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Proposed Small and Microenterprise Program Activities for USAID in Hungary:

The GEORGETTE Project

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GEMINI

GROWTH and EQUITY through MICROENTERPRISE INVESTMENTS and INSTITUTIONS
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Proposed Small and Microenterprise Program Activities for USAID in Hungary: The GEORGETTE Project

by

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EXECUTIVE SUMMARY

Since 1991, the Mission of the U.S. Agency for International Development in Hungary has obligated $216 million to that country, of which approximately 70 percent has gone for economic restructuring activities. Although many USAID projects have direct impact on the small and microenterprise (SME) sector, none are directed explicitly to SMEs. The USAID Mission engaged Development Alternatives, Inc. (DAI), through the Growth and Equity through Microenterprise Investments and Institutions (GEMINI) Project, to suggest possible new activities that might improve the viability and growth prospects for SMEs in Hungary. This report is the result of that engagement.

Before 1989, Hungary permitted some small enterprises to operate. As a result, a private enterprise base existed at the end of the communist era. In the past six years the private enterprise sector has grown rapidly. Estimates are that as many as 1,200,000 registered and informal enterprises exist. Of that number, approximately 400,000 are active today and the others are inactive or represent part-time activities. Of these active businesses, 396,000 employ fewer than 100 people, so 99 percent of active Hungarian enterprises are small by the current Hungarian definition.

By some measures the Hungarian economy is performing well. The initial downturn has been reversed and incomes are now rising. The purchasing power of the average Hungarian is about 40 percent of that of the average Austrian. Almost 60 percent of gross domestic product (GDP) is now generated by the private sector. Other measures, however, present a less rosy picture: the government's budget deficit is almost 10 percent of GDP, inflation is increasing, and the currency will be devalued by almost 20 percent this year.

Although Hungary's economic transformation has clearly moved past its early stages, small businesses and the economy as a whole still face serious problems. Three problems continually plague business owners:

- Absence of capital of all types for productive investment;
- Knowledge and information gaps among business owners; and
- A public policy environment that does not adequately support private enterprise.

The absence of capital results from a complex of factors including a banking system with limited experience in serving SMEs and capital markets in which government debt crowds out private financing. The knowledge and information gaps among business owners are not in how to start a business, but rather how to move past an initial starting point to a more competitive and stable position. The policy environment is characterized by at least two major impediments: very high taxes on businesses and a burdensome system of licensing and regulations.

Several institutions presently help to resolve some of these problems. An active network of small enterprise support organizations receives funding from the European Union-Phare program and volunteers from the Peace Corps, and two small business development centers are supported by the U.S. government. Several policy advisors work in agencies of the government and in large national banks under contracts and programs supported through international assistance. USAID supports a variety of contractors, voluntary agencies, and other nongovernmental organizations seeking to resolve these and other problems.

This study recommends that USAID undertake a project targeted specifically at SME problems. Given the limitations on time and resources, the proposed project would be limited to certain regions of Hungary, and would build on existing institutions instead of creating new ones. It would draw to the maximum extent possible on collaborative relationships with existing donor and government-supported institutions.

The proposed program would have a set of core activities and optional enhancements. The project would select perhaps five counties in Hungary that meet a set of established criteria, and would target services to three types of institutions:

- Local savings cooperative banks, to upgrade operating capacity and improve their ability to serve small businesses;
- Technical assistance providers, to provide skills and methodologies for providing business services with higher value on a commercial and sustainable basis; and
- Local governments, to assist them in streamlining the procedures for licensing and registering businesses and to make better use of their locally owned assets.

The optional enhancements could include linking local credit providers to the larger financial system, expanding access by SMEs to equipment leasing, creation of commercially operated small business incubators, use of franchising to strengthen businesses, promoting regional initiatives with strong growth prospects (such as local tourism), and installing Internet linkages into local governments and technical assistance organizations.

The ultimate goal of the project would be to enhance the ability of Hungarian small businesses to compete in domestic and international markets. However, the outcome of the project would really be two-fold: an upgrading of the quality of financial and nonfinancial services available to SMEs, and a strengthening of the local institutions that provide those services to businesses. As a result of this project, businesses would operate in a less hostile economic policy environment and have higher-quality business and financial services — services that are available, responsive, and competitive.

INTRODUCTION: DESCRIPTION OF THE TASK

Under the auspices of the Growth and Equity through Microenterprise Investments and Institutions (GEMINI) Project of the U.S. Agency for International Development, a team from Development Alternatives, Inc. (DAI) reviewed programs funded by USAID/Hungary to suggest possible new activities to improve the growth prospects for small and microenterprises (SMEs) in Hungary. The objective of this assignment, as stated in the Scope of Work, was to: "Assess the viability of discrete micro/small business project activities relevant to the established USAID micro/small business strategy for Hungary." The outcome of the task would be new programmatic activities that would have as an explicit objective the improvement of the prospects for small enterprise growth in Hungary. This assessment was conducted during April 24-May 30, 1995, and included a three-week on-site survey by a team of three specialists in finance, technical assistance, and public policy.

Since its inception in 1991, USAID/Hungary has obligated a total of $215,708,000 for programs in three principal categories:

- Democratic Governance;
- Economic Restructuring; and
- Quality of Life.

Of the three categories, Economic Restructuring accounts for $151,386,000, or 70 percent of the total. A variety of activities have been funded under this category including the Hungarian-American Enterprise Fund ($70,000,000), energy sector programs ($17,140,000), business services and education activities ($28,339,000), privatization and enterprise restructuring ($20,999,000), and agriculture and agribusiness support ($6,616,000). Many of these activities have at least a partial objective of encouraging SME development, although in a high percentage of cases the target of activity have tended to be medium-sized to larger enterprises and institutions. Some of the projects have been completed but a substantial number are ongoing.

USAID/Hungary has defined five critical areas for small business development:

1. Strengthen Hungarian institutions assisting small and microbusinesses;

2. Help the Government of Hungary (GOH) and private business groups to develop a better policy framework for business development;

3. Provide training to private sector managers in critical areas such as finance, management, and marketing;

4. Provide training and technical assistance to improve government capacity to undertake its new role as administrator and regulator of a private competitive market system; and

5. Develop innovative pilot credit guarantees and other financial programs to assist small businesses.

The recommendations of the GEMINI Team presented here explicitly address the first and the third areas. With regard to the second and fourth, program recommendations are targeted at regional and local government rather than the national government. Because USAID already has a pilot credit guarantee program in the works, there are no specific recommendations for that area. Recommendations are made that would have an impact on the financial sector and an option is suggested for establishing further credit guaranty activity.

To arrive at its recommendations, the team brought three types of learning to the assignment:

- A review of the SME market in Hungary through analysis of background data and interviews with individual Hungarian businesses;

- A review of existing programs and activities through interviews with program operators and reports; and

- Experience gained by members of the team from work with public and private sector development and finance activities both in the United States and internationally.

This report is divided into two parts. Part One is an overview of existing conditions in the SME sector in Hungary; a brief survey of relevant macroeconomic factors affecting SMEs; and summary descriptions of key organizations, institutions (including local government), and programs that support SME development. Part Two offers suggestions for new project activity to support SME development.

PART ONE

A SURVEY OF EXISTING CONDITIONS AND INSTITUTIONS IN HUNGARY

AN OVERVIEW OF SOME CRITICAL MACROECONOMIC FACTORS IN HUNGARY

As was the case throughout the region, Hungary suffered a major downturn in economic conditions during 1990-1992. However, for at least the past two years, growth appears to have resumed. Official statistics are unreliable because of a substantial amount of off-the-books activity. However, data show a growth in the gross domestic product (GDP) of 1 percent in 1994 and an estimate of 2.5-3.0 percent growth for 1995.[1] Construction has increased in Hungary at about a 7 percent annual rate for the past two years. Unemployment has dropped from 12.6 percent to 11.5 percent over the past year.

Although some economic numbers are getting better, others are getting worse. Hungary undertook a rapid privatization in 1991 by selling off a number of companies to domestic and foreign investors. Hungary benefitted by having the largest amount of direct foreign investment in the region, and the government realized several billion dollars in income from those sales. The result was a budget surplus and stable currency for 1991 and 1992. However, the government postponed making the painful (but necessary) cuts in social spending. More recently the pace of privatization has slowed. Losses from state-owned enterprises (SOEs), the fall-off in revenues from privatization sales, and continued overspending have contributed to a serious budget imbalance. As a result, Hungary's deficit has expanded to more than $4 billion, or about 10 percent of reported GDP. Unlike most of its neighbors, Hungary's inflation rate increased in 1994, rising to 22.8 percent. That has triggered a currency devaluation that is expected to be 20 percent over the 1995 year.

The large budget deficit and the inflation have had a detrimental impact on small businesses seeking financing. Government borrowing through the issuance of bonds makes it easy for banks to profit by purchasing the bonds rather than lending to businesses. Some estimates show that as much as 95 percent of all commercial bank lending is to the government through the purchase of bonds. Banks see no reason to lend to risky small businesses when they can earn a comparable rate with no risk by lending to the government. Similarly, the high rate of interest, currently in the 35 percent range, makes most financing for businesses uneconomic.

To further complicate the problem, Hungary has a tax policy that falls heavily on businesses. Wage taxes on employees approach 50 percent in addition to other taxes and fees on profits and operations. To avoid wage taxes, many companies treat their employees as independent contractors. Tax avoidance devices such as this also deprive the government of tax revenue, thereby exacerbating the deficit problem. In addition, there are high tariffs on imports that raise the cost of equipment for business modernization.

Hungary has clearly moved past the initial stages of transformation. Although there is certainly a wide diversity of views on strategies and the extent that the future transformation should take, a private

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[1]This projection was made by the European Bank for Reconstruction and Development at the end of 1994. It now appears that actual 1995 GDP will fall short of that projection.

sector mentality is firmly established throughout the country. More than half of GDP is now private enterprise generated. The financial system, although perhaps moving more slowly than we would like, is on a path toward a more private, less-regulated structure. There are no widespread shortages of consumer products. Public infrastructure is being steadily improved, as are the privately owned physical facilities.

According to *Business Central Europe*, the average Hungarian now has purchasing power of 40 percent of the average Austrian citizen. Overall, Hungary is not a poor country. However, some regions in Hungary still lag far behind the average. These tend to be in the areas east and south of Budapest, along the borders with Croatia, Romania, Ukraine, and Slovakia. They are largely rural regions, with a few cities of 100,000-200,000 population.

AN OVERVIEW OF THE SME SECTOR IN HUNGARY

Background

Hungary always permitted some small enterprises to operate under Communism. In 1989, approximately 15 percent of GDP was produced in the private sector. As a result of the liberalization of the 1990s, private sector GDP now approaches 60 percent. Estimates of the total number of enterprises, both registered and informal, vary from 800,000 to 1,200,000. It is generally acknowledged that about half of that number are inactive or part-time activities. Still, approximately 400,000 active private sector enterprises are operating in Hungary today.

Most enterprises in Hungary are small, or, as commonly defined in Hungary, employ fewer than 100 people. Less than 4,000 companies employ more than 100 people, or 1 percent of the total number; thus, 99 percent of the active enterprises in Hungary would be considered small. Although it is possible to debate the precise numbers and definitions, it is clear that small enterprise represents an extremely important part of Hungary's economy.

The explosive growth in the number of small enterprises in Hungary means that, as a percentage of the total population, Hungary now outranks most of the developed world in the ratio of small enterprises to population. With a population of 10.4 million, the 400,000 enterprises represent 1 enterprise for every 25 people. This suggests that future support strategies need not concentrate as much on generating new start-ups but instead on helping firms establish more permanent roots in the economy.

In discussions with small business owners and institutions serving SMEs, three types of problems are often identified as plaguing small business owners:

- Absence of capital — investment capital of all types and particularly term financing for productive assets — is almost impossible to obtain. Much of the problem is the result of the macroeconomic factors described above. Given the complex and negative factors in the macroeconomic environment, one cannot simply conclude that the absence of capital for small businesses represents irrational behavior of bankers, or that this behavior can be substantially overcome simply with loan guarantees or increased banker training designed to enlighten them about the vast, unserved SME market.

  There are other contributing factors to lack of capital, however, including a continuing aversion by banks to what they consider to be the more marginal part of the market, an unwillingness of business owners to provide complete and accurate financial data on their companies, the tendency of companies to hide revenues and assets to avoid taxes, and absence of a fully functioning legal environment for loans and investment transactions.

- Knowledge and information gaps exist among business owners. Private enterprise is a new concept in Hungary, and many business owners are inexperienced. They are often not familiar with basic business approaches and concepts, which makes them prone to mistakes and vulnerable to fraudulent dealings by others. The SME sector has expanded quickly and the knowledge gap is shrinking. However, there are still significant management shortcomings, particularly as companies seek to expand beyond the family or individual manager level.

- Support from the public policy environment is inadequate. Before 1989, government policy toward private enterprise was generally hostile. Although Hungary was more liberal than most countries in the region, the business environment was by no means supportive. Changes over the past five years have introduced considerable improvement, but there are still serious problems. Tax policy represents a tremendous burden on businesses. High government budget deficits cause inflation and high interest rates that greatly complicate efforts by businesses to obtain expansion capital. Licenses, permits, and tax compliance absorb a huge amount of the time and energy of businesses, though, curiously, because of the experience of the past 40 years, most people accept the "hassle factor" as simply a part of life.

