

Financial risks of microenterprises

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Abstract: Since the second half of the 19th century, the main drivers of the global economic development were the big enterprises and corporations due to their rapid growth and wide range of opportunities and potential. After a long time, it had been proven that micro-, small- and medium-sized enterprises or SMEs are indispensable participants of the modern market economy due to their flexibility and dynamic growth rate. My research and work is dealing with – the smallest participants of the SMEs – the microenterprises. Their importance is coming from their characteristics and from several other factors, among which perhaps the most valuable is their job creation capability. As in case of any business organization, microenterprises always have to face the various types and forms of risk. The main reasons for this process are the rapid changes in the economic environment and the increasing market competition and globalization. In my secondary research, I examined various financial risks arising during the operation of domestic microenterprises. In addition, – in the framework of my primary research – I made individual in-depth interviews with consultants, experts and leaders of micro-business segments of several Hungarian commercial banks about the supply side of the domestic money market. I consider as an important part of my research work, to formulate helpful suggestions and to explore and describe foreign and domestic good practices. By bringing these recommendations and advices back into practice, I try to help the microenterprises to find the potential ways for reducing financial risks and the favorable directions of development.

1 Introduction

Since the end of the 19th century, the main participants of the economic development were the large enterprises due to their big potential and opportunities. Soon, after the fragmentation of the Hungarian corporate structure, it had been proven that SME-s (Small and medium-sized enterprises) are important actors of the modern market economy. Among them, the micro-companies have a huge role because of their dynamic growth rate, flexibility and job creation capability. The day-to-day operation of these enterprises is constantly accompanied with various forms of risk. The possible causes are the strong competition, globalization and the fast-changing economic environment. These

risks can be divided into smaller groups: market, political, financial, human resource and territorial risks. My article is investigating the situation of Hungarian micro-enterprises and exploring their financial risks in today's rapidly changing economic environment.

In the beginning of my research, I formulated my objectives:

O1: search and evaluate the financial risks of the domestic micro-enterprises.

O2: examine opportunities for development and to formulate suggestions according to these.

O3: study the relationship between credit products and the microenterprises.

2 Secondary research

During the secondary research, I explored the domestic and EU microeconomic environment. First, I dealt with the proper enterprise classification, which main aspects are the total number of employees, the annual turnover and the balance sheet total. Thus, those organizations are micro-enterprises, that have less employees than 10 and have a maximum balance sheet total or turnover of 2 million euros and the corresponding forint amount. In this group, companies with 0 employees and private entrepreneurs are usually treated separately.

From the last report of the Central Statistical Office (CSO) we can see, that the total micro-enterprise proportion was determined at 97.8% in 2017. Based on the yearly statistics, we can conclude that the number of the Hungarian micro-enterprises is constantly growing, while the proportion of larger organizations is decreasing [5]. The huge role of micro-companies is also proven by the fact that around 10-12.5 thousand billion forints – almost one third – of the annual revenue in the SME sector is reached by them. The micro-enterprises are outstanding in the country's GDP as well. According to the CSO, 6.4 billion HUF – which is 35% – of the gross domestic product is produced by these enterprises. Thanks to their enormous number, more than 50% of the SME sector employees is working in micro-enterprises – which is more than 1 million people – and this ratio is steady during the years [4].

Recognizing their importance, the state started to support these organizations. This process includes various programs with solution for credit difficulties, changes in the legal, administrative and taxation system.

2.1 Micro-enterprises in the European Union

The internationalization of Hungarian micro-, small- and medium-sized enterprises is unique, because it took really short time and was difficult due to the developed EU market and its competitiveness. During the process micro-companies had to cope with the lack of capital and knowledge to build their business relationships and position. The average number of employees of domestic micros is like the European ones, but in case of export they have huge lag, because only 10% of them is dealing with export activities. The growth of the micro-enterprises could be accelerated if those larger organizations, that offer them supplier position, would raise their exports [6].

