Own Capital to Credit - The Financial Practice of the Sme Project in Hungary

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Abstract

The project as action in the 21st century is one of the strongest calls. Without a project, no company can be imagined. Growth is the fundamental interest of every organisation and the most obvious way to do this is to start successful projects that also end successfully. Projects allow for corporate value growth and qualitative progress in time. Larger companies are at the forefront of project management, following best practices that can be copied by the SME sector. Many tools and literature are available for project management but success, in many cases, does not depend on the methodology. In order for a project to be truly successful, one should always pay attention to the evolution of the three baselines from initiation to closure. However, the cost of the three baselines is the most important: from where and to what extent the project can be financed. The aim of this study is to present the financing practices of the Hungarian SME project based on the results of a research, highlighting the most favoured and rejected sources based on the opinion of the responding companies.

Keywords: *project, financing, SME, primary research*

Introduction

Research shows that the Small and Medium-sized Enterprises sector is less financially conscious compared to larger firms. However, it is also true that their ability to obtain resources are rather limited. This statement is especially true when it comes to financial resources (Beck et al., 2015). The SME's credits were expansive before the crisis (Balogh & Nagy, 2014); they decreased since then and the situation worsened in the first half of 2013 (Fábián, 2014). Due to lack of finance, the sector is unable to grow, as demonstrated by those years after the crises. The financing of the SME sector has been examined by various studies, in terms of both its development and financial growth (Ahmed, 2013; Bumann et al., 2013; Liu-Hsu, 2006; Shabbaz et al., 2013). These studies examined this topic from many angles from the financial opening and liberalisation up to the developmental effect of the sector's financial economic growth.

The financing of enterprises will be discussed through two aspects. On the one hand we differentiate between internal resources which derive from the companies' operations and external resources deriving from the financial and capital market. On the other hand, there are short term resources- within one year – and long term ones – more than a year. The integration of these resources into a company's operation and finding the right ratio has been the interest of many professionals researching this topic. One thing that can surely be said is that there is not a single proved ratio which can be used universally for one given sector and same sized companies. They operate from different resources, they are older, have more experience and their financial relationships make them capable of receiving other types of resources (Cabra & Mata, 2003).

The Hungarian SME sector has been widely criticised in the past because of its financial dependence. At the same time, it needs to be mentioned that besides the financing aspect, these companies' competitiveness and their strategic management are also not based on high standards (Varga & Csiszárik-Kocsir, 2016). The local SME sector's capital market relations are very weak since they are restricted only to the share and debt financing. This method is highly influencing the practical financial strategy too (Csiszárik-Kocsir & Varga, 2015). The share financing does not come from the capital market but as IPO to the company. Consequently, it cannot be used for operation finance or only in a limited way. This is supported by the Hungarian National Bank's data.

Investment and financing are crucial topics in the life of the enterprises. The finance decisions determine those frames which guarantee the companies' long term competitiveness and success. An effective financial strategy tailored to the company's size and maturity enables the company to grow, invest and develop. The investment and finance decisions should always be handled together and both should be measured in context and with consistency. These investments' developments are key questions in the life of a country, in a national economy as well as in an enterprise. If the economy grows, GDP growth increases, leading to subsequent growth in enterprise.

The investments concrete interactions are the projects. However, an enterprise is only starting out with a project if it is able to run a sufficient source of funding. Inadequate financing decisions are also able to bring a well-designed project to failure. Thus it is very important to carefully and thoroughly plan the financial situation and funding. The planning is also important through all life-cycle of the project. The iterative model needs a very accurate planning process, instead of the agile method, when the planning is only a high-level planning (Rosenberger & Tick, 2018; 2019a; 2019b). The research described in this study has also examined the project risks (Csiszárik-Kocsir & Varga, 2017). The investigation showed that the vast majority of the risks are because of inadequate financial planning, incorrect funding decisions and poor cost management.

