



Eurofound

Restructuring in SMEs: Hungary

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Introduction

From 2000 Hungary's export-driven post-socialist development model faced new challenges: in particular, decreasing foreign direct investment (FDI) inflow, and low small- and medium-sized enterprise (SME) efficiency coupled with fiscal problems stemming from subsequent governments' 'neo-Keynesian'-style policies resulting in major budget imbalances peaking in 2008 and 2011. The second, socialist-liberal government had to tackle the perceived problems arising from the budgetary policies of previous governments. In June 2006, immediately after re-election, the government announced a comprehensive package of austerity measures and reform proposals to redress budget imbalances and to ensure the country would meet the strict macroeconomic conditions required to join the eurozone.

Consequently, in 2007 real wages dropped by 8%. The adoption of these reform initiatives mainly affected the public sector and welfare provisions. However, the government soon backed away from reforming the health insurance system and introducing higher education tuition fees after its plans generated overwhelming opposition in a referendum held in March 2008. The 2010 general election gave the centre-right Fidesz-Hungarian Civic Union the strongest mandate of any government since the fall of communism (Neumann, 2010). The currency, the Hungarian forint (HUF), remains subject to volatility, given the risk of fiscal slippage and the country's large debt burden. The government's comprehensive fiscal reform aims to reduce the budget deficit below 3% of GDP over the medium term. Most new legislation puts a high burden on SMEs, increasing taxes, introducing new types of taxes, and placing extra taxes on the bank and telecommunication sectors, which have an indirect effect on SMEs.

Table 1: *Major economic indices*

Index	2006	2007	2008	2009	2010
Gross domestic product (% annual growth)	4	1.2	0.9	-6.5	1.2
Gross fixed capital formation (% annual growth)	-6.2	1.8	-2.3	-8	-5.3
Export (according to national accounts, %)	18	16.4	4.6	-15	14.2
Import (according to national accounts, %)	14.4	13.4	4	-17	12
Annual consumer price index (% annual growth)	3.9	8	6.1	5	4.9
Balance on current account (% annual growth)	-5.5	-6.6	-7.4	-2.2	-3.8
Balance on current account (% annual growth)	6	4.4	3.4	1.5	2.1
Unemployment rate, %	7.5	7.4	7.9	10	10.8
Hungarian Central Bank base rate at the end of the year, %	8	7.5	10	6.25	5.75

Source: ECOSTAT (<http://www.ecostat.hu>, *Hungarian*), *HSBC data*

The 1990s saw profound restructuring of the Hungarian economy. According to Körösi (2007), during the 1993–2000 period 15% of all jobs were destroyed and created each year, much higher than the gross job turnover in other transition countries. The overall restructuring trend is a rapid decline in the share of the primary sectors and, to a lesser extent, job losses in manufacturing, while the share of services is steadily growing. However, with 23% of all jobs in manufacturing and 8% in construction, Hungary is far from being a post-industrial society similar to those of the EU15 countries. In the last 15 years, massive FDI-driven reindustrialisation occurred, which resulted in relocation of industrial jobs into Hungary and thus the industry's share has only decreased slightly (Jókay and Osváth, 2006). Nonetheless, the new trend of relocation out of Hungary from 2006 has outweighed industrial job creation in the most recent period, 2008–2011. Obviously, this process was somewhat accelerated by the economic crisis.

As far as the employment impact of the global recession is concerned, the unemployment rate grew sharply by over 11% in 2011, the highest figure for 13 years. The employment rate for the age group 15–64, which had been almost the lowest in Europe, dropped by 1.1%, and its level in 2010 was as low as 55.1%. The Labour Force Survey showed that employment dropped by 134,000 compared with 2008, and according to the Public Employment Service, the number of registered job-seekers has grown steeply. National Statistical Office data show that 2,710,000 people were employed by companies with five or more employees in December 2011. The Hungarian population age group 15–64 was 6,874,000 in 2010. A new feature was that larger firms no longer predominated; for example, firms employing fewer than 250 outnumbered larger firms. In other words, the recession began with the contraction of large firms and is now also affecting SMEs (Fazekas and Molnár, 2010; Neumann, 2010).

SMEs' role in employment is eye-catching in all regions and microenterprises offer most jobs. Microenterprises are dominant in services, while medium-sized enterprises are mainly active in industry. Active SMEs have diminishing chances of survival, although survival rates differ by region. In other words, the more recently established the firm, the less its chance of survival. The highest survival rates were found in central Hungary, and west Danube in 2004–2009. Corporate enterprises have a much better chance of survival than sole proprietors (KSH, 2011a).

The majority of companies in general see labour force reduction rather than other forms of restructuring as the solution. Leaders and HR staff have experience neither of crisis management nor of a strategy for solving the problems and overcoming the crisis. As a consequence, with the crisis deepening, bankruptcies, drastic production cutbacks and soaring unemployment are to be expected (DSG, 2009).

Lacking the money to respond to the crisis, the vast majority of small and medium-sized companies have made cost reductions. This was a necessary but not a sufficient step. It is also important to ensure a healthy cash flow. Emerging medium-sized companies have to establish growth, which refers to creating the possibility of funding.

A substantial portion of registered enterprises is not active. The number of active enterprises was 688,000 in 2009. Large companies (250 employees or more) numbered only 870. One fifth of SMEs were in wholesale and retail, and 16% in science and engineering sectors. The most important sectors are industry and construction (18% combined), but real estate, administration, communication, lodging and catering amount to over 30,000 each (KSH, 2011a).

More than half of medium-sized enterprises (53%) are in industry, construction or agriculture, compared to 20% of microenterprises. Overall, companies employ 2,706,000 people; 74% work in SMEs, and produce 56% of GDP (KSH, 2011a).

Table 2: Number and distribution of active enterprises in 2009

Sector	SME Total (% of all)	1–9 employees (% in size class)	10–49 employees (% in size class)	50–249 employees (% in size class)
Trade, repair	20.2	20	25.4	16.6
Expert, science, engineering service	15.6	16.1	6.1	3.3
Building industry	9.8	9.8	12	6.7
Industry	7.9	7.1	22.7	39.6
Administrative and business support services	5.5	5.5	5.5	8.3
Other personal services	5.3	5.5	1	1.2
Information and communication	4.9	4.9	3.2	2.9
Real estate transaction	4.7	4.6	6.9	3.5
Lodging and catering	4.7	4.6	2.9	1.6
Transport, warehousing	4.5	4.4	5.5	4.6
Other sectors	17.1	17.6	8.8	11.7
Total	100	100	100	100
Total	688,126	657,102	26,278	4,746

