KOVÁCSNÉ ANTAL ANITA*

New aspects of financing small and medium-sized enterprises

Új szemlélet a KKV-k finanszírozásában

A kormány a 2052/2006. (III. 20.) számú határozatában a vállalkozói banki feladatok kialakításáról és a kis- és középvállalkozás-fejlesztési intézményrendszer továbbfejlesztéséről rendelkezett. A határozat nyomán változások következtek be a KKV-kat finanszírozó intézményi struktúrában. A JEREMIE (Joint European Resources for Micro to Medium Enterprises) az EU közös kezdeményezése abból a célból, hogy a strukturális alapokból a mikro-, kis- és közepes vállalkozások finanszírozási forrásokhoz jutását támogassa. A program többek között hozzájárul a tagállamok tőkepiacának fejlesztéséhez, illetve ösztönzi a magánszféra szerepét a KKV szektor finanszírozásában. A program lényeges elemeinek és a kockázati tőkealapokat érintő kérdéseinek vizsgálatát követően a Kisvállalkozás-fejlesztő Pénzügyi Zrt. befektetési portfoliójának elemzésével foglalkozom, mivel ezen állami kockázati tőketársaságnál történt meghatározó számban és nagyságrendben KKV-kba történő befektetés hazánkban.

1. Changes in the institutional structure

The government adopted a resolution on establishing entrepreneurial tasks for banks and development institutions to facilitate the development of small and medium-sized enterprises (SMEs) in its Order No. 2052/2006. (III.20.). In this way, the Hungarian Development Bank was forced to set up cooperation with the institutions set forth in the Order until 31 December 2006 regarding the issue of awarding more financing to SMEs as loans and in other forms of financing from domestic and EU funds.

In accordance with this Order, *MAG – Hungarian Economic Development Centre* – was established (previously called VTK Zrt. – Vállalkozási Támogatásközvetítő Zrt.) through the integration of four state-controlled institutions[1] that participated in the implementation of GVOP (Gazdasági Versenyképesség Operatív Program) and NFT 1 (National Development Plan – Nemzeti Fejlesztési Terv). This institution deals with the mediation of all financial instruments paid out from state funds to develop enterprises and is consequently involved in the developing and financing SMEs. It participates in the GOP (Gazdaságfejlesztési Operatív Program) and manages the tasks of the KMOP (Közép-Magyarország Operatív Program) and carries on the obligations having resulted from GVOP. MAG is not primarily motivated to generate a profit, but market-oriented considerations are also considerable.

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[1] A Magyar Fejlesztési Bank Támogatásközvetítési Igazgatósága, a Magyar Vállalkozásfejlesztési Kht., az IT Információs Társadalom Kht and partly Kutatás-fejlesztési Pályázati és Kutatáshasznosítási Iroda (KPI).

The advantages resulting from the establishment of this institution are apparent in the following areas: a single-window, client-friendly system, conveying an image of efficient and controllable public spending and cost-efficiency. Having only a single window makes calling for tenders and applications less complicated and more transparent for clients, deadlines shorter and the provisions on pledging collateral less strict, the administrative burden lighter than earlier and electronic tendering can become more widespread. The simplified procedure that can be following when announcing procurement tenders of low values allows for differentiating applications in favour of micro and small enterprises and at the same time largely reduces the administrative and payment periods. Integration terminates many parallel activities and with the help of this, more cost-efficient operation can be realised. The extent of cost-saving may reach HUF 450 m, which is 10 per cent of the total expenditure of the formerly operating institutions in 2006. The adoption of 'best practices' may contribute to the efficient and successful operation of the system, too. It means that the best procedures are applied of formerly used practices thus creating a uniform and standard system of procedures for managing applications.

MFB Invest Zrt. was established in November 2006 through the integration of several institutions[1] too and it is in MFB's ownership in 100%.

In the short run, the developmental and private equity financing activities of the MFB banking group is going to be merged, which practically means that they deal with the portfolio management (asset management) companies taken over from the Corvinus Group and invest money directly from their own resources for 3-5 years. Besides these, they also step up the use of other forms of financial resources and rendering professional (financial, strategic and management) services.

The medium term objective of the company's operation is to be transformed into an 'investment bank'. But what content will fill this role of an investment bank and whether the existence of a state-owned bank can be reasonable are still unknown; the process is being formed right now. Besides these, this institution does not finance the SME sector since it is striving to provide funding for medium-sized and large enterprises as its investment targets, which is higher than the one required by SMEs.