The literature provides a variety of sources and offers the opportunity to finance projects. Before the crisis in 2008, funding was fundamentally credit-driven because unlimited liquidity makes it much easier and much more viable to lend a capital from banks. The 2008 crisis was a milestone in this respect, as the era of unlimited liquidity ended and banks became more cautious and prudent. After 2008, the banks were willing to finance a project by risking their money only after careful consideration. Subsequently, there were also financing opportunities such as Community funding, which had previously been available only for works of art (Bethelendi & Végh, 2014). Once community funding was made available to enterprise projects, the potential financier expanded further. It also provided venture capital funding as a way to provide a well-designed, viable project for good resources in the long run. Venture capital funding not only gives money to a project but it also offers its contacts and knowledge. Businesses in countries with an Anglo-Saxon financial system can use the option of issuing bonds but due to their insufficient financial knowledge and the underdeveloped capital market system, Hungarian companies still cannot count on the capital they can get through bond issuance (Csiszárik-Kocsir, 2017). Unfortunately, in the case of small and medium-sized enterprises, the situation is worse and the can count neither on venture capital nor on Community funding because of their size, investment activity and the volume of projects. However, by expanding the project financing activity of Community funding, small and medium-sized enterprises will also benefit from it in the future. For if an SME wants to invest in a narrower and wider environment, micro and macro-interested stakeholders will also be willing to participate actively in the project, even financially.

Hungarian companies, like the companies in the neighbouring countries, base their project activity on grants from the European Union and from the State. As long as they prove to be sufficient, they do not seek other market-based resources. However, it should be noted that market-based resources do not even seek the small and medium-sized business sector. They consider it risky and uncertain and so, they do not open up to their point of view. This situation was also observed in Hungary. Following the crisis in 2008, the lending activity that would have been necessary for the growth and healthy development of the economy did not start in 2013, like in many countries. This is why the Hungarian National Bank has launched the Growth Loan Program which has provided the small and medium-sized enterprise sector with the most difficult loans for investment and with development resources at a tolerable level of interest rates. The aim of the program was clearly to increase the investment activity of the SME sector in order to enable the sector, which is the largest employer, to be able to withstand the ever-increasing market competition under modern conditions. However, the 2008 crisis is not only a milestone for financiers but also for borrowers. Following the economic downturn in the aftermath of the crisis, borrowers became more cautious due to the increase in loans. Because of the fear of increased credit, they decided to postpone their investments and tried to use the tools available, while keeping their market. The Growth Loan Program also helped with the interest rate on the loans. Another objective of the program was to launch the market-based lending of banks. Even with the increase in the value and number of investments, the program was clearly successful. However, it was difficult to start lending on the market basis.

Material and Method

The research results introduced in this study are part of a primary questionnaire research conducted in 2017. The research was carried out in Hungary with the help of a pretested and standardised questionnaire form. The present research was preceded by a previous survey among enterprises, which had been preceded by an in-depth interview analysis. The present questionnaire was created as a result of these two former rounds and it was a complex questionnaire covering the financing and investment activity of the enterprises. The survey paid special attention to the enterprises' project management and project financing practices as well.

During the research, we received 521 questionnaires but only 416 of them were tenable for inclusion in the sample. The results of the research are presented in this study based on the employment figures of the responding enterprises. The majority of the sample - 85% - is made up of smaller enterprises with less than 50 employees, which means 355 enterprises. The proportion of the medium-sized enterprises was 9% (38 enterprises) while the larger companies had a percentage of 6% (23 enterprises).

In this study, we would like to analyse the sample according to the financial stability of the enterprises. The composition of the sample is illustrated below. The figure shows that companies consider themselves more stable or totally stable (more than 80% overall), which may lead to more active capital market participation.