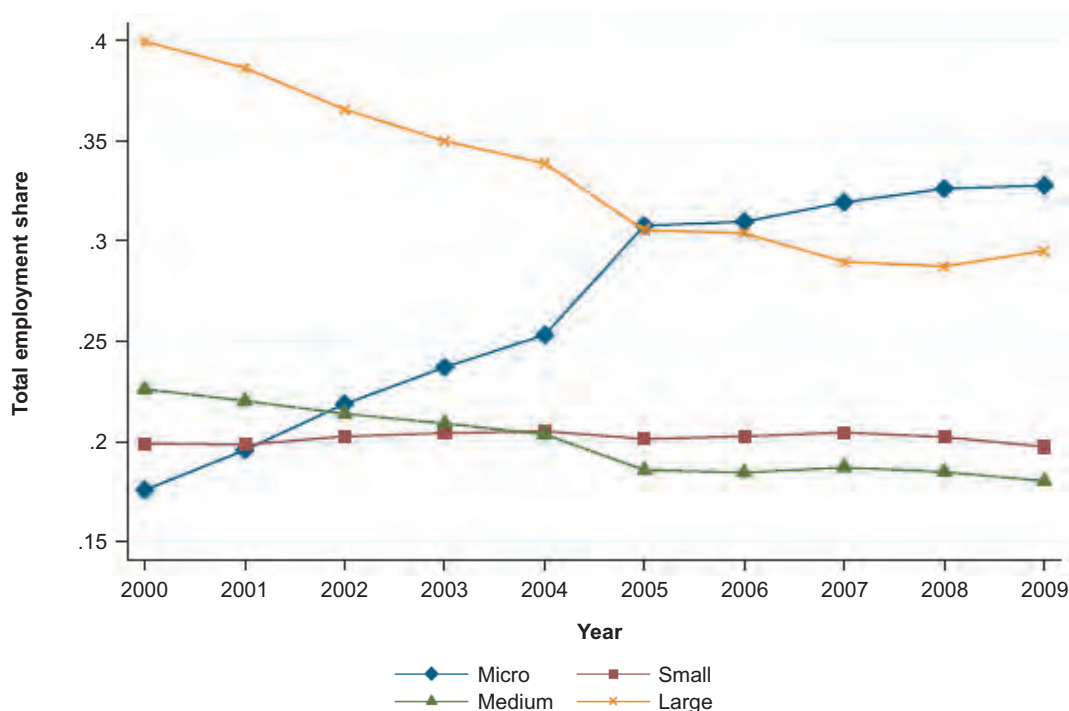
Source: KSH, *The situation of small and medium sized enterprises in regions, 2011a*

During recent decades policies have targeted SMEs, mostly to increase their chances to grow and survive. SMEs have been considered to be a cure for the low employment rate because they create a disproportionately larger share of jobs than large enterprises (Papanek, 2009; Szabó, 2009; Szirmai et al, 2009; Szirmai et al. 2010).

Telegdy and Sutherland (2011) analysed Hungarian tax authority data, which contain information on all double-entry book-keeping companies for each year in the period 2000–2009. The number of firms rose steadily, from 151,261 in 2000 to 362,420 by 2009 – mainly because companies are getting more formalised.

In Hungary job creation decreased a little, and job destruction increased a lot in 2008–2009. Jobs lost numbered 124,532, 5% of total jobs in 2009 (2,608,288). Employment fell in all size categories, but somewhat surprisingly, micro firms (with fewer than five employees) contributed only 858 jobs lost. This shows how the crisis hit small firms. In the last pre-crisis year, small firms increased employment by more than 23,000. Large firms with at least 500 employees lost many more jobs: almost 34,000. Looking at net employment changes by age distribution, new firms created 95,000 net jobs, only 10,000 fewer than in the previous year. Firms born in 2008 also grew, creating more than 22,000 net jobs. Older firms decreased their aggregate employment.

Figure 1: Total employment share by firm size



Notes: N = 2,902,680, micro: 1-10, small: 11-50, medium: 51-250, large: 251+
 Source: Telegdy and Sutherland, *Who creates jobs in Hungary?*, 2011

Exporting firms created 6.1% more jobs in 2008 than non-exporters. In the crisis, however, this trend reversed and export-oriented firms' net job creation rate declined by 11.6%. The crisis, therefore, hit exporters hard as international demand shrank (Telegdy and Sutherland, 2011).

In 2004, 71,220 new businesses started operations (13 large, the rest SMEs). Each year, only a moderate proportion survives. After five years, 42% of the original population existed; 5% fewer than among large companies (KSH, 2011b).

Due to favourable economic conditions in neighbouring countries, the number of SMEs delocating headquarters and paying taxes in other countries has increased. Most of these SMEs earn most of their income in Hungary (Szabó, 2009). This is a very unfavourable tendency which harms fiscal stability, but is difficult to restrict without infringing EU directives.

Another unfavourable tendency is low investment activity. The K&H Bank and GfK research agency cooperative representative study of 700 SMEs shows that only 55% of SMEs plan investment, 5% lower than the previous year. Most plan IT development (27%), machine (21%) and vehicle purchase (16%) (Piac & Profit, 2011a).

The Small Business Development Centre (SBDC) of Corvinus University, Budapest, studied the winners and losers of the economic crisis. Macro figures and tendencies mentioned above are approved by this quantitative (N = 1,192) research among SMEs (Szirmai et al., 2010).

In Hungary, the second phase of the crisis appears as a spreading recession. Research shows that this has a much bigger impact on SMEs. The disappearance of potential markets rather than the lack of financial resources forces SMEs to react.

The strong negative effect has several causes (Szirmai et al., 2010):

- From 2000 to 2011, the current balance deficit could not be financed without IMF help even with favourable financial markets before the crisis. EU accession did not bring the expected ‘money inflow’. Handling the current budget deficit as a priority made it impossible to moderate a 6.5% GDP setback. It is still a question whether there were other options for the government, and what would be the result of different policy.
- The Hungarian economy is very open. Exports and imports together compared to GDP is very high. This makes the economy vulnerable to changes in other countries. Decreasing foreign sales forced domestic companies to lay off people and moderate production. Closure of facilities became common news.
- The weak structure of Hungarian economy. Large oversized governmental bureaucracy; large institutional burden – social care system, local government system – and education reform is still delayed.

It is obvious that SMEs did not benefit from the opportunities of EU accession. Just the opposite – increasing competition and currency fluctuation had very bad effects. The majority of SMEs were not prepared for the future. The deteriorating situation is not only caused by institutional settings and macroeconomic imbalances, but also internal factors influencing SMEs’ competitiveness.

Restructuring in Hungary happens at two levels. First there is macroeconomic and institutional restructuring. This opens new opportunities, but at the moment also drives many SMEs out of business. At micro-level, SMEs have to change in order to survive the crisis. This process is characterised by drastic cost-cutting (50%), restructuring the organisation and cutting back on educational expenses (each 23%). Reducing costs primarily meant paying smaller premiums and bonuses and, to a lesser extent, freezing wages. A total of 10,000 jobs were lost in the DSG surveyed firms. A large minority (40%) of organisations, employing fewer than 50, laid off workers and are therefore not required by law to report redundancies; moreover they receive no media coverage (DSG, 2009).

Most companies would request assistance in the form of reduced wage levies and reduced business taxes. The SBDC finding was similar to others, that companies expected economic policy measures to solve their problems arising from the crisis. In addition to tax reductions, they expected central assistance to be able to introduce shorter working time combined with training and to apply the annual reference period (Szirmai et al., 2010).