Characteristics of Small Enterprises in Hungary

Based on visits to firms by members of this team, as well as discussions with several individuals who work with small enterprises in Hungary, the team felt that the need to make programmatic distinctions between small enterprises and microenterprises based on concerns of class, ethnicity, or gender is far less significant in Hungary than in less developed regions of the world. In many parts of Africa, Asia, and Latin America, a cultural and class distinction often exists between typical microenterprise entrepreneurs and more established small and medium-sized enterprise entrepreneurs. The distinction arises out of educational disparities, racial and ethnic divisions, gender, and geography. Therefore, special care has to be taken to design programs to reach these disparate groups.

However, in Hungary as well as throughout Central Europe, with the possible exception of the Gypsy underclass, these cultural differences are far more muted. There are pockets of ethnic Hungarians living in Slovakia and Romania, and similar pockets of Romanians, Slovaks, and Germans living in Hungary, but the economic impact of these cultural differences is far less than that between indigenous and colonial populations in Africa and Latin America. Similarly, although there may be some gender disparity in Central Europe, it is far less an economic factor than in Asia or the Middle East.

Educational levels are generally high throughout the population, so the nature of enterprise development is not influenced by class distinction based on educational attainment. There are noticeable economic distinctions based on geography (rural areas tend to be poorer than urban areas). This does suggest a need to focus support activities in the more hard-pressed regions of Eastern and Southern Hungary.

It is probably true that in the early privatizations, well-connected insiders were able to benefit by gaining control of valuable business assets. This gave them a starting advantage and continues to be a significant success factor. In a certain way, being a well-connected insider during the communist regime represented a "class" distinction that continues to have a bearing on economic well-being. More importantly, however, the team believes that the most significant functional differences between "small" and "micro" enterprises in Hungary — and the differences that program designers must take into account — are the following:

- In a substantial number of cases, the distinction between small and microenterprises arises out of the nature of the enterprise. Some types of businesses simply need less capital than others to start and prosper. Similarly, many family-type businesses reach a stable operating status providing an adequate family income, but never employ more than a few individuals.

- Smaller financing transactions are viewed differently (and often legitimately so) by investors. The cost and risk of very small transactions can make them uneconomic for conventional lenders, and avoidance of these is not entirely the result of cultural bias or irrationality.

- An important operational distinction based on enterprise size results from the nature of the management problem as enterprises grow. A family business whose employees are principally family members will have a very informal management structure. As a company grows and departmentalizes, divisions of responsibility become necessary and the management task becomes more complex. Therefore, the management skills needed in growing enterprises change, suggesting a need for different types of technical assistance for growth-oriented companies.

- As a company grows, the nature of its financing needs will also change. Therefore, it is important to develop financing programs that can address the financing needs of companies throughout their life cycle, rather than focusing on narrower specialized aspects of small business finance.

A SURVEY OF KEY ORGANIZATIONS AND INSTITUTIONS AFFECTING THE SME SECTOR

The Hungarian Foundation for Enterprise Promotion and the Local Enterprise Agencies

The Hungarian Foundation for Enterprise Promotion (more commonly known by its Hungarian acronym — MVA) is the apex organization for a network of county-level technical assistance providers known as Local Enterprise Agencies (LEAs). Together the MVA/LEA system is the most complete network of business assistance centers throughout Hungary, with an LEA in each of the 19 counties. Most LEAs have established satellite offices and the network now has 150 branches. Along with a grant from the Government of Hungary, MVA/LEA receives substantial funding from the EU-PHARE program. EU funds have been used to provide equipment and staff training and to create microenterprise loan funds that the LEAs administer. EU-PHARE does not pay staff or overhead costs of the LEAs and requires that those costs be raised locally. In addition to the LEA centers in each county seat, satellite offices (RVAs) were established as necessary. Each of the LEAs is a foundation itself and in some cases predates the LEA structure.

The LEAs must raise some of their own initial capital, and contributions have been received from local governments, banks, and businesses. Some contributions were in-kind — for instance, local governments typically contributed the office space and municipally owned real estate, which could be used for a business incubator or leased out. Other international donors have supplemented the funding by contributing resources to individual LEAs or to MVA. The U.S. Peace Corps has placed a business volunteer in 12 LEAs.

EU-PHARE donated more than $5 million for microloan programs that operate out of the LEAs. PHARE trained the microcredit manager. Credit decisions are made by a committee in the county; the purchases made with the loan proceeds constitute the only collateral, and the LEA chooses a local bank or savings cooperative branch to do the loan funding and accounting. The loan limit was originally ECU 5,000, but is now being raised to ECU 10,000 (about $12,000). The program has been widely used and includes a highly subsidized interest rate. The default rate is estimated at 10 percent.

In addition to credit, the LEAs offer a variety of business information systems, training programs, incubators, and programs specific to the needs of the county, often related to agriculture or agroprocessing. One of the RVAs near the Slovak/Ukrainian border is involved with a promising trans-border trade development project.

In practice, the quality and range of work done by the LEAs have varied widely, depending on the competence and experience of the LEA executive director. LEAs that have been cited as good operations include:

- Nyiregyhaza, in Szabolcs-Szatmar-Bereg County (PRIMOM);
- Borsod-Abauj-Zemplin County (particularly the Zemplin RVA);
- Pecs, in Baranya County;
- Szekesfehervar, in Fejer County;
- Kaposvar, in Somogy County;
- Szolnok, in Jasz-Nagykun-Szolnok County; and
- Vallalkozoi, in Tolna County (Szekszard).

Small Business Development Centers

The Small Business Development Centers (SBDCs) in Hungary were established in 1991 under the auspices of the Central European Small Business Development Commission, which was created in 1990 by the U.S. Congress to provide management and technical assistance to small business owners in Poland, Hungary, and the Czech and Slovak Republics during their initial transition from socialist to market economies. The two SBDCs in Hungary are located in Pecs and Debrecen, county seats some distance from Budapest. Congressional funding for this project was committed through September 1995.

Each of the SBDCs is a nonprofit foundation with a local board. There is also a National Advisory Council, which was established to reinforce the central government's commitment to funding the SBDCs after September 1995. Members included Arpad Goncz, the former president of Hungary, and several government ministers. Unfortunately with the change in government all contacts were lost, so there has been no central government funding.

The SBDCs have defined their target as assisting small businesses to survive and to create jobs. Statistics indicate that half of their clients are people who are interested in starting businesses, and half are businesses that range from those just started to businesses established as much as five years ago, rarely longer. For increased efficiency the offices have stopped working directly with pre-entrepreneurial clients, but have them attend classes on starting a business. This leaves staff free to devote counseling time to more established businesses. Although the total number of clients counseled in 1994 dropped to 539 from 742 in 1993, the average one-on-one counseling time rose from three to five hours.

Funding, or lack of it, has been a consuming problem for the centers in the past year. Although funding from U.S. Government sources has dropped from year to year, little local income has been generated to take its place. Each of the centers has current annual expenses of $115,000-$120,000, of which about $100,000 is covered from the Congressional funding, a drop from the $150,000 that each center received two years ago. After Congressional funding ends on September 30, 1995, no immediately apparent means is available by which they can continue to sustain their operations.

There have been some recent discussions within USAID-funded programs concerning possible use of the SBDC organization for related purposes, which could provide ongoing financial support. However, no final resolution has emerged.[2] Support from the Hungarian government is unlikely, both because of its commitment to MVA/LEA and its current austerity budget. The local governments in Pecs and Debrecen have provided office space and may continue to do so. In Pecs, the city-provided building has excess space that could be developed as a revenue generator. A grant request to the Soros Foundation was denied, and although proposals have been submitted to other foundations the SBDCs are not hopeful.

Unless the centers are able to develop a grant source of income, they will have to start charging fees for their services or else close. This poses both structural and philosophical problems: because the SBDCs are nonprofit foundations with specific aims, their charters (as a matter of Hungarian law) will have to be changed. Perhaps the greater problem is attitudinal, however, because the SBDCs feel that they were created to help the smallest businesses or those just starting up, and these businesses are least able to pay fees. Historically the centers have not charged for seminars and counseling services. In doing this they have followed the U.S. model (which is based on the philosophy that center users have already paid for the services through paying taxes). The centers do charge clients for use of telephones, faxes, and computers, but only to cover costs. The centers are concerned that their commitment will change if they prioritize their work on the basis of ability to pay. The Debrecen SBDC director noted that there will always be startup businesses in the economy, and that the SBDCs in the United States exist to serve this part of the market. The center director in Pecs seems more supportive of the concept of switching the SBDC focus to more established businesses.

Cooperative Savings Bank Network

Throughout the rural regions of Hungary there is an extensive network of savings cooperative banks. There are 256 such banks in the country, with the following characteristics:

- 2 million members (both individuals and businesses);
- 1 million additional nonmember customers;
- 6,000 employees;
- Combined total assets of Hungarian Forints (HUF) 156 billion (about $1.3 billion); collectively, the savings cooperative banks make up the fifth or sixth largest bank network in the country;

[2]This statement is correct as of June 1995. It now appears, however, that an agreement has been reached to incorporate the SBDC centers into other USAID post-privatization activities, thereby creating a new source of financial support.

- 1,800 branches, or two-thirds of all the bank branches in the country, in the 3,100 villages of Hungary;
- Combined deposits that represent 6.5-7 percent of total bank deposits, but 17 percent of individual deposits; and
- Collectively the savings cooperative banks hold 13 percent of loans. Of the total stock of bank loans, HUF 43 billion in loans are to individuals, which grew 7 percent last year, and HUF 21 billion are loans to enterprises, which grew 13 percent last year.

There are three apex organizations for the savings banks:

Takarekbank, the Bank of the Savings Cooperatives, is the central bank for the savings cooperatives; it was established in 1989. It manages liquidity for the system, arranges participations, and develops bank financial products.

OTIVA, the National Fund for the Institutional Protection of Savings Cooperatives, was created to deal with crisis management in the savings banks. It acts as a controller and auditor for the savings cooperatives and provides deposit insurance for individual accounts. This entity was created in late 1993 as a part of the integration agreement described below, and succeeded the OTBA, which had performed insurance functions since December 1991.

OTSz, the National Federation of Savings Cooperatives, is a membership lobbying organization that works on banking laws, marketing and human resource issues.

Required minimum capital for the savings cooperative banks is HUF 25 million (about $220,000). If a cooperative savings bank is not a member of OTIVA, required capital is HUF 50 million. Most of the HUF 21 billion of loans to businesses cited above are short-term loans. Although the savings cooperatives have made some term loans with two- to three-year maturities, the savings banks are subject to the same banking regulations as the commercial banks, which require that they match maturities of deposits and liabilities. (Interestingly, depositors in the savings banks are also protected by the OBA, the deposit assurance fund for all the banks, in addition to coverage by OTIVA.)

The savings cooperative bank system is fragile. In October 1993 the savings cooperative banks entered into an integration agreement, which called for them to develop bank products as a group, grant credits as a consortium, and develop common lending standards and bank systems. This agreement was signed in tandem with plans to recapitalize the system. The government has injected some HUF 20 billion into the system to recapitalize about one-third of the banks, to bring them to an 8 percent capital adequacy ratio. These funds were injected in February 1994 through the Takarekbank, effectively giving the government an 86 percent shareholder interest in that entity. PHARE has also worked on recapitalization of the savings banks, and has put some ECU 11 million into the system through OTIVA. Nine savings cooperative banks opted not to join OTIVA or sign the integration agreement, and it seems that these are among the stronger savings cooperative banks in the country.

Systemwide, another major problem for the savings cooperative banks is untrained, undereducated personnel. The major need of the system is development of human resources, including training in risk management, particularly for midlevel administrators. The system also needs to develop bank products and marketing activities, and to elaborate a common strategy.

Despite these serious shortcomings, the cooperative savings banks have some advantages that can contribute to a regional development strategy. These include:

- They are local and thus know the local businesses and individuals. They are in a much better position to evaluate borrower character and reliability.

- They are small with few branches. Unlike the local branches of the national banks, the savings cooperatives are not subject to policies and management from Budapest.[3]

- They are local institutions and thus have a stake in seeing that the regional economy thrives.

- Finally, the LEAs have indicated a marked preference for dealing with locally based institutions whose profits will not leave the region.

The following table summarizes the average size and legal lending limit of the savings cooperative banks. Information is as of December 31, 1992, and is taken from a publication from the National Federation of Savings Cooperatives. Although this information is somewhat out of date, the figures are indicative of the size and lending capacity of the industry. The banks have, on average, 7,778 members and seven branches.

The table indicates that on average the savings cooperative banks have $6.2 million in total assets. A review of individual bank statistics indicates that the average is not untypical; only 30 institutions had total assets of more than HUF 1 billion (about $13 million), and only one had total assets of more than HUF 2 billion. They are highly leveraged, although it should be noted that additional capital injections were made in 1993-1994. By U.S. bank standards they are very profitable, with return on total assets averaging 1.3 percent (compared with the 1 percent return on assets that is standard); given the high interest rates earned on loans and government paper, this may not be surprising.

A more qualitative review of the assets and liabilities of each savings cooperative bank in each county indicates that an approach through the savings cooperative banks may be appropriate because they appear to be more popular in the counties that have been identified as needing more help. For instance, in Szabolcs County, which includes the successful PRIMOM LEA located in Nyiregyhaza, there are 18 savings cooperative banks with an average of 10,463 members and eight branches each. On the other hand, average total assets are only HUF 347 million (about $4.4 million), so growing small businesses may need to seek assistance from more than one savings cooperative bank.

Additional statistics and financial information on the savings cooperative banks are shown in Annex D.

