

# Study on the social enterprises ecosystem in Hungary



RaiSE

***Enhancing social enterprises competitiveness through improved business support policies***

*This publication only reflects the author's views. The programme authorities are not liable for any use that may be made of the information contained therein*

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## 1. About the research

RaiSE aims to contribute towards the competitiveness of social enterprises (SEs) in the European Union through improved regional policy development and implementation, enabling specialised business assistance and support. RaiSE's particular focus is on promoting growth and access to markets, thereby targeting relatively consolidated SEs. This explorative study on "social enterprises and their ecosystems" is delivering new intelligence on the diversity of social entrepreneurship in Hungary through quantitative data collection (administrative and financial data) and in-depth interviews (on the motivations of social entrepreneurs) covering all regions of Hungary. The entire analysis is based on empirical data collection composed by the entire pipeline from start-up social enterprises (50%) to mature so called "investment-ready" ones (50%) too.

Our study is applying the European Commission's definition on social entrepreneurship as follows: "European Commission defined a social enterprise as 'an operator in the social economy whose main objective is to have a social impact rather than make a profit for its owners or shareholders'". In this study, we refer to organizations that aim to make more than 50% of their revenues from commercial activities.

**Our study is providing an overview to policymakers and stakeholders how to improve current social enterprise policies to better foster competitiveness (sustainability) through enabling social enterprises getting better access to market, access to finance, internationalization and impact measurement. Findings and lessons learned will be an input to create a customized development process for the Hungarian market which is based on the collected current social enterprise policies. Through raising the competitiveness of the market members, they will have better conditions to access financial sources, learn more business skills, enter foreign markets and lay down a shared research methodology of the created social value.**

Within the survey a total of 50 Hungarian social enterprises have been carefully studied and analysed through an online questionnaire between May and July 2017. Findings lessons learned are displayed in the current study applying quantitative and qualitative assessment.

## 2. Definition and Criteria in the regional context

Developing the ‘social economy’ has been on the government’s agenda for recent years – with partial success. In 2006, the X/2006<sup>1</sup> law on cooperatives was born, then it was also followed by a governmental decree on social cooperatives<sup>2</sup>, and so a new form of social economy could appear in Hungary. Although – besides non-profit arrangement - recent times saw new types of more ‘business-like’ social enterprises emerge this is still a rather slow process to date. <sup>3</sup>Yet, “certain ambiguities exist to date in Hungary as regards to which organisations can be considered ‘social enterprises’”<sup>4</sup>. However, even the term itself is interpreted in various ways by stakeholders and policymakers. Recently, the national priority project PiacTárs (funded under the EDIOP-5.1.2-15-2016-00001) has drawn conclusions regarding the definition of social enterprises – unleashing the former “narrow-sense interpretation”<sup>5</sup>. Main empirical research including 220 social enterprises shows that social enterprises in Hungary are mainly “foundations, associations and other non-profit organisations working under different legal statutes” with “having social purpose, demonstrable social impact and realise revenue from sales activity in their respective market”. The amount of the revenue is not determined, the main focus is on the revenue re-investment. Innovation and democratic decision making are not requirements of social enterprises<sup>6</sup>.

By today, the most widely accepted definition has been created by the European Commission acknowledging the following types of business with “no single legal form”<sup>7</sup> as social enterprise:

- ❖ “those for which the social or societal objective of the common good is the reason for the commercial activity, often in the form of a high level of social innovation,
- ❖ those where profits are mainly reinvested with a view to achieving this social objective,

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<sup>1</sup> The cooperative is an organisation working on the base of the principles open membership and changing capital that has a legal entity and the aim of which is the promotion of the fulfillment of the economic, and other social (cultural, educational, social and health) needs of its members.

<sup>2</sup> Passage 1 of §8 of the 141/2006. (VI.29) governmental decree says: Social cooperative, in accordance with the §7, is a cooperative:

- ❖ The aim of which is to establish the working conditions for its socially disadvantaged members, and to improve their social state in other ways;
- ❖ That works as a school association
- ❖ The social association has to include in its name the nomination social association –or - in case of scholar association- the nomination scholar association.

<sup>3</sup> G. Fekete, Éva, 2012

<sup>4</sup> European Commission, 2014, pp.7

<sup>5</sup> Olga Horváth, 2010

<sup>6</sup> National Employment Nonprofit Ltd., 2017

<sup>7</sup> European Commission, 2011, pp.2

- ❖ and where the method of organisation or ownership system reflects their mission: using democratic or participatory principles or focusing on social justice.

Thus:

- ❖ businesses providing social services and/or goods to vulnerable persons (access to housing, health care, assistance for elderly or disabled persons, inclusion of vulnerable groups, child care, access to employment and training, dependency management, etc.); and/or
- ❖ businesses with a method of production of goods or services with a social objective (social and professional integration via access to employment for people disadvantaged in particular by insufficient qualifications or social or professional problems leading to exclusion and marginalisation) but whose activity may be outside the realm of the provision of social goods or services”.

**Another interpretation of social enterprises** has been elaborated by **NESsT** states that “social enterprises have consciously organized and operated entrepreneurial activity in order to solve social challenges in an **innovative way**.”<sup>8</sup>

**Matyódesign** creates casual hand embroidered clothing, embellished with traditional motifs from the Matyo region in Hungary. The embroidery work is done by local women who master this craft and who would otherwise find it difficult to access a job in the region.

Some **academic papers**<sup>9</sup> refer to the definition used by the EU ‘CONSCISE’ report according to which, social enterprises:

- ❖ are not-for-profit organisations;
- ❖ seek to meet social aims by engaging in economic and trading activities;
- ❖ have legal structures which ensure that all assets and accumulated wealth are not in the ownership of individuals but are held in trust and for the benefit of those persons and/or areas that are the intended beneficiaries of the enterprise’s social aims;
- ❖ have organisational structures in which full participation of members is encouraged on a co-operative basis with equal rights accorded to all members;
- ❖ encourage mutual cooperation.

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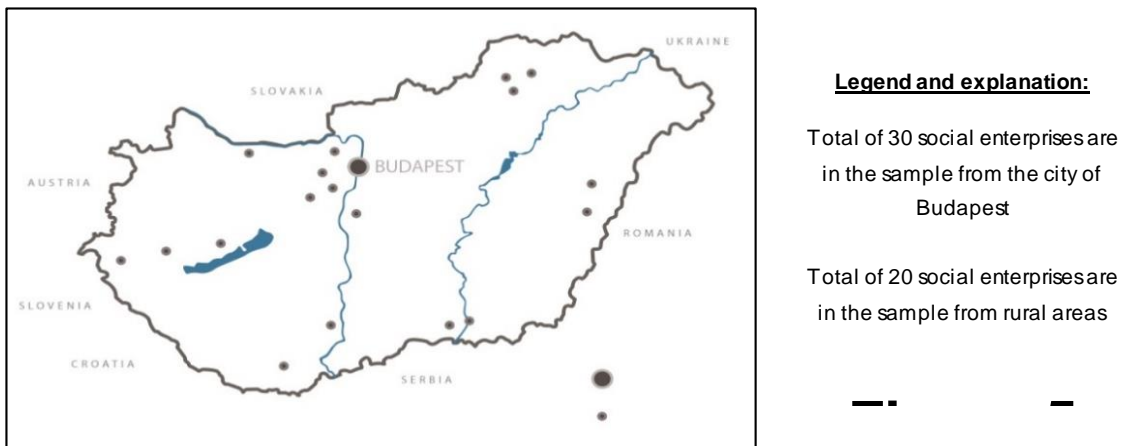
<sup>8</sup> Fekete Éva G. et al, pp8.

<sup>9</sup> Petheő Attila István, 2009. p.10.

### 3. Characteristics and development of social enterprises

Our research shows that social enterprises are now playing a larger role than ever in Hungary and that **they have large opportunities to grow in size and positive influence on society**. The correspondents apply different kinds of legal forms and the entrepreneurs do not have the knowledge of business operation. Most of the organisations have been established in Budapest (30 social enterprises) while other 20 social enterprises operate in other regions of Hungary. It means that social entrepreneurship is equally widespread across the entire country, however, **the scope of activities greatly depends on the territorial needs and managerial skills of the social entrepreneurs**.

*Figure 1 Geographical of social enterprises*



*Source: own data collection and visualization (IFKA)*

Due to the nascent nature of the market and related policies, and due to a lack of unambiguous and widely accepted definitions of what constitutes a 'social enterprise', no specific data exist on the size of the sector. However, the Eurostat (the database of the European Union) is collecting data on the number and economic performance of organisations under the relevant legal forms.

Estimates by the European Commission's expert **group**<sup>10</sup> suggest (2014) that approximately 260 social cooperatives (old type), 250 social cooperatives (new type), 3,000 traditional cooperatives, 400 associations and foundations (NGO) undertaking some economic activity and 2,600 non-profit companies with social aims exist in Hungary.

Further individual data collections suggest that according to NESsT's definition, there are 300-400 social enterprises **in Hungary**<sup>11</sup>. According to the SELUSI project, the average age of social enterprises is 15.9 years and half of those organizations are 13

<sup>10</sup> European Commission, 2014, p.22.