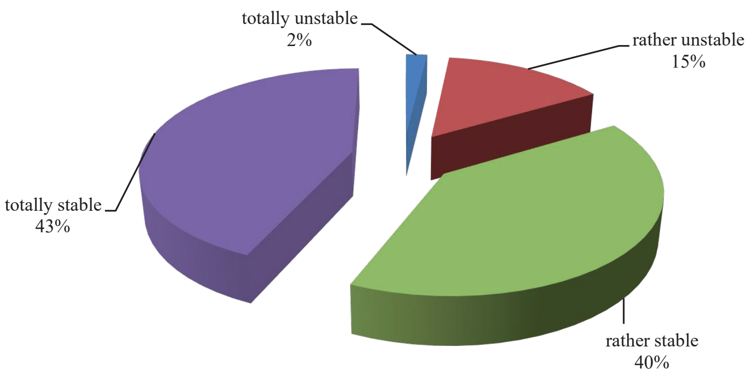

Figure 1. The consumption of the sample according to the financial stability (Source: own research, 2017, N = 416)

Results

In our study, we sought to answer the question of the types of capital involved in the financing of projects by the companies that filled in the questionnaire, first, second, third, place or later according to the importance of the sources. The answers were weighted, the first-ranked sources were weighted 4, the second-ranked sources were third, and the third-ranked sources were weighted. The grouping feature is the financial stability of the enterprises. Here we work with the mean values obtained from weighted responses. The highest average values characterise the most preferred source type.

In terms of the overall sample, the respondent companies prefer to finance their projects primarily from their own resources, as shown by the average of 3.71. Respondents understand the recycled result under equity and the owner's resources. In addition to equity, it is also feasible to include non-refundable grants (3.15) as well as subsidized corporate loans (3.05). On the basis of the average values, these sources are "podium" based on the opinion of enterprises. Equity capital (2.83), project loan (2.51), supplier credit (2.39) and leasing (2.34) also have an average value of more than two. This means that although some of the businesses are not the primary source, they also use these options as a secondary or tertiary option. They can even be used as additional funding for projects. Regrettably, novel and mainly capital market-type sources such as venture capital financing (1.74), crowdfunding (1.71) and bond issuance (1.64) are almost absent from the project finance palette. Enterprises do not think about primary use in terms of non-subsidised loans (2.07), as shown by the average value. On the basis of the above, it can be said that the 416 companies in the sample are prudent: they are financing projects from their own capital or they are also willing to use resources that are cheap or free. Businesses also consider equity as having no cost at hand and which can be used immediately without cost. Even though equity is not a cheap form of financing, it is always necessary to count on the expected return of the owners, or if it is difficult to quantify, at least with the ROE indicator.

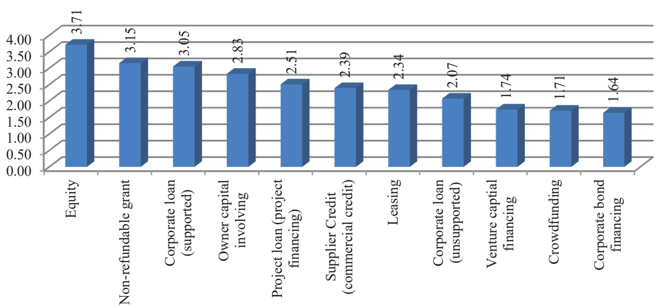

Figure 2. The structure of project funding sources according to the weighted opinions of the respondent enterprises (Source: own research, 2017, N = 416)

The results will be further analysed based on the financial situation of the companies, revealing the financing priorities and differences compared to the sample average. First, we present the opinions of some of the companies who considered themselves financially unstable (2%). In the case of these enterprises, the order of the sources of the sample average is also formed but in many cases, the mean values of their patterns are much lower than those of the whole sample. Financial instability also carries a high risk for the success of projects, which also severely hampers their investment activity. Interestingly, these companies are more confident in modern capital market instruments (crowdfunding, venture capital financing) than their competitors with a more stable financial background. However, in order for these resources to work, it must be a marketable product, an idea in the hands of the business, which is often absent.