Thus, MFB Invest Zrt. is leaving SME financing and it was undertaken by *Magyar Vállalkozásfinanszírozási Zrt.* (MV Zrt.) with a different approach as of 6 July 2007. The Company's subscribed capital amounts to HUF 1 bn and equity to HUF 2 bn. It is in MFB ownership in 100% and represented by the directors of state institutions dealing with SME financing (MAG Zrt., Corvinus Zrt.). This is a financial company dealing with granting repayable financial instruments to SMEs as determined in GOP and managing domestic and EU funds, the holding fund of the JEREMIE-Programme available from 2007 to 2013 facilitating SMEs' access to external financing, (see Point 2 of this study). Guaranteeing loans is its main scope of activities, but it is also involved in not for profit micro

[1] Nemzeti Ingatlanfejlesztő és Lakásberuházó Zrt. and the organisation of MFB dealt with development capital and private equity financing

credit and private equity financing programmes acting as an intermediary for NFÜ (Nemzeti Fejlesztési Ügynökség).

Four further state-owned private equity funds deal with private equity financing:

Informatikai Kockázati Tőkealap-kezelő Zrt. was established for 15 years (with possible extension of five years), in June 2002 by RFH Zrt. (Regionális Fejlesztési Holding), which is in governmental ownership in 100%. Its subscribed capital amounts to HUF 3 bn and its aim is to finance SMEs operating in IT and telecommunications, in their starting up, early phases or expansion by also actively participating in their decision-making bodies. This affiliated company of RFH was the only one to operate as per the provisions of Act of 1998[1]. In order to facilitate the operation of the domestic IT society and the commercial utilisation of the results of the innovative activities of the above-specified sectors it provides HUF 50–450 m to any company for 3-7 years and gets shares of 25–49 per cent in exchange in the form of either capital increase or the establishment of a new joint company. It practically did not invest anything in the first two years of its operation (a sound management was missing). They passed decisions on six investments in the value of HUF 1.7 bn in 2003-2004 and on four in the value of HUF 1.1 bn in 2005.

Beszállítói Befektetői Zrt. was established in March 2002 with a subscribed capital of HUF 2.5 bn of which RFH owns HUF 2.499 bn and the rest is owned by Dél-Dunántúli Regionális Fejlesztési Zrt., a member of the RFH Group. This institution promotes SMEs already having or right now striving for a supplier's status and innovative project companies in the scope of which it invests HUF 20-250 m in each project for 3-5 years and obtains shares of maximum 49 per cent in exchange. They decided on investments in the value of HUF 231.6 m in 2003 and of HUF 240 m in 2004 and of HUF 465 m in 2005.

The main task of *Corvinus Kockázati Tőkealap-kezelő Zrt.* is to set up and manage several private equity funds to provide capital to innovative SMEs being in their start-up or early stages of development. Corvinus Első Innovációs Kockázati Tőkealap (CELIN) was established first for 15 years in October 2005 whose subscribed capital amounted to HUF 5 bn. Its investor is the state owned Corvinus Nemzetközi Befektetési Zrt. The institution provides capital of HUF 20-750 m to any company typically for 5-8 years to promote domestic innovation and the utilization of its outcomes commercially. During its relatively short time of operation, it has piled up more than 10 approved investments and four have already been realised. At present, there is practically a stop on providing funds. On the one hand, in the future, they are planning to finance only enterprises with positive cash flows, on the other hand they are looking at transferring their portfolio to Beszállítói Befektetői Zrt. and more recently that they will deal with international loans. *Corvinus Nemzetközi Befektetési Zrt.* has been the only one to provide capital to enterprises registered in Hungary for their investments and acquisitions realised exclusively abroad since 1997. Its subscribed capital was increased in June 2005 to HUF 15 bn and many of its

[1] Act XXXIV of 1998 on private equity financing and private equity companies and funds was effective until 1 January 2006

programs contribute to the development of SMEs. It provides capital ranging typically between HUF 20 m – € 1 m and HUF 100 m – € 2 m to companies for 5-10 years getting shares of generally 49 per cent in exchange. Eight applications received positive consideration in the value of HUF 7.2 bn in 2005.

Kisvállalkozás-fejlesztő Pénzügyi Zrt. has been operating since 20 December 2001 and is owned by the state in 88.24 per cent[1] and its equity amounts to HUF 3.5 bn. Contracts can be executed on the provision of private equity of HUF 10-100 m to companies for a term of 3-5 years with a maximum 49 per cent share in order to finance the development and growth of domestic SMEs. (See the detailed analysis of this company's portfolio in Point 3 of this study.)

