the county's industry a little, yet it is illuminating to survey these sets of data.

It turns out from the table that backwardness of the county's industry is significant even compared to the national average which does not represent a high standard either.

It must be mentioned that the industrial structure of Baranya can be described by the dominance of mining, light and food industries, and exactly in these fields the county indices are low or significantly lagged. We firmly believe that – all possible influences of errors taken into account – the data in their trends give a realistic evaluation of the relative situation of the county's industry. Experience proves that the companies which had a characteristic and determinant role in the county's industry previously are now almost without exception in the state of heavy recession, not rarely of disintegration.

Agriculture reveals a more favourable position regarding the county's economic potential. The previously used index of value added per employee was 379,000 Ft in Baranya in 1990, compared to 311,000 Ft of national average.

The average estate value, which reveals the quality of all the large farms' agricultural areas in Baranya is virtually identical with the national figure (18.8, 18.9 respectively), but within it cropland has a county average of 16.4, and the national average is 17.4. There are significant local differences within the coun-

ty average. For example, the productivity of the eastern and the south-eastern parts is distinctly favourable with large farms working efficiently, but the other parts are more or less disadvantageous. The greater part of the Pécs–Komló region belongs to the disadvantageous zone. For example the average index of productivity in the landscape of Hegyhát, a large part of Pécs–Komló region, is around 10–12.

Natural resources of this region don't encourage agricultural production in large farm, form especially in a production structure, which until recently because of economic and financial conditions was generally favourable (profitable in sectoral respect) for large farms in Hungary. Despite this fact, or perhaps that is why the regional plant concentration of the agricultural co-operatives here exceeds the county average. Though it cannot be proved directly – with data –, the accompanying over-employment within agricultural plants is likely to be significant.

It is very difficult to render anything probable in its future, however, agriculture may play only a partial role in the transformation of Baranya's economic structure, in its revitalisation through food processing. If we consider its role restricted to the Pécs–Komló region then we should suppose that it worsens the critical regional situation caused by the industrial structural change and the reduction of mining; because the change in the agricultural organisation and ownership system, the selection made by the market, and the ceasing of forced over-employment all make the region's agricultural supporting base weaker, free labour force, and in the case of certain towns, villages and small zones the lack of attached economic base may occur.

Summing up, the economic structure of Baranya is characterised by an industry which is organically and locally concentrated, obsolete in its sectoral structure, regressive in its activity and profitability and by an agriculture which is still developed and yielding above the average, with relatively favourable resources. However, in the case of the agriculture one the possibility of development – which promotes regional economic stabilisation is – differentiated in regions and exactly the Pécs–Komló zone is one of those where this chance is considerably less.

High-grade polarisation in its rural and urban structure has always been a feature of Baranya's regional development: lots of small villages at one end, and Pécs, which has the function of the regional centre at the other, and between the two the interim levels which are generally underdeveloped and can fulfil their functions in the rural-urban network system only partially. This is the reason

why processes in this region have been concentrated even more than necessary in territorial sense: the theoretically possible regional system and proportions for fulfilling different management-production-supply functions were replaced by a more concentrated regional system virtually, where the fulfilment of functions was by turns shifted upwards. The process, of course, was sustained and not in a small extent by concentration and centralisation of economic and regional policy. At present we are witnessing a virtual local „Budapest-syndrome”, with the difference that the centre which is much more developed than its region also got into a critical situation, because its economic structure has stiffened and become obsolete. The Pécs-centred feature of the county has been given, it cannot be ignored, and the fact that its whole region has got into an „operating dependence” of it cannot be ignored either.

The region which is directly threatened by depression has approximately 250,000 inhabitants, as we suppose it, and this is more than half of the county’s population. In this region – Pécs, Komló and about 50 connected villages – 80% of the county’s industrial employees and of gross value of fixed assets, 79% of net value of the industrial machines and equipment are concentrated here, so as to mention only some features. Internal concentration within this core area is of similar extent: 81% of the population, 92% of the industrial employees, 95% of the industrial gross value of fixed assets, 96% of net value of the machines and equipment can be found in Pécs and Komló towns.

Apart from this region, the territory of the county, with the exception of the north-east and eastern parts, is practically covered by underdeveloped rural areas (reaching into the supposed area of depressed zone at some places). A further one seventh of the population (approximately 60,000 people) live here. In order to make the difference clear: only 5% of the industrial employees of Baranya live in these rural zones and 11–12% of the whole gross value of fixed assets can be found here.

Underdeveloped rural and depressed areas jointly mean that the regional economy of the county struggles with severe development problems, and is characterised by structural crisis. Despite the internal differences and basically different internal relations the whole of the county’s economy needs an overall treatment. Though the development of economically underdeveloped rural areas and the restructuring of the depressed zone as programs should be placed in the centre of a county strategy as equal tasks, key position is taken by Pécs and partially Komló.

The size, structure, efficiency and dynamics of the economy in the Pécs and Komló region cannot fulfil the role of the engine, which it has played in development so far. The majority of reasons causing the economic development to stop short and decline does not differ from the factors which caused the emergence of the depressed areas in the developed countries. It also shows great similarity how general economic policy exerts its effect.

The critical situation of the Pécs–Komló industrial zone and its becoming a depressed area can be explained mainly by sectoral recession. The heavy reduction in the dominant coal and uranium mining cannot be counterbalanced by other structural elements or resources of the region. Moreover, the change of the economic regulatory system, the operativeness of normative regulators – first of all the reduction of export subsidies – as well as – and primarily – the dramatic change of market conditions shake the position of the light industry which is the other pillar of the economic base. Food processing, the third pillar also joins them, there are also negative signs are gathering at present.

This economically declining region – if factors bringing about economic crisis are jointly present already – is less and less capable of the economic restructuring or of lessening the local social and political tension. Economic reduction influences the psychological state of the local communities increasingly, a demographic erosion can be brought about, highly qualified people may transmigrate (it can be detected from certain signs that the rate of professionals among active wage-earners is continuously decreasing), the state of the service sector may get worse. That is, the conditions for introducing modern economy are becoming more and more unfavourable.

The present socio-economic state of the Pécs–Komló region indicates a deepening depression. The income yielding capacity and development hopelessness of the economy marks the beginning stage of the region's decline. However, the classical features of the depression cannot yet be found in the sociological structure of the society or in the infrastructural sectors. That is the very reason why there is a chance in mid-term to prevent deepening of the crisis and high-grade growth of social costs of revitalisation. It can be done by working out an regional adaptation and development strategy as soon as possible and by creating a system of means combined with it.

Unemployment more and more serves as some synthetic indicator of regional crises, which are more and more common and wide spread, and as a counterpoint of it: the spreading of new-type organisations, the intensity of enterprises being established can be an index number of positive reaction to the crisis. These two indicators – not by chance – denote a certain discriminant in the government policy as well, they give criteria according to which areas

which are in the worst state and are in need of central intervention most, can be pointed out.

Unemployment is present in Baranya appearing in absolute numbers as well from 1989. However, the presence of a considerable, yet indoors unemployment was foreshadowed previously by the county's economic structure, and by the signs of employers' financial position, liquidity, significant narrowing down of the market. The number of open and registered unemployed people was 960 in the first month of 1990 and it rose to 5,780 by the beginning of 1991. Within it the rate of unskilled and commuting unemployed people was dominant. Redundancy mainly hit the unskilled workers whom the companies had to reimburse travel expenses, so it was a money saving action.

At the same time on the demand side the 2,045 vacancies registered in January 1990 went down to 893 by the first month of 1991. Moreover, demand and supply sides showed great structural differences, as the above mentioned supply of mainly unskilled workers did not suit the companies seeking skilled workers first of all.

Tension accumulated in the production structure and in the employment structure of the county as well. While the number of employees in the production (the 1st and 2nd sectors) decreased and increased in the non-material services, processes leading to the constraint of structural change intensified. These processes were embodied in staff cuts in the first stage.

The fact that the industry of the county has been concentrated in the very region that has become a critical area makes it more difficult to ease the tension, and economic and infrastructural conditions for diversification are insufficient in other zones of the county.

As a consequent upon all these facts the number of employees in the Baranya county decreased by 17% in 1991, mainly in the industry and building industry, but other sectors have made considerable staff cuts, too (*Table 6*).

*Table 6*

**The number of the out-of-employment job-seekers**

Districts	January 1991	June 1991	December 1991	October 1992	Rate in October 1992 (%)
		(persons)			
Pécs	1,737	2,358	5,478	7,757	7.5
Komló	1,301	2,002	3,602	5,394	21.7
Mohács	1,167	1,752	3,310	4,709	18.3
Sellye		518	1,023	1,706	
Siklós	905	995	2,161	3,655	14.1
Szentlőrinc		369	613	1,068	
Szigetvár	670	725	1,816	2,959	24.7



Total	5,780	8,719	18,003	27,248	13.2
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*Source: Data by the Job Centre of Baranya County*

The heavy predominance of supply in the labour force market has also been and being effected negatively by the demographic growth of the labour force, until 1994 about 5,000–6,000 young people will seek for their first job. During the year a rapidly growing unemployment which increases by 1,000–1,500 persons every month was registered. By the end of 1991 the number of out-of-employment job-seekers multiplied by 3.5 that is 18,003 persons. Among them 15,031 received unemployment benefit or allowance. In April of 1992 the number of out-of-employment job-seekers was about 20,000 person and in October more than 27,000 (23,068 persons received unemployment allowance): the rate of expansion has not reduced.

The rate of unemployment from 2.7% in January 1991 rose to 13.2% by the end of October of 1992 (the national average in December of 1992 was 11.2, that of the provinces 12.6%) which average covers considerable territorial spreading. While it implies 7.5% in Pécs, it implies 14–25% in the towns Komló, Mohács, Szigetvár and in their districts.

The labour force market was burdened with contradictions, which meant regional on one hand and structural troubles on the other hand. Great majority of jobs was offered by employers in Pécs (80–90%), at the same time only 20–40% of job-seekers were inhabitants of Pécs.

The change in the unemployment structure is marked by continuous growth of skilled unemployed people, and simultaneously the number of unemployed people with higher education has also increased. About 60% of out-of-employment job-seekers are men, which is more than their share within active wage-earners, 75% belong to the 25–55 age group, the rate under the age of 25 is 22%.

Despite the increasing tension of the labour force market, employment opportunities are „the most favourable” in Pécs. The relatively favourable position may originate in the Pécs-centredness, however there is also a dynamic unemployment growth in the background. The large companies concentrated in the town struggle with severe problems, majority of them have lost their markets, their liquidity is weak. Negotiations with foreign partners are drawn out or do not realise. Privatisation is slow and difficult.

The unemployment rate is 7.5% in Pécs in October 1992. The number of unemployed people is continuously growing. More than one third (38%)

of the unemployed are skilled workers and one third are professionals. 68% of the reported job vacancies are in Pécs.

Depression effects concerning the county are concentrated in the Komló region. Employment opportunities for those who have become unemployed because of staff cuts have narrowed down, the period of time when they wait for employment has increased. Employment of unskilled women implies a special problem here.

The unemployment rate of Komló is 5.9% in January 1991, number of unemployed people is 1,301; 21.7% in October 1992, 5,394 men which shows a 4.15 fold growth. Only 13% of the reported job vacancies in the county is in Komló and its district. But this means so few in absolute numbers that we cannot speak about job supply. Only 5 jobs can be offered to 100 unemployed people.

To sum it up, we can state that the heavy unemployment which is already pressing at the moment – and is bearing social tension – is growing on in Baranya, too. Resulting from the regionally different effects of the processes which foster the growth of unemployment (industrial bankruptcies, restructuring of agriculture, etc.), the prognostic concerning the county in 1993 shows hardly any modification in the structure. The nearly 30% share of Pécs in the number of unemployed will remain, the 20% share of Komló and its district will increase a bit, but supposedly in a way that the unemployment in the district increases more than in Komló town.

The reduction of labour force supply, its tolerable extent can be achieved only by job creation based on well-considered conception. Only in this case the means of employment can help this process to be implemented and realised. The county's Employment Fund is not capable of doing this properly. The claims for the deconcentrated fund in 1991 and 1992 – especially in job creating investments, retraining and retirements with waiving of the age-limit – far exceeded the possibilities.

Significant worsening in the condition of the labour force market can be revealed in other indices as well. Another index of the social situation is the income positions of the population. It is a well-known fact that with regard to property and income Baranya – due mainly to the mining industry – was one of the regions in the country where people were better off reaching back for several decades. This better position seems to disappear according to income and tax statistics for 1990. The revealed taxable income per person is 156,000 Ft in Baranya, and the national average is 165,000 Ft in 1990.

With regard to the size of the specific income tax this means the following: compared to the national average of 12,000 Ft of income tax per person, and to the provincial average of 9,600 Ft, Baranya's index is 11,000 Ft. Average specific tax bases of Pécs and Komló are better (181,000, 158,000 Ft respectively) than the county average.

According to the formation of new businesses and the spreading of enterprises, Baranya county is around the national average, or a bit above the provincial average. Of course Pécs plays a determinant role in this respect: according to the data given in the firm bulletin one (0.94) person from about a hundred founds a new enterprise. The town average in Baranya is 86 persons from 10,000, though Mohács, the next town, has less than half of it compared to Pécs. Moreover, if we do not take Mohács into account, the villages belonging to the district of Pécs have an average enterprise-frequency index which exceeds the index of other towns of Baranya. This means that Pécs and its district – following a model of concentrated and hierarchical spreading (diffusion) – produce the position of Baranya in the spreading of enterprises. The counterpoint is, unfortunately, Komló. According to the situation at the end of 1991, Komló is the 39th among the 176 Hungarian towns in its population, whereas,

- it is the 70th according to the number of new enterprises,
- within this it is the 81st according to the number of limited liability companies,
- it is the 122nd according to the frequency of new enterprises (number of new enterprises per 10,000 inhabitants),
- it is the 140th according to the frequency of limited liability companies,
- it is the 122nd according to its growth rate of new enterprises in 1991.

Almost each of the data proves the very disadvantageous position of Komló when compared to both the national and the county state, especially to Pécs in the field of economic revival and transformation of organisation. Characteristically enough, the indices of Sásd and Pécsvárad, two previous, historically established microcentres of the region, are better. The frequency index of the new enterprises in these villages together with some other villages of the district is nearly equal with the index of Komló town (27 people found a new enterprise from 10,000 in Komló, and 24 in its district). The number of new businesses more than doubled in each town of the county in 1991, in Komló this index was only 78%, so the pace compared to 1990 slowed down.

If we consider the reaction to crisis according to the spreading and frequency of new organisations, then we must state that Pécs and its district are in

an advantageous, the town of Komló and its district are in quite a disadvantageous position. Because of the economic structure and the development of the economic base, the whole of the Pécs–Komló region suffers from depression crisis, which would need regional policy intervention. This region is surrounded by a large underdeveloped rural zone, which together with the depressed core implies the very imminent chance of turning into a socially and economically critical region if it does not get support. It would be much more difficult and the costs would be much higher if it was handled later.

Development level of Baranya county's economy on the whole is still in mean position in the order of the counties of Hungary (*Table 7*). The former development advantages of this region in Hungary seem to be lost.

## **6.2 A change in the function of the regional development**

In relation to the development of depressed zones the most uncertain point of regional (county) policy, or rather strategy is in a paradoxical way just the county level, the role and possibilities, system of instruments of the counties. This uncertainty emerges not so much in formulating the tasks and the requirements of the responsibility, but when in connection with certain groups of questions the issues of the theoretical degree of freedom of regional decision-making come up and the extent to which it may be reduced by the available system of instruments. The other side of the question is the nature of the division of labour between the national, local (urban) and county levels of the regional policy and strategy.

In the emergence of the regional crises – that is, of the problem of the economically underdeveloped areas and the depressed zones – the macroeconomic processes and the central decisions played a decisive role to such an extent that the accumulation of the regional tensions have grown beyond the present framework of the regional administration by far by today.

*Table 7*

### **Some characteristic features of the counties in Hungary**

Counties	Density of new businesses <sup>a</sup> 1991	Proportion of enterprises with foreign capital (%) 1991	Income to personal taxation per 1 inhabitant (1000 Ft) 1991	Un-employment rate (%) July 1992	Complex index <sup>b</sup>
Budapest capital	120.04	26.84	125.13	4.9	3.14572
Győr-Moson-Sopron	59.33	24.19	81.30	7.4	0.98477
Vas	37.29	24.27	81.73	7.8	0.64739
Komárom-Esztergom	67.57	16.43	89.16	12.6	0.48983
Pest	56.78	16.79	81.68	8.6	0.47537
Zala	59.14	14.64	79.23	8.1	0.37797
Veszprém	49.04	18.06	84.88	10.3	0.37768
Fejér	57.20	12.50	91.18	11.2	0.27317
Somogy	53.61	14.66	71.34	8.7	0.08403
Csongrád	41.06	16.63	79.36	10.3	0.06444
<i>Baranya</i>	<i>52.67</i>	<i>16.35</i>	<i>77.01</i>	<i>11.8</i>	<i>0.06105</i>
Bács-Kiskun	52.63	17.08	67.22	14.1	-0.27807
Tolna	39.97	13.37	77.81	12.5	-0.31623
Hajdú-Bihar	41.68	10.80	71.39	11.5	-0.49599
Heves	38.31 <sup>c</sup>	11.62	70.01	13.6	-0.68288
Jász-Nagykun-Szolnok	37.00	10.12	73.97	15.1	-0.80256
Nógrád	50.06	10.38	71.88	17.7	-0.82933
Békés	33.80	10.68	68.91	13.7	-0.82948
Borsod-Abaúj-Zemplén	43.47	8.26	72.34	18.2	-1.06438
Szabolcs-Szatmár	31.68	7.60	57.73	19.5	-1.68312
Hungary average	61.20	19.70	84.90	10.1	0.00000

Source: NEMES NAGY J.(1992): *Hosszú távú országos és regionális növekedési pályák.* (Macroeconomic and regional growth paths for a long term). Budapest: PM GII.

<sup>a</sup> Number of new businesses (associations) per 10,000 inhabitants

<sup>b</sup> Estimated factor scores of a factor analysis with the 4 indices (78.2% of variation explained by this principal component)

<sup>c</sup> Estimated value

The consequence of the absurdity and confusion of the existing situation is that in the solution of these territorial problems it is precisely the local and county levels which have the narrowest autonomy of movement and decision-making within the present institutional and regulating framework.

Today it is simply impossible to develop specific areas and remove them from the deadlock without the decisions taken at the central government level. It is obvious that the phenomenon well-known from the past (namely the dependence of local action on central decisions) may recall echoes of past solutions in a lot of people, strengthening further the myth of the omnipotence of central intervention and injections. At the same time it can be seen that today the central administration, the „state” may undertake only to moderate the regional crises which are mainly of social character, it can manage crises only on the short term.

The tasks of developing and restructuring the depression zones will be faced decisively by the local and county level administration (the local governments) on the long term. The central state subsidies may be directed at achieving the socio-political moderation of the short-term tensions and indirectly at creating the framework and system of instruments in which the scope of movement of the local and county levels required for solving the tasks comes into being. Central government investments will not get a role in the structural changes of the depressed zones because there will be hardly any. But the local and county administration has to dispose of the incentive, supporting and regulative (in a word influencing) possibilities of the economic sphere, that is competence based on actual economic bases – according to the division of labour formed in the process of development – by means of which the restructuring of a region becomes possible on the regional level. There is no time and sufficient resources to leave everything to the economic automatism nowadays, on the one hand, because these automatism first should become comprehensive and consistent, on the other hand, because the existing critical situation would lead to losses aggravated by the regional differences, which would be inequitable and unfair with respect to the citizens of the adversely affected zones as well.

The transformation of the institutional framework, the system of tasks and instruments of the local and county administration is most likely underway owing to the reforms ripening these days, although in a form which can be predicted with difficulty for the time being.

