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# Interpreting a Regional Knowledge Centre

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## SUMMARY

*The 21<sup>st</sup> century is the century of paradigm change, the century of the development of completely new structures, and of the rearrangement of the old ones. The exponential development trends reach points of breakthrough, and the earlier quantity accumulation of the changes turns into qualitative leaps. Contemporary times, the initial, very first period of which is our times, project the future image of a new society and economy, in which the material dimensions of products and services keep diminishing, the mass of knowledge accumulated in them keeps increasing, and the ratio of added value rises steadily. Large industrial centres look more and more like large research institutes, and the qualification level of the labour force used in the production of goods is steadily increasing. Their locations tend to get closer and closer to large university campuses, and all the features suggest a dramatic increase in the demand for knowledge. Knowledge centres come into being, and become more and more attractive for capital investors as well. In the 21<sup>st</sup> century it is the production, reproduction and distribution of knowledge that is worth investing in.*

The 21<sup>st</sup> century is the century of paradigm change, the century of the development of completely *new structures*, and of the *rearrangement of the old ones*. The exponential development trends reach *points of breakthrough*, and the earlier quantity accumulation of the changes turns into qualitative leaps.

There appear new growth paths of scientific-technological and social-economic development, the driving forces of which include

- *information technology revolution,*
- *biological revolution and,*
- *creating a living space outside the Earth.*

We can witness new events and phenomena that so far have only appeared in science fiction.

The 21<sup>st</sup> century is the century of *knowledge-based society*.

Knowledge has never before been such a decisive factor in the history of mankind, and now it has become a direct production force, a factor that is exclusive in determining development. It follows that the „*production of knowledge*” is becoming the most important “industry”, which implies that *lifelong learning* will become a fundamental condition for success, for carrier, for the livelihood of each and every individual.

The development of knowledge based society is an organic result of historical development, therefore I consider it important that we should recognise this objective tendency in a very early period, in the *embryonic form* of the phenomenon, in order to be among the first of those implementing it in practice.

In the course of my own examinations related to this field I elaborated a *historical development tendency*, together with a table summarising the factors of influence:

Table 1.

	<i>Age</i>	<i>Economic and political centre</i>	<i>Social foundation</i>	<i>Preferred capital investment</i>
I.	The Middle Ages	large estates in agriculture	agricultural society	investment in agriculture
II.	Modern times	industrial centres	industrial society	investment in industry
III.	Contemporary history	knowledge centre	knowledge based society	knowledge oriented investment

I. In the *Middle Ages* agricultural production ensured the economic power of the country, it played a decisive role in the then GDP, the population in active employment worked in the agricultural sector. This was where the members of the political and the management elite came from, and this was the most attractive and favourable area of capital investment.

*Large estates ensured wealth, power and carrier for individuals.* It is justified to consider this period to be that of the

*agricultural society.*

II. *The modern times* were the first really revolutionary period in technical-scientific and social-economic development. The industrial revolution pushed the section in the lower third of the exponential growth curve steeply upwards, which had an impact not only on production, but on every field of life as well. (This was the time when concerns about overpopulation first appeared in the history of mankind, let us just think about the tenets of Malthus, who claimed that epidemics and wars were the blessings of God to stop the rapid increase of the population.)

The real centres of the age representing economic-social power were *industrial centres*. The population left agriculture for the industry, and this sector was the origin of the masses of products and services representing the power and wealth of the nation; the demands of this sector induced scientific-technological development, this was where the members of the social and political elite came from. In terms of capital investment and capital attraction the industry offered the most favourable opportunities. It is justified to consider this period to be that of the

*industrial society.*

III. *Contemporary times*, the initial, very first period of which is our times, project the future image of a new society and economy, in which *the material dimensions of products* and services keep *diminishing*, *the mass of knowledge* accumulated in them keeps *increasing*, and the ratio of *added value* rises steadily. Large industrial centres look more and more like large research institutes, and the qualification level of the labour force used in the production of goods is steadily increasing. Their locations tend to get closer and closer to large university campuses, and all the features suggest a dramatic increase in the demand for knowledge. *Knowledge centres* come into being, and become more and more attractive for capital investors as well. In the 21<sup>st</sup> century it is the *production, reproduction and distribution of knowledge* that is worth investing in. This is

*knowledge based society.*

(There are debates in the social sciences about the definition of our age, and the definition as *information society* is also very frequently used. For our aspect – the aspect of a university – what is essential is that knowledge plays a crucial role in every interpretation.)

Consequently, *my image of the future in a long perspective* as related to the 21<sup>st</sup> century and projected to

the time horizon of the middle of the century is that a *Knowledge based Globe* will emerge, giving rise to tornado-like storms in the developing countries. At the same time the agenda of the decades to come will include meeting the demand for knowledge in the order of billions. Approximately four fifths of the population of the Earth live in these countries, with an almost complete lack of education infrastructure.

Tens of millions of teachers will have to be trained, hundreds of millions of demands for university education will have to be satisfied, staff for scientific and research work will have to be trained. This results in concrete future tasks for the University of Miskolc at least for a time horizon of ten years.

## REGIONAL KNOWLEDGE CENTRE

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Concerning domestic relations, this is a novel scope of issues, although it has been on the agenda in the European Union for years now – together with its novel features following from the theoretical deduction. Concrete implementation is surely to be expected at about the middle or the end of the decade.

Establishing a Regional Knowledge Centre will represent an unprecedented and un hoped for *widening of the sources of funding* for the universities: the so far single channel financing system (Ministry of Education) will be supplemented with new channels. They will include the development opportunities provided by the European Union, which will ensure a background infrastructure and practical venue for technological-scientific research that will create new opportunities for the universities that they have never experienced before.

The realistic nature of the idea is substantiated by international experience. I have given particular attention to the example of *Ireland*, in view of the fact that this country – which today is one of the best in the EU as regards development parameters – was in a rather unfavourable situation similar to ours not very long ago, and as for R&D activities, it is still looking for solutions. Their ideas may be good models for our country as well.

For the period 2000-2006 the following have been recommended:

- *creating a technological knowledge network,*
- *state-of-the-art research centres,*
- *supporting research co-operation between universities and the industry.*

The investment supporting policy *is encouraging foreign investors to settle in the vicinity of universities.*

In 1994-1999 outstanding significance was given to the development of Regional Technology Centres, and which is essential for our standpoint: *separate funds were created for university research.*

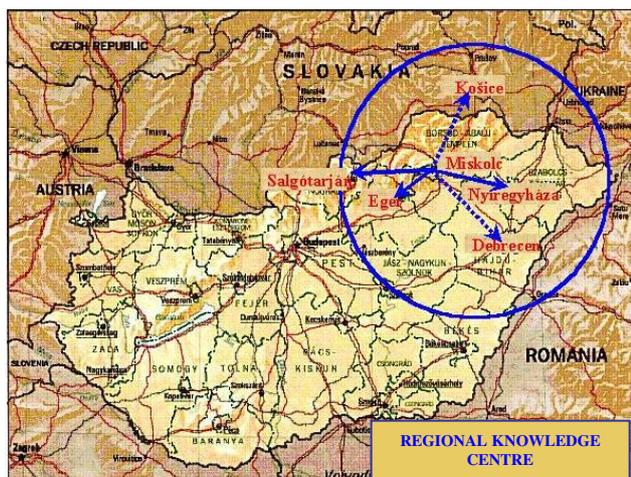
The Irish example is very convincing in verifying the correctness of our ideas and supports the fact that they interpret regional knowledge centres including the role of

universities in them in international practice in the same way as we do. (In terms of forecasting modelling we can say that – Hungary being a follower nation – the Irish adoption of the historical analogy is expedient and justified.)

How do I imagine the implementation of a Regional Knowledge Centre at the University of Miskolc?

## KNOWLEDGE CENTRE – SUB-CENTRE – PARTNER CENTRE

The following map gives a visual idea of the venue of our activities.



In my interpretation

*the Regional Knowledge Centre of Northern Hungary has as its central unit the University of Miskolc, with the connected sub-centres (colleges) in Eger, Gyöngyös and Salgótarján.*

According to European Union interpretation, a region means an area across borders, at the same time a wider interpretation within a country is also to be taken into consideration. (This is all the more true because the so-called statistical regions to be implemented at present will divide the country into 6 areas, however, we are aware of the “dissatisfaction” of the EU, which says that the regions are too small and Hungary should be divided into 3 regions. In this way Northern and Eastern Hungary would belong into the same region.) For the University of Miskolc the *University of Debrecen* is in all cases a strategic ally, and without and against which we could never achieve real results in the long term.

The centre of the region across the border is *Kosice*, Northern Hungary and Eastern Slovakia are natural geopolitical allies, it would be a mistake to talk about a knowledge centre without them after Hungary’s accession to EU.

Thus our *partner centres are Debrecen and Kosice.*

In the line Kosice-Miskolc-Debrecen we have to establish the *Strategic Alliance of the Partner Centres*, and define

within that the *strategic leading roles* of the individual centres.

This will require thorough consideration, negotiations and elaboration, however, it cannot be doubted that the *University of Miskolc* will have to play a strategic leading role in

- *engineering earth sciences (mining),*
- *materials sciences (metallurgz),*
- *some fields of information technology and mechanical engineering,*
- *political and legal sciences,*
- *economics and*
- *some fields of the humanities (e.g. cultural anthropology, early and classical ages, etc.)*

The *University of Debrecen* possesses unchallenged strategic leading role in

- *health sciences,*
- *natural sciences,*
- *certain fields of the humanities,*
- *in fields of agricultural sciences.*

After getting to know the research fields of the University (Universities) of Kosice, it will be possible to determine the fields counting as their areas of strength.

The establishment of the strategic alliance of the partner centres will prepare the way to satisfy the requirements at the middle or end of the decade. The member countries of the European Union are laying greater and greater emphasis on creating strategic alliances in business life, in which they see the most flexible form that can best adapt to fast changes and recommend it also for small and medium-sized enterprises. This is also making its appearance in the market for knowledge production.

*Summing up what has been said so far:*

The development of a knowledge centre is an *objective necessity* entailed by the economic-social and scientific-technological development.

In the decades to come the global competition will basically concentrate on the *renewable human capital*, and the *knowledge* resulting from it, and the ratio of products with a high added value will increase.

Thus

### *Knowledge/Learning Regions*

will come into being, where valuable, highly trained labour force,

### *knowledge workers*

will be concentrated.

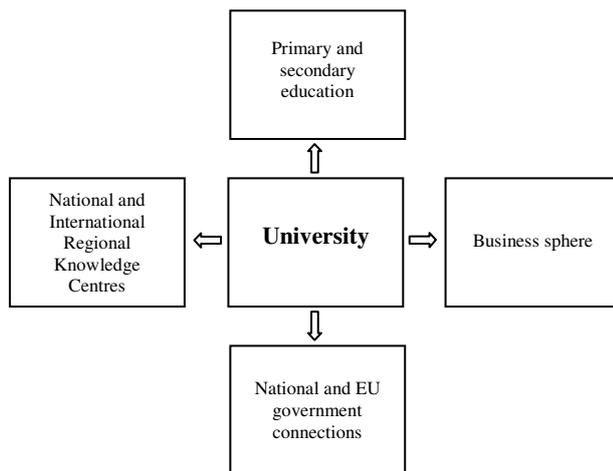
By the end of the decade, the Regional Knowledge Centre, with the University of Miskolc as its central element, will have been developed and strengthened.

The centre will attract of itself and direct the sub-centres (Eger, Gyöngyös, Salgótarján) in the professional-scientific fields. Within the regional system of connections it will form a strategic alliance with the partner centres of Kosice and Debrecen.

## INTERPRETATION AND STRUCTURE OF THE REGIONAL KNOWLEDGE CENTRE OF NORTHERN HUNGARY

The *central unit* of the knowledge centre is the *University of Miskolc*, where the intellectual capital is concentrated, which drives the centre itself, directs and coordinates the elements connected to it.

With some simplification, I imagine the structure of the knowledge centre according to the following scheme:



In my view there are four sub-systems connected to the university:

### a) *Primary and secondary education*

The education system of the region has to constitute an integral whole, with the different levels connected organically to each other. The current compartmentalisation is harmful in many respects, with the pupils and students suffering the most of the negative effects. Developing the smooth *transitions* between the individual levels and their practical implementation are the most essential requirements, which naturally requires harmonisation between the curricula as well. (After the expected modifications in public education this will have the legislation background also guaranteed.)

### b) *Business sphere*

It is an essential factor concerning the strength and viability of the Knowledge Centre. The *outputs* arising from here provide orientation for the university, and enhance the infrastructure of research and academic programs. They receive the effects coming from university research as *input*.

*Small and medium sized enterprises* do not have the capital necessary for technological-scientific research; they need a professional organisation providing *research service*, where they can purchase the required intellectual products, and where they can give orders related to their own professional fields.

The *role of the state* is considerable in this, and forms an organic part of the *Regional Development Programs*. The research and development background has to be realised with government support, but the operation will be based on own resources.

Thus the *University* will find a *favourable market* for its product of knowledge while indirectly contributing to the development of small and medium sized enterprises.

The experience of several small countries proves that large multi-national companies typically leave their technological-scientific research in the countries of their origin and small countries come sooner or later to realise that their small and medium size enterprises have to create the R&D background by establishing regional knowledge centers. Ireland, as mentioned above, is definitely going in this direction.

The first signs of the necessity of the university-business sphere connection have already appeared, and small and medium sized enterprises, various economic lobbies, chambers and societies raise the issue with increasing urgency that there should be an R&D infrastructure created in the vicinity of the university that will ensure for them the completion of research, development and measurement work required for marketability and competitiveness. The quantity of this work is such that individual enterprises cannot complete it on their own. So far the material and organisational background of these demands has not been formulated, however, the establishment of the Regional Knowledge Centres will create them.

In the system of connections between the business sphere and the university *the production and distribution of knowledge* receive new interpretation and reality. The university takes into consideration the requirements of the business sphere, even undertakes to elaborate curricula in specific programs, incorporates in university education the opportunity to acquire practical knowledge necessary for efficient work and at the same time the development of university education and of the academic-research infrastructure becomes a direct practical need.

### c) *Government and EU connections*

In the years to come, concerning the funds arriving in Hungary and meant for development purposes some worries have already been formulated: we may have doubts as to whether there will be “absorbing channels” through which we will be able to use the funds available to us, that is whether we will be able to take advantage of the opportunities.

The fundamental objective of harmonising the community and national policies of the European Union and Hungary is social and economic cohesion and its instrument is the *Structural Funds*.

The mission of the Structural Funds is to

„*moderate the regional inequalities of the community, to promote lasting and sustainable development.*”

Its objectives include

- promoting the development and structural transformation of regions lagging behind in development (this includes region a per capita GDP below 75% of the EU average),
- supporting the economic and social transformation of regions struggling with structural problems,
- assisting in the use and modernisation of educational, training and employment policies and systems.

I will neglect elaborating further details, it can, however, be estimated that in the years to come an annual amount of 20-30 billion HUF will be available for national development purposes and from which – based on the objective of the Structural Funds Funds – *our region and university* may obtain a significant share.

All the conditions are given for a substantial part of the assistance to come to us.

*The basic requirement is that there should be well-prepared complex projects, that the Regional Knowledge Centre should be created, that regional development and university development should form an integral whole.*

All this also means that in the history of our university and in that of Hungarian higher education it will be *the first time* that a concrete organisation is established in which the university plays the role of *financial reception point*, where *the material-financial funds of regional development are the sources for the scientific and technological development of the university at the same time.*

#### *d) National and international Regional Knowledge Centres*

The eastern border of the European Union and the development of the professional–scientific chain of connections within the country are intellectually organically connected to the *partnership relations* required and expected by the EU. We have to be aware that by European standards, Hungary and within in the six regional are an extraordinarily small geographical and economic unit. This applies even more to Slovakia.

The individual Regional Knowledge Centres have to be significant even by European standards and we have to find the strong points of the individual centres at European level. This makes it justified that in the chain of partner centres of *Kosice-Miskolc-Debrecen* the individual centres should have their own outstanding values and the organisational forms and frameworks should be provided for. The *mobility and connections* between the centres as well as the *joint program developed on the basis of the joint objectives* will create new opportunities that will further enhance the economic-scientific power of the centres and the universities leading them.

The connections along the border, the joint programs are already very popular today and in many cases represent the criterion for winning certain grants. In some years - around 2006 – the chain of centres will be of great importance for the then members of the EU and the countries outside the EU waiting for accession in another few years' time.

The Regional Knowledge Centre interpreted in the above mentality will provide *a completely new development path for the university*, which will offer the following novel advantages over the developments so far:

- the complex, many-sided relations between the university and its surroundings based on mutual advantages with the unambiguous leading role of the university,
- the enrichment of the financing channels of university academic and research work, in addition to current „single channel” system (Ministry of Education) a multi-channel system will develop in which academic programs and research work are not isolated but appear as parts of an „enterprise” producing knowledge and determining economic-social development .

In order to show the significance of what has been said so far I wish to mention that between 2004-2006 the funds for development purposes coming from the structural funds are expected to be around 1300 billion HUF.

*All this incurs enormous opportunities and enormous responsibility* for university managements.

## Összefoglaló

A XXI. század a *paradigmaváltás* évszázada, merőben *új struktúrák* kialakulásának, a *régiek átrendeződésének* az évszázada. A XXI. század a *tudásalapú társadalom* százada, a „*tudástermelés*” a legjelentősebb „ágazattá” válik, s ehhez kapcsolódóan az *élet hosszíig tartó tanulás* minden ember számára a siker, a karrier, a megélhetés alapvető feltétele lesz. A *legújabb kor*, amelynek kezdeti, legelső szakaszában vagyunk, egy új társadalom és gazdaság jövőképét vetíti előre, a *termékek és szolgáltatások anyagi dimenziói* egyre *zsugorodnak*, a bennük felhalmozott *tudástömeg* egyre *növekszik*, a *hozzáadott érték* aránya folyamatosan emelkedik. A nagy ipari központok egyre inkább nagy kutatóintézetekre hasonlítanak, a javak előállítására felhasznált munkaerő képzettségi szintje egyre emelkedik. Elhelyezkedésük jellemzően egyre közelebb kerül a nagy egyetemi campusokhoz, minden jellemző a tudás iránti igény ugrásszerű növekedésére utal. *Tudásközpontok, tudáscentrumok* jönnek létre, melyek egyre vonzóbbak lesznek a tőkebefektetők számára is. A XXI. században már a *tudástermelésbe, újjátermelésbe és elosztásba* lesz leginkább érdemes befektetni.

## Резюме

XXI столетие век изменений парадигм. В этом столетии формируются новые структуры, а старые переформируются. XXI век - это век знаний в обществе, отрасль любознательности станет одной из самых мощных отраслей. Для каждого человека учение на всю жизнь станет основным критерием достижения успеха, карьеры и существования.

Самый новый век, в котором мы сейчас живём демонстрирует для нас новое экономическое и общественное будущее, в котором увеличивается часть добавленной стоимости, которая добавилась с помощью знания. Большие промышленные центры переформируются в научные центры, а уровень рабочей силы работающей в этих центрах неизменно растёт. Эти центры знаний станут привлекательными для инвесторов, которые с удовольствием вкладывают в них деньги. В XXI столетии наиболее выгодно будет вкладывать в производство, воспроизводство и распределение знаний.

# Using VAR to Determine the Value of a Company

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## SUMMARY

*This paper deals with one particular basic problem of discounted cash flow methods, and one of their possible solutions. the most accepted company evaluation method determines the market value of an enterprise to estimate the incremental cash flows from the operation (free cash flow), then to discount them with the weighted average cost of capital (WACC), which fits to the risk of the company operation. The problem occurs, when we should like to determine the weights for WACC calculation, because theoretically these weights are the market value of capital elements – among them the market value of equity, so we should know the result before the calculation. This dilemma cannot be solved in the frame of discounted cash flow methods, therefore alternative company methods – first of all – the option pricing model – emerged. However the application of option pricing models come together also with serious problems, that’s why the authors offer another methods to solve the dilemma – the application of VAR methods. This method is presented by the case of Elmü Rt – which is the largest electricity utility in Hungary.*

## INTRODUCTION

The methods of the company valuation can be classified into 6 groups. (Fernandez, 2002; page 1): methods based on balance sheet, methods based on income statement, mixed methods, methods based on value creation capacity, methods based on option pricing and methods based on discounted cash flows. Theoretically those methods are „fair” among these, which are based on discounted cash flows, since these meet the general value principle, respectively „every asset’s value is equal to the present value of their operating cash flows.”

In equation:  $GPV = \sum_{i=1}^n \frac{CF_i}{(1+r)^i}$

where, GPV – internal value of particular asset (Gross Present Value);  $CF_i$  – amount of Cash Flow  $i$ ;  $r$  – hurdle rate adjusted by the risk of cash flows;  $n$  – life span of particular assets.

I only list the other methods, since these are not „fair” theoretically, but they are used in wide range due to the problems of discounted cash flow method discussed later. The calculation of these methods is simpler than the methods based on discounted cash flows.

The main groups of company evaluation and the major methods are shown the table 1.

Table 1. Overview of company evaluation methods

Based on balances sheet	Based on income statement	Mixed (Goodwill)	Value creation	Discounted cash flows	Option pricing
Book value Adjusted book value Liquidation value Market value	Sales multiplier P/EBITDA Other multiplier	Classic Adjusted profit Other	APV EVA Economic profit CFROI	Free cash flow Equity cash flow Dividend yield	Black and Scholes Investment options Enlargement option Investment delay option

(Source: Fernandez: page 2.)

## WHAT ARE THE PURPOSES OF COMPANY EVALUATION?

The value of a company is not an objective one. The value is different for the buyer and the seller. There are several reasons, why the value of a company is willing to determine. The most important ones are the followings: (Wiesenrieder, 2002; page 10)

1. In case of takeover:
  - It tells the buyer, what the maximum price is for the company.
  - It tells the vendor, what the minimum selling price of the company is.
2. Valuation of registered companies:
  - The company value per share can be compared with the price of the share.
3. Share issues:
  - Determining the price of issued shares.
4. Transformation and liquidation
  - The book value of new company's assets mirrors the real value.
5. Applying incentives based on value creation
  - The appraisal of company or division is vital, if the managers are rewarded on the incremental value caused by them.
6. Determining the value drivers
  - The company evaluation model encourages identifying and optimizing the main value drivers.
7. In case of strategic decisions on company survival
  - The value appraisal precedes the decision on selling, amalgamating or taking over a company or merging with an other one.
8. In case of strategic planning:
  - The company evaluation is vital, if we make decisions, if we keep or liquidate a division.

Below we deal with the discounted cash flow methods, since these are in accordance with the general value equation. On the other hand, we need some benchmark to employ other evolutionary methods, but the Hungarian economy offers rare opportunity for that due to its small size.

## DISCOUNTED CASH FLOW METHODS

The common characteristic of these methods is to estimate the operating cash flows produced by the company in future and to discount them with the hurdle rate adjusted by the risk of that operating cash flows. In that view the company is a cash producing machine and the value of the company is equal of the present value of this cash stream. (Price Waterhouse, 1999; page 122)

The discounted cash flow methods are based on the detailed, careful estimation of that factors (sales, operating costs, change in working capital), which

influence the cash flow. The determination of each item needs appropriate hurdle rate, that's why one of the most important tasks is to select this rate.

## GENERAL APPROACH OF DISCOUNTED CASH FLOW

The various discounted cash flow methods begins with the following equation:

$$V = \sum_{i=1}^{n-1} \frac{CF_i}{(1+r)^i} + \frac{V_n}{(1+r)^n},$$

where V – value of the company; CF<sub>i</sub> – operating cash flow of the company in year i; r – hurdle rate adjusted by the risk of operating cash flow; V<sub>n</sub> – value of the company in year n.

However it seems to be in first sight, that the above equation considers the future stream of cash flow only in a certain period, this is not absolutely true, and since the scrap value of the company (V<sub>n</sub>) can be calculated with the equation of perpetuities. Supposing an incremental perpetuity, we get the value of a company in year with the help of the following equation:

$$V_n = \frac{CF_n \cdot (1+g)}{r-g},$$

where V<sub>n</sub> – scrap value of company; C<sub>f<sub>n</sub></sub> – company operating cash flow in year n, r – hurdle rate; g – annual growth rate of operating cash flow.

The various discounted cash flow methods diverge, how they calculate the cash flow, the discounted cash flow and the scrap value.

## IDENTIFYING THE APPROPRIATE CASH FLOW

The discounted cash flow methods define three cash flows. Their names and the related hurdle rates are shown by table 2.

*Table 2. The company cash flows and the related hurdle rates*

Cash flow	Hurdle rate
Free Cash Flow	Weighted Average Cost of Capital
Equity Cash Flow	Return On Equity (r <sub>e</sub> )
Debt Cash Flow	Return on Debt (r <sub>d</sub> )

The cash flow of debt is the annual debt service of liabilities (amortization and interest). To determine the present value of debt, we should discount the debt service with the return on debt – which is mostly the interest rate of debt. This method gives us the book value of debt in case of market rate debt. However the present value of debt is less than the book value, if the rate of debt is less,

than the market rate, thus it's create wealth for shareholders.

The managers are tending to enhance their company over their optimal size. The enlargement increases the power of managers, since it raises the scope of controllable resources. This enlargement is in strong correlation with the managers' salaries. (Murphy, 1985, page 16)

If the company hasn't got enough internal sources, to finance this enlargement, the managers often borrow the required cash. The borrowings increase the company capital leverage over the optimal level, which reduces the shareholders' value. An exact company evaluation helps to detect this agency problem and force the management to act for the benefit of shareholders.

So let's look, how the discounted cash flow methods measure the company wealth!

## FREE CASH FLOW

Free cash flow is the incremental cash inflow, which the company produces after financing all investment opportunities with positive NPV. The free cash flow is a taxed cash income comes from the operation of company which excludes the effect of borrowings. This is the extra cash, which is available for the company after

+ Net Sales, other revenues
- Cost of Sales
= Gros Contribution
- Overheads
- Other expenditures
+ Amortization of goodwill
<b>= Earnings Before Interest Taxes and Amortisation (EBITA)</b>
- Corporate Tax on EBITA
<b>= Net Operating Profit Less Adjusted Taxes (NOPLAT)</b>
+ Depreciation of operating fixed assets
± Change in working capital
- Operating investments
<b>= Free Cash Flow (FCF)</b>
- New investments
= Cash Flow before Financing

financing its investments in fixed assets and working capital, supposing, that the company is unlevered hence it hasn't got interest expenditure. The interest conflict between shareholders and managers is extremely strong, when the firm produces meaningful free cash flow. The managers always tend to keep the money to enlarge their power, while the shareholders want an extra return above their hurdle rate. How can we stimulate the managers to pay the cash as dividend and not to invest it below hurdle rate!

To calculate the free cash flow, we should forecast the amount of the cash inflow and cash outflow in certain periods. The financial accounting doesn't give us this value directly; as the accounting employs operating view, not cash one.

The deduction of free cash flow is shown by the enclosed Figures. We should clear the operating profit from the goodwill, as the goodwill is the amortization of market value, which we should determine. After the deduction of corporate tax from the operating profit enhanced with the

amortization of goodwill, we get the net operating profit after taxes (NOPLAT), from which the expenditure devoted for supplemental investments should be deducted. The depreciation of operating assets should be added to NOPLAT. The final result is the free cash flow, which we discount. (Price Waterhouse, 1999; page 67)

## THE METHODOLOGY OF COMPANY EVALUATION

In company evaluation we tried to set up the trend of company variables analyzing the five years actual figures. We have used the data from period between 1998 and 2002, as the last audited report at the paper preparation was the one of 2002.