In the following sections, we discuss the different types of SME restructuring. We discuss the limited research materials on particular issues and add our expert view. This is followed by examination of the drivers of restructuring, and how SMEs restructured and why. In the final section, we summarise the characteristics, challenges and business support available for restructuring.

Relevance of different types of restructuring for SMEs

Overview

Identifying restructuring events in the Hungarian SME sector is a challenging task. In small companies, restructuring events can be the quick, unplanned, non-communicated decision of the owner-manager. We would not read about most of these changes in the media. Sometimes, even SME managers, lacking a formal management education, do not realise that a restructuring process is going on in the company. They run companies instinctively, reacting to market challenges and possibilities. For this reason, the measurement of the number and effect of restructuring events in SMEs is difficult. Perhaps changes in employee numbers can be a good, but not perfect, indicator of restructuring – but not all restructuring produces employment effects. Internal restructuring, relocation and outsourcing might not cause changes in employee numbers. The high tax burden on employment in Hungary means SMEs may hire new employees only after much deliberation. If additional labour is required, employers may reorganise or use overtime rather than hire new people. The European Restructuring Monitor (ERM) has collected data on restructuring events in Hungary since 2002 (Table 3).

Table 3: *Breakdown of employment effect by type of restructuring since 2002*

Type of restructuring	Planned job reductions	Planned job reductions (%)	Planned job creation	Planned job creation (%)	Cases	Cases (%)
Internal restructuring	79,306	73.57	5,497	10.35	139	37.67
Business expansion		0	46,742	88.04	136	36.86
Bankruptcy / Closure	11,523	10.69	45	0.08	42	11.38
Closure	4,096	3.8	0	0	14	3.79
Bankruptcy	5,105	4.74	0	0	14	3.79
Offshoring / Delocalisation	2,615	2.43	0	0	9	2.44
Other	2,615	2.43	808	1.52	8	2.17
Relocation	1,132	1.05	0	0	3	0.81
Outsourcing	910	0.84	0	0	2	0.54
Merger / Acquisition	500	0.46	0	0	2	0.54
Total	107,802	100	53,092	100	369	100

Source: [ERM](#), *European Restructuring Monitor database, 2011*

Although the ERM database includes only large-scale restructuring events with media coverage, Table 3 identifies the most frequent types of restructuring as internal restructuring, business expansion and bankruptcy/closure. Although there are no empirical studies to confirm our assumptions, our opinion is that Hungarian SMEs follow the same trend of large and medium-sized companies. Outsourcing, bankruptcy/closure, internal restructuring and business expansion are frequent restructuring types in Hungarian SMEs. Offshoring/delocalisation, relocation and merger/acquisition are rare phenomena among Hungarian SMEs.

Based on ERM data and SBDC professional judgement, the following table assesses the relevance of various restructuring types by company size.

Table 4: *Relevance of various restructuring types by company size*

	Micro	Small	Medium
	Companies		
Relocation	Weak	Weak	Weak
Outsourcing	Weak	Medium	High
Offshoring / Delocalisation	Weak	Weak	Medium
Bankruptcy / Closure	High	Medium	Weak
Merger / Acquisition	Weak	Weak	Weak
Internal restructuring	Medium	High	High
Business expansion	Weak	Medium	High

Source: *Author compilation*

For larger SMEs, the potential for restructuring is higher. While microenterprises often lack the needed capital and knowledge to manage restructuring, small and medium-sized companies have greater financial possibilities, a more developed organisation and extensive knowledge that enable them to exploit the possibilities of restructuring. Unfortunately, microenterprises are the most affected by bankruptcy and closure.

In the following sections we examine in detail the different types of SME restructuring in Hungary.

Relocation

Relocation is not a common restructuring event among Hungarian SMEs. Strong SME bonds to the local community, inflexibility in changing location and the cost of relocation combined with the small size of the country (93,030 sq km, 35,919 sq m) limit the significance of relocation in Hungary. Our opinion is that there are few differences in possibilities, wages, property costs/ rents, markets, available workforce or natural conditions that might influence the relocation of Hungarian SMEs.

Outsourcing

Outsourcing of activities is a preferred business solution among Hungarian SMEs. Two types of outsourcing can be differentiated: first, activities outsourced from the beginning of operations. These activities include accounting and payroll calculation and, depending on sector, design, logistics and IT. Such activities were never performed in-house. SMEs outsource these activities for cost reasons – it is cheaper than employing someone to undertake them. The second type is outsourcing of activities previously conducted internally for cost or quality reasons.

Larger companies outsource activities for cost reduction while smaller ones profit from higher service quality and reliability (Sebök, 2007). The majority of SMEs outsource payroll due to complexity and changing legislation. Accounts/payroll constitutes 35–40% of the outsourcing market, which can expand by 20% due to financial or economic crises, encouraging firms to seek cost reductions (HVG online, 2010). A professional, specialised company can provide reliable, high quality services at lower cost than in-house solutions. HR functions are outsourced too – working hours register, cafeteria, competence analysis, organisational information flow assessment and planning. The main constraints of outsourcing HR tasks are data confidentiality requirements. IT development online, providing real time access to service provider systems, solved this problem (Tímár, 2009).

IT outsourcing is also a flourishing area in Hungary. Previously, only large companies choose this solution but now smaller firms with 10–15 employees also use this option. Usually the main motivators of IT outsourcing are previous data loss or collapse of IT systems (Tugonyi, 2008). The financial-economic crisis generated cost reduction requirements and stimulated development of the area (ITExtreme, 2009).

Research examining 54 Hungarian companies (SMEs and larger corporations) shows that outsourcing of logistics – inland and international transportation, storage, and import/export clearance – is also a common trend in Hungary. The reasons for logistics outsourcing include cost reduction, greater flexibility, higher service quality and focus on core competence. The main constraints are reliability, prompt and effective answers to customers' needs, and high quality customer service (KPMG, 2009).

Among Hungarian SMEs, there is a new trend to outsource document management and printing. The outsourcing of printing can result in 15–20% printing cost savings (Sebök, 2010).

Although outsourcing is a more accepted and popular SME management tool, an InCoDeSME study (2010) of two Hungarian counties (Békés and Csongrád, N = 500) shows that as an organisational innovation its significance remains low.

The main SME/large company difference is that while large corporations usually seek cost reductions, SMEs are also motivated by lack of trusted workforce and time. Typically, SMEs only outsource new tasks which have never been part of the company activity.

Offshoring/delocalisation

Hungary is an offshoring/delocalisation destination rather than a sending country. The AT Kearney (2004) offshore location attractiveness index measures the viability of countries as offshore destinations based on their financial structure, people skills and availability, and business environment. Hungary is ranked the eleventh most attractive offshore destination of 25 countries examined. Hungary's strength comes from its close location to European, and particularly German, companies, cultural similarities, attractive cost, good language skills, solid technical capabilities and minimal regulatory problems (AT Kearney, 2004).

Offshoring/delocalisation is not a well researched area. Studies by Kiss (2006) and Hunya and Sass (2005) focus mainly on large companies. Kiss (2005) found that during 2000–2005, Hungarian industry delocalised to China and Ukraine, primarily for cost reduction reasons, especially wages. Drawing on Hungarian newspaper reports, Hunya and Sass (2005) identified 299 foreign investment cases from July 2003 to September 2005, of which 65 were delocalisation, 58 to Hungary and seven from Hungary (to Romania, Austria, Latvia, Poland, Slovakia and Ukraine).