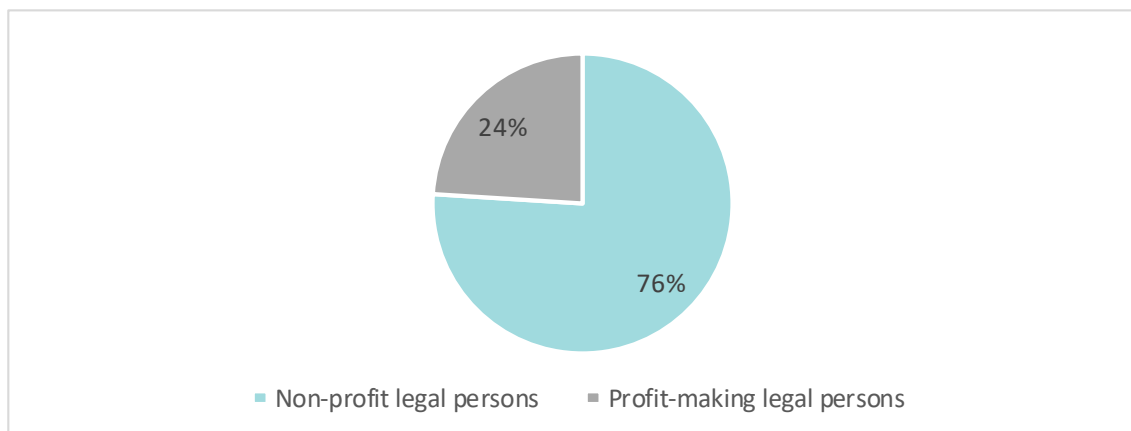
<sup>11</sup> NESsT Hungary Country Assessment, 2011

years old or younger. However, NESsT, according to its own stricter definition, considers that the first social enterprises appeared only some 16 years ago, so the average age is much younger. In the frame of the SEFORIS project, NESsT has further examined 122 social enterprises in Hungary stating that top industrial sectors are community, social and related services (44%), health and social work (18%), education (16%), trade, gastronomy, transport and telecommunication (9%), business activities (8%), industry, construction and **extractive industry (5%)**<sup>12</sup>.

### 3.1 Ownership structure and legal form of social enterprises

Based on our survey, Hungarian social enterprises are founded under different kinds of legal forms: a) non-profit **private limited company**<sup>13</sup> (2%), b) **social cooperative**<sup>14</sup> (26%), b) **foundation** (22%), c) **limited partnership** (24%), d) association (20%), e) **limited company operate on the whole market** (24%). (Source: own data collection, IFKA)

Figure 10 Type of ownership



Source: own data collection and visualization (IFKA)

Within our survey we distinguish two different kinds of the ownership: non-profit legal persons (24%), profit-making legal persons (76%) reflecting the degree of entrepreneurial orientation. The reason for this phenomenon is laid down in the Civil Law codified from January 1, 2012, which has new legislations related to operation of associations and foundations. It contains a **chapter about the public benefit legal status as well**. Law about the economic activities of organizations controls the operation of non-profit companies.

Hungarian legislation allows non-profit organizations to carry out “entrepreneurial activities”, but they have to reinvest the income into to original activity identified in their founding document (e.g. Deed of Foundation). “Public benefit” status can be achieved by a non-profit organization which results in more favourable taxation. These hybrid legal

<sup>12</sup> SEFORIS Contry Report: Hungary, 2016

<sup>13</sup> (Private) non-profit companies with social aims which are established under the non-profit legal form and sometimes are supported by the government.

<sup>14</sup> Social cooperatives are associations of individuals, who voluntarily cooperate for their mutual, social, economic and cultural benefit.



forms as social cooperative and non-profit company can be a barrier for growing and attracting investments. These organizations are entitled to publish annual Public Benefit Report that is made up of a simplistic balance sheet, statement of financial performance and other special auxiliary appendix. Being a for-profit social enterprise, however, at the existing practice excludes organizations from state grants.

### 3.2 Stages of growth in the lifecycle

Based on international research, the stages of development of social enterprises follows the above **classification**<sup>15</sup>:

- ❖ **Later-stage growth:** (>5 years) Having established a reputation with stakeholders, the enterprise looks for additional growth beyond the initial products or services. Several capital options are available. Some founders and/or investors may make exits.
- ❖ **Start-up phase:** (1-3 years) The team develops the prototype and brings it to market. A customer base is established and KPIs are identified. The enterprise receives its first revenues and attracts additional resources in the form of investments or loans.
- ❖ **Early-stage growth:** (3-5 years) The enterprise aims to increase its scale through new channels and markets. It hires talent, improves quality and implements standard management processes. Funding comes from revenues and growth capital.
- ❖ **Seed phase:** (0-1 years) The founding team develops the idea and translates it into a prototype product or service. Prototype funding comes from founders' resources and/or contributions from friends, families and crowdfunding.

**Figure 19 Legal forms vs. stage development**



Source: own data collection and visualization (IFKA)

In our research, the legal form and the year of the establishment of social enterprises are being compared. 50 out of 38 social enterprises have been established as non-profit legal persons and 14 social enterprises as profit-making legal persons. Evidence shows

<sup>15</sup> Economic Times, s.e.

that within the seed phase, solely non-profit social enterprises (3) are being established, while in the start-up phase there is roughly equal number of social enterprises with for-profit (6) and non-profit orientation (10). This category contains the greatest number of social enterprises with for-profit orientation.

**Millenial Chestnut Social Cooperative** located in a former mining district – Pécsbánya – which has been gradually declining and segregating since the democratic transition in the 1990's, sells roasted chestnut at their design stalls in Pécs's city centre and therefore generates income opportunities with the disadvantaged groups living in the neighbourhood. Millenial Chestnut Social Cooperative is part of NESsT's portfolio.<sup>16</sup>

However, the more developed social enterprises are, the more often non-profit legal type has been picked. Within early-stage and later-stage growth phases, there is a privileged position of non-profit making organisations (25) compared to for-profit ones (4).

**Kockacsoki**<sup>17</sup>, located in Budapest is a chocolate manufactory offering high quality handmade chocolate products and chocolate-making workshops created by people with autism. Besides chocolate manufacturing, the social enterprise provides a complex portfolio of supporting services to people with autism such as coaching course to learn how to become more self-sufficient their daily life, making possible to gain work experience in our trainee programme and provide permanent employment. Kockacsoki has been part of NESsT's portfolio.

**In sum, findings show that legal types of social enterprises are closely linked to the EU funding cycles that further weakens the sector in terms of financial sustainability in the long-run as the distance between social enterprises and the market is still considerable.**

This fact can be seen as direct outcome of the government policy of 2007-2013 and related "progressive grant-making", the scope of government funding has been placed on two main domains, namely on business support (e.g. business planning, management skills, marketing etc.) as well as on training and coaching schemes. However, Hungary is allocated considerable amount of funding to social enterprise in the period of 2014-2020, the topics include areas of providing funding opportunities for "access to market" awareness raising and networking – preconditions for a well-functioning social enterprise ecosystem.

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<sup>16</sup> The website of "Millenial Chestnut Social Cooperative" s.e.

<sup>17</sup> The website of „Kockacsoki”, s.e.

**Table 1 Financial allocation of ESIF (2014-2020)**

| Support type                                                                 | Are there any schemes specifically targeting social enterprises? | Are any of these schemes funded by ERDF/ESF? | Are any of these schemes funded by the policy instrument you address? |
|------------------------------------------------------------------------------|------------------------------------------------------------------|----------------------------------------------|-----------------------------------------------------------------------|
| Pre-start support (e.g. incubators)                                          | NO                                                               | NO                                           | NO                                                                    |
| Awareness raising (e.g. awards)                                              | YES                                                              | YES                                          | NO                                                                    |
| Social entrepreneurship education (e.g. school for social entrepreneurs)     | NO                                                               | NO                                           | NO                                                                    |
| Business support (e.g. business planning, management skills, marketing etc.) | YES                                                              | YES                                          | YES                                                                   |
| Training and coaching schemes                                                | YES                                                              | YES                                          | NO                                                                    |
| Investment readiness support                                                 | YES                                                              | YES                                          | YES                                                                   |
| Dedicated financial instruments                                              | YES                                                              | YES                                          | YES                                                                   |
| Physical infrastructure (e.g. shared working space)                          | YES                                                              | YES                                          | NO                                                                    |
| Collaborations and access to markets                                         | YES                                                              | YES                                          | YES                                                                   |
| Networking, knowledge sharing, mutual learning initiatives                   | YES                                                              | YES                                          | YES                                                                   |
| Internationalization                                                         | YES                                                              | YES                                          | Partly                                                                |

*Source: own edition based on EDIOP Economic Development and Innovation Operational Programme*

Having a closer look at the geographical perspectives, still, the majority of social enterprises apply non-profit legal forms that is especially true for those being established more than 5 years ago. **Only relatively young, start-up phase social enterprises located in Budapest apply for-profit arrangements.** The Hungarian ecosystem applies various solutions to push more mature social enterprises towards market-based operation via financial and non-financial supporting programmes. One prominent example is **NESsT<sup>18</sup>** that has recently changed its scope of support from seed to scale-up social enterprise development. Similar attempts have been observed in the case of Impact Accelerator (the investment-ready programme<sup>19</sup>) and **ERSTE SEEDS<sup>20</sup>** programmes or SENSES project that aim to attract social enterprises regardless of age or sector to build closer relationships with investors and demonstrating certain economic visibility and sustainability for establishing market-related co-operations.