From the aspect of active local (self-government) influencing the local-regional economy the basic elements of a regional „self-government-friendly” future concept might be outlined by way of a model as follows:

- property of communities (local governments), interestedness in the management of resources and property at the same time,
- real managing-enterprising possibility and ability for the local government („economic local government”),

- independent regional economic regulation which is in accordance with the responsibility of the local-regional policy (e.g., within limits possibilities to reduce or increase all kinds of taxes which bring in revenues,
- a regional system of banks and financial institutions (which greatly differs from the current system of commercial banks) including the varied system of funds and foundations, associations, partnerships, etc.,
- regional business and information infrastructure with the complete abolishing of state monopoly.

Economic development, the appearance of new structural units would be greatly promoted by business infrastructure providing services (at the start on a non-profit but later inevitably on a business venture basis). This palette might be further coloured by various social-civil organisations, development societies, foundations and funds (private or communal, domestic as well as foreign), associations, confederations, etc., that is everything which has proved useful elsewhere in the world in the recovery of regions having faced a similar situation. Furthermore, the international relationships or informal links of the county and its settlements might also become a useful means, whether by resorting to exchange of experience or cooperation in specific fields.

A separate issue is represented by the regional system of banks and financial institutions. The currently existing commercial bank branches are not able to finance the local-regional business ventures because they are not interested in doing so and this is a grave obstacle. The establishment of a regional development-investment bank in the field of financing regional business ventures seems to be expedient in the long run. The demand for business venture funds having been created within the framework of the regional administration shows that there is a significant gap in the field of financing. Another argument for the establishment of an independent development-investment bank is the fact that the system of the necessary preferences and subsidies would function within a clear, inspectable but normal banking framework, with guarantees of return which are not provided by the institutional framework of administration and management despite the best of intentions.

The different formations of subsidies and subventions should not be concentrated by all means, but rather they should be transformed into transactions resting on uniform economic-financial bases in their functioning, the requirements and guarantees of utilisation, or be diverted in this direction. In all probability calling for tenders, awarding and rational utilisation would work more efficiently in such a system. In an optimal case a regional bank should be

comprised of a great number of independent joint ventures and major responsible organisations or institutions directly interested in the territorial-regional development becoming participants as part-owners depending on their financial possibilities.

Restructuring, business and entrepreneurial actions having become necessary in the depression zones can be implemented by providing peculiar regional subsidies and preferences as mentioned above. This is a sphere which can take shape within the existing system only and exclusively through central state decisions, albeit the available information and interestedness at the regional-local level are greater. Most of these decisions are related to regulation and are, therefore, elements suitable for becoming objects of decentralisation in the field of the formerly mentioned regional competence and regulation.

Concerning the instruments, functions of the restructuring and development of the depression zones, so far we have spoken mostly about the possible forms without taking into account the addressees, although the division of labour between the concerned levels of administration is of great importance. The typically disproportionate role of the central (state) level obviously has to be reduced today. At the same time it should be considered, under what conditions of labour division between the regional and local (settlement) levels should decentralisation and the development of the depression zones take place in the course of restructuring and crisis management.

Two factors have to be mentioned here because of their possible importance:

- in the foreseeable future rapid progress towards a regional and local government is highly probable owing to the trend of the self-governing character of the local-regional administration: interestedness, information, decision-making ability and competence are shifted to the level of settlements, being concentrated there with the necessary instruments;
- in the developing-restructuring process of the depression zone, the core region of Baranya county – as we have repeatedly referred to it – Pécs and Komló, but Pécs in particular, will play a key role.

Unlike in the case of the economically backward areas, where weaker structuring, the atomisation of the natural, artificial and development endowments do not allow for radical decentralisation and the role of the county (regional) administration will continue to be of primary importance, in the management of the depression zones the majority of the development tasks and means should be gradually taken over by the local governments of the settlements concerned. The point at issue is not the withdrawal of the regional level



because it would be impossible on account of the impacts and relationships of the regions, but it is the reduction of its role in the form of such an efficient co-operation between the towns and the county where the development programmes affecting the towns – and presumably the majority of the programmes will be like that – will become the task, responsibility and possibility of the local (town) governments. The existing and new competencies, decision-making licences, material-financial means which have been or will be decentralised should be assigned accordingly. We are convinced that concerning the possible ways of the development of the depression zones as well as the methods and tasks of restructuring, a division of labour in this manner might release further energies for organisation, development and management. It would harmonise better with the nature of the expectable processes, creating more direct relations of interestedness, in brief, it would create a complex, more favourable situation and mainly a fair chance to recover from the crises.

### **6.3 Restructuring: encouragement and initiation of new businesses and local development**

The entrepreneur and entrepreneurship are treated in a very simplistic way in the interpretation of today's conceptions according to which business ventures are motivated by advantages and possibilities which can be expressed exclusively in terms of money. Reality, however, is much more varied than that. The complex phenomenon of business ventures has also sociological, psychological and cultural linkage points.

Why does not the entrepreneur type turn up in a particular context? The explanatory force of limited capital supply and access to information is significant. Outstanding importance may be owed to information on account of the fact that joining the information stream of the world or a country has become a decisive factor of development. The pressure of accelerated decision-making may condemn to backwardness regions which are unable to get reliable information quickly enough. We can say that the costs of obtaining information are infinitely much higher in the regions driven to the periphery or being in a state of crisis than those in the centres. Therefore, it is impossible to interpret their competitive situation as a rule. The task facing the local governments is obvious. They should function as local development organisations in the capacity of a peculiar catalyzer enabling the population to become familiar with the economic and social processes of the world, that is, they should create the essential conditions by spreading innovation, since the building out of information systems is hardly conceivable on an individual basis. Inasmuch as it is conceivable,

then the use of the obtained information will be individual as well. This, however, cannot bring about a solution either on the local or regional level.

The other limit is represented by the supply with capital. At this point, however, we have to give a more differentiated wording. We do not have the human capital but rather other factors in mind. It is undeniable that in launching or continuing businesses the majority of the capital injections are utilised with low efficiency. This applies to nearly all the countries. The fault generally lies with the exaggerated extent of the physical capital investments of the small businesses. That is to say, in the beginning the majority of the small businessmen come up with a relatively low demand for capital, mainly in the form of working capital. Money or buildings are not a great help to them by all means. In addition to the working capital, however, assistance in the administration of the business and consultation would also be required. Similar is the case with obtaining the necessary management practice and marketing knowledge. Apparently, besides the small venture capital the local power or the local government is able to carry on an effective development policy if providing of the indirectly indispensable business background (infrastructure) is recognised and ensured.

In our days the encouragement of businesses cannot be confined to the traditional form of capital aid any more. A local government aiming at achieving success regards as its task also the creation of institutions which are related to the business infrastructure in the widest sense. This does not imply merely some kind of physical background but also human and informational conditions.

Since local development regards chiefly the population as the final resource of economic development and growth, this policy should rely on internal persons, groups and activities. This also results in the shifting of the main points of this policy as compared to the traditional regional policy. While the latter is mainly directed at large organisations and physical capital, the former should target the businessmen of small organisations and the human factor. It is inevitable that the system of means of the policy should be changed.

The solution of this issue is not so simple as it might appear at first sight because the changes are directed emphatically at the spheres of social existence outside the economy. That is, they affect an area in the influencing of which our experience is insufficient. It is not enough to ensure the conditions of development (access to information, promoting the qualifications of people) if the motivation required for the launching of businesses does not appear in the population. On the other hand, motivation may emerge as a result of the transformation of the skills, values and way of thinking.

A perceptible contradiction emerges if we examine this from the side of the state. The state grants may rarely aim at changing the behaviour of the

population, at creating entrepreneurial spirit. This is so because it might have an impact only on the long term and through the formation of complicated relations. Consequently, the regional aid programmes which take into consideration quickly tangible results, may assign only the role of transmission, „distribution” to the organisations of local development. The short-term interestedness may bring about only short-term resolutions to the problems. The errors of the conception supporting the up-bottom approach may be eliminated by the local development activity feeding on local roots.

We must not conceal, however, that the advantages of the conception based upon local development are its disadvantages at once. The long term means uncertainty, it can be measured less satisfactorily by the traditional economic indicators than the short term.

The objectives, instruments and evaluation possibilities of the local development policy are summarised in a comprehensive table (*Table 8*).

*Table 8*

**Tasks and spheres of activities of local development policy**

	<b>1 Foundation</b>	<b>2 Information</b>	<b>3 Stimulation</b>
<b>TARGET GROUP (Direct beneficiary)</b>	Small business	Population in the wide sense	Social groups
<b>MAIN OBSTACLE</b>	Scarcity of capital	Lack of information, difficult access	Inability of region to organise itself, generating entrepreneurs
<b>PRIORITIES</b>	1 Financing 2 Information, training 3 Organising and organisation	1 Information, training 2 Organising and organisation 3 Financing	1 Organising and organ- isation 2 Information and training
<b>MEANS OF IM- PLEMENTATION</b>	Quasi-banks Loans Aids	Professional training, grants, modern technologies in information transfer	Local development organisations
<b>EVALUATION CRITERION</b>	Planned profitability	Internal criterion of the supply with services	Heterogeneous criteria for generating long-term growth potential

The three columns of Table 8 set increasingly complex aims for local development that are far away from immediate profitability. The relations in column 1 are definitely close to the logic of the systems generally functioning at present. Column 2 already represents components of a new approach. It does not set the granting of financial aids as an objective, but aims at establishing a

contact with the whole population by means of which entrepreneurial motivation may be created in the most suitable persons. In nearly all the countries this group is characterised as a rule by the fact that it has suitable organisations, but only at the national level, while the regional or local dimension rarely appears in their functioning. Column 3 sets the most abstract and ambitious goals. At the same time its system of means and feedback mechanism cannot be considered to be elaborated in the least.

## **7 THE DEVELOPMENT OF ORGANISATIONAL STRUCTURE IN BARANYA COUNTY**

The administration system with its permissive or prohibitive attitude is in the closest relation with the organisational structure of the economy. Till the 1980s the number of business organisations was standard both at the national level and in the county of Baranya. In fact during the previous periods centralising processes characterised the economy.

Small signs of divisions of organisations and their strive for independence can have been observed since the first half of the 1980s, they mainly manifested in the termination of large companies, the independence of their units and subsidiary companies. Parallel with the changes based on decisions of the higher level, the entrepreneurs started to think about smaller number of employees, manageable and more flexible new business forms. The small companies, the small co-operatives, and the working partnerships under the liability of a company, etc. appeared. They were the forerunners of the joint small organisations and small enterprises of today. Some of them are still operating in an unchanged form or as a new type of organisation after transformation.

The process was given a stimulus by passing the Act on Business Associations and the Act on Transformation of Business Organisations and Associations in the second half of the 1980s when everybody both natural person or legal entity could start to form an organisation under the same conditions with no respect to ownership. The existence of these Acts and the simultaneously accelerating social and economic changes, the stagnation of the COMECON trade that badly affected the organisations operating in the county, the gradual liberalisation of the export and import gave the manifold organisational changes a push. By the end of the 1980s several traditional large companies transformed as a whole or some of their divisions or units formed independent business associations, most often medium-sized enterprises. At the same time the foundations of personal ventures based on private initiatives, that required not too high capital investment, accelerated.

It is not possible to follow the number of business organisations and ventures and to give unambiguous accurate data on them because of the dispersion of the information. The documentations on foundations, transformations and terminations, and the recordings of the changes at the different central organs are made with some delay in time and discrepancy. As a result the data published at different places and in different times vary often.

The size of the business organisations with legal personality is given by the Central Statistical Office (*Központi Statisztikai Hivatal*, KSH) with respect to the number of employees. Regarding economic importance the organisations with 50 or less employees can be considered small organisations. (It needs to be mentioned that the opinion of the Tax and Financial Control Office is different on that since the reporting obligation (thus the size of the firm, too) is dependent on the figure of the realised or the expected return from sales.) We do not have accurate information on business organisations not having legal personality, but according to their current role and their small number almost all of them can be considered small organisations.

The objective of this study is to outline with respect to the number of organisations the current economic structure of the county of Baranya, the space of the change and its important directions, the major areas of interest of the entrepreneurs between the end of 1988 (as the status just before the Act on Business Associations came into force) and October of 1992. Since the used data are from the local data base (data available at the Department of KSH in Baranya county) and the changes and the retroactive effective trends are often recorded in the register with a difference in time at the beginning of the year, thus our data can be different from the ones published on the county of Baranya according to the national recordings. This, however, does not have a significant effect either on the direction of changes or their extent.

### **7.1 Business organisations with legal personality**

At the end of October 1992 the number of organisations having legal personality was 2319 in Baranya county. Their number had increased by 677 during the first ten months of that year and with respect to 1988 (considered as the first year of the analysis) by more than two thousand, basically since 1990. The organisations were most often formed in the trade industry and industry, the construction industry and in other material activities; in personal and economic service sector. The importance of the major motives affected the economy as a whole varied according to sectors.

During this time the traditional large companies of the industry and the construction industry faced such crises as a result of the effect of internal and external market conditions that it could be foreseen that some of those companies were bound to be wound up. Previously or as a result of the winding up procedure those units that were considered to be capable of living became independent. At the same time the conditions of venture had favourable changed. The venture stimulating factors appeared in the economic policy, thus the ideas

could be more freely realised in every field. The rapid growth in the number of unemployed forced people to start venture to ensure their existence.

After coming into force the Act on Pre-privatisation incited and stimulated the trade industry.

Benefiting from the favourable conditions ensured by the tax system played an important role in stimulating the formations of business associations in the personal and economic service sector.

As a result of the changes in the number of organisations the organisational structure of the economy altered in the county, too. Despite the significant increase between the end of 1988 and October 1992 the share of industry decreased from 31 percent to 21 percent. The participation of the trade industry, however, increased with 20 percentage points, and within the sector the number of business units operating in foreign trade grew practically from zero to close to a hundred. Despite the crises of the construction industry with respect to the number of organisations the sector's weight has grown. It suggests that the units forced to separate from the companies under winding up procedure were able to recover, and a group of entrepreneurs believes that the small and flexible units are viable even in this critical sector.

Decisive majority of business organisations is business associations operating in the form of limited liability company (*korlátolt felelősségű társaság*, hereinafter: Kft). Most of the time the new business associations begin their activity in the above mentioned form because of the small initial capital that can be provided even by one or more individuals. As a result of the transformations the number of companies decreased in the county between 1988 and 1992. They continue their activity in the form of a company limited by shares (*részvénytársaság*, hereinafter: Rt) or in some case of limited liability company. The decrease in number affected mainly the manufacturing, the commerce and to a lesser extent the construction industry, these sectors are characterised by the foundations of Rts. At the same time the Kft became popular in every sector of the economy maybe to a lesser extent in the postal service and telecommunication sector, where the solid monopolistic position is still prevalent and narrows down the scope of ventures.

The increase in the number of organisations speeded up in 1991. Two-third of the growth in number between the end of 1988 and October 1992 happened after January 1991. The increase in number in the large sectors was with respect to manufacturing 66 percent, construction 74 percent, agriculture and forestry additionally commerce 72–72 percent. The later happened in less then two years.

Despite the fact that beginning from the 1970s foreign capital investment was allowed in Hungary, the foreign investors become really interested only in the last two years. In 1991, in the aggregate, 153 business associations were formed (only Kfts) with foreign participation in Baranya county. Because of the importance of the everyday relations half of the organisations belonged to commerce and a quarter of it was formed in manufacturing.





Table 2

**Number of business organisations according to sectors and business forms, October 31, 1992**

a) In number

Sectors	Total	Of which				
		Enter-prises	Business associations	Of which		Co-ope-ratives
				Kft	Rt	
Industry	489	37	425	408	16	27
Construction	333	4	314	307	4	14
Agriculture and forestry	165	7	84	80	4	74
Transport, postal and tele-communication services	59	3	54	54	-	1
Commerce	767	7	741	720	19	19
Water supply	61	3	4	2	-	54
Personal and economic services	324	18	231	226	2	72
Health, social, cultural services	89	2	77	76	-	2
Communal, administration and other services	32	-	16	14	-	-
<b>Total</b>	<b>2,319</b>	<b>81</b>	<b>1,946</b>	<b>1,887</b>	<b>45</b>	<b>263</b>

b) Growth and decrease in relation to December 31, 1988

Industry	411	-6	414	401	14	3
Construction	312	-3	313	307	4	1
Agriculture and forestry	96	1	83	80	4	12
Transport, postal and tele-communication services	55	1	54	54	-	-1
Commerce	733	-8	738	718	18	3
Water supply	53	-	3	2	-	50
Personal and economic services	290	4	227	224	1	56
Health, social, cultural services	84	-	76	76	-	-

Communal, administration and other services	31	-	15	13	-	-
<b>Total</b>	<b>2,065</b>	<b>-11</b>	<b>1,923</b>	<b>1,975</b>	<b>41</b>	<b>124</b>

Most of the later mentioned 18 business associations pursue activities in machinery industry. Eleven joint ventures were formed in the light industry, primarily in the timber industry, and in the textile and clothing industry because of the frequent opportunity for commission work. The new organisations were characterised that they started to operate with the mandatory minimum one million forints worth initial capital as it was stipulated. The majority of the Kfts with foreign interest did the same. Currently they play a minimal role in the economy of the county. It needs to be mentioned that we do not have information on foreign investments through raising capital in operating organisations or acquiring quotas.

Three quarters of the business organisations with legal personality had maximum 20 employees in October 1992, and at an additional 8 percent the number of employees did not exceed the 50. Since the decisive majority of newly formed organisations belongs to the group employing few people, their proportion is significantly increasing from year to year. (At the end of 1991 the figure for organisations with less than 50 employees was 77 percent, while at the end of 1988 it was only 20 percent.) In the sectors where the establishment of organisations has been the most vivid for a long time (manufacturing, construction, commerce) the number of ventures with small number of employees is above average. (For example 89 percent of the organisations in commerce employs less than 20 persons.)

The organisational sizes significantly vary at the different business forms in relation to the frequency of new foundations of enterprises. While at the end of October 1992 11 percent of the companies, 41 percent of the co-operatives, one quarter of the Rts employed less than 50 persons, then the 95 percent of the Kfts belonged to ventures small in number.

At October 31, 1992, 21 percent of the business organisations, 489 organisations pursued primarily industrial activity (*Table 3*). The number of the operating organisations is most significant in machinery industry, it follows the light industry and then the food industry. The growth was the highest in these three sectors during the last years. While the number of the firms belonging to mining industry has hardly changed anything, regarding the electric energy industry it has not changed.

Considering their number there were only few business organisations operating in mining and in electric energy industry. Although their economic weight is very significant because of their size with respect to both the number of employees and production.

The general trends of the sectors prevailed in the industrial organisations with legal personality during the last years. The decrease in the number of com-

panies caused primarily by the transformations began in January 1992. It has affected every sector except for mining, metallurgy, chemical and other industry. The number of Kfts pursuing industrial activity has grown by at about 138 (51 percent) since 1989. The figure is 6 with respect to Rts (*Table 4*).

*Table 3*

**Distribution of business organisations pursuing industrial activities**

Sectors	Organisation			
	Number		%	
	1988	1992	1988	1992
Mining	2	4	2.6	0.8
Electric energy	2	2	2.6	0.4
Metallurgy	2	11	2.6	2.2
Machinery	25	198	32.0	40.6
Of which:				
Manufacturing equipments, machinery	9	88	11.5	18.0
Transportation vehicles	5	33	6.4	6.7
Precision engineering	2	21	2.6	4.3
Building material	5	35	6.4	7.2
Chemical	4	28	5.1	5.7
Light industry	26	141	33.3	28.8
Of which:				
Wood-processing	9	51	11.5	10.4
Leather, fur, shoes	8	28	10.3	5.7
Textile and clothing	3	30	3.8	6.1
Other industries	1	11	1.3	2.2
Food industry	11	59	14.1	12.1
<b>Total</b>	<b>78</b>	<b>489</b>	<b>100.0</b>	<b>100.0</b>

*Table 4*

**Number of industrial business organisations according to business forms, October 31, 1992**

Sectors	Total	Of which				
		Enter-prises	Business associations	Of which		Co-opera-tives
				Kft	Rt	
Mining	4	2	2	2	-	-
Electric energy	2	-	2	-	2	-
Metallurgy	11	1	9	8	1	1
Machinery	198	14	175	173	2	9
Of which:						
Manufacturing equipments and machinery	88	7	76	75	1	5
Transport. vehicles	33	2	30	29	1	1
Precision engineering	21	-	19	19	-	2
Building material	35	2	32	30	2	1
Chemical	28	1	24	24	-	3
Light industry	141	9	120	114	5	12
Of which:						
Wood processing	51	2	46	44	2	3

Leather, fur, shoes	28	4	20	17	2	4
Textile and clothes	30	-	28	27	1	2
Other industries	11	1	10	8	2	-
Food industry	59	7	51	49	2	1
<b>Total</b>	<b>489</b>	<b>37</b>	<b>425</b>	<b>408</b>	<b>16</b>	<b>27</b>

The size composition of the organisations has significantly changed in the industry since 1988. While at the end of 1988 less than 22 percent of the number of business organisations with legal personality belonged to enterprises small in number, in October 1992 almost four-fifth of them (389 enterprises) are small enterprises. The 95 percent of them was business associations (all of them but one was Kft), additionally there were 7 companies and 11 co-operatives.

