HVCA JUBILEE YEARBOOK

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PEER-REVIEWED BY:

Judit Karsai — scientific advisor, Centre for Economic and Regional Studies, Institute of Economics

Levente Zsembery — CEO, X-Ventures Zrt. chair of the Supervisory Board of HVCA

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Chairman greetings

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Chairman greetings

Dear Reader,

This yearbook is for you. We have spent a lot of time and made a great effort to highlight the role of the Hungarian venture capital and private equity sector, the role of HVCA in this field, the three decades of success of our association, and the added value we contribute to the development of the Hungarian and regional economy.

We, the venture capital and private equity funds, the ”Company funding SWAT Team” are the rapid response unit tasked with safeguarding the economic and enterprise development of the country. We are managers responsible for ensuring the rapid growth of SMEs and large corporations and the increase of the capital under our management.

Venture capital and private equity, by their very nature, always make financial return on funding intellectual added value. In the medium and long-term the members of our association aim to contribute to the prosperity of the Hungarian and regional economies on a gradually growing scale, similar to the examples of Israel and Singapore. The performance of the domestic participants in the sector is measurable via the reports submitted to the Central Bank of Hungary and through the statistics published yearly by Invest Europe, the European association of venture capital and private equity fund managers.

Elemér Eszter

chairman
2019-

It is our duty to react timely, ”foresee the future” and make prompt decisions by considering the most aspects possible in order to creatively ”curve space” for certain portfolio companies. At the same time, we must comply with all the strict regulations in the course of our operation and keep a cool head at all times. As their names suggest, venture capital and private equity have the opportunity of enabling enterprises to fly undetected under the radar - as compared to a stock market operation - at the time of their extreme growth periods alongside ample transparency and within the limitations of the framework.
Supportive membership is an important component of the integrity of our association and the functioning of our fund manager members. They are the advisors and experts who provide their services in collaboration with the members of the funds to perform transactions, or directly impact the operation of a portfolio company by taking advantage of their expertise.

The investment process of venture capital and private equity may seem to be dominated by financial transactions, however it is more like an educational and business development process in which portfolio companies must learn how to expand and operate at a much higher level in an institutional framework. Rather, it is a validation step in the investment process it is an external confirmation of the existence of the target company which puts a hitherto unknown player on the map for the market and the financial sector. Networking, opportunities, and business development channels provided to the validated portfolio company by the fund through personal contacts and as a joint owner greatly outweigh the importance of the amount of capital provided during the investment process.

With their work, our members ensure that lots of SMEs can utilize the sources they receive as stepping stones. We have funded numerous enterprises that provide products or services to global markets alongside their high intellectual added value. We are confident in carrying out our job as a growing number of projects are implemented in Hungary as regional venture capital and private equity funds collaborate with each other, which also serves the aims of the export-oriented corporations in the region. The Hungarian venture capital and private equity sector came of age in the last 15 years of our 30-year history. In parallel with the initial dominance of American and Western European VC and PE investors, powerful Hungarian and regional market participants have emerged which has ensured that local interests are taken into consideration in the development of the regional economies and consequently those SMEs that utilize VC and PE sources have also expanded considerably. The increase of the capital under management also triggered the rise of the number of staff of funds. I am convinced that the education of the following generations and the adequate selection of intellectual capacity are key to the future success of the sector.

As an association, we are one of the priviliged legal entities that have been able to serve our members with the same mission since the change of regime. We are a community whose members are particularly concerned about the success of their respective portfolio companies. Despite the incidental conflicts of interest between us we always find ways to support and help each other, even as competitors. We are a community in which state-owned and private entities, domestic and foreign funds, collaborate successfully. As a representative body HVCA is a platform capable of safeguarding our shared interests via shared values. It is a significant result that the Ministry of Finance has realized that the central budget is better off if funds can use the amount of their sector-specific special tax as a source of further investment.