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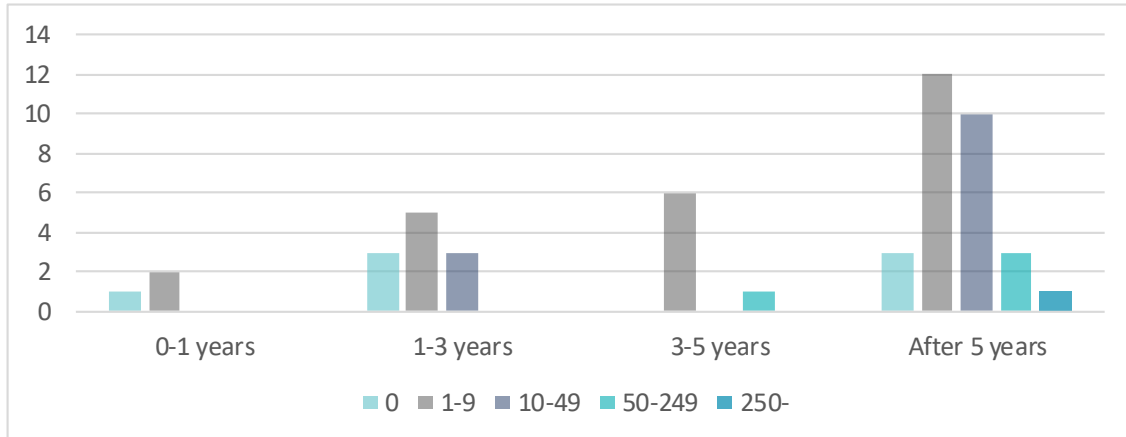
18 NESsT Europe Limited Company, 2017

19 The website of Investment Ready Programme, s.a., Impact Accelerator is 6-9 month long development program for social enterprises led by experts and investors to scale up the social impact and financial possibilities in Hungary.

20 The Website of Erste SEEDS Programme, 2017: a facilitator mentor programme, which support Hungarian social entrepreneurs with a business knowledge learning programme. With the end of the programme, entrepreneurs have an opportunity to introduce their portfolio for financial investors. Impact Accelerator Programme is a development support for investment-ready social enterprises. Through the programme the applicants have the chance to building relationships and communicate with the investors.

### 3.3 Employment capacity // labour market participation

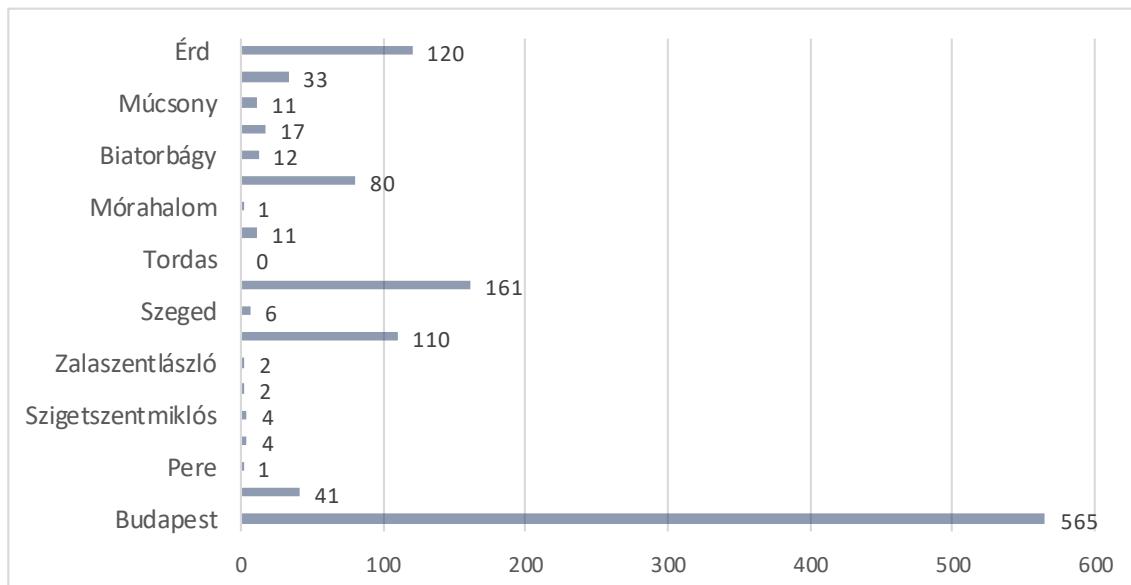
Figure 28 Organisational form



Source: own data collection and visualization (IFKA)

The main types of the organisational forms which are categorised by the numbers of employees are: 1-9 micro-, 10-49 small-, 50-249 medium-sized enterprises. Employment capacity is key regarding social enterprises' missions on providing jobs to vulnerable social groups. Measured along the European Commission's SME definition (EU recommendation 2003/361) **most social enterprises in Hungary fall into the category of micro-and small-enterprises leading to weak employment capacity and territorial impact.** This observation is equally true for seed phase, start-up phase and early-stage growth phase social enterprises.

Figure 37 Employment capacity of social enterprises



Source: own data collection and visualization (IFKA)

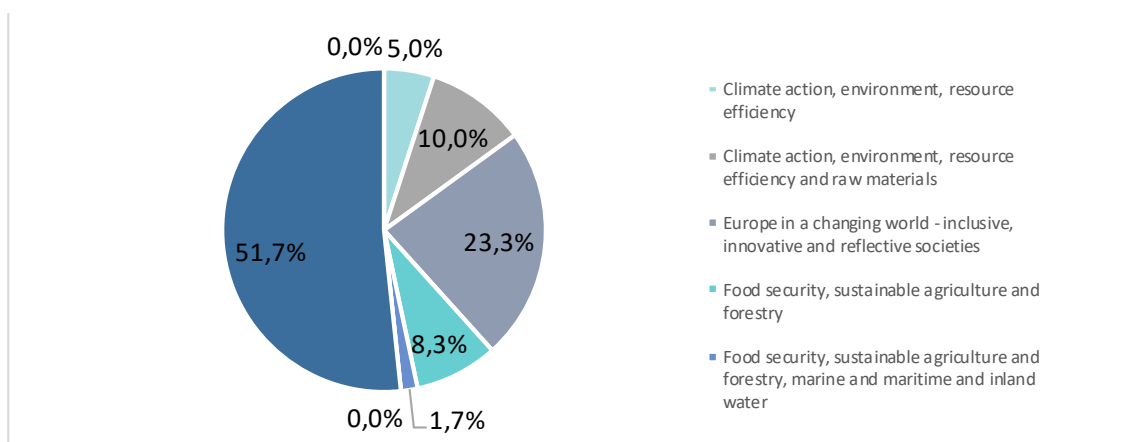
**Only social enterprises established more than 5 years ago are able to efficiently manage societal challenges and employ considerable number of vulnerable people – that is still lagging behind Western European trends.** Regarding geographical distribution, 60% of social enterprises (30) have been established in Budapest, and 40% in rural areas (20).

Within the sample, the employment capacity of social enterprises is Budapest centred. Out of the total of 1181 employees 565 are employed by social entrepreneurs located in the city of Budapest. The number of the vulnerable employees is 782 out of 1181 (exceeding 50%) that clearly demonstrates the employment character of social enterprises created in contrast to technology focus. This trend is in line with those observed in the Central Eastern European countries.

### 3.4 Societal challenges addressed

Most social enterprises (51,7%) are active in the field of “health, demographic change and wellbeing”, while only 23,3% is dealing with “inclusive, innovative and reflective societies” and additional 10% is engaged in “climate action, environment and resource efficiency and raw materials” (circular economy) and further 8,3% in “food security and sustainable agriculture and forestry”, 5% is handling “climate action, environment, resource efficiency”, further 1,7% is in “food security, sustainable agriculture and forestry, marine and maritime and inland water” and there was no answer for “green energy and transport”.

**Figure 45 Societal challenges addressed**



Source: own data collection and visualization (IFKA)

This order demonstrates that most Hungarian social enterprises are focusing on local solutions for traditional areas (e.g. the ageing population, migration, brain-drain and vulnerable social groups living in sparsely populated areas), **still there is a considerable lack of tech-type social enterprises that are relatively widespread in Western Europe.**<sup>21</sup>

<sup>21</sup> NESsT Europe Limited Company, UNIDO Conference, 2017

**BOOKR Kids**<sup>22</sup> is an online publishing social enterprise that provides 170+ classical and modern interactive e-story/audiobooks and 300+ educational games for kids accessible via mobile and tablet applications.

*Table 7 Societal challenges vs. geographical scope*

| TOP1                                     | TOP2                                                                        | TOP3                                                               | TOP4                                                | TOP5                                             |
|------------------------------------------|-----------------------------------------------------------------------------|--------------------------------------------------------------------|-----------------------------------------------------|--------------------------------------------------|
| Health, demographic change and wellbeing | Europe in a changing world - inclusive, innovative and reflective societies | Climate action, environment, resource efficiency and raw materials | Food security, sustainable agriculture and forestry | Climate action, environment, resource efficiency |
| Budapest                                 |                                                                             |                                                                    | Rural territories                                   |                                                  |

*Source: own data collection and visualization (IFKA)*

The most frequent area is Budapest, where societal challenges such as “healthcare and wellbeing”, “inclusive, innovative and reflective societies” and “resource efficiency and raw materials” are addressed. Contrary, rural social enterprises are mainly focusing on “food security, sustainable agriculture and forestry” and “climate action, resource efficiency”. Rural development services have own natural and environmental resources for example in agriculture.