We have chosen the following method to determining the free cash flow of the company:

1. We determined the main factors influencing the sales of Elmü. We worked on the basis of the customer segmentation presented by the firm's annual report. The Elmü committed the quantity and revenue from electricity sold to each segment. Based on this, we calculated the unit price applied in each segment. In the estimation of future sales we considered the trend of electricity sales to each segments, and the price increase as well. The unit price increased was determined to multiply the current unit price with the forecasted future inflation multiplier.
2. In case of bought electricity we multiplied the whole quantity with the future inflation multiplier. We don't consider that the state gives meaningful subsidy through the Hungarian Electricity Works and this subsidy should be canceled after the joining to the EC. Furthermore the entitled customers can choose another supplier after the liberalization. We supposed, that the electricity supplier can pass the price of purchased electricity to the consumers, so the price margin remains unchanged, furthermore the entitled consumers could be kept.
3. We forecast a staff reduction in the following years according to the detected trend in the five year data.
4. The other operating costs and the working capital were determined in the proportion of sales and we forecasted them with the help of last actual figures.
5. To forecast the depreciation, we needed the size of fixed assets and the average depreciation rate. We supposed a moderate increase in the depreciation rate, as the proportion of assets, which require quicker depreciation, will increase due to the result of investments in the information technology. We estimated the size of fixed assets in proportion of net sales supposing a moderate increase in asset turnover.

Table 3 contains the free cash flow of Elmü. 5 years' figures are fact, the remainders are budget. We have chosen the Elmü, because the forecast of big utilities may

cause the smallest problems, as the customer potential is given, which modifies the changes in technology and market to a minimal extent. However the planned liberalization and the free electricity purchases of entitled

consumers can change this situation in future and the competition comes together with the volatility increase of free cash flow, thus with the increase of risk.

Table 3. The shape of Elmű free cash flow

	Actual					Free Cash Flow								
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	Budget			
											2008	2009	2010	2011
Operating Cash Flow														
<b>NOPLAT</b>	6 954	7 934	9 713	6 758	10 041	11 603	12 522	13 427	14 267	15 077	15 925	16 820	17 766	18 764
Depreciation	8 702	9 470	10 428	11 592	12 177	12 238	13 433	14 466	15 504	16 456	17 381	18 358	19 390	20 480
<b>EBITDA</b>	15 656	17 404	20 141	18 350	22 218	23 841	25 955	27 894	29 771	31 533	33 306	35 178	37 155	39 244
Increase in working capital	6 064	1 098	33	-2 302	5 521	358	310	311	285	277	293	310	327	345
Investments	-13 482	-14 250	-15 208	-16 372	-16 957	-17 018	-18 213	-19 246	-20 284	-21 236	-22 161	-23 138	-24 170	-25 260
Gros Investments	-7 418	-13 152	-15 175	-18 674	-11 436	-16 660	-17 903	-18 935	-19 999	-20 958	-21 868	-22 828	-23 843	-24 914
<b>Free Cash Flow</b>	8 238	4 252	4 966	-324	10 782	7 182	8 052	8 959	9 773	10 575	11 438	12 350	13 312	14 329

## THE WEIGHTED AVERAGE COST OF CAPITAL

After estimating the future value of free cash flows, especially paying attention to the scrap value, we should find an appropriate discount rate, which is in direct proportion with to the their risk. The teaching book formula of discount rate determination is the weighted average cost of capital, whose calculation is made by the following equation:

$$WACC = r_e \cdot \frac{E}{D+E} + r_d \cdot \frac{D}{D+E}, \text{ where}$$

- $r_e$  – expected yield of equity;
- $r_d$  – expected yield of debt;
- $E$  – net market value of equity;
- $D$  – net market value of debt.

The calculation of expected yields is made by the following equation (considering the tax shield of interest expenditure.)

$$r_e = \frac{Div_0 \cdot (1+g)}{P_e} + g, \text{ where}$$

$$r_d = \frac{I \cdot (1-T_c)}{P_d}$$

- Div0 – dividend paid in time 0 (thus now),
- $g$  – long term growth rate of dividend,
- $I$  – interest rate of debt,
- $T_c$  – corporate tax rate (or the tax advantage of debt over equity),
- $P_e$  – net market value of one share in proportion of its nominal value,
- $P_d$  – received amount of debt in proportion of its nominal value, or the net market value of bond in proportion of its nominal value.

If the capital markets are efficient, the expected yields of capital structure elements are risk adjusted, thus their average is the appropriate discount rate. However we meet difficulties calculating the WACC.

1. In case of capital elements calculation we should consider only the interest or dividend bearing sources, hence the non-interest bearing liabilities are deducted from the current assets. There is not clear answer, how to handle the short term loans, whose interest expense can be deducted from free cash flow or can be considered in the calculation of WACC. In the latter case the free cash flow shouldn't be deducted with the interest expenses of short term loan.
2. We shouldn't consider the book value of capital elements, as the investors expect return not for the book value, but the market value of debt and equity. The market value of equity is not available before calculating the market value of the company. But the company evaluation requires the WACC calculation – if we appraise the company based on discounted cash flows.
3. The calculation of market value of capital elements may happen with the help of CAPM model, however it requires, that the debt and equity of the company are registered in the Stock Exchange; furthermore the market of capital elements should be efficient. In that case there would be no need to make company appraisal, since the stock exchange itself make it.
4. The determination of long term dividend yield is strongly subjective, further problem is, and that the expected return of equity is very sensitive to this yield.
5. Due to the retained profit or newly issued debt for investments the weights may change in the future. Furthermore the market yields are also tending to make rapid changes.

## OPPORTUNITIES TO AVOID THE PROBLEMS EMERGED BY USING WACC – APPLYING THE OPTION PRICING MODEL

An alternative way of company evaluation is the application of option pricing model. The model sets out from the recognition, that the equity of a legal entity is a call option, which is written out by the lenders of the company for the owners of the company, who can buy the company for the future value of loans. The owners would call the option, if the value of company assets is higher, than the maturity value of loans. In this case they get the difference between these two values. If the value of loans is higher, than the value of assets, the owners don't call the option, thus the company goes to the property of lenders during the liquidation process. The value of equity in function of asset value is shown by Figures 2.

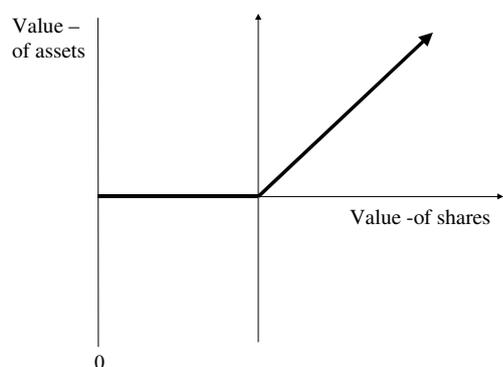


Figure 2 The value of company shares in function of value of company assets

If the shares are call options, the option pricing model tell us the value of shares and therefore the value of the company. Five parameters should be given to the Black-Scholes option pricing model. Table 4 shows the input parameters required by the option evaluation.

Table 4. Parameters required appraising the value of shares

Parameters	In case of financial underlying asset	In case of company shares
S	Price of underlying asset	Value of company asset
X	Exercise price of option	Maturity value of debt
$\sigma$	Coefficient of variation of asset price	Coefficient of variation of operating cash flow
T	Maturity of option	Maturity of debt
$R_f$	Risk free rate	Risk free rate

We need the value of assets for applying the option pricing. This figure is came from the discounted cash flow method, so the option pricing cannot solve the problems emerged by using WACC. The method can be

applied, if the assets' value can be directly evaluated. The following condition should be meeting for that: (Hull, 1999; page 426)

1. A wide secondary market of assets should exist, which makes possible the direct appraisal.
2. The synergy effect should be negligible, so the value potential of human resources should be small in the given sector.
3. The maturity of debt should be identical.

## COMPANY EVALUATION BASED ON VAR

The VAR means the scope of risk in forint at given period and given significance level. If the VAR of an investment is – let's say – 150 million HUF at significance level of 95% and in 10 days, it means, that the value of the investment won't decrease by 150 million HUF in 95 cases from 100 during 10 days. The big advantage of VAR method is to express the bearing risk of an investment directly in forint. The method is used by financial service providers to determine their risk exposure and capital requirements.

Our idea is to use the VAR method for determining the value of a company. The main point of our method, that we determine the value of a company as a difference with two factors. We suppose, that the operating cash flows of the company are risk free, thus we get their present value, it we discount them with the risk free rate. From this value we deduct the risk exposure determined by the VAR method, and then we get the value of a risk bearing company.

The way of calculation in our proposed solution is the following:

1. We estimate the free cash flow produced by the company for the foreseeable period similar to the discounted cash flow method.
2. We discount the free cash flow with the yield of long term T-bond with appropriate maturity. Mostly the yield of T-bond with 15 year maturity can be offered, since the duration of that is closest to the potential life time of the firm. The sum of discounted cash flow will be the value of the company without considering the risk.
3. We fit a regression curve to the actual and budgeted cash flow figures, and determine the standard deviation of residuals, which consider as the measurement of risk. We choose the standard deviation of residuals to query the trend effect. An alternative way to determine the risk can be, if we determine the standard deviation of free cash flow of various scenarios using sensitivity analysis or Monte-Carlo simulation. The latter method produces better result, but requires detailed knowledge about the economic circumstances of the firm, thus it can be applied in risk appraisal made by internal specialists.

4. After calculating the risk, it should be examined, if the residuals have got normal distribution or not. As generally few data are available, the Shapiro-Wilk test may be offered. Regarding to the fact, that the factors influencing the company free cash flow have generally normal distribution, we can suppose the normal distribution of residuals as well.
5. Then we choose a significance level, which is appropriate for the risk averse of investors. Let's say this should be 95% in our example. Then we depute the variables into the equation of VAR (Jorion, 1999; page 96):

$$VAR = -W \cdot \sigma \cdot \alpha \cdot \sqrt{T},$$

where

- W – the value of the company discounted with the chosen risk free rate,
- $\sigma$  – the coefficient of variation of free cash flow,
- $\alpha$  – the value of z test appropriate to the significance level,
- T – the number of forecasted years (if the forecasted free cash flows are annual ones).

The VAR calculated with the above equation should be simple deducted from the company value calculated with the risk free rate.

## THE VALUE OF ELMÜ USING THE VAR METHOD

In case of Elmü, we get the followings:

The function of fitted regression line to the Elmü free cash flow is the following:

$$Y = 2121 + 428 \cdot x.$$

The standard error of parameter „a” is 1198, thus we can't deny the hypothesis at significance level of 95%, that the theoretical value of “a” is not 0. The standard error of parameter “b” is 124, thus we can state at significance level of 95%, that its value is positive. The graph of actual and budgeted figures of free cash flow is shown by Figures 3.

million HUF **Actual and budgeted operating cash flows and the regression line**

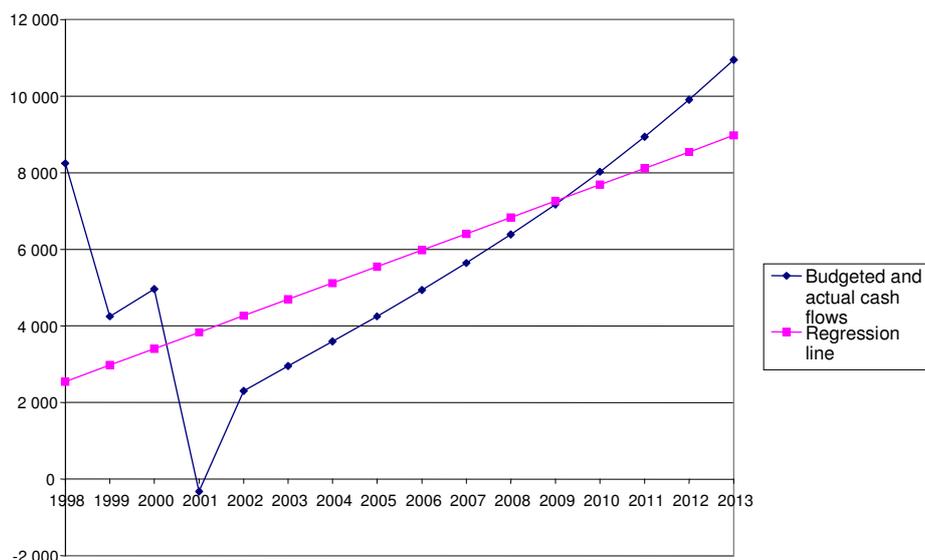


Figure 3 The free cash flow and its regression line

The standard deviation of residuals is 2206. Consequently the coefficient of variation is 1,89%. The time period is 15 years. Supposing, that the investors should like to hedge their risk in 95%, the appropriate value for alpha is 1,64. Deputing it to the equation of VAR, we get the following risk exposure:

$$VAR = 116.421 \cdot 1,89\% \cdot 1,64 \cdot 15^{0,5} = 14.014 \text{ million HUF.}$$

Deducting this sum from the value of the company, we get the risk adjusted company value, which is 102.406 million HUF.

The advantages of our proposed method compared with the discount cash flow methods are, that we can avoid the

above mentioned problems related to WACC calculation. However applying the VAR model to the company cash flow has got limitations as well:

1. The determination of the significance level doesn't lack the subjective elements. Consequently the method is not an objective one. It gives different results for different investors. This is not drawback by all means; hence the other company evaluation methods also give various results depending on different forecasting, expectation and researcher.
2. The uncertainty of method emerges mainly from the estimation of risk. The statistically correct applying of equation requires three conditions.

- a. The trend fitted to the free cash flows should strongly correlate the actual figures.
- b. The residuals should be independent, with normal distribution and zero expected value.
- c. Furthermore we need enough data to diminish the standard error of our estimation.

The current case doesn't meet any of the above mentioned conditions that are why we can worry, if the coefficient of variation derived from this model perfectly mirrors the risk. We need more statistical data or better risk map to find a more suitable

measure of risk. However an external researcher has rarely the opportunity to make such analysis.

3. The estimation of standard deviation comes mainly from forecasted future figures, which may distort the result. The budgeted figures don't contain the scrap value, but its value also reflects high risk.

Nevertheless we think that it worth preparing the company evaluation based on VAR method, and it has got a place as an alternative approach among the company appraisal methods.

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## Összefoglaló

A cikk a diszkontált cash flow módszerek egy alapvető problémájával és annak egy lehetséges megoldásával foglalkozik. A legelfogadottabb vállalatértékelési módszerek úgy határozzák meg egy vállalat piaci értékét, hogy megbecslik a vállalat működéséből származó többletpénzáramot (szabad pénzáram) és ezt diszkontálják a pénzáram kockázatának megfelelő elvárt hozammal (WACC). Azonban, mikor meg akarjuk határozni a WACC súlyait, már tudnunk kellene a vagyonelemek értékét, ami nem áll rendelkezésünkre. Ezt a dilemmát próbálja meg feloldani a cikk, a VAR módszerek alkalmazását javasolva a kockázattal kiigazított vállalati érték meghatározásához.

## Резюме

В статье описывается одна из основных проблем дисконтирования методом cash flow и возможность решения этой проблемы. Всеобщие принятые методы стоимости фирмы определяют рыночную стоимость фирмы следующим образом: примерно определяют излишек свободного денежного потока от деятельности предприятия и эту сумму денег дисконтируют с рискованным потоком ожидаемой доходности (WACC). Когда мы пробуем определить удельный вес WACC, нам необходимо было бы уже знать составные элементы стоимости предприятия, которыми мы к сожалению не обладаем. Эту проблему пробует решить автор в данной статье, предлагая использовать методы VAR, которые более точно определяют стоимость фирмы, так-как они включают в себя и рискованные выправления.



# Change by Successful Projects - IT and Change Projects in Hungary

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## SUMMARY

*The article's attempt is to answer the management and organizational questions arisen about Hungarian change projects. The objectives of my research\* were to uncover special areas concerning change management and reengineering projects and to investigate the conscious, organizational change for improving performance in the Hungarian economic environment.*

*An effective change project cannot be reached without an IT support, requiring the demands of the age, because it plays an important role either in analyzing preparations of decisions, or in the realization of the change. The development of informatics in Hungary shows some deficiency both in the aspect of quality and in reliability. The imperfect development of informatics ruins the effects of changing projects. In general, though it depends on the nature of the project and the kind of work you do; you might have to engage in a variety of tasks you haven't tackled before, such as assembling a team to complete the project on time and on budget, mapping out a plan and monitoring your progress at key steps along the way, using appropriate planning tools such as project management software or wall charts and keeping your team motivated and on target.*

*In the research special Hungarian characteristic features were emphasized and a methodology of process change project was created regarding the domestic circumstances. New and original statements were made, which deal with the achievement of change, the role of information technology, objectives and results of change projects in Hungary.*

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## INTRODUCTION

Reengineering was looked at some new curiosity by management science in the first part of the last decade, but since then it has found its place in the management theories thanks to the continuous improvement and to the fact that companies take a growing interest in it nowadays.

The dramatic increase in performance and effectiveness, and the intervention plans are topical activities for all who lead changes consciously in Hungary. The fast advance of the transnational and international companies also contributed to the increasing use of reengineering in practice, which must be focused on.

To investigate this topic in the domestic practices is a noble goal. In the empirical research various research instruments were used: a survey by questionnaires, case studies, interviews in Hungarian companies and organizations. The objective of them was to find and collect the domestic specialties, failures, results and effects.

In the research the special Hungarian characteristics were emphasized and a change management methodology was created regarding the domestic circumstances.

Furthermore new and original statements were made, which deal with the achievement of change, the role of information technology, objectives and results of reengineering and the role of reengineering in Hungary. In general, reengineering is present together with other approaches (e.g. TQM) or as part of it in practice in our country.

## METHODOLOGY BASED ON RESEARCH

Similar to most of the management innovations, the Business Process Reengineering also went through the hardships of a chaotic experimental phase. As soon as the companies recognized the significance of the BPR projects the advisors were ready to fulfill the need with „proved” methods.

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With the development of BPR many models evolved abroad. These models are adjusted to the conditions and characteristics of certain regions or countries and of course cannot be applied successfully to other places.

However, the failure is not because of the method, but in most cases because of the implementation. Moreover, the method does not show all the break-through, it only helps to find a radical change leading to competitiveness. The methodologies are the highest levels of problem solving methods. Methodology is the combination of problem solving principles and problem solving methods (Checkland 1981). The method carried out in this study is a series of set steps and activities leading to the required result.

## THE METHODOLOGY OF BPR PROJECT

After the analysis of many international and well known methodological approaches applied by consultants - with respect to both the common and country specific characteristics – a new project was born that can be applied in Hungary as series of methodological steps. The steps can be used as phases of a project in practice. Each level means a milestone in the project and all the levels can be further itemized. Table 1. contains the steps and the main tasks of the project.

*Table 1. Steps of the Reengineering project (based on the research)*

<i>Steps</i>	<i>Tasks</i>
<b>1. Preparation</b>	<ul style="list-style-type: none"> <li>• Recognizing the need for changes</li> <li>• Forming the leading guiding committee</li> <li>• Vision, general aims</li> <li>• Forming the team responsible for planning</li> <li>• Team development, team education</li> <li>• Accepting the operation model of the modification</li> </ul>
<b>2. Situation inquiry, identification of processes</b>	<ul style="list-style-type: none"> <li>• Detailed determination of the customers' demand</li> <li>• Identification of processes</li> <li>• Determining the business strategic needs</li> <li>• Initial success</li> <li>• Preparing the flow chart</li> </ul>
<b>3. Understanding and analyzing processes</b>	<ul style="list-style-type: none"> <li>• Understanding the structure of processes and procedures</li> <li>• Determining the value of increasing activities</li> <li>• Benchmarking</li> <li>• Problem solving processes</li> </ul>
<b>4. Aims of processes</b>	<ul style="list-style-type: none"> <li>• Assessing the opportunities</li> <li>• Detailed definition of aims</li> <li>• Approval of the leading committee</li> </ul>
<b>5. Planning new processes</b>	<ul style="list-style-type: none"> <li>• Structure of the new process</li> <li>• Analyzing the demand of information</li> <li>• Choosing the appropriate alternative</li> </ul>
<b>6. Technical planning</b>	<ul style="list-style-type: none"> <li>• Technical planning</li> <li>• IT planning</li> <li>• Defining the establishment</li> <li>• Introduction plan</li> </ul>
<b>7. Planning of human resources</b>	<ul style="list-style-type: none"> <li>• Determining the tasks and labor demand</li> <li>• Determining the needs for management and directing</li> <li>• Planning the new organization and sphere of activity</li> <li>• Communication of changes</li> <li>• Education plan</li> <li>• Planning the changes of the system of incentives</li> <li>• Planning the temporary organization</li> </ul>
<b>8. Implementation</b>	<ul style="list-style-type: none"> <li>• Continuous communication</li> <li>• Assessing the inclination to changes of the employers</li> <li>• Implementation of the technical planning</li> <li>• Education</li> <li>• Plans of control and implementation</li> <li>• Experimental introduction</li> <li>• Gradual or complete introduction</li> </ul>
<b>9. Assessment of the changes</b>	<ul style="list-style-type: none"> <li>• Analyzing and assessing the changes</li> <li>• Systematic research of further BPR opportunities</li> </ul>

The steps were planned as phases of a change project for a more successful practical use. (The author’s dissertation contains the tasks with complete details, which have to be prosecuted in each of the steps and the applicable techniques for change actions.)

Furthermore, there are plenty of techniques to apply. There is a system of criteria in each stage, which help to find the right technique. Table 2. contains the main groups of techniques and the system of criteria.

*Table 2. Main groups of techniques and system of criteria*

Techniques to apply	
Groups	Criteria of choices
1. Project management	a. Task according to its size and complexity
2. Teambuilding	b. Delimitation of the situation or operation inquiry
3. Analyzing the demand of the client	c. Setting different opinions
4. Fantasy – stimulating methods	d. Determining the direction of the inquiries
5. Problem solving and situation analysis	e. Forming the parameter of analysis
6. Operation analysis and modeling	f. Way of assessment
7. Efficiency calculations	g. Condition of application
8. IT analysis and planning	h. Contributory method
9. Organizational development	i. Characteristics of the quality system
10. Changing the behavior	j. Principle of comparison
11. Measuring and directing the process	k. Appearance of the quality system
	l. Dimensions of comparison
	m. Members of the analytical team

An effective change project cannot be reached without an IT support, requiring the demands of the age because it plays an important role either in the analysis preparing the decisions, or in the realization of the change.

## THE ROLE OF INFORMATION TECHNOLOGY IN THE PROJECTS

It can be generally stated that information technology (IT) can play an important role in the change projects. An enterprise that is not able to change its point of view concerning its information system cannot be successful in reengineering.

IT means new strategic possibilities for such organizations that reevaluate their mission and function. Automation can provide new products to sell for the organization. E.g. several airlines developed or brought to the market reservation systems that they passed over to travel agencies to make bookings. The same happens in the field of medicine wholesale in Hungary, where the ordering between distributors and pharmacies occurs via an online system. Information systems offer competitive advantage for societies as they have reduced the cost of workforce, have provided further information to the competition; and have helped to transform organizations in the interest of facing the changing environment more effectively.

The rapid progress changes the application potential of the reachable information technology, nearly from month to month. This includes the change of approach in what is possible or what will be possible in one or two years. In projects the application of IT has a direct benefit in the following areas:

- Helps the workout of the organization model with describing the organization or some of its parts, recording it in the documentation (Füstös, 1998)
- Helps in the optimal utilization of means and resources
- Can help in the workout, design, control, and documentation of work processes
- The organizational model(s), the work processes and the required devices can be assigned together
- Data and results of the processes can be recorded, and become part of the means of the global communication
- The adequate information is available anywhere and anytime
- The recording of information happens where it is originated
- Pieces of information can be related to each other that belong primarily not together
- Decision-preparation, helping, modeling, analyzing, and the graphical appearance of business processes are aids at all levels of the management
- The direct user becomes an important part of the process, the flexible device-system can offer a customized and situation fitting solution
- By the workout of relevant connection points, external information sources can be involved in the system easily, giving a proper base for the preparation of the strategic decisions.

Fine methodology and combination of IT means leads to great possibilities of process- improvement or reengineering. Until now, IT was taken into consideration only in case of processes’ automation. Some business processes were planned and analyzed with the use of IT possibilities. Actually, most of the business processes

were developed before the appearance of modern computers and telecommunication. On the other hand, e.g. the possibilities of Electronic Data Interchange (EDI) resulted totally new processes in the field of ordering from suppliers (e.g. ECR project of Unilever, Pátkai et al., 1999); distribution and marketing processes have been transformed in the wholesale trade stock-management. Indirect computerized diagnostic tools and telecommunication have changed some correction and maintenance processes. It is unquestionable, that IT can play a central role in the innovation of business processes, and it is difficult to reach significant improvements in performance without utilizing its potential.

However, domestic experiences in this field are rather mixed. In Hungary, up to now, it can also happen, that a large amount of enterprises use IT only for performing subtasks. It also happens that IT is fully forgotten, the representatives of this profession are not involved in the change and coordinating team. The reason for this is that the organization and the task it performs fall beyond the traditional manufacture and service processes, and are not viewed as part of the value-chain. Many high executives have a skeptical opinion about the work and efficiency of IT areas. Nevertheless, it is also a fact that this area is not able to show instant results, and the effectiveness of the investments is questionable. (Füstös, 1998)

## NEW FACES IN THE PROJECT TEAM

The duty of IT departments and professionals within Hungarian enterprises is highly transforming: in the future, they can be the initiatives or inventors of change, or part of the execution team. It is not efficient any more for the IT to interpret its duty as transforming the detailed description of activities into feasible systems. IT professionals should understand the business strategies of the organization as a whole. Only after it they will be able to utilize their technical skills in the interest of realizing the future purpose of the enterprise. IT managers have to organize instructional conferences for other managers about how IT could help to realize the strategy of the enterprise. In addition to all these, IT has to play a prominent part in developing flexible and massive infrastructure for the enterprise to meet the future challenges. This involves setting fundamental rules on standards, operating systems, data references, and other factors. IT will be judged increasingly by its value-addition ability, and not by its ability of process automation. IT function should develop an open way of thinking.

By change concerning the information technology, the following simple rules should be kept: on the one hand, the adequate staff must be provided from either outside or by educating the internal professionals. Their knowledge, capabilities, insight, and experiments mean invaluable

worth for Hungarian enterprises. On the other hand, it is absolutely necessary for this field to be involved in the continuous control system; and it is necessary also here to keep up with the recent solutions.

However, let us not forget that developing IT is only one part of the total solution, though it helps the management to collect, store and analyze data more effectively, to communicate more efficiently, and to distribute information in a better way. Successful application of information technology requires also the transformation of management- and organizational culture.

## CHANGE AND REENGINEERING PROJECTS BY THE HUNGARIAN ORGANIZATIONS

The most important statements of the research are the following:

1. The owners, following a conscious strategic behavior, take a primary and significant role as initiators of radical changing projects inside the organizations in Hungary. The cancellers co-operate especially in the planning and the realization of the change.
2. The leaders of the Hungarian companies grant less hard tools to decrease the resistance successfully. Consequently, the acceptance of changing is based on communication, arguing, training and discussion. On the other hand, threatening and manipulation are rarely used.
3. In Hungary there is a connection between the change of processes and the motivation system.
4. An effective change cannot be reached without support of informatics, requiring the demands of the age because it plays an important role either in analyzing preparations of the decisions, or in the realization of the change. The development of informatics in Hungary shows some deficiency both in the aspect of quality and reliability. The imperfect development of informatics ruins the effects of the changing projects.
5. The perfect IT developments add less countable, but very good results to the increase of the output. In connection with this, the level is widening among the employees, because their work is an integral part of the process and through them, their cooperation has influence on the whole project. The same work is required from them, than from other types of workers of the project. Consequently, the experts of informatics move from the role of a separate specialist to the direction of the expert of a heterogeneous group.
6. Not depending from the original aim – the change has an affect on other factors (aim, technology, processes, structure, people) of the company, too. In case of Hungarian companies the change projects

start with the aiming to change the structure and after they deal with the processes.

7. The decrease of the dealing levels realized by the reengineering – do not exist in Hungary.
8. Among the aims of the Hungarian reengineering projects the decrease of prices and the profit are the most important aims. The results appear in the area of market surviving, better financial checking and the exact information; less appears in the increase of the employees' level of motivation.

