

**University of West Hungary**  
Sopron

The themes of the thesis

Financing furniture manufacturing small ventures and middle-sized  
business enterprises in Hungary

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## **1. The aims of the research, the definition of the topic**

Small ventures and medium-sized business enterprises (henceforth SVMBEs) provide the bases of economies all over the world. They have a particularly significant role in employment and technological innovation. Furthermore, they have a greater share in the production of gross added value than well-known big companies. They employ 60 percent of the employees in Hungary, they produce 40 percent of the gross added value and they realise 20 percent of the sales on export.

Their dimensional characteristics provide them with strengths and with weaknesses as well. Their advantage is their flexibility, they react to the changes in the external environmental conditions quickly, they have “flat” organisations, which rely more on the diversification of employees than large enterprises. On the other hand, their disadvantage lies in their weaker ability to bargain with their customers, their suppliers and other external contractors when compared to big companies.

They have to stay alive in very strong competition, which is very hard to do. According to our experiences, only half of the newly founded business enterprises can celebrate the fifth anniversary of their foundation. The main factors of the failure are: lack of the sources of finance and lack of the appropriate company management and market analysing skills as well as difficulties in information access. Thus the reasons of failure are not only due to the competition on the market but also due to lack of knowledge, capital and information.

One of the most important growth limits of SVMBEs is undercapitalisation. Risk capital investment is a widespread method of reducing scarcity of capital in market economies. From this aspect the situation of Hungary is unfavourable in international comparison. Besides low level of supplies, the other main reason for this is the fact that the business enterprises are not prepared enough to accept risk capital and thus they withstand sharing ownership rights with an external owner.

The system of ways and means as far as the development of small ventures is concerned, has been mainly determined by the aspect of gathering cheap sources in the last years. Instead of supplementing the sources needed to accomplish the already existing business aims, these small ventures created artificial development aims to meet the requirements of grant applications. This resulted in the development of an approach that means: the good aims are those that were created by the government and that are financed by the government.

Bank loans have become the determinant means of reducing scarcity of capital.

Loan banks are the most significant providers of institutional forms of financing in the case of foreign capital funding: loan banks, or fiscal business enterprises owning these loan banks, play key roles in supplying credit-, leasing- and factoring services. The character of the operation of the loan bank sector in Hungary determines the possibilities and conditions of gathering institutional forms of financing for SMVBES fundamentally.

The Hungarian fiscal system may be considered as a bank-type fiscal system since the role of loan banks in financing economies is significantly higher than that of loan markets.

The development of the Hungarian furniture production, the application of modern corporate policies as well as our European Union membership have opened new prospects for the business enterprises of the furniture industry. If they want to use these new possibilities they have to invest constantly, which means they need appropriate funding.

*The financing of furniture manufacturing SVMBEs is an exciting topic for researchers, for the entrepreneurs themselves and for the specialists of finance, like me. This motivated me to analyse the financial behaviour of this sector and their connection to financial mediator systems.*

The topicality of this subject is proved by the fact that those Hungarian furniture producing SVMBEs that have entered the EU market often find difficulties in choosing the form of financing that is appropriate for their size, capital intensiveness and market share and also in obtaining sources.

In my dissertation I analyse the entrepreneurial characteristics, the opinion about the economic conditions and prospects of the country, the judgment about the business enterprise and about the development of the economic frameworks as well as the financial behaviour of the Hungarian furniture producing small ventures and medium-sized business enterprises.

## **2. Applied methods**

I carried out a primary and a secondary research during the preparation of the dissertation. While analysing national and international publications I tried to review the wide range of sources in connection with financing SVMBEs.

The methodology of the applied research contains a mix of quantitative and qualitative research methods (hybrid method) since more financial sources would be needed to carry on with a questionnaire survey of great volume and wide range.

I used a qualitative method to study the opinions about forms of financing economic frameworks and to reveal the decision-making mechanism that helps to choose between the individual forms of financing.

I used a quantitative method to put up a rank in connection with the usage of forms of financing and the habits of using forms of financing.

During the primary research I carried out interviews with the help of questionnaires in 55 companies and I examined and analysed the financial habits, the usage of forms of financing and the opinion about economic frameworks of furniture producing small ventures and middle-sized business enterprises. The members of the sample operate in different regions of the country, as far as the form of their enterprises is concerned: there are 11 private enterprises, 9 limited partnerships, 1 unlimited partnership, 33 limited-liability companies and 1 joint-stock

company. The average size of the companies of the sample is similar to the national standard. As a consequence, I managed to give an account of the situation and financial habits of the furniture manufacturing companies similar to the national.

The structure of the questionnaires enabled me to gather primary data and to carry out quantitative data processing. I used variables according to the answers given to the questions:

- A scale of 1-5 (interval scale) shows the attitudes in connection with the given question;
- Continuous random variable (e.g. sales revenue, number of staff)
- Binary variable (e.g. Are you leasing something? Yes or No?)

I recorded the answers given to the structured questions as variables on a SPSS sheet. I carried out the quantitative data analysis by statistic methods allowed to the given range of variables.