Membership Organizations and Associations

In the past year Hungary passed legislation establishing a mandatory chamber of commerce system modeled on the scheme used in several Western European countries. This system creates three business associations for each county: a Chamber of Industry and Trade, a Chamber of Craftsmen, and a Chamber of Agriculture. Each of these local chambers will feed into one of three national Chambers. The system is just being formed, and it is unclear what role the chambers will play for their members.

[3]The small size of the institutions does not mean that many are economically viable in their present form. Almost certainly one step in making the system more efficient will be to encourage mergers and consolidations of some of the smaller institutions.

At worst, the Chambers may just be a way to collect membership dues that are passed through to the government, or another form of taxation.

PROFILE OF THE AVERAGE SAVINGS COOPERATIVE BAN
(December 1992)

Characteristics	Value in HUFs 000*	Value in U.S. Dollars
Total Assets	491,020	$6,215,443
Capital	22,059	$279,228
Profit	6,594	$83,468
Deposits	388,117	$4,912,873
Loans	177,723	$2,249,658
Due Froms	169,316	$2,143,241
Legal Lending Limit at 10 % of Capital	2,206	$27,923
Legal Lending Limit at 15% of Capital	3,309	$41,884

* Average exchange rate in 1992 was HUF 79 = $1.

One interesting aspect of the new legislation is that the Chambers are charged with providing training for their members. It may be possible for the LEAs to contract to be the training arm of the local Chambers, and fees for this work could be a major revenue source. At present, however, the Chamber system is so new that its eventual importance, if any, cannot be predicted. Although the Chambers as institutions have not been incorporated into the suggested USAID plans, they could be brought in on a local basis if it is clear that they are becoming significant players.

In addition to these mandatory Chambers, there are quite a large number of voluntary business associations typically organized around industry groups. Most of these appear to be fairly weak. Furthermore, there is a great concern that businesses will withdraw from the voluntary associations as the mandatory Chambers become active — not so much out of a belief that the Chambers will serve their needs, but rather because the money they have available for dues paying is limited.

Hungarian-American Enterprise Fund

The Hungarian-American Enterprise Fund (HAEF) is the largest single recipient of USAID funds in Hungary, having received $70 million for capital and technical assistance in 1991. It makes equity investments and loans to small and medium-sized private enterprises. HAEF committed $5 million for an SME loan fund through the central bank so that funds could be on-lent through commercial banks. The two banks chosen for the program were the Magyar Hitel Bank, a major government-owned bank, and Mezobank, which is owned by a group of agricultural cooperatives. This program had two purposes: to get loan capital to small businesses and to train and encourage bank lending to this sector. The banks chosen had extensive branch networks, particularly in rural areas, and thus were expected to be able to reach clients where the economic need was the greatest.

With respect to financing small businesses, the program performed well: HAEF's capital financed more than 160 businesses, many of which stand as entrepreneurial models for their industries. As a vanguard for banking activity, however, the program did not fare as well. Although the banks did some relending with funds received from repayments on the first round of loans (and bore the entire risk of principal, rather than sharing it with HAEF as in the first round of lending), loans to SMEs never become an integral part of bank lending strategy. This is not a criticism of HAEF, which took the bold first steps that needed to be tried in the early years of the economic transition. It is rather a commentary on the state of banking, as discussed elsewhere.

HAEF subsequently committed $400,000 for microloans, which it funded through smaller credit institutions and SME outreach projects, including an LEA, a craftsmen's chamber, a savings cooperative bank, and a small commercial bank. These programs have been considerably more successful, primarily because of the more local nature of the institutions.

In 1994 HAEF requested an additional $10 million from USAID to expand its small and micro credit programs, and planned to expand its outreach along the lines of its existing micro programs. HAEF believes that to be effective in the SME market it must operate at a scale of approximately $20 million. HAEF has decided to withdraw from the SME market unless additional funds are forthcoming, and does not plan to renew the tranches given for the small loan program when they expire, starting in 1996. It has an additional $100,000 that it has committed but not yet funded for micro loans, and is interested in establishing a program for gypsies if an appropriate partner institution can be found. HAEF's early efforts in small and microenterprise lending have been an important learning experience, and it is unfortunate that it has chosen to withdraw from that market.

Other USAID and Donor-Supported Organizations

The following is a brief overview of other organizations receiving support from USAID or other international donors that may have a continuing role in small and microenterprise support in Hungary.

Peace Corps has 15 business volunteers in Hungary, mostly working in eastern Hungary with the LEAs. Others are with OTP Bank working in strategic planning, at the center for Private Enterprise Development, and at the BB Foundation. The caliber of the volunteers is high and their work is well regarded by their Hungarian counterparts. Peace Corps projects have included working on strategic management and industry development such as tourism in Pecs and ceramics in the south. They have also worked with the LEAs on fundraising. At present they are surveying cities to see whether the Peace Corps could play a role in municipal economic development.

Volunteers in Overseas Cooperative Assistance has 20-25 volunteers per year, and is encouraging development of local, agriculturally related businesses such as slaughterhouses, bakeries, and dairies. VOCA has also been somewhat involved in the nascent development of credit unions.

Center for Private Enterprise Development is a middleman between American instructors and Hungarian clients, and does training courses on business subjects. Videos prepared in 1993 have replaced all first-level training; these have been shown on television a couple of times. CPED is concentrating on existing businesses and is training university professors to develop themselves as consultants. The agency has a local staff of four and a Peace Corps volunteer. Financially it is supported with a four-year grant from USAID, which expires in 1998.

International Executive Service Corps has been in Hungary since 1991. It provides various services including technical assistance, its best-known service. An executive specialist is matched with a company for a three-week to three-month period, most commonly to work on management or marketing problems; 250 of these assignments have been completed. Other services include annual sector surveys, where one industry is chosen annually and 10-15 businesses are visited by an executive in the field who advises all of them. Most recently the field chosen was agro-machinery. IESC previously worked with 64 mayors and their staffs to introduce the concept of a professional city manager, and is now looking for a joint Hungarian-Slovak project to work on with its counterpart in Slovakia.

Center for International Private Enterprise works with a variety of organizations on institutional change. A major project recently has been the Carpathian Border (CBED) project, for which it provided funding and technical assistance. It has also worked on legal analysis to encourage franchising, intellectual property rights, and financial intermediation problems. It is also currently working with Women's World Banking to set up an association in Budapest. The annual budget for CIPE in Hungary is $497,000.

BB Foundation has not been a direct recipient of USAID funding, but has worked closely with several of the U.S. agencies. It is funded by the Soros Foundation and gets some income from charges for services. It provides up to five days of individual consulting to small businesses, for which the small businesses pay out-of-pocket expenses only. It also does training seminars under the auspices of other organizations (such as the LEAs) on topics such as organizing trade shows and developing export business. Fifty-five programs have been presented over the past three years. Seminar topics have become more sophisticated, and BB no longer offers general business topics. The seminars are used to identify clients for individual consultancies. BB's typical SME client is 1-3 years old and has fewer than 10 employees.

BB has four full-time staff members plus a Peace Corps volunteer. All consultants are on call. The annual budget is $350,000, and the foundation handles 100 individual consultancies a year.

The Soros Foundation is a private foundation supported by contributions from George Soros. Although economic development is not the principal objective of the Foundation, there could be certain areas within USAID's future SME strategy for which the Soros Foundation might consider making contributions. In particular, Soros is interested in linking Hungarian businesses and institutions to Internet and to worldwide databases. That idea has been incorporated into the proposed SME strategy.

LOCAL GOVERNMENT AND ITS RELATIONSHIP TO SME DEVELOPMENT

Under socialist governments in Hungary, most power resided at the national level. A 1990 law created a new structure of municipal and county government. Many unresolved issues remain because of the overlapping responsibilities and functions of the new government units; this overlapping of functions contributes to confusion and has had negative impacts on small business development and growth. In addition to the confusion, two local government policies seem particularly harmful to business: burdensome regulations and oppressive taxation.

Numerous licenses, filings, forms, permits, and declarations are required of a business. One small retail shopowner showed a packet of 18 permits that were required for him to move to a new shop, a distance of about 30 meters. He worked full time for almost two months to obtain the required permits. Another entrepreneur said that once permits are obtained, he estimates that each of his employees will lose a minimum of one week per year to remain current with the required filings. In a World Bank survey, 160 business owners were asked about the barriers faced in establishing a business. Eighty percent mentioned bureaucratic procedures, 70 percent mentioned social security obligations, and 25 percent mentioned administrative paperwork as barriers to founding a business.

Bureaucratic procedures are lengthy and nontransparent. Unclear lines of authority in approving company registrations result in further delays. Government officials are increasingly adding fees and charges along with permits, and the system often leads to official corruption. Interestingly, no government official or trade association representative volunteered that bureaucratic procedures are a primary constraint. When prompted, however, they agreed that bureaucracy is in fact a major problem.

The second governmental impediment is the imposition of very high taxes. Taxes include a company tax (36 percent of profits), turnover tax (up to 25 percent of value added), personal income tax (progressively ranging up to 40 percent), social security taxes (44 percent of payroll), Solidarity (unemployment) taxes (6 percent for employers and 3 percent for employees), and vocational training tax (1.5 percent of payroll). Compounding the problem of high taxes, many of the taxes must be paid by standing in a queue for several hours.

The regulatory thicket faced by small business owners hinders their growth through lost productivity, and because there is a disincentive to hire additional workers to expand operations. Therefore, many employers hire workers off the books under contracts of questionable legality, or the business owners may chose simply to not expand beyond the immediate family because they do not pay family members wages or salaries that would be subject to the numerous taxes and regulations.

As a partial result of the regulatory problems, one estimate by a Member of Parliament placed the proportion of the GDP that was in the unregistered gray market as more than one-third. Out of an estimated GDP of $45 billion, he estimated that $16 billion was in the gray economy, and $5 billion was in the black or criminal economy. With more than one-third of the productivity in the informal sector, the tax burden on those businesses that are registered becomes onerous as government units strive to compensate for lost revenues.

Through privatization, municipal governments now own much of the business real estate. In some cases municipalities are operating businesses in competition with the private sector, though many have divested themselves of business enterprises. Others have placed the businesses under a parastatal management structure. The ascendancy of the socialists in the last election has slowed the process of divestiture and privatization.

Most of the land in the central commercial districts is owned by the municipalities. Business tenants can get rental rights or usage rights to a commercial site. Sometimes the land is sublet to a new business and the new tenant invests in business improvements. Several instances were reported where after business improvements were made, the rental rate for the land and the tax burden were substantially increased, driving the entrepreneur out of business. It also appears that, in at least some instances, rents bear little relationship to true economic value. Location, traffic patterns, and other factors influencing market value are not taken into consideration in setting rents. Governments simply set high prices in an effort to generate more income for the cash-strapped governments.

Most local government units do not have a department or agency to promote business and economic development. They often know little about the business activity operating within their jurisdiction.

It may not be possible within a USAID-sponsored SME project to make fundamental change in national government tax policy, but several changes at the local level could be helpful to small businesses. These include:

- Making the process of licenses and permits less burdensome;

- Improving the way local government uses its newly acquired business property as an inducement for new business development; and

- Installing an economic development function within local government.

PART TWO

PROPOSED SME PROGRAM ACTIVITIES FOR HUNGARY: THE GEORGETTE PROJECT

PARAMETERS OF THE GEORGETTE PROJECT

As USAID prepares to exit Hungary over the next several years, and Hungary prepares to enter the European Union, the most appropriate target for the final phase of USAID assistance is that part of the SME sector with the greatest chance of maintaining a competitive market position.[4] Assistance should be channeled through the local and regional institutions most able and willing to reach and serve that client group. Little more can be done to induce larger financial institutions to expand their SME market, but much can be gained by looking for alternative sources of credit for SMEs in smaller, local financial institutions.

During the first five years of the transformation, a very large number of new private enterprises have emerged, as have institutions and support systems to serve these enterprises. USAID should not use its limited resources to support the startup of new enterprises or new institutions, but rather to build on the existing base and help position both types of entities for a sustainable presence in the more competitive future.

As will be elaborated below, the proposed GEORGETTE project — an acronym developed by the team for Growing Enterprises, Organizations, Resources; Gaining Expertise, Technology, Trade, and Entrepreneurship — is a targeted, locally centered activity that seeks to create new linkages and collaborations among three types of entities now operating in Hungary: technical assistance providers, savings cooperative banks (possibly in conjunction with other financial institutions), and local government.[5] Each component of the triad will be eligible to receive training, technical support, and other resources to encourage them to function in a more effective and systematic manner and to move toward more market-based service delivery.

The broad parameters and assumptions on which the project is based are as follows:

1. Given the short time frame and limited resources remaining in USAID's program activity, the project:

   - Should not contemplate the creation of new institutions but must instead concentrate on the strengthening and leveraging of existing institutions. Furthermore, although institutional change is an objective of this program, the focus should be on individual local institutions rather than nationwide systems such as the entire system of savings cooperative banks;

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[4] Hungary is expected to enter the European Union within 5-10 years. Upon entry, enterprises in Hungary will face even greater competitive pressure than they face now. In advance of EU entry, the emerging SME sector needs proper support to become stronger.

[5] The project activity suggested here meets the USAID guidelines for a microenterprise project (see Annex C).

- Should maximize leverage through collaboration with existing institutions, both purely private institutions as well as those supported by GOH and international donors; and

- Should draw on resources available through other USAID mechanisms such as banker training initiatives already in place, post-privatization contracts, and regional or global IQCs. At least some elements of the project could be put in place quickly by using existing resource organizations and contracting mechanisms.