## UTILIZATION OF THE ACHIEVEMENTS OF THE RESEARCH

While the leading consulting companies' methods helped in the development of practical methods, only a few theoretical researches were done. This research concentrates on one hand on the Hungarian application of the project; on the other hand, it helps to the company leaders, too. The model gives a useful help in

preparations of action plans' steps and in technologies that require the demands of the project. If the company intends to do the change independently with the help of these results, it can use the consulting services to solve the upcoming problems. As a result of the research one thought comes to the surface: experts can help a lot in the success of reengineering-projects if they have appropriate abilities. This way, they can profit from the modeling, establishing of prototypes and planning area.

The achievements of the research can be utilized in practice, in higher education and in further researches as well. The developed methodology can help towards project teams to fit with their mission and in building up a higher level of confidence in the reengineering process. Additionally, the attitude accepting change and continuous learning will increase in the corporate culture. The key statements and theses of the research can act as guidelines for further research and practice as well.

The picture of the ideal change project changes itself, but methods and technologies of the present research, can be a good basis of the further experiences.

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## Összefoglaló

A cikk megkísérli azon szervezeti és vezetési kérdésekre megtalálni a választ, amelyek a magyar változtatási projektek kapcsán felmerülnek. Kutatásom célja volt felfedni azokat a speciális területeket, amelyeket a változtatás menedzsment és a reengineering projektek érintenek, továbbá megvizsgálni azokat a tudatos szervezeti változtatásokat, amelyeket a magyar gazdasági környezet teljesítményének javítása érdekében hajtottak végre. Hatékony változtatási projekt nem hajtható végre a kor igényei által megkövetelt IT támogatottság nélkül, mivel mind a döntés-előkészítésben mind a változtatás megvalósításában fontos szerepet játszik. Magyarországon az informatika fejlesztése a minőség és a megbízhatóság területén is komoly hiányosságokat mutat. Az informatika tökéletlen fejlődése a változásmenedzsment hatásait lerontja. Általában, bár ez a projekt természetén és az általunk végzett feladat típusán múlik: esetleg olyan feladatokkal találhatjuk magunkat szemben, amelyekkel eddig nem találkoztunk, pl. egy olyan csapat összeállítása, aki időben és a költségkereten belül kivitelezzi a projektet, terv kidolgozása és a folyamat kulcslépéseinek nyomon követése a megfelelő tervezési eszközökkel, mint például a project menedzsment software, valamint a project team motiváltságának fenntartása. A kutatásban a speciális magyar jellemzők kaptak hangsúlyt, és a folyamatváltoztatási projekt módszertana került kialakításra a hazai körülményeknek megfelelően. Új és eredeti megállapítások születtek, amelyek a változás megvalósításával, az információs technológia szerepével, a célokkal és a magyarországi változtatási projektek eredményeivel kapcsolatosak.

## Резюме

Статья пробует найти ответ на те управленческие и структурные вопросы, которые появились в видоизменённых проектах. Цель данного исследования найти те специальные сегменты, которые касаются изменяющегося менеджмента и реинжиниринга проектов. В дальнейшем статья исследует также те сознательные изменения в структуре предприятий, которые возникли в силу повышения производительности венгерской экономики.

В исследованиях нашли своё отображение специальные венгерские атрибуты, описана методология изменения процесса, а также их основные черты. В статье описаны новые определения, которые связаны с осуществлением изменений, роль информационных технологий, целями и венгерских изменений процессов.

# Enterprises in Hungary from a Global Perspective – The Examination of Strategical Possibilities and Threats

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## SUMMARY

*Publications dealing with globalisation have paid relatively small attention to the fact how to influence the sphere of enterprises this process so far. In our study – after clearing up some concepts and contexts we analyse which strategic possibilities and threats globalisation means for small-sized, medium-sized and large enterprises operating in Hungary. During the empirical research we determine the competition position of these enterprise groups, new elements of the global competition perceived by them, more important categories of followed strategies, and the organisational and relationship system of the enterprises, and where we can, we expound comparison with adequate data of earlier surveys.*

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## INTRODUCTION

The thesis, that perspectives and possibilities of growth in the developing market economies are in a positive relationship with the process of globalization taking place at present in the world economy can be proven easily.

The activities of multinational and global enterprises are behind this process, which has been analyzed by a number of people from a number of viewpoints. However, we know less about the fact what effect the gaining of ground of global enterprises has on the operation of the enterprises in Hungary or whether they help or inhibit their access to global markets, with what advantage or disadvantage they compete on a world scale, with what strategies and success they respond to global challenges and what kind of changes take place in the organizational and relationship system of national enterprises.

It is easy to utter axiomatically the conditions of success on the level of the strategic theory of enterprises –after all who would not know that the issue is the reformation of the product (the service process), the market, the human factors and processes -, but it is much more difficult to realize it in practice.

The present study, which was prepared within the framework of the *István Széchenyi Scholarship* makes an attempt to sketch the enterprise context of globalization. It summarizes the major statements of domestic literature closely connected to the set of questions. It sketches the conceptional model of the research project and describes its assumptions. By means of the enterprise sample it

presents in detail the results of the empirical investigation and draws its conclusions.

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## EARLIER EMPIRICAL RESEARCH PROJECTS AND THE LATEST SURVEYS

The interest towards the enterprise connections of globalization in this country in recent years is indicated by the surveys conducted by questionnaires ever more frequently, which were seeking information exploring the situation in the following five central areas:

- export of capital,
- competitiveness,
- entrepreneurial activity,
- company management system,
- information technology.

We summarize briefly the results of these empirical investigations in Table 1. and here we dispense with their detailed presentation because of limits of size.

We wish to utilize the most important statements of more significant empirical research projects carried out in Hungary in the era of globalization in the course of the determination of the main goals of the present research project and/or comparative evaluation of the results obtained.

## THE GOALS OF THE RESEARCH PROJECT

Before sketching the goals of our present empirical research project we are going to make a short mention of our book, which could be regarded as the theoretical foundation of the research project. A significant portion of the textbook entitled „Global enterprise strategies” is about the contents, types and special analytical methods of these strategies. The theoretical message of the book, in addition to the above, has also been taken into consideration during the determination of the research goals.

The basic goal of the research project is to investigate in what form and to what extent do the effects stemming from globalization, as the determining characteristic factor of our age effect the enterprises in Hungary; i.e., to clarify how the consequences stemming from globalization are tolerated and/or what strategic alternatives they have for these challenges.

Within this context the research project wishes to find an answer to the following four questions:

1. Do the globalization and performance attained so far of domestic enterprises makes the immediate access possible for them to the global market?
2. How can the enterprises handle those problems, which arise from the fact that new elements of global competition have appeared such as quality, consumer orientation, production capacities becoming increasingly more important, technologies and life style becoming increasingly more individualized, which has an effect on shopping habits?
3. What strategies have the enterprises developed related to utilizing the opportunities offered by the globalization process and/or in order to avoid the more serious risks of this process?
4. What new questions are posed and/or what new problems to be solved are induced, given the differing organizational abilities and enterprise cultures, the development of the global connections of enterprises operating in different regions?

The provision of an exact answer to the above questions is facilitated by the conceptual model of the research project.

*Table 1. The research projects in Hungary in connection with globalization*

<i>The researchers</i>	<i>The area of research</i>	<i>The sample</i>	<i>The results</i>
<i>Chikán, Czakó and Mrs. Zoltay (1996 and 1999)</i>	Competitiveness	325 and 319 middle-sized enterprises	The <i>competitiveness</i> of the group of enterprises investigated has <i>improved</i> significantly between the two survey periods. <i>The adaptation to the market relations</i> developed has played a leading role in this. For this group of enterprises to be able to get ahead <i>the acquisition of resources needed for growth</i> means the biggest problem.
<i>Makó (2001)</i>	Enterprise management system	75 multinational enterprises operating in Hungary	The experiences warn about the fact that the issue is such, relatively <i>new phenomena</i> appearing in the <i>management and labor utilization practice</i> of organizations operating in the national economy whose models can only be identified and characterized by means of <i>further systematic research</i> projects.
<i>Ács, Szerb, Ulbert and Varga (2001)</i>	Entrepreneurial activity	2000 adult inhabitants, 36 experts	Summarizing the result it can be concluded that the domestic enterprises are basically <i>walking along the right path</i> and under relatively <i>favorable environmental conditions</i> it can be hoped that <i>they will stand their ground</i> in the world among the circumstances of increasing globalization and primarily also subsequent <i>to our joining of the European Union</i> .
<i>Antalóczy and Éltető (2001-2002)</i>	Export of capital	22 domestic firms registered on the stock-market	Taken everything together because of the complexity of the factors <i>it is difficult to predict the evolution of Hungarian capital investments</i> abroad. In the short run the continuation of the present trend is likely, although the realization or delay of a one or two major project will also continue to significantly influence the processes of the export of capital.
<i>Losoncz (2002)</i>	Informational technology	Small, medium-sized and large enterprises	<i>The worldwide phenomenon of globalization does not have to be mystified</i> : getting to know various effects and mechanisms may also dispel a number of misunderstandings. The time is not far when the <i>application of business solutions based on the Internet does not mean a competitive advantage, but puts an end to a competitive disadvantage</i> in the Hungarian enterprises, i.e., it will be a necessary but by no means sufficient condition of competitiveness.

## THE CONCEPTIONAL MODEL OF THE RESEARCH PROJECT

The conceptual model of enterprise research strives to take into consideration the key factors of global thinking, more precisely those of the formation of global strategy and direct data collection and analysis in accordance with this.

The main factors of the model shown in Figure 1 and their connection can be described in the following way:

- The model has the hypothesis that the enterprise process is launched by two important set of factors which are in close relationship with each other: in one of them the external environmental factors or driving forces are lined up, while the other one is determined by internal conditions.
- According to the model for thinking in global business the reformation of the enterprise along three dimensions is needed. For successful realization of this the enterprise has to compare, according to particular points of view, its products, markets and people and processes with those of its competitors. It has to determine what the internal strengths and weaknesses of the enterprise are and it has to identify the external opportunities and threats of global competition.
- It can be seen in the conceptual scheme presented in Figure 2 that in case the comparison of the opportunities and threats of the global market with the strong and weak points of the enterprise has taken place, the opportunity presents itself for the formation of a strategy in accordance with this.
- A new element of the logical process is related to the introduction of the strategy, in the course of which the enterprise has to pay attention to the fact that the strategic agreement should be realized as much as possible. The enterprise structure, the management of operations and the systems of connections plays a major role in this.
- The conceptual model of the research project reflects the fact that in the formation of the process of global thinking evaluation plays an important role. The value of the global strategies can be analyzed by the enterprises from two sides. On the one hand they can summarize the potential advantages stemming from the application of strategies and on the other hand they can describe those circumstances, which can pose a risk in the course of following the strategies.

The main characteristic of the conceptual model described above is that both factors of the process contribute to the formation of the value (in other words the independent variable of the model) of the global strategy. The system of connections seen in Figure 1 presumably also has such other elements, which cannot be identified easily.

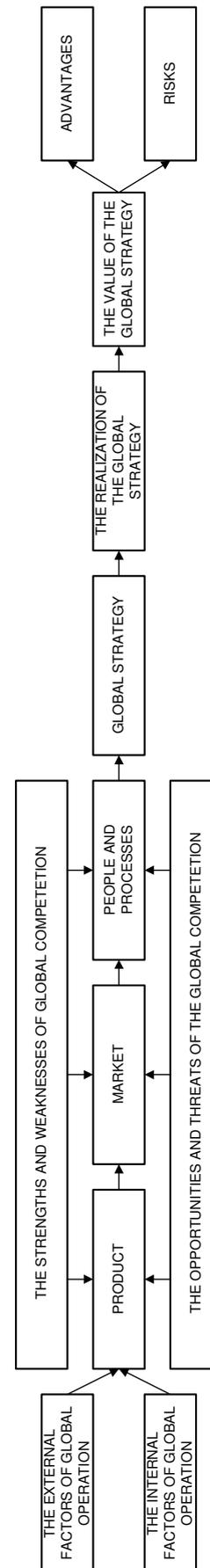


Figure 1 The conceptual model of research: the factors of the formation of global thinking/strategy

## THE RESEARCH METHOD AND SAMPLE TAKING

Because of the deficiencies of national statistical data and/or in order to be able to better judge the effects of globalization a survey based on a questionnaire was conducted.

The questionnaire of 12 pages directed at upper management consists of five parts:

1. The situation of the enterprises – the access to the global market
2. The new elements of global competition – the identification of competitive advantages and opportunities
3. The enterprise strategies and the value of enterprise strategies
4. The organization, operation and systems of connections of the enterprises
5. The statistical pieces of information pertaining to the enterprises featured in the survey

Small, medium-sized and large enterprises are featured in the sample. The selection of the enterprises took place on the basis of the 2001 data of the Central Statistical Office ensuring representation according to belonging to a sector, number of employees and ownership structure.

These categories were supplemented by other ones in the course of the analysis. Such category of analysis is still the age of the enterprise, the form of capital investment, the value of the equipment and stock of goods of the enterprise as well as the proportion of export and import from gross sales realized.

We succeeded in collecting questionnaires that could be evaluated from a total of 300 enterprises.

The processing of questionnaires and the completion of statistical investigations took place by means of the *Microsoft Excel* computer program.

## THE CHARACTERISTICS OF THE SAMPLE

Among the 300 enterprises featured in the sample 78 small enterprises, 114 medium-sized enterprises and 108 large enterprises can be found (Figure 2).

One quarter of the enterprises investigated deals with in the manufacturing of tools of production and consumer articles. 23 percent of them carry out mining, chemical industry, motor vehicle industry, energy industry and construction industry activities. The larger circle (52 percent) provides commercial, transportation-communication, financial and other services (for example hotel and tourism trade and real estate management).

The breakdown of the enterprises according to capital investment form is as follows: 52 percent is investment on a lot lacking any infrastructure (foundation of a completely new firm) and 48 percent is investment on a lot with existing infrastructure (the purchase of an existing firm). In our analysis the enterprise, which did not yet exist in 1990, can be regarded as established by means of investment on a lot lacking any infrastructure and the enterprise which was founded before 1990 by investment on a lot with existing infrastructure.

The enterprises were distinguished according to the ownership structure (private property is 85 percent; state-private property is 12 percent and state property is 3 percent) and the ownership origin (100% Hungarian ownership 55 percent; majority Hungarian ownership 9 percent; 50-50% Hungarian-foreign ownership 2 percent; majority foreign ownership 13 percent and 100% foreign ownership 21 percent).

The size according to value of equipment is characterized by the fact that 53 percent of the enterprises belong to the group above 500 million forints and 47 percent into the group under 500 million forints.

On the basis of the gross sales figure, even if by a small amount, the composition of the sample was shifted to the smaller firms.

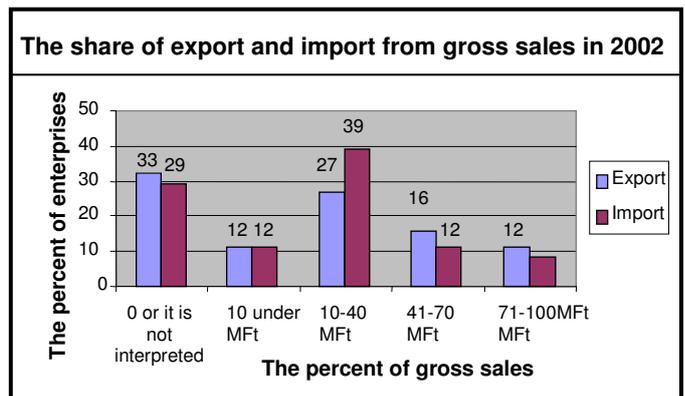
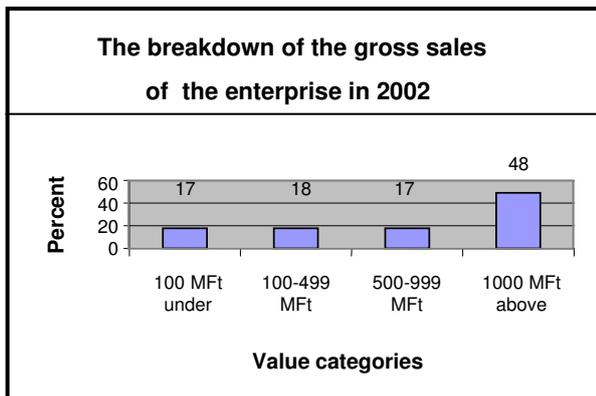
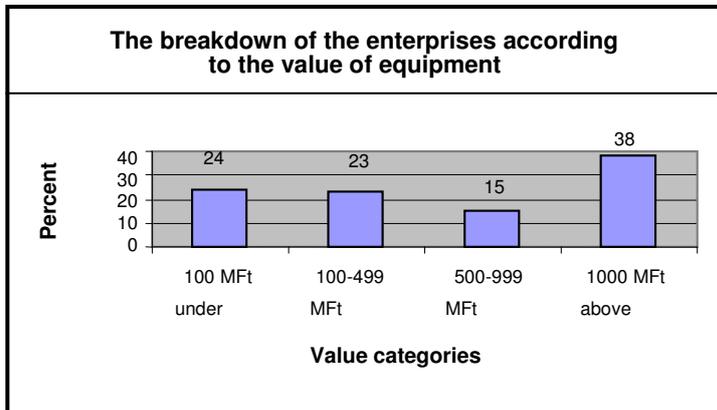
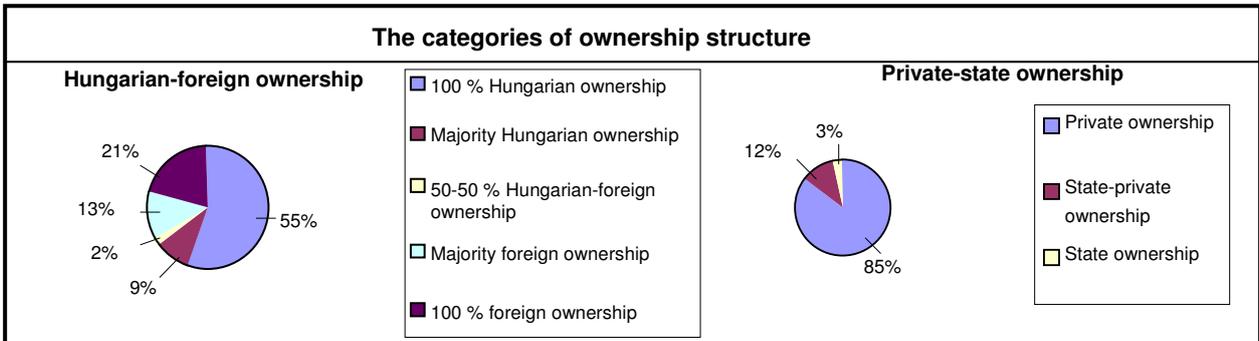
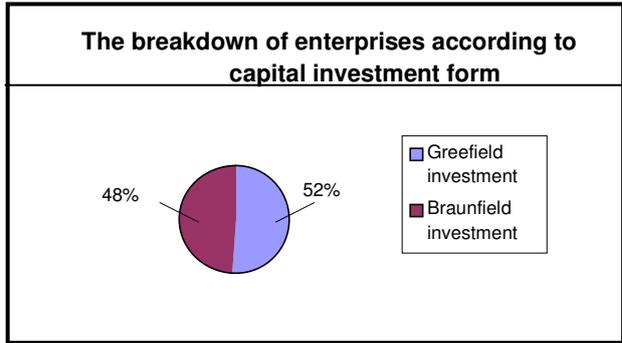
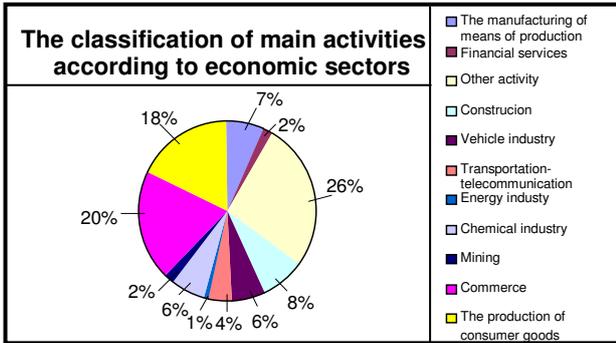
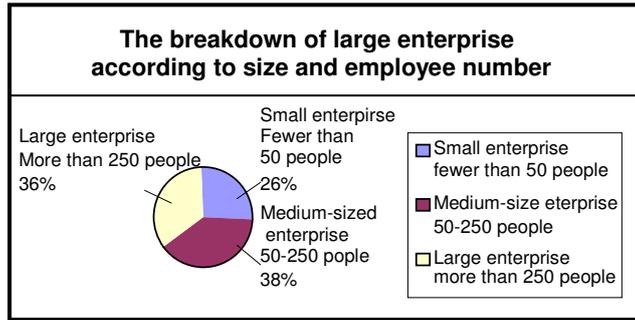


Figure 2 The composition of the sample

With regard to the proportion of export and/or import to gross sales it can be said that in firms where the proportion of export and import activities are under 40 percent of gross sales, the import is identical to export or exceeds it and where it is larger than that there the export gross sales are more significant.

The survey covered mainly the medium-sized and large enterprises. More than half of the enterprises featured in the sample are newly established firms and they are the properties of domestic private persons. This circle of enterprises tends to produce for the foreign market at present, which is increasingly interesting from a strategic point of view, since the factors of the development of the business world exercise a more direct influence on its operation and opportunities.

## THE CONCLUSIONS OF THE EMPIRICAL INVESTIGATION

We think that this research project has significantly enriched our existing knowledge about the question in what form and to what extent globalization has an effect on Hungarian enterprises, at the same time it has also made it possible to examine our enterprises not only in a combined form, but also in a comparison according to size categories. For drawing the conclusions of the empirical investigation the actual contents of the conceptual model serves as a reliable basis. Figure identifies the global economic process and factors of small, medium-sized and large enterprises in Hungary. According to these our statements are the following:

The survey has shown that by now several tens of thousands of domestic enterprises take part directly in the global system of connections, while several tens of thousands, although indirectly, depend on the developments of the globalization process. This has not only a modernization effect, but inevitably it also makes them part of the business trend effects. It strengthens the role of the external factors in the strategic decision making of the domestic enterprise sphere. In the case of large and medium-sized enterprises the most important factor is the growth of the pace of technical development and the cessation of the limits of international trade, while the formation of multinational networks also affects the small enterprises.

The self-evaluation of enterprise performance presents a relatively good picture. In comparison to the major foreign competitors the strength of large enterprises lies in close customer relations and good management, while

that of small and medium-sized enterprises in flexible satisfaction of demand and in skilled employees. Nevertheless in the majority of the enterprises the rate of being behind is still great, which is shown in small and medium-sized enterprises in low technical standard, market share and poor profitability, while the efficient operation of large enterprises is mainly hindered by the lack of information systems.

There are too many enterprises which do not know the new elements of global competition; the wide and standardized variety of products is important for medium-sized and large enterprises and the appropriate marketing knowledge and processes; for the small enterprises the reaching of the market of countries rich in basic abilities is of prime importance.

According to the survey an increasing proportion of enterprises (at present close to 20 percent) are developing a strategy for the utilization of global opportunities. The small enterprises compete with a defensive strategy with local or globalized products on the local market. The expansive and combative strategy appears in medium-sized or large enterprises with regional or globalized products for the regional and/or global market.

Upon the impact of globalization changes have occurred in the organization and system of values of the enterprises. The large enterprises are advancing towards flexible organizational forms, intuitive management and team-work; the small and medium-sized enterprises are striving for ensuring appropriate information and getting intuitive co-workers. Large enterprises facilitate the reaching of these goals by the application of the methods of cost reduction and the development of supplier networks, while the small and medium-sized enterprises apply the management methods of the intensification of the R+D activity.

The enterprises featured in the survey have perceived the advantages stemming from the pursuance of international strategies in getting new customers and in the utilization of basic abilities and skills in a new way. However, for us the risk posed for the enterprise from the admission of the candidate countries into the European Union is an enigma.

It is hardly doubtful that the globalization process has brought about rearrangements in the competitive conditions, system of activities, organization and strategic thinking of small, medium-sized and large enterprises in Hungary. It is a key question that in this process when, to what extent and by what methods do the enterprises realize the development of their strategy in accordance with globalization expectations.

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### Összefoglaló

A globalizáció témájával foglalkozó publikációk ez idáig viszonylag csekély figyelmet fordítottak arra, miként hat ez a folyamat a vállalati szféra. A szerzők tanulmányukban azt elemezték, hogy a globalizáció milyen stratégiai lehetőségeket és fenyegetéseket jelent a Magyarországon működő kis-, közép- és nagyvállalatok számára. Az empirikus vizsgálat során meghatározták a vállalatcsoportok versenyhelyzetét, az általuk érzékelt globális verseny új elemeit, a követett stratégiák főbb típusát, valamint a vállalatok szervezeti és kapcsolatrendszerét, és ahol lehet, ismertették a korábbi felmérések megfelelő adataival való összevetést is.

### Резюме

Публикации связанные с темой глобализации очень мало внимания уделяют такому вопросу, как процесс глобализации влияет на сферу предприятий. Авторы статьи анализировали то, как стратегические возможности и угрозы глобализации могут повлиять на действующие малые, средние и большие предприятия. Эмпирическое исследование определило, конкурентоспособность этих групп предприятий (концернов), новые складовые глобальной конкуренции, основные типы складовых этих конкуренций, а также структуру предприятий и их связь. Где можно было в исследованиях авторы статьи сделали сопоставление данных с исследованиями сделанными в прошлом.



# The Acceptability of Foreign Retail Chains by the Inhabitants of Slovakia

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## SUMMARY

*Consumer behaviour in choosing purchasing place is one part of reaction to changed sales circumstances after the year of 1989. The paper deals with brief development of retail market in Slovakia having in mind the penetration of foreign retail chains especially in forms of new supermarkets and hypermarkets. Changes in consumer behaviour are researched later in connection with the choice of purchasing place. In the range of five years it analyses the existing dependences from the point of view of information availability and popularity of individual retail chains. The article is supported by VEGA Grant project No. 1/1266/04.*

*Key words: retail, foreign retail chains, research of information availability and popularity.*

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## INTRODUCTION

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In their research work more slovak authors deal with problems of transformation of retail structures and further implantation of foreign sales chains under the circumstances of Slovakia (Viestová, Strážovská, Štensová, Štofilová). The monography with the title “Theory and practise of retail policy” (Viestová a kol. 2003) gives the theoretical frame to this problem. The mutual interest of more authors in factual problem leads to solving research grant project of MŠ SR Vega č. 0108/96 under the leadership of Štensová during the years of 1996 - 1998 under the title: “The development of retail forms under the circumstances of the SR” and the grant project 1/7179/20 under the leadership of Viestová during the years of 2000 - 2002 with the title: “Theory retail policy of transformative economies”. Quiet a big importance is devoted in Slovak specialized literature to problems of implantation and marketing of retail chains. Lieskovská (2001) deals with globalization and its influence on retail development. Lieskovská (2002) deals with consumer behaviour and distinctiveness of retail market. The change of consumer behaviour is connected with implantation of foreign sales chains. Chosen problems of consumer behaviour of inhabitants of East Slovakia region were analysed by Lieskovská and Gazda (2003, b). The field of using payment cards in the same region is dealt in the article of Lieskovská and Gazda (2002) and leaflet campaigns in retail are dealt with Lieskovská and Gazda (2003, a). Consumer credits and their place in retail of East Slovakia are dealt with (Lieskovská 2003).

It was inevitable to manage problems of statistics working of marketing facts while working on analyses of consumer behaviour. It was worked out in details by Rimarčík in the form of statistical navigator and in the article “On support of statistical marketing data processing” introduced by (Gazda 2003).