**ToldiHouse** is an organisation which improve children who have mental problems and help the parents to go through special child-rearing. The children can live with near of the nature in the campsite part. The enterprises located in Nógrád county, which is a poor region in Hungary and the rate of employment capacities is very low. The institute employ the local population. and help them to live a better life.

There are many business services with the profile of healthcare in the hospitals. There is a strong correlation between social enterprises’ goals and objectives. Mostly, the “protection of human rights and creation equal opportunity” (23%) together with “assistance of creating local community” (21%); “assistance to municipality” (16%) represent the majority of answers received. Less preferred objectives are “assistance of training opportunities of youths” together with “renewable energy production”, “rehabilitation of criminals”, “rehabilitation of districts” and “managing social exclusions” with zero answers.

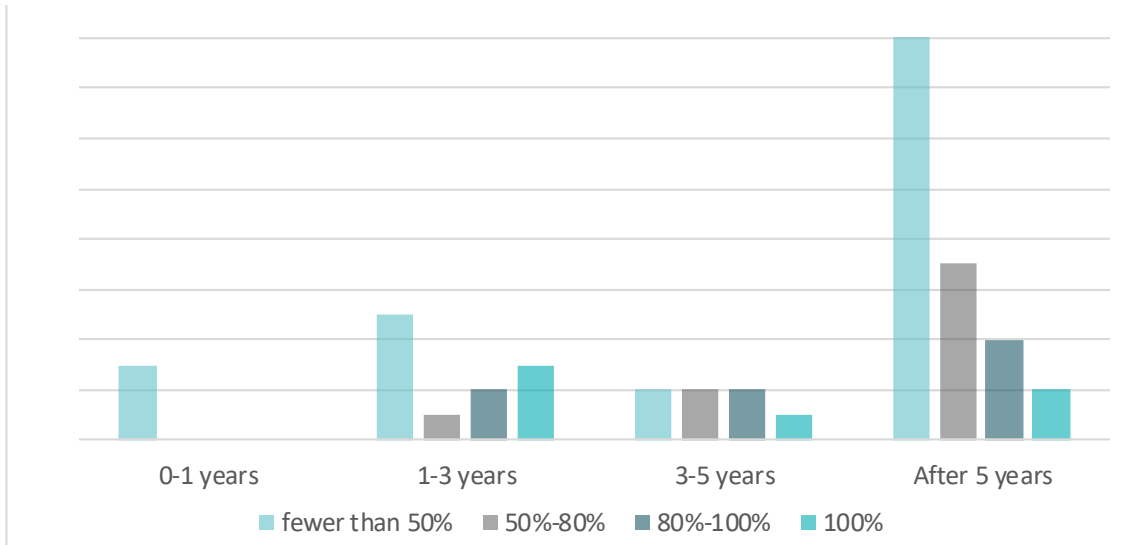
**Down Association**, a Budapest-based social enterprises is providing disabled people (mostly children, adults and elderly people suffering from Down's syndrome and other kinds of mental problems) with complex rehabilitation programme and training including medical attendance, PR activities towards social exclusion of disabled, publishing activity with the topic of mental illness and nursing, rehabilitation of families and **educational programmes**.<sup>23</sup>

<sup>22</sup> The website of BOOKR Kids, s.e.

<sup>23</sup> The website of Down Association, s.e

### 3.5 Revenue streams and income generation

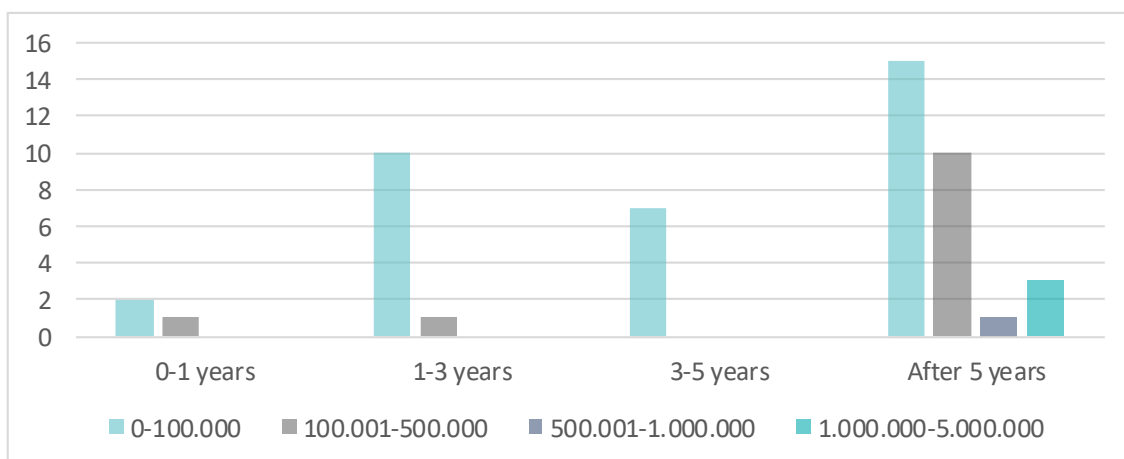
**Figure 55 Proportion of the realised revenue of the sales activity from total revenue**



Source: own data collection and visualization (IFKA)

All social enterprises analysed realize revenue of sales, however only 11 out of 50 social enterprises have been able to diversify their income generation and apply “sales on the market” successfully (realizing 80%+ revenue on sales activity). Again, the start-up phase social enterprises demonstrate an overall good understanding of the market. With regards to economic sectors, social enterprises active in “health, demographic change and wellbeing” located in Budapest are the most market-oriented ones.

**Figure 64 Total revenue in 2016 (EUR)**



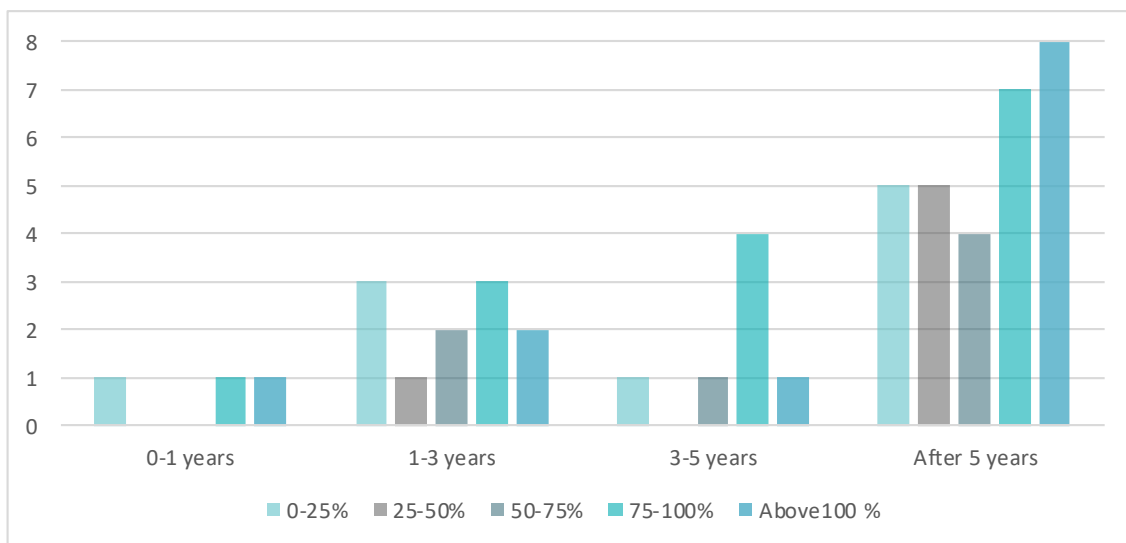
Source: own data collection and visualization (IFKA)

The highest revenue has been realized by later-stage growth social enterprises active in the field of “health, demographic change and wellbeing”, while the least profitable areas are low added value “food security, sustainable agriculture and forestry” and “culture,



arts, sports and recreation”. In sum, the sector is not financially self-sustainable and even today a high number of mature social enterprises, 13 out of 50 social enterprises, are active in sector with limited income generation and low added value. Similar to social enterprises’ employment capacity, there is considerable disparity regarding the scale of revenue generation. The highest revenue has been realized in the segment of the later-stage growth social enterprises demonstrating relatively stable market position and revenue streams. The total revenue of the social enterprises depends on the quality of the value proposition and the awareness of social value creation. It consists of donations, grants, commercial loans, public procurement and invested capital.