2. The JEREMIE-Programme

2.1. The Programme's main characteristics

JEREMIE[2] is a joint initiative of the European Commission, the European Investment Bank and the European Investment Fund (EIF) to improve SMEs' access to financing from the Structural Funds of the EU. The aim of the EIF is to encourage micro, small and medium-sized enterprises to use repayable rather then non-repayable sources of financing from the Structural Funds of the European Union in the forms of loans, equity, venture capital and guarantees on competitive terms since the rate of return can be increased through these means of financing from the European Regional Development Fund[3] (ERDF).

The Programme contributes to the expansion of the capital markets of European Member States and may motivate venture capitalists to finance SMEs. SMEs, prone to development, managing the financial instruments profitably may later acquire bank financing individually at a later date. The compliance with the tendering requirements of the programme relying on a new philosophy that is based on repayable sources may lead to competition among enterprises, which will also serve the fundamental objectives set forth in the New Hungary Developmental Programme (ÚMFT – economic growth and job creation).

Each member state may decide individually whether to join this initiative. Hungary has prepared such a programme. In the scope of this programme, sources are technically used in the way that a part of the money derived from structural funds is used for financing the JEREMIE programme and the criteria of the programme are integrated into ÚMFT as the resolutions of GOP 4 and the criteria of KMOP. The Programme focuses on three areas, which are the follow-

[1] Other shareholders besides the Hungarian Development Bank are Budapest Bank Nyrt., Hitelgarancia Zrt., Magyar Külkereskedelmi Bank Zrt., OTP Bank Nyrt. and Erste Bank Hungary Nyrt.

[2] Joint European Resources for Micro to Medium Enterprises

[3] In Hungary a GAP analysis was prepared by GKM. Its title is „SMEs' acces to finance and an analysis of the insufficiencies of the financial market". This analysis makes a comparison between aims and expected returns relying on the future and tries to find solutions for the discrepancies.

ing: micro credit loans, guarantee instruments and the development of the capital market. Repayable instruments of HUF 190 bn may be invested during the next 7 years (from 2007 to 2013), which may indirectly support SMEs by as high an amount as HUF 2,000 bn. So the elements of the programme may have a multiplier effect too. In the case of micro credit programmes, for instance, banks may join the programme by means of the JEREMIE guarantees which will have a multiplier effect and for this reason, in the next development period funds of several hundreds of billion HUFs may be granted and in the scope of the capital programmes, investment funds of HUF 100 bn may be established through private equity programmes, which may satisfy domestic capital demand.

Table 1
JEREMIE's repayable financial instruments and their objectives from 2007 to 2013[1]

Financial instruments	Available funds (HUF bn)	Main objectives
Micro credit loans	55	Easing the deficiencies of the loan market by providing funds to uncreditworthy enterprises excluded from bank financing.
Guarantees for loans	90	Managing the problems caused by the shortage of cover for credits by pledging absolute guarantees both for micro credit loans and SME loans to banks to back their receivables
Private equity financing	45	Expansion of the capital market by attracting private equity (to a larger extent) through funds operating on competitive terms, in particular to finance start-up enterprises.

The programme and its budget (holding fund) are managed by MV Zrt. SMEs can access the holding fund through financial intermediary institutions[2], which are chosen with the help of a tender open for minimum two years provided they possess the prescribed own capital and comply with the requirements. Probably, approximately 30 financial intermediary institutions will join the micro credit programme while 5–10 banks will join to provide guarantees and about ten private equity funds are expected to be established. The micro credit programme will be launched on the market at the end of November 2007, guarantee instruments are expected to be available in December and private equity financing will actually start in 2008 (private equity funds will be established at the end of November or at the beginning of December).

[1] Source: own compilation.
[2] Specialized microcredit institutions, banks, managers of private equity funds registered in Hungary and having authorization from PSZÁF.