Empirical research on Hungarian SME delocalisation activity is absent. Hungarian SMEs have the advantage that in neighbouring countries they can find ethnic Hungarian employees. Finding good examples, highlighting the benefits and mapping out the main challenges of delocalisation would help to inspire Hungarian SMEs to exploit the opportunities of delocalisation.

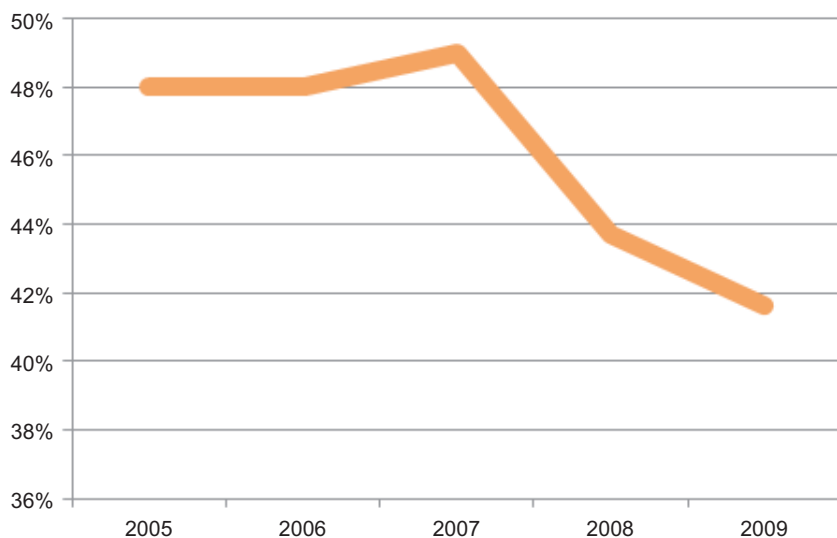
Bankruptcy/closure

Unfortunately, bankruptcy is a frequent problem in the Hungarian SME sector. In 2011, insolvency cases grew by 30%. As Coface research highlights, 10% of Hungarian companies are insolvent and every twelfth company will have closed by the end of 2011. The most affected companies in insolvency operate in construction, commerce and tourism (Piac & Profit, 2011b). Although not all insolvent companies close, in 2011 the closure of businesses was at a peak in Hungary.

Micro and small companies are most affected by closure: the closure rate reached 9.9% in 2007. Almost a quarter (22.1%) of closed companies were financial intermediary or insurance agents. Companies working in the healthcare sector proved to be more stable; among them the closure rate was 3.5% (KSH, 2011b).

The Hungarian Central Statistical Office examined business survival rates. Of 71,220 companies established in 2004 (99.98% were SMEs), only 42% of SMEs survived until 2009. Partnerships proved to be more durable than sole proprietors due to higher capital and more developed organisation. The study does not examine the effect of the crisis on survival rates but our opinion based on other research is that in 2008–2009 Hungarian SMEs were not heavily exposed to the effects of the crisis. The main effects have occurred since 2010.

Figure 2: Five year survival rate of SMEs



Source: KSH, *Demography of enterprises 2009, 2011b*

The risk of closure forces SMEs to react, restructure or innovate. Preliminary results show this tendency continued in 2010 and 2011 (Piac & Profit, 2011b). Disaggregating results by sector, during the period 2004–2009, healthcare and social services had the highest survival rate (67.5%), and, as in previous years, financial and insurance business had the lowest survival rate (17.4%) (KSH, 2011b).

Based on SDBC opinion, the main reasons for SME bankruptcy/closure are:

- shrinking markets, strong competition (e.g. textile industry);
- specific industry problems (e.g. construction);
- financial and economic crises;
- high tax and social security burdens (affect mainly sole proprietors);
- failed succession, business transfer;
- technical closure.

Media articles report record closure numbers in Hungary in 2011 (Infovilág, 2011a, b). The general economic situation, influenced heavily by the financial and economic crisis, is also a reason for company closures, but many of them are technical closures when authorities close those inactive companies that have failed to submit financial statements.

Merger/acquisition

Mergers and acquisitions are not typical phenomena in the Hungarian SME sector. Statistical and research data are not available for SMEs.

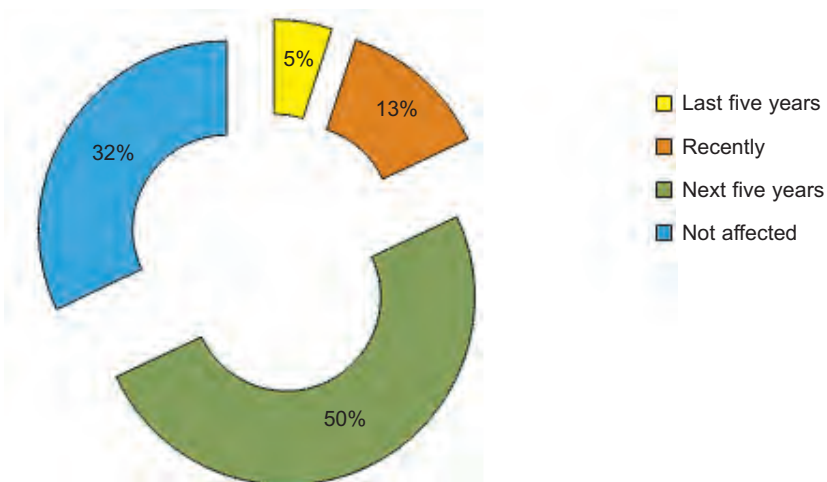
Internal restructuring

Information on internal restructuring is very limited in Hungary. Most SME internal restructuring is not covered in the media, with the possible exception of business succession/transfer, which is a current topic in Hungary.

Few Hungarian entrepreneurs can say they founded firms in ideal circumstances. In the 1980s, the capital and experience were not available. Transition to a market economy and continuous regulatory change has made entrepreneurs' situation more difficult (Filep, 2006). Entrepreneurs who founded enterprises around the age of 40 in the 1980s will reach pensionable age 20–25 years later, in 2000–2015. They are confronted with the problem of succession, with the difficulties of generational change which holds huge challenges for Hungarian entrepreneurs (Filep and Szirmai, 2007).

In EU founder countries, small family enterprises are more likely to have had experience of succession. In Hungary, many are confronted with the challenge of generation change for the first time. In 2007, SBDC conducted research to examine 460 SMEs succession plans using survey methods (Filep, Pákozdi, Szirmai, 2007).