**Figure 73 The percentage of costs covered from revenue**

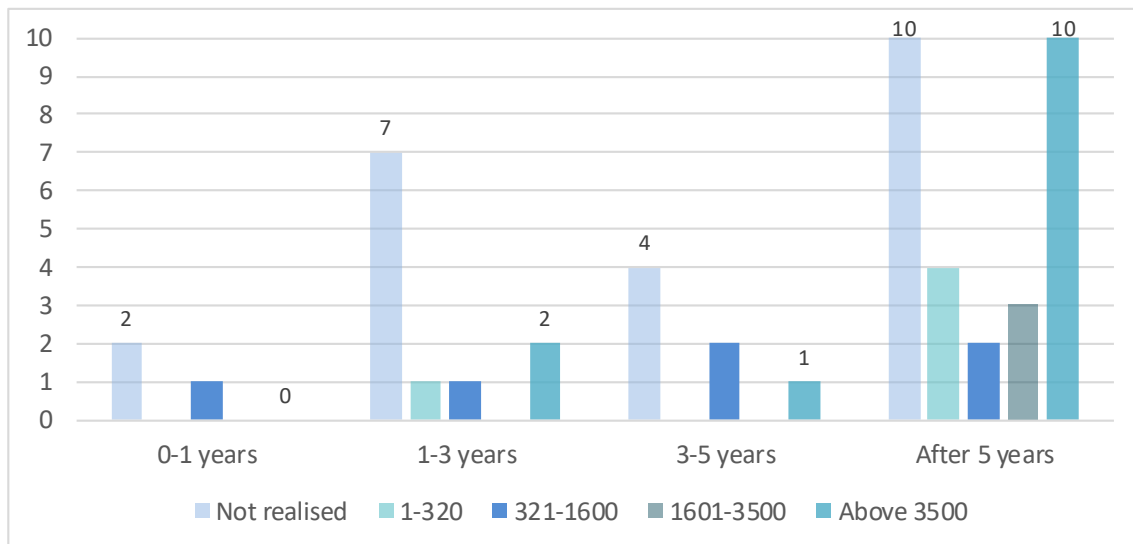


Source: own data collection and visualization (IFKA)

Similar to figures on sales, Hungarian social enterprises are struggling to generate income on the market that leads to huge amount of costs not covered from the revenue they generate. Approximately, 75% of the cost are covered only, however, in later-stage growth phase there are self-sustaining social enterprises. 15 out of 50 social enterprises cover at least 75% of their costs through their operation, mostly active in “health, demographic change and wellbeing” without realizing further income. **50% of these “nearly self-sustainable” social enterprises realize fewer than 50% revenue on sales, that shows the vulnerability of the sector.**



**Figure 82 Amount of the realised profit (EUR)**



Source: own data collection and visualization (IFKA)

Total of 23 social enterprises do not realise any profits through their operation. The most profitable social enterprises (10) are in the late stage growth phase, cover at least 75% of their costs and 50% of their revenues on sales. 27 out of 50 social enterprises realize profit above the realised revenue, but only 13 out of 50 social enterprises are situated in Budapest. This means that profitability is not linked to Budapest.

**The Hungarian social enterprise sector is weak and pre-mature in terms of employment and financial sustainability. Apart from successful champion social enterprises that are well introduced into the market with stable service / product portfolio and divers income sources, most social enterprises face challenges on the market: a) low employment capacity (employing approx. 9 employees), b) operating in low added-value sectors (or sectors not acknowledge by the society) such as “climate action, environment, resource efficiency and raw materials”, c) are newly established (less than 5 years ago) with fragmented market-based co-operations. Few social enterprises demonstratively good understanding of the market. Income and profit generation are common in case of social enterprises tackling healthcare and social exclusion problems. However, the vast majority of the social enterprises are in the beginning of exploring market opportunities, and to establish business relationships. Consequently, their employment capacity and financial sustainability are below our expectations.**

## 4. Needs assessment and main challenges for scaling social enterprises

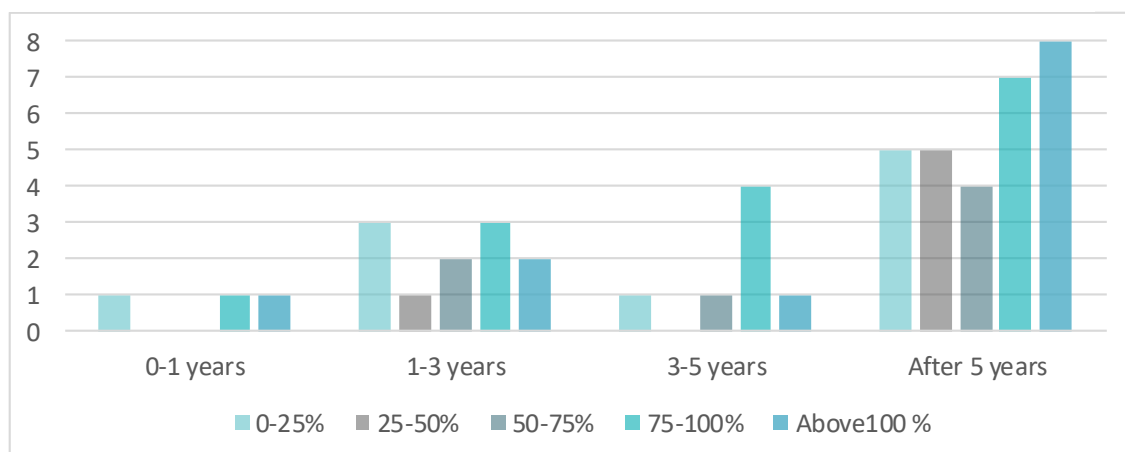
Our analysis shows that approximately 50 % of revenue streams come from sales in Hungarian social enterprises meaning that without other funding sources they are not able to break even. Products and services created by social enterprises are mostly overpriced – providing an opportunity to customers to share social goals and additional cost items together – and size limitations do not allow social enterprises for delivering in bulk. This fact underlines that **social enterprises are in need of both financial and non-financial assistance in order to prepare solid ground for scaling and internationalization.**

### 4.1. Financial assistance provided to social enterprises

Our **preliminary research**<sup>24</sup> on the (social) impact investment sector states that the Hungarian market is nascent due to the lack of sustainable financial model(s), the enterprises are reluctant to access main financial resources (e.g. microcredit, venture capital, equity, impact investments). Social enterprises are in lack of knowledge on social impact investing, business and financial planning, social impact measurement, ability and experience in planning and structuring the investment deal.

Within our research, 10 out of 50 social enterprises are not able to cover their operational costs from their revenue (under 25%) or do not realise adequate revenue on sales activity relying solely on donations or grants. Surprisingly, 50% of the above social enterprises (5) are at the late stage growth phase that clearly illustrates their overreliance on grants. On the other hand, 12 out of 50 social enterprises are able to cover 100%+ of their costs, but only 50% of their revenue is generated by sales activity. **Benchmarking start-up and scale-up social enterprises performance, still, self-sustainability is questionable.**

*Figure 91 Percentage of the covered cost from revenue*



*Source: own data collection and visualization (IFKA)*

<sup>24</sup> IFKA Public Benefit Non-Profit Ltd. for the Development of Industry, 2017

## 4.2 Investment needs of social enterprises

Investment needs of Hungarian social enterprises are primarily determined by their actual lifecycle stage and sector. As stated before, Hungarian social enterprises are mainly reliant on government grants while the social impact investment markets are not developed enough to provide the financial support needed to scale-up.

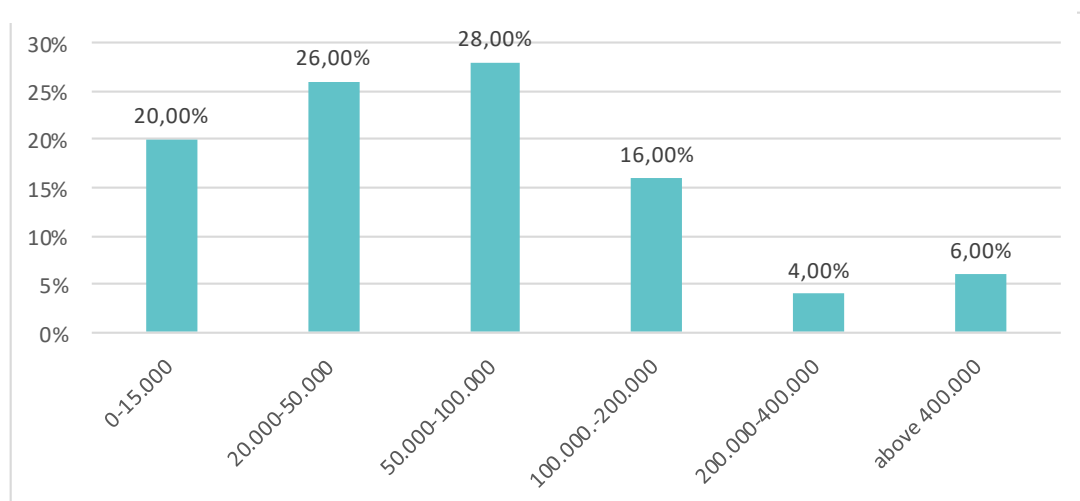
Profiling shows that **a typical social enterprise (cluster 1) with the investment need exceeding 400,000 euro** is a) in its later-growth stage phase, b) active in the “Health, demographic change and wellbeing” sector, c) realizes considerable revenue on sales (>50%), d) is profitable (>3,500 euro) and last but not least is e) established as a non-profit organization.

**Social enterprises with an investment need exceeding 200,000 euro but not reaching 400,000 euro (cluster 2)** are characterized by a) relatively high revenue on sales (80%-100%), b) low profitability, c) active in the “health, demographic change and wellbeing” sector, d) providing only services and last but not least e) placing focus in their operation on innovations, namely delivering “new product/service innovation: changes to what an organization offers”.

**Social enterprises having an investment need of 100,000 – 200,000 euro (cluster 3)** are a) in the later-growth stage, b) providing services, c) active in impact measurement, d) are in need of management and financial skills enhancement and last but not least are e) financially stable organizations covering all costs from revenue.