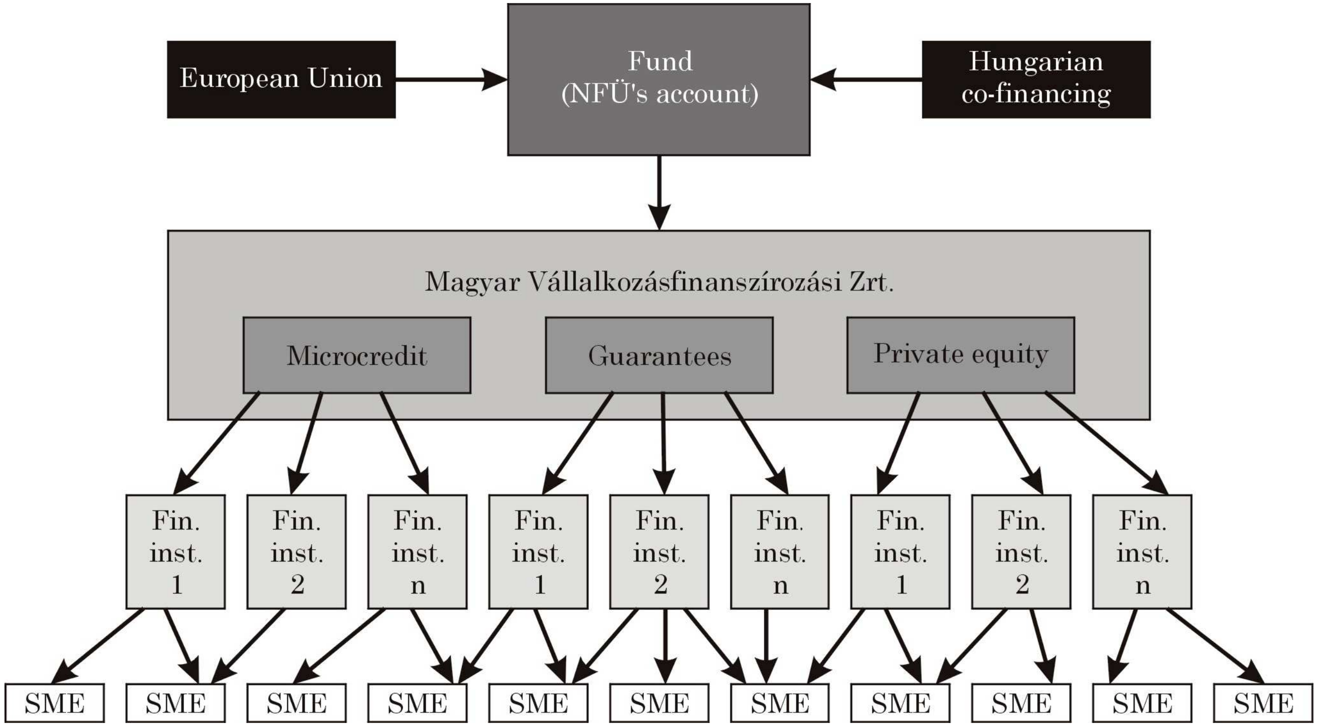

Chart 1
The financial structure of the JEREMIE programme[1]

[1] Source: László Bátora: JEREMIE Programme.

2.2. Private equity funds in the Programme

The total funds allocated for private equity financing amount to HUF 40–50 bn and as per negotiations, each private equity fund may receive maximum HUF 5 bn (as requested by GKM). It is possible to make investment in any enterprise of maximum € 1.5 m yearly for 3 years, which amount includes private equity and governmental financing but excludes own resources. It is necessary to sum the amounts of non-repayable and repayable financial instruments received by the given SME as per an EU Directive[1] on 'de minimis' supports, but who will need to do it is still an open question. Each enterprise can get at most □ 200,000 for 3 years as repayable financial instrument, which is considered as a subsidy of small amount and for this reason it may not have an impact on market competition. Because the non-repayment of EU funds is not acceptable (similarly to the funds of the EIF), losing the capital leads to the application of sanctions against the enterprises concerned. The rules of the procedures to be followed are still being examined by lawyers.

The duration of any fund may reach maximum 10 years, but it is necessary to invest its resources until 2013 that is by the end of the budgetary period. If this fails to happen, the monies are taken out and reallocated to other funds.

According to current legal regulations,[2] it is necessary to pay 10 per cent of the allocated capital of any fund at the start-up, which is at least HUF 250 m, and the total sum in 6 years. For this reason, the drawing technique cannot be applied in full at present. (The related proposal on amending the law has been with the Ministry of Finance for one year.) In the case of newly established funds, it is possible to apply the drawing technique similarly to those registered abroad.

The management fee may be maximum 3 per cent, but its actual rate shall probably be determined by competition. The expected yield rate means an IRR[3] of 10-15 per cent calculated in HUF, but of course, it needs to cover the management fee, too.

Both GOP and KMOP will invite applications expectedly in November 2007. There is a regional limitation, which means that the geographical location of the primary beneficiary is considered in the tenders, that is, the portfolio company will need to be from Middle Hungary or beyond.