The huge administrative burdens and cost are also making the internationalization more difficult. Hungary is in the bottom third among the member states in case of the percentage administrative burdens relative to annual GDP, so it would be necessary to simplify and decrease these burdens [11]. So, we can conclude, that domestic SMEs are not in a good place in case of the international comparison. Most of them, does not even reach EU averages [2].

2.2 Financial risks and state programs

According to the technical approached risk definition: “The basic unit of risk is the average expected probability of occurrence of events that have a negative, undesirable impact on man and his environment.” But there is no objective risk-perception, because the negative impact is subjective. In the economy, we use subjective utility: “unit expresses satisfaction or insufficiency in an event” and this way positive effects appear [10]. The risk itself has three main groups, which are strategic, operational and financial risks, among which I deal with the last. “Financial risk is essentially the value of the financial position due to the uncertainty of the future event” [3]. It is important to know all the emerging risk factors and the opportunities to eliminate these. In this article I mainly focus on the credit risks and the connecting bank credit products.

In recent years, big changes could have been perceived in the domestic economic structure. Since the fragmentation of large companies and the establishment of new micros, the number of SMEs grew radically. Since these enterprises do not have any antecedents and are often “forced companies”, they have capital shortages and have to face financing difficulties. The greatest financial problems are due to the compulsory legislation, which have three groups: compliance, administrative and financial burdens. Among these the most serious difficulty is that the legislative changes are unpredictable. It is also a problem, that the sum of the administrative burdens can reach even 10% of the micro-enterprises’ income.

Because of the constant shrinking of the bank lending and the high-risk level, it is hard for micro-companies to get any kind of credit from commercial banks. Even

in case of positive judgment, it is huge task for micros to pay the increasing amount of repayment and they easily get in a debt spiral [11]. The government has launched several programs to reduce these risks levels for banks, so they could give loans for worse-situated micro-enterprises. The most wide-spreaded programs are the Microcredit Program, the Growth Loan Program, the Szechenyi Enterprise Development Program, the Szechenyi Card and the MFB Points. The aim of these programs is to provides state cover, more favourable conditions and lower interest rates to promote the development of micro-enterprises.

3 Primary research

In order to complement my secondary research, I made 4 individual in-depth interviews with the representatives of domestic commercial banks to collect current and accurate data. My interviews were semi-structured, with open-questions and defined areas, so I could easily adapt my questions and the order to suit the partners' way of thinking. The conversations lasted 1.5-2 hours and the all data presenting in my work was discussed and approved by the interviewees. I refer to these conversations according to their numbers.

Table 1.: Interviews with the representatives of commercial banks

Number of interviews	Bank	Representative
1	K&H Bank	Leader of SME Segment Marketing Department
2	MKB Bank	Branch manager
3	CIB Bank	Small Business Segment Manager
4	Raiffeisen	Branch manager

Source: Own work

In this session I will briefly expound the issues covered during the interviews. Banks usually define micro-enterprises based on only the annual turnover. During the years, the number of micro-enterprises seriously increased, because of the currently low interest rates and favourable economic environment. These organizations mostly apply for a loan in forint currency with an average amount of 5 million forints and various maturity from 36 months till 7 years. Every commercial bank has its own, special products for micro-enterprises to attract and keep these companies. It is hard to make a general picture of these products, because of their specialities they differ bank by bank. Banks also have state credit offers, in this group the Growth Loan Program is the most common.

The process of the application and the judgement is unique in every commercial bank and according to this, the number and the form of the required documents and the platform also different. All of them try to use more and more online operations and opportunities to make the whole process easier for micro-enterprises. The loan disbursement period is depending on the special product but is generally between 1-4 weeks.

Because of the bank secrecy, some of my questions were only partially answered or remained without any response. These questions were about the proportion of positive and negative judgements and the causes of those. In case of the unsuccessful placements it is interesting, that the rate is really low, this can be due to the fact that banks are monitoring them after the positive judgement of credit application.

