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SMEs' investment readiness in Hungary

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Dilemmas of financing rural SMEs

- SMEs are the main drivers for economic growth and job creation
 - **Supply side:**
Lenders and investors are reluctant to invest in rural SMEs due to
 - o Lack of trust, reliable data on the business
 - o High risks
 - o High overhead costs
- } Not compensated by realised returns
- **Demand side:**
 - o Low capitalisation
 - o Poor knowledge on modern business management practices
 - o Three reasons for insufficient knowledge about finance:
 1. Lack of knowledge about financing
 2. Fear of losing control
 3. Information assymetry

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Investment readiness III/I

Many types of financial instruments have been developed and launched to boost the economies and SMEs (supply side)



Similar emphasis shall be placed onto the demand side of the financial tools, that is to develop an entrepreneurial environment that is able to efficiently absorb the financial resources

David Cooksey, Risk Capital Summit, London, 2005: „coaching, education and investment readiness programmes should accompany any financial measures”

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Investment readiness III/II

European Commission: Discussion paper on *Investment readiness*, 2006:

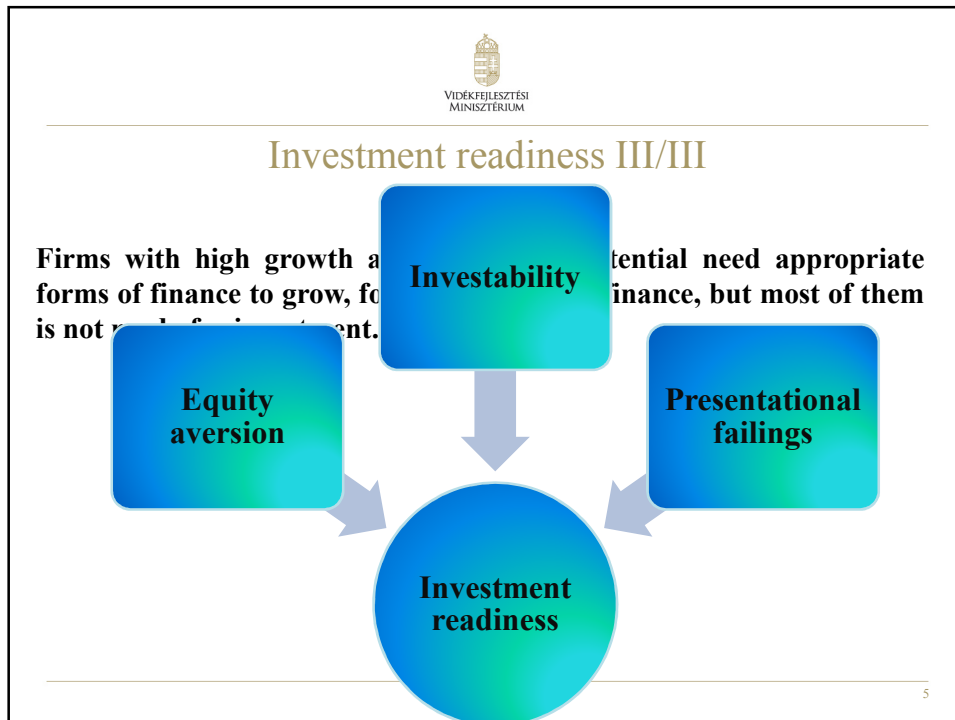
Investment readiness may be defined as

„The capacity of an SME or entrepreneur – who is looking for external finance, in particular equity finance – to **understand** the specific needs of an investor and to **be able to respond** to these needs by providing an appropriate structure and relevant information, by being credible and by creating confidence.”

Investment readiness programmes can help SMEs develop in a number of areas, such as

- developing a business plan,
- explaining the sources of financing,
- understanding investors' requirements,
- ensuring that the right management skills are available, and
- improving the quality of presentations to convince the investors.