Start-up and early stage companies will be supported with a lower amount of private capital requirement than those operating in their expansion (developmental) stages. However, the limit of the early stage is so far not defined. In practice, a company may already generate sales of □ 1-2 m when it requires a middle management and about 15 employees are employed, etc., but the sector of the economy is also a determining factor. As part of providing early stage

[1] EC Committee Decree No. 69/2001/EK of 12 January 2001 on the application of Sections 87 and 88 of the EC Treaty on "de minimis " (minor value) supports

[2] See Paragraph 7 of Section 296/G of Act CXX of 2001 on the Capital market

[3] The Internal Rate of Return is a discount rate where the present value of an investment amounts to zero. To calculate the IRR of an investment for a period of T years, we can use the following formula: $NPV=C0 + C1/(1+IRR) + C2/(1+IRR)^2 + \ldots\ldots + CT/(1+IRR)^T = 0$

support, another solution is being worked out that would allow for covering the costs of investment consultation in the scope of other tenders and would not have to be paid from the management fee. If PSZÁF has started the approval procedure, which takes app. 2 months, is enough for submitting the application and preparing documents will take a further 2 months. The Company can be established after the PSZÁF permit is obtained.

Investors can cooperate in 3 ways or forms of cooperation in the scope of the private equity programme:

1. *Setting up common funds,* in which the government (holding fund managed by MV Zrt.) invests capital of 70 per cent and private investors of 30 per cent.

   In this case the holding fund and private investor(s) establish a Common private equity fund registered in Hungary in which the holding fund may get shares of 70 per cent (in the amount of maximum HUF 5 bn in any fund).
2. *Setting up parallel funds* (establishment of an own fund in a parallel structure), which are fully owned by the government and makes joint investment with private investors automatically upon agreement in the proportion of 70 to 30 per cent in each case.

   In the case of private funds registered abroad, the holding fund establishes an own fund registered in Hungary owning capital of maximum HUF 5 bn to make investments together with the foreign fund automatically (without ad hoc decisions on any investment). The manager of the Own fund concludes agreements and contracts on parallel investments with private fund managers active in the market. It is possible to provide financing to all Hungarian investment projects with the same terms and conditions and investment rates from both parallel and own funds.
3. *Setting up co-investment funds* (establishment of an Own fund operating in a co-investment structure) which are also owned by the government in full and invest on project bases with private investors also in proportion of 70 to 30 per cent in enterprises. This means that the holding fund establishes an Own fund with separate legal entity to make common investments with private funds registered abroad or in Hungary, but the terms and conditions are agreed upon with private funds per transaction.

   As per Hungarian law[1], common and own funds may operate as fund managers selected by tender. So far it seems that private fund managers or at least institutions independent of MFB Zrt, as parent institution are eligible to apply, but it is still uncertain which institutions will manage parallel and co-investment funds. The experience of persons dealing with private equity financing will be considered at the selection of fund managers, namely what references and work experience the given person has at which foreign/domestic fund. It is important that the companies to be financed and the fund managers may not be owned by each other. Common and Own funds may also operate as 'Pledge Funds', which means that the holding fund and also the private investors of Common funds undertake the obligation to pay their shares of capital and that they shall make the actual payment (in the case of Common

[1] See Paragraphs 296/A – 296/F of Act CXX of 2001 on the Capital market

funds pro rata payments) when requested by the fund manager according to the schedule of investments. After choosing the fund manager and concluding the contracts on fund and asset management, drawings from the holding fund will not require special permissions one by one but will happen automatically until the other investors of the funds pay their shares too.

3. Portfolio analysis at Kisvállalkozás-fejlesztő Pénzügyi Zrt. (KvfP)[1]

Of the state private equity funds mentioned in the first part of this study, KvfP provides sources of investment of significant values and sums to SMEs, so now I am going to analyse its investments realised up to 6 September 2007. The rising number of applications submitted to the Company for private equity capital suggests that KvfP is increasingly known as a private equity fund among SMEs. Besides, the growing proportion of presented and positively considered applications may imply that SMEs look for resources with a more thorough preparation.

KvfP gets about 150-200 applications for capital a year, which also includes clients' inquires (inquiry by phone, participation in discussions, etc.). Of these, about 60-80 applications are documented in the company's system, while the other enterprises retire. For example, KvfP sent 67 information letters (including refused and accepted applications) to enterprises based on the prequalification forms received in 2006 while in 2007, up to the above-mentioned date there were already 69. Of last year's 67 applications, 15 transactions were realised (22.4%) and consequently, 52 were not (77.6%). About half of the latter was immediately rejected (in general the project objective or the enterprise did not fit in with the regulations) and the other contracts were not concluded due to the claimants' default (e.g. inadequate capital structure, lack of collateral, etc.) These enterprises could not perform the obligations undertaken thereby – in their data sheets or contracts, etc. – and their capital was not increased.