Please take your time to read the thoughts, analysis and opinions of our members in this publication. We, the members of HVCA are going to strive to promote the economic development of Hungary and the consolidation of the region in line with the interests of our investors and portfolio companies in the coming 30 years. We encourage you as partners to initiate contact with Hungarian venture capital and private equity fund managers and the HVCA community in our jubilee year and in the future.

Elemér Eszter, HVCA chairman

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András Bodor, Judit Karsai, Milos Milicsevics

The status of the venture capital and private equity sector in the Hungarian economy

Abstract

The jubilee survey of HVCA has assessed the investments of nearly 130 investors in almost 800 portfolio companies based on data from 2009 to 2018. The survey aims to present the economic role of the venture capital (VC) and private equity (PE) investment funds that have been active in Hungary via the features and results of their portfolio companies. Following the financial crisis in 2008, the earlier dominant international funds that mainly focused on major PE transactions tended to reduce their business activity in Hungary. On the other hand, state-owned market participants that could make investments from EU and private equity sources as well, directly and indirectly funded a gradually growing number of transactions. Most investors applied a wide range of investment strategies as they funded early stage enterprises (VC) and mature companies (PE), as well as conducting buyouts. The extensive research below is one-of-a-kind in the sense that it is the first one based on the database of Bisnode[1], which analyzes the data of the portfolio companies directly or indirectly owned by VC and PE investors. The approach of the survey is substantially different from the ones based on the voluntary disclosure of management funds (HVCA, Invest Europe), as it identifies the domestic portfolio companies with regard to their ownership structure and it contains the officially published transactions of the management funds as supplementary information. By presenting transaction and stock figures that go beyond those recorded on the basis of voluntary disclosure, the survey provides for the first time a large-scale estimate of a number of aggregate indicators that can be used to measure the impact of domestic venture capital and private equity investment on the Hungarian economy. An estimation[2] has been made for the employees of the portfolio companies based on the database with respect to their turnover rate, value added, and taxes paid to the state budget. To get the whole picture about the economic impact of the venture capital and private equity sector, data regarding the management and number of staff of the management funds would have to be taken into consideration, which is beyond the scope of the survey.

[1] Fazekas-Becsky-Nagy (2018) and Kállay-Jáky (2019) conducted similar surveys regarding the Jeremie programme.
[2] Certain data were not completely attainable with regard to the term of the survey, i.e. their availability was between 70-99%.

Introduction

The financial and professional contribution and the market validation by venture capital and private equity investors may help portfolio companies gain a competitive advantage, develop a new product, or reach a domestic or foreign market in shorter time. The two main fields of the venture capital and private equity sector are aligned with the developmental phases of the portfolio companies. Classic venture capital funds the launch, early phase and growth phase of enterprises. However, an investment made by a private equity fund in a buyout alters the ownership structure of mature firms. In both areas, investors aim to add value to their (partly) owned businesses through market validation, their involvement, synergies within the portfolio, and their domestic and foreign networks.

To celebrate the 30th anniversary of HVCA, three individual members of its Education Committee were commissioned to conduct a survey that presents the **significance of the Hungarian venture capital and private equity**, i.e. it provides an insight into the contribution of financial intermediaries to the economic development of the country. The pioneering nature of the survey is underlined by the fact that, although HVCA publishes an aggregated quarterly report on the volume of VC and PE investments and exits in Hungary, and Invest Europe, its affiliated European data provider, produces an annual report, no survey has yet been produced that has analysed the **individual characteristics** of all domestic and foreign VC and PE firms' portfolio in the sector over the past ten years[3]. On the one hand, it was a challenging task because the yearly reports are based on the voluntary disclosure of the investors. On the other hand, the particular data of the transactions, even in case of the state-owned management funds, are considered **business secrets**. Consequently, there is no publicly available comprehensive database regarding the enterprises funded by venture capital and private equity funds. Completeness is also hampered by the difficulty of identifying the ownership of firms, in particular the occasional inaccurate registration of foreign investors. Another factor that prevents the identification of the funded enterprises is the inclusion of special purpose vehicles (SPVs) and asset management holdings in the investment process. In addition, the range of investors that provide data to HVCA and Invest Europe is incomplete, as they do not include all the entities that make venture capital and private equity investments in Hungarian companies. HVCA and Invest Europe collect registration data mainly through their member organizations, therefore complementary information about investors that are not in touch with the professional organizations performing the advocacy functions of the sector may only be available from the business press.[4] As a result of the above, the activities of all the participants of the Hungarian venture capital and private equity sector, the impact of investments on the portfolio companies and, through this the role of the sector in the development of the Hungarian economy has been obscure due to lack of information.