Figure 3: Are you affected by the challenge of business succession or business transfer? (N=460)

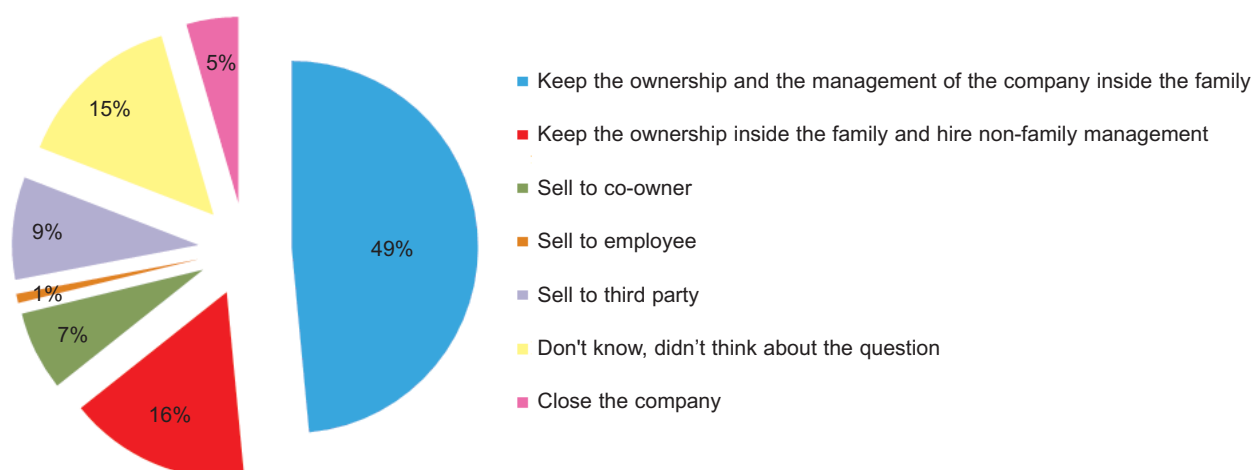


Source: Filep, Pákozdi, Szirmai, *Generational changeover in the Hungarian SME sector and its financial consequences*, 2007

Almost two thirds (63%) responded that now, or in the next five years, they will become involved in succession and generation change; a third (32%) did not, and 5% had already been involved in succession in the past five years. The results suggest significant numbers of Hungarian SMEs will face internal restructuring challenges in the near future.

Figure 4 shows the potential outcomes of inter-generational business transfer. Almost half of the enterprises interviewed (48.6%) prefer full family succession with ownership and management retained within the family. One in six (15.8%) wishes to retain family ownership while external parties take over management, while 14.6% do not know anything about, or have not thought about, succession.

Figure 4: Potential outcomes of business transfer in % of affected respondents (N=247)



Source: Filep et al., *Generational changeover in the Hungarian SME sector and its financial consequences*, 2007

In Hungary, business succession is the most important form of SME internal restructuring. Affected companies face a huge challenge. Many companies, mostly family businesses, have plans for the future but many do not. Other types of internal restructuring are not the subject of research.

Business expansion

Hungarian SMEs might expand in three ways: insourcing, inland expansion, and internationalisation. Insourcing is not a common business activity among Hungarian SMEs. No related research, media articles or examples were found. As the Hungarian market is relatively small and SMEs usually target the whole market or, due to the competition, are active in a niche market, inland expansion is not their typical activity.

Internationalisation is a desired mode of business development. Although Hungary holds a good position in FDI and export, the contribution of the SME sector is rather low. Only 5–10% of SME revenue comes from export activity. Foreign-owned companies have a higher 25–40% export rate and the top 50 large companies produce 69% of export sales (Szerb and Márkus, 2008).

A Hungarian Investment and Trade Agency (HITA) research report says that SMEs contribute only 18% of total exports. In 2010, only 18% of SMEs sold products and services abroad, compared to the EU average of 25% in 2006–2009. Another warning sign is that 40% of exporting SMEs are foreign-owned (Piac & Profit, 2012).

The SME export rate is 25% in the processing industry, 30–55% in the textile, clothing, leather and shoe industry, and in plastic product, machinery and equipment production. Only 2% of micro, 10% of small and 23.5% of medium businesses have export sales. Only a few Hungarian companies have export sales comprising more than 5% of total revenue (Neumanné, 2008).

Hungarian SMEs internationalise mainly by exporting products rather than through equity investment. Hungarian companies not only trade with neighbouring countries, but also much further. Investment in foreign countries is driven mainly to gain market share, but delocating some aspects of the production process has cost advantages. Seldom do firms move complete production lines abroad. SMEs are poorly capitalised and cannot execute greenfield investments or participate in privatisation tenders abroad.

Tourism and logistics supported by cross border projects like Phare and Interreg are most likely to cooperate in the future. There is a good chance that border areas will develop through cooperation, which will be a win-win situation and help modernisation and restructuring of these areas (Majoros, 2007).

Drivers of restructuring

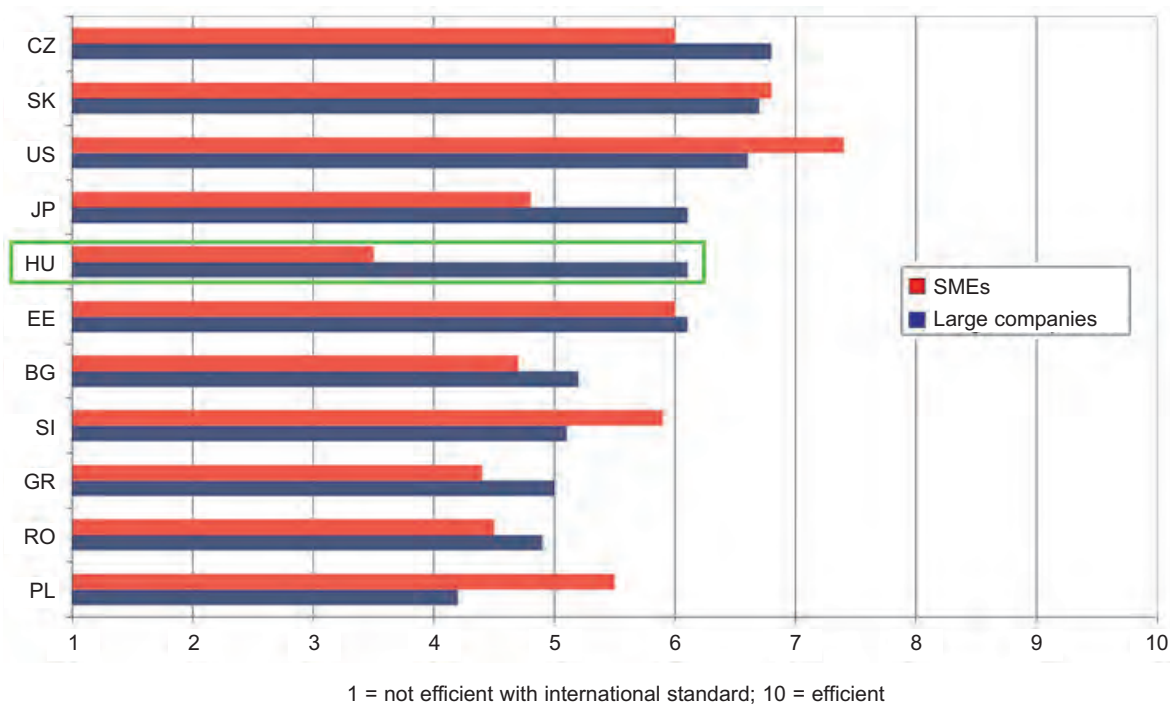
The literature suggests three main drivers of restructuring:

- financial and economic crises (closure, survival, search for new opportunities);
- after EU accession competitive disadvantage became visible, low competitiveness of SMEs;
- generational change in family businesses – the first generation of Hungarian entrepreneurs have reached pensionable age, and have to find their successor.