The sectoral distribution of investments

KvfP. had financed 44 enterprises in the amount of HUF 2734.86 m up to 6 September 2007 (together with already realised exits). The capital was provided to enterprises in various sectors (see *Chart 2*). Most of it was invested in tourism and catering, but a significant part was given for the development of engineering, the food industry and producing packaging materials. Considering the number of enterprises financed by private equity, we get the same sectoral order[2].

[1] As per interviews given by Katalin Viczainé Papp, the tax and investment expert of a company dealing with advising investors and SMEs and documents made available by KvfP Zrt.

[2] Tourism, catering and engineering – 15.9%, food and packaging industry – 11.4%

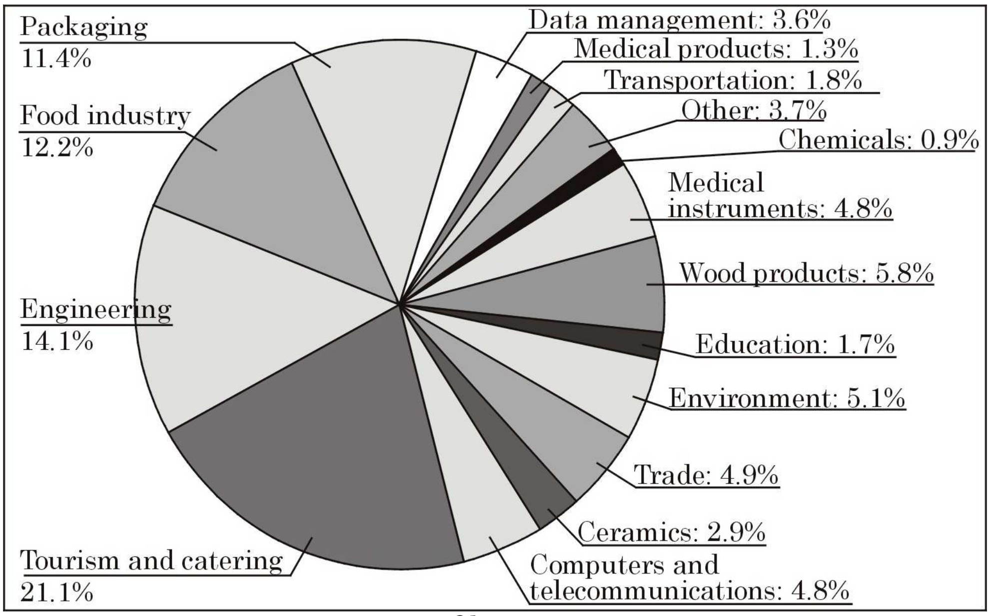

Chart 2
The distribution of KvfP's investments paid until 6 September 2007 as per sectors of the economy (exits included)[1]

The calculated specific indicator (invested capital in any enterprise) leads to a somewhat different sectoral order, which is mostly due to the realisation of one, or two projects realised in the given sectors.

When we analyse the relationship between sectoral specification and the amount of invested capital by variance analysis[2], we can state that belonging to a given sector of the economy explains the deviation, variedness of the invested capital in 25.4 per cent (H^2) while other factors do so in 74.6 per cent. The relationship between the two criteria is stochastic ($0<H^2<1$) and the correlation between the two ($H = 0.50395$) is average ($0.4 < H < 0.7$).

The relationship between types of enterprises and the amount of capital requested

In connection with the classification enterprises as per SME[3] categories we can find 9 enterprises in the category of micro enterprises, the majority (33 peaces) in the category of small enterprises and two in the category of medium-

[1] Source: Own calculation and chart based on KvfP documents.

[2] $H^2 = \frac{\sigma^2_K}{\sigma^2}$; $\sigma^2_K = \frac{(\overline{x}_j - \overline{X})^2}{N}$; $\sigma^2 = \frac{(x_{ij} - \overline{X})^2}{N}$.

[3] As per Act XXXIV of 2004 on Small and Medium-Sized Enterprises and aid for their development.

sized enterprises when private equity was awarded to them. With the help of the invested capital two enterprises could climb to the next category with stricter criteria (one micro enterprises has become a small one and one small enterprise has entered the category of medium-sized enterprises).

When we analyse the relationship between the classification of enterprises as per SME categories and the amount of invested capital by variance analysis, that belonging to a given sector of the economy explains the deviation, variedness of the invested capital in 3.52 per cent (H^2) while other factors do so in 96.48 per cent. The relationship may be called stochastic ($0 < H^2 < 1$) and its correlation can be considered ($H = 0.18758$) loose ($0.4 < H < 0.7$) which after all indicates a lack of relationship. This result is also justified by that the distribution ratios of invested capital to the number of enterprises in the given categories possess almost the same value (see *Table 2*).