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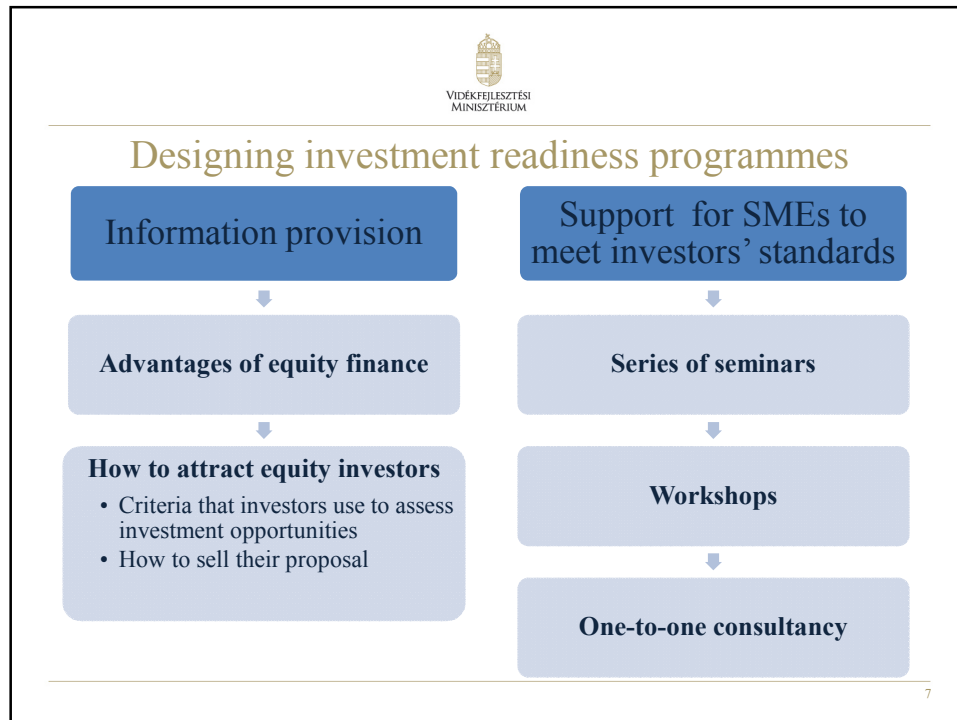



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Table 1. 'Own goals' in Business Plans

Inappropriate statement in business plan	Explanation
"It is our intention to hire a CEO within three months of initial funding."	Investors need to see who they are investing in and who is going to give leadership and direction to the company before investing. As a minimum, the plan must be able to say who has been targeted and agreed to lead the business once finance has been raised.
"The three founders each hold an equal share of the business and decision-making is on a consensual basis."	Investors don't invest in committees, they invest in leaders. Someone has to be the boss.
"Our existing company has developed a new technology and we would like you to invest in this subsidiary company we have set up to develop the idea."	Investors don't invest in subsidiaries. Management must be totally committed to the project they have invested in, not spending their time running another company in which the investors have no interest.
"We have been running at a loss for three years and have run out of cash. During the period the owner has continued to draw a salary of €150,000."	Investors don't invest in companies just so that the management can maintain their lifestyle. They invest in growing businesses and expect management to take a reasonable share of the risk as well as the reward.

Source : N Gray: The Angel's Share, The Herald, 4th September 2002, page 25. Nelson Gray was EBAN's European Business Angel




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Legal background, common directives for supporting SMEs

Priorities of the **Lisbon Treaty & the current financial framework**: enhancing competitiveness, growth, jobs, innovation