**Social enterprises expressing need for investment of 50,000 to 100,000 euro (cluster 4)** are a) covering less than 50% of their costs from revenue, b) 100% of the revenue is invested back into operation, c) mixing for-profit and non-profit organizations, d) actively cooperate with other social enterprises and market actors.

**Figure 99 Investment needs of social enterprises**



Source: own data collection and visualization (IFKA)

As the chart illustrated above, the **most frequently indicated investment “ticket size”** varies between 50.000-100.000 EUR that represents approx. 25% of social enterprises observed.

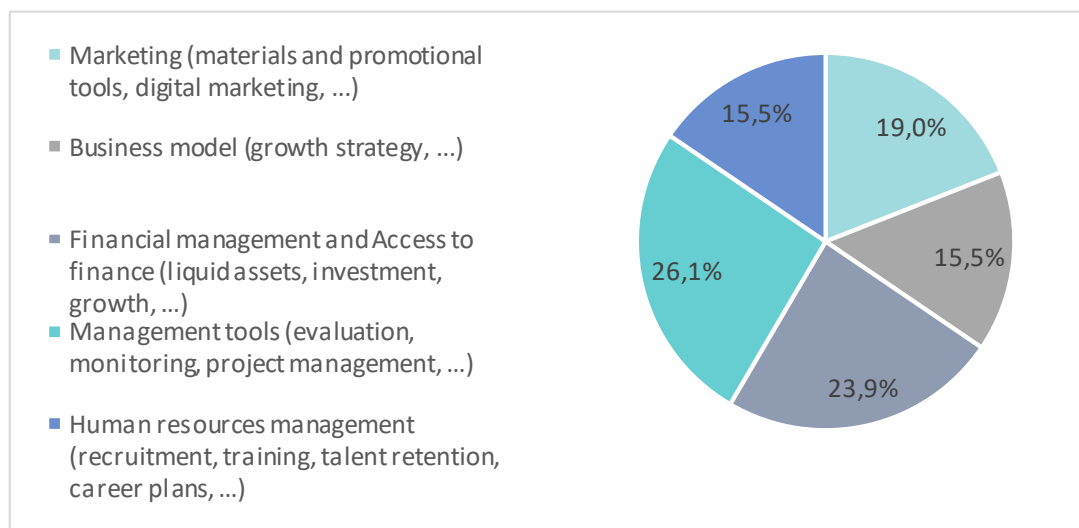
### 4.3 Non-financial (skills enhancement) provided to social enterprises

32 out of 50 social enterprises are involved any kind of social enterprise development programmes (managed by ASHOKA, NESsT, ERSTE Bank) currently that is a promising sign. Cross-fertilization and multiple participation (15) in various programmes are also common. Within our former survey on social entrepreneurial skills needs, social enterprises marked the following topics relevant:

- ❖ access to market (mentorship programmes with clear focus on scaling),
- ❖ strategic planning (HR and business planning),
- ❖ financial management and business planning (incl. access to investors),

### 4.4 Co-operations with other organisations and the main relationships of the market

*Table 12 Cooperation forms*



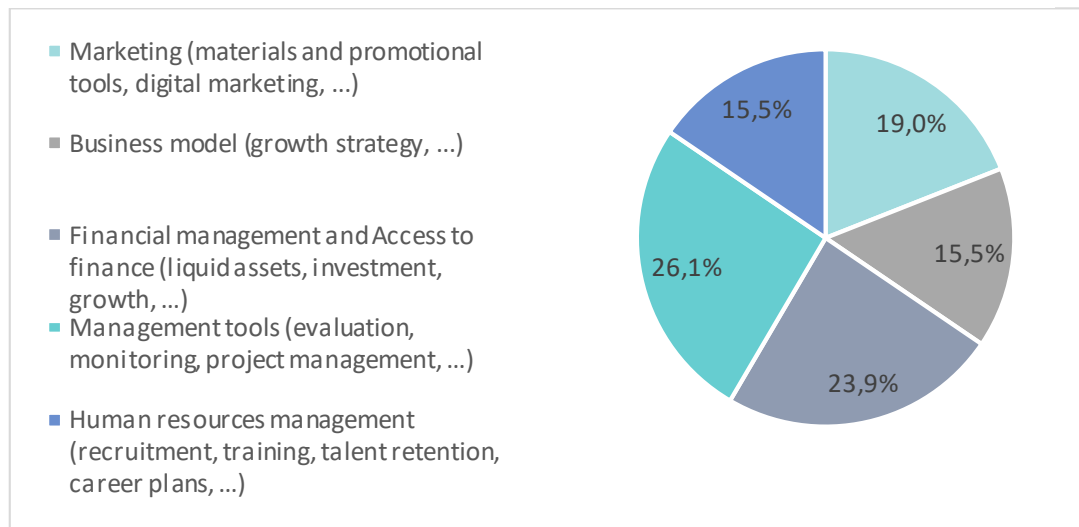
*Source: own data collection and visualization (IFKA)*

According to the typical financial need of the sector is 400,000 EUR which is being signed by later-stage growth enterprises, have good profitability and considerable revenue. These non-profit organisations are strong in financial management and management tools. Those later-stage growth enterprises which need 100-200EUR, are active in social impact measurement but they have got obstacles in management skills (26.1%) and financial management (23.9%) because they are able to cover their costs only. Marketing skills (19%) are very necessary for early-stage enterprises which have higher level of sales but they have got a low profit rate, so with this strategic need they will able to

popularise themselves for a wider range of customers. Business modeling (15,5%) and HR management skills (15,5%) can support those start-ups which the financial need of 500-100 EUR and they very active in cooperation between non-profit and for-profits.

#### 4.5 Strategic needs

*Figure 105 Strategic needs of social enterprises*



*Source: own data collection and visualization (IFKA)*

Respondents expressed that the most important shortage is the management tool which involves monitoring of the competitors and the market, social impact measurement and project management special skills (26.1%). Re-appearing answer is the financial management, which is indispensable through the operation (23.9%). Marketing skills (19 %) is the elementary asset to achieve the targeted customers, but the websites are not well-developed even there are lack of information about the prices or relevant addresses. Human resource management and business modelling (15.5%) are connected to strategic thinking which are supported by accelerator programmes.

In line with research published by McKinsey & Company, the identified five main challenges of scaling social enterprises are:

- a) **The sector and its stakeholders focus too little on scaling up:** In the head of entrepreneurs the vision and the mission of the organisations are combined. There is no clear burden between the two concepts and they cannot imagine the fact to generate and realise revenue and profit with their market operation. The market needs to identify the sectoral operation, public acceptance to generate profit, improve business attitude and creating a common social impact measurement process.
- b) **Difficult to attract management talent for the next stage of growth:** The main components of a competitive management talent are business attitude, strategic thinking, creation of business modelling, market experience, achieving financial sources and co-operation. More and more accelerator programmes and

consultant companies serve different kinds of mentor programmes to these skills for the social entrepreneurs and to support them on the market. There is a raising cooperation between the commercial and the social sector, but the leaders from the commercial organisations have a fear to maintain social enterprises or invest financial asset and equity into their operation. According to them, it is a risky business at the moment.

- c) **‘Friendly but lazy’ money decreases the urgency of growth:** There is a lack of improving business plans of the sectorial enterprises because in the first years of the market operation, social enterprises are supported by financial resources of the government. As a consequence, they do not have a pressure to develop their competitiveness and market interest. So fewer and fewer social enterprises create themselves sustainable environment which entails the slow steps of organisational growth.
- d) **Limited standardized impact measurements hinder tracking and comparison:** Most of the social enterprises do not use an integrated research methodology about the created social impact. It would be relevant for customers, the government, financial supporters and for the organisational transparency as well. The transparent operation is a criteria of clear strategic competition on the market. The popularity is a very important concept, because the firms need more and more customers and create their own target group. Due to the measured social value the government and financial investors get an organisational portfolio to invest into them.
- e) **Buying from social enterprises is not yet widely seen as a priority:** In order to reach the appropriate level of demand for the sector, there is a need of competitiveness skills on the market which consists of the value proposition, the quantity and the quality of the served products, the price strategy and **customer relationships**<sup>25</sup>.

**The compared topics are the special needs of the social sector and the main barriers of scaling the operation of the market. As a result, co-operations are very important for the Hungarian organisations because currently the most frequent form of is working with civil communities together. The relevance of the academies is at a low level on the market. In the future they can contribute to the social impact measurement and compose the new entrepreneurs. The main financial source is guaranteed by the government, on the Hungarian market it is 60% of the whole financial assets. This level is unfortunately very high, so policymakers will have to create the direction of private investment forms. On the other hand, the main focus of the sectoral development connected to the non-financial scores. The main needs of the sector are to improve strategic thinking and business modelling to settle the business awareness through the cooperation with “mainstream companies” to implement their business skills and the attitude of conscious entrepreneurship. To overcome the obstacles, the clear concept of vision and mission of the organisations are necessary, and the main aim is the creation the competitive management of the sector. From financial situation (financial support, percentage of the covered cost from revenue, needed financial**

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<sup>25</sup> McKinsey & Company, 2016, pp.22-23.

support) we examined the following aspects: difficulties with business areas, the forms of relationships and the strategic needs.

Conclusions highlight that the main obstacles of social enterprises having a more entrepreneurial attitude are the lack of awareness of business thinking (even though social entrepreneurship education is embedded into national education curricula and there is a great number of educational programmes established), the focus of financial support provided, the relatively hesitating behaviour of business actors getting engaged in market-based co-operations with social enterprises as well as the various interpretations of social entrepreneurship by stakeholders. For these reasons, the visibility of the overall sector is not well-established in the society.