The present survey has revealed and summarized the staff and management data of those companies seated in Hungary on the basis of the **shareholder register** of domestic enterprises, which were listed as portfolio companies affiliated with domestic or foreign private equity funds from 2009 to 2018. The survey looked at Hungarian portfolio companies from two aspects. On the one hand, it took a snapshot of 2018 by presenting the enterprises listed in the portfolios of investors at that time with regard to their size, business sector, employment, revenue, value added, and tax payment. On the other hand, the changes in the portfolio structures of the investors between 2009 and 2018 were analyzed.

The survey was conducted by using a database[5] that included all the domestic and foreign management funds and incorporated firms dealing with venture capital investments, which performed venture capital or private equity investments prior to 2009, and the ones that acquired stakes in Hungarian companies between 2009 and 2018. In possession of the list of these funds and their managers, the management data of all Hungarian companies and subsidiaries in which the funds and companies in question held an

[3] Earlier surveys analyzed shorter time spans or narrower range of enterprises – for instance, companies in the JEREMIE programme.
[4] Transparency is further hindered by the fact that private equity management funds have taken on a new role in the last few years, substituting for the off-shore structure, which raises difficulties in assessing the significance of private equity investments.
[5] The list of investors was provided for the celebratory survey of HVCA by Judit Karsai.

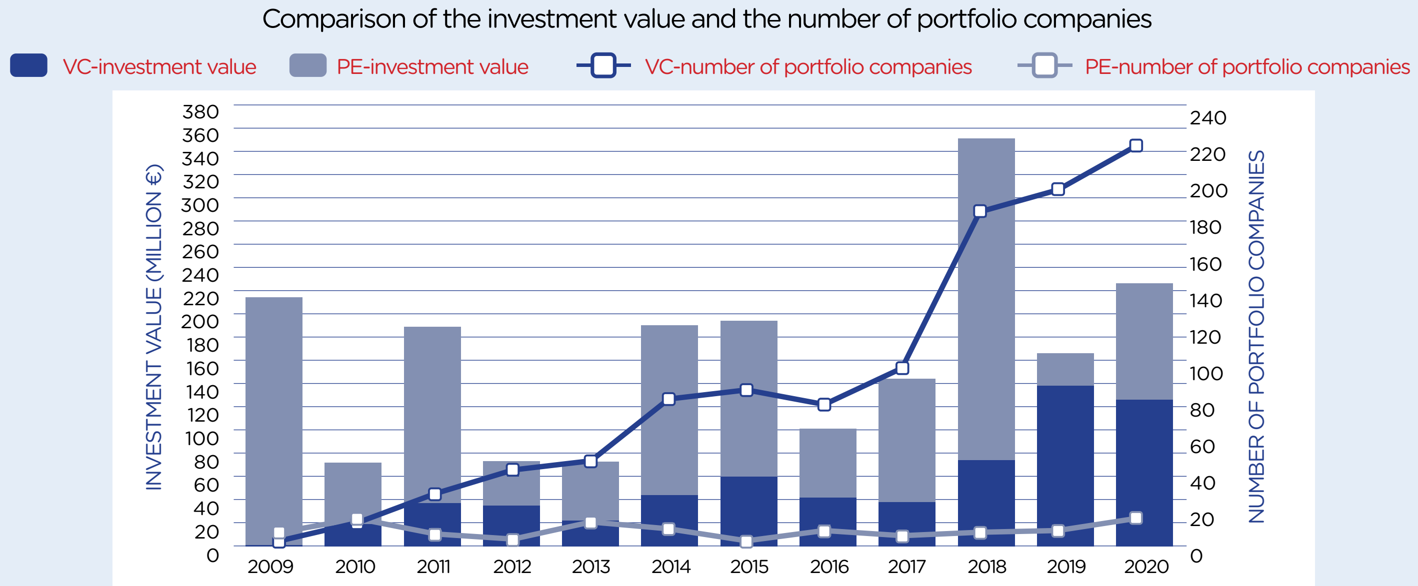
ownership stake between 2009 and 2018 were requested from the data controller Bisnode. For investor-affiliated firms and their subsidiaries, the database contains the ownership structure and equity ratio, date of establishment and termination, year of investment and exit, and the main financial and employment data of the annual balance sheets.