2. Given the greater need in the Northeastern, Eastern, and Southern regions of Hungary as well as the limited time and resources:

   - The initiative should be targeted in selected local regions rather than being applied uniformly throughout Hungary;

   - The only organizations and regions that should receive support are those able and willing to contribute something substantial to the process, and that have a prospect of becoming fully independent and sustainable over the life of the project. The most likely providers of technical assistance to enterprises will be the LEAs and SBDCs, though other nongovernmental organizations (NGOs) and private providers should not be eliminated from consideration; and

   - Although the key operating entities for this activity may be parts of larger governmental networks (MVA for the Local Enterprise Agencies and Takarekbank for the savings cooperative banks), assistance should not be provided through the national entity but rather directly to selected participants at the local level.[6]

3. Given the localized nature of the project, lack of USAID funds for business credit, and the likely lack of response from larger nationwide banks, the program should focus primarily on existing, individual savings cooperative banks as the principal source of capital for SME credit in this project. Although there is certainly a need for institutional strengthening throughout the system of savings cooperative banks, it would be more cost-effective to concentrate only on those institutions that are reasonably stable and viable, and enthusiastic about joining into a local collaboration as contemplated in this project. On a selected basis, other local financial institutions could be supported if they have the minimum capital requirements, are stable, and share the project objectives.

4. Given the very large number of existing but very small enterprises in Hungary, greater impact will result from a project that focuses on small but established companies and helps to expand them. Although this target clientele suggests that the nature of the business services must be more advanced, services to this clientele are more likely to be of a type for which the beneficiaries are more able to pay all or part of the costs.

5. Although there are certainly may things the Government of Hungary could do to improve the business environment, there are already enough advisors and initiatives in place in government. Little value would be gained by trying to place a "small business policy advisor" directly into the

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[6]As a separate activity, USAID may wish to explore the possibility of directing some of its assistance from the various banking contractors directly to Takarekbank.

GOH. In this project, the public policy component is targeted at the local level, as are all other forms of assistance.

It should also be recognized that the clientele identified here will match the characteristics conventionally associated with a USAID microenterprise project, though not one with an exclusively poverty-alleviation objective. Many of the companies will fall under the employee threshold for a microenterprise (fewer than 10 employees). It will be possible to limit the target group to those that fall under the USAID definition of a small enterprise:

- Companies with fewer than 50 employees; and
- With assets of less than $250,000 excluding land and buildings.[7]

THE CORE ELEMENTS OF THE GEORGETTE PROJECT

Problem Statement

Three types of problems plague small and microenterprises in Hungary:

Problem 1: Lack of a responsive financing source for productive capital.

Target Institutions: savings cooperative banks.

Project Solution: upgrade operating capacity in selected banks to improve their ability to serve small businesses.

Problem 2: Insufficient institutional sources that can provide operating businesses a higher level of information, technical assistance, and training concerning markets, management, and operations.

Target Institutions: LEAs and/or SBDCs.

Project Solution: provide LEAs or SBDCs with skills and methodologies for providing business services with higher value on a commercial and sustainable basis.

Problem 3: A public policy environment that is not supportive of enterprise development.

Target Institutions: local governments.

Project Solution: provide local governments with training and technology that will allow them to streamline the licensing and registration process; and provide them with training so that they can use their resources and powers in a manner that is more conducive to enterprise development.

[7]Refer to Annex C for more on this point.

The Project's Core Activities

The proposed GEORGETTE project would be a highly focused initiative designed to demonstrate the viability of providing sustainable credit and technical services to a carefully defined and selected subgroup of the SME market in economically distressed regions of Hungary. It consists of a set of three Core Activities that have been selected to focus on the three identified problems.

The project description is couched in terms of service improvements for SMEs, but in reality it combines direct service delivery for SMEs with institutional strengthening for the service providing organizations. The project will provide the three types of institutions (financial, business service, and local government) with capabilities to improve their services; it will at the same time help those organizations develop long-run operating strategies to improve their operating viability and sustainability. Therefore, the services offered to the participating institutions will have a dual nature — improving the quality of services for SME clients and also improving the operational viability of the institutions themselves.

In addition to the Core Activities, a set of Optional Enhancements and Elaborations are suggested. These enhancements are such that they can be added in locations where they are most applicable to expand the scope and reach of the project, but failure or inability to incorporate some or all of these into the project will not render the project unworkable. Conversely, it is felt that pursuing most of the enhancements as stand-alone activities, without incorporating them into a system as described here, will greatly reduce their prospects for success.

The project would operate at the county level, and could in principle be carried out in any or all of the counties of Hungary. However, it is felt that the project should concentrate in the counties Northeast, East, and South of Budapest and Pest Megye because these are the locations in Hungary with the greatest need. Furthermore, it should only take place in those counties where the necessary operating institutions possess the characteristics considered necessary for success. Fortunately, the early assessment indicates that there are competent and interested technical assistance entities and savings cooperative banks located in several of the counties of great need.

Activity 1. Upgrade Financial Services for SMEs

In each project location at least one local financial institution will be selected to receive assistance in upgrading financial services for SMEs. As noted previously, it is felt that the entities most likely to respond favorably to the available assistance would be savings cooperative banks. The project should not exclude the possibility of working with an independent private commercial bank or even a local branch of a national bank. However, it is felt that the project should not target assistance at either the headquarters level of a national bank or at the Takarekbank that serves the savings cooperative banks.

The objective of these services would be three-fold: improving the management and strategic planning capabilities of the institutions, improving the deposit/capital acquisition programs of the banks, and improving financial products and services for local SMEs. These improvements would come about through a combination of training and individualized technical assistance. Some of the assistance would be provided on a group basis to all of the financial institutions in the program, although other assistance would be individualized on an as-needed basis. To determine the precise package of assistance to be provided, a needs assessment will be conducted to identify the specific nature of training and systems upgrades needed to upgrade each institution.[8] Specific types of assistance could include:

- Improved Operational Capabilities for Financial Institutions
  - Strategic planning for senior management
  - Training credit analysts and loan officers[9]
  - Installing loan management software
  - Mobilizing new resources (expanding the capital base)

- Improved Services for SMEs
  - Introduction of new flexible financing arrangements for SMEs
  - Introduction of additional client services for SMEs

With regard to expanding capital and introducing new financial products, the availability of incentives such as USAID loan guarantees or development deposits would be helpful. However, because USAID/Hungary is operating with limited and shrinking resources, the program proposed here is structured so that it is not totally dependent on those types of incentives.

Activity 2. Upgrade Business Services provided by Technical Assistance Organizations

Virtually all of the existing business service organizations in Hungary concentrate on serving newer businesses with basic services. Counseling is typically provided on a superficial and generic basis. However, businesses often outgrow the service capability of these organizations and have nowhere to turn for assistance in continuing their growth. This project would provide assistance to LEAs or SBDCs in the targeted regions to give them a capacity for providing more advanced services. In addition, the business service organizations would be provided assistance and strategies for expanding their revenue and support base through a combination of fee-for-service activities and more creative fundraising.

An initial sample of potential enterprises will be identified by the LEA/SBDC from each of the participating localities. Based on individual meetings with this sample of businesses, the business assistance needs of those clients will be identified. Given the more advanced nature of the proposed target clientele, the LEA/SBDCs would learn to provide services of the following nature:

- Services to be delivered by LEA/SBDC to Business Clients
  - Strategic planning for senior management
  - Marketing for significant expansion
  - Sales force development
  - Production planning
  - Identifying and negotiating strategic alliances

[8]OTIVA, the insurance fund for the savings cooperative banks, is presently conducting a systemwide human resource needs assessment. The results of this study will be available in a few months and will be extremely helpful in identifying specific training needs.

[9]LEA/SBDC technical assistance providers should also attend this type of training.

— Developing financing strategies for expansion
— Advanced management information systems

- Services to improve the operation of LEA/SBDCs

  — Assessing client needs and tailoring appropriate responses
  — Generating support revenues from business and program services
  — Strategic planning for the business service organization
  — Creative fundraising techniques for business service organizations
  — Management information systems for service organizations

As with financial institutions, some of these services would be provided to all participating organizations through group trainings, although others would be more individualized. Once the specific nature and level of services needed becomes clearer, a decision would be made as to how those services can be provided. Initially it may be necessary to supplement the local technical assistance capability with experts from the United States, but over the life of the project, the ability to deliver those types of services will be developed locally.

Activity 3. Increase the Involvement of Local Government in the Development Process

Assistance to local government would focus on two areas:

3a. Creating a System for Expedited Permits, Licenses, and Tax Filings. Local governments will be assisted to create one-stop centers to facilitate filing and processing of the numerous licenses, permits, reports, and declarations. Governments can be provided computer hardware and software, training, and technical assistance to implement these systems. In many instances these permits all require the same or similar information. At a minimum it should be possible to consolidate the forms so that a single form will serve multiple purposes. In addition, by automating the databases and filing systems, the processing of the applications and permits can be accomplished more quickly. Ultimately it is hoped that governments will come to recognize that much of the permitting procedure is simply unnecessary, but in all likelihood those lessons will take some time to be realized. The participating local governments will be required to commit personnel to this task as a condition for entering the program.

3b. Encouraging Public-Private Joint Venture Development. Over the past 15 or so years, local governments in the United States have developed a number of innovative techniques for participating in development projects with private businesses. Typically the governments will provide resources (money or property) or undertake actions such as assembling land parcels or waiving property taxes. In return, the governments benefit by having companies bring new jobs and income into the locality, and in many instances may also share in the profitability of the project.

In Hungary, local governments often own land and buildings obtained through the privatization process. Although some of this property is now being rented to private users, much of it still sits idle or is being used in a minimally beneficial manner. Training courses and technical assistance interventions can be developed to assist local governments in becoming more actively engaged in stimulating development to both increase the local employment base and also contribute new revenue sources to support government operations.

Choosing Project Locations

The minimum condition for selecting a county for the project should be the presence of a LEA or SBDC prepared to join in the effort, one or several savings cooperative banks or other similar financial institution with a minimum cumulative asset base of $5 million and an willingness to participate, and a local government entity that also expresses a willingness to participate in the project. The financial institutions would be provided training, consultancy assistance, and limited physical assets (primarily computer software) to enhance their ability to serve the client market. Similarly, the technical assistance organization would be eligible to receive support for expanding its ability to provide a higher level of service to the client market. Local governments would be expected to create enterprise offices and to help leverage local resources where possible.

Probably the most objective way of selecting project locations would be through a competitive tender process through which consortia of local entities would compete for program services. To provide quality and in-depth assistance with the limited resources available to the project, a target of no more than five counties or subcounty jurisdictions should be selected for this initiative. Requests to participate by localities should meet the following threshold conditions:

<u>Threshold Criteria for Participation</u>

- An existing LEA or SBDC willing to provide or broker technical assistance services to local businesses on a fee-for-service basis, with an explicit indication of the approximate number and character of businesses it plans to serve under the project;

- A financial institution or institutions with a deposit base of at least $5 million and an expressed willingness to serve its local SME market, with an explicit commitment to allocate a portion of its loanable funds to serve local small businesses;

- An expression of willingness by local government (Mayor, Assembly, or both) to participate actively in the project, including a willingness to make available property and other assets of the community in support of the project.

All three institutions will be expected to make individuals available to participate in the training and technical assistance made available under the project, and to make their best efforts toward achieving the objectives of the program.

The Target SME Market

Although each of the three Core Activities has a specific institutional target (financial institutions, business service organizations, and local governments), the ultimate beneficiaries of project assistance are SMEs. Therefore, the project must be explicit as to the characteristics of enterprises that this project is intended to serve, and the services provided to the target institutions must bear an explicit relationship to the intended business clientele.

A typical enterprise client would be a company with:

- Two to four years of operating history (not necessarily profitable for that period, but also not so financially and operationally impaired that survival is unlikely);

- Approximately 5-20 employees upon entry into the program;
- An expressed desire to expand and/or to improve the operational efficiency of the company;
- A willingness to make fully available to the technical assistance providers and lenders the company's financial statements, accounting records, and key personnel; and
- A willingness to pay for services received.

Anticipated Outcomes of the Project

By selecting regions, institutions, and business clientele with the above characteristics, it is expected that specialized services and financing can be brought to bear on the businesses and institutions such that, by the end of the project:

- The participating **financial institutions** will have established an effective process for identifying, reviewing, closing, and servicing SME loans. At least 200 new financing relationships will have been established between participating businesses and lenders. New financial products will be available to business clients to better serve their financing needs. Institutions will be more efficient and competitive with enhanced prospects for long-term viability.
- The participating **technical assistance providers** will have upgraded the quality of their technical services and established ongoing sources of revenues from fees and program income. In at least some of the localities, the LEA/SBDC will have evolved into the role of being the lead economic development entity for the community.
- **Local governments** will have in place a more efficient system for permits, licenses, and registrations. Municipally owned real estate will be used more effectively in the promotion of SMEs, and the support institutions will be able to rely on real estate income to cover their operating costs.
- At least half of the **businesses** that meet the target characteristics and that seek assistance from lenders will have developed new financing relationships with local lenders. At least 75 percent of the companies receiving assistance from the business service organizations will have had profitability improvements of at least 25 percent in real terms.

Another significant outcome of this project would be the **demonstration impact** it could have on other technical assistance providers, lenders, and governments. By using these localities and their institutions and businesses as a laboratory, there will be a documentable process that will set baseline characteristics leading to a clearer definition of criteria for successful and sustainable SME credit and services in Hungary. This should be looked upon as an important secondary outcome. Although the primary focus of the project will be on the target regions and institutions, it is expected that there will be replications in other locations as the techniques and successes become known.