Business organisation having legal personality with less than 50 employees was not founded in mining and in electric energy industry (*Table 5*). In all other sectors their participation was 50–100 percent, respectively. Most often the Kfts were the small enterprises, the figure for this form of business association with less than 50 employees was 92 percent. The larger sizes inherited from the past are prevalent considering companies and co-operatives. The operating divisions separated from companies increase the number of medium-sized (51–300 employees) enterprises. Since a relatively high initial capital is required for the formation of a Rt and it has a more complex organisational form the Rts belong to the larger sized enterprises.

*Table 5*

**The number and proportion of business organisations having legal personality with less than 50 employees by sectors, October 31, 1992**

Sectors	Number	Per cent			
		in total	in enterprises	in associations	in co-operatives
Metallurgy	7	63.6	-	77.8	-
Machinery	173	87.4	50.0	91.4	66.7
Of which:					
Manufacturing equip- ments and machinery	71	80.7	14.3	88.2	60.0
Transport. vehicles	27	81.8	50.0	86.7	-
Precision engineering	19	90.5	-	89.7	-
Building materials	27	77.1	-	84.4	-
Chemical	25	89.3	-	100.0	33.3
Light industry	102	72.3	-	82.5	25.0
Of which:					
Wood processing	40	78.4	-	84.8	33.3

Leather, fur, shoes	14	50.0	-	70.0	-
Textile and clothes	22	73.3	-	75.0	50.0
Other industries	9	81.8	-	90.0	-
Food industry	46	78.0	-	88.2	100.0
<b>Total</b>	<b>389</b>	<b>79.6</b>	<b>18.9</b>	<b>87.3</b>	<b>40.7</b>

Measuring the output of small enterprises is made by using representative methods nation-wide, thus it does not give us useful information on the counties. To show their weight it needs to be mentioned that despite their large number their participation in the gross industrial national production value was at about 6 percent. Thus despite their dynamically growth (about 20 percent increase in production) they could mitigate the production set back in the larger companies caused by the worsening market conditions to some extent.

## 7.2 Business organisations not having legal personality<sup>1</sup>

Similarly to the national trend the formation of numerous organisations belonging to that group can be witnessed during the last years, though the information on the aggregate number is only available in Baranya county from the end of 1991. The reason for their popularity is that there are no provisions on a compulsory minimum initial capital for these business forms. By now the different legal forms bear different significance. In the middle of the 1980s quite a large number of work partnerships in enterprises (formed pursuant to Decree 28/1981. (IX. 9.) MT, *vállalati munkaközösségek*, Vgmk) and other private work partnerships (*magán gazdasági munkaközösségek*, Gmk) operated in the county. They are disappearing, however, since according to the new Act on Business Associations it is not allowed to form new venture in those forms any longer. Following the acceptance of the new Law the limited partnerships have become the most popular of the possible forms.

By the end of October 1992 the figure for business organisations without legal personality was 2,346 (*Table 6*). A significant increase has taken place during the last ten months of the year 1992. Particularly the number of limited partnerships showed a major increase, its number has doubled during that year. It might be in relation with the fact that beyond the new establishments the work partnerships (that were founded according to former laws) and individual entrepreneurs, that built up marketable businesses, pursue on their business activities in this form after the abolition of the previous business forms.

An extremely large divergence can be witnessed with respect to the sectors the organisations operating in different forms belong to. A decisive

number of work partnerships (Gmk) pursues manufacturing and construction activities. Almost half of the limited partnerships operated in commerce both at the end of 1991 and at the end of October 1992.

The number of operating organisations without legal personality is the most significant in two sectors, in the machinery and light industry. The figure was more than one quarter for the organisations in light industry and 47 percent for the organisations in machinery industry (*Table 7*).

*Table 6*

**The number of business organisations without legal personality by sectors and business forms, October 31, 1992**

Sectors	Business organisations	Of which		
		work partner- ships	deposit organisations	individual entrepreneurs
Industry	479	247	216	79
Construction	335	187	143	25
Agriculture and forestry	77	8	30	9
Transport	88	18	66	4
Communication	12	9	3	-
Commerce	844	76	730	103
Wholesale and retail	798	76	687	103
Foreign trade	46	-	43	-
Water supply	2	2	-	-
Personal and economic services	401	116	279	27
Health, social and cultural services	86	5	81	4
Communal, administration and other services	22	8	13	-
<b>Total</b>	<b>2,346</b>	<b>676</b>	<b>1,561</b>	<b>251</b>

*Table 7*

**The number of business organisations not having legal personality by industrial sectors and business forms, October 31, 1992**

Sectors	Business organisations	Of which		
		work partner- ships	deposit organisations	individual entrepreneurs
Mining	3	1	2	-
Electric energy	2	2	-	-
Metallurgy	1	-	1	1
Machinery	223	133	82	19
Of which:				
Manufacturing equipments, machinery	112	78	28	-
Transport. vehicles	32	14	18	3
Precision engineering	21	14	7	8
Building materials	18	8	9	-

Chemical	39	22	15	-
Light industry	125	48	73	3
Of which:				
Wood processing	46	19	27	3
Leather, fur, shoes	21	9	11	-
Textile and clothes	30	14	16	-
Other industries	28	7	20	53
Food industry	40	26	14	3
<b>Total</b>	<b>479</b>	<b>247</b>	<b>216</b>	<b>79</b>

The trend regarding business forms significantly differs from the trend characterising all the sectors. Half of the business organisations without legal personality were work partnerships (Gmk) and 45 percent was limited partnerships in the industry, while with respect to all the sectors two-third of the organisations operated in the later form.

There are differences between the industrial sectors regarding the prevalence of legal forms. The work partnerships (Gmk) operating for a long time now are the prevalent in machinery industry, and beside that there are dynamically developing limited partnerships. At the same time the limited partnerships caught up or passed the work partnerships (Gmk) in number in the other areas.

Since the first half of the 1980s numerous individual entrepreneurs have pursued their businesses in the county, though there are no detailed data available on their activities or their number.

It is a fact though that before the appearance of the different small enterprises with or without legal personality a decisive part of the consumer services for the population and a growing proportion of retail supply were provided by them.

During the last two years there had been a radical increase in the number of entrepreneurs too, as a result of the spreading of economic services and canvassing. Their total figure was 24,511 in Baranya county in December 31, 1991. With respect to retail the figure was 21 percent and one-third of them worked in some kind of an industrial area. Their activity is important in providing direct and quick services for the population.

### **7.3 The regional distribution of business organisations**

The distribution of business organisations in the county is similarly concentrated as happens in the country. A significant role is played by the cities, four-fifth of the organisations with and without legal personality operated there in October 1992. Because of the central role played by the organisations with a county location two-third of them are located in the county's capital.



The different sectors play different role in each of the regions. The organisations that belong to agriculture and forestry are located close to the cultivable fields in the villages. Thus 65 percent of the organisations with legal personality and 57 percent of the organisations not having legal personality operating in these sectors can be found in those settlements. The organisations of the management of water-supply industry that are located in the villages also play important role.

Generally the foundations of ventures are more dynamical in the towns, thus their share in the total figure for the number of organisations is still increasing. We could mention the organisations belonging to manufacturing and construction industry as exceptions, where during the last ten months of 1992 the proportion of organisations operating in towns slightly decreased. It may be in relation with the separation of industrial and construction divisions of co-operatives, choosing new business form or the willingness to venture and the increasing urgency to start ventures in the smaller settlements.

By the end of October 1992 some kind of a venture was operating in 150 settlements that is in half of the county's settlements. Naturally they more frequently appear in the larger settlements, close to towns, in settlements playing the central role of a smaller region, or settlements that are affected by tourism (*Table 8*). The organisations operating in commerce are present in the largest number in the settlements, organisations of agriculture and forestry follow them in the row.

The highest proportion was represented by the organisations operating in industry, commerce, and pursuing other material activities; personal and economic services in all the five towns of the county. Beyond that the weight of construction industry was significant in Pécs and Mohács, and the number of organisations operating in agriculture and forestry was about 10 percent in the later town because of relatively developed agricultural conditions.

At the end of October 1992 as we previously mentioned four-fifth of the industrial organisations operating in the county had less than 50 employees. Their number began to increase strongly in 1990. At the end of 1988 the figure was only 17, it doubled in 1989 and by the end of 1990 it increased to 144, and by the end of 1991 it reached 253. Practically the number of business associations, particularly of the Kfts grew.

The industrial organisations with less than 50 employees are concentrated to towns to a lesser extent than all the organisations of the county and the industrial organisations as a whole (*Table 9*). The number of industrial organisations with few employees, that can be found in the five towns of the county, is

close to 76 percent. All 7 companies operating with less than 50 employees, and 9 from the 11 co-operatives can be found in the towns, and three-fourth of the business associations conduct their activities in one of those towns.

The 94 industrial organisations small in number operating in villages pursue their activities in 38 settlements. In October 1992 one of each operated in 20 settlements, two or more ventures were in 18. These later settlements decisively belonged to the settlements with a population of two thousand or more.

The number of the industrial organisations without legal personality<sup>3</sup> was 558 at the end of 1992, and four-fifth of them, 444 organisations operated in the five towns (*Table 10*).

*Table 8*

### **The regional distribution of business organisations, October 31, 1992**

#### a) Organisations with legal personality

Sectors	Pécs	Komló	Mohács	Siklós	Szigetvár	Towns	Villages	Baranya
Industry	286	27	32	15	16	376	113	489
Construction	270	6	13	2	2	293	40	333
Agriculture and forestry	38	2	11	2	4	57	108	165
Transport and communication	42	2	4	2	-	50	9	59
Commerce	577	19	27	14	13	650	117	767
Water supply	9	2	2	-	1	14	47	61
Personal and economic services	251	12	16	6	11	296	28	324
Health, social and cultural services	74	3	1	1	1	80	9	89
Communal, administration and other services	24	2	1	1	1	29	3	32
<b>Total</b>	<b>1,571</b>	<b>75</b>	<b>107</b>	<b>43</b>	<b>49</b>	<b>1,845</b>	<b>474</b>	<b>2,319</b>

#### b) Business organisations without legal personality<sup>2</sup>

Industry	359	24	33	11	17	444	114	558
Construction	240	13	8	3	9	273	87	360
Agriculture and forestry	25	4	4	2	2	37	49	86
Transport and communication	67	5	5	3	5	85	19	104
Commerce	650	47	39	20	21	777	170	947
Water supply	1	-	-	-	-	1	1	2
Personal and economic services	354	3	3	-	-	391	37	428
Health, social and cultural services	75	3	3	-	-	81	9	90
Communal, administration and other services	21	1	-	-	-	22	-	22
<b>Total</b>	<b>1,792</b>	<b>111</b>	<b>104</b>	<b>45</b>	<b>59</b>	<b>2,111</b>	<b>486</b>	<b>2,597</b>

*Table 9*

**The number of industrial organisations having legal personality operating with less than 50 employees by business forms and regional distribution, October 31, 1992**

Settlements	Total	Of which		
		enterprises	business associations	co-operatives
Pécs	231	2	224	5
Komló	16	2	13	1
Mohács	21	1	18	2
Siklós	14	1	13	-
Szigetvár	13	1	11	1
<b>Towns total</b>	<b>295</b>	<b>7</b>	<b>279</b>	<b>9</b>
<b>Villages total</b>	<b>94</b>	<b>-</b>	<b>92</b>	<b>2</b>
<b>County total</b>	<b>389</b>	<b>7</b>	<b>371</b>	<b>11</b>

*Table 10*

**The number of industrial organisations without legal personality by business forms and regional distribution, October 31, 1992**

Settlements	Total	Of which	
		Work partnerships	Deposit organisations

Pécs	359	150	146
Komló	24	12	7
Mohács	33	28	2
Siklós	11	5	5
Szigetvár	17	7	8
Towns total	444	202	168
Villages total	114	43	48
County total	558	245	216

In accordance with the opportunities the role of the county's capital is decisive as it is the case in all the sectors. The 64 percent of the industrial organisations without legal personality operating in the county and 81 percent pursuing business activities in towns conducted business in this settlement.

The 44 percent of these organisations was work partnerships (Gmk)<sup>4</sup> that have strong linkages to the industrialisation of the towns. A significant part of them was formed within the industrial organisation as work partnerships in enterprise in the years of the 1980s. A larger proportion, 22 percent of the limited partnerships worked in villages at the end of October 1992.

We found the 114 industrial organisations without legal personality operating in villages in 47 settlements. There were 26 villages where there was no industrial organisation with legal personality, and in half of the later settlements only one organisation operated even from among the ones without legal personality.

In summary it can be stated that the organisational structure of Baranya county regarding both the business forms and the organisational sizes went through fundamental changes similarly to the national one in the 1980s. The role of traditionally large companies has gradually decreased, and the small ventures gained large ground in every sector.

It needs to be mentioned though that the structure with respect to the number of organisations cannot be compared to the role played by the sector regarding activity and production, since the size of the organisation has a basic influence on the position gained in the economy.

The small organisations are founded with different objectives and for different scale than the larger sized organisations. The requirement can only be that an organisational structure that is capable of complying to the quantitative and qualitative requirements of internal and external market conditions would evolve in the county with respect to size and sectoral belonging.

## Notes

- <sup>1</sup> All the way through the general analysis it includes the business organisations without legal personality, but from the individual entrepreneurs it includes only those who did not keep cash book.
- <sup>2</sup> The joint business ventures together with the 251 individual entrepreneurs recorded in the detailed registers at county level
- <sup>3</sup> The joint business ventures together with the 79 individual entrepreneurs recorded in the detailed registers at county level
- <sup>4</sup> Together with the work partnerships operating under the liability of legal person

## **8 FUNCTIONING OF SMALL AND MEDIUM-SIZED ENTERPRISES IN BARANYA COUNTY (REPORT ON A SURVEY)**

The fourth year students of the Faculty of Economics at the Janus Pannonius University in Pécs were commissioned by the University and the Centre for Regional Studies of the Hungarian Academy of Sciences to make an investigation with the use of a questionnaire within the scope of ACE project. Students were informed on the tasks of an interviewer and were given the name and address of firms to be interviewed on 29th October 1992. The list of enterprises was given us by the Statistical Office of Baranya County. It contained 264 units. Among them there were 127 economic units with the legal entities and 137 economic units without being legal entity. During the investigation it came to light that about 50% of the firms included in this list does not exist any more and we got more addresses from professional corporate organisations.

Thus, 140 questionnaires were filled in during the month of November.

The general experiences reported by the interviewers are as follows:

- the firms that were interviewed were helpful and co-operative, cases of denial were rare;
- there were some difficulties in the time scheduling of interviews with managers;
- apart from the items on property volume, profit, rentability managers gave true information in general;
- interviews was slowed down by the need of indicating a lot of items in %; the majority could not give a prompt reply to these items and in many cases the answers were only rough estimations;
- some items and some terms used in items needed a further explanation (e.g. the term of marketing);
- items related to market were difficult for very small enterprises (with a staff of 1–2 persons).

The filing of questionnaires was done at the Faculty of Economics at the Janus Pannonius University in the first half of December.

### **8.1 Results of the questionnaire's general section**

Apart from the number of staff and employees in the previous month, the majority of items were replied by all the (140) firms interviewed. Among from the

firms interviewed 30.75% (43) is interested in wood and furniture industry, 36.4% (51) in leather, fur, textile and clothing industry, and 28.6 (40) is interested in food industry. The activity of 4.3% (6) enterprises have a mixed type so they belong to a „mixed” category (*Table 1*).

*Table 1*

**The branch structure of the enterprises analysed**

Specification	Total	Wood industry	Textile and cloth industry	Food industry	Mixed profile
The number of enterprises	140	43	51	40	6
Percentage	100.0	30.7	36.4	28.6	4.3

Among from the 140 firms 60% (84) is situated in Pécs, 14.3% (20) in medium-sized towns, 6.4% (9) in small towns and 19.3% (27) in villages (*Table 2*).

*Table 2*

**Location of the enterprises analysed (%)**

Specification	Total	Wood industry	Textile and cloth industry	Food industry	Mixed profile
A town of over 100 thousand dwellers	60.0	62.8	68.6	45.0	66.7
A town of 20–99 thousand dwellers	14.3	14.0	15.7	15.0	0.0
A town of under 20 thousand dwellers	6.4	7.0	3.9	10.0	0.0
Village	19.3	16.3	11.8	30.0	33.3
Total	100.0	100.0	100.0	100.0	100.0

A telephone is available at 80.7% (113) of them but 20.3% (27) must work without the possibility of using telephone. There are only minor differences from this average within branches.

22.3% (31) of enterprises interviewed was founded in 1989 or before 22.1% (31) was founded in 1990, 42.9% (60) in 1991 and 18.9% (18) was founded in 1992.

The majority – 41.9% (13) – of the new firms formed in 1989 (or before) was working in wood and furniture industry. In 1990 leather, fur, textile and clothing industry was the most popular with its share of 45.2% (14) from the total of new enterprises. This sector was still the most active in 1991 with a share

of 43.3% (26), while it was furniture and wood industry with its share of 50% (9) which was the most attractive in 1992.

2 firms (1.4) were not able or willing to answer for the item on their initial assets. The initial assets of 79 enterprises was below 1 million HUF (35.7%) and they exceeded the sum of 10 million HUF only in case of 9 firms (6.4%).

From initial assets cash rate remained below 10% (12.9%) in 18 enterprises; it is between 11 and 30% in 16 enterprises. This is 11.4% of all the firms interviewed. Cash rate is between 31 and 60% in case of 98 firms (this is 27.1% of all the enterprises interviewed), it is between 61 and 90% in 8 enterprises (5.7%) and it is over 90% in 58 enterprises, that is 41.4% of all the firms interviewed.

9 enterprises did not answer for the item on their present volume of assets (6.4%). 38 firms (27.1%) estimate their present volume of assets for less than one million HUF, 73 firms (52.1%) estimate their present volume of assets between one and ten million HUF and 20 enterprises (14.3 percent) declare their present volume of assets to be more than 10 million HUF.

Among the enterprises interviewed there are 9 (6.4%) private firms, 3 (2.1%) co-operative (private) associations, 98 (70%) businesses based exclusively on private persons, 20 (14.3%) are based on the mixture of private and legal entities and 10 (7.1 percent) are based exclusively on legal entities.

21 (15%) of the enterprises interviewed uses foreign capital. Among from the firms with foreign capital involved 42.9% is interested in furniture and wood industry, 47.6% is interested in leather, fur and clothing industry and only 9.5% in food industry.

In October 1992 there were 51 firms (38.1%) with a staff less than 5 and 24 (18%) with a staff between 6 and 10. There were 28 enterprises (21.1%) with a staff of 11–20 and 22 (16.5%) with a staff of 21–50. There were only 8 firms with a staff over 50 (62.5% of them is interested in leather, fur and clothing industry).