2008 EC Communication on „**Small Business Act**” laid down principles

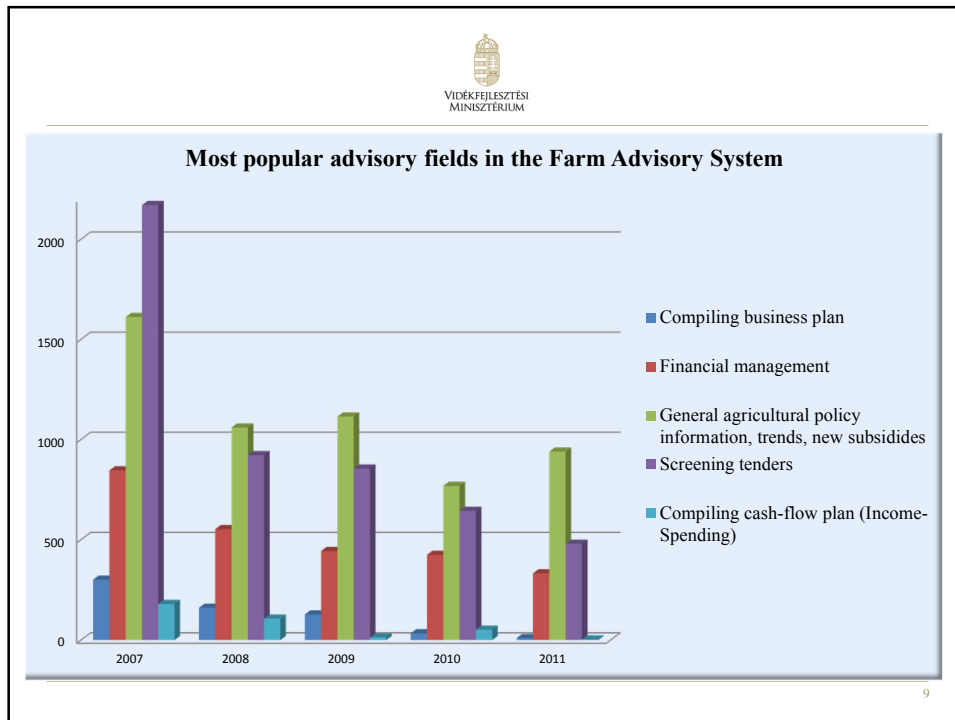
- More tailor-made regulations for SMEs
- Increasing support for SMEs
- Integrating entrepreneurial skills and approach in education from the beginning

Agricultural, fishery and general de minimis regulation

General and agricultural group exemption regulation

- Simplified rules and procedures for state aids of certain types given to SMEs
- Higher available subsidy intensity for investments
- Subsidies given for training, employment, R&D
- Regional subsidies

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EU funds for the development of SMEs: Structural and Cohesion funds

Structural and Cohesion Funds → New Széchenyi Plan

- Economic Development Operational Programme (~ Regional OPs), priorities:
 - 1) Innovation, R&D carried out by enterprises
 - 2) Complex development of enterprises (Development of rural micro enterprises on settlements with less than 5 000 inhabitants: for those enterprises that have not received subsidy from EAFRD)
 - 3) Business environment
 - 4) Financial instruments (Micro credits for SMEs, guarantee, equity finance)
- Social Renewal Operational Programme
 - In-service training, developing the human capital
 - In 2013: Promoting the youth in becoming entrepreneur
 - A. Building entrepreneurial skills, supporting services to set up a business
 - B. Initial finance for start-ups

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Developing entrepreneurial culture in Hungary II/I

In the early 1990s the **Hungarian Foundation for Enterprise Promotion** launched an **entrepreneurship development programme** with the help of the PHARE programme.

In the frame of this programme **local entrepreneurial centres were established in each Hungarian county** to support the local firms and to spread the entrepreneurial culture.

Examples for services provided by these centres:

- business trainings, customized technical advisory
- consultancy for individual, small, medium sized firms and for natural persons who plan to start a business
- compiling economy development plans
- compiling marketing plans
- screening tenders and writing applications
- organising language and computer courses
- project management

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Developing entrepreneurial culture in Hungary II/II Role of the Hungarian Investment Bank (MFB)

The Hungarian Investment Bank (MFB) was established by the Hungarian State to boost the economy by providing finance with favourable conditions to SMEs in the broad economy and specifically in agriculture.

The State charged the MFB with founding regional development corporations with the objective to promote capitalisation of SMEs and hence to foster the private sector.



Regional Development Holding Ltd. was established having subsidiaries in each region



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Regional Development Holding Ltd. (MFB Group) + Regional Development Corporations + Regional Development Non-profit Ltd.

- Financial service provider and adviser, state-owned company
- Following the national development conception and providing finance for development for local governments
- Objective: providing and financing
- + Helps in full available sub
- Equity finance
- 15 subsidiaries
- Owner: Hungary
- **County-based** (MFB), providing

Example: In the frame of the New Hungary Development Plan's Regional Operational Programme the town of Zalaegerszeg involved the **regional development holding** that **compiled the application and provided expert consultancy for the project management for the establishment of business incubator.**

The business incubator offers for about 25 micro enterprises to settle in, and beyond ordinary office services it provides management and legal consultancy, secretarial, translation services, market analysis and other business advices.