Nonetheless, the applied method also sheds light on the **limitations of the survey**, i.e. what the developed database is incapable of assessing. The information in the database enables an indirect assessment of the actual amount of investments, i.e. data regarding investments are only estimates. The amount of new and follow-on investments in each year is estimated by the changes in the balance of the subscribed capital and capital reserves. Consequently, it is only the investments made in the portfolio companies that are accounted for and the amount of buyout transactions between owners are not assessed. The amount of (disbursed and repaid) net funding deriving from investors in the form of subordinated and long-term shareholder loan was estimated, however, distinguishing long-term loans from other sources is not straightforward. It can be assumed that in case of venture capital investments and when the enterprise had EBITDA loss, the majority of the financing was provided by the fund(s) performing the investment. As the database of the survey does not contain information regarding patent applications, yet another deficiency of the applied method is that the innovation activities of the enterprises can only be assessed by the ratio of the intangible assets to their total assets.

1. A brief overview of the investments made in companies based in Hungary by venture capital and private equity firms and of the capitalization of the Hungarian market

It is practical to provide insight into the status of venture capital and private equity investments in Hungary based on annually published data from HVCA and Invest Europe before presenting the findings of the survey. VC and PE firms generally choose to invest and gain stakes in companies with the potential of exceptional growth and promising human resources on a temporary basis using exit strategies that maximize their yields on exiting the companies.

Figure 1. - Annual number and value of first and follow on venture capital and private equity investments in Hungarian companies, 2009-2020 (EUR million and number of investments)



Source: *Invest Europe (2021)*

According to the records of Invest Europe, **venture capital investments** have had a **significant share** of the Hungarian venture capital and private equity market for several years, however, the market share and the number of private equity buyout transactions have shrunk. The investment value of a particular year is highly impacted by whether or not there was a buyout transaction funded by foreign capital beyond the average value of transactions in that year, or only a handful of minor transactions were performed.

Hungary **has played the leading role in the venture capital market** in Central and Eastern Europe (CEE), however, its **performance in the private equity market has been insignificant**. Accordingly, over half (52%) of the portfolio companies funded through venture capital in the CEE region in 2019 were Hungarian enterprises, amounting to over one-third (36%) of the total investment value in the region. Hungary has a prominent position from a European perspective as well due to its dominance in venture capital investments. As for investments as a percentage of GDP that also represents the size of the countries, the Hungarian venture capital market was ranked 5th in 2020, 11th in 2019, and 9th in 2018[6]. However, with regard to all **private equity investments** as a percentage of GDP, the Hungarian market was ranked much **lower** due to its scaled-down value of private equity investments from an international perspective. The Hungarian venture capital and private equity market was ranked 17th regarding all private equity investments. As the significance of private equity investments in Hungary is also low compared to the regional average as a whole, the figures on all private equity investments as a percentage of GDP are also low in CEE.