Table 2
KvfP's investments paid until 6 September 2007
as per SME classification (exits included)[1]

SME classification	Number of enterprises (piece)	Invested capital (thousand HUF)	Distribution ratio of the number of (%)	
			enterprises	invested capital
Micro enterprises	9	508 000	20.5	18.6
Small enterprises	33	2 041 860	75.0	74.7
Medium enterprises	2	185 000	4.5	6.7
Total	44	2 734 860	100.0	100.0

Development of specific indicators

In four of the investments capital was increased in two phases to finance new projects, which asked for concluding new contracts and determining new terms for the second financing in each case. Of these, one has already reached the exit stage when the complete KvfP share was paid back in one sum despite the different maturities. Because of the subsequent claims for capital, the amount of invested capital as per enterprise in a certain year is higher than the value per transaction in several cases (see *Chart 3*). The trend of the amounts of specific indicators shows a marked increase in 2006. However, we must be aware of the fact that the highest amount was invested in that year when the four business years are considered, with the highest number of enterprises (15) and transactions (16) was financed.

[1] Source: Own calculation based on KvfP documents.

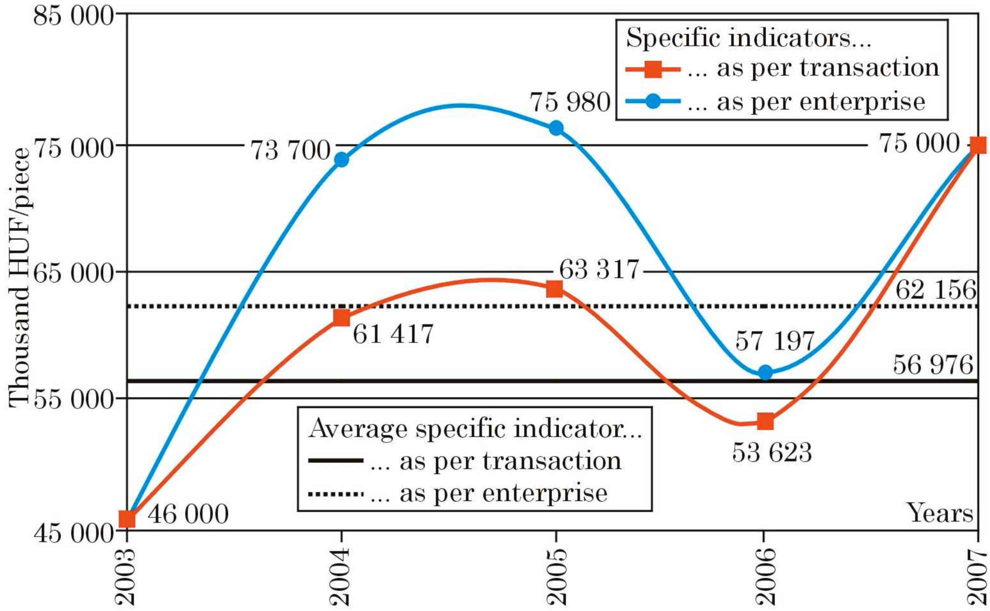

Chart 3
The development of the relative ratio of intensity calculated with KvfP's capital invested and paid in a given year up to 06. 09. 2007 (thousand HUF/piece)[1]

Table 3
The deviation indicators of average investment sizes calculated with KvfP's capital invested and paid in a given year up to 06. 09. 2007 (thousand HUF/piece)[1]

Deviation indicators[2]	Range of deviation – R	Average margin – δ	Deviation – σ	Relative deviation – V
	thousand HUF			%
Per transaction	82 000	22 308	25 797	45.3
Per enterprise	75 600	22 516	24 817	39.9
Comments	The range of deviation of the data.	The average margin of data as compared with the mean expressed in thousand HUF and percentage.		

[1] Source: Own calculation based on KvfP documents.

[2] $R = x_{max} - x_{min}$; $\delta = \frac{|x_i - \bar{x}|}{N}$; $\sigma = \sqrt{\frac{(x_i - \bar{x})^2}{N}}$; $V = \frac{\sigma}{\bar{x}}$.

The specific investment data range in a wide scale and show a significant deviation both in terms of transactions and enterprises (see *Table 3*). This fact is determined mainly by sectoral specification and the size of the projects to be implemented. The higher deviation values per transaction are due to the subsequent requests for capital submitted by the above mentioned enterprises that are of significantly smaller amounts than average investment sizes.