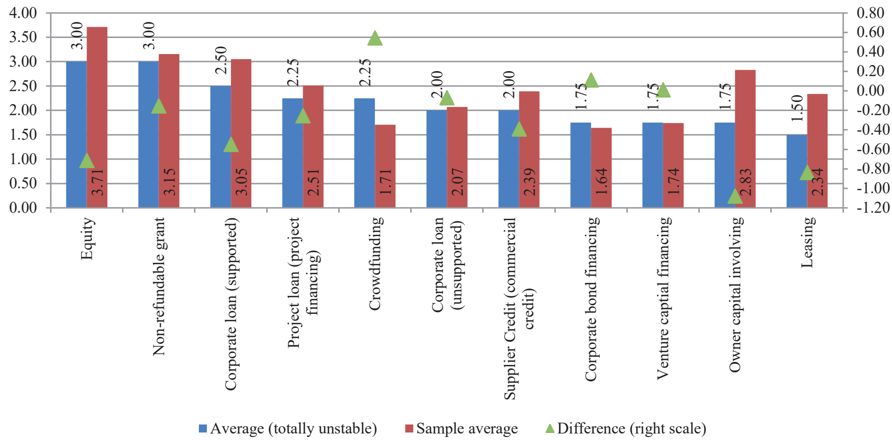

Figure 3. The structure of project funding sources according to the weighted opinions of the totally unstable enterprises (Source: own research, 2017, N = 416)

Enterprises that say they are more unstable (15%) also prefer equity but their value differs slightly (-0.22%) from the sample average, which is used for other sources than subsidised corporate loans (+0, 13% points). Within these enterprises this source came in second. Interestingly, the companies in this group are already bolder in terms of lending finance (+0.07% points) and non-subsidised loans (+ 0.17% points) than the sample companies. Similarly, it can be seen in the case of modern financing instruments, which have a stronger value than the average of the sample.

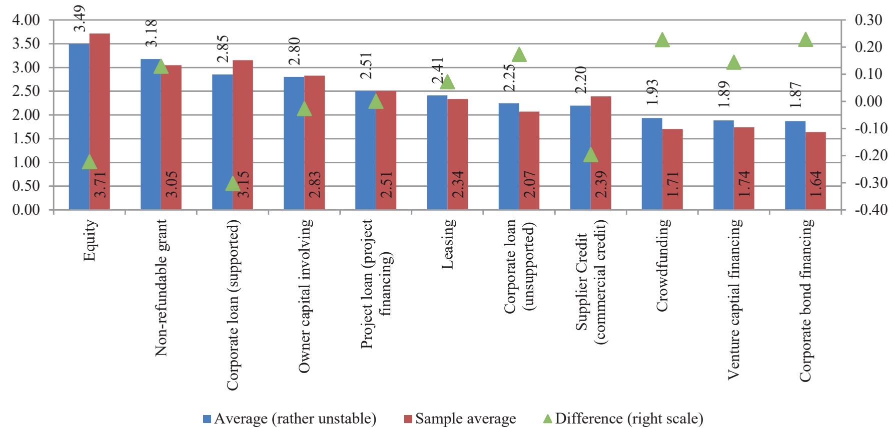

Figure 4. The structure of project funding sources according to the weighted opinions of the rather unstable enterprises (Source: own research, 2017, N = 416)

Enterprises that said they were more stable (40%) had very little difference in the average results of the sample. In almost every case, the sources received a slightly stronger evaluation than the average, especially for podium items. Leasing is even more important to them than in other groups. They also consider the novel sources anomalous, which is why they have assigned smaller values to them.