Most Hungarian SMEs were not prepared for EU accession and had to face increased competition. This new experience was the motivator of a large number of outsourcing and internal restructuring events which increased efficiency.

The financial and economic crisis can have various effects on SME restructuring: closure; outsourcing and internal restructuring to increase efficiency through cost reductions which help long-term survival; and reorganisation through employee dismissals and working hours reductions to pull through the hard times. The crisis can create new opportunities for companies implementing new developments and investments with the aim of expansion. A recent study examining SME reactions to the financial and economic crisis found that 34% of the sample (N=1,192) plan to find new markets and think that the changes offer new opportunities (Szirmai et al., 2010).

Figure 5: Large companies and SMEs performance efficiency 2009



Source: GKI, *Competitiveness Yearbook 2009, 2009*

Hungarian SME efficiency is poor compared with other countries, while large companies are very effective. A Ministry for National Development and Economy study emphasises internal problems – poor management, finance and marketing knowledge, lack of motivation and strategic thinking (Papanek, 2009; Szirmai et al., 2009).

Although closure, or asset sale, is suggested by literature on the crisis, SMEs hardly use these methods at all, as entrepreneurs do not close businesses until creditors force them to pay. As there are limited buyers on the market, currently asset sale is not a valid option. Acquisition is rare among SMEs. Although we have found examples for mergers and acquisitions, the number of transactions declines sharply in 2011 according to PricewaterhouseCoopers (PwC) analysis. As the market is still so weak, there is very little interest in mergers and acquisitions as companies try to lower risk (PwC, 2011). Expert opinion warns companies to spread internationally.

Rising unemployment might discourage entrepreneurs from closing businesses because there are few alternative employment opportunities, and might instead force reorganisation.

Hungarian Tax Authority data show that export is one of the driving forces behind growth (Palócz, 2011). A strong correlation exists between export and growth. SMEs with 10–49 employees are in the worst situation. Medium-sized exporting businesses are in the best position: 52% have remarkable growth. Companies with high export ratios can grow faster. Growth is not determined by sector, but size and capital have a positive influence on internationalisation. Generally, growth characterised by debt financing – bank credit – decreases short-term profitability but in the long run is one of the growth take-off points. Of 2,883 fast-growing SMEs, 2,700 are micros – because it is easier to grow rapidly from a lower base. Palócz (2011) suggests a huge restructuring is going on, and medium enterprises increasing their market share.

The Global Entrepreneurship Monitor shows that only 23% of Hungarian early stage SMEs export, 20% below the overall average – a much larger gap than in other countries. Reasons for internationalising can be divided into international pull and national push (Szerb and Markus, 2008). The most common national push factors are (although not very strong):

- small size of Hungary, markets are quickly saturated, with no possibility to gain new customers;
- open economy, wide international relationships, networks makes it easier to go abroad;
- Hungary is located on the periphery.

At macro-level, industry shifted from Budapest towards the north-west and from low- to high-tech activities. In the early 1990s, horizontal FDI was common, but later only vertical FDI was received, focused on cost advantages. After 2000 transnational corporations (TNCs) started to reinvest profit accompanied by delocalisation, moving production from the west to Hungary. Government policy was successful in attracting FDI, but not in integrating it into the Hungarian economy – multinationals were not forced to use Hungarian SMEs as suppliers, which is crucial for keeping them long term (Külkely, 2008). SMEs connected to TNCs – as vendors and subcontractors – are following multinationals in delocalisation. In intense production, geographical proximity became crucial, generating agglomeration. Buyer proximity is a key motivation behind delocalisation. This tendency conserves regional structures and increases geographical inequalities (Külkely, 2008). Employees move towards new job opportunities. This shift increases worker mobility, as more and more people commute from Budapest to the north-west region.

Distinctive characteristics of restructuring in SMEs

Statistical data and research literature on SME restructuring is limited. Research focused on SMEs does not distinguish crisis in life cycle from restructuring. SMEs have been categorised according to organisational structure, type of management, level of control and strategic behaviour but studies do not investigate what happened between stages or how transition happened, only the before and after situation. Research is limited to large, mature enterprises. There are gaps in longitudinal studies for SMEs.

Larger firms follow an explorative strategy (growth or attacking) with higher probability than smaller firms, in line with Penrose (1959): larger firms possess advantages in advance while growth raises new growth opportunities. The uncertainty of foreign markets in certain industries (manufacturing industry and agriculture) is higher, which refers indirectly to the fact that these industries are more interlinked in international circulation (Szabó, 2010). So restructuring in SMEs has higher risks and lower gains compared with large companies.

Phases of restructuring

Research on medium-sized enterprises has found that most entrepreneurs are overwhelmed by daily operational problems, so they never have time for planning and preparation for restructuring events (Bálint, 2010). Sudden changes (health problems, sales drop) highlight entrepreneurs' attention to strategic planning. Most medium-sized companies are not prepared for restructuring, and often experience administrative problems, including making and receiving payments late, information system collapse, causing delays in production, and a general lack of management control.

SME owners often avoid planning predictable events such as succession and business transfer. Owners think that succession is a natural process that can be managed successfully with little forethought. Although the majority of Hungarian SMEs face the challenges of succession and business transfer nowadays and in the near future, detailed information about the succession processes and procedures is not available (Filep, Pákozdi, Szirmai, 2007).

SBDC (2010) investigated how 300 SMEs reacted to the crisis. The main findings were:

- SMEs reacted late, postponing decisions even if the warning signs were already evident.
- SMEs had a very pessimistic outlook before the crisis, so international environment change is only a multiplicative effect, not the cause of the shock.
- 'Gazelles' (fast-growing firms) are still optimistic, the only segment where dismissal is not common.

SMEs in Hungary experienced shrinking markets, reduced income, and stronger competition. They responded by reducing costs, implementing employee dismissals and shorter working hours, and improving quality as they tried to improve competitiveness to overcome difficulties. The IMD World Competitiveness Yearbook survey facilitates comparison of SME and large enterprise performance.

SMEs have restructured their organisations and culture in order to win new customers. Table 5 provides data on various SME responses to the crisis. The most common action taken was to search for new customers. Discounting is a common but short-term strategy, because after a time there is no room left for discounts. Negotiating better payment terms, searching for new suppliers and new product development were reported by SMEs too.