According to the study in all types of settlements the most popular form of ventures is the one founded solely by natural persons, 70% (98 firms) of the interviewed enterprises belong to them. There is a significant difference regarding small towns where this form is represented only by 44% (4 firms) of the firms. 14.3% (20 firms) of the interviewed enterprises were founded by both natural and legal persons, it was the most popular form in towns, 25% (5 firms). 7.1% of the enterprises were founded solely by legal persons, this form cannot be found in towns, but it is represented in small towns by a figure higher than



the average, 22.2% (2 firms) and in villages by 11.1% (3 firms). 6.4% (9 firms) is individual enterprise, their proportion is 22.2% (2 firms) in small towns and 8.3% (7 firms) in Pécs. The least favoured form is the co-operative (private) enterprise, with its 2.1% in the total sample. 77.8% (7 firms) of the individual enterprises are located in cities, 22.2% that is 2 firms are in small towns, and from the three co-operative enterprise 2 firms are located in Pécs and 1 of them in a village. Among the enterprises founded solely by natural persons 61.2% (60 firms) is located in Pécs, 19.3% (19 firms) of them are operating in villages, 15.3% (15 firms) in towns, 4.1 (4 firms) in small towns. Half (10 firms) of the enterprises founded by both natural and legal persons are in Pécs, 25% in towns, 20% in villages and 5% in small towns. Similarly, half (5 firms) of the enterprises founded solely by legal persons is in Pécs, 30% is in villages and 20% is in small towns.

Regarding the number of telephones the co-operative (private) enterprises and the enterprises founded solely by legal persons are in the best situation, it is shown by the relevant 100% index. 95% (19 firms) of the enterprises founded by both natural and legal persons, and 77.6% (76 firms) of the enterprises founded solely by natural persons have telephones. In this respect the individual enterprises are in the worst situation, only 55.6% (5 firms) of them have telephones. According to that 67.3% (76 telephones) of the total telephones operating at the interviewed enterprises are at the firms founded solely by natural persons, 16.8% (19 telephones) of them are at firms founded by both natural and legal persons, 8.8% (10 telephones) is at firms founded solely by legal persons, 4.4% (5 telephones) at individual firms, and 2.7% (3 telephones) at co-operative enterprises.

In all sectors the decisive majority (68.8–83.3%) of the interviewed enterprises was operating in the form of enterprise founded solely by natural persons. Among the firms pursuing business in furniture and wood industry 18.6% (8 firms) of the enterprises was founded by both natural and legal persons, 7% (3 firms) operated as individual firms, 2.3% (1 firm) was founded solely by legal persons. The enterprises founded by both natural and legal persons were the second in popularity with their 15.7% (8 firms) in leather, fur, textile and clothing industry. The enterprises founded solely by legal persons – 17.5% (7 firms) of the enterprises – were at the second place in food industry. From the 9 interviewed individual firms 55.6% operated in leather, fur, textile and clothing industry, 33.6% in furniture and wood industry, 11% in food industry. For the co-operative (private) enterprises included in the study the same proportion of the enterprises were present in leather, fur, textile and clothing industry, in food industry and being involved in more than one industry at the same time. The respective data for enterprises founded by solely natural persons are 35.7% (35

firms) in leather, fur, textile and clothing industry, 31.6% (31 firms) in furniture and wood industry, 27.6% (27 firms) in food industry. 40% (8 firms) of the enterprises founded by both natural and legal persons are operating in furniture and wood industry, the figure is the same for leather, fur, textile and clothing industry, and it is 20% for food industry. The majority – 70% (7 firms) – of enterprises founded by legal persons are pursuing business in food industry, 20% in leather, fur, textile and clothing industry, and 10% in furniture and wood industry (*Table 3 and 4*).

*Table 3*

**Legal forms of the enterprises interviewed (%)**

Legal forms	Total	Wood industry	Textile and cloth industry	Food industry	Mixed profile
Private firms	6.4	7.0	9.8	2.5	0.0
Co-operative associations	2.1	0.0	2.0	2.5	16.7
Businesses based exclusively on private persons	70.0	72.1	68.6	67.5	83.3
Businesses based on private and legal entities	14.3	18.6	15.7	10.0	0.0
Businesses based exclusively on legal entities	7.1	2.3	3.9	17.5	0.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

*Table 4*

**Legal forms and branches of enterprises**

Legal forms	Total	Wood industry	Textile and cloth industry	Food industry	Mixed profile
Private firms	9	3	5	1	0
Co-operative associations	3	0	1	1	1
Businesses based exclusively on private persons	98	31	35	27	5
Businesses based on private and legal entities	20	8	8	4	0
Businesses based exclusively on legal entities	10	1	2	7	0
<b>Total</b>	<b>140</b>	<b>43</b>	<b>51</b>	<b>40</b>	<b>6</b>

From the 140 interviewed enterprises 42.9% was founded in 1991, 22.1% in 1990 also 22.1% in 1989 or previously. Only 12.9% that is 19 firms started operation in 1992. From the 9 individual firms 44.4% already operated in 1989, 33.3% in 1990, 11.1% in 1991 and the same 11.1% in 1992. The 3 co-operative

enterprises included in the study were established in 1989, 1990, 1992. 52% (85 firms) of the enterprises founded solely by natural persons have been operating since 1991, 19.4% since 1990, 16.3% since 1989, and 12.2% since 1992. 35% (7 firms) of the enterprises founded by both natural and legal persons were established in 1991, 30% in 1989, 25% in 1990, 10% in 1992. 40% of the enterprises founded solely by legal persons were established in 1989, 30% in 1990, 20% in 1992 and 10% in 1991.

The initial capital is less than 1 million HUF in the case of 56.4% of the interviewed enterprises, the amount was between 1 and 10 million HUF for the 35.7% and only 9 firms (6.4%) started business above that amount. The initial capital is less than 1 million HUF for 66.7% of the individual enterprises, it is between 1 and 10 million for the 33.3% of the them. Two-third of the co-operative enterprises had an initial capital between 1 and 10 million HUF and one-third started operation with an amount larger than that.

Similarly to individual firms, 61.2% of the enterprises founded solely by natural persons started business with less than 1 million HUF, 33.7% between 1 and 10 million HUF, and 3.1% (3 firms) with an amount larger than 10 million HUF. Half of the initial capital of enterprises founded by both natural and legal persons was less than 1 million HUF, in the case of 45% it remained under 10 million HUF, and only 1 of them (5%) started with a larger amount. An initial capital larger than 10 million HUF was characteristic of only 40% of enterprises founded solely by legal persons, it means 4 firms. From the enterprises belonging to the other forms of ownership structures 3 had an initial capital less than 1 million HUF and 3 that is over 10 million HUF (*Table 5 and 6*).

*Table 5*

**Initial assets of the enterprises interviewed (%)**

Specification	Total	Wood industry	Textile and cloth industry	Food industry	Mixed profile
Under 1 million HUF	27.2	41.8	17.6	25.0	16.7
1–10 million HUF	52.1	37.2	60.8	57.5	50.0
Over 10 million HUF	14.3	16.3	9.8	15.0	33.3
Don't know	6.4	4.7	11.8	2.5	0.0
Total	100.0	100.0	100.0	100.0	100.0

*Table 6*

**Legal forms and the initial assets of enterprises (%)**

Specification	Under 1 million HUF	1–10 million HUF	Over 10 million HUF	Don't know
Private firms	66.7	33.3	0.0	0.0
Co-operative associations	0.0	66.7	33.3	0.0
Businesses based exclusively on private persons	61.2	33.7	3.1	2.0
Businesses based on private and legal entities	50.0	45.0	5.0	0.0
Businesses based exclusively on legal entities	30.0	30.0	40.0	0.0
Total	56.4	35.7	6.4	1.4

The share of cash in the initial capital is over 90% at 41.4% (58 firms) of the interviewed enterprises, it is between 60–90% at 5.7% (8 firms) of the enterprises, for 27.1% (38 firms) of the enterprises this figure is 30–60%, for 11.4% of the enterprises it is 10–30% and the share of cash was less than 10% at 12.9% (18 firms) of the enterprises. The share of cash in the initial capital was 10–30% at more than half, 55.6% of the individual enterprises, it was 30–60% at 22.2% of them, and for a same number this figure was above 90%. The share of cash in the initial capital regarding enterprises founded solely by natural persons was over 90% at 43.9% of the firms, between 60–90% at 6.1% of the firms, 30–60% at 26.5% of the firms, 10–30% at 7.1% of the firms, and was less than 10% at 14.3% of the firms. The share of cash in the initial capital regarding enterprises founded by both natural and legal persons was over 90% at 40% of them, 30–60% at 30% of the firms, the figure was less than, between 10–30% than and 60–90% for 10% of the firms in each case. At half of the 10 enterprises founded solely by legal persons the share of cash was over 90%, it was 30–60% at 20% of the firms, 60–90% at the same number of firms, and was less than 10% at 10% of them.

The value of present assets did not exceed 10 million HUF at 52.1% (73 firms) of the total interviewed enterprises, it was less than 1 million HUF at 27.1% (38 firms) of the firms, and it exceeded 10 million HUF only in the case of 14.3% that is 20 firms. The value of the present assets of the 55.6% of individual firms amounted to 1–10 million HUF, 22.2% of them have less than 1 million HUF and the present assets of the same number of firms are worth more than 10 million HUF. Regarding property the status of the co-operative enterprises is the same as it was at the time of foundation. Half of the enterprises founded solely by natural persons has present assets valued at 1–10 million HUF, 30.6% of the firms' present assets are worth less than 1 million HUF, this value exceeds 10 million HUF in the case of 10.2% of the firms. There were 8 enterprises (8.2%) belonging to the group with this ownership structure who did not want to or could not answer that question. From the enterprises founded by both natural and legal persons 65% (13 firms) has assets worth 1–10 million HUF, 20% less than 1 million HUF, and 15% exceeding 10 million HUF.

Among the enterprises founded solely by legal persons the proportion of firms owing assets worth more than 10 million HUF is the highest, 40% (4 firms). 30% of them have assets valued at 1–10 million HUF and the assets are worth less than 1 million HUF in the case of 20% of the firms.

There is no foreign capital involvement in 85% (119 firms) of the interviewed enterprises. There is no foreign interest in the individual or co-operative enterprises. Foreign capital is present in 14.3% (14 firms) of the enterprises founded solely by natural persons, in 20% (4 firms) of the enterprises founded by both natural and legal persons, and in 30% (3 firms) of the enterprises founded solely by legal persons.

One month earlier than the interviews were made the figures were as follows regarding employment: 40.1% (55 firms) of the enterprises employed fewer than 5 employees, 16.1% of them had 6–10 employees, 21.2% had 11–20 employees, 16.8% had 21–50 employees, 5.9% (8 firms) had more than 50 employees. Naturally on the average individual enterprises employed the fewest employees, 55.6% of them had fewer than 5 employees, 22.2% had 6–10 employees, 11.1% had 11–20 employees and another 11.1% had 21–50 employees. 66.7% of the co-operatives employed 21–50 employees, and 33.3% employed 6–10 employees. From the enterprises founded solely by natural persons 44.2% was operating with fewer than 5 employees, 16.8% with 6–10 employees, 20% with 11–20 employees, 13.7% with 21–50 employees, and 5.3% with more than 50 employees. According to the data on the number of employed the enterprises founded by both natural and legal persons show similarities to the previous types of enterprises when 40% of them employed fewer than 5 employees, 10% had 6–10 employees, 25% had 11–20 employees, 20% had 21–50 employees, 5% had more than 50 employees. The enterprises founded solely by legal persons are characterised by larger plant size than the average thus the number of employed was 6–10 at 10% of the firms, 11–20 at 40% of them, 21–50 at 30% of them, and 50 or more at 20% of the firms (*Table 7*).

*Table 7*

**Legal forms and the number of employees in the enterprises**

Specification	0–5	6–10	11–20	21–50	Over 50	No answer	Total
Private firms	5	2	1	1	0	0	9
Co-operative associations	0	1	0	2	0	0	3
Businesses based exclusively on private persons	42	16	19	13	5	3	98

Businesses based on private and legal entities	8	2	5	4	1	0	20
Businesses based exclusively on legal entities	0	1	4	3	2	0	10
<b>Total</b>	<b>55</b>	<b>22</b>	<b>29</b>	<b>23</b>	<b>8</b>	<b>3</b>	<b>140</b>

## 8.2 Characteristics and motivations of entrepreneurs

The age of the majority of entrepreneurs (74%) is between 30–50 years. 38.1% of the entrepreneurs (32 persons) working in cities are 30–40 years old, while another 31% (26 persons) is 40–50 years old. The proportion of both entrepreneurs above 50 or under 30 years is at about 14%. The age of the majority of entrepreneurs in towns, 60% (12 persons) is under 40 years, 20% of them are 40–50 years and an additional 20% is above 50 years old. One-third of the entrepreneurs in small towns (3 persons) are 30–40 years old, two-third of them are 40–50. The age composition of entrepreneurs in villages is similarly varied as the one in cities, 48% (13 persons) of them are between the age of 40–50 years, 30% (8 persons) is 30–40 years old, 11% (3 persons) is younger than 25, 2 persons are 30–40 years old, and one of them is older than 50.

11.1% of the entrepreneurs at individual enterprises are less than 30 years old, 44.4% of them are 30–40 years old, 33.3% is 40–50 years old and 11.1% that is one person did not answer the question. From the three interviewed entrepreneurs at co-operatives two of them are 30–40 years old and one of them is between 40–50. From the entrepreneurs of the enterprises founded solely by natural persons 6.1% was younger than 25 years old, 10.2% that is 10 persons 25–30 years old, 38.8% is 30–40 years old, 34.7% is 40–50 years old, and 10.2% is 50 years old or older. The age composition of the entrepreneurs at the interviewed 20 enterprises founded by both natural and legal persons is slightly higher, 5% is 25–30 years old, 45% is 30–40 years old, 20% is 40–50 years old, 25% is over 50 years old, and one person did not answer. The age of 10% (1 person) of the entrepreneurs at enterprises founded by solely legal persons is 30–40, of 70% is 40–50, and of 20% is 50 or more (*Table 8*).

*Table 8*

### The age of entrepreneurs (%)

Specification	Under 25	25–30	30–40	40–50	Over 50	No answer	Total
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Private firms	0.0	11.1	44.4	33.3	0.0	11.2	100.0
Co-operative associations	0.0	0.0	66.7	33.3	0.0	0.0	100.0
Businesses based exclusively on private persons	6.1	10.2	38.8	34.7	10.2	0.0	100.0
Businesses based on private and legal entities	0.0	5.0	45.0	20.0	25.0	5.0	100.0
Businesses based exclusively on legal entities	0.0	0.0	10.0	70.0	20.0	0.0	100.0
<b>Total</b>	<b>4.3</b>	<b>8.6</b>	<b>38.6</b>	<b>35.0</b>	<b>12.1</b>	<b>1.4</b>	<b>100.0</b>

In all location category the proportion of male entrepreneurs is significantly higher than of the female ones (78% and 22%). It is particularly true in the case of villages where the proportion of female entrepreneurs is less than 15%. On the other hand the proportion of female entrepreneurs is the highest in cities with 24%.

According to the data on gender the following proportion of the entrepreneurs are male: 88.9% (8 persons) from the 9 interviewed individual entrepreneurs, two-third at the co-operatives, 78.6% (77 persons) at enterprises founded solely by natural persons, 75% at enterprises founded by both natural and legal persons, 70% at enterprises founded solely by legal persons (*Table 9*).

*Table 9*

**The sex of entrepreneurs (%)**

Specification	Male	Female
Private firms	88.9	11.1
Co-operative associations	66.7	33.3
Businesses based exclusively on private persons	78.6	21.4
Businesses based on private and legal entities	75.0	25.0
Businesses based exclusively on legal entities	70.0	30.0
<b>Total</b>	<b>77.9</b>	<b>22.1</b>

There was only 1 entrepreneur who only had primary school education. 38% of them (53 persons) earned some kind of a diploma in higher education. 16% of the interviewed (22 persons) earned a diploma in higher technical education, 10% (14 persons) in higher economic education, 1% (person) in higher legal education and 11% (16 persons) in other form of higher education. The proportion of entrepreneurs graduated from secondary technical schools is significantly high, 31% (43 persons), the other 30% either graduated from basic vocational schools or general secondary schools. Regarding educational level the entrepreneurs working in cities show the most varied picture (all categories

are represented), the respective figures for those graduating from different schools are the followings 29% (24 persons) from secondary technical school, 14% (12 persons) from vocational school, 16% (16 persons) from general secondary school, 16% (16 persons) from technical college or university, 13% (11 persons) from economic university, 11% (9 persons) from other colleges or universities, and 1 from primary school and 1 from law school. Thus the proportion of entrepreneurs having a diploma in higher education is over 40% (34 persons). The majority of entrepreneurs in towns, 40% (8 persons) graduated from secondary technical schools, the respective data for the other types of educational institutions are: in each case 15% (3 persons) from vocational school, general secondary school, technical college or university, 5% (1 person) from economic university and 10% (2 persons) from other college or university. 33% (3 persons) of the entrepreneurs in small towns earned a diploma in higher technical education, the figure is 22% (2 persons) for both secondary technical school and economic university, 11% (1 person) for both vocational school and general secondary school. The respective data on graduating from different educational institutions for entrepreneurs settled down in villages are the followings: 33% (9 persons) from secondary technical school, 22% (6 persons) from general secondary school, 15% (4 persons) from basic vocational school, 11% (3 persons) from technical college or university, 18% (5 persons) from other colleges or universities.

The level of education of individual entrepreneurs included in this study is characterised by the following: 44.4% of them were skilled worker, 22.2% earned a diploma at general secondary schools, 11.1% graduated from technical college or university, and 22.2% graduated from other colleges or universities (*Table 10*).

*Table 10*

**The structure of business owner's education (%)**

Specification	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Primary school	0.0	0.0	0.0	5.0	0.0	0.7
Vocational school	44.4	0.0	14.3	5.0	10.0	14.3
Secondary technical school	22.2	0.0	33.7	35.0	10.0	30.7
General secondary school	0.0	33.3	18.4	10.0	20.0	16.4
Higher technical education	11.2	0.0	15.3	10.0	40.0	15.7



Higher economic education	0.0	0.0	7.1	25.0	20.0	10.0
Higher law education	0.0	0.0	1.0	0.0	0.0	0.7
Other higher education	22.2	66.7	10.2	10.0	0.0	11.5
Total	100.0	100.0	100.0	100.0	100.0	100.0

One-third of the entrepreneurs at co-operatives earned a diploma from general secondary school and two-third of them from other colleges or universities. From the entrepreneurs working at enterprises founded solely by natural persons 33.7% (33 persons) graduated from secondary technical schools, 18.4% from general secondary school, 15.3% from technical college or university, 14.3% was skilled worker, 10.2% earned a diploma at other college or university, 7.1% at economic university, and 1% at law school. The respective data for entrepreneurs at enterprises founded by both natural and legal persons are: 35% (7 persons) earned a diploma at secondary technical school, 25% at economic university, 10% at general secondary school, 10% at technical college or university, 10% at other college or university, 5% finished primary school, and 5% basic vocational school. From the entrepreneurs at enterprises founded solely by legal persons 40% graduated from technical college or university, 20% from economic university, 20% from general secondary school, 10% from secondary technical school, and 10% from basic vocational school.

38% (53 persons) of the interviewed entrepreneurs previously worked as a manager, 26% (36 persons) of them as clerical worker, 21% (29 persons) as skilled worker, and 11% (15 persons) of them were the owner or co-owner of another private firm. There was no one among the interviewed who started business because of being unemployed, and it was the first job experience for only 2% that is 3 persons. In the category of big city, that is in Pécs, the proportion of managers was 40% (34 persons), 24% (20 persons) was former clerical workers and an additional 24% (20 persons) was skilled workers previously, and 6% (5 persons) owned another firm or was a co-owner in it. The proportion of entrepreneurs having previous experiences as owners was higher with its 30% in towns, while the proportion of managers was smaller, 25%, and this figure is 35% for clerical workers. 11% of the entrepreneurs living in small towns or villages gained previous experience as owners. The proportion of former clerical workers is most significant with its 44% in small towns. 40% of the interviewed entrepreneurs in villages previously held a manager position.