## 1. IMPLANTATION OF RETAIL FORMS ON THE SLOVAK MARKET

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About ten years ago we witnessed a market penetration of international retail sales chains into Central and Eastern Europe. The Slovak market entered the process of globalization in market by its liberal policy a little bit later than all the countries of V4. The situation was probably repeated for the last time in 2000, when in the first ten of sales firms there were eight firms with more Slovak capital and only two international ones. While in 2000 the first ten sales firms gained the turnover of 35.1 mld Skk (Slovak crowns) in 2001 the turnover reached 50.85 mld - it was an improvement by 44 %.

The conjuncture of multinational salesmen penetration into the group TOP 10 gained its high increase in the years of 2000 - 2001. In 2002 it started to culminate the total saturation of integrational activities of domestic salesmen, problems of multinational chains with bureaucracy and choice activities connected with settlement of properties, domestic lobby, under developed logistic infrastructure etc. In spite of this it is possible to say that quantitative expansion of foreign chains has not been finished. The evaluation of Slovak trade for 2002

showed the direction to quality of sales firms and assortment structures. In 2003, the number of international hypermarkets increased by 7. Even so the TOP ten firms were not changed, their positions stayed firm not only due to sales strategy, but also thanks to the fact that more international competitors were not implanted. Retail chains placed in TOP 10 scored total turnover 57.48 mld Skk in 2002 and 75.8 mld Skk in 2003. Building and opening more hypermarkets, trade centres and supermarkets helped to this important shift. Number of functioning supermarkets at the end of 2003 was 204. In a more detailed research we have found that the share of firms with prevailing Slovak capital has changed in comparison with the previous year. Fig No 1 shows the factual rankings of retail firms in 2003.

Figure 1 TOP 10 of Slovak trade in 2003 - total turnover in milliards Skk.

Rankings	Name	2002	2003
1	Tesco	16,5	17,8
2	Metro	10,9	13,6
3	Billa	8,2	9,3
4	Kaufland	7,2	7,2
5	Carrefour	6,5	6,7
6	Hypernova	4,5	5,8
7	M-Market	4,4	4,8
8	Prima Zdroj	4,1	3,6
9	Baumax	3,7	4,4
10	Labaš	3,1	3,3

Source: Moderní obchod 2004

In spite of the fact that in rankings of TOP 10 Slovak trade for 2003 were mainly foreign sales chains, evaluation of TOP 50 for 2003 showed a large increase of share for co-operatives COOP Jednota Slovensko, SD. From the total number of 34 active members - 21 were placed in among the first 50 with the reached total turnover of approximately 30 mld. Skk.

Contemporary, there are more than 57 hypermarkets on the area of the SR. Even if floorage per one inhabitant of the SR does not reach the European level (average floorage per 1000 inhabitants is 434 m<sup>2</sup> in the SR, European average is 1000 m<sup>2</sup>), building of sales chains of hypermarkets and supermarkets fast reaches the standard of developed states. But it is not the same on the level of purchasing power of inhabitants and we suppose it will be like this for a longer period.

## 2. ANALYSIS OF CONSUMER BEHAVIOUR AT CHOOSING THE BUYING PLACE

In the research project we compared situation from the point of view of preference of the place of sale in 1997 (936 respondents) and further in 2003 (625 respondents). The questioned were people in East Slovakia region. We had 5 grade scales at our disposal and by means of it they

could express their preferences concerning the place of purchasing. 1 meant the highest preference, 5 means the lowest preference. On the base of individual average we gained the final evaluation, represented in Fig. No 2.

Figure 2 Comparison of purchasing place choice

Purchasing place	1997	2003
Department store	2,29	2,44
Sales centre	-	2,0
Hypermarket	-	1,96
Specialized store	1,98	2,35
Outlet store	2,60	2,98
Fleamarket	3,82	3,51
Abroad	3,84	3,74

As it can be seen from the above data, in 2003 the inhabitants of east Slovakia preferred at choosing purchasing place hypermarkets, followed by sales centers and the last places were taken by the possibilities of purchasing at flea market and in abroad. In the time of research the inhabitants can choose form these relatively new possibilities of purchasing: hypermarket TESCO, sales centre of CASSOVIA - hypermarket Carrefour sales centre of OPTIMA - hypermarket Hypernova, Kaufland. In the further research (in 2003) we tried to find the information availability and popularity of consumers toward various firms performing in Slovak retail market. Respondents expressed themselves in scales from 1 - very well informed (favourite), 2 - well informed (favourite), 3 - neutral attitude, 4 - partly not informed (partly unliked), 5 - not informed (unliked). Then we did the average and we gained the ranking shown in Fig. No 3.

Figure 3 Information availability and popularity of individual sales places

Sales places	Information availability	Popularity
Tesco	1,894	1,885
Billa	2,342	2,405
Baumax	2,626	2,741
Baťa	2,929	2,734
Jednota	2,084	2,258
Carrefour	2,729	2,324
Kaufland	3,397	2,980
Metro	3,183	2,734
Hypernova	2,411	1,945

As it can be seen from the above data the highest information availability, concerning the firms and their sales places, is the highest for firms functioning on the Slovak market for a longer period of time. They are: Tesco, Jednota and Billa. The lowest information availability was, at the time of research, about the sales places of Kaufland. It was connected with their dates implantation in the East Slovakia markets and as well as with the fact that growing phase of sales places of Kaufland was just before us. The popularity was the

highest with Tesco, Hypernova and Jednota. The lowest one - on for contrary - Kaufland, Baťa and Metro. The base of the further research was to test hypothesis concerning relationship of demographic characteristics (sex, age, employment, education, average monthly income per one household member and the permanent address of respondents) and their information availability and popularity of individual firms. By means of Main effect Multivariate Analysis of Variance (Main effect

ANOVA) we tested statistical significance between averages of individual groups.

To be complete we show in Fig. No 3 and 4 the most statistical important differences in evaluation of information availability and popularity of individual sales firms from the point of view of gender, age, occupation, education, place of living and income. Thick figures represent statistical significance of studied parameters at the level of significance 0.05 and 0.01.

Figure 4 Statistically significant differences in information availability of respondents

	Gender		Age		Occupation		Education		Place of living		Income	
	F-Ratio	Prob	F-Ratio	Prob	F-Ratio	Prob	F-Ratio	Prob	F-Ratio	Prob	F-Ratio	Prob
Tesco	0.64	0.4228	<b>2.83</b>	<b>0.037</b>	1.69	0.1505	2.50	0.058	<b>5.32</b>	<b>0.0012</b>	<b>6.90</b>	<b>0.0002</b>
Billa	0.12	0.7319	0.34	0.7966	<b>4.16</b>	<b>0.0024</b>	2.33	0.0732	<b>22.18</b>	<b>0.0000</b>	0.95	0.4352
Baumax	0.26	0.6772	0.51	0.6772	<b>4.74</b>	<b>0.0009</b>	0.67	0.5676	<b>6.24</b>	<b>0.0003</b>	<b>3.36</b>	<b>0.00986</b>
Baťa	<b>20.5</b>	<b>0.0000</b>	<b>2.66</b>	<b>0.047</b>	1.63	0.164	1.07	0.3619	<b>9.82</b>	<b>0.0000</b>	<b>4.66</b>	<b>0.0010</b>
Jednota	1.20	0.2735	0.84	0.469	<b>2.83</b>	<b>0.0242</b>	0.78	0.5055	<b>29.1</b>	<b>0.0000</b>	1.55	0.1868
Carrefour	0.26	0.6077	0.90	0.4413	<b>4.51</b>	<b>0.0013</b>	<b>2.99</b>	<b>0.0306</b>	<b>24.41</b>	<b>0.0000</b>	<b>3.31</b>	<b>0.0107</b>
Kaufland	0.40	0.5280	1.92	0.1200	2.17	0.0712	2.29	0.0072	<b>38.43</b>	<b>0.0000</b>	<b>5.69</b>	<b>0.00016</b>
Metro	0.83	0.3632	0.80	0.4938	<b>5.55</b>	<b>0.0002</b>	1.98	0.1159	3.01	0.0298	<b>7.08</b>	<b>0.00001</b>
Hypernova	5.12	<b>0.0242</b>	1.46	0.2251	1.52	0.1957	1.71	0.1650	<b>14.24</b>	<b>0.0000</b>	1.55	0.25234

Figure 5 Statistically significant differences of popularity from the respondents' point of view

	Gender		Age		Occupation		Education		Place of living		Income	
	F-Ratio	Prob	F-Ratio	Prob	F-Ratio	Prob	F-Ratio	Prob	F-Ratio	Prob	F-Ratio	Prob
Tesco	5.02	0.0253	0.75	0.5218	0.81	0.5214	<b>2.98</b>	<b>0.0310</b>	0.27	0.8481	1.40	0.2197
Billa	0.16	0.6895	0.99	0.3985	1.37	0.2415	1.79	0.1472	<b>15.38</b>	<b>0.0000</b>	0.38	0.8246
Baumax	0.55	0.4586	0.37	0.7727	<b>2.66</b>	<b>0.0321</b>	0.04	0.9884	0.63	0.5976	1.06	0.37
Baťa	0.53	0.4688	<b>3.56</b>	<b>0.0142</b>	1.30	0.2687	0.88	0.4491	1.42	0.2358	0.81	0.5198
Jednota	0.49	0.4840	0.76	0.5160	1.74	0.1391	0.74	0.5275	<b>19.85</b>	<b>0.0000</b>	2.30	0.0573
Carrefour	0.23	0.6336	0.48	0.6936	1.60	0.1721	2.08	0.1015	<b>6.39</b>	<b>0.0002</b>	0.64	0.6313
Kaufland	0.07	0.7916	1.83	0.1410	<b>2.83</b>	<b>0.0247</b>	0.73	0.5328	<b>7.04</b>	<b>0.0001</b>	0.33	0.8604
Metro	0.19	0.6630	1.20	0.3111	1.78	0.1326	1.23	0.2971	2.02	0.1103	1.44	0.2189
Hypernova	0.52	0.4731	0.46	0.7131	1.99	0.0962	1.89	0.1318	<b>10.59</b>	<b>0.0000</b>	0.75	0.5604

As it can be seen from the findings, the most significant differences in evaluation of individual firms and their sales places originated from respondents with different places of living. In other parameters more significant differences in evaluation on of popularity with

respondents were not recorded. We would like to show more detailed information from our findings concerning information availability of respondents about sales places from the point of view of their place of living.

Figure 6 Average information availability of respondents about firms - from the point of view of their place of living

Information availability	Place of living						
	Firma	Košice	up to 100	up to 50	up to 25	F-Ratio	F-Prob
Tesco	1.75	1.77	2.1	1.95	5.32	0.001274	**
Billa	2.71	2.55	1.81	2.3	22.18	0.000000	**
Baumax	2.48	2.39	2.86	2.78	6.24	0.000354	**
Baťa	2.62	2.94	3.19	2.93	9.82	0.000002	**
Jednota	2.69	2.01	1.72	1.91	29.01	0.000000	**
Carrefour	2.09	3.07	3.09	2.66	24.41	0.000000	**
Kaufland	3.88	2.14	3.78	3.78	38.43	0.000000	**
Metro	2.96	3.27	3.27	3.23	3.01	0.029804	*
Hypernova	2.53	3.22	1.76	2.13	14.24	0.000000	**
Accorage score	2.63	2.6	2.62	2.63			

In spite of this, the complete average Score shows nearly the same evaluation from the point of view of respondents information availability living in various size places, at some more detailed research we have found some statistically significant differences in all cases. Plots indicated by two stars represent statistical significance of researched parameters on the level of significance 0.01. Where there is one star, it is statistical significance on the level of 0.05.

The most distinctive differences in evaluation were shown in Kaufland sales places. It was caused by localization of sales chains. At the first stage of implantation of these sales places smaller town as Prešov, Spišská Nová Ves, Michalovce were given preference - as there was shown some consumer interest from the point of possibility of increasing their purchasing power and there was not very district competition of other retail firms. On the contrary in Košice, there were - at the time of Kaufland opening - relatively well implanted other foreign companies.

If we compared evaluation of sales place of Jednota by Košice respondents and those of smaller towns, we have found the bigger popularity in the countryside than in Košice. The smallest differences were shown from the point of view of respondents place of living while we compared popularity of Metro.

## RESULTS

The penetration of foreign sales chains into TOP 10 group caused the gradual change of structure of sales places with preference to strengthen the possibility of purchasing in hypermarkets, supermarkets and sales centres. On the base of our analyses we have found that there are some differences from the point of view of information availability and popularity of individual trade firms. The best evaluation was gained by the retail firms that are implanted on the Slovak market for the longest period of time (Tesco, Jednota, Billa). The differences in evaluation of information availability were different when we pursued them from the point of view of respondents' living place, income and occupation. While pursuing popularity of sales places, differences occurred mostly from the point of view of respondents' living place. Variables - age and gender - did not show statistically significant differences in evaluation of sales firms' popularity. The given results, serve to deeper understanding of consumer, to finding his/her attitudes to individual forms of purchase and factors determining choice of purchasing place. They also map the newest trends in consumer behaviour and show the possible future outlook of gradual adjusting to new needs and requests and by this they create the background for implementation of European trends of sale in the field of retail.

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### Összefoglaló

A vásárlás helyének kiválasztása során tapasztalható fogyasztói magatartás is egyike az 1989-es évek után megváltozott értékesítési körülményekre való reakcióknak. A cikk bemutatja a szlovákiai kiskereskedelmi piac gyors fejlődését, különös tekintettel a külföldi kiskereskedelmi láncok térhódítására, amely elsősorban az új szuperkärketek és hipermarketek formájában jelentek meg. A fogyasztói magatartásban bekövetkezett változások a vásárlás helyének kiválasztásával kapcsolatban kerültek vizsgálatra. Öt éves időszakon keresztül került sor a meglévő összefüggések feltárására, amelyek a az információ rendelkezésre állásától és az egyes kiskereskedelmi láncok népszerűsége szempontjából képezték az elemzés tárgyát. A cikk az 1/1266/04 sz. VEGA Garant project támogatásával készült.

### Резюме

Определение места покупки товаров, интерес поведения потребителя-это одна из складовых изменения обстоятельства на изменившуюся реакцию продажа товаров после 1989 года. Статья описывает быстрое развитие розничного рынка Словакии, особенно в отношении захвата рынка, которые в первую очередь появились в форме новых супер- и гипермаркетов. Изменения произошедшие рассматривались в контексте выбора места покупки товаров. Диапазон исследования охватил последние 5 лет, которые включили в себя отношение наличия информации о сети и их популярность среди покупателей. Статья была написана с помощью проекта VEGA Garant № 1/1266/04.





viewed in a certain period as a political opposition and sought to limit its influence. The NGO community, unified as a strong lobbying group and public recognition of the role of NGOs grew. As a result, the Slovak NGO sector is considered nowadays as one of the most dynamic in Central and Eastern Europe. The third sector became a very significant actor in Slovakia, with an influence on many aspects of social, political and economic life. The development in Slovakia led later to a regionalization of NGOs activities, after the regional state administration was introduced. Regionalization in the third sector was one of the natural responses to the expansion of the state, and aimed at a comparable strengthening of civil society in the regions. Also, the network of Third Sector Regional Panels has been created. The third-sector service centers along the lines of administrative regions already exist. These centers are concentrated on intensifying cooperation among NGOs within their regions, improving activities of NGOs in regions, presenting their activities to the regional administration and citizens in regions, and cooperating with regional media.

Some doubts about NGOs organizational capacity and long-term sustainability still exists. The funding base of many NGOs and community-based organizations is weak in this period, and only a small minority account for the major share of foreign funding. The largest number of active NGOs concentrates on education-related activities. The disparate range of NGOs and community-based organizations that focus on social and economic exclusion and the environment are less well supported and are likely to be confronted by a number of challenges.

Regionalization is being one of the most influential factors of local development in Slovakia and it has been one of the most interesting fields of social and political development during the 1990s. Two important phenomena emerged during the 1990s in relation to the regional dimension in Slovakia: cross-border cooperation and spontaneous bottom up regionalization. Cross-border cooperation seemed to be very natural in Slovak conditions as the share of bordering regions of the country is very high. Nevertheless, state, political interests dominated this field. Euro-regional initiatives were not officially supported and their development was partially undermined during the 1990s. The Slovak Republic brought its legal basis in this field rather closer to European standards, including the signing of bilateral treaties during 1999–2001.

The economic and social transformation during the 1990s caused deep regional disparities that were not addressed effectively. A highly centralized and state centrist approach prevailed. Activities in favour of regional development were in fact decided and controlled by the central government and organized within various ministries, often as individual decisions and short-term initiatives. Only later they were combined with the limited role of state institutions in the regions. The main

tasks were supposed to be organized by the state and its agencies, financed by the state budget. The Košice and Prešov regions, being part of CE are the most economically affected regions in Slovakia.

Nowadays, the local and regional development in Slovak Republic is being much influenced by the process of EU accession. European Commission of the European Union influences regional development through its agencies and programs. The main aim is to utilize the Union's Structural Funds to promote a coordinated public/private approach to development at the local level, with the overall aim of creating higher employment. Local development initiatives are intended to be locally driven, but higher-level authorities can facilitate the conditions by which this can come about, and this role they indeed seem to be taking on.

In order to be recognized by the European Commission, Territorial Employment Pacts must satisfy three criteria:

1. there must be a "bottom-up" approach whereby initiatives should come from the local level;
2. there should be the involvement of a partnership that brings together all the local actors involved: administrations and the public sector; social partners; private organizations and associations;
3. an integrated approach should be followed, based on a detailed analysis of the local situation, to be used to develop an integrated strategy with innovative measures (action plan).

The programming documents are being prepared within EU on the basis of intensive consultations between the European Commission, the respective member state and other authorized authorities and institutions. Depending on regulations and current practice of each member state, these authorities include economic and social partners at national, regional and local levels. This process of partnership is one of basic principles of the regional policy of EU. In accordance with the principle of partnership, the preparation of the National Plan of Regional Development of the Slovak Republic was also executed, with participation of central bodies of state administration, regional offices, self-governments and their associations, representatives of the third sector, associations of businesspeople, science, education and other relevant organizations. (presently, in 2003, only National Development Plan and Sectoral Operational Programs are agreed). Instead of Regional Operational Programs, only so called Programs of Economic and Social Development of Municipalities approved at the regional level should harmonize the interests of local communities with the intentions of economic and other entities (organizations) located in the territory covered by them, depending on local conditions and possibilities. The elaboration of these programs lies within the authority of the individual municipalities.

## 2. FINANCIAL MECHANISMS FOR PUBLIC MANAGEMENT OPERATION

There are several financial mechanisms for public management operation in Slovakia.

The first one is the State Administration. Naturally, the state budget is the funding source for the state administration's central bodies and the regional and district offices also. Individual branches within the district and regional offices are financed through the budget chapter of the respective regional office. In 2001, the government came to the decision to decrease the number of budget chapters. The regional offices chapters will be abandoned. The local state administration was to be financed through the chapter of respective ministry or the Ministry of Interior of the SR. Later on, the entire system shall be revised by the Act on the state treasury.

The second one is a municipality. The municipality funds needs of public management primarily through its own revenues, state subsidies and other sources. Major sources of municipal revenue are:

- a) Share in the state tax revenue: The funds from the state tax revenue (personal income tax, corporate tax and road tax) are distributed to the municipalities in compliance with the given rules. These rules changed during the 1991– 2000 period. Revenues from the personal income tax are distributed according to the population (of the municipality). Distribution of corporate tax revenue reflects the localization of the corporation. Sixty percent of revenues are distributed proportionally to population and another forty percent according to the residence of a taxpayer. Municipalities receive 40% of road tax revenues also. These funds are distributed proportionally to population as well. The overall portion of state tax money allotted to the municipalities is annually determined by the state budget (except for the share in the road tax revenues).
- b) Revenue from local taxes and local fees: The real estate tax is an exclusive municipal tax. It is calculated as a multiple of the rate for individual types of real estate given by the notice of the Ministry of Finance of the Slovak republic. Local fees (taxes) include fines/licenses for: dogs; alcohol and tobacco products sale; gambling and slot machines; cash registers; car entry into the historical centre of the city; taxes for lodging; advertisement; public entrance; spa and recreation; non-residential use of an apartment; public property use; air pollution; waste disposal as well as other fees.
- c) Revenues of enterprise and property ownership.
- d) Administrative and other fees and payments.
- e) Capital assets sale revenues.
- f) Revenues from provided loans.
- g) Revenues from rental of buildings and facilities, transfers from contributory organizations and transfers from the financial funds of the municipality.

- h) Donations and voluntary fundraising for municipality revenues. Besides these revenues, municipalities can have also the following revenues.
- i) Transfers and other subsidies from the state budget: Subsidies to municipalities for the provision of self-governmental services belong under this category. Until 1995, all municipalities under 5,000 inhabitants were eligible for this subsidy.
- j) Subsidies from state funds: This category consisted mainly of transfers from the State environmental fund for construction of technical infrastructure facilities (sewage, wastewater treatment facilities, etc.) Also, Pro Slovakia, the State fund for funding cultural activities, the State water management fund for supporting the construction of water supply systems and the State fund for housing development and construction. The above mentioned funds were cancelled.
- k) Received credits and revenue from municipal bonds.

The third one is the Self-Governmental Region. The self-governmental regions mostly use the revenues from their share in state tax collections, surcharges to personal income taxes they create, and funds of horizontal leveling of self-governmental regions. In addition to these sources, self-governmental regions can use financial sources similar to municipalities. Exact mechanisms for the finance of self-governmental regions do not exist yet. Instruments are loan guarantees, credit programs and subsidies.

The Association of Towns and Communities of the Slovak Republic (ZMOS) is the most influential organization in protecting local government interests in Slovakia. More than 90% of the country's cities and communities are members. For more than ten years, ZMOS has been promoting the interests of local government and presenting important arguments in support of regional government.

The Union of Cities is the second most influential association of local governments, and is dominant among larger cities. This smaller association (in terms of membership) developed large and long-term public administration reform campaign. It made regionalisation as one of its most important objectives (many member cities are centers of particular regions). The main difference compared to the ZMOS was that the Union of Cities endeavoured to prepare its own reform proposal, including the position and roles of regional governments.

The State funds for the public management operation are available as well. When evaluating developments in the financing of municipal self-governments since 1991, it is necessary to take into account the overall social and economic evolution of the state as a consequence of the extensive transformation process of the former state-man. In 1996, state funds have joined the financing of municipal needs with regular and capital grants. There were 10 state funds in the Slovak Republic but most of them have been cancelled by the parliament in 2002.

The most important of these funds playing an important role to municipalities were:

- the State Fund for the Living Environment, which was founded to concentrate financial means to provide for environmental protection;
- the Pro Slovakia Fund, which administers grants for the development of cultural activities, including preservation of historical monuments;
- the State Water Economy Fund, which particularly supports construction of water supply systems;
- the State Fund for the Development of Housing, whose aim is to help recover the dynamics of housing development.

The dominance of Bratislava city and region presents a significant regional development issue within the country. Bratislava has the most encouraging socio-economic indicators without exception – for example, the GDP exceeded the EU average by over 20 percent; over 90 percent of the employees in the financial sector were concentrated in the Bratislava region; as is over 60 per cent of the total foreign capital. The most underdeveloped

areas are in the east of the country - the farthest from the capital and, therefore, least likely to benefit. The only exception being Košice, the second most significant urban area. This still creates a potential for a negative cycle of development. As a result, the regional development trend is the emergence of an increasing west-east divide. In common with other CEE countries, the western Slovak regions have generally benefited more from economic co-operation and other impulses arising from relative proximity to western European countries.

Finally, there are a number of highly disadvantaged rural areas. According to OECD criteria, 87 per cent of the Slovak districts can be classified either as predominantly rural (36 percent) or typically rural (51 percent) regions. A number of these regions, located principally in the southern border and eastern areas of the country, have a highly agrarian structure with poor infrastructure, and are currently undergoing a difficult process of transition. The basic characteristics of Košice and Prešov regions in comparison to other regions of Slovakia are given in the Table 1.

*Table 1. The basic characteristics of Slovakia regions.*

Region	Area (km <sup>2</sup> )	Inhabitants	Density	Number of villages	The degree of urbanization				
Bratislava	2 053	599 042	291,8	72	83,94				
Trnava	4 148	550 918	132,8	249	50,28				
Trenčín	4 502	604 917	134,4	276	57,83				
Nitra	6 343	712 312	112,3	350	48,09				
Žilina	6 788	692 434	102,0	315	51,22				
Banská Bystrica	9 455	661 343	69,9	516	54,33				
Preš	8 993	791 335	88,0	666	50,34				
Košice	6 753	766 650	113,5	439	56,68				
Total	49 035	5 378 951	109,7	2 883	56,13				
				Over 50,000	0.06	0.06	0.3	0.4	0.4

The municipal structure of Slovakia features instability and a large number of small municipalities (fragmentation). In 1950, there were 3,344 municipalities in Slovakia averaging 1,029 residents. In 1989, there were only 2,694 municipalities with an average population of 1,963. After the changes in 1989, the number of municipalities rocketed to 2,825 in 1991 (1). The Table 2 shows the share of municipalities in Slovakia.

*Table 2. Development of the share of municipalities in given size categories in Slovakia [%]*

Size Category	1950	1961	1980	1991	2000
Under 500	44.6	35.8	35.3	41.2	41.5
500 –999	30.6	31.5	29.2	27.6	27.0
1,000 –1,999	16.7	20.1	20.8	18.5	18.6
2,000 –4,999	6.2	9.9	10.3	8.4	8.7
5,000 –9,999	1.2	1.7	2.0	1.8	1.8
10,000 –49,999	0.7	0.9	2.0	2.2	2.1

### 3. THE NON-GOVERNMENTAL SECTOR IN SLOVAKIA

The four basic legal forms of non-governmental non-profit organizations include organizations associating individuals and/or organizations (civic associations), organizations managing assets – foundations, non-investment funds, and non-profit organizations providing public-benefit services.

Activities of international organizations in Slovakia are regulated by Law no. 116/1985 coll. on conditions for operation of organizations with an international element as described in Law no. 157/1989 coll. These organizations can register in accordance with the laws on foundations, non-investment funds, or non-profit organizations.

*Civic Association* is the legal entity associating citizens and/or organizations with the aim of promoting their common interests.

*Foundation* is the organization which associates asset in order to support a public-benefit purpose. The public-benefit purpose can be particularly development and protection of spiritual or cultural values, human rights or other humanitarian goals, protection and development of the environment, preservation of natural values, protection of health, rights of children and youth, development of science, education and physical education, humanitarian help for specific individuals or groups in threat of life or in urgent need of help after a natural disaster.

*Non-Investment Fund* is the organization associating assets in order to support a public-benefit purpose. The public-benefit purpose can be particularly development and protection of spiritual or cultural values, human rights or other humanitarian goals, protection and development of the environment, preservation of natural values, protection of health, rights of children and youth, development of science, education and physical education, humanitarian help for specific individuals or groups in threat of life or in urgent need of help after a natural disaster.

*Non-profit Organization Providing Public Benefit Services* is non-profit legal entity which associates financial resources to fulfil a public-benefit purpose or to provide humanitarian help to an individual/group in threat of life or in need of urgent assistance after a natural disaster. The public-benefit purpose can be particularly any of the following:

- development and protection of spiritual or cultural values
- protection of human rights
- protection and development of the environment
- preservation of natural and cultural values

- protection and promotion of health and education
- development of social services

The last ten years have been connected with an extraordinary development of the third sector in Slovakia. The sector fundamentally cultivates new values in society such as assisting others, charity, solidarity and philanthropy, as well as citizens' participation in decisions on public affairs. Its service and advocacy roles are implanting themselves more and more into the consciousness of the public as a whole. The sector has proved that it is also able to function under great pressure, and that it is developing and maturing politically. It is constructing new relations, not only within the third sector community, but with central and local governments, and other important groups in society. In future there is a risk that the role of foundations and NGO's as catalysers of social changes generally will be decreasing because of several factors; the leading one is lack of capital. The Table 3 demonstrates the number of NGOs in percentage according to legal form in the Slovakia. The Table 4 demonstrates the geographical distribution of the NGOs in Slovakia.