ENHANCEMENTS AND ELABORATIONS TO THE CORE PROJECT

In addition to the Core Program, several enhancements and elaborations are possible. Some of these will apply to the entire project, while others may apply more selectively to individual regions and participants. A decision to add some or all of these enhancements should be based on the availability of resources and the likelihood that the critical variables necessary to achieve success with the suggested activity can, in fact, be brought into the project. Furthermore, as localities form their partnerships and make application to participate in the project, other special activities and enhancements are likely to be suggested.

Linking the Local Credit Providers to the Larger Financial System

Each of the likely credit providers for this project are independent, free-standing institutions with limited access to capital. Within the project, these institutions will receive training in techniques for increasing the deposit base. However, other techniques may also be used to expand available capital, such as:

Selling Capital Instruments

One savings cooperative bank recently sold a five-year debenture to increase both its capital and its ability to extend credit for longer terms. Debt or equity instruments could be used to expand the capitalization of other cooperatives. If possible, USAID or OPIC guarantees might be used to make these instruments more marketable.

Developing Mechanisms for Loan Participations

In advanced market economies, lenders commonly sell participation interests to other lenders. The originating lender generally maintains the client relationship and services the loan, and other lenders buy shares in the loan. This spreads the risk and allows the originator to extend its portfolio. Techniques for participation could allow credit co-ops to share loans and to bring in capital from larger institutions.

Developing a Secondary Market for Loans

Once a lender has established a portfolio that has predictable performance and return, it becomes possible to sell the portfolio (or shares in the portfolio) to other investors. The European Bank for Reconstruction and Development might become a potential buyer of seasoned small business portfolios.

Expanding Access to Equipment Leasing for SMEs

Equipment leasing offers an alternative means by which SMEs could get the use of productive equipment for their businesses. It is very difficult for companies to borrow for periods of longer than one year in the Hungarian market, and companies cannot normally pay for equipment within a one-year timeframe. Leasing companies now operate in Hungary. This project could expand the availability of leasing in two ways. Equipment lessors could be brought into the local projects as direct participants in the business financings; or the savings cooperative banks could enter into participation relationships where they act as originating and servicing agents for lessors.

Commercially Operated Small Business Incubators

Incubators are facilities that have been developed to provide small businesses with work spaces, equipment, and supportive services, for which the business pays a fixed rental payment. A few incubators have been developed in conjunction with the LEAs. However, these are being operated with substantial subsidies for the occupants.

A commercially operated incubator would rent space to a more established business that would pay a market rate for the space, equipment, and services. If a local government donates vacant building space, and other contributions are raised either through local contributions or project resources, the revenues generated could provide a sustained source of income for the technical assistance organization, contributing to the eventual self-sufficiency of the organization. Rather than force tenants to leave an incubator after three years (that is typical in the subsidized model), the municipality could simply develop more properties as each becomes filled and achieves a market return.

Franchising

Franchise organizations can be an effective way of increasing the success probability of small businesses. The franchisor organization offers the individual business owner a range of support services including training, management systems, advertising and name recognition, supplies, equipment, and financing. Although franchises are not available or appropriate for all business enterprises, the use of franchise programs could enhance the success of at least some of the client businesses.

It will be possible to identify a group of U.S. franchisors whose businesses are suitable for the target locations and clientele. They would need to be businesses whose capital requirements are modest and that appeal to moderate income Hungarian households. The franchisor organizations would be encouraged to establish programs in Hungary to provide their services locally and cost-effectively. Ideally the franchisors would also provide some financing, particularly for equipment and facilities.

The types of enterprises that might be most suitable for franchise operations in the target locations include automobile maintenance and repair, tourism-related activities, computer service and repair, business and tax services, small-scale retailing and food service, and industrial maintenance.

Regional Tourism Promotion

Some regions of Hungary could become very attractive sites for tourism and thereby increase opportunities for small enterprise. Locally owned enterprises such as small inns, restaurants, tour guides, recreation facilities, and gift shops could benefit from expanded tourism. However, tourism promotion generally requires collaboration of a number of entities in the locality. Within the context of this project, regions could receive technical assistance in techniques for developing a tourism infrastructure and promoting opportunities in the region. Several useful models for this exist in both Europe and the United States. Specialists in developing local tourism programs could be brought in as advisors to communities interested in developing their tourism markets. Already some local tourism activity is being promoted by LEAs, Peace Corps volunteers, and other local organizations. The efforts of those individuals could be strengthened through collaborations within this project.

Other Regional Initiatives

One very promising activity already under way in Hungary and its neighboring countries involves removing impediments to cross-border trade. These efforts are concentrating on expediting customs procedures at the borders. A link to that initiative should be encouraged. In that context, it might be helpful to develop bonded warehouses using municipally owned real estate to further facilitate this trading activity.

Installing Internet Access for LEAs/SBDCs

A suggestion made by the Soros Foundation was the installation of Internet linkages in LEA/SBDCs or in the local government development offices. Internet is rapidly becoming a preferred method of communication between businesses, and in places where voice communication is less reliable, Internet is extremely valuable. Furthermore, the Internet offers access to a wealth of business and economic data for local enterprises.

An Internet link could become an income-generating activity for a technical assistance institution. Individuals and businesses will pay for the ability to use on-line services. In Poland, USAID is supporting the creation of computer-based information centers that allow individuals and organizations to access information about donor programs. In Ukraine a similar system is being created, with the idea also of linking businesses, NGOs, and other institutions in an information exchange network. In Hungary, a system that links all of the LEAs, SBDCs, donors, local governments, and NGOs could be extremely valuable for exchanging ideas for improving economic conditions overall as well as for facilitating commercial transactions between individual businesses.

PROJECT IMPLEMENTATION

Organizing and Managing the Project

This project does not contemplate the creation of any new permanent institutions in Hungary. All of the essential activities will be channelled through existing structures, though, in the process of participating in this project, some may have transformed missions and activities. There is, however, a necessity for a project management capability — an individual or entity acting as an Integrator, bringing together the participants in new relationships. USAID could consider performing this integrating role from within its own structure or it could contract-out the management function to an outside entity. If managed from within USAID, the Project Manager could coordinate a series of grants and contracts to implement the Core and Optional Activities. If the project is managed by an outside contractor, there will still need to be a considerable amount of coordination rendered by the USAID Mission, since the implementation strategy also contemplates the use of other contracting vehicles and institutions implementing ongoing USAID activities of a related nature.

Under a typical USAID project implementation arrangement, a U.S. organization would be engaged as overall Project Manager. The contractor would provide a lead Technical Advisor who would work with a Hungarian counterpart organization for 18-24 months. The contractor, its local counterpart, and other subcontractors would provide training, technical assistance, advice, and equipment in completion of the established work plan.

The Advisor would be a senior technical specialist with advanced skills in small business finance and technical assistance, organizational development, and training. The contractor would support its advisor with short-term technical assistance and training resources. The Hungarian collaborator would provide local project management, office space, and administrative support for the project, and would also play a significant role throughout the project in the local organization technical assistance and training. Neither the U.S. contractor nor its Hungarian partner would carry out any significant amount of firm-level technical assistance, but rather would confine its assistance to strengthening the other local institutions such as the banks, LEA/SBDCs, and local governments.

Along with this external technical capability, there will also be a need for substantial involvement by USAID personnel. As described below, this project contemplates drawing on a number of existing contracts and activities already available in the region. This will require a great deal of coordination to bring the parties together, and it may not be possible for a contractor to create the linkages without the direct "encouragement" of USAID.

The role of this management capability would be to undertake the following:

- Assess the viability and commitment of the participating local entities, including the LEA/SBDCs, financial institutions, and local governmental organizations;
- Select, or recommend to USAID, the localities and specific entities that should receive assistance through the project;
- Assist in negotiating relationships among the participating entities;
- Coordinate the delivery of training, technical assistance, and systems installations for the financial institutions and other organizations;
- Serve as an advisor to local institutions participating in the project; and
- Assure compliance with USAID contract regulations and reporting requirements.

The Core Project would require only a nominal budget for procurement of tangible assets. Basic office equipment, supplies, and a project vehicle would be needed for the U.S. Technical Advisor. It would also be useful to have a budget to purchase at least some of the cost of computers and software for the participating financial institutions. If available, USAID loan guarantees or other credit enhancements could help with the introduction of new financial products for businesses.

Should USAID choose to add the Optional Enhancements referenced above, it would be useful to have a budget that could be used as incentive funding for such components as small business incubators.

Project Work Plan and Timetable

The following is a general work plan and timetable for implementation of the project over a two-year period:

Step 1: Selection of Participating Localities and Entities

The project contemplates the selection of approximately five regions or localities in Hungary in which three types of organizations (financial institutions, business service groups, and local governments) are linked around a single set of business development objectives. This selection would be best done by means of a public tender process. The Project Manager would prepare terms of reference that would be circulated to business service organizations, local governments, financial institutions, and other NGOs in the targeted regions. The selection of participating entities should take approximately two months from the first public announcement.

Step 2: Refinement of Technical Assistance Needs

Although it is possible now to identify in broad terms the types of assistance that participating entities may need, a detailed identification of needs cannot be completed until the entities have been identified. Part of the needs identification will emerge from the responses that they submit to the tender. However, it should also be anticipated that many may not accurately identify all of their technical assistance needs. Approximately one month after the final selection of participants, the project would produce a refined work plan for training and technical assistance to the business service groups, financial institutions, and local governments.

Step 3. Improved Service Delivery

Beginning in the fourth month of the project, the contractor will begin providing services to the three types of participating entities. Much of the initial wave of activity will be in the form of group seminars and training sessions. In some instances the services will be designed to build cohesive working relationships among the three types of entities within a single region. In other instances the entities from a single type (for example, financial institutions) will be grouped in training sessions that address needs common to that type of entity. In still other situations the needs may be unique enough such that individualized assistance would be directed to a single entity. In all instances the assistance would be for the ultimate purpose of improving the ability of all three types of entities to provide services to local small businesses, operating both individually and as mutually reinforcing partners in a regional development process.

Since all of the entities participating in the project will be existing entities already providing services in some fashion, the delivery of client services will be ongoing. However, as delivery capabilities improve, so will the quality of client services that they provide. Furthermore, as the capabilities improve, these entities will be able to bring a different type of business client into the organization based on the enhanced service capability. In each region, the lender(s) and technical assistance provider will negotiate an active relationship for referrals, will develop a common understanding as to credit criteria and expectations, and will establish a fee structure for financings, referrals, and technical assistance. For at least some of the training (particularly credit analysis), the bankers and technical assistance providers would attend training together.

By approximately eight months into the project (four months after the institutional technical assistance begins), it should be possible to observe a significant improvement in the quality of services being provided and the nature of the client groups being served.

Step 4: Institutional Transformation

At the same time, and as a result of the improved service capabilities, the participating institutions will themselves change some of their basic operating characteristics. As the business service organizations and financial institutions attract newer, more viable clients, the viability of the institutions will themselves improve. Financial institutions will become better able to compete for clients and resources and will become more profitabie as a result. Similarly, business service organizations, perhaps in collaboration with local governments, can change the nature of their financial support. Rather than being totally dependent on donor grant funds, they can evolve into a form in which a substantial part of their support is generated through service fees, supplemented with contracts or other financial support from local government. This type of organizational transformation will be longer term in nature, but should become more apparent by the middle of the project's second year.

Step 5: Transfer to Local Operation

As noted previously, a local counterpart organization would provide a critical function in the operation of this project. Initially the counterpart's role would be more of a coordination and logistical nature. Over time greater and greater responsibility will be shifted to the local counterpart, and at the same time the U.S. contractor's role will diminish. By the start of the third year, USAID support for the project will begin to diminish. By that point the counterpart organization will be in a position to continue providing institutional development and business services to other institutions in Hungary.

A careful record of each client's progress will be maintained. Of particular interest will be documentation of changes in revenues, profits, assets, and capitalization of the companies, and an assessment of the extent to which the project is responsible for those changes. There are two reasons for maintaining this information:

- By documenting the extent to which the services have improved company profitability, selling fee-based services will be easier in the future; and

- Other lenders, service providers, and local governments in Hungary can learn the specific factors most likely to predict success in small enterprise development and consider replicating the approach.

This project does not contemplate an explicit replication or "roll-out" phase to expand it countrywide, primarily because of lack of time and resources. However, by providing sufficient documentation of actions taken and outcomes realized, it is expected that at least some other regions and institutions will initiate replications on their own. The counterpart organization will have the capability at that point to provide services to those entities on a fee basis.

Level of Effort and Notional Budget

There are a number of variables that could have a major effect on the level of effort and project budget. Among these are:

- Number of regions in which the project operates
- Starting level of competence of the participating institutions

- Mix of project responsibility and activity between USAID staff and contractors and between U.S. and host country professional services
- The extent to which some or all of the optional enhancements are incorporated into the program
- Overall length of time for the project

To narrow the range of estimates, two variations are considered: one in which resources are severely constrained and another that assumes that each of the above points is generally at midpoint in its probable range. The project budget presented here is for a 36-month period. In both instances it is assumed that a Hungarian counterpart organization will be a key part of the project operation, providing logistical and technical support from the start and gradually assuming a greater share of overall program operations. In the "normal" budget, a U.S. Technical Advisor would be placed in Hungary for the first 24 months, with a full complement of housing and family allowances. However, under a more constrained budget environment, it could be possible to operate the project through a U.S. contractor that relies more heavily on a local counterpart and short-term technical assistance. Budget estimates assume a multiplier on contractor direct labor of 2.2x, no multiplier on host-country subcontractors, and current travel and per-diem rates.