Analysing the data on the entrepreneurs' previous job we got the following results (*Table 11*).

*Table 11*

### Business owners' former profession (%)

Specification	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Owner of another private company	11.2	0.0	13.3	5.0	0.0	10.7
Manager	0.0	33.3	35.7	50.0	70.0	37.9
Clerical worker	44.4	66.7	22.4	30.0	20.0	25.7
Skilled worker	44.4	0.0	21.4	15.0	10.0	20.8
Unskilled worker	0.0	0.0	1.0	0.0	0.0	0.7
None of the above (first job)	0.0	0.0	3.1	0.0	0.0	2.1
None of the above (unemployed)	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	3.1	0.0	0.0	2.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

From the individual entrepreneurs 44.4% were clerical worker and another 44.4% skilled worker, 11.1% was owner or co-owner at another private enterprise. At the 3 co-operative enterprise two-third of the entrepreneurs was clerical worker, one-third was manager. The data on entrepreneurs working at enterprises founded solely by natural persons show that previously 35.7% of them worked as manager, 22.4% was clerical worker, 21.4% was skilled worker, 13.3% was the owner of another private enterprise, 1% was unskilled worker and this was the first job of 3 persons, 3.1%. Half of the entrepreneurs at enterprises founded by both natural and legal persons was a manager before, 30% of them were clerical workers, 15% worked as skilled worker. The data on entrepreneurs at enterprises founded solely by legal persons showed the highest proportion of former managers, 70%, an additional 20% was clerical worker and 10% was skilled worker.

At the 57% (80 firms) of interviewed enterprises the natural person owner(s) is(are) employed full-time and they have a part-time job at an additional 19% (26 firms) of the firms. The owners are not employed at 16% (23) of the firms. The proportion of owners employed by their own enterprise is the highest in Pécs 61%, the figure is 60% in towns, 56% in small towns, and the lowest, 44% in villages. Among the interviewed the proportion of not employed owners is the highest in small towns and villages 22% in each case, and the lowest, 14% in Pécs.

From the employed owners 63% (88 persons) is a manager or a director, 10% (14 persons) is a clerical worker, 19% (27 persons) is skilled worker, 4% (5 persons) is unskilled worker. The proportion of managers among the em-

ployed owners is decreasing in relation to the size of the settlement of the firm's location, while this figure is 68% in Pécs, it is only 48% in the case of villages. The proportion of clerical workers among the employed owners is the highest in villages 19%, 5 persons.

The natural person owner or owners were employed full time at all of the firms, 77.8% of them hold a manager position, 33.3% is employed as clerical worker, 44.4% as skilled worker, 33.3% as unskilled worker. Among the owners of the co-operative enterprises 33.3% was employed full time and 33.3% was part-time in a manager position or worked as clerical worker. 58.2% of the owners of enterprises founded solely by natural persons were employed full-time (an additional 21.4% in part-time), 66.3% of them worked as manager, 8.2% as clerical worker, 18.4% as skilled worker, and 2% as unskilled worker. 65% of the natural person owners of the enterprises founded by both natural and legal persons were employed full-time and 20% in part-time, 75% of them hold a manager position, 10% worked as clerical worker, 25% as skilled worker.

For the question about the most important motivation for starting up a new business 16% of the interviewed gave the answer of „the need for self-fulfilment”, 19% „the need for independence”, 2% „the need to take risk and to test one's ability”, 37% „the need to gain more money”, 11% „the unemployment”, 4% „the continuation of family traditions”. Nobody chose „imitation of friends and relatives” or „restitution of properties taken over by the state in the past” as motivation factors. To some extent 26% of the entrepreneurs in Pécs, 35% in towns, 11% in small towns, 33% in villages consider self-fulfilment an important factor (according to the questionnaire the order of importance: most important, very important, moderately important). The need for independence is most emphasised by the entrepreneurs (44%) in Pécs, it is considered important by 40% of the entrepreneurs in towns, 22% in small towns and 18% in villages. According to 58% of the entrepreneurs (61% in Pécs, 60% in towns, 78% in small towns, 41% in villages) earning higher income is in some way a motivation factor. Entrepreneurs in small towns felt the most strongly about unemployment, 44% of them marked it, while in the other types of settlement the proportion was only between 18–25%. The continuation of family traditions did not appear important, the highest figure 15% was in villages (*Table 12 and 13*).

*Table 12*

**The most important<sup>1</sup> motivations for setting up a business activity in relation to the company's location (number of answers)**

Motivation	Town of over 100 thousand dwellers	Town of 20–100 thousand dwellers	Town of under 20 thousand dwellers	Village	Total
Need for self-fulfilment	22	7	1	9	39
Need for independence	37	8	2	5	52
Need to take risk and to taste one's ability	15	3	2	3	23
Need to gain more money	51	12	7	11	81
Unemployment	15	5	4	5	29
Following the example of friends and relatives	0	0	0	0	0
Continuation of family traditions	7	1	1	4	13
Reprivatisation of formerly nationalised property	0	0	0	0	0
Other	11	4	0	7	22
<b>Total</b>	<b>158</b>	<b>40</b>	<b>17</b>	<b>44</b>	<b>259</b>

<sup>1</sup> Enumerated by the interviewees on the first position

*Table 13*

**The most important<sup>1</sup> motivations for setting up business activity (%)**

Motivation	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Need for self-fulfilment	11.1	0.0	19.4	10.0	10.0	16.4
Need for independence	11.1	0.0	21.4	25.0	0.0	19.3
Need to take risk and to taste one's ability	0.0	0.0	3.1	0.0	0.0	2.1
Need to gain more money	55.6	33.3	32.7	40.0	60.0	37.1
Unemployment	22.2	0.0	9.2	20.0	0.0	10.7
Following the example of friends and relatives	0.0	0.0	0.0	0.0	0.0	0.0
Continuation of family traditions	0.0	0.0	5.1	0.0	0.0	3.6
Reprivatisation of formerly nationalised property	0.0	0.0	0.0	0.0	0.0	0.0

Other	0.0	33.3	11.2	15.0	30.0	12.9
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<sup>1</sup> Enumerated by the interviewees on the first position

For the question on the motivations for starting up a new business the following answers were given, the respective percentage is indicated; need for self-fulfilment by 11.1%, need for independence by 11.1%, need for higher income by 55.6%, unemployment by 22.2%. 33.3% of the entrepreneurs at cooperative enterprises found higher income, and 33.3% independence as important motivation factors. For the entrepreneurs at enterprises founded solely by natural persons the most important motivation factors were self-fulfilment, 19.4%, need for independence, 21.4%, need to test one's ability, 3.1%, need to earn higher income, 32.7%, unemployment, 9.2%, to continue family traditions, 5.1%. The entrepreneurs at enterprises founded by both natural and legal persons found the followings the most important motivation factors: self-fulfilment, 10%, need for independence, 25%, higher income, 40%, unemployment, 20%. The entrepreneurs at enterprises founded solely by legal persons saw self-fulfilment 10%, and unemployment, 60%, as the most important motivation factors.

The decisive majority of the initial capital of the interviewed enterprises was originated from own savings accumulated in Hungary. For 65% (91 firms) of the entrepreneurs this was the only source of initial capital. Two-third of the initial capital was made up by it for 6% (4 firms) of the enterprises. Half of the initial capital came from this source for 10% (14 firms) of the ventures, and a quarter of it for 1.4% (2 firms). This source of capital played the most important role in cities, where 84% of the enterprises counted on it to the extent of 25–100% of their capital. The importance of this source was the lowest in small towns. Money earned abroad was used to start business by only two entrepreneurs in Pécs covering 50 or 75% of the initial capital. 9% that is 12 entrepreneurs asked for loans from friends or relatives, from them 5 are pursuing business in villages, it means 19% of the enterprises operating in villages. (2 persons – 1 in Pécs, the other in town – covered their initial capital fully from this source.) The initial capital, at least in part, originated from capital from foreign private enterprises and joint ventures in the case of 10% of the enterprises. (The capital of 2 firms in Pécs, and 1 in a town and another one in small town was fully covered by it.) This source played some role in the foundation of 12% of the enterprises in cities, 10% of firms in towns, 11% of firms in small towns, and 4% in villages. Only two enterprises in Pécs obtained loans from foreign banks and financial institutions, it covered 100% of the needed initial capital. It means 1.4% of the total enterprises. Loans from government or local governments were provided to start up business for 7% (10 firms) of the enterprises, it includes 4 firms in Pécs (5% of the total number of firms in cities), 2 firms (7.4%) in villages. The amount covered the 100% of the initial capital. 13% of

the firms used other sources for setting up business. the proportion of other sources was the highest, 33% in small towns (*Table 14*).

*Table 14*

**Sources of initial capital in relation to the company's location (number of answers)**

Sources of initial capital	Town of over 100 thousand dwellers	Town of 20–100 thousand dwellers	Town of under 20 thousand dwellers	Village	Total
Personal savings	70	16	5	22	113
Money earned abroad	2	0	0	0	2
Loans from friends and relatives	3	3	0	5	11
Capital from private foreign enterprises or joint ventures	9	2	1	1	13
Loans from foreign banks or other foreign financial institutions	2	0	0	0	2
Money from government or local authorities	7	1	0	2	10
Other	9	2	3	4	18
<b>Total</b>	<b>102</b>	<b>24</b>	<b>9</b>	<b>34</b>	<b>169</b>

Regarding individual enterprises the source of initial capital was own savings accumulated in Hungary for 66.7% of them, 11.1% got loans from friends and relatives. 66.7% of the co-operative enterprises started up new business only on own savings accumulated in Hungary, 33.3% ensured three-quarter of the needed capital from this source. With respect to enterprises founded solely by natural persons the source of the total initial capital was own savings accumulated in Hungary for 67.3%, capital gained from foreign private or joint enterprises for 3.1%, loans from foreign banks for 2%, loans provided by the government or local governments for 5.1%. 65% of the enterprises founded by both natural and legal persons could start up business exclusively on own savings accumulated in Hungary, 10% of them covered half of the needed capital by capital from foreign private ventures, and 5% obtained loans provided by the government or local governments. The whole initial capital is originated from own savings accumulated in Hungary for 40% of the enterprises founded solely by legal persons, from capital of foreign private firms for 10% and other sources for 20% (*Table 15*).

*Table 15*

**Source of initial capital (number of answers)**

Sources of initial capital	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Personal savings	6	3	87	13	4	113
Money earned abroad	0	0	2	0	0	2
Loans from friends and relatives	2	0	9	0	0	11
Capital from private foreign enterprises or joint ventures	0	0	7	2	4	13
Loans from foreign banks or other foreign financial institutions	0	0	2	0	0	2
Money from government or local authorities	1	0	8	1	0	10
Other	1	1	8	4	4	18
<b>Total</b>	<b>10</b>	<b>4</b>	<b>123</b>	<b>20</b>	<b>12</b>	<b>169</b>

### 8.3 Factors of production

From the 140 interviewed small enterprise 84.3% had employees. 40% of the enterprises employed more than 10 persons, 23% of them had 1–5 employees. The enterprises with higher number of employees are not particularly characteristic of towns, since while the proportion of enterprises employing more than 10 employees is 41.8% in Pécs, this figure is 55.5% in small towns and 33.3% in villages. On the other hand the proportion of enterprises employing more than 20 employees is very low in villages, only 3.8% (*Table 16 and 17*).

*Table 16*

#### Number of regular employees in relation to the company's location (%)

Number of regular employees	Town of over 100 thousand dwellers	Town of 20–100 thousand dwellers	Town of under 20 thousand dwellers	Village	Total
None	14.3	15.0	33.3	14.8	15.7
One	4.8	0.0	0.0	11.1	5.0
2–5	25.0	30.0	11.1	14.8	22.9
6–10	11.9	20.0	0.0	25.9	15.0
11–20	19.0	10.0	22.2	29.6	20.0
Over 20	23.8	20.0	33.3	3.8	20.0
No answer	1.2	5.0	0.0	0.0	1.4
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

*Table 17*

### Number of regular employees in relation to the type of enterprises (%)

Number of regular employees	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
None	11.1	0.0	20.4	5.0	0.0	15.7
One	11.1	0.0	5.1	5.0	0.0	5.0
2–5	44.5	0.0	23.5	25.0	0.0	22.9
6–10	11.1	33.3	14.3	20.0	10.0	15.0
11–20	11.1	0.0	19.4	20.0	40.0	20.0
Over 20	11.1	66.7	15.3	25.0	50.0	20.0
No answer	0.0	0.0	2.0	0.0	0.0	1.4
Total	100.0	100.0	100.0	100.0	100.0	100.0

There is a quite diverse picture of the types of employees at small enterprises. The four studied groups (manager, clerical worker, skilled worker, unskilled worker) show an uneven distribution among the enterprises. There are no managers at 68.6% of the small enterprises, and no clerical workers at 65% of them, 26.6% does not employ skilled worker, and 57.1% does not employ unskilled worker. Since the more diversified ventures are located in Pécs it is understandable that one-third of the organisations there employ 1–5 managers. Only one-fifth of the enterprises in villages employ one manager. We found similar ratios with respect to clerical workers.

The size and the type of activities of an enterprise determine the employment of qualified worker. Three-quarter of the enterprises located in Pécs employ skilled worker, and 60% of the skilled workers employed by small enterprises in the county are working in Pécs. It is a good sign that the ratio of unskilled workers is 42.9% in the county, while it is 34.5% at firms in Pécs.

The unfavourable situation of the labour market in Baranya county is reflected in the answers given to the question on labour market supply for small enterprises. The relatively high (12.3%) unemployment rate is in the enterprises' favour since it is easier to find labour force.

Regarding all groups of employees the majority of the interviewed firms did not have any difficulty in recruiting workers. Firms having manager or clerical worker position could find somebody to employ almost immediately, it was a little bit more difficult to find skilled worker, 25% of the entrepreneurs met with some problems (*Table 18*).

*Table 18*



**Recruitment of what employees posed problems for the enterprises  
(number of answers)**

Specification	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Managers	0	0	3	0	0	3
Clerical workers	0	1	2	0	0	3
Skilled workers	1	2	23	8	1	35
Unskilled workers	0	0	10	0	2	12
<b>Total</b>	<b>1</b>	<b>3</b>	<b>38</b>	<b>8</b>	<b>3</b>	<b>53</b>

A typical characteristic of small enterprises is that they have only one site – operating in a building. 86% of them are operating in one building, 6.4% of them in two and 5% in more than two buildings. One-third of them rent the place of operation, and two-third of them owns it (*Table 19*).

*Table 19*

**Buildings used by the enterprises (number of answers)**

Specification	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Own buildings	6	3	44	6	3	62
Rented buildings	3	0	59	14	7	83
No answer	0	0	2	0	0	2
<b>Total</b>	<b>9</b>	<b>3</b>	<b>105</b>	<b>20</b>	<b>10</b>	<b>145</b>

92.1% of the enterprises use machinery-equipment. 34.3% of them use less than 5, 21.4% between 5–10 and 30.7% use more than 10 machineries-equipments. The firms own the majority of the machinery-equipments. Non of the enterprises used the leasing technique.

The quality of the building stock shows the peculiarities of the Hungarian enterprise development. Since most of the enterprises burst into business life the entrepreneurs operating their business with a lack of capital rather financed the improvement of machinery and equipment than the investments on buildings from sources separated for investments. Thus 60.7% of the operating enterprises do business in buildings that was not built for the purpose of production. It is probable that the higher prices of real property account for that the highest ratio (66.7%) is in Pécs (*Table 20 and 21*).

*Table 20*

**Were the buildings designed for the current manufacturing process? (%)**

Specification	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Yes	66.7	33.3	37.8	35.0	40.0	39.3
No	33.3	66.7	62.2	65.0	60.0	60.7
Total	100.0	100.0	100.0	100.0	100.0	100.0

*Table 21*

**Were the buildings designed for the current manufacturing process? (%)**

Specification	Town of over 100 thousand dwellers	Town of 20–100 thousand dwellers	Town of under 20 thousand dwellers	Village	Total
Yes	33.3	45.0	55.6	48.1	39.3
No	66.7	55.0	44.4	51.9	60.7
Total	100.0	100.0	100.0	100.0	100.0

An almost accurate information is given on the technical status of enterprises by the data about the age of machinery and equipment. Though the age is not an entirely reliable source for qualifying the technical-technological status, these data can indicate the quality of the produced products. Regarding the technical status of the technological machinery-equipment the situation is not too favourable. The average age of the machinery is more than one year at 72.9% of the interviewed enterprises. The ratio of the 1–5 year old machinery is 52.9%, also the ratio of the 6–15 year old machinery is high too (32.1%). The outdated technology is especially characteristic to enterprises in Pécs, where the proportion of the 15 year old machinery is high regardless of the size of the firm (*Table 22*).

*Table 22*

**Average age of the machinery used by the enterprises  
(number of answers)**

Average age	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
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Under one year	1	1	28	5	1	36
1–5 years	4	1	46	9	2	62
6–15 years	3	1	63	16	6	89
<b>Total</b>	<b>8</b>	<b>3</b>	<b>137</b>	<b>30</b>	<b>9</b>	<b>187</b>

There is a similarly unfavourable situation regarding the proportion of used machinery. 65% (69% in Pécs) of the firms operate with only used machinery. Only one-tenth of the enterprises work with entirely new machinery and equipment, and the ratio of used machinery is less than 50% at only 2.9% of them (*Table 23*).

*Table 23*

**Share of second hand machinery in its total amount (%)**

Share	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
None	22.2	0.0	18.3	10.0	20.0	17.1
1–50%	0.0	0.0	4.1	0.0	0.0	2.9
51–99%	11.1	33.3	14.3	15.0	10.0	14.3
100%	66.7	66.7	62.3	75.0	70.0	65.0
No answer	0.0	0.0	1.0	0.0	0.0	0.7
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

The supply of computer technology is poor at the enterprises. 35.7% of them have computers, there is no difference between the enterprises in towns or in villages. Though 86.4% of them use computers for office work and 77.1% for management purposes through other organisations. The application of modern methods in production management is not widespread yet (*Table 24*).

*Table 24*

**The supply of computer technology (%)**

Specification	Town of over 100 thousand dwellers	Town of 20–100 thousand dwellers	Town of under 20 thousand dwellers	Village	Total
Yes	36.9	25.0	44.4	37.0	35.7
No	63.1	75.0	55.6	63.0	64.3
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

35% of the firms do not keep stockpiles. 29.3% of them operate with a stock lower than 25% of the turnover, half of them operate with a stock between

50–75% of it, and the stock is greater than the turnover only at 5% of the firms (Table 25).

Table 25

**Share of stockpiles on firms turnover (%)**

Share	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
None	55.6	33.3	31.6	30.0	60.0	35.0
1–25%	22.2	66.7	28.6	30.0	30.0	29.3
26–50%	0.0	0.0	20.4	15.0	10.0	17.1
51–75%	0.0	0.0	5.1	0.0	0.0	3.6
76–100%	0.0	0.0	3.1	0.0	0.0	2.1
Over 100%	11.1	0.0	1.0	25.0	0.0	5.0
No answer	11.1	0.0	10.2	0.0	0.0	7.9
Total	100.0	100.0	100.0	100.0	100.0	100.0

The extremely low import component of the products made by small enterprises is shown by the fact that only 26.4% of the interviewed firms have stock with foreign origin. We found similar ratios in all settlement categories. The share of imported goods is above 50% in the total stockpile only at 9.3% of the firms.

The majority of the enterprises (82.1%) does not use intermediate goods. They purchase raw material, complementary goods and energy. 9.2% of the interviewed buy the intermediate goods from local (county) producers, 10.1% buy them from Hungarian suppliers, and 1.4% obtains them from foreign sources. Regarding the share of intermediate goods we found only a few enterprises that buy more than half of the products from foreign suppliers. The enterprises purchasing 75–100% from outsiders get their product from local or national producers in a similar ratio. In this category group only 6 enterprises have contacts with foreign suppliers.