Table 5: *What is SMEs' reaction to the crisis situation? N = 290*

	Did / do		Did / do and going to do in the future		Not doing yet, but planning in the future		Not today, or in the future	
	Number	%	Number	%	Number	%	Number	%
Search for new customers	64	22	91	31	41	14	96	33
Offer discount to clients	58	20	69	24	21	7	141	49
Search for new suppliers	47	16	54	19	39	13	149	52
Development of new product	40	14	60	21	36	12	153	53
Negotiating better payment condition	50	18	54	19	31	11	149	52

Source: SBDC, *How SMEs react on economic crisis?*, 2010

Looking at Hungarian good practices in managing restructuring based on case studies, five elements repeatedly show up. First, employers have to set goals for employees. Second, effective internal communication. With growth, communication problems multiply. Third, quick decision-making. SMEs have an advantage compared with large businesses, as entrepreneurs are in daily circulation, so results come faster and the learning loop feeds back faster. Fourth, close contact with clients. Most entrepreneurs have direct contact with clients and are able to see trends early on. Last, but not least, SMEs can recruit the best employees, as working conditions are better and more personal.

Actors involved

According to the literature, involving other actors, outside consultants and experts is strongly recommended during the restructuring process. Entrepreneurs underestimate difficulties and do not prepare for problems in advance. Mistakes are easy to avoid if experienced people help. Entrepreneurs should step back, and take a 'helicopter' view, analysing competitors, industry and other stakeholders. The management literature is a great help to highlight steps, and provide a planning framework. Entrepreneurs are willing to sacrifice weekends and evenings to learn from others.

For historical reasons works councils and trade unions are neglected both by employees and employers in SMEs. Even if they exist on paper because this is required by law, in reality they are not active and have no effect on restructuring.

We found no evidence that government programmes help restructuring. In individual cases, government support was common – in the form of EU funds – and often a force to document development and restructuring. Only a small proportion of international activities are helped by the government. SMEs experiencing difficulties in generation change or internationalisation can request consultancy free of charge, paid for by government.

Table 6: *Did any state, municipal or professional, interest representative organisation help the initiation of the international activities of your enterprise, and if so, what type?*

	Békés	Csongrád	Total
No international activity	17	41	58
No	212	221	433
Yes			
Helping organisation			
Local municipalities	2	7	
Chambers	2	7	
Professional organisations, associations	2	7	
Local enterprise development centres, regional development of innovation agencies	1	8	
Labour centres	2	7	
Higher education institutions	0	9	
Research institutes	0	0	
Hungarian Investment and Trade Development Agency	0	0	
Eximbank, Hungary	0	0	
Industrial Parks	0	0	

Source: *InCoDeSME, Innovation and cooperation characteristics of micro, small and medium enterprises and their internationalization in Békés and Csongrád counties, 2010*

One other interesting characteristic of restructuring is that in the planning phase, only owner-managers are involved. Usually, plans are kept secret from employees until the start date. Employers have to communicate plans by the time they are put into action and involve most of the employees. As the process is very risky and requires specialised knowledge, the help of experts is strongly recommended. Large companies with a developed structure act differently. They have slower but more efficient processes, greater resources and a lower chance of failure.

The consultancy market for corporate restructuring is well developed. Consultants focus on improving returns in times of transformation and deteriorating performance and growth. They support managing work-out or turn-around processes and evaluating business plans objectively. Most medium-sized businesses can afford consultants and trainers to help the restructuring process (Zavagyil, 2011).

The key implication of this section is that SMEs need expert help in restructuring in several business fields: in formulating and planning strategy; improving internal communication; and human resource management. Large companies are more experienced and developed in these fields, enjoying relative advantages compared to SMEs.

Main challenges and constraints facing SMEs in restructuring

The major constraint on SME restructuring is internal reluctance and fear of change. Change is not warmly welcomed by employees. Normally there is an external force behind the change, such as, adapting to market change, or reaching the next level of development. There is a high risk of failure, so job security decreases (Bálint, 2010). Management time and energy is another limiting factor. Managers must find time to prepare, acquire knowledge, and listen to experts. To start the process is a mighty challenge which needs many drivers (Matolay et al., 2007).

Restructuring needs financial resources which are not available at the moment. The Ministry for National Development and Economy, the Bank Association, and the National Federation of Savings Co-operatives monthly survey of Hungarian financial institutions shows that financial resources provided to SMEs have decreased since 2009. In Hungary, two-thirds of SME credit was in the form of short-term loans in 2009. The crisis has discouraged banks from renewing short-term loans to SMEs to support their continuing operation. SME investment credits have always been very low (5% of total SME credit in 2008). SME business expectations were very pessimistic, encouraging them to postpone investment. So, even where restructuring is crucial for survival, the majority lack the financial reserves to start the process.

The main obstacles to internationalisation are lack of capital, competitive products and language skills. InCoDeSME (2010) found that 58.2% of business managers and employees speak only Hungarian. Szerb and Márkus (2008) confirm Hungarian entrepreneurs' limited language skills. In companies where language skills are greater, export and import activity is stronger (InCoDeSME, 2010).

Table 7: *Entrepreneurs' language skills*

Language knowledge	No. of entrepreneurs	%
Only Hungarian	243	48.89
English	158	31.79
German	79	15.9
Russian	8	1.61
French	3	0.6
Other	6	1.21
Total	497	100

Source: Szerb and Markus, *Internationalisation tendencies among Hungarian SMEs in the middle of 2000s, 2008*

Because of cash flow problems, businesses cannot finance internal training, although changing the culture of employees is one of the restructuring success factors.

In Hungarian SMEs succession and business transfer is a risky internal restructuring event. SBDC research shows that business owners consider the lack of appropriate successors, the training of the successors, the decision about their retirement and the preservation of the company financial stability after succession the biggest challenges (Filep et al., 2007).

Business support from public and private sources

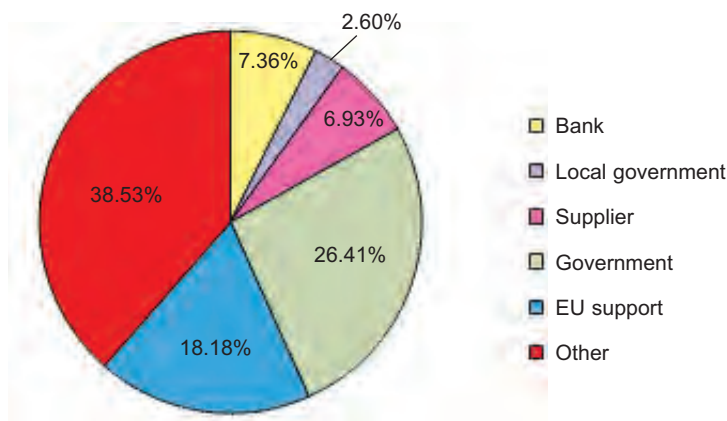
SBDC (2010) research shows that most SMEs wait for government help (26.41%), and EU support (18.18%) to solve their problems. The majority expect the Ministry for National Development and Economy to reduce the tax burden, and expect chambers and associations to articulate their needs to government. Approximately 20% do not expect any support; they do not believe anybody can help them.

As a top priority, SMEs prefer a simple, stable and predictable legal order. SMEs cannot prepare financial plans easily where taxes and regulation change frequently. SMEs prefer a stable policy environment. Policy uncertainty hinders restructuring. Concerns that new regulation will be implemented make it nearly impossible to prepare for the future.

In relation to support for restructuring, SMEs would like to have stable policy and affordable finance. The two actors who can help are government and banks. Both have to ensure favourable conditions for restructuring.