	"NORMAL" BUDGET	"MINIMALIST" BUDGET
Advisor/COP (Level of effort)	24 p-m	-0-
Advisor (dollar cost)	$340,000	-0-
Allowances	$100,000	-0-
Short Term Tech Asst (LOE)	60 p-m	40 p-m
STTA (dollar cost w/travel & p.d.)	$1,283,250	$855,500
Project Support (local counterpart)	$600,000	$500,000
Project Support (contractor)	$150,000	$150,000
Procurement	$300,000	$200,000
Other costs	$300,000	$200,000
TOTALS	$3,073,250	$1,905,500

Opportunities for Leveraging Other Available Resources

The Micro and Small Enterprise Support Project (MSES), funded by the Global Bureau of USAID, was recently awarded to DAI. Under this project USAID contemplates funding approximately 75 separate training courses for small businesses and banks worldwide. Credit officer and management training for the savings cooperative banks and increased business technical assistance training for LEA/SBDCs could be funded under the MSES project. Alternatively, the Barents Group is already under contract with USAID to provide training and systems upgrades for OTP Bank. According to OTP's advisor (Ted Parrish), it may be possible to link some of the proposed training for savings cooperative banks to that contract.

The Center for International Private Enterprise has a highly regarded project under way in Hungary dealing with business associations and legal reform. A programmatic link to CIPE's activity would be very useful in this project, particularly with regard to the local government component.

USAID-Hungary contemplates undertaking a buy-in to USAID's Public Administration IQCs in the region. The local government support activities described in this project could be undertaken either through this Public Administration contract or complementary to it.

As noted previously, the Soros Foundation is prepared to consider co-funding of an initiative to expand Internet linkages throughout Hungary. For example, a program could be established to place Infernet links in LEA/SBDCs or other suitable local institutions. Soros would share the cost of equipment and/or training. A grant application or other proposal would have to be made to Soros for this support.

The World Bank is in the exploratory stages of considering establishing lines of credit to be offered through the savings cooperative banks or OTP to assist small, rural-based, nonfarm businesses. A delegation from the savings cooperative bank network met with World Bank representatives earlier this year. The World Bank is planning an assessment visit to Hungary later this year to further explore the possibilities. Although such lines would not be available for at least 6-12 months, funding of this type could provide the term loans needed by businesses that financial institutions are generally not willing to provide because of the matching maturities problem. The World Bank wishes to be kept advised on the progress of USAID's SME project, and it does seem that a paired effort is possible.

In designing a regional tourism promotion as an enhancement to this project, it may be useful to call on IESC to take on the task. In the past, the IESC in Hungary has done a sector survey annually, in which it brought in an executive who worked with several businesses in the same industry. Using tourism as an example, this approach could be expanded to bring in a team that would travel from site to site, giving specific assistance in areas such as accommodations, targeting markets, developing local attractions, and establishing a centralized reservations system for small hotels and inns. As an alternative or a complement, the Peace Corps could be encouraged to recruit volunteers with a tourism background to help encourage small-scale tourism development.

Project Sustainability

Because no new institutions are being formed directly within the GEORGETTE project, sustainability objectives concentrate on the key institutions being served by the project.

The technical assistance organizations (LEAs and SBDCs) will be provided with a variety of programs and techniques to enhance their sustainability. These include:

- The ability to deliver higher valued business services for fees paid by the businesses;
- Commercially operated business incubators; and
- Placement fees and other revenues provided by financial institutions.

Perhaps more importantly, however, it is hoped that local governments will come to realize the value of having an economic development capability within the locality, and will contract with these technical assistance entities to perform that function.

Along with the technical assistance institutions, the participating financial institutions will be provided with capabilities to enhance their sustainability. These capabilities will include new systems to improve productivity, enhanced operating skills for managers and credit officers, new financial products, and new markets. These financial institutions will become better able to compete in the financial services market, and can become significant contributors to the small business financing in Hungary.

Finally, the ultimate goal of the GEORGETTE project is to enhance the ability of Hungarian small businesses to compete in their domestic and international markets. This is particularly important in view of the likelihood that Hungary will become part of the European Union within the next 5-10 years. As a result of the GEORGETTE project, small businesses in Hungary will be able to operate in an environment that is less hostile, and in which higher-quality business and financial services are available and competitive.

ANNEX A

THE HUNGARIAN BANKING SYSTEM AND LOAN AVAILABILITY FOR SMALL BUSINESSES

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Hungary has a range of banks that could be making loans to small businesses, but which to date have not been active in the SME sector. These include:

- Commercial banks created through the spinoff of commercial activities from the Hungarian National Bank (MNB), the central bank. These include Magyar Hitel Bank and Budapest Bank. Although these are scheduled to be privatized, actual implementation has been stalled.

- OTP Bank is the national savings bank, and is the largest banking institution in the country (total assets of HUF 700 billion, about $6.2 billion) with the most widespread network of more than 400 branches.

- Postabank was developed as a savings scheme through the post offices. Although originally viewed as a major competitor to OTP, anecdotal reports indicate that it has been particularly inflexible about working with businesses.

- Various private banks, usually fairly small. One of these, Mezobank, is owned by 1,400 agricultural cooperatives, and has been a participant in the Hungarian-American Enterprise Fund's small loan program.

- Savings cooperative banks, located in outlying and rural areas. There are some 256 of these savings cooperatives, with about HUF 156 billion combined total assets.

- Credit unions have recently been introduced in Hungary. Four have been in operation for about a year, and a fifth is scheduled to open soon. Unlike the savings cooperative banks, credit unions only accept deposits from and make loans to their own members.

The banking system as a whole has been very reluctant to lend to small businesses. Although some short-term loans are being made, long-term credit for even two to three years is virtually non-existent. The small business loan market has not developed for a variety of reasons:

- The banks are basically funding the huge government deficits. Bank assets are concentrated in government bonds, which pay rates comparable to bank loan rates, and require no underwriting or analysis effort from the bank.

- Historically the banks have loaned to large state enterprises, and continue to seek business on this scale. The desired minimum loan size is well above the loan amount the would realistically cover administrative costs.

- Notwithstanding a fondness for large, "riskless" state enterprises, the banks are working out huge problem loan portfolios created by the actual or effective bankruptcy of state companies.
- Interest rates charged by banks are in the 33 - 40 percent per annum range, and are deemed to be too high for small businesses to pay. These rates reflect the substantial inflation in the country, and the competition by the government for credit. Further, the banks' base rate for the best borrowers is set independently of the government paper rate, and the rates may be too close to each other to reflect the risk differential.

- There has been little credit assessment training in the banks for loan officers, as well as a lack of risk management training for managers. The banks tend to look only at collateral coverage, and do little business or project cash flow analysis.

- Because of the inflation in the country, virtually all deposits are short term. This dictates that only short-term loans be made, in order to match maturities of loans and deposits.

- Small businesses are still fairly new, without much track record to review. Further, largely due to the desire for tax avoidance, accounting records are often opaque and ownership of assets used for the same business may be spread among several entities, as well as personally owned.

Several efforts, which are described below, have been made to get around some of these problems. The macroeconomic problems of the heavy government debt level as well as the high interest and inflation rates are overwhelming, so efforts to address banking system problems per se will simply not be greatly effective until macroeconomic conditions change.

There have been several attempts to train bankers to lend to SMEs, and to provide lendable long-term funds. One major effort has been undertaken by PHARE through banks, which provided training, computers, software, and furniture, in addition to half of the loan capital at substantially subsidized interest rates for borrowers to buy medium and long-term capital assets. Maximum loan size is ECU 50,000 ($60,000). The full principal risk is borne by the banks, which had to bid to participate on a county by county basis, and had to designate SME branches in the county. According to an EU-PHARE representative, the program has not been successful, and "the banks hate it." In some cases less than half of the loan funds passed to the banks has been on-lent, and some funds have simply been given back to PHARE. It appears that the original bank interest was in getting the equipment and training, also in benefitting from the considerable publicity attached to the program.

Another significant effort at encouraging lending to SMEs was made by the Hungarian-American Enterprise Fund. HAEF committed $5 million to be on-lent through Szechenyi Bank, a division of Magyar Hitel Bank, and Mezobank. The latter was particularly chosen because it did have an extensive branch network in rural areas. Loan size generally ranged from $10,000 - $100,000, HAEF provided all funding (thus solving the matching maturities problem), and the Fund and the bank shared principal risk equally. All of the monies were drawn down quickly, and the banks have been willing to do short-term lending to the customers generated through the program. The main problem that the program encountered was that it was too small in banks that were too large. Although individual loan officers and branch managers were enthusiastic about the program, communication to senior management was poor. The lessons learned at a local level have never been incorporated into the bank credit policy.

Another U.S. initiative is the Credit Guarantee program, presently being implemented at OTP Bank. This will allow for $3 million of guarantees for 50 percent of loans not exceeding $150,000, with losses shared equally by the program and the bank. The program requires that lenders, trainers, and borrowers be trained in cash flow planning. Training on credit policy and risk management is given to senior management. The bank may also need to amend its credit policy. The program will be implemented in six of OTP's four hundred plus branches, and there is legitimate concern that the initiative is too small for OTP to pay much attention to it.

In addition to these programs, there are several foreign government loan programs that are available to finance purchases of equipment from the respective country. These are not much used, and anecdotal evidence indicates that the banks know little about the programs and borrowers rarely meet program standards.

The bottom line on these programs is that efforts to change the system on a national scale have not worked. In formulating this new initiative it was important to be dealing with lending institutions that were locally based, and small enough that communication between the branches and management would be good. Although the savings cooperatives do have capital adequacy problems and personnel need significant training, individually they are a part of the local business scene and have a stake in regional economic prosperity.

In planning participation by the savings cooperative banks it is useful to review banking terms and principles, to understand what would constitute realistic performance expectations for them.

<u>Sources of Repayment:</u> There are fundamentally only two primary sources of repayment for any loan. These are:

1. Conversion of Assets - for repayment of short-term loans. This means that there is a timing difference that can be bridged with a loan, and the loan can be repaid as soon as soon as an asset is converted to cash. A classic example of this is a loan to purchase inventory: when the inventory is sold the loan can be repaid. Note that as long as the asset is sold for at least its purchase price, a business does not have to be profitable to repay the principal of a short-term loan.

2. Cash Flow - is the term that describes the repayment of long-term loans (generally considered to be one year or more) by operating businesses. This is the cash that is available to pay debt after covering operating costs, and the formula can be described as net profits with non-cash expenses added back, less amounts needed to cover increased working capital needs and existing long-term debt service. Unlike a short-term loan, assets are not converted to cash to repay the loan.

<u>Primary and secondary sources of repayment</u>: Typically a banker will look for both a primary and a secondary source of repayment on every loan. The primary sources of repayment have been described above: secondary sources include:

1. Sale of collateral - Initially this appears to be the same as the conversion of assets described above. However, as a primary source of repayment goods are sold in the ordinary course of business. As a secondary source the sale of the assets would be outside of the scope of the ordinary course of business. For instance, if a loan is made for inventory purchases and is secured by that inventory as well as business equipment, it is expected that the loan will be repaid from the resale of that inventory. If the inventory cannot be sold, the business and/or the bank may resort to the backup source of repayment, the sale of the equipment.

2. Guarantees - These are promises to repay a loan, made by an entity who is not a party to the loan per se. Typically the shareholders of a closely held business will guarantee a loan, as will related businesses. The guarantor may also be someone who is totally independent from the business such as an interested relative or a business supplier or customer, and the borrower may or may not pay a fee to the guarantor for his guarantee. A guarantee is not the same as collateral, because there are no specific assets that the lender is looking to for secondary loan repayment. A guarantee may be collateralized, however.

(Note that government guarantee loan schemes such as the U.S. Small Business Administration's 7a program, or counterpart programs in other countries, may rely either merely on the full faith and credit of the government, or may be backed up by a fund. In the latter case guarantees may be given in amounts totaling multiples of the fund amount (e.g., 5X or 8X the total fund, depending on claims experience) but the fund is not pledged directly as collateral.)

It should also be noted that banks take pledges of collateral not just for backup repayment, but to control borrowers and ensure that collateral is not pledged elsewhere. Any borrower will certainly repay a collateralized loan before an unsecured loan, so in taking collateral the bank is ensuring that the borrower will pay attention. The bank will only require less collateral, give a lower interest rate, offer a longer term, and require fewer guaranties as market forces come into play (i.e., there is another lender who is willing to lend with less collateral, perhaps for a longer period and at lower interest rates.) This type of competition this is a normal part of lending practice and bank marketing.

What sort of lending, then, is it realistic to expect from the savings cooperative banks participating in this project? Based on common bank lending practices and country economic conditions, the following outcomes are expected:

1. As long as the government finances large deficits with government bonds and inflation continues, very few long-term loans will be committed. This should ease once deposits have a longer tenor, and commercial lending is more profitable relative to holding government paper.

2. Short-term lending could begin immediately, since the LEA/SBDC will be referring more than small businesses with proven track records. After training the banks will be positioned seek out these customers themselves. Once the banks become more confident in evaluating this type of loan request, a line of credit loan instrument could develop that would cut down on paperwork and documentation.

3. If term loan programs become available (such as through the World Bank or the Hungarian-American Enterprise Fund) bank participants in the USAID program would be able to in a good position to use them. The USAID project coordinator would be keeping track of new programs, and could likely arrange that these be established in tandem with the USAID program.

4. Until the market becomes very competitive the banks will want to take as much collateral as possible. Training on both short- and long-term credit techniques will encourage making a loan where less collateral is available, but (in absence of market competition) it is not realistic to think that a lender will give up collateral just because the cash flow seems strong.