**8.4 Products, markets, competitors**

Decisively concentrated product scale characterises the activities of the interviewed enterprises: principal product represented a proportion between 75 and 100% of the total sales at three-quarter (75.7%) of the enterprises, and 64% of the firms do not have „a second most important product”. Totally 30 entrepreneurs indicated a second important product (21.4%), five (3.6%) indicated a third product and only one marked fourth and fifth product. The proportion of products other than the principal product in total sales was less than 25%: from

the 30 enterprises 10 indicated a 25 to 50% proportion of sales for the second most important product.

There is no significant difference in the concentration of the product scale (homogeneity of the activities) as to the location of the enterprise, or its form of ownership. More diversified products (only up to 2 products) are present at a relatively large proportion of enterprises operating in towns with a population less than 20 thousand (small towns), and beyond that in Pécs, where the number of products are 3, 4 or 5 some times.

With respect to the distribution of ownership structure a more varied scale of products can be found at individual enterprises and enterprises founded solely by legal persons, although together they account only for a smaller number of the total interviewed firms, one-seventh of them.

81.4% of the enterprises carry out all phases of production themselves, they do not co-operate. Considering that an overwhelming majority of the enterprises are organisations operating with only few employees, fewer than 20 persons, it also means that the main output determining the homogeneity of the production is a relatively simple product, it goes through only a small number of production phases and does not require the involvement of specialised organisations.

Regarding the location of the enterprises external co-operation characterises the organisations in Pécs and in small towns, while considering owners this is a characteristic of enterprises founded solely by natural persons, however it means only a small divergence compared to the situation characterising the total sample (*Table 26*).

The main form of co-operation in production is subcontracting (half of the 26 enterprises indicating co-operation preferred it), first of all, to domestic entrepreneurs (in 11 cases) working with few employees (fewer than 5) or to local enterprises (8 cases) with few employees. Only 5 of the interviewed enterprises established co-operation with foreign companies (these are firms with foreign capital interest).

*Table 26*

**Does the firm carry out all phases of production?**

Specification	Yes		No		Total	
	Number of answers	%	Number of answers	%	Number of answers	%
Town of over 100 thousand dwellers	67	79.8	17	20.2	84	60.0

Town of 20–100 thousand dwellers	17	85.0	3	15.0	20	14.3
Town of under 20 thousand dwellers	7	77.8	2	22.2	9	6.4
Village	23	85.2	4	14.8	27	19.3
<b>Total</b>	<b>114</b>	<b>81.4</b>	<b>26</b>	<b>18.6</b>	<b>140</b>	<b>100.0</b>
Private firms	9	100.0	0	–	9	6.4
Co-operative associations	2	66.7	1	33.3	3	2.1
Businesses based exclusively on private persons	77	78.6	21	21.4	98	70.0
Businesses based on private and legal entities	17	85.0	3	15.0	20	14.3
Businesses based exclusively on legal entities	9	90.0	1	10.0	4	7.1
<b>Total</b>	<b>114</b>	<b>81.4</b>	<b>26</b>	<b>18.6</b>	<b>140</b>	<b>100.0</b>

The composition of total sales by targets is characterised by an even distribution (diversification, if you wish), among final consumers, retail shops, wholesalers, manufacturing firms. All interviewed enterprises had their own shop, but do not have an own network of shops (characteristically, one or two shops are operated either at the plant site or at the settlement) (*Table 27*).

Almost all enterprises used the above mentioned four channels of distribution to some extent, though the most important buyers (with a ratio of sales above 50%) of the firms' product were the final consumers for 24%, the retail shops for 18%, wholesalers for 12%, and manufacturing firms for 23% of the enterprises. According to the answers all channels of distribution mean a sale relation with several organisations of similar type at the same time. It was observed that the most important client bought more than half of the sold products at 37% of the enterprises, and half of the sales were absorbed by the five most important clients only at 38% of the firms. It means that usually there is only one important client, and the others are smaller ones with similar significance.

Thus while the activity is characterised by a production with few phases, reliance on one or only a few products and a low frequency of production co-operation, in summary by a simple production character, the sale is characterised by extended market relationships with large number of contacts.

*Table 27*

**The main buyers of firm products (number of answers)**

Specification	Final consumers	Retail shops	Wholesalers	Manufacturing firms	Total
Town of over 100 thousand dwellers	23	15	9	15	62

Town of 20–100 thousand dwellers	2	5	2	7	16
Town of under 20 thousand dwellers	1	3	1	1	6
Village	8	4	4	9	25
<b>Total</b>	<b>34</b>	<b>27</b>	<b>16</b>	<b>32</b>	<b>109</b>
Private firms	3	2	1	0	6
Co-operative associations	0	0	1	2	3
Businesses based exclusively on private persons	29	20	8	19	76
Businesses based on private and legal entities	2	3	5	6	16
Businesses based exclusively on legal entities	0	2	1	5	8
<b>Total</b>	<b>34</b>	<b>27</b>	<b>16</b>	<b>32</b>	<b>109</b>

The enterprises in their first phase start according to their market opportunities, not depending upon the concentration of demand, and undertake the manufacturing of one or two products that are the simplest, require the smallest capital and can be brought into being the fastest. A more difficult product (service), a more diversified production, and the need for co-operation would require longer preparation (and probable large capital accumulation), therefore the second phase of the diffusion and strengthening of the enterprise, or the second generation, will be characterised by them. At that time though the sales relationships will be more concentrated and probably more stable. This above mentioned sales diversity also means that up to now sales channels and long-term partner relationships have not been established, and the majority of the enterprises sell (distribute) their products by themselves on the market (not relying on specialised organisations).

According to the geographical location of the enterprises the structure of sales relations shows that the market relations of the enterprises in small villages are the most concentrated (93% of them are using one of the first four channels to distribute more than half of their product, within it the final consumers and the manufacturing firms are the most important, additionally the most important client accounts for more than half of the sales at 60% of the enterprises in villages, moreover it is not characteristic to establish a significant sales relationship with more than five clients). Among the other groups the distribution picture by sales partners is the most varied at enterprises in Pécs. Enterprises in towns are concentrated in terms of the number of important clients, and these clients are typically retail shops and manufacturers. In the case of small town enterprises, partly because of the small sample, there is no significant concentration, their sales relations are individual and rather scattered (*Table 28*).

Table 28

**Degree of company's dependence on one to five most important clients  
(number of answers)**

Specification	The most important client buys 50–100%	Five most important clients buy 50–100%	Total
Town of over 100 thousand dwellers	30	29	59
Town of 20–100 thousand dwellers	4	12	16
Town of under 20 thousand dwellers	2	2	4
Village	16	10	26
Total	52	53	105
Private firms	1	4	5
Co-operative associations	3	1	4
Businesses based exclusively on private persons	29	36	65
Businesses based on private and legal entities	11	9	20
Businesses based exclusively on legal entities	8	3	11
Total	52	53	105

In the examination of sales relations from the point of view of ownership structure it seems to be the most important of the characteristics that firms owned partly or entirely by legal persons are in connection with fewer and more determinant partners, and sell primarily to wholesalers and manufacturers. The dispersal of sales is characteristic mainly in the case of individual enterprises or enterprises founded solely by natural persons. Co-operative, although being composed of individuals, can rather be included in the first (legal entity) group.

86% of the responding enterprises were able to identify the typical geographical location of their sales market. Accordingly, the majority of them (52%) sells in their respective local (regional) markets, that is, more than 50% of their sales are directed to these markets. Next is the domestic (national) market (27%), while at 21% of the firms more than half of the sales are directed to Western (European or other developed) country (these can be most appropriately described as OECD countries). According to geographical location of foreign sales partners the former COMECON countries are mentioned only in very few cases, representing insignificant proportion of sales.

Two-third of the firms in villages claimed that their local (regional) market is the most important, and only 13% of them sells the majority of output abroad. In the group of enterprises in towns and small towns the foreign sales orientation is above average, however, the proportion of national and local mar-



kets together still represents more than two-thirds (within which local, regional, and national markets have approximately similar weights). The Pécs firms, naturally, represent the average values here as well.

From the ownership viewpoint it is characteristic, too, that the domestic market direction has a weight of at least two-thirds at each organisational form. Within this, business associations founded solely by natural persons or natural and legal persons (which have decisive weight in the sample) work primarily for the local market, this orientation is mentioned twice more frequently than the national market. Foreign sales (which, as it has been shown above, means only developed Western countries) are represented by above the average values only in the case of organisations owned partly or entirely by legal persons. Individual entrepreneurs did not mention such a significant ratio of sales at all, even in the case of enterprises founded solely by natural persons only 18% of them sell primarily abroad (*Table 29*).

*Table 29*

**Geographical structure of SMEs' sales market (number of answers)**

Specification	Local market	National market	COMECON countries	Western countries	Total
Town of over 100 thousand dwellers	36	20	0	14	70
Town of 20–100 thousand dwellers	8	5	0	6	19
Town of under 20 thousand dwellers	3	3	0	2	8
Village	16	5	0	3	24
<b>Total</b>	<b>63</b>	<b>33</b>	<b>0</b>	<b>25</b>	<b>121</b>
Private firms	3	5	0	0	8
Co-operative associations	1	1	0	1	3
Businesses based exclusively on private persons	47	21	0	15	83
Businesses based on private and legal entities	9	4	0	7	20
Businesses based exclusively on legal entities	3	2	0	2	7
<b>Total</b>	<b>63</b>	<b>33</b>	<b>0</b>	<b>25</b>	<b>121</b>

Almost one-quarter of the enterprises (23%) believes that they have no significant competitor. Within this primarily firms in villages and towns, or according to the form of organisation, co-operatives and firms owned entirely or partly by legal persons feel that the market lacks competitors.

The 108 organisations that believe that they work in the presence of competitor(s) named 1,3 strong competitive firms on the average. Half of these

mention individual entrepreneurs as major competitors, next are private firms (34%) and state owned enterprises (27%).

From the firms in Pécs 81% answered that they have one or more competitor present in the market. Out of these 54% named individual entrepreneurs, and 38% private firms, as major rivals. In the case of groups of other location the distribution of types of competitors is more even, but most frequent ones are almost always individual entrepreneurs and private firms. The only exception is the group of village business organisations, where half of the respondents who mentions significant competitor(s) names state owned enterprises as most important.

There is no significant difference regarding the type of competitors among groups of respondents according to ownership structure (*Table 30*).

*Table 30*

**Organisational and legal forms of SMEs' competitors (number of answers)**

Specification	No-body	Individual entrepreneurs	Private firms	State owned firms	Co-operatives	Importers	Others	Total
Town of over 100 thousand dwellers	16	37	26	15	3	3	4	104
Town of 20–100 thousand dwellers	7	5	3	3	1	2	0	21
Town of under 20 thousand dwellers	2	3	2	1	0	2	1	11
Village	7	9	6	10	3	0	0	35
<b>Total</b>	<b>32</b>	<b>54</b>	<b>37</b>	<b>29</b>	<b>7</b>	<b>7</b>	<b>5</b>	<b>171</b>
Private firms	1	4	3	0	0	1	2	11
Co-operative associations	1	1	1	0	0	0	0	3
Businesses based exclusively on private persons	21	40	27	21	6	3	3	121
Businesses based on private and legal entities	6	8	4	4	1	2	0	25
Businesses based exclusively on legal entities	3	1	2	4	0	1	0	11
<b>Total</b>	<b>32</b>	<b>54</b>	<b>37</b>	<b>29</b>	<b>7</b>	<b>7</b>	<b>5</b>	<b>171</b>

A very vague tendency may be noticed perhaps that proceeding from individual entrepreneurs to organisations owned entirely by legal persons the named competitors are increasingly compound organisations (private firms,

state owned enterprises, co-operative firms, importer organisations, etc.) That is, private firms and business organisations of solely private individuals are the main competitors, however, the perceived competitors are characterised according to the form and size of the respondent organisation, and the relatively typical competitor group has similar properties (for example, individual entrepreneur for individual entrepreneur, or state owned firm for business organisation of legal persons, etc.) .

Half of the perceived strongest competitors are local ones (working within the county). About 40% of the respondents referred to domestic competitors out of their respective region, and only one-tenth of the respondents mentioned foreign competition.

Groups of respondents according to geographical location and ownership structure produced the same distribution almost to the one percent accuracy as a result of their answers (*Table 31*).

*Table 31*

**Location of SMEs' strongest competitors (number of answers)**

Specification	Local	National	Foreign	Total
Town of over 100 thousand dwellers	33	32	9	74
Town of 20–100 thousand dwellers	9	5	1	15
Town of under 20 thousand dwellers	4	3	1	8
Village	14	8	1	23
<b>Total</b>	<b>60</b>	<b>48</b>	<b>12</b>	<b>120</b>
Private firms	4	4	1	9
Co-operative associations	1	1	1	3
Businesses based exclusively on private persons	44	35	8	87
Businesses based on private and legal entities	7	7	0	14
Businesses based exclusively on legal entities	4	1	2	7
<b>Total</b>	<b>60</b>	<b>48</b>	<b>12</b>	<b>120</b>

Regarding the advantages of competitors and the disadvantages of own firms approximately the same number of answers were received. About 32% of the respondents do not feel specific advantage of their competitors, and 23% of them do not feel own weakness. (These ratios are approximately the same

through the various business groups.) These are the most frequent answers, too. Next to the answer that the competitor has no advantage at all, the second most frequent answer (25%) is, surprisingly, the larger plant size (seen this way especially by non-Pécs town and village firms), then capital strength is the third factor mentioned by 21% of the firms as one of the important advantage of the competitor. (This, on the other hand, is felt relatively more frequently by firms in Pécs.) (Table 32)

Table 32

**Advantages of competitors by location of firms (number of answers)**

Specification	Town of over 100 thousand dwellers	Town of 20–100 thousand dwellers	Town of un- der 20 thou- sand dwellers	Village	Total
Larger plant size	19	8	2	6	35
Efficiency of production	9	3	1	2	15
Technological innovation	8	4	4	5	21
Low overhead costs	8	0	11	3	12
Marketing and advertising expertise	8	1	0	0	9
Efficient channels of distribution	9	2	0	5	16
Credit availability	4	0	2	3	9
High start up and/or working capital	21	3	1	5	30
Quality of products	6	1	0	2	9
Low wages and salaries	6	0	0	3	9
Others	12	0	2	2	16
None	26	7	3	9	45
<b>Total</b>	<b>84</b>	<b>20</b>	<b>9</b>	<b>27</b>	<b>140</b>

From the ownership structure aspect the order and frequency of the above answers is most characteristic in the case of business organisations founded solely or partly by natural persons. (The other groups, partly because of the low number of their members, demonstrate individual characteristics neither here, nor when naming their own weakness.) (Table 33)

Answers regarding own weakness are much less concentrated to one factor. Besides the answer „there is no such” the most frequent is „other” (according to the adjoining verbal explanations these are related to occasional, temporary, often alleged factors, thus this category can hardly interpreted as answer). A relatively more frequently mentioned perceived weakness is capital

size (apparently with opposite sign), available loans, and technological innovation (which appear characteristically at entrepreneurs in Pécs and at business organisations owned entirely or partly by natural persons) (Table 34 and 35).

Table 33

**Advantages of competitors by legal forms of firms (number of answers)**

Specification	Private firms	Co-operatives	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Larger plant size	1	0	26	6	2	35
Efficiency of production	1	0	7	6	1	15
Technological innovation	1	0	16	2	2	21
Low overhead costs	0	1	7	2	2	12
Marketing and advertising expertise	0	0	7	1	1	9
Efficient channels of distribution	0	0	10	5	1	16
Credit availability	2	0	5	2	0	9
High start up and/or working capital	0	0	26	3	1	30
Quality of products	0	0	7	1	1	9
Low wages and salaries	0	0	6	2	1	9
Others	3	0	10	0	3	16
None	4	2	28	8	3	45
Total	9	3	98	20	10	140

Table 34

**Weaknesses of own enterprises by location of firms (number of answers)**

Specification	Town of over 100 thousand dwellers	Town of 20–100 thousand dwellers	Town of under 20 thousand dwellers	Village	Total
Larger plant size	12	2	1	4	19
Efficiency of production	14	3	1	1	19
Technological innovation	11	3	1	5	20
Low overhead costs	10	2	0	1	13
Marketing and advertising expertise	10	0	2	1	13
Efficient channels of distribution	6	1	0	3	10
Credit availability	13	3	1	4	21
High start up and/or working capital	18	2	0	4	24
Quality of products	7	0	0	1	8
Low wages and salaries	5	1	0	2	8

Others	13	6	3	8	30
None	19	4	4	5	32
<b>Total</b>	<b>84</b>	<b>20</b>	<b>9</b>	<b>27</b>	<b>140</b>

*Table 35*

**Weaknesses of own enterprise by legal forms of firms (number of answers)**

Specification	Private firms	Co-operatives	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Larger plant size	2	0	16	0	1	19
Efficiency of production	0	1	13	4	1	19
Technological innovation	1	0	16	2	1	20
Low overhead costs	1	0	7	3	2	13
Marketing and advertising expertise	1	1	9	2	0	13
Efficient channels of distribution	1	0	7	1	1	10
Credit availability	2	1	12	5	1	21
High start up and/or working capital	1	0	18	4	1	24
Quality of products	1	0	3	2	2	8
Low wages and salaries	0	2	3	2	1	8
Others	3	1	19	5	2	30
None	3	0	22	4	3	32
<b>Total</b>	<b>9</b>	<b>3</b>	<b>98</b>	<b>20</b>	<b>10</b>	<b>140</b>

Considering advantages of competitors and own weakness pairwise from the aspect of market competition, from the viewpoint of an entrepreneur the critical factors are those where both are more frequent: strength of competitor meets weakness or own firm. According to responses such factors are efficiency of production, plant size, technological innovation, and capital size. Besides these, rather as own weakness, availability of loans can be mentioned. That is, respondents believe that their market position is primarily dependent on the availability of production factors, and there is relatively lesser role of, for example, product quality, marketing, advertising, sales channels, etc. It can be seen again that we are only in the initial, spontaneous phase of the diffusion of (Eastern European) entrepreneurship, which has just succeeded, often on a constrained track, the centralised planned (shortage) economies; and the entrepreneurial standards and quality demanded by a real market economy can be observed rarely.

## 8.5 Services and financial activities

General administration as a service is supplied partly or entirely from internal sources at the majority of the interviewed enterprises (120 from 140). This statement is valid for all types of settlements. Half of the interviewed firms turn to an accounting and consulting firm to fulfil their obligations (from the 140 firms only 63 firms tried to find some internal solution), in this case no differences were found with respect to plant sites either. 65 firms indicated that to some extent they pursue their own marketing activities, an additional 13 firms said to use external sources, thus the conclusion can be drawn that close to half of the firms do not pursue any kind of planned marketing activity.

More than half of the enterprises in cities and villages asked for marketing services (from internal or external sources), the figures are 46 firms from 84 firms in Pécs, 19 firms out of 27 firms located in villages, meanwhile only 9 from the 20 enterprises in towns, and 4 from the 9 firms in small towns. 102 firms use internal sources for performing commercial activities to domestic markets and an additional 20 firms used external source. The use of internal sources is the strongest at firms in villages, from the 27 interviewed firms 23 gave such an answer. Commercial activities related to foreign markets are done by the firm itself at 35 enterprises, and 25 firms requested external help. Regarding this field from the 84 entrepreneurs in cities 24 of them solved its problem mostly within the firm and 14 firms asked for external services.

The figures for enterprises on using internal or external help in commercial services are as follows: from the 20 firms in town 4 asked for internal, 3 external help, from the 9 firms in small town 2 for internal 3 external help, from the 27 firms in villages 7 for internal 5 external help. To provide technical-engineering services 69 enterprise looked for internal solution at least partly, and 20 firms found external solution. To some extent more than half of the enterprises located in towns and in villages solved the technical-engineering problems from own sources. Financial services are provided from internal sources at most of the interviewed firms (103 firms from the 140 enterprises included in the study), 27 firms looked for external solution. This statement is not true for the enterprises with plant site in small towns, since from the 9 interviewed firms only 4 indicated internal solution. 43 enterprises provided their own security-guard service, 13 firms turned to other organisations. It is the most frequently requested service by the enterprises in villages, 14 firms from the 27 indicated and 11 enterprises provided it within the firm.