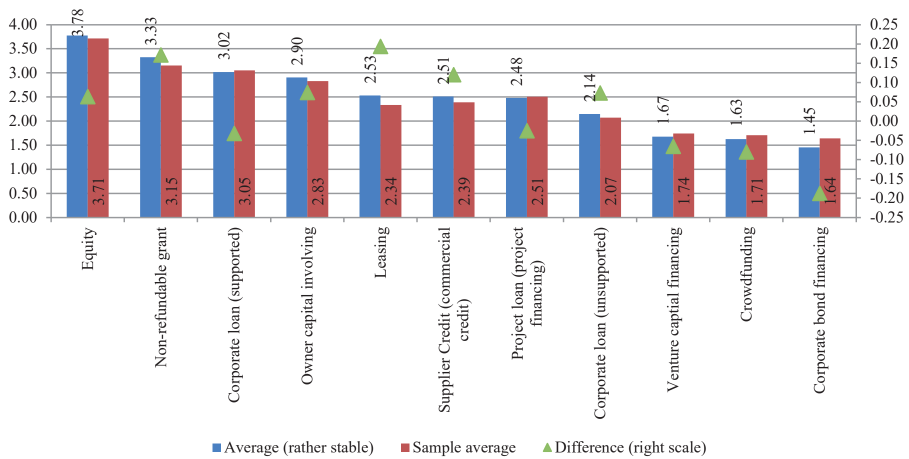

Figure 5. The structure of project funding sources according to the weighted opinions of the rather stable enterprises (Source: own research, 2017, N = 416)

Enterprises that say they were completely stable showed similar characteristics and values as the sample average. They are interested in the willingness to finance loans with greater courage. Project financing as a form of credit is more favoured on the basis of average values than a subsidised loan, although it is much more expensive and risky than a normal corporate loan. After project financing, supplier financing is also discussed with them, but with less value. Leasing is ranked behind.

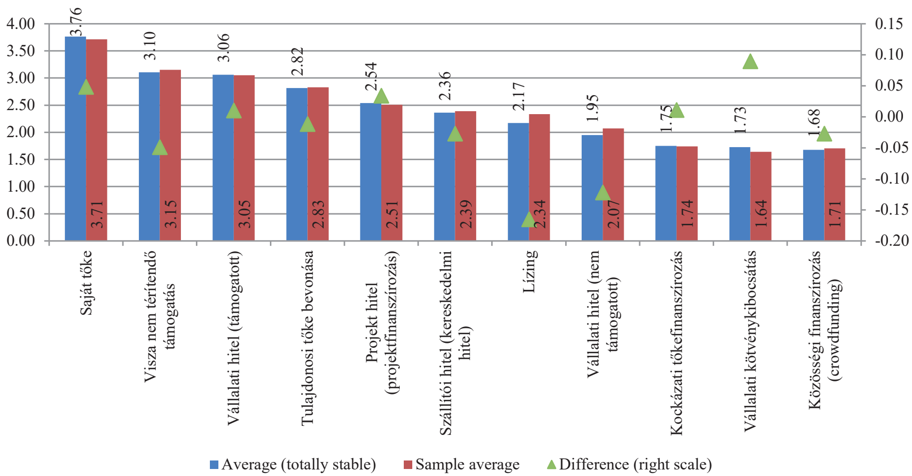

Figure 6. The structure of project funding sources according to the weighted opinions of the totally stable enterprises (Source: own research, 2017, N = 416)

Summary

Based on the above, it can be seen that more than 10 years after the crisis, Hungarian SMEs are still cautious about financing their projects. When it comes to a project, it is mostly based on one's own resources: a project can be started only if there is a source of in-house income. Another project-inducing factor are EU funds as well as subsidised loans, which are popular due to low financing costs. The lack of use of modern capital market instruments and the use of projects to finance projects can be traced back to the lack of financial literacy of businesses and their size. In this area, as in the development of individual financial knowledge and awareness, there is still room for improvement. The transfer of the methodological basis of project management, planning and financing can be the solution in which educational institutions, training institutions and organisations play a key role. The necessary expansion of knowledge within roadshows and professional events can be realised quickly and efficiently; the result of which can be even more successful, well managed and financed projects in the medium term.

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Bio-notes

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