SMEs seeking growth provide most new job opportunities, and growth is usually coupled with some form of restructuring. This is one of the reasons business support for micro-level enterprises is generally regarded as a tool of macro-level growth (Low and MacMillan, 1988).

Figure 6: From which institutions do SMEs expect help?



Source: SBDC, *How SMEs react on economic crisis?*, 2010

There are no significant correlations between types of problems experienced and the demand for help. Those in financial difficulties because of late customer payment turn towards banks. In other cases like research and development, they seek government support. The demand side is extremely large, and EU funds are slow to reach SMEs – it takes 306 days for national authorities to sign the contract (NFU, 2010).

As there is a huge lack of capital, and reinvested profit is not sufficient for development, EU funds and private equity are the only possibility of financing.

The main aim of government programmes is to preserve jobs. The government in Hungary, unlike in other countries, was not in a position to launch generous state programmes to bail out endangered companies, owing to the large national debt, a lack of foreign currency reserves and the limited share of publicly owned enterprises (Neumann, 2010).

Various government programmes exist to support SME restructuring, including support for process management and electronic trade, technology development, business consultancy, employee training, site development, innovation and sales development support.

There is no specific public support for relocation or outsourcing and little effective support of generation change; for many years, government has neglected this field.

Outcome of restructuring events

Restructuring events can produce outcomes that affect the organisation and employment. Table 8 shows the most significant effects of typical Hungarian SME restructuring cases.

Table 8: *Outcome of the restructuring events*

Type of restructuring	Organisational effects	Employment effects
Outsourcing	<ul style="list-style-type: none"> • Increased effectiveness • Cost reduction • High quality service 	<ul style="list-style-type: none"> • Dismissal of employees • Reduced workload
Bankruptcy/Closure	n/a	<ul style="list-style-type: none"> • Dismissal of employees
Internal restructuring	<ul style="list-style-type: none"> • Change in organisational structure and culture • Change in management • Change in ownership • Temporary uncertainty • More formal processes 	<ul style="list-style-type: none"> • Dismissal of employees • Hiring new workforce
Business expansion	<ul style="list-style-type: none"> • Change in organisational culture • Growing organisation • New challenges • Growing financial needs 	<ul style="list-style-type: none"> • Hiring new workforce

Source: *Author compilation, based on SEED, Family business case studies, 2008*

In the three Hungarian cases conducted for this project, the initial phase of restructuring involves employee dismissal and rationalisation of processes. Organisational change is a must. These medium-sized enterprises are flexible, but lack appropriate company culture and experience. During growth, company structure and IT systems do not keep up with changing needs. In the restructuring phase, most of the missing elements are put in place. They implement a new structure, new system and new management style (Szabó, 2010).

One important outcome is that employees change behaviour and teamwork becomes common. Informal processes are changed by formal well-documented practice, and besides a focus on the core activity, new opportunities appear. These new opportunities open the door for further growth. After restructuring, medium-sized enterprises start recruiting again to fill vacancies in the new organisational structure. Additional managers are needed to direct a more complex activity. The three case studies each show that, following restructuring, employees have to take more responsibility for their work.

Restructured companies often focus more on their profile and innovate in their special segment. Increasing market share shows that in some respects they perform better than competitors who do not restructure. Generally, service/product quality improves; this is the foundation of further growth. Successful restructuring followed by rapid sales growth demands extra management time and effort (Csapó, 2010). Altogether, in the long run, it is a job creation process, but one that is only visible after many years. In most cases, without restructuring, companies would fail, so even greater job destruction is avoided (Palócz, 2011).

Our opinion, based on all cases – SBDC has 452 cases from the last three years – is that successful restructuring makes employees more enthusiastic. New mid-term strategy increases job security. The growth orientation is clearly visible in all cases where restructuring happened. With increased capacity, and more efficient performance, these enterprises are ready to execute larger and more innovative projects than before. Successful restructuring made leaders more self-confident and goal-oriented.

Internal communication and improved documentation are important factors of success. Even if the trigger for restructuring is external, outcomes largely depend on internal factors. Restructuring processes take years, with frequent adaptation to the changing environment (Zavagyil, 2011). Structural change is not implemented without cultural change. The new company becomes more coherent and owner-managers create new work norms, forming common ground for understanding, helping different areas to work in closer relation.

Following restructuring, new markets become accessible, and most prepare to exploit new opportunities. Restructuring often affects every single employee and managers must learn to manage change rather than a fixed pool of employees in a business that grows organically. The challenge is especially great for a customer-facing business, where service quality has to be improved. The new organisation should operate at higher level, with more developed processes towards the market. Heavy use of modern IT is frequent, and performance measurement is used as a tool to reach excellence by owner-managers.

Corporate downsizing is not a temporary or individual phenomenon, but one of business continuity. Modern methods of management and organisation often involve downsizing (Angyal, 2000).

Based on the related literature and research the main outcomes of restructuring in Hungarian SMEs are formalisation of processes, more focus on the company main profile, improvement of products, service quality and more enthusiastic employees.

Conclusions and policy issues

As there is very little literature on SMEs' restructuring – no data source is available at national level – our knowledge is very limited. Also research methodology should be developed, because without it we can get information only from individual cases.

Individual cases imply that restructuring occurs frequently, but much of it remains unnoticed because of self-interest. Companies are not willing to share internal secrets, as competitors are quick to use this information. This is a delicate issue, and often goes along with internal conflicts putting a large burden on management.

There is no general tool that is good for all restructuring cases, but common elements were identified. Further segmentation of restructuring and identification of best practices would help investigation of the field.

Our main empirical findings are:

- There is limited research material on restructuring processes and outcomes.
- In most cases, the trigger for restructuring was external.
- Credit is the source of growth, so lack of access to credit creates a bottleneck to further growth.
- Venture capital investment is very low, especially informal capital investments which are rare and which are needed in restructuring.
- Employee training and cultural change are common key elements of restructuring.
- The share of high growth firms is very low; these companies are characterised by several restructurings during their growth phase (Csapó, 2010; Szerb, 2010).
- Improved internal communication and the use of state-of-the-art technology during restructuring are the bases of future competitiveness.
- Export is one of the driving forces. It opens new growth opportunities for SMEs (Palócz, 2011).

According to the literature, SMEs with at least 50 employees and export incomes over €2 million have the best chances to become approved vendors. Hungary had only 773 medium enterprises with over €2 million income from exports and among them only 607 had profit in 2008, and one-third of these (199) are fully foreign-owned. It is difficult for small businesses to ascend the subcontractor hierarchy because they lack the resources to cover development costs. These companies need more flexibility from banks. First, they need long-term (three to four years) revolving credits, if they are to build strong subcontractor relations (Palócz, 2011). Second, Hungarian economic policy should focus more intensively on the inflow of FDI, which uses the SME sector as a subcontractor – this could be called indirect export activity. This would help SMEs to internationalise and provide new opportunities to maintain or expand their activities. Such ideas should be included in a new strategy for SME development including a concentrated industry and service development (in some specific fields) and a bigger focus of EU funds for their purposes (Nagy et al., 2011).

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