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Nurturing infrastural background

- Clusters, industrial parks
 - Business incubators
 - Service pool
 - Information, training
 - Coordination, business advice, market analysis
- Integrated Community and Service Spaces (IKSZT) under EAFRD Axis III

Obligated to provide at least **once in half a year** training, presentation or office hours to the local SMEs in business law, finance, accountancy, tax and other management issues

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Education, schools, universities

General integration of business approach and practical thinking must be further strengthened in the Hungarian education from the elementary to the tertiary level

A novel initiative at the University of Debrecen: Rural TeamEntrepreneurs:

- The Finnish Team Academy (TA) education, an innovative Finnish model developing team entrepreneurs founded in 1993 by Johannes Partenen could form the basis of this new rural education concept.
- **TA is based on a learning triangle: theory (individual), team learning (discussion, sharing ideas) and learning by doing (running real projects, business)**
- 14 BSc students specialised in trade-marketing, tourism-hosting, finance-accountancy, rural development and agri-business
- **Starting with team building training, personal development trainings**
- **Working out project ideas and creating living enterprises (e.g. event organisation, compiling surveys, organising wine tourism)**
- Integrated in the accredited MSc course of Business development (coaches instead of teachers)
- Later connection with LEADER approach

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Research and Technology Transfer

Szent István University – Office for Technology Transfer

organising venues for researchers to present their ideas to investors

ELTE – Regional Knowledge Centre

- Promoting innovation in tertiary education -> technology development
- Collecting and generating knowledge, ideas and innovations
- Building relations with the industry, enterprises -> marketing of technology (spreading risk)
- Role of the university within innovation: collection of ideas, launching and evaluating projects, networking
- Role of uni+private equity: business strategy, establishing business,
- Role of business sector+private equity: equity finance, marketing
- Innovation chain:



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Financial instruments

I. Credit programmes

- a) Subsidized credit programmes of MFB: investment and current asset loans, bankguarantee programmes
- b) Subsidized current asset overdraft programmes: Széchenyi Card Programme (agricultural and non-agricultural)

II. Guarantee funds

- a) Garantiqa Creditguarantee Co. Ltd.
- b) Rural Credit Guarantee Foundation

III. Equity finance

- a) MFB
- b) Jeremie Programme (Joint European Resources for Micro to medium Enterprises)
- c) Small Business Development Company Ltd. (Kvfp)

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Rural Credit Guarantee Foundation (AVHGA)

- Established under the PHARE Programme in 1991 by the Ministry of Agriculture and 5 banks
- Mission: to increase the creditworthiness of rural and agricultural SMEs through **providing suretyship**
- Promotes access to bank loans by easing credit conditions, increases financial institutions' lending propensity
- In partnership with 150 financial institutions (banks, rural savings cooperatives etc.)
- Service of the Foundation covers loans, bankguarantees, factoring and leasing products
- The Foundation's portfolio is covered by a 85% state counter-guarantee
- Gives guarantee basically on a subsidized fee (the rate of subsidy is the same, and given under the following subsidy categories: 3 types of de minimis, agricultural group exemption subsidies or notified state aid)
- Communication towards the beneficiaries, as well as towards financial institutions, lectures

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Rural Credit Guarantee Foundation (AVHGA) - AVHA Service and Consultancy Lp.

- To provide consultancy services, the Foundation established the AVHA Service and Consultancy Lp. in 2007
- Engaged in professional assistance in the course of business and decision-making of farmers and enterprises
- Consultancy services promote to obtain credits and non-refundable aids, as well as facilitate their rational use and smooth proceeding.
- The consultancy activity includes application monitoring, elaboration of the project idea, advising on credit facilities, writing of application and application management.
- Fee: 1) applications are success-based, 6-8% of the subsidy; 2) consultancy within FAS is subsidized up to 80%
- Advertises the Foundation's activity through monthly releases, direct marketing tools, questionnaire surveys

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Small Business Development Company Ltd. (MFB Group)