5. The banks will develop a competitive attitude, and will seek profitable banking relationships through long-term association with customers.

ANNEX B

A NOTE ON SUSTAINABILITY

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A key objective of much of the USAID enterprise support programming is sustainability. It is highly desirable that initiatives begun with USAID funding reach a point where they can maintain themselves without the need for ongoing support. However, it is an objective which is not easily attained. Sustainability can be attained through one of two routes: either the funding is maintained by other government and private sources, or the activity generates support revenues from service fees. In the Hungarian context, the first route is unlikely, so that the second becomes the only realistic means by which projects sustain themselves.

As desirable as market-based sustainability may be, there is a great deal of mythology and muddled dialogue on the subject. This note is not intended to provide the final answer on a very difficult subject, but it is provided to raise the critical issues and suggest some possible approaches to their resolution. The Growing Enterprises, Organizations, Resources; Gaining Expertise, Technology, Trade, and Entrepreneurship (GEORGETTE) Project will seek to advance the thinking through a test of market-based business service delivery.

A fee-supported project is itself an enterprise. It must deliver services which are valued by the client market, and must be able to produce sufficient fee income to cover all operating costs. Fees may be generated in a variety of ways: sale of materials and publications, training and seminar fees, consultancy fees, interest and other fees from financing activities, and the rental of tangible assets. The last two types of income require the project to own tangible assets (financial or physical). The other fees are in the nature of service revenues.

The SBDC and LEA business centers presently do not operate on a commercial basis. Although at times they charge nominal fees for seminars and publications, they typically cover no more than 15 percent of their operating budgets through user fees. These institutions are organized explicitly to provide free services and consider that fee-based programs represent a violation of their initial mandates. Furthermore, it may well be that by converting to fee-based programs, they will violate their foundation status under Hungarian law and become subject to taxation on both their fee income and their donor grants.

Almost certainly a shift to fee-based programs will require a significant change in their market positioning. They will need to provide higher value services to clients who can afford to pay. That means they will need to become more specialized and more proficient themselves in order to serve these more established clients. In doing so they also become competitors with other commercially organized business service providers. It is important that they not compete with local consultants unfairly, using the benefit of their donor subsidies to undercut the market prices and thereby destroy the indigenous business service industry.

Perhaps an appropriate compromise would be the creation of a collaborative — either a real or virtual company which brings together a network of local service providers under a single marketing system. The business center could act as the outreach entity on behalf of local consultants, establishing quality standards and an appropriate working environment, for which it would receive a share of the revenues.

As noted previously, support revenues can also be generated from financing fees, interest income, and the rental of physical assets. Where an organization has control of financial assets, income can be generated by lending or investing those funds, producing income in a variety of ways. These include interest, closing fees, dividends, capital gains, guarantee fees, servicing fees, and many others too numerous to mention. As the GEORGETTE project is currently contemplated, local service providers will not have direct control of financial assets and therefore cannot rely on these types of revenues.

However, the project does contemplate a linkage with savings cooperative banks and other similar entities which do have financial assets. These entities will be permitted to earn a full market-rate return on their financial assets. Furthermore, it is contemplated that the business service organizations may well earn a share of these financing fees for such activities as loan packaging and monitoring.

Business service organizations may at times own physical assets from which they can earn rental income. At a minimum they can earn income by renting out the use of their computer equipment, copier, and fax machine. More importantly, however, they will be assisted in efforts to acquire and develop physical facilities for service and manufacturing businesses. There already is in Hungary a trend toward the development of "business incubators" which are owned, controlled, or managed by business centers. However, these currently operate on a subsidized basis. New businesses are offered space below the market rate and in addition receive other free services. Under the GEORGETTE project, similar types of shared-space facilities may be developed, but with the expectation that in time they will generate a market commercial rate. They may receive a subsidy in the form of free building space from the local government or equipment and renovation funding from a donor. However, they will be operated with the intention that the rental and service income will be fully cost recoverable, and will contribute to the support of the overall center operation.

As noted previously, this concept of fee-based services represents a fundamental departure from the philosophy of helping new startup businesses with free services. However, at the current stage of transformation, this change in approach is necessary as Hungary moves toward the 21st Century and eventual membership in the European Union.

ANNEX C

USAID'S MICROENTERPRISE INITIATIVE

The Administrator of USAID chartered a Microenterprise Initiative in June of 1994. The Initiative is a set of policies, strategies and specific actions designed to make microenterprise a prominent part of USAID's economic growth strategy. The goals of the initiative are:

- To assist poor people to increase their income and assets, thereby gaining the basis to improve their welfare, nutrition, health, housing and education.

- To increase the skill and productivity base of the economy, so that the capacity of the economy to grow is enhanced.

- To develop sustainable institutions through which disadvantaged groups gain greater access to resources, fostering a social fabric that more effectively weaves poor people into their societies as participating members.

Microenterprises are very small, informally organized, non-agricultural businesses. Many microenterprises employ just one person, the owner-operator. Some microenterprises include unpaid family workers, and others may have one or several hired employees. Although no single characteristic distinguishes microenterprises from small enterprises, USAID has adopted a threshold of ten employees, including the owner-operator and any family workers, as the upper bound for an enterprise to be considered "micro". USAID's Policy Determination also identifies the Microenterprise Initiative as the businesses run by, and employing the poor.[1]

At the upper end of the microenterprise continuum are the growth oriented businesses. The major shift in orientation appears to be when a business expands beyond the level of using only family labor. A very small minority of microenterprises are expansion-oriented. The growth oriented enterprises expand quickly with annual growth in the range of 40 per cent to 80 per cent not uncommon. The expanding enterprises are often characterized by the proprietor having had previous experience in a related business, family support, engineering or technical skills, a productive work force and not being risk-averse.

The USAID Microenterprise Initiative does not have a specific definition of microenterprise, however PD-17 gives some guidance.

> As a working definition, subject to the following exceptions, a microenterprise should have no more than approximately 10 employees and should have characteristics (assets, revenue, etc.) that fit well within the framework of objectives set forth below. Special emphasis should be placed on small-sized and individually owned productive activities. An attempt to define or limit the size of a microenterprise too severely would exclude from the program some enterprises that Congress desired to receive the benefits of the program. Furthermore, the objective of gradually advancing an enterprise to access formal sources of financing could be undermined with too severe a limit based upon the firm's employees.[2]

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[1]PD-17, dated October 10, 1988 on Microenterprise Development is currently being revised.

[2]A.I.D. Policy Determination: Microenterprise Development Program Guidelines, October 10, 1988, paragraph B-2 <u>Program Beneficiaries</u>.

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The policy guidance goes on to state that *"Missions may well have to use a locally appropriate definition of microenterprise. This definition should be delineated in project of program documentation."* Following are some of the areas of focus of the USAID Microenterprise Initiative and how the Hungary strategy may relate. In pursuing microenterprise programs, USAID is committed to the following areas.

Focus on Women and the Very Poor: *"Programs should be designed ideally to (a) seek out the very smallest enterprises and, among them, those with the greatest potential for expansion: (b) help firms access formal systems of financing and technical services; and (c) make at least 50 percent of their resources (credit, technical, and training) available to women-owned and -operated enterprises."* The conference report accompanying the legislation suggested that the microenterprise beneficiaries should be individuals in the poorest 50 percent of the population, women-owned businesses, and businesses owned and operated by the poorest 20 percent of the population[3] The strategy suggested for USAID/Budapest is clearly consistent with all of this policy guidance.

However another portion of the USAID Microenterprise Initiative emphasizes poverty lending programs. Poverty lending programs are defined as extending loans of $300 or less. The USAID/Budapest microenterprise strategy clearly does not qualify as a poverty lending program.

Assist implementing organizations in reaching greater numbers of people: The PD-17 encourages USAID to maximize use of private sector institutions such as local privately owned and controlled financial institutions. Support for the savings cooperative banks, franchising organizations, or leasing companies clearly falls within these guidelines. The USAID/Budapest strategy of strengthening natural business relationships assures that large numbers of businesses and individuals will benefit.

Work toward sustainability and financial self-sufficiency: Working with commercially viable businesses finance and service organizations, USAID/Budapest assures that institutional strengthening will support the ability of these entities to continue to develop new small businesses.

Develop partnerships with local organizations: USAID will seek improved partnerships with governmental organizations, associations, credit unions, and other institutions. The USAID/Budapest strategy that allows working with Chambers of Commerce and trade associations is clearly within the guidelines of the USAID Microenterprise Initiative.

Microenterprise Innovation Program

USAID/Budapest has the opportunity to leverage Mission funds by tapping into the Microenterprise Innovation Project. The project components are interrelated and carry through several themes embodied in the Microenterprise Initiative. As part of the Microenterprise Initiative, increases in funding are anticipated to rise to $140 million in fiscal year 1995. A Microenterprise Innovation Program (MIP) of $30 million for 1995 and again in 1996, will finance grants to NGOs, PVOs, provide matching funds to increase Mission support for microenterprise, and expanded technical assistance in design, monitoring, and evaluation.

The Implementation Grant Program: This will expand the microenterprise service provision by strengthening local organizations to build capacity, increase effectiveness and improve financial viability of services to microenterprises. The Implementation Grant Program is intended to support USPVO and other experienced organization's microenterprise programs that provide financial services, non-financial

[3] PD-17

services or innovative pilot efforts in more than one country. Apparently Ohio State University and Globinfo Foundation, a Hungarian training organization, have applied for funding under this portion of the MIP to set up a microenterprise services program in Hungary.

Mission Co-financing Program: The goal is to improve the quality and increase the quantity of Mission support to microenterprise programs. The Mission Matching Grant component is intended to support Mission microenterprise projects with local NGOs, government organizations, credit unions and other organizations. In early March of this year, the USAID/Washington Microenterprise Development Office (G/EG/MD) sent guidelines to Missions on applying for co-financing from the Microenterprise Innovation Project PRIME Fund (Program Initiative in Microenterprise).[4] Although the deadline has passed for funding under this program for FY '95, additional funding will be available in subsequent fiscal years.

Technical Assistance, Training, Research and Information Exchange: This portion of the program will increase the capacity of implementing organizations and USAID organizations to undertake microenterprise programs, to expand the knowledge base of the field, and to improve the design and implementation of USAID-supported projects. Research results, through Best Practices in Microenterprise Development, and technical assistance will be available to Missions through the Microserve portion of this project. This should be an ongoing source of assistance to the Mission.

Impact Component: This portion of the project will develop better tools for monitoring the performance of microenterprise programs and to assess the impact of programs on microentrepreneurs, their enterprises, and their families. USAID/Budapest will be able to request assistance for design, monitoring and evaluation under the Impact Component.

[4]Cable P110458Z MAR 95 on the subject "Guidelines for Missions to Apply for Microenterprise Project Co-financing Funds"

ANNEX D

THE HUNGARIAN SAVINGS COOPERATIVE BANKS: SELECTED STATISTICS

The figures shown on the following tables for the savings cooperative banks are taken from A Magyar Takarekszovetkezetek Tortente Es Modernizacioja by Dr. Sandor Gergely, the president of the Federation of Savings Cooperatives, published in 1994. This is a history of the savings cooperative bank movement in Hungary, with a summary chapter in English. The book includes addresses, telephone numbers, officers and directors for all 256 of the savings cooperative banks. It also contains year end financial statement figures and statistics individually for each of the savings cooperative banks as of December 31, 1992, as well as cumulative data by county. Although these data are somewhat old, 1994 figures are not yet published, and the intention here is to give a general idea about the size and scope of the industry, as well as of the individual savings cooperative banks.

Table D-1 This is a summary of the number of cooperative savings banks and total number of members in each county, as well as the average number of branches and members per county.

Table D-2 This shows the average size of the cooperative savings banks in each county, including total assets, capital, profit for the year, deposits, loans, and due from banks (substantially equal to loans to the government/government bonds) in millions of forints. This table was constructed by dividing the total figures for each county by the number of savings cooperative banks located in each county.

Table D-3 This table is identical to Table D-2, except that it is shown in thousands of U.S. Dollars. The conversion rate, at HUF 79/$1, was the average conversion rate for 1992.

Table D-4 This shows the average legal lending limits by county for the savings cooperative banks, in thousands of forints and in dollars. These figures indicate a relatively low lending capacity per borrower, which suggests that small business borrowers, with relatively smaller capital needs, could be a good target market for the savings cooperative banks. Note that additional capital has been put into several of the banks recently, and the plan to encourage loan participations could also resolve the need for more credit.

Table D-5 This table looks at individual savings cooperative banks. These examples were chosen because they have had discussions with the Hungarian-American Enterprise Fund about participating in any new small and micro credit schemes, and one of these, in Baranya County, is a active participant in the current micro program. No discussions have been held with these concerning the new Project, but the figures do give the reader an idea of the size of savings cooperative bank that could be a part of the partnership.