### **3. The list of results as theses**

3.1. The financial situation of small ventures and middle-sized business enterprises is characterised by significant scarcity of capital and relative supply capital surplus at present. Their own sources are not enough for the investments needed to ensure international competitiveness. The majority of SVMBEs are not able to utilize external financial opportunities with the usual market conditions.

Further favourable conditions of supply have been formed recently as a result of our EU membership and government initiatives coordinated by the financial sphere. However, we are afraid that the majority of SVMBEs will not be able to employ the offered opportunities since they do not have the financial and other criteria of the tenders. At present the demands and supplies do not correspond in the area of external corporate financing. The relative excess supply could be reduced by raising the tendering and credit ratings of the corporate sphere representing the demand sector.

The business policy of loan banks focuses on SVMBEs as customers in Hungary today since this is a market segment, which has great growth and profit potentials. The mediation of the benefits of the member states and of the union is also a great opportunity, the loan banks' ability to utilize these possibilities depends basically on their information- and counselling-services and their product range.

The expansion of the clientele from the SVMBE sector, as well as closer business relation, have created the need to enlarge the number of corporate counsellors and branch networks.

The government can best help the SVBME credit business branch by ensuring the conditions for a balanced economic growth. If these conditions are given, the relations of the rate of exchange and the real interest rate can be calculated. A favourable macro economic environment can motivate both credit supply and credit demand. The government is also required to create a legal and infrastructural



background that accelerates credit administration on the related legal- and organisational actions while making them legally calculable.

**Thesis 1:** *A choice of market economic forms of financing have been created in Hungary that offer complex solutions for financing the investments and the current asset needs of SVMBEs even if the system of mediators - that help demands and supplies to meet – is sometimes underdeveloped.*

3.2. By summarising the answers given to the questions about the financing of furniture manufacturing SVMBEs we can clearly see that internal financing is significant in the case of both short run and long term financing. The proportionate share of own resources and loans from members is outstanding. The interviewed people have the uniform opinion that they would like to satisfy their financial needs with the help of internal forms of financing and they only use external forms if the internal resources do not cover these needs.

The most significant external source is suppliers' credit in the short run financing of business enterprises. Its significance is higher than that of the other short-term institutional and non-institutional external sources. The roles of customers' deposit and short-term bank loans have been considered moderate among short run forms of financing, while the roles of loans from friends, different varieties of state benefits and factoring are said to be insignificant. The most important external form of financing is the bank loan as far as long-term corporate financing is

concerned, followed by leasing. The role of loans from friends and state benefits is marginal in long-term financing as well.

**Thesis 2:** *The hierarchy theory- which says that business enterprises prefer internal forms of financing and among external forms of financing first they favour those with foreign capital characters and then sources from own capitals – is also true for Hungarian furniture producing small ventures and middle-sized business enterprises. The managers of these business enterprises hesitate to involve external silent partners so they are reluctant to forms of financing with own capital character.*

3.3. A high proportion of the respondents, 44 %, makes use of leasing. The most important reason for this is that form of financing is tailored to their needs and it is primarily connected to investments involving machinery and technological vehicles. Business enterprises utilise the advantages of this construction: they can obtain a device of higher value by paying a monthly instalment instead of the whole price, they put this device into function, they earn an excess profit from its operation and so it produces its own price itself during its term.

They are able to follow technological and mechanical developments with the help of leasing constructions; they can acquire the most modern devices constantly, even by leaving one leasing transaction for another. The given improvements can be well separated, planned and monitored financially. Even start up enterprises or not creditworthy businesses can finance their investments this way.

Since furniture manufacturing SVMBEs are planning mainly technological, mechanical and vehicle investments in the next three years, leasing, as a form of financing, will be dominant in this sector.

There is considerable need for bank loans, the firms of the sample do not hesitate to ask commerce banks for loans and more or less accept the form and term of the administration of the banks. Hungarian loan banks have defined in their business policies that they intend to open towards the SVMBE sector, it also contributed to the above-mentioned phenomenon. This change in the strategies is mainly due to the fact that the accessible credit spread has deflated and there is severe competition on the market of large-scale business ventures. The average standard of interest went down creating the need and opportunity for opening towards this sector.

As far as short run financing is concerned, the role of factoring is marginal; many people do not even know the financial possibilities of factoring. Factoring firms and banks supplying factoring services are too keen on securing themselves and they only purchase active debts originating from delivery of goods and services including a very narrow circle, mainly multi-national firms. This limits the spread of factoring.

**Thesis 3:** *Leasing constructions and bank loans are the most important forms of financing among furniture manufacturing SVMBEs. The role of factoring and state supported loans is insignificant. There is not much need for factoring, while in the case of state supported loans the main hindrance is the difficult access to these loans. The use of leasing constructions is more frequent among business enterprises than that of*

*bank loans since it is an easily accessible financial source if vehicles or machinery is purchased.*

3.4. I have found that suppliers' credit is the most significant external form of financing in the area of short run financing. It is a practically general phenomenon that business enterprises finance their operation with the help of suppliers' credits. They are relatively easily available since the suppliers want to sell their products and so they are able to gain and keep markets. Business enterprises regard suppliers' credit as a cheap source. Most business enterprises do not calculate upon the "concealed interest rate" that is usually equal to the price reduction they could get when they pay prompt cash.