## 5. Ecosystem of business support tools and instruments

### 5.1 Business support tools and instruments

Hungarian social enterprises are currently provided with a broad range of financial and non-financial (namely business knowledge support tools) instruments including governmental support system, co-operations with mainstream companies through Corporate Social Responsibility (CSR) programmes, accelerator and start-up incubator programmes serviced by advisory companies.

*The Unheard Foundation's <sup>26</sup>mission is to develop innovative technological solutions in order to promote barrier-free access to information for the hearing impaired and their social inclusion by promoting the widespread use of sign-language." The organisation takes part in ERSTE SEEDS Mentor Programme. The aim of the programme is to endow Hungarian social enterprises with business skills as it was mentioned above.*

#### 5.1.1. Social impact measurement tools

Evidence shows that most Hungarian social enterprises experience difficulties in defining their social goals and assessing the market in which they wish to work. In-depth interviews with social entrepreneurs highlight that **currently only a limited number, 19 out of 50 Hungarian social entrepreneurs are willing to apply in-house techniques to measure and follow-up social impact.** Most of these social enterprises are now in the later—stage growth phase (9) and in the start-up growth phase (8). Only 5 social enterprises measure social impact by external company, finding “sources, liquidity problems, lack of human resources, lack of business skills” the most pressing difficulties during their operation as non-profit legal entities.

The lack of knowledge and tools for measuring social impact by 36 out of 50 social enterprises, as well as citing the lack of financial resources, platforms providing information to prospective donors, public decision makers and the general public about

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<sup>26</sup> The Website of Unherad Foundation, s.e.



these impacts has been highlighted by local experts as a major gap of the social enterprise ecosystem to be addressed:

- In January 2014, the Hungary Impact Group was established with the aim to bring together the key stakeholders from across the NGO sector, public sector, private sector and academia to support the development of the impact agenda in Hungary. The group is currently open and looking for new members.
- Social Impact Award, a year-round educational program on social entrepreneurship dedicated to students. Launched by Impact Hub Budapest, SIA supports the youth in building social enterprises that find solutions to the most challenging issues of our time. In doing so, Impact Hub Budapest hosts events and organizes workshops to raise awareness for social entrepreneurship, teaching the necessary skills to navigate from vague intentions to promising ventures, providing access to networks and promoting the best teams in Hungary and in Central Europe with the Social Impact Award.

### 5.1.2 Networks and collaborations

Business collaboration between social enterprises is rare. Mostly these small enterprises serve local markets, working alone. However, some good practices exist, first of all cooperating in selling local agricultural products. Some of these initiatives have set up a common cooperative to sell together, some involves several independent businesses. These cooperations in many cases fail, and after a short period they stop operating. Even if they survive, they face many difficulties, mainly because of the lack of understanding the common interest, the lack of proper business and marketing knowledge and leadership shortage (Value Product Social Cooperative in Zalaszentgrót, or Amber Social Cooperative in Letenye).

Nowadays, accelerator services offer the opportunity to connect the organisations with each other. Through an online platform, social enterprises can work together, the entrepreneurs can exchange their market experience and they can change their resources and assets with others. Currently this opportunity is in start phase but in the future the main direction will be to involve “mainstream” companies too.

### 5.1.3 Corporate Social Responsibility (CSR)

In Hungary, multinational organizations, banks and foundations - as part of their CSR Corporate Social Responsibility Programme - occasionally publish small-scale tenders providing a modest grant to non-profit organisations or social enterprises:

- In 2014, UniCredit Bank together with UniCredit Foundation and NESsT Hungary jointly launched the „Social Innovation“ project with the total of 60 000 EUR with that aim of improving the economic situation of disadvantaged groups in a sustainable way. The adequate projects were those that helped private individuals or organisations in the introduction or improvement of sustainable activities, rather than providing them with financial support directly.
- In 2017, UK-based Badur Foundation in cooperation with NESsT Hungary re-launched the Springboard Programme, its Social Enterprise Competition to identify and develop social enterprises that improve the employment chances and livelihood of people in deep poverty.



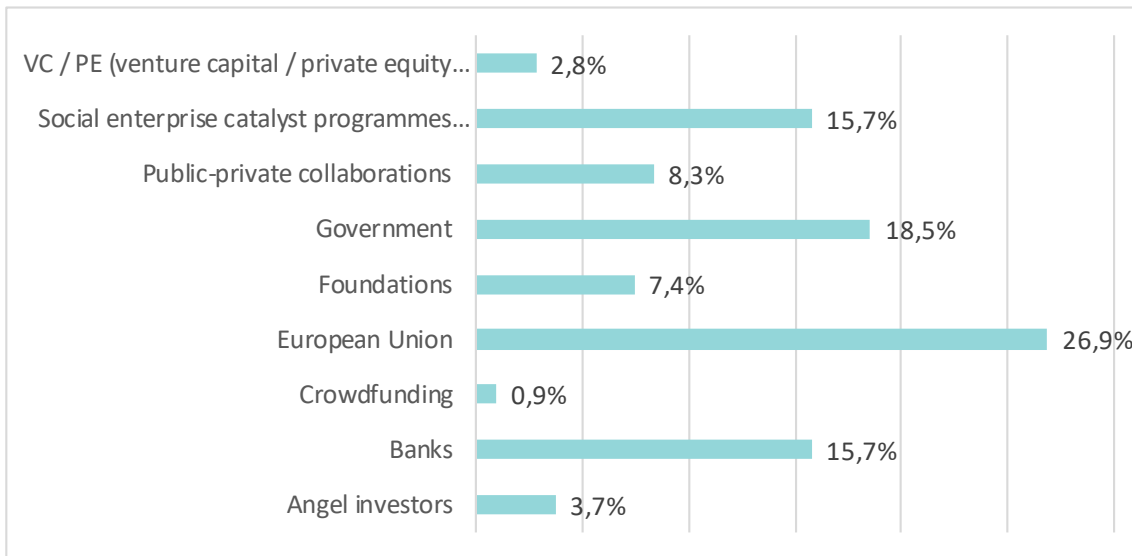
**Fairfood**, the Hungarian social enterprise has collaborations with other SEs and “mainstream companies too through CSR projects. Fairfood supports financially non-profit organisations with 20% of their revenue. On the website of the institution, different collaborations are introduced.

## 5.2 Access to finance

In the last years, four private award initiatives has been targeting social enterprises or organizations active in the social economy as follows:

- KPMG’s Programme for a Responsible Society supports non-profit organizations or social enterprises active in education, health and environmental protection across Europe. Started in Hungary in 2009, it provides pro bono professional support, such as audit, tax advisory, strategy, operations, IT and HR consultancy for one year for 3-4 selected organizations, specially focusing currently on organizations working with disadvantaged children. The advisory work is complemented by an operational grant of 250.000-750.000 HUF (€830-2,500) and donations of used laptops if needed.
- UniCredit bank’s Social Responsibility Project “Step with us” was launched in 2013 in Hungary and is also implemented in several other European countries. It is a competition among non-profit civil associations and foundations, social cooperatives, supporting innovative initiatives addressing the economic vulnerability of disadvantaged groups by helping them establish economic self-sufficiency. The three best placed organizations are awarded (1st placed project: €19.500, 2nd: €18.000, 3rd: €16.500).
- The Competition of Social Enterprises organized between 2009 and 2015 by NESsT in its European countries of operation. A sum of \$10,000 was awarded to the social enterprises with the best business plan among the companies included in NESsT’s first stage portfolio (i.e. help in the detailed elaboration or refinement of their business plan). Companies successfully completing the first stage received funding from NESsT. The award was given out in collaboration with Citibank, financed from the bank’s Social Responsibility Fund. Citibank has stopped its operation in Hungary in 2016, so this program was finished. (Besides, NESsT has changed its focus of operation to existing social enterprises with growing potential.
- Badur Association, founded by private persons, operating in the UK and Hungary organizes competitions, and support social enterprises’ ideas on the route of realization. Badur’s focus is exclusively Roma community initiatives or people living in very poor neighbourhood.

**Figure 112 Access to finance**



*Source: own data collection and visualization (IFKA)*

The figure shows the forms and distribution of the financial sources on the Hungarian market. As we mentioned, the main financial source is grant (18.5%) or the European Union (26.9%). **The figures above (adding up to 50%) suggest that Hungarian social enterprises cannot distinguish between grant schemes distributed by the government regarding the origin of the financial assistance.** Mostly donation-based social enterprise catalyst programmes (e.g. NESST, ASHOKA) are responsible for 15.7% of financial resources available on the market. Moreover, Hungarian social enterprises are now discovering the opportunities provided by social (ethical) banks. Social banking is in its initial phase, the “commercial lending mechanisms” by commercial banks (15.7%) are more frequent. Last but not least, financial resources allocated by public-private collaborations and foundations (7.4%) angel investors (3.7%), venture capital and private equity investors (2.8%) are immature. Crowdfunding (0.9%), the scaling community financing instrument is barely known in Hungary for financing social purpose initiatives and projects.