Data as of December 31, 1992

County	# Banks	# Members	# Branches	Average # Members	Average # Branches
Baranya	9	22,343	96	2,483	11
Bacs	22	145,182	93	6,599	4
Bekes	10	135,493	68	13,549	7
Borsod	21	153,303	117	7,300	6
Csongrad	14	87,044	65	6,217	5
Fejer	7	98,255	91	14,036	13
Gyor	14	102,917	118	7,351	8
Hajdu	16	131,431	74	8,214	5
Heves	15	116,516	117	7,768	8
Komarom	7	62,199	76	8,886	11
Nograd	9	55,660	60	6,184	7
Pest	17	264,059	139	15,533	8
Somogy	13	71,958	88	5,535	7
Szabolcs	18	188,338	143	10,463	8
Szolnok	13	106,798	68	8,215	5
Tolna	16	67,178	62	4,199	4
Vas	8	58,668	69	7,334	9
Veszprem	11	55,018	72	5,002	7
Zala	16	68,895	62	4,306	4
Totals	**256**	**1,991,255**	**1,678**	**7,778**	**7**

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Financial Data in Hungarian Forints, 000,000 Omitted

Total System Assets and Liabilities, by County

Data as of 31 December 1992

	Assets	Capital	Profit	Deposits	Loans	Due Froms
Baranya	7,293	322	99	5,734	3,052	2,174
Bacs	13,326	455	100	10,621	4,782	4,967
Bekes	7,080	380	135	5,433	3,206	1,553
Borsod	5,979	331	45	6,556	3,107	1,312
Csongrad	9,803	348	71	7,652	2,132	3,746
Fejer	5,408	212	22	4,200	2,075	1,857
Gyor	7,308	329	122	5,643	2,141	3,109
Hajdu	5,751	282	106	4,798	2,513	1,932
Heves	8,714	429	216	7,393	3,864	2,370
Komarom	4,956	209	41	3,303	2,973	530
Nograd	2,787	106	20	2,155	686	1,273
Pest	16,392	789	275	11,663	5,047	6,312
Somogy	4,796	214	39	3,791	1,600	1,666
Szabolcs	6,239	265	72	5,171	2,596	1,699
Szolnok	4,911	227	79	4,104	1,221	2,475
Tolna	4,846	250	55	3,764	1,116	2,514
Vas	2,963	140	40	2,182	1,310	937
Veszprem	3,140	118	77	2,068	1,381	637
Zala	4,009	241	74	3,127	695	2,282
Totals	**125,701**	**5,647**	**1,688**	**99,358**	**45,497**	**43,345**

Average Assets And Liabilities per Savings Cooperative Bank in each County

Data as of 31 December 1992

	Assets	Capital	Profit	Deposits	Loans	Due Froms
Baranya	810	36	11	637	339	242
Bacs	606	21	5	483	217	226
Bekes	708	38	14	543	321	155
Borsod	285	16	2	312	148	62
Csongrad	700	25	5	547	152	268
Fejer	773	30	3	600	296	265
Gyor	522	24	9	403	153	222
Hajdu	359	18	7	300	157	121
Heves	581	29	14	493	258	158
Komarom	708	30	6	472	425	76
Nograd	310	12	2	239	76	141
Pest	964	46	16	686	297	371
Somogy	369	16	3	292	123	128
Szabolcs	347	15	4	287	144	94
Szolnok	378	17	6	316	94	190
Tolna	303	16	3	235	70	157
Vas	370	18	5	273	164	117
Veszprem	285	11	7	188	126	58
Zala	251	15	5	195	43	143
Average for Country	**491**	**22**	**7**	**388**	**178**	**169**

Financial Data in Hungarian Forints, 000,000 Omitted

Financial Data in $ U.S., at HUF 79/ $1 (Average for 1992) , 000 Omitted

Total System Assets and Liabilities, by County

Data as of 31 December 1992

	Assets	Capital	Profit	Deposits	Loans	Due Froms
Baranya	92,316	4,076	1,253	72,582	38,633	27,519
Bacs	166,684	5,759	1,266	134,443	60,532	62,873
Bekes	89,620	4,810	1,709	68,772	40,582	19,658
Borsod	75,684	4,190	570	82,987	39,329	16,608
Csongrad	124,089	4,405	899	96,861	26,987	47,418
Fejer	68,456	2,684	278	53,165	26,266	23,506
Gyor	92,506	4,165	1,544	71,430	27,101	39,354
Hajdu	72,797	3,570	1,342	60,734	31,810	24,456
Heves	110,304	5,430	2,734	93,582	48,911	30,000
Komarom	62,734	2,646	519	41,810	37,633	6,709
Nograd	35,278	1,342	253	27,278	8,684	16,114
Pest	207,494	9,987	3,481	147,633	63,886	79,899
Somogy	60,709	2,709	494	47,987	20,253	21,089
Szabolcs	78,975	3,354	911	65,456	32,861	21,506
Szolnok	62,165	2,873	1,000	51,949	15,456	31,329
Tolna	61,342	3,165	696	47,646	14,127	31,823
Vas	37,506	1,772	506	27,620	16,582	11,861
Veszprem	39,747	1,494	975	26,177	17,481	8,063
Zala	50,747	3,051	937	39,582	8,797	28,886
Totals	**1,591,152**	**71,481**	**21,367**	**1,257,696**	**575,911**	**548,671**

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Average Assets And Liabilities per Savings Cooperative Bank in each County

Data as of 31 December 1992

	Assets	Capital	Profit	Deposits	Loans	Due Froms
Baranya	10,257	453	139	8,065	4,293	3,058
Bacs	7,667	262	58	6,111	2,751	2,858
Bekes	8,962	481	171	6,877	4,058	1,966
Borsod	3,604	200	27	3,952	1,873	791
Csongrad	8,863	315	64	6,919	1,928	3,387
Fejer	9,779	383	40	7,595	3,752	3,358
Gyor	6,608	297	110	5,102	1,936	2,811
Hajdu	4,550	223	84	3,796	1,988	1,528
Heves	7,354	362	182	6,239	3,261	2,000
Komarom	8,962	378	74	5,973	5,376	958
Nograd	3,920	149	28	3,031	965	1,790
Pest	12,206	587	205	8,684	3,758	4,700
Somogy	4,670	208	38	3,691	1,558	1,622
Szabolcs	4,387	186	51	3,636	1,826	1,195
Szolnok	4,782	221	77	3,996	1,189	2,410
Tolna	3,834	198	44	2,978	883	1,989
Vas	4,688	222	63	3,453	2,073	1,483
Veszprem	3,613	136	89	2,380	1,589	733
Zala	3,172	191	59	2,474	550	1,805
Average for	**6,215**	**279**	**83**	**4,913**	**2,250**	**2,143**

Financial Data in $ U.S., at HUF 79/ $1 (Average for 1992) , 000 Omitted

Total System Assets and Liabilities, by County

Data as of 31 December 1992

	Assets	Capital	Profit	Deposits	Loans	Due Froms
Baranya	92,316	4,076	1,253	72,582	38,633	27,519
Bacs	168,684	5,759	1,266	134,443	60,532	62,873
Bekes	89,620	4,810	1,709	68,772	40,582	19,658
Borsod	75,684	4,190	570	82,987	39,329	16,608
Csongrad	124,089	4,405	899	96,861	26,987	47,418
Fejer	68,456	2,684	278	53,165	26,266	23,506
Gyor	92,506	4,165	1,544	71,430	27,101	39,354
Hajdu	72,797	3,570	1,342	60,734	31,810	24,456
Heves	110,304	5,430	2,734	93,582	48,911	30,000
Komarom	62,734	2,646	519	41,810	37,633	6,709
Nograd	35,278	1,342	253	27,278	8,684	16,114
Pest	207,494	9,987	3,481	147,633	63,886	79,899
Somogy	60,709	2,709	494	47,987	20,253	21,089
Szabolcs	78,975	3,354	911	65,456	32,861	21,506
Szolnok	62,165	2,873	1,000	51,949	15,456	31,329
Tolna	61,342	3,165	696	47,646	14,127	31,823
Vas	37,506	1,772	506	27,620	16,582	11,861
Veszprem	39,747	1,494	975	26,177	17,481	8,063
Zala	50,747	3,051	937	39,582	8,797	28,886
Totals	**1,591,152**	**71,481**	**21,367**	**1,257,696**	**575,911**	**548,671**

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Average Assets And Liabilities per Savings Cooperative Bank in each County

Data as of 31 December 1992

	Assets	Capital	Profit	Deposits	Loans	Due Froms
Baranya	10,257	453	139	8,065	4,293	3,058
Bacs	7,667	262	58	6,111	2,751	2,858
Bekes	8,962	481	171	6,877	4,058	1,966
Borsod	3,604	200	27	3,952	1,873	791
Csongrad	8,863	315	64	6,919	1,928	3,387
Fejer	9,779	383	40	7,595	3,752	3,358
Gyor	6,608	297	110	5,102	1,936	2,811
Hajdu	4,550	223	84	3,796	1,988	1,528
Heves	7,354	362	182	6,239	3,261	2,000
Komarom	8,962	378	74	5,973	5,376	958
Nograd	3,920	149	28	3,031	965	1,790
Pest	12,206	587	205	8,684	3,758	4,700
Somogy	4,670	208	38	3,691	1,558	1,622
Szabolcs	4,387	186	51	3,636	1,826	1,195
Szolnok	4,782	221	77	3,996	1,189	2,410
Tolna	3,834	198	44	2,978	883	1,989
Vas	4,688	222	63	3,453	2,073	1,483
Veszprem	3,613	136	89	2,380	1,589	733
Zala	3,172	191	59	2,474	550	1,805
Average for Country	**6,215**	**279**	**83**	**4,913**	**2,250**	**2,143**

Financial Data in $ U.S., at HUF 79/ $1 (Average for 1992) , 000 Omitted

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Table D-3

Average Assets And Liabilities per Savings Cooperative Bank in each County

Data as of 31 December 1992

	Assets	Capital	Profit	Deposits	Loans	Due Froms
Baranya	10,257	453	139	8,065	4,293	3,058
Bacs	7,667	262	58	6,111	2,751	2,858
Bekes	8,962	481	171	6,877	4,058	1,966
Borsod	3,604	200	27	3,952	1,873	791
Csongrad	8,863	315	64	6,919	1,928	3,387
Fejer	9,779	383	40	7,595	3,752	3,358
Gyor	6,608	297	110	5,102	1,936	2,811
Hajdu	4,550	223	84	3,796	1,988	1,528
Heves	7,354	362	182	6,239	3,261	2,000
Komarom	8,962	378	74	5,973	5,376	958
Nograd	3,920	149	28	3,031	965	1,790
Pest	12,206	587	205	8,684	3,758	4,700
Somogy	4,670	208	38	3,691	1,558	1,622
Szabolcs	4,387	186	51	3,636	1,826	1,195
Szolnok	4,782	221	77	3,996	1,189	2,410
Tolna	3,834	198	44	2,978	883	1,989
Vas	4,688	222	63	3,453	2,073	1,483
Veszprem	3,613	136	89	2,380	1,589	733
Zala	3,172	191	59	2,474	550	1,805
Average for Country	**6,215**	**279**	**83**	**4,913**	**2,250**	**2,143**

Financial Data in $ U.S., at HUF 79/ $1 (Average for 1992) , 000 Omitted

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Legal Lending Limits, based on 12/31/92 Figures

Average Figures for County:	HUF 000 Capital	Lending Limit at : 10% Capital	15% Capital	$* Capital	Lending Limit at : 10% Capital	15% Capital
Baranya	35,778	3,578	5,367	452,883	45,288	67,932
Bacs	20,682	2,068	3,102	261,795	26,180	39,269
Bekes	38,000	3,800	5,700	481,013	48,101	72,152
Borsod	15,762	1,576	2,364	199,518	19,952	29,928
Csongrad	24,857	2,486	3,729	314,647	31,465	47,197
Fejer	30,286	3,029	4,543	383,363	38,336	57,505
Gyor	23,500	2,350	3,525	297,468	29,747	44,620
Hajdu	17,625	1,763	2,644	223,101	22,310	33,465
Heves	28,600	2,860	4,290	362,025	36,203	54,304
Komarom	29,857	2,986	4,479	377,939	37,794	56,691
Nograd	11,778	1,178	1,767	149,086	14,909	22,363
Pest	46,412	4,641	6,962	587,491	58,749	88,124
Somogy	16,462	1,646	2,469	208,374	20,837	31,256
Szabolcs	14,722	1,472	2,208	186,357	18,636	27,954
Szolnok	17,462	1,746	2,619	221,032	22,103	33,155
Tolna	15,625	1,563	2,344	197,785	19,778	29,668
Vas	17,500	1,750	2,625	221,519	22,152	33,228
Veszprem	10,727	1,073	1,609	135,788	13,579	20,368
Zala	15,063	1,506	2,259	190,665	19,066	28,600
	ERR					
Average for Country	22,059	**2,206**	**3,309**	**279,223**	**27,922**	**41,883**

*Financial Data in $ U.S., at HUF 79/ $1 (Average for 1992)

Table D-5

Statistics for Selected Savings Cooperative Banks Data as of 31 December 1992

	Assets	Capital	Profit	Deposits	Loans	Due Froms	Lending Limit at: 10% Capital	15% Capital
Szigetvar es Videke, in Baranya County, ten branches; current participant in HAEF microcredit program								
HUF 000,000 omitted	1,086	49	10	840	365	467	5	7
$ 000 omitted	13,747	620	127	10,633	4,620	5,911	62	93
Other savings cooperative banks identified by HAEF for inclusion in an expanded microcredit program:								
Komye es Videke, in Komarom County, nine branches								
HUF 000,000 omitted	605	21	8	395	305	100	2	3
$000 omitted	7,658	266	101	5,000	3,861	1,266	27	40
Belapatfalva es Videke, in Heves County, nine branches								
HUF 000,000 omitted	319	21	14	268	102	145	2	3
$000 omitted	4,038	266	177	3,392	1,291	1,835	27	40
Orkenyi, in Peste County, eleven branches								
HUF 000,000 omitted	1,112	48	12	904	312	529	5	7
$000 omitted	14,076	608	152	11,443	3,949	6,696	61	91

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ANNEX E

LIST OF MEETINGS AND PARTICIPANTS

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