All individual and co-operative enterprises provide more than 50% of the general administration by themselves. 87.5–95.2% of the enterprises founded

solely by natural or legal persons, founded by both natural and legal persons act similarly. Accounting and tax consulting were provided from internal sources at 4 individual, 2 co-operative enterprises, 40 enterprises founded solely by natural persons, 13 enterprises founded by both natural and legal persons, and 4 enterprises founded solely by legal persons. Within that more than half of this type of service was given from internal sources by 25% of the individual enterprises, 100% of the co-operative enterprises, 82.5% of the enterprises founded solely by natural persons, 76.9% of the enterprises founded by both natural and legal persons, and all the enterprises founded solely by legal persons.

Marketing services are partly performed from internal supply by 5 individual, 1 co-operative enterprises, 44 enterprises founded solely by natural persons, 13 enterprises founded by both natural and legal persons, 2 enterprises founded solely by legal persons. Within that 100% of the individual, co-operative enterprises and enterprises founded solely by legal persons, 88.6% of the enterprises founded solely by natural persons, and 92.3% of the enterprises founded by both natural and legal persons provide marketing services from internal sources.

Sales activities for domestic markets are provided partly from internal sources by 8 individual and 2 co-operative firms, 78 enterprises founded solely by natural persons, 11 enterprises founded by both natural and legal persons and 3 enterprises founded solely by legal persons. Within this 100% of the individual and co-operative firms, and the enterprises founded by both natural and legal persons and enterprises founded solely by legal persons also 97.4% of the enterprises founded solely by natural persons relied on internal source to more than 50% in performing sales activities for domestic markets.

Sales for foreign markets are accomplished partly from external source by 2 individual enterprise, 26 enterprises founded solely by natural persons, 7 enterprises founded by both natural and legal persons, 2 enterprises founded solely by legal persons. Among them 50% of the individual enterprises, 73.1% of the enterprises founded solely by natural persons, 71.4% of the enterprises founded by both natural and legal persons, and 100% of the enterprises founded solely by legal persons relied on external source to more than 50% regarding foreign markets' sales.

4 individual enterprises, 1 co-operative firm, 52 enterprises founded solely by natural persons, 8 enterprises founded by both natural and legal persons, 4 enterprises founded solely by legal persons tried to find internal solution for providing technical-engineering services. Among them 100% of the individual



and the co-operative enterprises, 87.5% of the enterprises founded by both natural and legal persons, 88.5% of the enterprises founded solely by natural persons relied on internal solution to more than 50% in solving technical-engineering problems.

Financial services were provided from internal sources at 8 individual and 3 co-operative enterprises, 73 enterprises founded solely by natural persons, 13 enterprises founded by both natural and legal persons, 6 enterprises founded solely by legal persons. The share of internal sources used to provide financial services was more than 50% at 100% of the co-operative firms, and the enterprises founded solely by legal persons, 94.5% of the enterprises founded solely by natural persons, 92.3% of the enterprises founded by both natural and legal persons, 87.5% of the individual enterprises.

2 individual and 2 co-operative firms, 31 enterprises founded solely by natural persons, 4 enterprises founded by both natural and legal persons and 4 enterprises founded solely by legal persons relied partly on internal sources in providing security-guarding services. Among them all the individual and co-operative firms, also the enterprises founded solely by legal persons, and 90.3% of the enterprises founded solely by natural persons, and 75% of the enterprises founded by both natural and legal persons supplied more than half of the needed security-guarding services from internal sources.

8 individual enterprises, 64 enterprises founded solely by natural persons and 11 enterprises founded by both natural and legal persons turned to an accounting and tax consulting firm. From them 62.5% of the individual enterprises, 98.4% of the enterprises founded solely by natural persons, 81.8% of the enterprises founded by both natural and legal persons relied on external sources in providing this type of services.

With respect to other types of services the use of external sources is not significant at any form of the enterprises.

80% (109 firms) of the interviewed enterprises do not pursue advertising activities, the figures of advertising expenditures given in the percentage of the firm's turnover are as follows: 7.1% (10 firms) of the firms spent less than 0.5%, 6.4% (9 firms) spent 0.5–0.9%, 5.7% (8 firms) spent 1.0–4.9%, 1.4% (2 firms) spent 5.0–9.9% and an additional 1.4% spent more than 10%. Doing advertising activity mostly characterises firms operating in Pécs, 28.6% of them spent at least 0.5% of its turnover on this, while only 3.7% of the enterprises in villages had similar attitude. Without an exception all firms spending more than 1% of its turnover on advertising are located in city.

The proportion of firms spending money on advertising is the highest among individual enterprises, 33.3% that is 3 firms, it is the lowest among co-operative firms, 0%. 23.5% of the enterprises founded solely by natural persons,

23.5% of the enterprises founded by both natural and legal persons and 10% of the enterprises founded solely by legal persons spent on advertising.

22.2% (2 firms) of the individual enterprises spent 0.5–1% of their turnover on advertising, and 11.1% (1 firm) spent 1–5% of its turnover.

Regarding enterprises founded solely by natural persons 8.2% (8 firms) spent 0.5% of its turnover on advertising, 5.1% (5 firms) of them spent 0.5–1% of their turnover, 6.1% spent 1–5% of its turnover, 2% spent 5–10% of its turnover and an additional 2% spent more than 10% of its turnover on advertising.

5% (1 firm) of the enterprises founded by both natural and legal persons spent less than 0.5% of its turnover and an additional 2 firms that is 10%, spent 1–5% of its turnover on advertising.

Only one enterprise founded solely by legal persons spent money on advertising that amounted to less than 0.5% of its turnover.

Based on the study the most popular channels of advertising are the local newspapers, 18.6% (26 firms) chose it. For the enterprises in towns, small towns and villages this means almost the only channel of advertising while the use of the combination of different types of advertising techniques is typical of firms in cities (*Table 36*).

*Table 36*

**The most popular channels of advertising (number of answers)**

Specification	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Local newspapers	2	0	22	3	0	27
National newspapers, magazines	0	0	3	0	0	3
Radio, television	1	0	3	0	0	4
Play-bills, handbills	1	0	1	0	0	2
Advertising brochures	0	0	3	1	0	4
Others	0	0	4	0	1	5

The most favoured advertising technique by all forms of ventures are the local newspapers. 25–50 of the advertising activities are carried through this channel by 11.1% of the individual entrepreneurs, and 11.1% uses this channel for 50–100% of the advertising. 16.5% of the enterprises founded solely by natural persons, and 15% of the enterprises founded by both natural and legal persons use this channel to 50–100%.

3.1% (3 firms) of the enterprises founded solely by legal persons put 25–50% of their advertisement in national newspapers and magazines.

11.1% of the individual enterprises and 3% of the enterprises founded solely by natural persons use television and radio to reach their advertising objectives.

22.2% of the interviewed individual enterprises and 3% of the enterprises founded solely by natural persons use play-bills and handbills for advertising their activities. Only 5% of the enterprises founded solely by natural persons and 5% of the enterprises founded by both natural and legal persons used advertising brochures as tools of advertising.

Last year only 34.3% (48 firms) of the interviewed enterprises were profitable. The largest proportion of enterprises earning profit was located in Pécs: 36.9% that is 31 firms, it was the smallest of firms located in villages with its 29.6% (8 firms). The figures for enterprises in towns and in small towns, 30 and 33.3% respectively, represented the middle value. Last year 44.4% (4 firms) of the individual enterprises, 66.7% (2 firms) of the co-operative firms, 30.6% (30 firms) of the enterprises founded solely by natural persons, 40% of the enterprises founded by both natural and legal persons, and 40% of the enterprises founded solely by legal persons were profitable.

Regarding the interviewed enterprises the data on profits given in the percentage of the total assets show that the profit was less than 5% at 4.3% of the firms, 6–10% at 6.4% of them, 11–30% at 7.9%, 31–50% at 2.1%, 51–100% at 2.9% and it exceeded the total value of the total assets at 2.1% that is 3 firms. Only firms in Pécs and villages can take pride in having a profit exceeding 50% of total assets. However, while 3.6% of the firms in cities earned profit that is 51–100% of total assets, 3.7% of the firms with village location had similar position. Last year a profit exceeding the value of the total assets was earned by 1.2% of enterprises in cities that is 1 firm, and by 7.4% of enterprises in villages that is 2 firms (*Table 37*).

*Table 37*

**The proportion of profit in total assets in the last year (%)**

Proportion of profit in total assets	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Zero	55.6	33.3	69.3	60.0	70.0	66.4
Under 5%	0.0	66.7	4.1	0.0	0.0	4.3

5–10%	11.1	0.0	4.1	10.0	20.0	6.4
11–30%	11.1	0.0	6.1	15.0	10.0	7.9
31–50%	0.0	0.0	3.1	0.0	0.0	2.1
51–100%	11.1	0.0	3.1	0.0	0.0	2.9
Over 100%	0.0	0.0	1.0	10.0	0.0	2.1
No answer	11.1	0.0	9.2	5.0	0.0	7.9
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

The proportion of profit in total assets was 6–10% at 11.1% of the individual enterprises, 11–30% and 51–100% at the same number of firms in each case. The profit of the 66.7% (2 firms) of the co-operative enterprises did not reach 5% of the total assets.

Regarding enterprises founded solely by natural persons the profit was less than 5% of the total assets at 4.1% of them, and it amounted to 6–10% at the 4.1% of them, it reached 11–30% at 6.1% of the firms, 31–50% and 51–100% at 3.1% of the firms in each case, it exceeded the total assets at 1%, and 9.2% that is 9 firms did not give any information on their profit. The profit was 6–10% of the total assets at 10% of the enterprises founded by both natural and legal persons, it was equal to the 100% of the total assets at 10% of them, and it amounted to 11–30% at 15% of them. The profit was 6–10% of the total assets at 20% of the enterprises founded solely by legal persons, and it equalled to 11–30% of the total assets at 10% of the firms.

86.4% of the interviewed enterprises found difficulties in borrowing financial resources because of the too high own share in the existing credit constructions. 85.7% (72 firms) of the enterprises in cities, 95% (19 firms) of enterprises in towns, 88.9% (8 firms) in small towns, 81.5% (22 firms) in villages were of the same opinion. 50.7% of the interviewed considered high interest rate as one of the hampering factor in obtaining loans. 53.6% of the entrepreneurs in Pécs, 45% of them in towns, 44.4% in small towns, and 48.1% in villages stated the same. Too heavy collateral securities were seen by 55.7% of the interviewed entrepreneurs as a factor that makes it difficult to obtain loans. Similar opinion was expressed by 57.1% of the firms in Pécs, 80% in towns, 44.4% in small towns, and 37% in villages. As a result of internal financing 8.3% of the entrepreneurs in Pécs, 5% in towns, 22.2% in small towns, and 14.8% in villages faced no difficulties in obtaining financial resources (*Table 38*).

*Table 38*

**Types of difficulties in borrowing financial resources (number of answers)**

Types of difficulties	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Too high own share in existing credit constructions	1	1	13	2	2	19
High interest rates	7	2	47	11	2	69
Too heavy collateral securities	2	3	43	10	4	62
No difficulties as a result of internal financing	1	0	23	3	2	29
No difficulties as other reasons	0	0	8	2	4	14
<b>Total</b>	<b>11</b>	<b>6</b>	<b>134</b>	<b>28</b>	<b>14</b>	<b>193</b>

11.1% of the individual enterprises, 33.3% of the co-operative firms, 13.3% of the enterprises founded solely by natural persons, 10% of the enterprises founded by both natural and legal persons, 20% of the enterprises founded solely by legal persons considered the too high own share in the existing credit constructions as a hampering factor in obtaining loans. High interest rates are seen by 77.8% of the individual firms, 66.7% of the co-operative firms, 48% of the enterprises founded solely by natural persons, 55% of the enterprises founded by both natural and legal persons, and 20% of the enterprises founded solely by legal persons as an obstruction in getting loans. The heavy burden of collateral security makes it difficult to borrow money according to 22% of the interviewed individual enterprises, 100% of the co-operative enterprises, 43.9% of the enterprises founded solely by natural persons, 50% of the enterprises founded by both natural and legal persons, and 40% of the enterprises founded solely by legal persons.

Because of internal financing the acquisition of financial means does not cause any problem to 11% of the individual enterprises, 23.5% of the enterprises founded solely by natural persons, 15% of the enterprises founded by both natural and legal persons, and 20% of the enterprises founded solely by legal persons.

32.9% (46 firms) of the interviewed enterprises had no business relationship with banks, 50% had with 1 bank, 10.7% (15 firms) with 2 banks, 6.4% with more than 2 banks. 36.9% of the firms in city do not have any contact with banks, 45.2% with 1 bank, 11.9% with 2 banks, and 6% with more banks. 10% of the firms worked with 2 banks, 60% with 1 bank and 30% had no business relationship with any bank.

11.1% of the individual firms have no contact with banks, and 88.9% of them have contact with only 1 bank (*Table 39*).

*Table 39*

**Business relationship with banks (%)**

Number of banks related to the enterprise	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Zero	11.1	0.0	31.6	50.0	40.0	32.9
One bank	88.9	66.7	51.0	35.0	30.0	50.0
Two banks	0.0	33.3	11.2	10.0	10.0	10.7
More banks	0.0	0.0	6.2	5.0	20.0	6.4
Total	100.0	100.0	100.0	100.0	100.0	100.0

66.7% of the co-operative enterprises have contact with 1 bank and 33.3% of them has contact with 2 banks. 31.6% (31 firms) of the enterprises founded solely by natural persons have no contact with banks, 51% (50 firms) operates with 1 bank, 11.2% of them with 2 banks, and 6.1% with more than 2 banks. Half of the enterprises founded by both natural and legal persons have no contacts with banks, 35% (7 firms) has a business relation with 1 bank, 10% works with 2 banks, and 5% works with more financial institutions. 40% of the enterprises founded solely by legal persons do not have a business relation with banks, 30% (3 firms) works with 1 bank, 10% works with 2 banks and 20% works with more than 2 banks.

The only individual enterprise without any contact with banks finds the needed financial means from internal sources. For the 31 enterprises founded solely by natural persons the needed financial means are provided by the suppliers for 12.9% (4 firms) of them, by the consumers for 22.2% (7 firms), and by the firms themselves through internal financing in the case of 71% (22 firms) of them. For the 10 enterprises founded by both natural and legal persons without any contact with banks the financial means are guaranteed by the suppliers for 1 firm, by the consumers for 5 firms, from internal financial sources at 4 firms.

Those 4 enterprises founded solely by legal persons not working with banks find the needed amount of financial means through the firms' internal financing. The proportion of enterprises not having debts is the highest, 75% (15 firms) among enterprises located in towns, the debts mounted to 25–50% of the

total assets at 15% of the firms, and the debts exceeded the total assets at 5% of the firms.

Till this year only 22.2% (2 firms) of the enterprises in small towns have not asked for a loan, 33.3% of the firms had debts mounted up to 1–25% of total assets, at another 33.3% this figure was 25–50% and it was 50–75% at 11.1% of the firms (*Table 40*).

*Table 40*

**Proportion of total debts on total assets (%)**

Proportion	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
None	44.5	66.7	65.3	80.0	60.0	65.7
Under 25%	33.3	0.0	5.1	5.0	30.0	8.5
25–50%	11.1	33.3	16.3	5.0	10.0	14.3
51–75%	11.1	0.0	3.1	0.0	0.0	2.9
76–100%	0.0	0.0	3.1	5.0	0.0	2.9
Over 100%	0.0	0.0	5.1	5.0	0.0	4.3
No answer	0.0	0.0	2.0	0.0	0.0	1.4
Total	100.0	100.0	100.0	100.0	100.0	100.0

Among the enterprises located in villages the proportion of firms not having debts is high: 63% (17 firms). The debts of 18.5% (5 firms) of the firms are equal in value to 25–50% of their total assets, and total debts are greater than the value of total assets at 7.4% of the firms.

Last year 44.4% of the individual enterprises did not have any debt, the debt did not reach the quarter of the total assets at 33.3% (3 firms) of them, the total debt was 25–50% of the total assets at 11.1% of the firms, and 50–75% at the same number of firms. 66.7% of the co-operative enterprises did not have debts, the debt of 33.3% (1 firm) equalled to 25–50% of its total assets.

65.3% of the enterprises founded solely by natural persons did not have debts, total debt was less than the quarter of the total assets at 5.1% (5 firms) of them, it was 25–50% of the total assets at 16.3% of the firms, it amounted to 50–70% of the total assets at 3.1% of them, and to 75–100% at the same number of firms. Total debt surpassed the value of the total assets at 5.1% (5 firms) of the enterprises.

Last year 16 (80%) enterprises founded by both natural and legal persons did not have debt, the debt amounted to 0–25%, to 25–50%, to 75–100% of the total assets and it exceeded the total assets at 5% of the firms, respectively. Last year 60% (6 firms) of the enterprises founded solely by legal persons did not

have any debt, the total debt did not exceed the quarter of the total assets at 30% of the firms, and it amounted to 25–50% of the total assets at 10% of the firms.

Last year 80.7% (113) of the interviewed enterprises did not have any short-term debt. The share of short-term debts surpassed the 75% of total debts at 23 firms that is 16.4% of the interviewed (*Table 41*).

*Table 41*

**Proportion of short term debts on total debts (%)**

Proportion	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal persons	Total
None	55.6	66.7	83.7	85.0	70.0	80.7
Under 25%	0.0	0.0	1.0	0.0	0.0	0.7
25–50%	0.0	33.3	1.0	0.0	0.0	1.5
51–75%	0.0	0.0	1.0	0.0	0.0	0.7
Over 75%	44.4	0.0	13.3	15.0	30.0	16.4
Total	100.0	100.0	100.0	100.0	100.0	100.0

Last year 83.3% (70 firms) did not have short-term debts, while the value of short-term debts exceeded the 75% of the total debts at 13.1% of them. From the enterprises located in towns 90% (18 firms) did not obtain short-term loans and the short-term debts mounted to more than 75% of the total debts at 10% of the firms. Regarding enterprises in small towns 33.3% of them have no short-term debts, but the share of short-term debts at 66.7% (6 firms) of the firms exceeded the 75% of the total debts. 81.5% (22 firms) of the enterprises in villages did not ask for short-term loans. The share of short-term debts in total debts surpassed 75% at 14.8% of the firms.

Last year 55.6% of the individual enterprises did not have short-term debt, while the share of this type of debt in the total debt was more than 75% at 44.4% of them. 66.7% (2 firms) of the co-operative enterprises did not have debts, short-term debt of the 33.3% of them amounted to 25–50% of the total debt. Last year 83.7% (82 firms) of the enterprises founded solely by natural persons did not have short-term debt, while the share of short-term debt was 0–25%, 25–50% 50–75% in the total debt at 1% of the firms, respectively. It exceeded 75% at 13.3% of the firms. 85% of the enterprises founded by both natural and legal persons were not burdened with short-term debts, while the share of short-term debt surpassed three-quarter of the total debt at 15% (15 firms) of them. 70% of the enterprises founded by solely legal persons did not have any short-term debt, while the share of short-term debt exceeded three-quarter of the total debt at 30% of them.

Besides cash and current bank account from the interviewed enterprises 11 (7.9%) had other financial means, too. 11.9% (10 firms) of the firms in Pécs,



5% (1%) of the firms in town and no enterprise in small town or village belonged to that group.

From the 10 firms in Pécs 4 marked bank deposits, 2 marked shares, and 4 marked foreign financial assets, though in most cases their share in total assets was not specified. The single firm in town having other financial assets than cash and current account owns bank deposits that amount to less than 5% of its total assets.