### **5.3 Accessible governmental support in Hungary**

Government aids are responsible for the greatest share of available financial resources. A total of two dedicated ministries are in charge of allocating ESIF European Structural and Investment Funds resources to the social economy agents, such as social enterprises, social innovation initiatives. On the one hand, the Ministry of National Economy (abbreviated as NGM, in Hungarian: Nemzetgazdasági Minisztérium) acts as a Managing Authority of EDIOP Economic Development and Innovation Operational Programme. On the other hand, Ministry of Human Capacities (abbreviated as EMMI, in Hungarian: Emberi Erőforrások Minisztériuma) manages the HRDOP Human Resource Development Operational Programme.

In the case of the support of the social economy, social enterprises are encouraged under the EDIOP priority 5 by establishing sustainable business models and also a general framework for **social enterprise development by supporting transit employment** in order to promote the employment of disadvantaged people. Permanently supported jobs will be created for the most disadvantaged groups and temporary employment will be offered for those with reduced work capacity within the framework of the HRDOP. By the Rural Development OP the supported vocational training and advisory services will be also available for social agricultural enterprises. Furthermore, the cooperative developments, the common market entry activities (Short Supply Chain) and initiatives of local communities (CLLD) of small economic actors operating in rural areas (including social agricultural production) are also eligible for support. The community supported agriculture models are new possibilities.

Supporting social enterprises requires continuous counselling/mentoring and financial incentives in the form of non-repayable grants and FI (the measure is related to the financial instruments provided under priority axis 8 of EDIOP). For the implementation of the projects, complementary ERDF Funds are applied under cross-financing. Main target groups cover disadvantaged unemployed and inactive, actors of the social economy and social enterprises. Typical beneficiaries are actors of the social economy and social enterprises, independent of their organizational structure (EDIOP, 2014).

**Consequently, the Hungarian government has already committed the largest share of financial resources to social economy in Europe that exceeds 5 billion euro. The Operational Programmes emphasize that “there is a large potential in untapped opportunities of the social economy in Hungary, -among others – in the field of employment.” Sadly enough, financial instruments solely pay attention to “number of workplaces created by the supported social enterprises in less developed regions”. Moreover, above financial instrument are addressed to non-profit organizations leaving for-profit social enterprises out of the development programmes. In the period of 2014-2020, there are no financial mechanisms applicable for start-up social enterprises and the scaling of the sector is mainly driven by strong employment focus. There is limited focus on **investment-ready social enterprises**<sup>27</sup>.**

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<sup>27</sup> The Website of proposal monitoring, s.e.

<sup>26</sup> The Website of proposal monitoring, s.e.

<sup>27</sup> The Website of palyazatfigyelo, s.e.

## 6. Gap analysis and policy recommendations

According to the social entrepreneurs, there are many intervention areas that should be better organized and / or supported by public policies:

- ❖ **Transparent legal environment and administration:** according to the unified concept of the **European Union**<sup>28</sup>, the **business law** ensures the mobility of firms in order to allow them to benefit from the advantages of a unified market; the equality of the conditions of competition between firms established in different Member States; the promotion of commercial links between the Member States; the stimulation of cooperation between firms across borders and the facilitation of cross-border mergers and acquisitions. As stated in chapter 2, there is no national strategy on social entrepreneurship in Hungary, however, the area of the social economy (and social entrepreneurship) has been already integrated into sectoral policies and strategies. Moreover, in the period of 2014-2020, Hungary has allocated the highest amount of ESIF resources to facilitate the sector. **Consequently, there is a need for more elaborated coordination of sectoral policies led by ministries.**
  
- ❖ **Improved access to market:** social enterprises have just recently started establishing business relationships to businesses, yet, cooperation with the government is rather ad-hoc. The legislation on socially responsible public procurement (SRPPP), enabling social enterprises providing services to local, regional and national policymaking spheres, has been codified (by Ministry of Human Capacities through creating “sheltered” organizations) but not applied yet. **Consequently, there is an urgent need for improving socially responsible business opportunities and business behaviour. Reserved contracts and social clauses should increasingly become used in competitive tenders, following the introduction of national legislation.”**
  
- ❖ **Improved access to finance:** “**social investment market** <sup>29</sup>is still (very) nascent in Hungary. There is very limited number of private investors (and business angels) and the public financing (also combined with the EU funding streams) accounts for large proportion of available financing. On the demand side, adequate investment readiness to absorb refundable financing is still limited. **Social banking services together with mainstream hybrid financial instruments adopted to the unique lifecycle of social enterprises (including lower return expectations) should be established by public and private financial service providers and banks. Investment-ready social enterprises should be strengthened through equity.**

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<sup>28</sup> The Website of Europedia, 2011

<sup>29</sup> European Commission, 2014, A map of social enterprises and their  
in Europe, Country Report Hungary, p.1

- ❖ **Bottom-up decision-making procedure and balanced relationship with government:** in Italy and Germany there is a higher tendency to solve market problems through **bottom-up decision making**<sup>30</sup>. “One part of the enterprises interact with public agencies, which turn out to be their main client in almost all EU countries. The forms and modalities of these interactions are therefore strategic to support the development of social enterprises. **Consequently, two-way communication and broad stakeholder consultation should be improved by government in order to develop adequate management tools between regional/local authorities. Through facilitating public authorities and social enterprises’ representatives to co-create actions and gather good practice, stronger trust and common understanding are achievable.**

Our policy improvements may contribute to the proper functioning of the social enterprise ecosystem and to foster a growing number of social enterprises pioneering alternative forms of finance:

- ❖ **Integrating social impact and social value creation into the heart of government funding programmes:** the first step of the development procedure is the national priority project EDIOP-5.1.2-15-2016-00001 „PiacTárs (link to source: <http://piactars.hu/>) that has already been improved by IFKA. IFKA has been in charge of developing „new methodology for monitoring (audit) proposals” as „pre-qualification criteria” for refundable (EDIOP 5.1.7.17 – grant + loan scheme) and non-refundable (EDIOP 5.1.3-16. „Társadalmi célú vállalkozások ösztönzése”) ESIF grants. The new methodology is composed by 3 aspects: a) minimum requirement (administrative data), b) sustainable business plan, c) social impact measurement. Certified social enterprises demonstrating economic viability and measurable social impact are provided with access to a wider portfolio of financial sources mentioned above. As a result, the improved measure is now better aligned with Western European social enterprise certificates (audit schemes) placing emphasize on social enterprises’ financial viability and social impact as well. By up till now, a total of 900 enterprises registered into the online certification system and 180 social organisations passed successfully the evaluation (audit) covering the total amount of the 15,979 EUR as follows:
  - 6,5 -15 million HUF grant size projects with 75 certificates issued,
  - 15-50 million HUF grant size projects with 81 certificates representing the highest success rate (60%),
  - 50-250 million HUF grant size projects with 24 certificates issued.
- ❖ **Exploiting the potential of mixing public and private financing:** EDIOP call for proposals 5.1.7-17 “Társadalmi célú vállalkozások ösztönzése”, has been improved by IFKA. IFKA has been in charge of developing “a new methodology for monitoring (audit) proposals” as „pre-qualification criteria” for the hybrid grant scheme. The new methodology is composed by 3 aspects: a) legal form applied (e.g. NGO, non-profit organisations, social cooperatives), b) financial viability (at least one closed fiscal year) and c) the economies of scale. Certified social enterprises demonstrating economic viability and willingness to test refundable

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<sup>30</sup> European Commission, 2016, Social Enterprises and their Eco-systems: Developments in Europe, p.13.

financial instruments are provided with access to a higher grant size up to 7,5-250 million HUF (up till 60 million HUF the grant scheme is accessible as non-refundable financial resource).

- ❖ **Promoting internationalization:** internationalization of social enterprises has been partly addressed by policy instruments in Hungary. The national priority project EIDOP 1.1.4-16 (“A kiemelt növekedési és innovációs potenciállal bíró feldolgozóipari KKV-k azonosítása, felmérése, motiválása, támogatása nemzetközi versenyképességük és hálózatosodásuk elősegítése céljából”) is supporting high-growth innovative enterprises to exhibit international markets.
- ❖ **Enhancing private capital in social enterprises:** in 2016, to build the social enterprise sector in CEE, a small group of key stakeholders - EVPA, NESsT, Yunus Social Business Initiative, IFKA and the European Commission decided to join efforts and work together to solve these critical issues in the region. The idea was to form and lead a region-wide Task Force of key players that would work together in the next five years to build a social investment movement to foster more of an appropriate capital for social enterprises, while also preparing more and higher impact social enterprises to receive these investments. Ambitions of the initiative: a) to develop the ecosystem for social investment in Central and Eastern Europe, b) to attract more and better adapted resources for early-stage social enterprises, c) to showcase social investment examples from Central and Eastern Europe, d) to position CEE in the global movement to develop and grow the social impact investing sector.

Based on the policy gaps and on-going improvements illustrated above, we believe that **government should pay more attention to the regulatory aspects** and decreasing the government’s share in financing social enterprises via grants. Regulatory improvements, thus, should better address favourable taxation environment for social enterprises – that is currently an underexploited policy area - and on the wider application of SRPPP. Acknowledging for-profit social enterprises in government initiatives and schemes is also more than welcome.

New law on public procurement created by the **Ministry of Human Resources (in Hungarian: EMMI Emberi Erőforrások Minisztériuma)** should be further elaborated in close cooperation with the Ministry for National Economy, acting as a Managing Authority for ESIF resources. <sup>31</sup>.

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<sup>31</sup> The website of Palyazatfigyelő, s.e.



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