*Table 3. Number of NGOs in percentage according to legal form in Slovakia.*

<i>Legal form</i>	<i>Number</i>	<i>%</i>
Civic associations (societies, unions, movements, international NGOs)	17,000	95.3
Foundations	472	2.7
Non-investment funds	269	1.5
Non-profit organizations providing public benefit services	103	0.5
Total	17,844	100.0

*Table 4. The geographical distribution of NGOs in Slovakia*

<i>Region</i>	<i>%</i>
Bratislava	35.0
B. Bystrica	10.2
Košice	12.4
Nitra	9.4
Prešov	10.0
Trenčín	7.0
Trnava	6.4
Žilina	9.5
Total:	100.0

There are several NGOs that provide the support for non-governmental organizations for community development. Below are listed the most important of them.

### *I. Foundation with offices in the Slovak Republic*

- EPCE - Environmental Partnership for Central Europe
- FDCE - The Fund for the Development of the Carpathian Euroregion
- Jan Hus Foundation
- Charta '77 - Well known foundation supporting democracy development
- NOS – OSF: Slovak office of the world wide network of George Soros's Open Society Foundation
- The Foundation for a Civil Society
- The International Visegrad Fund (Czech Republic, Hungary, Poland and Slovakia)

### *II. International Foundations*

- EPCE - Environmental Partnership Central Europe Foundation (Czech Republic) - Czech office foundation supporting environmental activities
- ESF-Strasbourg, F - The ESF - European Science Foundation acts as a catalyst for the development of science on pan-European level
- Ford Foundation (International Affairs Grants) - The Ford Foundation is a resource for innovative people and institutions worldwide
- MOTT Foundation - Supporting efforts that promote a just, sustainable and equitable society
- OSF - Open Society Foundation - Network of Soros Foundations
- Pew Charitable Fund
- RBF - Rockefeller Brothers Fund - RBF is dedicated to improving the well-being of all people through support of efforts that contribute in the transition to global interdependence
- REC - Regional Environmental Centre for Central and Eastern Europe - REC supports environmental activities in Central and Eastern Europe
- Sabre Foundation - Conceptual and material support of academic, educational and professional institutes in Central and Eastern Europe - Contact: Sabre Foundation,
- Sasakawa Peace Foundation
- The William and Mary Greve Foundation, Inc. - Foundation granted projects in education, USA - Eastern Europe relation, environment etc.

### *III. International Institutions Providing Grants*

- Central European University Foundation - The USA foundation supporting projects in higher education and academic research
- Charity Know How Fund, UK
- UNEP - United Nations Environment Programme - UN organisation for environmental programmes

- UNESCO - UN organisation for education, science and culture
- UNIDO - United Nations Industrial Development Organization - UN organisation for industrial development
- USAID - US Agency for International Development - USA agency supporting international development and cooperation
- USIA - US International Agency

### *IV. Other Foundations*

- Foundation Centre - Information about (mainly) USA foundations
- Council on Foundations - Information about USA foundations
- European Foundation Centre - Information about European foundations
- Non-profit Resources Catalogue - Contacts to foundations in world
- NGO.net - Information about NGO organisations

### *V. Organisations providing services to NGO sector and grant seekers*

- ETF - European Training Foundation, Torino - I - ETF is grant-holding institution of Phare Programme
- ISPO - Information Society Project Office, BE - Office for support of Information Society projects
- PIET - Partners for International Education and Training - PIET administrates USAID educational and training projects in Central Europe
- SAIA – Slovak Academic Information Agency, Bratislava, Slovakia, The national contact point for international programs

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## **IV. CONCLUSIONS**

Local development in the Slovak Republic is changing in the meantime, and is getting been more and more influenced by the entering European Union. Grant schemes like PHARE, ISPA, SAPARD and expected structural funds of EU are becoming dominant in financing local development and there are substantially changing life of local communities. Local development tends to be more organized, institutionalized, lead by the frames of European and state regional policy but also supported and giving rather big chances for development of microregions, communities, municipalities, etc. Continuing dependency on foreign funding was one of the major constraints to the financial viability of the NGO sector and in actual situation they can utilize their experience in gaining European grants and using already existing partnerships and networks.

In the near future,

- the local development will be supported from horizontal objectives for all European Social Fund operations,
- small grants from the ESF for the activities of NGOs and local partnerships can be made available,
- the Community Initiative EQUAL, providing substantial funding for testing new approaches to combat discrimination and exclusion is also based on the key principles of local development

➤ Moreover, the URBAN and LEADER Community Initiatives, focusing respectively on urban and rural development, support area-based approaches putting the emphasis on capacity-building, empowerment of local actors and targeting of local activity.

This means also, that their mission is going to be less political and more practical, influencing everyday life of communities.

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## Összefoglaló

A cikk a regionális fejlődés lehetőségeit vizsgálja Szlovákiában, és a Szlovák Köztársaságban működő Közösségi Fejlődés Pénzügyi Intézményeit elemzi. Kassa és Presov önkormányzó régió került a vizsgálat középpontjába. A közmenedzsment működésének pénzügyi mechanizmusa és Szlovákia tercier szektorának leírására is sor kerül.

## Резюме

Статья рассматривает возможность регионального развития в Словакии, и анализирует действующие в Словацкой Республике Институты Финансового Развития Сообщества. В центре исследования были регионы самоуправления Кошицы и Прешова, а также механизм финансовой деятельности общественного менеджмента и описания Словацкого сектора услуг.



# The Structural Problems of Pricing Approach in Hungary

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## SUMMARY

*This paper examines the two main problematic fields of Hungarian pricing approach with respect to the change of the national base of knowledge: as economic- legal system regarding the formation of price-information on the cost-side is not equivalent of the market economy's system in many respects. The second problem is that Hungarian ownership companies have considerable methodological lags in the field of profitability qualification of prices formed on the market, and in the field of estimation of product-profitability driven from price-information.*

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## MAIN CHARACTERISTICS OF THE HUNGARIAN MARKET ECONOMY KNOWLEDGE

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At the time of the change of regime Hungary belonged to the firsts regarding the existing market economy knowledge owing to the two decades long indirect economic control system. Although from the point of view of a quick close up it did not seem to be enough. The main inducement of the market economy is the capital, and their main scene of organization is the market, but *exactly the basic practical knowledge concerning the real capital and real market were missing from the national base of knowledge.*

In the developed countries the market economy knowledge has *become a deep social knowledge as an effect of a many decades long experience.* (Their lawn is beautiful because they have cut the grass for a hundred years - says the saying of the Hungarian economists.) This knowledge has been formed along with the validity of the market regulations, which are technically carefully worked out and are finally adjusted to the actual level of advancement, and is built on the wide knowledge of coherence generating changes. The actual rules and regulations are not an analogous adaptation of some objective range of criteria; it has been formed by a kind of public will – *with differences based on the countries and depending on the national culture.* (That is another question, that nowadays we can witness a unifying tendency of the main rules as a consequence of the interactive coherence of globalization. The gradual unification of rules within the European Union can be *considered a natural part of development.*)

*To exploit the short-term potential advantages of the change of the economic system there would have been need for valid market economy knowledge, mainly for capital and market operational knowledge both on micro- and macro-level. Although the learning, which aim was to compensate for the lack, took place on many levels and in many forms with big efforts and considerable foreign help, a deep social knowledge did not emerge from one day to another.* The learning process, which was affected by different shock events, was decelerated by a relative slowness and uncertainty of the economic-legal regulation needed for the fine adjustment of the operation and by the lack of the law-supporting behavior of the economic actors. The Hungarian economy needs some improvement to designate as a real market economy.

The related company level of knowledge can be considered diversified even today. The main task of the Hungarian owned companies was a basic change of approach and methodology, but the working capital flowing in from the high developed countries brought with the practical knowledge of market economies. For these latest the ruling system of the Union is also known along with the deep knowledge of modern economic management. After joining the EU it will be new for some companies that their behavior set to the characteristics of the transitional economy must be substituted by an attitude set to the features of the Union. Probably it will need some time. The enforcement of a law-supporting behavior assumes, for example, a further development. Today the foreign and mixed ownership companies - along with the national companies - also excel in negligence of some national laws. A typical example: although law regulates that companies are bound to deposit their balance sheet at the Court of Registration, many companies ignore this regulation even

today. Thereby, law-supporting companies may get into competitive disadvantage against their competitors, who can keep their secrets successfully.

*After joining the EU, the quality of the competitive environment also changes, which may bring new conditions mainly for the institutions and professional experts (for example practicing economic lawyers) of the macro economy and for the national small- and medium sized enterprises.*

*A considerable improvement of knowledge would be required in the field of operating and managing local public services, which operate together with the competitive sphere. We have less disadvantages concerning the demonopolization of the separable business shares of the non-local natural monopolies ('linear' companies), since we learn it partly together with the developed market economies. However, to compensate for Hungarian disadvantageous base of knowledge, a stronger research and analyzing preparedness is needed.*

## DIRECTIONS FOR PRODUCT COSTING

*There are two main characteristics of the directions regarding product costing of the competitive sphere:*

*A, companies can make a decision regarding a band of costs, whether to rank it as direct or indirect in the official statements,*

*B, the obligation for product costing extends to the level of direct costs.*

Both characteristics emerged in the eighties.

The strictly terminated category of direct costs was modified in connection with the introduction of the price-reform in 1980 – as to improve “the authenticity of costs”-, and the possibility of accounting the “extended” direct cost was introduced. According to this, beyond the traditional direct costs (direct material costs, direct wages costs and its contributions, production and sales extra costs<sup>1</sup>), machinery costs and within costs of depreciation could be considered among the other direct costs depending on the decision of the company. (All the costs of a one-product factory could be accounted among the direct costs.)

It is worth mentioning, that in the rating possibilities of the cost of depreciation a complete change happened in two steps within a short time. This characterizes partly

the quality and depth of the collective professional knowledge, and partly the change of power of certain professional groups. The sum of the change: the pattern of extending possibilities of direct costs had been changed since 1985. They were working from the principle that the cost of depreciation is essentially fixed cost because of the crucial importance of the time-proportionate depreciation systems, so it does not change according to the change of volume, so this element was taken out from the elements of “extended” direct costs. (Companies, which had chosen the extension earlier, had to put back the cost of depreciation to the factory overhead costs.) It can be easily seen that the conformation to the change of the volume had theoretically improved with this modification, but on the other side the authenticity of costs had injured, that is the information how much the product really costs. This step shows, that the decision-makers did not unequivocally know the connection, that a legally specified cost-accounting version in its given form cannot become an information-carrier suitable for all purposes. Since 1988 the establishment of the possibility of cost-authenticity had been emphasized again. Factory depreciation was put back to the items accounted among the direct costs (and a cost version, which is less expressive regarding the change of volume, was restored again.)

*Until 1984 costing to be made for the total costs - along with a considerable simplification of the appropriation of operational costs made meanwhile, and the above mentioned extension possibilities of the direct costs. The effects of appropriation of indirect costs based on the known scheme kept back the advantages of volume-increase and distorted the rates of net costs; therefore it had an unfavorable influence on decision making of the companies. This recognition led to a specific step. The solution was not seen in the refining of the method, but in the elimination. As a consequence, a crucial change happened in the compulsory documented cost-informational system. Since 1985 costing have to be made only until the level of direct costs according to the main rule of accounting regarding the competitive sphere. The widespread application in the world of market economies was mentioned as the main reason of the introduction of the method.*

We can state in the mirror of literature that the main argument could feed from quite odd information. It can be surprising, but the direct costing<sup>2</sup> started to diffuse in the United States only from the end of the seventies and

<sup>1</sup> *Later as a consequence of the calculation making obligation reduced to the level of direct costs and the reduction of functions officially set to the direct costs to one function (supply data for the evaluation of production) the extra costs of sale was taken out from the direct costing scheme.*

<sup>2</sup> *Direct costing is a cost accounting method, according to which only direct or variable costs are charged for the product. Other costs are accounted directly against the revenues. Publications about the system saw the light first in the United States in the thirties. It has given rise to much controversy ever since. Even its name is controversial. Direct costing means literally direct cost-calculation. The method – originally and theoretically - does not charge the direct, but the variable costs for the products. Even so the practice and many pieces of literature tell about only the charging of direct costs. Some American authors – expressing their displeasures regarding this “degeneration”- try to eliminate even the expression from their vocabulary. They talk about alone the conception of variable and marginal cost calculations, and direct costing is only mentioned in brackets – as a terminological slip. In connection with the application of direct costing the question is whether fixed costs are costs of the product, and whether it is important to know, how much of it charges each of the products. Those understanding the method emphasize that without fixed costs*

*(precisely its content) production would be impossible. Differentiation of the two costs is needed in order to become clear what kind of (and how much) costs are changing along with the volume. A number of experts emphasize the important role of the method, which it plays in the economic philosophy.*

mainly as a component of the information basis made only for inner use of the companies, and not in the cost accounting systems made for official purpose<sup>3</sup>. In market economies the average cost as accurately documented information can be very important mainly from competition supervising aspect. (Decisions can be made based on this, whether our rival produces as cheaply as the price of its product shows, or any market disruption can be assumed.) Therewith it can be considered as very important documented information from the aspect of *tax control and the arrest of illegal income re-arranging activities* of enterprises belonging to the same orbit.

In some cases literature overemphasizes the characteristic of the average cost according to which it contains elements of fixed costs. Of course it cannot be arguable, that – containing a part of incurring fixed costs per unit of production - *the total net cost is inappropriate to determine the additional cost emerged from the additional volume or to estimate the additional profit.* This is only a characteristic, which restricts the application possibilities of the indicator. Taking into consideration that a universal product cost category cannot be constructed, every product cost category could be eliminated because of any kind of information-carrier feature. These disadvantages actually do not lower the value of the indicator, only estimate the effort, which wished to use a cost category containing fixed costs at the quantity determination of the effects of additional volume.

It is also not practical to identify the traditional total cost-accounting practice (which has significant information-distortional effects) with the total cost-accounting. On one hand *the method of total cost-accounting fitting into the system of accountancy can be refined (this is shown by the method of activity based costing), and on the other hand companies can work out estimating methods carrying good informational quality also for the total costs for their own purpose and set to their private characteristics.*

It is useful to see it clearly, if costs based on direct costing become the only cost-information of the product and the company does not change to the “extended” direct costing, it is a case of the blind leading the blind. The bigger the standard of mechanization, the more the material costs become the dominant element of direct costs, and the less the information can be driven from the accounting system, how much the given product really costs. Because of this characteristic of the state-dictated system, a part of the Hungarian ownership companies quantity-determinate the traditional total costs – for want of something better - for their own purpose.

From the literature the conclusion can be drawn, that in the developed market economies the required compulsory record system regarding the product cost usually embraces a wider category that the category of direct

costs. Meanwhile in some countries the different official bodies release different costing and recording recommendations. The information got so far from the literature is very random and heterogeneous. *Expedient and systematic researches should be made towards a stable close up in knowledge in a way to find out what kind of costing and recording requirements are prescribed in general and for the different company groups and what kind of recommendations are released in the developed market economies; and knowing these, it should be surveyed what kind of advantages could the differences from the Hungarian regulation assure from the aspect of acquaintance of the companies and the regulating and inspectoral bodies.*

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## PRICE THAT MIGHT PERFORM PAY BACK REQUIERMENTS

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It is an understood thing, that purchase prices and sales prices have defining importance in companies’ lives. Deep knowledge of their details and developing them into the right direction are essential fundamentals of companies’ proper operation. Today, it is clear for every counterpart of the competitive market, compared to the reversed view of our former barrier supply conception, that marketability is dependant on the price, set to the conditions and approach of the market, and that well-stated prices are also needed in order to “produce income”. The company-specified method about maintaining market requirements in a systematic, price-based way developed in a comparatively short period of time. *Although, we can find remarkable disadvantages when looking at the suitability of prices regarding the producer side’s qualification of pay back requirements.*

In order to make good decisions we should create product cost information excels, that show relatively correct numbers of how performing pay back requirements at certain prices. This information *shows the limit of costs under the production of a given product would be profitable for a company.* This means a kind of price-information for the company, and is not equal to the offered price. *The offered price on which we offer our products for sale to the costumers – depending from the market conditions and the sales policy decisions – might be lower or higher than the price that might performs pay back requirements.*

The price that might perform pay back requirements can be calculated from the point of view of both the production start and change in the volume. Both calculations are easy in the case of a single product company. In the case of a multi product company, starting from considering the connections of using up resources, we can use different simplifying possibilities.<sup>4</sup>

<sup>3</sup> Ralph S. Polimeni – Frank J. Fabozzi – Arthur H. Adelberg: *Cost Accounting. Concepts and Applications for Managerial Decision Making*. McGraw-Hill, Inc. 1986. (pages 62. and 493.)

<sup>4</sup> *This subject is deeply elaborated: Mária Illés, “Vezetői gazdaságtan” (Kossuth Kiadó, 2002. Budapest) pp. 368-444.*

As practical experiments show, those companies with Hungarian ownership have a huge disadvantage regarding the application of this price information calculating method. The results of this kind of calculations in the developed market economies are rather kept in secret. Some price assessment, though, let us conclude to the fact that most companies, in order to be perspicacious enough, apply fine calculation methods, which take the companies' individual features into far-reaching consideration to *ground their decisions*.

Consequently, significant changes are needed in the field of calculating price information practices. These are even more required by the changing features in the conditions of the competition situation when the country's joining the EU. It is a fact, *that new Hungarian companies, who just entered the field of market economy, get comparatively few help of methodology while being under the pressure of conforming to the market. They get less help in respect of choosing the appropriate method to be the basis of calculating the price information from the point of view of pay back.*

The basic problem is that general methodology is so complex and every company has to simplify it to its own features. As above mentioned, the applicable methodological solutions differ in every case. There is no recipe for simplifying.

Those companies which operate in developed market economies will not provide us solutions as – according to their well known interest – they rather treat these results and calculations as secret, moreover, there is only a very narrow range of authorized persons inside the company structure, who have access to see them. This is another question that they give certain schemes for the price calculating to the authorized employees of price- and marketing departments. These schemes are mostly composed that they are able to mediate all the aspects of price policy, but even the applier of the method can not “roll back” to the given (and regularly variable) parameters to the level of price policy considerations. (In each case the lines can look enigmatic in themselves.) The defining of the offering price has definite product-specific features as well.

So, the “price calculating scheme” is usually a guide which includes price political considerations hidden in it.

## MARKUP PRICING

The term pricing in itself refers to a calculating scheme where the seller defines the price of his product on the basis of this given scheme. For this procedure, usually pricing and cost accounting schemes and formulas are used. As mentioned before, in a case where the schemes are composed prudently it is hard to conclude back to a

company's price political considerations. Study materials often fill this gap with the scheme of markup pricing.

Markup pricing in the common language means a kind of price norm calculating which shows the needed sales price to be reached, first of all, in order to refund the costs of the product and the profit expectations. Markup rates are usually built up from profit expectations, or from the sum of certain costs and profit expectations.

Markup pricing can be regarded as an *ancient* method of price calculating in trade. The method, in principles, conforms to the rules of trade sector's features very well, follows the system where capital rate and profit acquisitiveness is perceived on the basis of capital precept by the more money is in capital, the biggest amount it ties up. A wide ranged method is to differentiate trade profit rates by groups of products.

In the literature are mostly mentioned trade companies as well as an example for the practical usage of markup pricing. In spite of this the general subscription of the method places it into the line of generally applicable methods. As a generally applicable method this will not stand out though. Its result will differ from the reality as both a supply price calculating method and as a bid price calculating scheme too. Moreover the markup price does not show the pay back requirements. From the point of view of profit calculating and profit layering capital is an active part, it moves according as to find the place where it can make bigger profit. The product's cost structure and equity requirement structure show big differences, except in trade sector. In the producing sector, for example, the regular markup pricing is widespread *and those passive material costs – from the viewpoint of the profit layering – deform the expected profit per product.* (The more material cost there is the biggest profit requirement burdens onto the product). *The profit rate, containing the coverage, can deform according to the specific work and technology used as well.*

*As a calculating scheme of the supply price* the method also mediates a kind of strictness and defines a price by not regarding the market conditions (moreover this price does not even reflect the return interests of the producer). If the calculated price is too high considering the market conditions, the product's opportunities for sale will decrease. *The literature in the developed market economies introduce the disadvantage of markup pricing that the method does not consider market conditions, but do not refer to the fact that it does not reflect the pay back requirements an appropriate way.*

Before the political transformation in Hungary, the background of this method developed in a very special conscious way. For example in 1988, a pricing expert by a company declared that he would always have gratitude to his acquaintance, who had had whispered him the “great secret” of price calculating. With this secret in

their pocket and adopting the company practice of his acquaintance, they now calculate their prices according to the 30 per cent rate of coverage to the direct cost, and as he saying this way it works very well. As is turned out from the previous discussion, the question of changing the markup rate did not even emerge, because of the possible differences in the costs of material or the state of mechanization. It is not hard to concede that this 30 per cent markup rate could have easily dragged the 'copiers' into a deficit beside a much more mechanized production process or products which need less material. (At that time, the market did not correct this kind of price enforcement besides its controlled price features and the period's conditions of reduced domestic range of supply.)

*Although the literature of the markets attaches great importance to the suggestion of markup pricing, the deeper analysis and mainly, the practical prices point to use a totally different kind of price calculating by the production and service.*

1. From the 1970's the gradual revival of foreign trade at home attracted attention to the analysis of the price of similar products in the economically highly developed countries, which resulted in some remarkable information. For example in the case of electric motors it was shown, that the prices of the Hungarian products (calculated with profit rate price) followed more steeply, the increase of capacity (and material costs) in the country to the products made by partners.
2. Also experience without any detailed analysis refers to the divergence of the projective basis and by any chance to the difference of theories as well. The wool industry gave example, when the tenuous yarn with same quality exported to the western markets was all bought up, but the traders got saddled with the thick ones. The reason could be the fact that in case of the Hungarian co., profit expectation was divided by the projective base including material costs, while its competitors applied some base not including them.

This one fact could explain that the Hungarian thin yarn, which contained less material, was qualified as an over-cheap product and the thick yarn containing extreme profit expectations because of the high material costs, as high-priced.

3. The fact that in the highly developed countries usually a regulate sum and a variable depending on the changing amount compose the bank charges of money-exchange, but unto these days, in this country, conversion is simply calculated as a percent of the exchanged sum of money, points to different attitudes as well.
4. We may gain some interesting experience with looking into the ice-cream prices as well. In 1986, Vienna, the prices and the clean-cur structure from them were the following.

Prices:

1 cone	= 7 ATS	(4+3)
2 cones	= 10 ATS	(4+3+3)
3 cones	= 13 ATS	(4+3+3+3) but these were in more cases offered for 12 ATS

On the other hand in Hungary just till these days the single price multiplied by the numbers of cones gives the total price of an ice-cream.

Of course these mentioned examples do not substitute the systematic research of the economical price relations. *The better cognition of actual calculating processed and pricing methods, the systematized exploration of profile-specific particularity could give a significant help by giving complement in gaps. Because of this ticklish theme, the direct exploration could be probably not bid fair to succeed. From the point of the scanned theme also the qualified group wouldn't be easy attainment. For all that, this way would be worth trying. From the nature of these, using the indirect methods (followed back from the recoverable profile-specific price-inherences) could also be effective.*

### Összefoglaló

Az előadás magyarországi tudásbázis alakulásával összefüggésben tekinteni át az üzleti árszámítás két fő problémacsoportját. Egyrészt rávilágít, hogy a költségoldali árinformációk (és árkontroll információk) képzésére vonatkozó gazdasági-jogi szabályrendszer több tekintetben eltér a fejlett piacgazdaságokétól, másrészt rámutat, hogy a hazai tulajdonú cégeknek jelentős módszertani elmaradásaik vannak a piaci körülmények között kialakuló árak jövedelmezőségi szempontú minősítése, illetőleg az árinformációkból kiinduló termék-jövedelmezőség becslése terén.

### Резюме

Статья описывает две группы проблем связанных с ценами бизнеса с венгерской базой знаний. С одной стороны показывает как информация цен (и контрольные информации цен) и их экономико-юридическое определение отличается от тех определений, которые действуют в странах с развитой рыночной экономикой. С другой

сторона показывает то, что предприятия, которые находятся в венгерской собственности имеют значительные недоработки по определению оценки качества доходности и по информации цен исходя из оценки доходности продукта (товара).

# Competence-Based View in the Marketing Theory

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## SUMMARY

*The study analysis the dominant marketing theories created in the last decades. In the comparison the author states that the different approaches did not mean paradigm changes in the marketing, but they approve the theoretical and methodological development of a practice-oriented, practical and generalizing field of science, which gives an appropriate basis for the marketing management of the enterprises. The paper specifies the characteristics of the competence-based approach of the marketing resources, as marketing, strategic and methodological answers given to the network cooperation, integrated customer requirements and the challenges related to a technology-oriented economy.*

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The development of marketing applications and interpretations has undergone several development stages in the past few years, starting from distribution functions, later focusing on customer needs, then appearing as a management function, market-based concept and strategy and after this as an individual element, multioptional and interconnecting relationship marketing. In the implementation of professional tasks and the content focus of marketing activity more and more new participants and phenomena are involved so that an enterprise is able to meet the challenges of competition of the implementing organisation in the best way taking into account the view changes to be listed below. The stages and content weight-point changes are as follow (Meffert 2000):

- > distribution-based
- > user-based
- > trade-based
- > competitor-based
- > environment-based
- > network-based.

In the elaboration of the development trend of applications there are several different theoretical views despite the fact that marketing has often been accused of being a ‘statement system without theory’.

A view or a paradigm is a basic ruling principle and a problem-solving example shared by a wide range of representatives of the science. Scientific progress means denying the ruling paradigm and proposing new problem-solving solutions. Scientists have disagreements regarding the use of the term paradigm in the science of management and the field of marketing. Several results of scientific researches and theoretical views concerning

marketing, supplementing or competing with each other, have appeared in the past few years, most of which are defined as basic paradigm changes especially by their promoters. There have been continuous disputes about paradigm changes for several decades.

Theoretical approaches and schools of marketing basically differ in the following:

- > the way they take advantage of exchange whether they look at it as an ordinary transaction or a relationship built on longstanding cooperation,
- > what is considered to be a factor, a process, skills and environmental linkage mechanisms leading to success,
- > the role interactivity plays in solutions,
- > what is considered to be the basis and possibility of development of competitive advantages, and how they are determined. The question is whether the scientific approach is based on outside expectations, specifications, clearly outside market-based (outside in) effects or mainly on its own resources, development of competencies having the outside requirements met and acceptance (inside-out).

## 1. SCHOOLS OF MARKETING THEORIES

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There are numerous evaluations and classifications (Sheth-Garrett, 1986; Meffert, 2000) on the basis of which a development trend, certainly not linear, not strictly following each other can be determined:

- Classical approaches:
  - > institution-oriented

- product type-oriented
- function-oriented
- Modern, but rather traditional theories of nowadays:
  - behavior-oriented
  - decision-oriented
  - system-oriented
  - situation-oriented
- New, post modern views:
  - new institutional
  - information economics
  - process-oriented
  - relationship-oriented
  - society-oriented
  - competence-oriented
  - organisational dynamic (network) oriented

Among the classical views developed in Europe in the fifties the institution-oriented approach focuses on varieties of factory forms in trade and on research of their changes, whereas the product-oriented view taking into account the peculiarities of certain product types (consumer goods, industrial goods, services, etc.) concentrates on marketing decisions. The function-oriented approach gives priority to contextual, chronological, geographical and object related optimization of certain marketing functions.