Among the interviewed individual and co-operative enterprises no one has other financial means than cash and current bank account. 7.1% (7 firms) of the enterprises founded solely by natural persons, 10% (2 firms) of the enterprises founded by both natural and legal persons, 20% (2 firms) of the enterprises founded solely by legal persons have at their disposal other financial means, too.

From the 7 enterprises founded solely by natural persons 4 have bank deposits, 2 have shares and 1 has foreign financial means. From the above mentioned 2 enterprises founded by both natural and legal persons 1 has bank deposit, and the other has foreign financial means. Both enterprises founded solely by legal persons marked foreign financial means as other financial means.

### 8.6 Perspectives, constraints and actions

No strong relation can be shown between the location distribution of the enterprises and the expectations regarding future turnover. The interviewed enterprises had similar pessimistic view on the future perspective of turnover whether it was in large, medium-size or small town. The 70% of the 140 interviewed enterprises expected slow growth or a turnover remaining at the same level. Fast growth was predicted in smaller towns and villages, 11.1% of the enterprises in small towns and 14.8% of them in villages expected a fast growth of turnover. In larger towns 8.3% of the enterprises and 5% of the enterprises in medium-size towns expected fast growth. Seven firms rendered the termination of their activities probable, 1 was operating in a large town, 2 in medium-size towns, 1 in smaller town and 3 in villages. Three of the enterprises operating in large towns thought probable not to survive if the present situation was to be maintained (*Table 42*).

*Table 42*

#### Expectations regarding future turnover (%)

Specification	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal persons	Total
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Fast growth	11.1	0.0	11.2	0.0	10.0	9.3
Slow growth	55.6	0.0	42.8	60.0	30.0	44.3
Remaining at the same level	11.1	100.0	24.5	20.0	40.0	25.7
Slow down but survive	22.2	0.0	8.2	10.0	10.0	9.3
Not to survive	0.0	0.0	10.2	10.0	10.0	9.3
No answer	0.0	0.0	3.1	0.0	0.0	2.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

The interviewed 140 enterprises characteristically predicted a slowly growing or stagnating turnover without any distinction as to ownership. 70% of the firms are expecting it. Among the individual entrepreneurs 55% predicted slow growth, 22.2% counted with a decrease and 11.1% expected a turnover remaining at the same level in the future. Only 11.1% of the individual entrepreneurs think that there is a likelihood of a fast growth. In this circle no one plans to close down. The three interviewed co-operatives do not expect any changes.

From the 98 ventures formed by natural persons 42.9% expects a slow growth of turnover, 24.5% to remain at the same level, and 11.2% a fast growth. In this circle of owners 13% said to close down if the current conditions were going to remain unchanged. The 20 business associations formed by natural and legal persons 12 firms predicted a slowly growing turnover, 4 firms stagnation, and 2 a decreasing turnover, also 2 firms counted with termination. From the 10 ventures formed solely by legal persons 3 expected slow growth, 4 predicted the turnover to remain at the same level, and only 1 hoped for a fast growth. One of them thought it possible to close down the firm.

32% of the enterprises of which 73.9% was operating in larger towns saw insufficient demand for existing products as one of the constraints for the growth of the company. Insufficient demand was not typically considered as a constraint for the growth of the company in smaller towns or villages. Lack of skilled work force as a constraint was seen only by 7 from the 84 companies operating in large towns, 2 from 20 companies in medium-size towns, 2 from 9 companies in smaller towns and 3 from 27 enterprises operating in villages. Restrictions on the supply of raw material and intermediate goods were not considered as constraints by companies operating in smaller towns, and it was not seen a typical constraint in the other settlements either. The most emphasised constraint was the lack of financial means for expansion. Among the 46 enterprises marking the lack of financial means 63% are operating in large towns, 8.7% are operating in both medium-size and small towns, and 19.6% in villages. From the companies operating in the four different types of settlements only two companies in large towns mentioned a lack of managerial and organisational capability. The excessive legal and administrative restrictions were not con-

sidered constraint for economic growth by enterprises in medium-size and small towns, and from the 27 enterprises in villages only 1, and from the 84 in large towns 12 thought it hampers growth (*Table 43*).

*Table 43*

**Main barriers of enterprise development (number of answers)**

Specification	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Insufficient demand for products	5	0	31	5	5	46
Lack of skilled work force	1	0	9	4	0	14
Restrictions on the supply of raw material and intermediate goods	0	0	7	2	0	9
Lack of financial means	1	1	35	7	2	46
Lack of managerial and organisational capability	0	0	2	0	0	2
Excessive legal and administrative restrictions	3	0	9	0	1	13
Excessive indebtedness	0	0	2	3	0	5
Insufficient factory space	3	1	12	1	0	17
Insufficient capacity of machinery	0	2	14	4	1	21
None	1	0	6	1	1	9
Other hampering factors	1	1	18	4	4	28
<b>Total</b>	<b>15</b>	<b>5</b>	<b>145</b>	<b>31</b>	<b>14</b>	<b>210</b>

Excessive indebtedness was considered as a constraint for growth only by the companies in large town and 1 company in each of the other two settlements. Insufficient factory space was a typical constraint for companies – total 17 companies – in large towns and in villages. Among them 11 were operating in large towns, 4 in villages and 1 in both medium-size town and small town. Insufficient capacity of machinery as constraint was marked by 21 enterprises, 47.6% of them pursued business in large towns, and 28.6% in villages.

From the interviewed 140 enterprises 9 saw no constraints for growth. Other hampering factors were given by 20% of the enterprises most of them operating in small towns or villages.

Based on ownership structure the companies gave partly similar and partly different reasons that caused to hamper the growth of the firm. With the exception of the co-operatives, the other forms saw insufficient demand, lack of financial means, insufficient capacity of machinery, and insufficient factory space as constraints for growth.

For the three co-operatives the main constraints were rather the capacity of machinery and the insufficient factory space. They also mentioned the lack of financial sources. Among the individual entrepreneurs 55.6% saw the main constraint in insufficient demand, 33% found the operating factory space insufficient, and 11% had problems with the lack of financial means, also 11% thought that there was no limitation to their growth.

With respect to individual entrepreneurs indebtedness, lack of managerial capability, difficulty in recruiting skilled employees were not counted as hampering factors.

From the 98 enterprises, formed solely by natural persons 35.7% considered the insufficient financial means, 31% the insufficient demand, 14.3% insufficient capacity of machinery, 12.2% insufficient factory space as constraints for growth. Since two answers had to be given for the question it is probably that if lack of financial resources was a constraint for the company, capacity of machinery and insufficient demand were also hampering the firm's growth.

From the 20 ventures formed by both natural and legal persons lack of financial means represented a constraint for 7 enterprises, and 5 enterprises marked insufficient demand and insufficient factory space as constraints. 4 Enterprises also mentioned insufficient capacity of machinery as a hampering factor. 5 companies saw a constraint for growth in other conditions. This circle of entrepreneurs does not see the lack of managerial capability, and the legal administrative restrictions as encumbering factors.

From the 10 business associations formed solely by legal persons 5 considered insufficient demand, 2 lack of financial means, 1 capacity of machinery, 1 legal restrictions as the barrier of development.

Next we will analyse what the relation is between the measurements planned to be taken in the future for improving efficiency and the settlement distribution of enterprises. 38.6% of the enterprises considered important to improve the efficiency of production. The importance of taking those measurements was more emphasised in small towns than villages. Similar importance as to the others was given to improve efficiency in large and medium-size towns. A similar importance was attached to introducing technological innovation, 27.1% of the companies found it necessary. 55.6% of the enterprises in small towns, though only 14.8% of them in villages are planning to introduce ones. In order to improve the firm's performance 16.4% of the enterprises plan to reduce the overhead costs, mostly in medium-size and small towns. To improve perfor-

mance by this method bears no significance with respect to large towns or villages (Table 44).

Table 44

**Measurements planned to be taken in the future for improving efficiency of enterprises (number of answers)**

Measurements	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Improve the efficiency of production	6	0	37	10	1	54
Introducing technological innovations	5	1	25	5	2	38
Reducing the overhead costs	1	1	18	2	1	23
Increasing advertising expenditures	3	0	13	2	0	18
Improving the channels of distributions	1	0	11	1	1	14
Obtain short-term credit	0	1	4	2	0	7
Obtain long-term credit	1	0	13	2	0	16
Increasing their equity	0	0	1	2	0	3
Reduction of indebtedness	1	0	6	1	1	9
Improving the quality of products	3	0	17	4	1	25
Reducing the wages	0	0	0	0	0	0
Reducing employment	1	0	2	1	0	4
Other	0	1	24	5	5	35
None	1	1	19	3	3	27
<b>Total</b>	<b>23</b>	<b>5</b>	<b>190</b>	<b>40</b>	<b>15</b>	<b>273</b>

To increase advertising expenditures is planned by 12.9% of the firms. Advertising activity is seen important in large and small towns, though it is thought not to be playing an important role in villages.

10% of the companies plan to improve the channels of distribution. Companies in medium-size towns saw it particularly important in improving performance. 25% of those companies plan to pursue such an activity, while companies in large towns or villages do not attach any particular importance to it.

5% of the interviewed firms want to improve its performance by obtaining short-term credit. Despite the fact that the enterprises' supply of working capital is insufficient only 1–2 firms plan to obtain short-term credits in all types

of settlements. Also only 11.4% of the enterprises plan to obtain medium or long-term loans.

The intention to draw in long-term credits is on the average in large towns, but it is not characteristic for medium-size towns. Regarding small towns 22.2% and with respect to villages 14.8% of the interviewed companies plan to obtain such a long-term credit.

From the 140 enterprises only 3 plan to increase their equity, 1 is operating in a large town, and 2 in villages. Similarly only a few consider the reduction of indebtedness as a mean to improve performance. Only 4.4% of the interviewed enterprises plan to pay off their debts in the near future, mostly in medium-size and small towns. There is no intention to do so in villages. 17.9% of the interviewed enterprises plan to improve the quality of products. Among the firms operating in villages only 1 wants to increase performance by it, while in smaller town 33.3%, in large towns 20.2%, in medium-size towns 20.0% of the companies want to do so.

No reduction of wages or salaries is planned in any of the settlements. The intention to reduce employment appears only in a few cases, no one wants to use it in medium-size towns, and only 1 of the firms in each of the other settlements.

At 19.3% of the enterprises want to do nothing in order to improve performance. Almost one-third of them are pursuing business in villages.

To improve the firm's performance the enterprises plan to take similar and different action. Since there was no limitation how many answers could be chosen from the 14 possible answers, the enterprises are characterised by the followings according to their ownership structure. From the 9 individual entrepreneurs 5 plan to improve the efficiency of the production, 3 to increase advertising expenditures to improve their performance, and 3 want to improve the quality of the products. 1 entrepreneur for each case thought that reducing employment and overhead costs might improve performance. 1 entrepreneur wants to obtain credit and the other wants to pay off his debts. No one plans to reduce wages or salaries or to increase its equity.

From the co-operatives 1 wants to introduce technological innovation, 1 wants to reduce overhead costs, and 1 plans to apply for short-term credit. 37.8% of the ventures of natural persons believed that improving the efficiency of production were the source of growth, others believed in something else, 25.5% in technological innovation, 18.8% in reducing costs and expenditures, 17.3% in improving the quality of products, 13.3% in increasing advertising expenditures. Some of the enterprises wanted to improve performance by obtaining credit, increasing equity, or reducing debts.

From the interviewed 20 ventures of natural and legal persons – similarly to the order of the previous one – 10 plan to enhance performance by improving efficiency, 5 by innovation, 2 by reducing costs, 2 by increasing advertising expenditures. 2 companies want to increase their equity to enhance performance.

From the interviewed 10 ventures formed solely by legal persons 1 plans to improve the efficiency of production, 2 to introduce innovation, 1 in each case to improve the channels of distribution, to reduce debts and costs. There were 5 companies who saw other possibilities to improve performance, while 3 companies did not want to do any changes.

During the last five years 36.4% of the enterprises were not aware of the existence of enterprise supporting scheme provided by the government or local government. Half of the enterprises in villages, and more than 40% of them in medium-size and small towns lacked information on such an industrial policy program or subsidies. 19.3% of the interviewed enterprises gained support for starting the venture. The ratio is only 14.8% regarding villages, it is average in large towns, and with respect to the other settlements more than 20% of the enterprises have got some kind of support.

36% of the interviewed 140 enterprises did not know about any governmental or local entrepreneurship supporting schemes during the last five years. Half of the enterprises with legal persons participation, one-third of the enterprises of natural persons and also the individual entrepreneurs did not have information on it. All the co-operatives had that information (*Table 45*).

*Table 45*

**SMEs awareness of support from the government and local authorities**

Specification	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Number of companies know about supports	6	3	64	11	5	89
Percentage of companies know about supports	66.7	100.0	65.3	55.0	50.0	63.6

The entrepreneurs attached importance to efficient governmental intervention in order to develop private entrepreneurship. 66.4% of the interviewed enterprises saw reduction of interest rates as a mean for it. All companies without an exception as to settlement found it important. The reduction of interest rates was considered important by 75% of enterprises in medium-size towns, 70.4% in villages, and even in large and small towns the proportion expecting

efficient help from governmental interventions was above 60%. Liberalising the banking system was seen as a supportive central measurement by 13.6% of the enterprises. It is not important for those operating in villages, but 33.3% of the interviewed in small towns saw its significance. From the enterprises in large and medium-size towns only a few sees liberalisation of banking system as a tool to help to enhance private entrepreneurship. Infrastructure investments are considered much more needed (*Table 46*).

*Table 46*

**The hierarchy of importance of governmental interventions in order to develop private entrepreneurship (number of answers)**

Government's interventions	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Reduction of interest rates	5	3	66	14	5	93
Liberalising the banking system	2	1	13	2	1	19
Infrastructure development	2	1	19	1	1	24
Reducing inflation	6	1	34	8	3	52
Simplifications of procedure of setting up a company	1	1	7	3	1	13
Application of a tax system based on preferences	4	2	65	11	6	88
Protection of domestic market	1	0	12	4	1	18
Other	1	0	18	2	5	26
None	0	0	1	1	0	2
<b>Total</b>	<b>22</b>	<b>9</b>	<b>235</b>	<b>46</b>	<b>23</b>	<b>335</b>

17.1% of the enterprises feel its importance, among them 20.2% in large towns, 18.5% in villages. 37.1% of the firms (46.5% in large towns, 35% in medium-size towns) thought that central interventions should reduce inflation. Only a few entrepreneurs operating in the other types of settlements thought that slowing down inflation is a tool for fostering private entrepreneurship. 9.3% of the interviewed companies see the simplification of the procedure for establishing and running a private enterprise an opportunity for supporting entrepreneurship. Firms operating in villages (22.2%) were thinking that way. Only a couple of companies operating in other types of settlements mentioned it. The application of a tax system based on preferences was considered as an efficient tool for support by 62.9% of the companies. The firms in all settlements found tax



allowances necessary (77.8% of the interviewed in small towns, 64.3% in large towns). 12.9% of the companies agree that the protection of domestic market is a form of support. Mostly companies operating in large towns and villages felt it important. 18.6% of the enterprises thought that other interventions could be efficient in fostering private entrepreneurship.

More than one answer was possible to give when answering the question of what kind of governmental interventions would be necessary. According to the answers there are no inevitable differences between priorities for governmental interventions based on ownership structure. Reducing interest rates was on the first place for all forms of ownership. The importance of it was emphasised at least by half of the enterprises with no respect as to ownership structure and by co-operatives without exception. Similarly they found important to reduce taxes.

66.7% of the individual entrepreneurs found important to slow down inflation. A similar answer was given by 30–40% of the other types of enterprises. Individual entrepreneurs and co-operatives also found that centrally organised interventions should play an important role in improving infrastructure. 44.4% of the individual entrepreneurs expected government actions for reducing taxes. The view on reducing interest rates, slowing down inflation and reducing taxes were similar in all forms of ownership. The enterprises with solely legal person members thought other governmental measurements were needed as well.

The need for interventions by local governments appeared in improving the local infrastructure of the enterprises, and providing services for small enterprises. 40% of the interviewed companies think it is important to improve infrastructure, according to the figures (51.9% of the firms) it is most needed in villages. The respective data for large towns and other settlements are 44%, 20%, 22%.

To provide services needed for small enterprises was considered important by 22% of the interviewed. It was articulated mostly by companies operating in towns. Only a fragment of the enterprises (total of 5) saw the importance of providing training and retraining at the local level. From the 167 enterprises 21% were complaining about the lack of other conditions, especially in larger and small towns (*Table 47*).

According to individual entrepreneurs (44.4%) local governments should play an important role in providing training and retraining programs also to improve local infrastructure. 22.2% of the individual entrepreneurs missed the services for small enterprises and other measurements.

Table 47

**The hierarchy of importance of local authority interventions in order to develop private entrepreneurship (number of answers)**

Local authority's interventions	Private firms	Co-operative associations	Businesses based exclusively on private persons	Businesses based on private and legal entities	Businesses based exclusively on legal entities	Total
Providing training and retraining programs	4	1	13	3	1	22
Setting up schools of business and technology	0	0	5	0	0	5
Improvement of local infrastructure	4	1	37	11	4	57
Providing services SMEs need	2	0	18	1	1	22
Other	2	0	22	2	4	30
None	1	1	21	5	3	31
<b>Total</b>	<b>13</b>	<b>3</b>	<b>116</b>	<b>22</b>	<b>13</b>	<b>167</b>

From the 3 co-operatives 1 emphasised the importance of training the other of the infrastructure development. From the enterprises with different ownership structure only the ones with solely natural person members felt the significance of providing business and technical schools at local level. In this circle of enterprises a demand for enhanced infrastructure, the issues of providing services, training and retraining for them were their main concern. The enterprises formed by natural and legal persons (55%) expected infrastructure development from local governments. 15% of them thought training and retraining important. 25% of this form of enterprises are not expecting any kind of intervention or measurement taking by local governments.

40% of the ventures of legal persons also considered local infrastructure investments necessary. 10% of them found training and retraining important, also to create the conditions for rendering services for small enterprises at the local level. According to this circle of enterprises local authorities should play an important role in other areas as well.

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Table 1

**Number of economic organisations, 1985–1990**

Organisations	Number of economic organisations in						Growth rate, 1990	
	1985	1986	1987	1988	1989	1990	1985=100%	1989=100%
	year							
Enterprises	7,916	8,578	9,597	10,811	15,235	29,470	372.3	193.6
From this:								
– co-operatives	4,848	..	..	6,880	7,076	7,132	147.1	114.9
– state enterprises	1,910	1,940	1,955	1,986	2,001	2,363	123.7	118.1
– ltd.	50	59	103	451	4,485	18,317	366-fold	408.4
– company limited by shares	–	–	–	116	307	646	–	210.4
Unlimited and deposit partnerships	17,849	20,262	22,674	34,082	44,062	65,400	366.4	148.4
Individual entrepreneurs	126,175	149,544	201,348	290,877	320,619	393,450	311.8	122.7
<b>T o t a l</b>	<b>151,940</b>	<b>178,384</b>	<b>233,619</b>	<b>335,770</b>	<b>379,916</b>	<b>488,320</b>	<b>321.4</b>	<b>128.5</b>

Source: Gazdaságstatisztikai Évkönyv. 1990. pp. 32–33.

*Table 1***Number of business organisations having legal personality according to sectors**

Sectors	1988	1989	1990	1991	October 1992
Industry	78	103	218	350	489
Construction installation	17	23	73	149	217
Architecture design	4	8	29	75	116
Construction total	21	31	102	224	333
Agriculture	68	71	94	122	157
Forestry	1	1	2	3	8
Agricult. and forestry total	69	72	96	125	165
Transport	4	6	21	48	56
Postal service and communic. total	-	-	-	2	3
Transport and communication total	4	6	21	50	59
Wholesale and retail	34	73	219	459	670
Foreign trade	0	4	24	56	97
Commerce total	34	77	243	515	767
Water supply	8	8	50	54	61
Personal and economic services	34	45	159	233	324
Health, cultural services, social welfare	5	1	31	65	89
Communal, administration and other services	1	2	5	26	32
Sectors total	254	355	925	1,642	2,319