Despite all the efforts done by commercial banks, – to facilitate the application of micro-enterprises – a survey by OTP Bank involving 800 SMEs, did not show satisfying results. Only 33% of the participating micros use external financing possibilities. Lot of participants think, that they have to do so much paperwork, or their situation is not good enough, that is why they do not even try to apply [8].

4 Conclusion, suggestions

I consider it important, to formulate suggestions and to collect and explain good practices, through which I contribute to the development of micro-enterprises. By the help of these advices, the financial risks could have been decreased. Zoltan Szira professor also expressed, that positive entrepreneurial models should have been published through media surfaces, so micro-companies would easier find the most suitable solutions and opportunities [11].

One of the most serious problems of these organizations come from the usual and large volume changes in the legislation. The reduction of the information access and administrative costs could cause big decrease in the operating costs. Because of the lack of capacity, micro-enterprises could not follow these changes and could easily get into really bad situations. That is why an automated system should be built, which monitors these changes and gives information about them for the micros. This process might be united with the previous part, and good practice forums could get a part and role in this system.

It is a huge problem today, that most leaders of micro-enterprises do not see the huge potential in the knowledge investments. They do not want to change the routine and well-organized processes and if they do, often they have not got enough money for it. So, centrally organized trainings or lectures with low price could help these people a lot. Magdolna Csath economist thinks the same way and in her recent publication she pays attention to the development possibilities of

organizations. According to a study made by European Investment Bank, our country spends minimal amounts on knowledge investments. She states, that lately productivity could be better increased by the help of new techniques and innovations, which requires the raise of overall knowledge level. An opportunity for this could be the cooperation of higher educational institutions and micro-enterprises. Nowadays, this possibility is more suitable for larger organizations, so it is needed to develop and expand this opportunity by the help of the state. Through this cooperation, entrepreneurs and lecturers could have a chance to exchange and broaden their knowledge [7].

The Chamber should also contribute to these processes, as they could have handle tasks containing information collecting and transferring to the micro-enterprises and organization of educational opportunities or trainings. For this, various options are available like courses or online tutorials and news. It is also an option to cooperate with the local governments and make efforts jointly, as they are aware of the local needs.

SMEs have limited human and financial resources than larger companies, so it is significant for them to concentrate on innovation. Innovation is a main element of competitiveness also, thus companies need to properly set their priorities in this field to be successful in the long run. It can be stated, that in our country lot of competitiveness hindering factors appear during the operation of micro-enterprises. Therefore, the above-mentioned state and Chamber support is really needed to facilitate innovation and competitiveness [9].

Information serving and therefore advertisings are really important for commercial banks to attract potential customers. However, most of the advertisings are for private people not for companies. Thus, direct information flow would be necessary between them and micro-enterprises. This could manifest in the form of various presentations, where professionals could make the leaders feel that their products are easily accessible, and they should choose them [1].

Based on my whole research, I set the following hypothesises for my questionnaire, which is the next part of my work:

H1: The financial difficulties of micro-companies are basically due to the high costs of complying with compulsory legislation.

H2: There is no any direct forum available to micro-enterprises, which is dealing with the current market environment analyses and information.

H3: Because of the excessive documentation requirement, most micro-companies do not even try to claim any loans.

5 Summary

I believe, that exploring and analysing the hindering factors and the development potentials of the micro-sector is important to be able to make relevant conclusions and suggestions. During my research the supply side of the financial system got bigger role, that is why I am going to continue my work with a questionnaire to properly examine the demand side also.

Based on my research, it is clear, that micro-enterprises are indispensable actors of the domestic modern economy. But they need support to be able to fully take advantage of their dynamic growth rate and flexibility. This includes not only financing, but knowledge and professional support as well, both in national and county level.

I would like to share my results and formulated suggestions with the practical life to make the every-day operation of micro-enterprises easier. Among these, the organization of different forums – collecting the current information of the market and most important changes in the economy – is the most important and helpful.

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