Exits and the position of other investments

The amount of HUF 667 m has been paid back to KvfP in full by 10 enterprises, which is 24 per cent of the capital dispersed. The majority of exits has been realised by buy backs realised by the original owners (not always by all) and in some cases by the company[1]. Companies were limited in applying the latter activity because repurchasing own shares (business shares) is limited because it may be realised from the capital (authorized capital) in excess of the subscribed capital (for the debit of provisions and balance sheet profit) while in the case of joint-stock companies own shares may only be purchased up to 10 per cent of the equity and both joint-stock and limited liability companies may keep their own shares in their possession for one year after purchasing them[2]. (The majority of the enterprises, 80 per cent that is 35 companies requesting capital operate as limited liability companies). Purchasing business shares by third parties or firms is subjected to conditions both with regard to the original owners and KvfP. The former may be realised upon the consent of KvfP and upon granting the right to sell under the same conditions and the latter may be realised in the last resort in the scope of KvfP's right to purchase.

The average term of buying back in connection with the total exits realised below 3 years, though individual data show a significant deviation also here. Buying prior to the stated date (3 or 5 years) – which is the right of the company or of the original owners, respectively that may be exercised at any time – may happen for several reasons. On the one hand, the company might wish to realise further projects for which subsequent loans are required and the bank or other company providing the loan will also finance buying out KvfP's share as well. The other reason is the further sale of the invested company. There are cases when the owner or the company decides to carry out the buy out, because it has piled up profit reserves, the company policy is changing or can access cheaper funds. The listed reasons have largely contributed to realising partial buy outs in the case of various investments (in the case of 6 enterprises representing 5 sectors in the value of HUF 169.214 m in total).

[1] The method of exit indicated above resembles Management Buy Out (MBO) of the possibilities open to venture capitalists to terminate their investments, but it doesn't cover its original meaning completely, because it is sometimes carried out by the managers (rather mainly by the founders or sometimes by the companies themselves) and does not carry the orginal economic content (e.g. motivation), but appears with a right to buy and is backed by obligations.

[2] See Paragraphs 135 and 223-230 of Act IV of 2006 on business organisations.

Considering the total of the investment portfolio of KvfP, there have been one instance in which liquidation was started against a target company as early as in the year of making the loan available. Since the given company has no history, its former management could not be evaluated. The unfavourable trend was made even more difficult by that a loss of market has also occurred regarding the activities of the company and the market opportunities of the parent company were also lost. In cases like these just a portion of the share might be expected to return so a large part of this is expected to be written off as depreciation. KvfP exercised its right to sell in two companies. In one of these cases the company had not purchased the business share of KvfP at all and in the other case the original owner had not purchased it in full. In these latter cases, however, we can expect some return since the collaterals prove to be sufficient. The three cases make up 8% of total settled payment of capital, the amount expected to be written off as depreciation is 2.2% (credit institutions usually count with a loss of 3–4%).

Future trends

With regard to the private equity part of capital investments an EU regulation[1] came into force in 2006 stating that capital investments and the share of equity funds shall include a private equity share of 30%. KvfP Zrt. was exempted from the application of this regulation temporarily. The continuation of the capital programme is ensured through the notification of the company, which included the examination and approval of the principles and rules of operation of the programme by the European Commission's Directorate General for Competition. This derogation allows for the inspection of investment return expectations, consequently, working out more favourable investment facilities for potential private equity investors and through them, involving further private equity co-owners or co-financing[2]. In accordance with EU criteria the merge applied in pricing was modified – thus it is easier to indicate larger risks –, and the range of eligible economic sectors has also been limited[3].

The company's further operation beyond 31 December 2013 shall require further notification. The notification of KvfP Zrt's current capital investment programme evidently justifies that the company's capital investment activities are needed both with respect to the sound development of SMEs and domestic capital market. KvfP, as a major player of domestic capital investment market, intends to participate in the life of the Hungarian economy within the field of enterprise development with undiminished energy.

[1] The European Committee in 2006 revised the provisions of the Community Directive (HL 2001/C 235/03) on venture capital supports effective from 2001 and in August 2006 it announced the community directive on state subsidies meant to promote venture capital investments in small and medium-sized enterprises.

[2] In the seven-member supervisory board of KvfP Zrt, the representatives of owner banks are overrepresented in proportion to their ownership shares even prior to 18 August 2007 (2 members) so the owners representing private equity already play a central role in the investment and decision-making policies of the Company.

[3] Metal industry, coal mining, ship building.

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