- **Investment corporation** that helps the development of SMEs with **equity finance**
- **Owner: MFB (state)**; other shareholders: 5 banks
- The company is backed by the State, but its **operation is market-oriented, so the investments are not considered to be subsidies, nor loans**
- Objective: improving competitiveness of SMEs with high growth potential by providing equity finance with favourable conditions as compared to other equity finance
- **Equity finance helps SMEs** to develop their product, assets and technology, hence **to increase their value added.**
- **Due to the capital injection the market position, perception and creditworthiness of the SME increase significantly**



Ready to receive ordinary bank loan

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Financing the agricultural sector II/I

- | | |
|---|---|
| — | + |
| <ul style="list-style-type: none">• Specific finance is needed due to seasonality and weather risks• Individual farms have low external finance, low creditworthiness• Banks basically do not accept land and animal stock as collateral• Public storage is down due to frequent misuses | <ul style="list-style-type: none">• Value of land increases, could be good collateral• Increasing crop prices (global trends, weak HUF)• Subsidies remain• New agricultural risk management scheme from 1 January 2012• The role of local, credit and savings cooperatives is increasing (9,5%-2007 -> 15,3%-2010)• Low portion of foreign currency credit (22%)• Banks started to open to the agricultural sector |

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Financing the agricultural sector II/II Further difficulties

- Lack of definite conception, incomplete business plans, uncertain return on investment, lack of own finance, weak preparedness to manage the project
- Small sized companies are not deemed to be creditworthy for commercial banks
- Producers cannot afford or do not want to spend on insurance, although weather risks are high

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Proposals and ideas to improve finance of rural SMEs IV/I

(Agricultural) investments are mostly linked to (agricultural) support schemes



if policy makers want to improve SMEs investment readiness they have to place even **higher emphasis on practice-oriented capacity building: management, strategic, financial, marketing skills in advisory sectors and from early education as well**

BUT FIRST OF ALL MAKE SMEs BE INTERESTED IN CAPACITY BUILDING

- I. Current state financed Advisory Schemes shall be **refreshed by financial and modern management training modules and more practical content**
- II. Available, partly or completely market-based business advice services shall be more intensively advertised and subsidized (but not free)
- III. **Business consultancy should be based on 3 aspects of the business environment: legal framework, market trends, financial solutions**
- IV. In order to increase efficiency of consultancy: **introduce client satisfaction feedback**

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Proposals and ideas to improve finance of rural SMEs IV/II

IV. **Constraint: Agricultural enterprises can obtain subsidized suretyship only under the agricultural de minimis regulation that is strongly limited (7 500€/3year)**

Solutions:

1. **Increasing the subsidy ceiling of agricultural de minimis**

Temporary regulation due to the crisis allowed a subsidy of 15 000€ that did not lead to the distortion of the market and competition -> this level could be retained

2. **Decreasing the time interval of the agricultural de minimis subsidy to 1 or 2 fiscal years**

3. Introducing **new subsidy category for suretyship** similarly to equity finance subsidized under the general group exemption regulation – irrespective of sector!

V. **Extending exemptions of micro enterprises**: subsidies for agricultural micro enterprises could be increased by listing them under the scope of the general de minimis regulation

VI. **Exemptions for enterprises using green and renewable energy**

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Proposals and ideas to improve finance of rural SMEs IV/III

- VII. Strengthening producer groups' role in assisting their members' financial and business management
- VIII. Strengthening local savings and credit cooperatives which are more suitable to finance rural SMEs in their proximity
- IX. Encouraging national administrations to introduce transparent registers of business operation, for example transparent income statement schemes also for SMEs and individual producers that are reliable and useful for analysing creditworthiness
- X. Subsidies should be channelled to competitive enterprises



Emphasis on the concept: subsidy is not a source of income, but a tool to improve

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Proposals and ideas to improve finance of rural SMEs IV/IV

- XI. Increasing income security of agricultural enterprises:
 - Increasing subsidies for agricultural insurance
 - When giving special aid in case of force majeure and inevitable economic adversity Community and national administration should concentrate on the vertical production chains, that is subsidies should be channelled **quickly and to the point of the chain where the adversity happened** (patching up ailing links in the chain)



The follow-through effect can be avoided and the production chain can survive



Financial institutions' trust increases towards agricultural enterprises

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Thank you for your kind attention!

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