Furniture manufacturing SVMBEs are often forced to use suppliers' credit since they have to, for one reason or other, provide suppliers' credit to other business enterprises and they often have to face overdue payment from their customers. Overdue payment causes them liquidity problems, which they can only handle by using suppliers' credits or by the alteration of the expiry date of the payment.

Using suppliers' credit and liquidity problems are connected. 62 % of the business enterprises in the sample have to face liquidity problems sometimes. 63 % of the business enterprises concerned mentioned overdue customers' payment as the source of the problem. The most often mentioned reason – in 76 % of the cases – is the too long expiry date of payment. Another reason is that costs occur first and the profit only later. Moreover, the default of some customers' income also causes

liquidity problems. In summary we can say that liquidity problems are mostly connected to active debts of the customers.

The use of insufficient business strategies, the too high competition in the category of price, the lack of cooperation and coalition among business enterprises and the lacking knowledge of the risk handling methods all cause expanding insolvency problems and circular debts. Ethics has become worse: debts used to be a shame, now they are almost fashionable.

**Thesis 4:** *The role of suppliers' credit is the most important foreign capital source among external forms of financing as far as Hungarian furniture manufacturing SVMBEs are concerned. It is connected to customers' debts related liquidity problems (circular debts!).*

3.5. Half of the respondents did not answer questions about risk incorporate companies or "business angels", many of them do not even know about the existence of these forms of financing. The majority of the respondents excluded firmly both risk incorporate companies and private capital investors as external finance possibilities. Only a few business enterprises are planning to involve "business angel" type capital investment in their enterprises and only 2 % of them are likely to use this investment form.

The fact that risk incorporate companies cannot be found in the sample as forms of financing is not surprising since most risk capital investors – like the ones in Western Europe – concentrate on the market of middle-

sized firms and there are only few of such firms in the sample. They are firms where high business and entrepreneurial risks – characteristic for the time period after the foundation of the firm and for the beginning of its development - have slightly decreased while they have significant growth potential even in the short run.

61 % of the furniture manufacturing SVMBEs in the sample said that the main reason why they would never turn to risk incorporate companies or private capital investors is that they do not want to lose their independence. The owners hesitate because they do not want to

- let others have access to their business routines,
- share the profit they earn with somebody else,
- let others interfere with their decisions.

Generally we can say that they would only use the above-mentioned forms of financing if they had no other choice.

**Thesis 5:** *Formal and informal risk capital financing is only insignificantly or absolutely not present in the financial practice of furniture manufacturing SVMBEs partly because of the lack of information but mainly because of the owners' reluctance.*

3.6. In connection with the short-term financing of furniture manufacturing SVMBEs we can state that the significance of customers' deposits is higher than that of loans from friends. Moreover, they have an important role in corporate financing. This is a surprising result if we consider that, on the one hand, the respondents think that loans from friends are cheaper than customers' deposits, on the other hand, if we

examine the tendencies in other branches, we can see that the role of financing with the help of customers' deposits is much less important.

Business enterprises consider loans from friends as a cheap source, but they try to avoid this form of financing for emotional reasons. The entrepreneurs' attitude towards loans from friends is similar to their attitude towards formal and informal risk capital investment. They only use this possibility if they cannot handle their financial problems in other ways.

The majority of the business enterprises in the sample have easy access to customers' deposits at least to ensure material acquisition. The clientele of the enterprises with access to deposits are primarily private customers, other small ventures and middle-sized business enterprises or large companies with years long close cooperation.

However, it is important to mention that SVMBs that have access to deposits do not always consider this source as a means of helping their financing but as an element reducing risks since if a customer pays a deposit, it signals the sincerity of their order and their solvency.

**Thesis 6:** *The role of loans from friends in the case of short run and long-term financing of furniture manufacturing SVMBEs is insignificant, it is even less important than the role of customers' deposits. Customers' deposits cover the costs of material acquisition and show the seriousness of the clients' orders.*

## **Publications**

1. Development of a bank in Sopron.  
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2. The situation of housing loans in Hungary  
In: Financial fragments: Extracts from the works of young teachers and students researching in academic study circles at the Department of Finance-Accountancy-Statistics of the Faculty of Economics at the University of West Hungary, 2001
3. Financing decisions. HUF or foreign currency?  
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## *Lectures*

1. The preparation possibilities for the EU membership for Hungarian small ventures and middle-sized business enterprises.  
2nd Conference of Wood Industry Marketing, Sopron, 2003
2. The possible effects of EU expansion on Hungary.  
3rd Conference of Wood Industry Marketing, Sopron, 2004
3. Financing furniture manufacturing small ventures and middle-sized business enterprises in Hungary.  
6th Conference of Wood Industry Marketing, Sopron, 2007