Among the modern views which follow and are considered to be traditional nowadays we came across the following approaches, the starting point of which is undoubtedly market-based:

- Decision – oriented approach, which became internationally acknowledged in the first half of the seventies adjusting itself to traditional concepts of company economics, lays foundation of solutions to definite marketing problems (decision logic, evaluation of alternatives, answers given to environmental challenges, analysis and determination of target and tool systems, etc.).
- The system-oriented approach, which gained attention because of complexities of assignments and increase of their dynamics, focuses on evaluation of market-related system analysis, exchange relationships between elements of the system and system behaviour. In spite of ‘tough’ expansion and popularization of the system theory in the ‘60s and ‘70s this model was a great disappointment for marketing science and its practical application especially because of the complex and comprehensive exploration of its correlation.
- The behaviour or attitude oriented approach is built on research conducted in the field of consumer and customer behaviour. They are expressed by the well-known S-R, S-O-R models and the so-called process model developed in the seventies. On the basis of these the outside and inside factors determining several customer decisions were identified. In the 70s and 80s this view was further developed and by concentrating on key factors it focused on attitude, image and satisfaction studies.

- The situational approach highlighted the necessity of the environment-determined adaption related to organization-theoretical experience, trying to identify the relevant situational changes. The essence and weakness of this view lies in various interpretations and manageability of these situations (market: its size, competition, life cycle, etc; environment: prosperity, technology, society, ecology, etc; enterprise: its size, structure, image, technology, financial power, etc; programs: production process, life cycle, structure, etc.)

Since the mid 80s the latest approaches have been trying to find an answer to market management of the changing market processes arising from accelerated technological changes. *The new institutional economics theory*, as compared to neoclassical promotional theory, dealt with various partial areas, e.g.: market deficiencies, potential development of markets (e.g.: analysis of institutions as target-oriented system of norms, enforcement of instrumental view, management of coordination problems, etc.) Laying a new basis to the elaboration of theory of transactional costs and information-economics interpretation is of great importance. *The information-economics approach* is a supplement to the behaviour and decision-based view. It focuses on the need for comprehensive and systematic analysis of market-specific information of uncertainty and risk structure, pointing out that during realistic transaction processes an informational asymmetry arises between the seller and the buyer, the reduction of which results in an increase in transaction costs and produces a multiple effect on transaction processes.

*The process-oriented view*, which has a strong environmental differentiation and divides company activity into product, function and regional views showed the necessity for a decrease in complexities as well as its contra-productive impacts. The effects of marketing extending over company functions and realization of its direction clearly expressed the fact that its division can be made accepted by a process-based view. Marketing missed a process-oriented proposal and recommendation for a long time. This long felt need has been met by both science and practice since the end of the 80s by putting more emphasis on Lean Management and Business Process Reengineering, which relating to marketing can be summarized as process-based view giving priority to internal marketing through functions extending over integration process thinking (process costs analysis) in effective realization strategies.

*The society-oriented (macro marketing) view* takes into account relationships between marketing methods and a society. Its essence lies in the fact that it looks at marketing as something the efficiency of which is affected by several environmental factors, and thus, it focuses on comprehensive and rational analysis of environmental variables having impact on marketing. It points out the effects of the society (environmental consciousness, social sensibility) and its consequences on

marketing systems and activities. Marketing attempted to form these environmental expectations into competitive factors (environmental friendly packaging, decrease of hazardous materials, recycling of materials) and include them into the marketing strategies of companies. (Meffert-Kirchgeorg, 1994).

The main term in *organisational dynamic-oriented approach* built on relationship marketing is the concept of power, conflict, control and its management. This trend uses terms taken from organisational behaviour, social psychology and sociology, focuses on the comprehension of behaviour between organizations, their interrelationships mainly in the field of B2B and consummates itself in a network marketing concept. (Achrol-Kotler, 1999; Ford 2003). In a time of interactive business networks, emphasis was put on the understanding of customer relations and the development of new organizational forms (strategy alliances, virtual organizations) instead of ideas built on certain transactions, which resulted in replacing the 'influence' of transactions by *relationship marketing*. As far as B2B is concerned relationship management at various interaction levels has long standing traditions. The novelty of relationship marketing lies in the extension of partnership forms in the direction of every outside and inside target group, the development of durable relationships and maintenance of their economic encouragement focusing on the confidence factor. The responsibility for consumer relationship encompasses the whole company organization.

According to the *competence-oriented marketing approach* developed from the so called '*resource-based view*' an enterprise has to concentrate on inside circumstances and competencies (inside out) to be competitively strong and flexible. This is the reason why competence marketing is considered to be a real turning point and a real paradigm change as it seems to interpret the essence of marketing, without taking into account the direct market needs or answers given to the needs.

Each marketing view described in this study lays emphasis on evaluation and problem solving methodology, which plays an important role in settlement marketing as well. The specific features, difficulties of development, qualities of settlement-product, the determining role it plays in the development of its current values and their operation put the resource-based marketing view in the center of attention of our further analysis.

## 2. COMPETENCE MARKETING

The competence marketing originates from the theories of Anglo-Saxon micro-economy, according to which advantages in competition resulting from the special resources, abilities and strength of a company result in returns above the average. (Penrose, 1959; Chandler, 1962)

The term competence means being competent (e.g.: in an assignment) or having an ability (to do something). In the science of management this term was misinterpreted. In marketing the concept of capability is taken into account, meaning types of competencies a company has when it enters a market and approaches customers. Becker was the first to call the conscious development of competencies a marketing objective and considered the company image to be a core competence (an ability, a factor ensuring advantage in competition). He considers competence development a communicative task.

Competence has two dimensions. The so called *experience competence* is based on background general experience and means the problem solving ability of a company, whereas the *possible competence* is related to abilities on the basis of which new problems are solved, and the acceptance and demonstration of which are primarily a matter of image.

*Competence transfer* involves acquiring competencies in the interest of customers and their utilization and realization for customers. On the other hand, competence transfer leads to specific knowledge transfer between a seller and a buyer. It is an essential tool in achieving customer satisfaction and development of custom-based process.

The competence-oriented approach (as an inside-out prospective type) and the market approach targeting customers' needs (the market-based view) seem to be in contradiction with each other at first, but only at first sight, as the inside features, the abilities of an enterprise and their values are never independent from the market conditions. The core competence and its values can be determined from the customer side, meaning that due to the core competence an enterprise is able to acquire considerable values in competition comparison.

*Considering marketing to be a resource-based view makes it possible to interpret important interdependencies and relationships, as a market is nothing else but a solution method of a bilateral resource-problem.* (Freiling, 2001). A customer demand is a lack of resources explored in a subjective way, where the responsibility of a seller lies in satisfying the demand and meeting the needs by utilizing his own resources and competencies. Strategy-competence marketing develops durable competitive advantages on the basis of understanding the market conditions and exploration of core competence of an enterprise.

According to the technology-based view taken in a broader sense the introduction of competence marketing fits into the above mentioned market-based view:

- considering it a porter's value chain, according to which competence can be identified or has an identifying ability, which can be registered in the value creating process and can be included in the value chain (Strothmann, 1997)
- laying emphasis on the competence-profit by a buyer and a principal as a buyer-integration (e.g. information, knowledge about a principal gained in the

process of a particular work can help the promotion of the following task solution). Customer satisfaction or

its feedback can also lead to the increase of competencies.

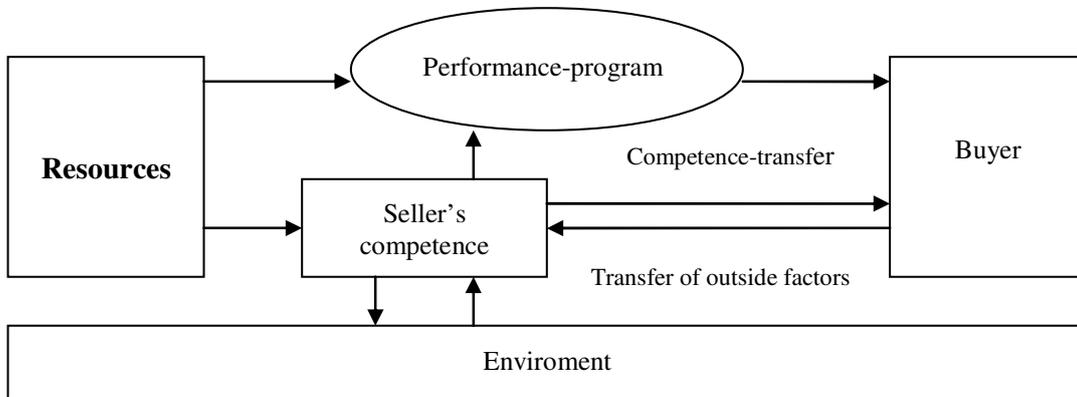
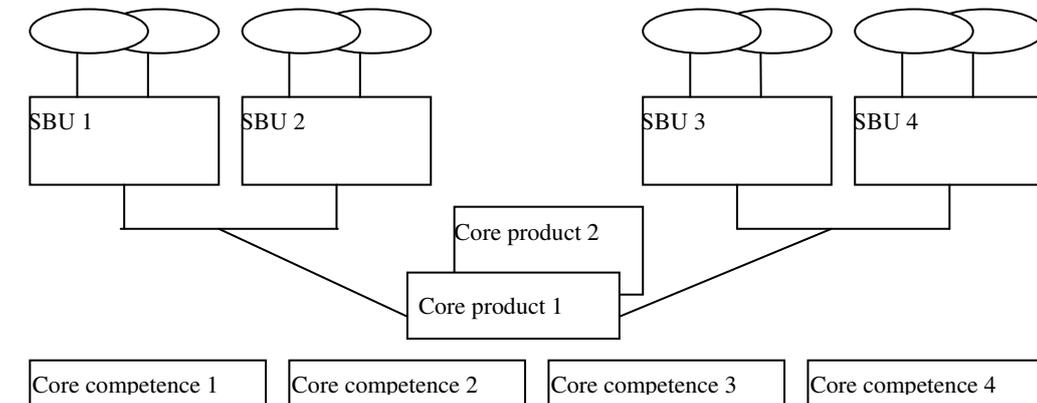


Figure 1 Competencies and transfers in broader interpretation

The resource-based views can be divided into two groups (Buchholz, (1996.) p. 48): *practice* (Core Competencies – Prahalad and Hamel (1990) and Capabilities – Stalk et.al (1992)) and *theory-based types* (Resources, Capabilities – Grant (1991) and Strategic Assets - which-Schoemaker (1993)). Prahalad and Hamel without, giving a definition of the term of core competence, illustrated with several

examples how competitive advantages can be generated by definite technological capabilities. Stalk et al. (1992) widened the concept of competence marketing, originally technology-oriented perspectives by giving interpretation to non-technology-dependent competencies (e.g. sales-management, etc.) and considering resources to be capabilities.



(From Prahalad and Hamel 1990, p.81)

Figure 2 Core competencies as basis of competitive products

Prahalad and Hamel (1990) criticizing the previous management views see the keys to success and company expansion in the core competencies, which are to be explored, transformed into a new product and sold by management. It differs from the traditional organization-based view and from the product-market combination of strategic business units. Its essence lies in the development of efficient portfolios of core competencies. The core competencies (e.g. microelectronics, laser-technology, special optics etc.):

- offer several potential possibilities in the market on the basis of which a wide range of final products and not particular product-oriented combinations can be developed;
- determine the acceptance of the buyer's side and the standard of the final product, which result in differentiation in competitors,
- lead to a constant competitive advantage only if the partners involved in competition are able to simulate them.

Achieving uniqueness and distinguish ability (the frame of which is made up by the concept of Corporate Identity) as a corporate objective depends on the prevailing atmosphere in competition and the intensity of competition.

Buyers' satisfaction appears as a result of a competence-transfer. However, in B2B the buyer's satisfaction is not a clearly defined concept, because due to the BC decision the satisfaction of several actors leads to buyer's satisfaction and can be considered as a contributor to the optimization of the buyer's value creating process.

Competence-marketing – compared with the traditional marketing concepts - brings about certain changes in priorities and weight shift in certain assignments. While traditional marketing, focusing primarily on the near future, was trying to create competition advantages, competence marketing puts emphasis on integration of development processes in the past, the current situation and future development. It can happen that potential processes in the near and distant future can be utilized and predicted, and we can take advantage of the situation when the market circumstances can be created in our own image. As a result the following activity weight points can be distinguished:

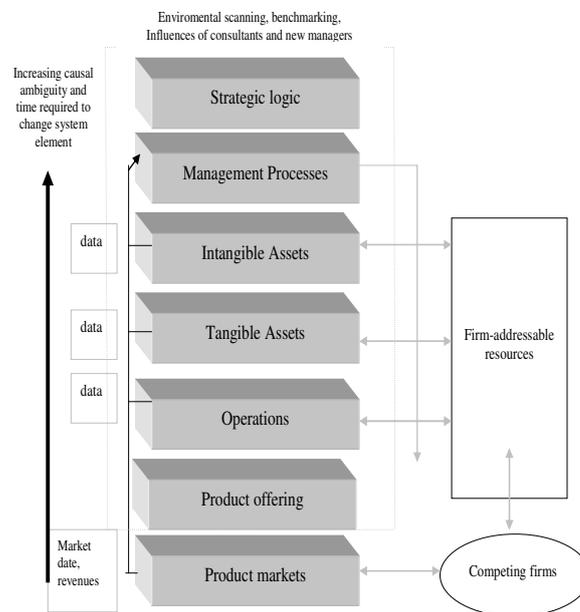
- > concentration on traditional strengths taking into account the important decisions made in the past;
- > research of future needs;
- > elaboration of future business models taking into consideration the 'forecasting in the industrial sector';
- > development of competencies, their transfer into core competencies which will play an important role in marketing and management.

The essence of marketing lies in adaptation and creation of something new. Considering the current market circumstances and targeting successful market activity it is essential to meet the buyer's expectations, which requires an extensive adaptation-based orientation. Analyzing the long-term interdependences it can be claimed that the buyer does not usually have the proper knowledge needed for describing potential problems or needs, thus, it is almost impossible and very difficult for marketing to determine the trends in needs in potential demand. In such cases lead users and elaboration of pilot-projects are of utmost importance, as cooperation with them makes need shifts possible as well as permitting the identification of need areas. It is obvious that our expectations and visions as far as the market supply is concerned are to be compared with the assessment of our own target groups. Consequently, it is not adaptation but the creative development that points this.

In the last few years marketing has been focusing primarily on strategic business areas. Having evaluated the competence-management it has become obvious that the utilisation of certain critical resources requires crossing certain business area borders. Branding belongs to one of these factors, but distribution and logistics networks as well as particular inside and outside types of

service resources are not related to certain business areas. They make up the competitive advantages using contexts spreading beyond these areas. The above mentioned facts show that there is a need for constant regeneration in order to achieve a more intensive portfolio-management of current resources and competence facilities, on the basis of which proper investment and reduction decisions are to be made. *Thus, marketing is nothing else, but a constant development and conscious utilization of resources and competencies.*

The shortage and lack of resources can be overcome only if the cooperation with the market and network partners is placed on strategic basis.



(Sanchez- and Heene 1997; in: Freiling 2002, p. 22)

Figure 3 Open System View

This also means that outside resources have to be consciously integrated into our enterprise, value creation and production have to be strengthened in a business like-manner, but this is possible only if our processes are supported by available resources in order to achieve more efficient product types and customer-oriented productivity packages, which meet the current customer's needs within certain transaction processes (Figure 3).

Emphasis should be laid not only on transactions, but on the experience gained during them as well. During organizational study processes our own value creation processes should be taken into account as on the basis of this proper structures and thus, efficient process operations will be created within an enterprise. (Rekettye 1999.) The task of marketing is not simply to take part in transaction processes, but to utilize the experience gained and use it in our own value creation process. It is only natural that marketing is used at different activity levels. The basic level is created by the whole market and its

selected segments. Continuous observation is required to identify the level we are at and to decide whether there is a possibility to open a more attractive new market:

The whole market or its segment:

- a continuous, competence-marketing based revision of the market choice
- development of competition-advantage marketing activity
- competence leveraging and not fragmenting

Business relationships:

- resource-based customer relation
- advantages developed on combinations of relationship platforms

Transactions:

- transaction as a requirement of customer-based resources and competence activity
- market learning and knowledge transfer in the company

The analysis of the above mentioned ideas show that competence-based marketing provides a different answer to certain sub-questions than the traditional one. It concerns market analysis, which requires a development of a comprehensive Marketing- Intelligence system and harmonizes market research with modern knowledge management. The 4Ps of McCarthy have to be more precisely defined and the weight points in the tool system have to be developed.

The Resource-Based View can not be opposed to the Market-Based View, since the inside-out types are also provided with market appropriacy as described in the classical article by Prahalad and Hamel (1990) in which customer value and competitor differentiation are two basic features of the core competence. The inside-out and

the inside-in views are, actually, two sides of the same coin, but they are thought to make an important content unity. (Backhaus 2001)

After this short overview of schools of marketing theory the following question can be put: Does a paradigm change exist and is there a need for it?

It would be easy and very simple to give a positive answer to the question, as there are so many things that have led to changes in the operation of the market and the factor of success that marketing can not be considered to be the same. Nevertheless, I am convinced that *there is no need for a change in the paradigm*, and it has not happened since the development of the basic concept of marketing. *The changes marketing have undergone in the past few years prove the development and the capability for the development of a science which is practice-based, experience-gained and generalizes both practice and experience.* Similar to the economy, the society and the technological development also rearrange business and competition relations when their determining processes undergo some transformation. Marketing theories and their practical implementors look for and find possibilities for their successful implementations even going ahead of market development processes.

It is not the essence, paradigm or the concept of marketing that have changed, but new 'organizing principles', logical and practical implementation frames, methodological approaches, weight points have emerged on basic elements of target-orientation and market-orientation as responds to challenges of competition and constantly changing conditional systems.

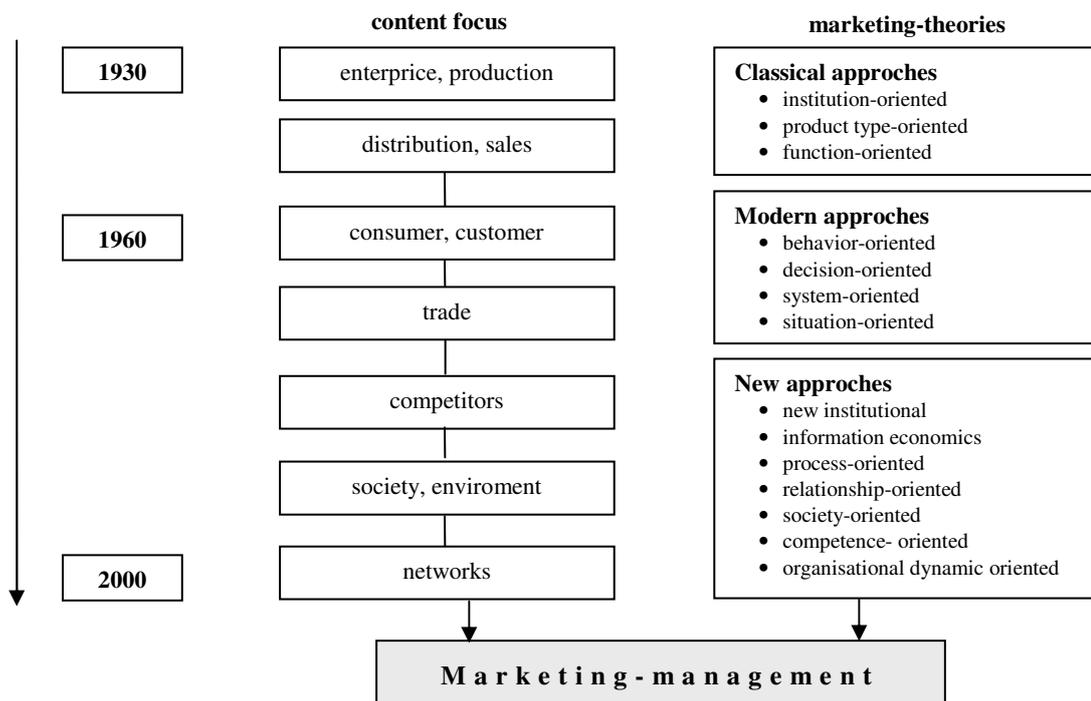


Figure 4 Marketing theories and content focus relationships in marketing management my own ideas on the basis of Meffert's (2002) page 20.

Development of marketing involves new solutions and combinations of methodology and tool system. These new solutions do not erase or annul, but further develop the previous experience of marketing. In case of most markets the application of traditional methodology is advised. Moreover, as the content of the already mentioned classical, modern and new views has proved, marketing today is *their 'mixture' where the marketing-orientation, the actual cocktail has to be mixed taking into consideration the current market and actual peculiarities.* (Brodie et.al,1997)

Marketing is becoming more and more complex, integrated and total. Its task is not only sales optimization, but developing purchasing, inside, the so-called public sphere and competitor strategy, whether it is built on the market or resource based view.

The task of marketing is to combine and integrate resources in a specific way adjusting them to market requirements. Competence-marketing appeared as a methodology elaborated on the basis of experience gained in the high-tech market and small and middle size enterprises, but it is related to other special market areas, like settlement and regional marketing. (Piskoti etc.2002).

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### Összefoglaló

A tanulmány az elmúlt évtizedekben megalkotott, domináns marketingelméleti iskolákat elemzi. Az összehasonlításban a szerző megállapítja, hogy a különböző megközelítések nem jelentettek állandó paradigmaváltást a marketingben, hanem a gyakorlatorientált, a gyakorlat tapasztalataiból táplálkozó, s azt általánosító tudomány fejlődését, elméleti és módszertani fejlődőképességét bizonyítják, mellyel a vállalkozások mindenkori marketing menedzsmentje számára megfelelő háttérrel teremtettek. A cikk részletezi a marketing erőforrás kompetencia alapú megközelítésének sajátosságait, mint a napjaink hálózati együttműködésekre, integrált vevőelvárásokra, technológia-orientáltságra épülő gazdaság kihívásaira adott marketingelméleti, stratégiai, módszertani választ.

### Резюме

Статья анализирует доминантные теоретические маркетинговые школы последних десятилетий. В сравнениях автор делает выводы, что разные подходы не являются постоянными парадоксальными изменениями в маркетинге, а ориентированный на практику, питающийся с практического опыта маркетинга. Доказывает теоретическое и методологическое развитие обобщающей науки, которая создаёт для маркетолога на предприятии необходимую перспективу.

Статья характеризует ресурс маркетинга, как своеобразный подход основ компетентности, сетевое сотрудничество, интегрированные требования покупателей, основанные на экономическом вызове теории маркетинга, стратегии и методологии.

# Sustainability Dilemmas of our EU-Accession

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## SUMMARY

*The principle of sustainable development was formulated in the Amsterdam Treaty as a basic principle of the European Union in 1997. The issues of sustainable economic development and social welfare are being formulated as conflicting aims from time to time during the Hungarian accession process to the European Union, as well.*

*We can set a real aim that the economic growth should serve for the aims of sustainability during the accession.*

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## INTRODUCTION

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The connection between economic growth and welfare has been engaged the attention of economists from the beginning of economics. From Adam Smith economists assume that although people generally do not intend to promote the public interest and work only for their own profit, there is an invisible hand that guides individuals to act for an end that was not part of their intent. We assume that market forces acting as an invisible hand guide the market towards the common good.

In the 20s of the 20<sup>th</sup> century Pigou however pointed out that the market is unable to handle external effects, therefore externalities lead to common bad instead of common good by distorting the mechanisms of demand and supply.

Not only scientist and green movements are looking for solutions of the conflict of growth and welfare-improving development, the discussion has started on international political and economical fora as well.

In 1983 the UN General Assembly requested Norwegian prime minister Ms Gro Harlem Bruntland to prepare a comprehensive program to mark the directions of necessary changes.

The World Commission on Environment and Development published its report entitled Our Common Future in 1987, stating principles and requirements necessary to preserve the world for future generations. These principles have become well-known as the principles of sustainable development worldwide.

Sustainable development is a complex process, which meets the needs of the present without compromising the ability of future generations to meet their own needs. The idiom means sustainable economic, ecological and social development. The ecological system, natural capital can

be substituted with economic capital only in a very limited way.

Donella and Denis Meadows call the society sustainable if it is “one that can persist over generations, one that is far-seeing enough, flexible enough, and wise enough not to undermine either its physical or social systems of support.”

A basic element and message of sustainable development is to treat the needs of future generations equally as those of today’s generation. In order to implement this principle of intergenerational equity, a serious and consequently implemented ethical decision is needed. The legal frameworks are not elaborated even within countries. (Initiatives toward this direction have started recently in Hungary and it is a subject of debate, how members of future generations could become subjects of law.)

## 1. SUSTAINABLE DEVELOPMENT AS A GOAL OF THE EUROPEAN UNION

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The European Union devoted serious attention to the implementation of sustainable development even at its earlier levels of development. Its 5<sup>th</sup> Environmental Action Program (1992-2001), “Toward Sustainability”, included the main concept of the program in its title.

The goal of sustainable development had remained only a goal included in the Environmental Action Program until 1997. The sign of the Amsterdam Treaty in 1997 brought an important change from the point of view of sustainability. The Amsterdam Treaty – which modified the Treaty on the European Union (signed in Maastricht in 1992) and the treaties of the European Communities – was signed on 2 October 1997. By modifying Paragraph B of the Preamble, it has become a goal of the European Union to promote economic and social development not

only considering environmental effects, but also the principle of sustainable development. Article 2 of the Treaty of Roma has been modified in a similar way which states that the European Community's goal is, among others, the promotion of harmonic, balanced and sustainable development of economic activities, high-level environmental protection and the improvement of environmental quality.

Including high-level environmental protection and improvement of the environmental quality among the goals of the Community indicates further improvement of the Community's environmental policy. By these modifications it has become a defined goal of the EU to improve its environmental policy in order to improve the quality of the environment as well. This requirement does not apply only for environmental policy but also for other policy fields of the Community.

## 2. THE ACHIEVEMENT OF SUSTAINABILITY GOALS

The European Communities started its first Environmental Action Program after the first Environmental World Conference held in Stockholm and had finished its fifth action program by the millennium. The assessments of the state of the environment and prospects for the following ten years included in these action programs are not prosperous.

The general environmental state of the European Union had not significantly improved by the millennium, and it had become worse in some areas. The main barrier of environmental improvement is believed to be the non-sustainable development of main economic sectors. Experts say that most of the main challenges stated in the Fifth Environmental Action Program remain actual in the present century. Table 1 shows the present state of the environment in the European Union and prospects for 2010 or longer. As we can see in the table there is an obvious positive change only in the case of pressure on ozone layer. Future pressure, state and impact data are usually less favorable or only slightly better.

Taking all these into consideration, it is understandable why EU decision-makers consider the environmental state and policy of the accession countries in a rather critical way.

What is the situation in Hungary with the environment? Is the distrust from the side of old EU Member States justified and we have only deficiencies or does Hungary also have some environmental goods which could be a gain for the EU after our accession?

Table 1. Environmental problems in the European Union 2000-2010

Pressure		Environmental problems	State and impact	
Present	Future		Present	Future
⇒	↓	Greenhouse gas effect and climate change	↓	↓
↑	⇒	Stratospheric ozone	↓	⇒
⇒	↓	Hazardous materials	⇒	?
⇒	⇒	Air pollution	⇒	⇒
⇒	⇒	Water usage	⇒	⇒
↓	↓	Soil contamination	↓	?
⇒	↓	Waste	↓	↓
⇒	?	Environmental and technological risk	⇒	?
⇒	?	Genetically modified organisms	?	-
↓	↓	Biodiversity	⇒	?
⇒	⇒	Environmental health	↓	?
⇒	⇒	Urban areas	⇒	⇒
↓	↓	Coastal and marine ecosystems	↓	?
↓	?	Rural areas	↓	-
↓	?	Mountain areas	↓	-
↑	Positive development			
⇒	Positive development but insufficient			
↓	Negative trend			
-	No qualitative data			
?	Uncertain (expert estimates only)			

Our major deficiency is the low level of sewage treatment. We have received the longest derogation for this problem (until 2015) and this is the requirement we can meet the most expensively (more than 1000 billion Forints according to present calculations). (Other problem areas include urban air pollution etc.)

Our strengths include nature conservation and biodiversity. (This strength of the accession countries is highlighted in the Sixth Environmental Action Program as well.)

During the accession process the harmonization of law was suitably delivered, but the implementation system is not strong enough.

Environmental protection is less important in the value system of the society comparing to other economic and social problems in Hungary than in the old EU Member States. This difference in its own can trigger some anxiety among EU citizens.

### 3. THE MEASUREMENT OF SUSTAINABILITY

As it is known, macro-indicators measuring economic performance (GDP, GNP) are not able to measure sustainability and welfare. These indicators have not been developed to measure welfare actually. Nevertheless several politicians and analysts treat these indicators as measures of welfare, and it is a source of problem.

GDP and GNP are not proper indicators of common good because:

1. National accounts do not indicate changes of environmental quality and resource depletion. The Gross Domestic Product reflects changes of productive capital by calculating with investments and amortization but it neglects natural capital changes.
2. GDP does not calculate with environmental services among incomes however they may influence the quality of life. Natural services that reduce emission abatement costs also remain hidden (e.g. natural self-cleaning capacity). This is misleading because these services influence production cost and thereby product prices and the GDP. Natural capital produces however non-market services beside the above-mentioned services and these are more valuable – according to reliable estimates – than its market services.
3. Several environmental costs increase the GDP. The costs of the so-called end-of-pipe methods (contrary to preventive environmental policy) are usually calculated. This means double counting of polluting economic activities: both their GDP increment and the abatement costs will increase the GDP.
4. Preventive environmental policy, reduction of material and energy usage will decrease the GDP. In this case welfare can be increased while the GDP will become lower.

The first new type macro-indicator called Index of Net Economic Welfare (NEW) was developed by W. Nordhaus and J. Tobin. The following, widely used indicator was the Index of Sustainable Economic Welfare (ISEW), and calculations have been made for several countries (e.g. the USA, Great Britain, Austria). Table 2. contains the components of GPI, column “impact” indicating whether the component’s impacts are positive or negative. Several components have different impact on GPI and GDP.

Table 2. The components of GPI

<i>Component</i>	<i>Impact</i>
Personal Consumption	+
Income Distribution	+ (low income differences) or –
Value of Housework and Parenting	+
Value of Volunteer Work	+
Services of Consumer Durables	+
Services of Highways and Streets	+
Cost of Crime	-
Cost of Family Breakdown	-
Loss of Leisure Time	-
Cost of Underemployment	-
Cost of Commuting	-
Cost of Household Pollution Abatement	-
Cost of Automobile Accidents	-
Cost of Water Pollution	-
Cost of Air Pollution	-
Cost of Noise Pollution	-
Loss of Wetlands	-
Loss of Farmland	-
Depletion of Nonrenewable Resources	-
Cost of Long-term Environmental Damage	-
Cost of Ozone Depletion	-
Loss of Old-Growth Forests	-
Net Capital Investment	+/-
Net Foreign Lending or Borrowing	+/-

In 1999 in the framework of a research project I had the opportunity to overview the changes of GPI in Hungary. GPI calculation has started: we suggested a statistical system supporting GPI measurement and calculated GPI changes during the 1990s for some components. We drew the following conclusions by analyzing Hungarian data.

Components with high negative impacts were:

- > Personal income weighted with income distribution
- > Cost of crime
- > Cost of long-term environmental damage

The increase of income differences intensified the negative impact of lower personal incomes due to the long recession period in the 90s (also reflected in the GDP).

The statistical system does not support the calculation of cost of crime. We could see, however, that the number of crimes had grown, and private costs of crime prevention increased sevenfold between 1993 and 1997.

Other significant long-term environmental damages include the costs of GHG and discounted environmental costs of nuclear energy production. (Because of “traditionally” low energy efficiency.) Present impacts of these components are slight, but according to the principle of sustainability they are still important because devolving these costs on future generations will compromise their opportunities.

Therefore it is very important to develop effective implementation strategies of international agreements on this area.

Components with medium negative impact were:

- Cost of unemployment
- Environmental damages

The cost of unemployment depends on the unemployment rate and the length of unemployment periods. There is an additional cost: the cost of health problems because of unemployment identified recently and also present in Hungary.

We could make detailed calculations for the cost of air pollution from environmental damages. The economic recession in the 90s – as an “environmental bonus” – could not compensate for pollution costs, according to our calculations, because of long-term environmental damages originating usually from the past. These long-term environmental pollutions (waste, soil, and groundwater) are the most serious ones and remediation costs will fall to the future generations compromising the principle and practice of sustainable development. These effects will presumably be different depending on the region and social status. It would be important from the point of view of our EU-accession to continue these calculations and develop a statistical system supporting data collection. Although EU evaluates its member states and accession counties with the help of a GDP-based indicator system, it would be useful to represent our development path by using new macro-indicators as well.

#### 4. SUSTAINABLE DEVELOPMENT AND GROWTH

The terms “sustainable development” and “sustainable growth” are often used as synonyms in everyday political and scientific discussion. In the framework of this article we cannot describe in detail why “sustainable growth” is impossible. (The American ecological economist H. Daly

published a great essay on this topic entitled “Sustainable Growth: An Impossibility Theorem”.)

It could be a realistic goal to set a development plan for a region for a limited time period. We have to consider environmental, sustainability aspects in this case, too. Tibor Erdős states in his essay, “Some Theoretical and Practical Problems of Sustainable Economic Development” about our growth potential during the EU-accession: “The costs of our accession are high, especially in the fields of environmental protection, traffic system, border-check system and public administration development. Further costs include the costs of agricultural development, law harmonization and satisfying other obligations. Some costs are attached to strict deadlines e.g. environmental costs and the development of border-check system. Environmental costs and the cost of traffic development alone would be as high as 6000 billion Forints, according to preliminary calculations, which is around 50% of Hungary’s GDP in 1999. It is possible that the need for external sources will increase significantly and it is a question whether this can regularly be covered by capital flow that does not generate facilities. If the answer is “no”, then the already reached 4-5% GDP growth can not be sustained without the real growth of liabilities.”

In my opinion high environmental related costs of our EU accession – that may slow down the speed of economic growth in Hungary – originate from ecological limits and therefore it is reasonable to calculate with these costs when analyzing long-term growth potential.

It is important to highlight again that we should always analyze changes of social welfare by means of sustainability indicators when studying growth potential and economic growth.

It was important to overview these sustainability questions because it could be a realistic goal for Hungary from the point of view of sustainability to improve sustainability potential and welfare, together with a GDP growth higher than the EU average.

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## Összefoglaló

A fenntartható fejlődés, mint az Európai Unió alapelve az Amszterdami Szerződésben került megfogalmazásra 1997-ben. A fenntartható gazdasági fejlődés és a társadalmi jólét mindig is ellentmondásos célként jelentek meg Magyarország Európai Unióhoz való csatlakozása során is. Valódi célként fogalmazható meg a csatlakozás során egy olyan gazdasági növekedés elérése, amely a fenntarthatóságot szolgálja.

## Резюме

Постоянное развитие, как один из главных критериев Европейского Союза было сформулировано в Амстерданском договоре в 1997 году. Поддержание экономического развития и общественного благосостояния всегда было противоречивой целью при присоединении Венгрии к Европейскому Союзу. Настоящей целью Венгрии при присоединении, было достижение такого экономического роста, который служит постоянному поддержанию развития.



# Changes in Labour Market, Job Creation and Job Destruction from the Change of Regime till Nowadays

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## SUMMARY

*I analyse the confirmation of Hungarian labour market process and the characteristics of workforce mobility and flexibility in my paper. Workforce mobility is influenced by privatisation and the changes in the property structures. In my paper I deal with the coherence between globalisation and relocation, the geographical resettlement of workplaces and the foreign companies that provide job to 35% of the employees. In the next section of my paper I examine the structure of employment, using the job creation and destruction rates, the relative changes in the weights of employment sectors and the development in the market evaluation of workgroups of different age and qualification. The conclusion is that the result of efficient capital – efficient knowledge copulation raises the value of knowledge which is mainly the increment of young and high qualified workforce.*

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According to a recent forecast of Employment Office there have been significant flows in the Hungarian labour market in the past few months. The forecast was established on the basis of data collected from 4550 business organizations in September 2002. The balance came out to be positive as the number of employment inflow (109,000) exceeded the number of layoffs of 70,000. The forecast was confirmed by future happenings. One of the first factory shutdowns was the one from Mannesmann resettling its production from Sárbogárd to China in 2000. Belgian fast food restaurant chain Quick has also brought investments to halt in Hungary. In 2002 steelwork manufacturer Butler Manufacturing Co. with American stake sold its subsidiary (Butler Kft.) in Nyíregyháza, and than in November 2002 IBM in Székesfehérvár announces the largest layoff providing an insecure future for 3700 workers. Salamander shuts down in Bonyhád, Phillips resettles its production from Szombathely to China. Along with these well known international companies further layoffs are expected in Hollóháza, in the region of steel Borsod, at Ajka Kristály (glass-, crystal-ware) and at Vértesi Erőmű (power-plant).

In spite of layoffs the average number of employed in the last three months of the past year was 3,903,000, up with 23,800 compared to the same period of the preceding year according to KSH (Central Statistics Office). This means that recent significant job destructing is compensated by the effect of job creating investments. As a sign of return on policy for stimulating investment General Electric and Bosch is still expanding in Hungary.

At the same time business behaviour of Flextronics is individual but to some extent typical. As the world's second largest contracting plant, Flextronics invested 800 million dollars in half of a decade in three different cities, neither in Budapest. Reacting rapidly to changes in market industrial park in Zalaegerszeg was put up in three months where Ericsson mobiles are assembled and computer spare parts are manufactured. R&D and training centre is also to be found here and the factory of Zalalövő also plans to move to Zalaegerszeg. Flexible product structure of the industrial parks in Nyíregyháza and Sárvár is often modified. Production of game console Xbox for Microsoft is moved from Sárvár to China and some output capacity was also resettled to the Ukraine where the level of wage costs is nearly the third compared to Hungary. (Farkas, 2003) Phillips and IBM seem to be just as flexible in the market with IBM not only relocating factories but also funding a new IT firm. Phillips (Phillips Magyarország Kft.) plans to launch a more complex product in Győr with more value added.

## GLOBALISATION AND RELOCATION, GEOGRAPHICAL RESETTLEMENT OF WORKPLACES

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Ideas above mentioned are not only characteristics of Hungary but also of the whole world, they are part of our life. The big question of the third millenary is the question of globalisation, the expanding world economy

through the countries of the world, which affects them not only horizontally but also vertically, becoming an important element to consider. (Szentes, 2001) The open economy of Hungary has long been horizontally part of the world economy, but vertical, real economical integration could be reached only after the change of regime, which was enforced by the intensive inflow of international working capital.

Relocation, geographical resettlement of workplaces has contributed to the more intensive relationship between global players. Relocation arises either with foreign trade, or paid-work relations, or international capital investments. The most advantageous for multinational companies are direct investments. Pure relocation means that well confinable jobs disappear physically in one country and are moved to an other one.

In the region of Middle-Eastern-Europe massive appearance of relocation proper and direct capital investments of Western-European multinational companies could be first noted after the change of regime, influencing both the recipient countries' and mother countries' economy and labour market. (Neumann, 1997)

There are a lot of researchers dealing with patterns of relocation in the West. Literature of relocation mentions many important causal factors such as gaining market or low costs of wages. Outsourcing of jobs results layoffs in the mother countries and can be judged as something hurting interests of employees and as a consequence several strikes organized by trade unions, or political crisis have already took place in Western-Europe on the occasion of multinational companies moving to an other country or shutting down. According to a recent report of UNICTAD summarizing positive and negative effects of relocation from qualitative, quantitative and territorial aspects highlights that outsourcing production requiring intensive physical work increases effectiveness and competitiveness. (UNICTAD, 1994) As a result of structural changes the mother countries withhold profitable and more value added activities demanding intensive human capital. Same favourable consequences can appear in Hungary after international capital moving out of the country. But this supposes job creation for high-qualified workforce. Balance of disappearing jobs and new jobs can vary countries. In Germany in the 70's more jobs disappeared than were created as low wage labour force from the Far East showed up in the country. But in the 80's after outsourcing basic activity secondary activities resulted new jobs exceeding the number of destructed jobs. (Neumann, 1997)

Hungary also encouraged Middle-Eastern-European relocation at the end of XX. century playing an important role in easing massive unemployment after the change of regime caused by the fall of the Eastern markets and the cutting back of unprofitable sectors. Inflowing working capital demanded mainly unqualified labour. Along with leaving the country the companies take their production culture also with them to low-wage countries. This

change of structure evokes the opportunity of creating such production cultures, which require skilled labour, high professional skills and contain more value added.

## FOREIGN COMPANIES IN HUNGARY

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According to KSH (Hungarian Central Statistical Office) 35% of employees in Hungary are employed by foreign companies. As to economic policy concepts foreign companies are entitled to play a special, influencing role in Hungarian economical processes, which includes the creation of a development model. As a result of foreign investments the property structure of the Hungarian economy has changed. Companies in most sectors including the ones that provide a large part of output, and the ones in several service sectors have now got in the hands of foreign owners. With the spread of foreign companies the question of "rootlessness" evokes, which can be observed from several aspects. (Szanyi, 2002) To what extent are they able to integrate themselves into the Hungarian economy? On the other hand, what happens if "rootless" companies leave the country? What is the balance of inflow and outflow? How did they affect Hungarian economy? Positive and negative effects both occurred. Positive effects are regarding mainly the Hungarian contractors of foreign companies. Hungary joining the EU means that the economical climate surrounding foreign companies in Hungary will change such as the means of stimulating foreign investment. So far unclear if there is relationship between the more intensive activity of foreign companies in Hungary starting from 2000 and the country's joining of EU. But as you can see there are plenty of questions to answer. One of them is the effect of job creation and job destruction on labour market processes, on the conditions of employment on both sector-level and company-level and on the structural composition of labour force.

## THEORY OF JOB CREATION AND JOB DESTRUCTION

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Transformation in Hungary is over; an operating market economy was born. Perhaps uniquely in this region privatisation has generally ended in Hungary. Between 1990-1996 Hungary's capability of attracting capital was outstanding with the highest inflowing capital per capita. Delay in time, which is linked up the individual characteristics of privatisation has resulted that from 1998 on more capital was flowing to Poland than to Hungary. This situation generated two advantages for Hungary: inflowing capital has expanded modernisation activity, often including R&D too, and the rate of technologically intensive commodity groups has grown radically in Hungarian export, while the rate of technologically not so demanding commodity groups has decreased. (RÁCZ, 2000)

Besides macro-economic advantages, effects on Hungarian labour market are also to be considered. Changes in the employment structure of the economy, in the composition of human resource in companies, effects on the different strata of employees. Instead of traditional indicators characterising labour market (participation rate, rate of unemployment) western statistical offices, research centres, universities dealing with this topic use indicators of job creation, job destruction, relocation to describe conditions of labour market and its flexibility. (Daood, 1998) Hungarian researches lead by Gábor Kertesi and János Köllő concerning the two stages of economical development, revaluation of human resources from the aspect of labour market apply these indicators. (Kertesi-Köllő, 2001)

When measuring the processes of job creation and job destruction firstly the company's average participation rate is calculated for two consecutive years, secondly companies are categorized whether the number of employees has increased or decreased. Consequently, the following indicators can be generated:

- > Gross rate of job creation: all employment growth at expanding companies in a particular sector divided by the average number of employed in the sector.
- > Gross rate of job destruction: decrease in employment divided by the average number of employed in the sector.
- > Net rate of job creation: difference of the first two indicators.
- > Gross relocation: sum of the first two indicators. Shows rate of change in employment structure.

These indicators concern the effect of changes in the company's lifecycle on employment, establishment of companies, layoffs, insolvency proceedings etc. and furthermore they assure the opportunity of analysing the transformation of economic structure. (Körösi, 2002)

Éva Surányi thinks that developed market economies bear an intensive job creation and job destruction process. An annual average of 10% of jobs is destructed and every ten jobs are followed by a new job. Although to a different extent but redistribution of jobs can be recognised in every sector of the economy and furthermore capability of reallocation and flexibility in labour market are varying between enterprises of one particular sector. There are several factors influencing reallocation of jobs, of which the most important are the size and age of enterprise. But property structure, wage level, capital intensity, level of production specialization, productive efficiency inside a sector are such factors that can either increase or decrease reallocation. (Surányi, 2002)

Research of flow of labour force in transition economies became one of the most popular objectives of researchers from the west. According to an Oxford researcher, Blanchard, in Hungary 71% of new jobs were filled with someone employed already instead of engaging the vast number of free labour force, the unemployed. This figure in Poland turned out to be only 40%. Flow of labour force could be perceived rather between two workplaces

instead of unemployment outflow. (Kertesi-Köllő, 2001) Two Belgian researchers from the University of Leuven, Bilsen and Konings observed labour market conditions in Bulgaria, Romania and Hungary between 1991-1994. They found out that job destruction was high in each country (9-13%) while job creation was low (under 1%). In transition economies structural changes of sectors were accompanied by high job allocation inside particular sectors. (Bilsen-Konings, 1998)

## JOB CREATION AND JOB DESTRUCTION IN HUNGARY

Different indicators of job creation and job destruction along with KSH data prove that in the past 13 years flow of workplaces has resulted change in the structure of Hungarian economy, in the structure of employment and in the demographical (age, sex, qualification) and economical (job cluster, job relations) characteristics of employees as well. Changes in economy structure, in job clusters and in the composition of employees are to be further analysed.

Census figures of distribution of employees between sectors indicate that significant job destruction occurred in agriculture with this sector engaging 15,5% of all employees in 1990 and only the third (5,5%) in 2001. Weight of industry and building industry has also sunk from 37,9% to 32,9%. Consistently the weight of sector of services has increased from 46,7% to 61,6%. (Fóti-Lakatos, 2002) Furthermore indicators of job creation and job destruction show that mining industry, energy sector and traditional light industry are net job destructors. So called narrow job reallocation indicators prove that the Hungarian labour market's reaction on the effects hitting companies of the competitive sector was flexible. The least flexible were mining industry and energy sector (10,6%), the most flexible was manufacture of machines (22,1%). Manufacture of machines suffering of massive layoffs in the mining industry at the early stages, has managed this outstanding net job creation figure by an intensive reallocation. (Körösi, 2002)

Transformation of economical structure has resulted shifting weights of different job clusters as well. Between 1990-2001 the weight of managers, white-collar workers and others in the sector of services has grown, while workers in agriculture, industry and building industry are less. (Fóti-Lakatos, 2002)

Flows in labour market significantly influenced not only the factors mentioned above but also the composition of employees. Value of school qualification has risen in market economy and at the same time the value of labour market experience attained in socialism has decreased. After the change of regime demand for unqualified labour has declined more intensively than the average. Number of jobs filled by unqualified labour (elementary school, vocational training school) was down by 48% in the first half of the 90's and stabilized at this level. Their crisis in

the labour market is clearly indicated by the rate of unemployment. Demand for skilled labour was also down by 11% during the first five years, but by 1999 their situation has normalized at the 1990-level.

Kertesi and Köllő say that on the way to market economy there are two stages regarding the value of qualification in labour market:

➤ at the first stage of transition, i.e. in the first half of the 90's, demand for unqualified labour has halved and consequently the wages were also significantly cut back. Demand for skilled labour has also decreased and their wages didn't get better as well, as a result of job destruction regarding jobs requiring skilled labour.

➤ at the second stage of transition, i.e. in the second half of the 90's, job creation improved the trends of wages. Situation got worse for elderly skilled labour compared to the younger generations of skilled labour whose wage-level increased.

Most beneficial was for those graduates who gained their degree at the time of the change of regime and entered the labour market when gross reallocation was dynamical and managed to establish themselves in foreign companies. Direction of revaluing human capital has changed and the devaluation of elderly skilled labour was accompanied by the increasing value of younger skilled labour. (Kertesi-Köllő, 2001)

Causes of revaluation evoke the question what are the covers of larger profits of young skilled labour? Using Cobb-Douglas production function researchers reported that the benefits of productivity of younger skilled labour have grown, while in case of elderly skilled labour it has declined.

Is it true that the connection of modern technology provided by foreign companies and modern knowledge produce extra benefits? Nevertheless, efficiently operating Hungarian owned companies confirm the hypothesis of efficient capital - efficient knowledge copulation as well. (Kertesi-Köllő, 2001)

Improving position of younger generations evokes the question whether "overqualified" young people really squeeze out unqualified labour inside the company? What role does direct substitution play in the structure of employment? Answer was sought by an EBRD research in which non-agricultural companies of Hungary, Romania and Russia, 300 each were observed. The research concerning 65,000 Hungarian employees states that the rate of direct substitution is low in Hungary.

10-15% of the unqualified lose their jobs therefore, while 30-35% of skilled labour establishes themselves in this way. The final consequence of the research in general is that reallocation inside the company is less considerable than reallocation between companies. (Köllő, 2002)

Researches carried out in the fields of Hungarian job creation and job destruction suggest that Hungarian labour market has of course individual characteristics due to the period of transition, but in many aspects similarity is to be recognized with the processes determining demand in the labour market of developed market economies. Flexibility of Hungarian labour market meets general market economy standards. High figures of job creation and job destruction indicate the fast and significant structural change of the competitive sector and not the flexibility of Hungarian labour market. Hopefully recent allocations of workplaces encourage a knowledge intensive economic structure with high productivity.

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## Összefoglaló

A tanulmány a magyarországi munkaerőpiaci folyamatok alakulását, a munkaerőmozgások jellegét és rugalmasságát elemzi. A munkaerőpiaci mozgásokra hatással van a privatizáció és a tulajdoni szerkezet átalakulása. A tanulmány foglalkozik a globalizáció és a relokáció összefüggéseivel, a munkahelyek földrajzi áttelepülésével, az alkalmazásban állók 35 százalékát foglalkoztató külföldi vállalatokkal. Ezt követően a munkahelyteremtés és a munkahelyrombolás mutatóinak segítségével az alkalmazásban állók foglalkoztatási szerkezetét, a különböző iskolázottságú és életkorú munkaerőcsoportok piaci értékelésének alakulását. Következtetés, hogy a hatékony tőke-hatékony tudás párosítás eredménye a tudás felértékelődése, amely döntően a magasan képzett fiatal munkaerő hozadéka.

## Резюме

В статье описываются изменения в процессе рынка рабочей силы, анализируются структура и эластичность рабочей силы в Венгрии.

На перемещение (флуктуацию) рабочей силы влияет приватизация и изменения которые произошли в структуре собственности предприятий. В статье описывается связь между глобализацией и реллокацией, географическим переселением рабочих мест, с занятостью на иностранных предприятиях, на которых работает 35% от общей чисельности работоспособного населения Венгрии. Далее в статье с помощью разных показателей анализируется структура занятости рабочих в зависимости от образованности занятых.

Вывод: эффективное использование капитала и знания приводит к переоценке знаний, причиной которых в большой степени является доходность от квалифицированной рабочей силы.



# Financial Controls, an Old Function in a New Role

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## SUMMARY

*Keywords: auditing, financial controls, financial stability, globalization, regulation.*

*The phenomenon of financial controls is as old as money. The ancient rulers wanted to know if their subordinates gave an accurate report on how the tax revenues was spent. Traders in Lombardy wanted to be ensured that their employees had not cheated. The owners of joint stock companies are also curious whether the board that leads the company and the managers act in the owners' interest when managing the company. I believe that the appearance and consolidation of the financial system, which is without internal values and based on trust, and the increasing need for financial stability have given increasing role to financial controls. The global financial crises in the third part of the 1990's has resulted a new situation in the operation of the international financial system. It has been pointed out that financial stability can only be guaranteed by global regulation and control, supervision and audit. Financial controls have been put in a new position qualitatively due to the development of the uniformed controlling procedures and the internationally co-ordinated operation of institutions. It cannot be ruled out that financial controls will be the generator and creator of global co-ordination. This article tries to discuss the arguments of this hypothesis as well as present some data supporting it.*

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## ABOUT THE CONCEPT OF CONTROL AND AUDIT

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Control and audit can be defined economically, politically, sociologically and organisation theoretically as a function, which is inherent in economic processes to deal with uncertainties and to achieve certain goals set by the stakeholders. The content of this function could be approached from several angles:

- Control and audit is an activity which analyses the accomplishment of certain actions, processes or events in accordance with a previously defined system of conditions. These activities are always part of a supervisory function, a management or guidance process. The analysis covers the difference between the actual facts and the expected goals, the reasons for the differences, the consequences and reveals the preventive measures that can be taken. Control and audit becomes separate function in the properly differentiated guiding and/or managing system, and can be institutionalised in various control and audit organisations. The institutionalised function or its appearance in a separate form is the consequences of a development phase and/or the results of regulatory acts.
- In technological terms control and audit is an economic analysing method, the combination of work and process-organisation principles set by the

characteristic feature of the activity as well as the action and the policy. All three elements of the definition are important. The analysis is linked to the fact that uncertainty needs to be solved or avoided. This means that one has to define the determinative factors concerning the function of the controlled and audited process, organisation or program, furthermore to discover the interaction between the various factors. To achieve this various analysing methods are available that range from a simple comparison through the methods of elementary statistics to the application of different models. The adequate method of analysis is not sufficient for appropriate control and audit. That is to say, the function of control and audit operates according to various interest criteria. It is required partly to take into consideration these interests, as well as to tackle the conflicts arising from the different viewpoints concerning the function. By introducing special work and process organisation principles and by set proceeding the different viewpoints and counter-interests can be excluded.

Control and audit always takes place in a previously defined field or space, in previously set of interests. Special work-organisation procedures, proceedings of control and audit as well as the expected behavioural norms of controllers and auditors have been created to

tackle the clash of interests without jeopardising the functions of control and audit.

In those economies in which the institutions are highly developed the function of control and audit is at great degree differentiated. In the everyday work of running the economy increasing number of functions of control and audit are used. Concerning the logic of market economy control and audit focuses mainly, but not exclusively, on financial processes. It is also the role of control and audit to ensure, just to name but a few, the basic pillars of the society, financial reports of different companies, the tax return of various participants of the economy, reports on government spending and providing data on the basis of the statistical system. With the economic function of the government managing a country has also become a lot more complex. In the public sector an increasing volume of resources are concentrated. As a result of this, in the field of traditional public finances fundamental changes are necessary concerning control and audit. State participation and the fluctuation in the range of regulations do not question the necessity of control and audit, but they might change its philosophy and professional approach.

Control and audit methods have been developing parallel with the ever broadening range of control and audit.

## THE EVER-INCREASING ROLE OF CONTROL AND AUDIT IN THE MODERN MIXED ECONOMIES

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The novelty of the past two decades has been the appreciation of financial control and audit in the economy as a whole. The roots of these changes are to be found in the changing economic and business climate. In one word one can call the new situation globalisation. Globalisation is based on the following factors:

- The technical environment of the economy has changed radically. Information technology-independent from the sectors- has revolutionised not just how information is processed, but also logistics and the organisation of production and services. This new technology is, however, a new source of uncertainty and risks.
- The financial sector has gone through deregulation since the 1960's and as a consequence of this, liberalisation has dissolved the segmentation of financial markets. This process has triggered the liberalisation of international trade which was initiated by GATT and later by WTO.
- The increasing size of companies and activities of certain companies are stretched into international networks of companies.

## THE APPRECIATION OF THE FUNCTION OF CONTROL AND AUDIT IN THE NON-FINANCIAL SECTOR

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Globalisation has dramatically increased the operational risks among non-financial companies. The increase in company size, the widespread locations of their premises, the applied technologies have all increased the sources of risks. In these conditions traditional company management practices and methods have lost their efficiency. Hardly can one overrate the change of paradigm that has actually taken place in the view and management practices of various companies. Corporate governance depends on two significant pillars to operate large, global businesses. One of the pillars is the management body in which the most important interest bearers concerning the business can be found. The other pillar is the internal control system, which can minimise by self-regulation the dysfunctions in business operation. The essence of the concept is that the only way to operate an increasing complex business efficiently and manage it for the satisfaction of its stakeholders is by creating and/or strengthening the internal control mechanism of businesses, in a partly self-regulated way and partly by the representation of and continual negotiations with the affected parties. As a result, the intended operation will be guaranteed. The key terms of this paradigm are internal control and the altered function of internal audit. This new approach of business operation is reflected in the establishments of voluntary organisations, i.e. consulting committees, e.g. Treadway Committee, Cadbury Committee, to deal with problems emerging in the private sector. International institutions such as the World Bank, OECD, INTOSAI, IFAC Public Sector Committee, have soon realised the significance of this question and they have tried to accomplish the new paradigm in an institutionalised form and to promote the international practice of supervision, control and audit.

## THE ROLE OF CONTROL AND AUDIT IN THE MONETARY SYSTEM

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As a result of a long evolution, today's monetary system is a monetary system without internal values. After the demonetisation of gold and since the creation of the monetary system international monetary institutions have been playing key roles. Such institutions are the Bank of International Settlement (BIS) established in 1930 and the institutions on Bretton Woods, established in 1944. The most important functions of the latter ones are the regulation and control of the operation of the international monetary system. On national level the central bank and the supervisory boards control the various financial services. The bank- and the stock exchange supervisory have become separated and

independent from the central bank because of the increased need for regulation and control. Central banks mainly concentrate on monetary stability, and on control on the money creation of commerce banks preventing an unwanted growth of money supply. Apart from these, central banks regulate, support and control national payment systems. In the case of partial convertibility central banks control currency transactions as well.

The second pillar of the monetary system is the bank and stock exchange supervisory committees. Due to the need to prevent further bank crisis which was so typical in the 1970's as a result of an international debt crisis, bank and stock exchange regulation and supervisory control to enforce the regulations have been appreciated. From the point of the topic it is negligible to mention what kind of forms these supervisory boards of financial services take. Actually they might range from unified, or attached to specific financial services, they might be individual bank supervisory, insurance supervisory or stock market supervisory. The question whether any of these supervisory functions are connected to the central bank is also negligible. The installment of the supervisory functions and their institutionalised forms depend on the country's monetary system, its traditions and its exact political situation. What is worth mentioning, though, is that the regulations and supervision of the supervisory boards are in accordance with supranational agreements, e.g. OECD, and characterised by voluntarily accepted norms, e.g., Basle Concordat and agreement upon "International Convergence of Capital Measurement and Capital Standards", which contains bank supervisory recommendations.

With globalisation the international monetary system has become permanently vulnerable. The most dramatic event that has to be mentioned is the 1997-98 south-east Asian financial crisis, which can be considered as the first global crisis. It became obvious that all crisis, let it be bank or currency crisis, are infectious. The local financial crisis gets widespread in a deregulated and liberated world economy easily causing serious damage all over the world. In these circumstances the idea emerged to set regulations to avert further global crisis. There are two Bretton Woods institutions that take key roles in preparing and managing a program with which the international financial system can be strengthened. The essence of the program is the action with which the national and international financial systems can be ensured to be stabilised. The main fields of the program are the following:

- to reveal the reasons of vulnerability in the system and to correct it in time
- to choose the proper exchange rate systems and operate them
- to improve the supervisory of the financial sector
- to make the economic policy of the countries more transparent
- to simplify the loan policy of the IMF

➤ to involve the private sector in the prevention of financial crisis and if it is necessary in its handling

Consequently, the activity of the IMF has to adopt a new role, a requirement to be the guard of the prudent international standard. The Economist *Special Report*, 28th September, 2002.; Báger 2003;

The increasing role of financial control and audit is not restricted only to the monetary system. Financial control and audit is a traditional function in the fiscal system too. The fiscal system, besides the monetary system, is part of the financial system. The increasing volume of the applied resources of the fiscal system and the fact that government finances have become international matters, take the aid to developing countries or the realisation of the European integration for example, have appreciated the traditionally used role of control and audit in this sector. International trust requires the transparency of the national fiscal systems. As far as the EU is concerned, there is special preference on the transparency of the Common Budget. This need caused the establishment of GFS, i.e. Government and Financial Statistics System operated by the IMF as well as the establishments of the international accounting standards of the public sector, and last but not least, the creation of the fiscal statistic system operated by Eurostat. The institutions that deal with the control and audit of the fiscal sector operate an international organisation called INTOSAI to ensure the uniformed control and audit principles and practices. In the EU as well as in NATO there are very strict financial control and audit institutions.

The most dynamically changing and most uncertain elements of the financial systems are the financial markets. With the globalisation of the financial markets, the incredibly quick development of financial innovations have resulted the biggest threat for some nations and for the stability of the international financial system. In the financial markets not only do the previously mentioned supervisory institutions operate as controllers and auditors but also there are monitoring institutions, auditing companies and rating agencies as well. The control and audit activities are carried out on the basis of voluntarily accepted and internationally consistent standards. Both in accounting as well as in ratings various standards did exist after the First World War but these standards were typically localised. However, in the 1960's the effort to harmonise and co-ordinate internationally the accounting and reporting practices speeded up. In this field one can witness the competition of IAS, which relies on European traditions, and of GAAP, which reflects the traditions of the US capital market. As far as ratings are concerned, the standards are based mainly on the experience of US companies. The supranational regulation and control is an institution that serves the international hegemony well but at the same time badly. The USA seems to rule the key fields of the financial system. The appearance of the common currency in Europe has not yet presented the existence of an alternative reserve currency. The various supranational

institutions are themselves the fields of competition for the hegemony. The dramatic developments of recent years have been the appearance of mistrust in the previously trustworthy monitoring institutions. The scandal of ENRON is just the dramatic example of the contradictions in the system. Monitoring institutions are profit oriented, and what is more, there is an oligopolistic situation in that market. Profit orientation and the oligopolistic competition resulted services that are not compatible with the basic functions, and one needs to take just a small step to commit fraud or forge the balance sheet.

After the bankruptcy of ENRON the US legislation passed the so-called Sarbanes-Oxley Act to ensure that financial reports are trustworthy. The situation is fairly similar concerning the rivaling accounting standards, i.e. IAS and GAAP. Despite the well-known management scandals the American Stock Exchange Supervisory insists on the application of GAAP. In October, 2003 the Financial Times organised a conference on which there was a heated debate on this topic. Finally, the participant came to an agreement saying that the American Stock Market Supervisory would also accept the plan to prepare a globally accepted accounting standard.

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## Összefoglaló

### Régi funkció új szerepben

A tanulmány a pénzügyi ellenőrzés szerepét, fejlődését új aspektusban mutatja be. A modern pénzügyi rendszerekben az ellenőrzési funkció önálló, összetett intézményrendszerből álló alrendszerbe szerveződik. A pénzügyi ellenőrzési rendszer funkciói a pénz iránti bizalom fenntartása, a gazdasági szereplők pénzügyi beszámolóinak hitelesítése, a pénzügyi rendszer stabilitásának biztosítása és a közpénzek korrupciómentes, szabályos és eredményes elköltésének szavatolása. A globalizáció a gazdasági szereplők interdependenciáját, technológiai és pénzügyi sebezhetőségét rendkívüli mértékben kiélezte. A tanulmány azon állítás mellett érvel, hogy a pénzügyi stabilitást szolgáló, a nemzetállamok feletti koordináció éppen az egységesülő pénzügyi ellenőrzéssel teremthető meg.

## Резюме

### Новая роль старой функции

В данном исследовании в новом аспекте рассматривается роль и развитие финансового контроля. В современных финансовых системах функция контроля организуется в подсистему, состоящую из самостоятельных, сложных по составу институциональных систем. Функциями системы финансового контроля являются поддержание доверия к деньгам, удостоверение подлинности финансовых отчётов участников хозяйственной деятельности, обеспечение стабильности денежной системы, а также гарантирование эффективного и законного расходования общественных денег с исключением коррупции. Глобализация чрезвычайно обострила интердепенденцию участников хозяйственной деятельности, их технологическую и финансовую ранимость. В исследовании доказывается, что наднациональная координация, обеспечивающая финансовую стабильность, создаётся как раз посредством унифицирующегося финансового контроля.

# Impact of EU Enlargement on Business Environment of Small and Medium-Sized Enterprises in Slovakia

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## SUMMARY

*The paper discusses the impact of EU enlargement on business environment in the Slovak Republic. Integration of Slovakia into EU has significantly influenced operating conditions for small and medium enterprises. Prosperity of small and medium enterprises depends mainly on their ability to adapt themselves to these new conditions.*

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## INTRODUCTION<sup>1</sup>

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One of the goals of Slovakia in the current period should be a full adaptation to EU economic standards. Basic assumptions of the successful integration of the Slovak economy into the EU are increase of competitiveness and productivity, decreasing the rate of unemployment, decreasing the state budget deficit and balance of payments deficit. This all is possible only under the condition of successful development of small and medium-sized enterprises (SMEs).

Globalisation and global economic competition with the USA, Japan, and China requires increasing the competitiveness of all EU member states and all entrepreneurial subjects. If we compare the US and Japan economics to the EU economics, the basic assumption of EU competitiveness increase is its integration into a compact economic complex with internally harmonised business environment. In order to achieve it, the EU has to take many important actions in the area of taxes, financial market, labour market, public administration, and agriculture.

## SME ABILITY TO ADAPT TO ON-GOING CHANGES

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If Slovak SMEs are to succeed in this competition, they must adapt to this business environment and respond quickly to constant changes. EU accession influences SMEs in various areas of their activities. Especially the following challenges should be pointed out:

- requirement to adapt to on-going changes,
- increase of the competitive pressure on SMEs,

- constant need to increase the human capital quality,
- efficient use of available EU funds,
- investment conditions and opportunities.

The pressure on SME's ability to adapt and flexibly react to changes in entrepreneurial environment and competition after the EU accession will keep growing. Research results of the pre-accession expectations CAPE (Corporate Readiness for Enlargement in Central Europe) carried out by EUROCHAMBERS based on comparison of results from the new EU member states, had been positive for the Slovak entrepreneurial subjects (see Chart 1).

The Slovak firms expected positive impacts mainly in the area of foreign investment inflow and more transparent entrepreneurial practices. SMEs also expected better access to the joint EU market of goods and services and to EU capital market.

Slovak SMEs had different expectations before the EU accession and besides of positive aspects of integration, entrepreneurs were afraid of several risks and threats. Slovak entrepreneurial subjects pointed out the following negative aspects of integration as the most serious:

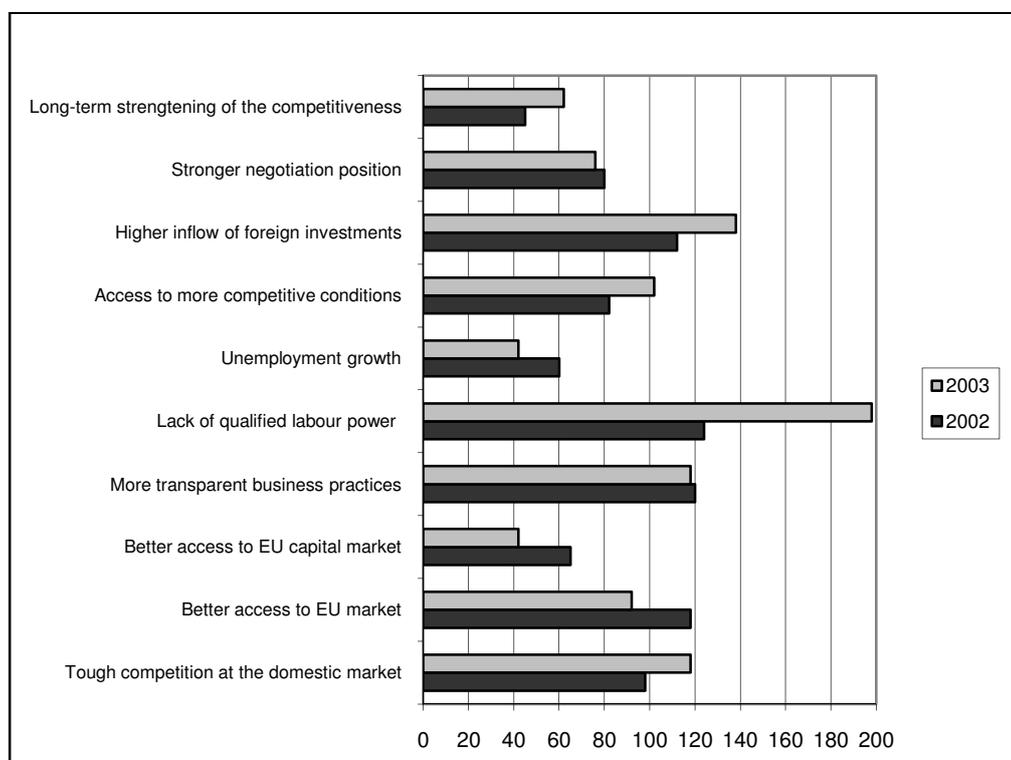
1. Fast price adjustment that can have negative impact on competitiveness of Slovak SMEs because of loosing competitive advantages such as lower energy prices, lower labour costs etc.
2. Growth of number of foreign competitors that would push domestic SMEs out of the market because of some important competitive advantages such as high production quality, high innovative capability, sufficient own capital etc.
3. Inefficient use of European funds that are expected to contribute to development of the member states'

economies such as the Structural funds and the Cohesion fund.

4. Lack of qualified and well trained entrepreneurs, managers and employees who would be able to respond to new conditions.

Success of Slovak SMEs on the EU market depends mainly on their capability to adapt to market changes and changes in the business environment that are going on a continuous basis. After the EU accession pressure on ability of SMEs to adapt and flexibly react to changes will grow steadily. Flexibility and adaptability have to be inseparable parts of the entrepreneurial activity.

The ability to react to the changes is proportional to the quality of SMEs management. The entrepreneurial subject can succeed on the market only if it manages to cope not only with standard changes but also with changes related to the integration process. After the EU accession the entrepreneurial subjects in Slovakia have to comply with the joint EU legislation including strong pressure to increase transparency and strengthening a company's goodwill in the public.



Source: CAPE Corporate Readiness for Enlargement in Central Europe. A Company Survey on the States of Preparations for Single Market 2003. Summary Report. Brussels: Eurochambers and SBRA, 2003.

Figure 1 Evaluation of effects of the joint market by Slovak firms  
(Average per 10 new EU member states = 100)

## INCREASE OF THE COMPETITIVE PRESSURE ON SMES

Another impact of EU accession is increase of the competitive pressure on SMEs in Slovakia. International comparisons and studies show that the competitiveness of SMEs in Slovakia is low (European Innovation Scoreboard, 2004). According to the enterprise efficiency in the area of innovation, profitability and trustworthiness Slovakia ranked 37<sup>th</sup> out of 49 evaluated countries, Hungary ranked 28<sup>th</sup>, the Czech Republic improved from 43<sup>rd</sup> to 31<sup>st</sup> and Poland ranked 46<sup>th</sup> in 2003 (NARMSP, 2004).

One of the most important sources of the competitive position increase of the Slovak SMEs is their innovation and investments to the research & development (R&D). Innovation is regarded as one of the key drivers of the economic welfare. As the Community Innovation Survey offered a Summary Innovation Index in 2004, Slovakia ranked in the "Catching-up" pattern for Acceding countries and currently is at the seventh position from bottom of all EU countries, USA and Japan. The Index uses only the twelve most widely available indicators such as human resources for innovation, creation of new knowledge, transmission and application of knowledge, and innovation finance, output and markets. It covers all EU countries. Nevertheless, the position of Acceding countries like Slovakia should not hide the existence of

serious problems: though these countries show a stronger growth performance than the EU, a large part of this growth is due to the fact that these countries have started from very slow starting values for several indicators. Moreover, public and private R&D spending is falling (European Innovation Scoreboard, 2004). Slovakia currently depends on foreign direct investments (FDI) for growth that will eventually reach an upper limit, unless there is an improvement in the innovative capabilities of domestic firms. Slovakia ranked among the trend leaders within the Acceding countries only in two indicators: Employment in med/high-tech manufacturing and ICT expenditures / GDP. In all other indicators Slovakia lies far behind not only all EU countries, but the Acceding countries as well. According to the European Innovation Scoreboard 2004, the major relative strengths of Slovakia are (1) trend for science and engineering (S&E) graduates, (2) trend for European Patent Office (EPO) high-tech patents, and (3) innovation expenditures. The major relative weaknesses are: (1) trend for public R&D, (2) current US Patent and Trademark Office (USPTO) patents, and (3) current and trend USPTO patents (European Innovation Scoreboard, 2004). Slovakia is doing better on diffusion than on the creation of innovation. Even 80% of Slovak firms are non-innovators, 8% are technology adopters, 4% are technology modifiers, 5% are intermittent innovators, and only 3% are strategic innovators (European Innovation Scoreboard, 2004).

Management of all SMEs must be aware of fact that after the EU accession they are under increased competitive pressure. Increasing the number of competitors and free movement of goods and services within the EU are the driving forces of this. Entrepreneurial subjects, if they want to succeed, must be prepared for such a trend. Slovakia ranked 40<sup>th</sup> most competitive country out of 60 measured by The World Competitiveness Scoreboard 2004 what meant the advancement from the 46<sup>th</sup> position. Slovakia ranked even better than the Czech Republic, Hungary, Slovenia or Italy.

The basic requirements of the business subject's competitiveness, as viewed by financial institutions and foreign investors, are:

- > financial power of SMEs and ability to raise the financial resources,
- > credibility of SMEs,
- > innovation capability and constant increase of expenditures on R&D,
- > lifelong education and training of both SME managers and employees,
- > creation and application of new knowledge inside the companies, and much more that are also of critical importance.

On the other hand, SMEs expected that after the EU accession accessibility to banking and non-banking financial resources would improve.

## IMPACTS OF THE EU ACCESSION ON SMEs IN THE REGION OF KOŠICE

It is difficult to evaluate the impacts of EU accession on SMEs because of small period from the accession. An opinion polling survey on impacts of EU integration showed, opinions of entrepreneurs from the region of Košice differ. The research was realized on a sample of 30 SMEs in December 2004. This research is not representative, but still it gives a basic indicative overview of SMEs opinions from the region of Košice on impacts of the EU accession.

Thirty SME managers from the region of Košice were asked to respond in a questionnaire-based survey. Companies from different sectors were involved in the following sample: retail trade – 9, catering services – 7, craftsmen – 5, clothing industry – 5, information technologies – 4.

SMEs' managers were requested to answer a simple question with seven possible responds. They were asked to choose the one that mostly corresponds with their perception of the impact of EU accession on their entrepreneurial subject.

**Question:** What is the main impact of the Slovak EU accession on your company?

1. Without significant changes.
2. Liberalization of the input prices.
3. Increase of the competition pressure.
4. Better access to EU market.
5. Better access to financial means.
6. Simpler EU funds raising.
7. Other impacts.

*Table 1. Impacts of Slovak accession on SMEs within the region of Košice*

Impacts of Slovak accession on SMEs within the region of Košice	No. of SMEs	Share (%)
Without significant changes	12	40 %
Liberalization of the input prices	6	20 %
Increase of the competition pressure	4	13 %
Better access to EU market	3	10 %
Better access to financial means	2	7 %
Simpler EU funds raising	3	10 %
Other impacts	0	0 %
TOTAL	30	100 %

Source: Own research

Though the research is not representative it allows getting the subjective opinions of the entrepreneurs within the region of Košice on the impact of the EU accession on their business activities. The results show that in the first months after the EU accession by Slovakia 40% of small

and medium entrepreneurs have not experienced significant impact on their entrepreneurial activities. This result is influenced by the regional performance of SMEs. We can suppose that in the case of big companies the share of enterprises which were not affected by integration would be much lower.

Significant is a share of SMEs (20%) that perceive the liberalization of input prices as a cause of the EU integration. The discussions are going on in the area of energy and gas markets' liberalization that would significantly affect SMEs. They have to calculate with further increase of the electric energy prices by 15-20%. The EU energy capacity is considered to be insufficient and with respect of a consumption pressure its price can increase. Entrepreneurs have to calculate with similar trends also in a gas industry (NARMSP, 2004).

Only 13% of responders perceive increase of the competition pressure as an impact of integration. Entrepreneurs were already under the competition pressure and that is why they do not perceive it as a major impact of the integration.

There is only 7% of SMEs perceiving a better access to financial means and 10% of entrepreneurs feeling a chance for an easier draw of financial means from the EU funds. This result is rather disappointing because the entrepreneurs expected from integration an improvement of opportunities to fasten and simplify the process of access to financial sources.

Imbalance of financial relations is a barrier for the Slovak SME competitiveness within the EU market. The liability maturity is in most Slovak SMEs approximately twice higher than the claim maturity. The insolvency has negative impact on the competitiveness of entrepreneurial subjects on the EU market.

One of the weaknesses of many SMEs is their inability to compete with financial services that are connected with the sale of goods and services. If SMEs want to succeed on the EU market, they have to eliminate this drawback. Almost every business subject can produce a product of good quality or offer a good service, the question is how to place them at the EU market and sell to customers.

## USAGE OF EU FUNDS

After the EU accession the key funds are Structural EU funds and the Cohesion fund. The PHARE, ISPA and

SAPARD projects will be finished in the period 2004-2006 and since 2004 the structural funds and the Cohesion fund are available for the Slovak SMEs.

A basic difference between pre-accession and the Structural funds is in project approval. A pre-accession aid operated in the ex ante regime of approval, it means that every project was submitted to a Committee for approval (besides SAPARD). On the other hand, the Structural funds are operating in a decentralized ex post regime, i.e. approval of the project by the European Commission (EC) is not required. Responsibility for selection of the projects is on every state itself, the EC has only a monitoring function.

The EU contribution is 75 % from public expenditures for pre-accession funds, the sum of contributions by the Structural funds varies from 25 % to 80 %. The advantage for Slovak SMEs is that the level of each contribution depends on the development rate of given region measured by GDP per capita. Especially entrepreneurs from underdeveloped regions have a chance to obtain sources; in the Slovak Republic these are all regions except Bratislava. Difference between pre-accession financing and post-accession financing from EU funds is in the volume of provided financial resources. The pre-accession aid for all candidate countries was around 3 billion EUR per year, since the EU accession the member states are allowed to spend 4 – 14 billion EUR. (Drahosová-Fáberová-Gazdová, 2003)

It is necessary to use all financial sources from the EU funds in order to sustain fast development of Slovak SMEs. Many entrepreneurial subjects obtain a capital needed for the establishment or development of the entrepreneurial activities by using these funds.

## STRUCTURAL FUNDS

The Structural funds focus on poor regions of the EU member states. Poor regions are classified using the criterion the GDP per capita that has to be below 75 % of EU average. The Structural funds are as follows:

1. European Regional Development Fund (ERDF),
2. European Agriculture Guidance and Guarantee Fund (EAGGF),
3. European Social Fund (ESF),
4. Financial Instrument for Fisheries Guidance (FIFG).

Table 2. Structural funds according to targets.

	TARGET 1	TARGET 2	TARGET 3
What does it finance?	Underdeveloped regions	Regions with structural difficulties	Regions requiring an aid in the area of education, scientific preparation, and labor skill
Structural funds	ERDF, ESF, EAGGF, FIFG	ERDF, ESF	ESF
Financial means for 2000-2006 (bill. EUR)	135,9	22,5	24,05
Share on structural funds' budget	69,7 %	11,5 %	12,3 %

Source: Action of the EU Council No. 1260/1999 about the Structural funds.

## COHESION FUND

Financial resources from the Cohesion fund are available after the EU accession. This fund does not belong to the Structural funds, it was established in order to help economically weaker EU states. The basic difference is that the Cohesion fund is aimed for states, while the Structural funds are for the regions. Countries with GDP per capita below 90 % of EU average are eligible for this fund.

The Cohesion fund focuses on projects in the area of life environment protection, traffic infrastructure development, it finances also studies that are related to project realization. The level of co-financing is 80-85 % of total public expenditures.

*Table 3. Commitments of EU towards Slovakia within the structural operations according to each year of shortened program financing in 2004-2006 in constant prices in 1999 in mil. EUR.*

	Structural funds	Cohesion fund	Structural measurements together
<b>2004</b>	261.50	174.40	435.90
<b>2005</b>	351.50	143.60	495.10
<b>2006</b>	437.30	191.70	629.00
<b>Total</b>	1 050.30	509.70	1 560.00

Source: www.finance.gov.sk

*Table 4. Commitments of EU towards Slovakia within the structural operations according to each year of shortened program financing in 2004-2006 in common prices in 1999 in mil. EUR.*

	Structural funds	Cohesion fund	Structural measurements together
<b>2004</b>	288.72	193.11	481.83
<b>2005</b>	396.56	162.66	559.22
<b>2006</b>	502.33	221.49	723.82
<b>Total</b>	1 187.61	577.26	1 764.87

Source: www.finance.gov.sk

Decision of the Slovak government on division of financial resources among all structural funds resulted from the reaction to lower level of direct payments into agriculture, which on the basis of negotiations in June 2002 were at the level of 25 %, 30 % and 35 % in 2004, 2005, and 2006. Increasing of the EAGGF and FIFG share had to secure enough means in the agriculture. The Slovak government approved the following division of financial means of the structural funds:

- EU initiative: 5,38 %,
- ERDF: 46,62 %,
- ESF: 28 %,
- EAGGF, FIFG: 20 %.

## WHAT WILL BE THE IMPACT OF EU ACCESSION?

According to the study carried out by the National Agency for the Small and Medium Enterprises Development the EU accession will have both positive and negative effects. Here are some of the examples:

- more opportunities for the cooperation with firms within the EU,
- more opportunities to succeed at the EU markets,
- threatening the firm activity by the competitors from EU countries,
- widening and improving the purchase conditions for the Slovak SMEs,
- equal legislative environment for all entrepreneurs within the EU,
- development of cooperative contracts with EU firms,
- regional and branch cooperation,
- easier access to financial sources,
- increasing export to EU,
- increase of competition on the domestic market,
- drain of the qualified working power,
- increasing of the requirements for the qualitative production.

In the area of economic and financial conditions it is necessary to secure an easier and simpler access to bank loans. This requirement has a permanent priority. It is necessary to eliminate risks at every level and to use offered opportunities.

## CONCLUSIONS

SMEs create a basis of the Slovak and the whole EU economy and therefore it is necessary to create such conditions that would allow them more effective functioning and prosperity. It is important to take following actions in order to secure a prosperous position for SMEs:

- legislative norms of good quality such as fast and inexpensive set up of a company, employment of workers, economic and accounting agenda (implementation of the International Accounting Standards),
- advancement in the area of finances, e.g. by obtaining of financial resources, in taxation load (implementation of the flat income tax rate 19 % and one value added tax rate at the level of 19 %),
- education system of good quality producing good quality human resources, well educated students with entrepreneurial spirit,
- good preparation of entrepreneurial ideas and projects that would classify for financial resources from the EU funds,
- strengthening of innovative and technological SMEs capacities, such as implementation of e-business,
- creation of effective representation of SMEs at the regional, national, and EU level.

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## Összefoglaló

A cikk az EU bővítésének a Szlovák Köztársaság üzleti környezetére gyakorolt hatását vizsgálja. Szlovákia Unióhoz való csatlakozása jelentős mértékben befolyásolja a kis és közép vállalkozások működési feltételeit. A kis és közepes vállalkozások jóléte főképp azon képességük függvénye, hogy mennyire tudnak ezekhez az új feltételekhez alkalmazkodni.

## Резюме

Статья рассматривает как расширение Европейского Союза повлияло на предпринимательское окружение в Словацкой Республике. Присоединение Словакии к Европейскому Союзу в большой степени повлияло на условия функционирования малых и средних предприятий. Благополучие малых и средних предприятий та функция, которая показывает, как эти субъекты могут адаптироваться к новым условиям.