Table 1: *Venture capital and private equity investments as a percentage of the annual GDP in Hungary and in CEE, 2010-2019 (%)**

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
HU	0,067	0,194	0,103	0,058	0,164	0,150	0,078	0,148	0,262	0,089
CEE	0,115	0,105	0,082	0,063	0,104	0,200	0,120	0,239	0,171	0,175

Source: *Central and Eastern Europe Statistics 2011-2020*

**Not identical to the contribution of the enterprises receiving VC and PE investments to GDP*

It is expected that the leading role of the Hungarian market with respect to classic venture capital investments will continue, as the market has seen the influx of considerable amounts of fresh capital with such investment purpose in recent years: venture capital funds in Hungary raised fresh capital of almost EUR 400 million in 2017, EUR 450 million in 2018, nearly EUR 670 million in 2019, and almost EUR 160 million in 2020. (Invest Europe, 2021)

[6] https://investeurope.eu/research/activity-data/ pp. 54 and 58

2. The findings of the survey regarding the portfolios of venture capital and private equity funds in Hungary

The aim of this survey was to present the direct economic impact made by the venture capital and private equity management funds operating in Hungary through the analysis of data with respect to their portfolio companies from 2009 to 2018. The accumulated data of the portfolio companies, the yearly records of newly added portfolio companies, and the data of the ones terminated were all assessed in the database of the survey for each year from 2009 to 2018. The findings of the survey show different data on transactions and staff numbers from those of HVCA and Invest Europe, and it **provides** only **order-of-magnitude estimates** for several aggregated indicators. For the sake of providing a full picture on investments, the survey also relied on data about those portfolio companies that received venture capital and private equity investments indirectly, i.e. **through** a transaction (SVP) or **holding** company.

The survey assessed investments made by **133 investors** in total, as there were as many as that foreign and domestic funds, investment firms, accelerators and incubators showing interest and holding stakes in portfolio companies from 2009 to 2018 that could clearly be identified in the Bisnode database. 25 of the investors had invested in Hungarian enterprises prior to 2009, whereas the further 108 did so during the years that were analyzed in the survey.

***Table 2:** The annual number of domestic and foreign venture capital and private equity investors owning shares in Hungary based on the celebratory survey of HVCA (2009-2018)*

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Number of VC and PE investors and funds [7]	37	38	46	47	59	75	75	82	94	108

***Source:** Own calculation based on the Bisnode database*

In accordance with the findings of the survey, 777 **enterprises** were directly linked to a certain investor over the whole period and formed the basis of the investment calculations. 30 companies of the 777 were included in the portfolio of an investor in the first year of the survey and 747 of them received funds between 2009 and 2018. 679 of the 747 companies received venture capital investment, while in case of the other 68 enterprises private equity investors gained stakes in them.

Besides the figures regarding the 777 companies included in the survey, it also relied on data about 459 **subsidiaries** that received venture capital and private equity investment **indirectly**, i.e. through a transaction (SVP) or holding company. The subsidiaries were assessed for their business sector, revenue, staff number, value added, tax payment, and innovation.

[7] It was the funds managed by the foreign and domestic management funds that we considered investors. The accelerators and business incubators that had invested in Hungarian enterprises were also regarded as investors, as well as the investment firms that made venture capital and private equity investments on a regular basis.

***Table 3:** The number of portfolio companies in Hungary belonging to venture capital and private equity investors (excluding subsidiaries), 2009-2018*

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
VC	18	35	50	78	121	198	271	372	466	662
PE	20	24	27	24	27	36	41	53	65	44
VC+PE	38	59	77	102	148	234	312	425	531	706

***Source:** Own calculation based on the Bisnode database*

3. The estimated value of investments

As for the calculation of the estimated value of investments in the survey, the changes in the balance of the subscribed capital and capital reserves were assessed on the basis of the ownership structure, and the changes in the amounts of subordinated loan and the long-term liabilities were accumulated to them. The estimated net value of funding deriving from this method of calculation claims that approximately nearly **HUF 380 billion** was injected directly into companies by **venture capital investors** and creditor **banks** between 2010 and 2018[8]. This amount is the balance of the funding and the repayment transactions, while the statistics of Invest Europe only contains the funding transactions. **One-third** of the amount above **was related to venture capital investments, and two-third was received by companies as private equity**. The total amount of HUF 380 billion funding consisted of capital increase of HUF 220 billion, and nearly HUF 160 billion subordinated and long-term loans. The latter derives from capital investors in case of venture capital transactions, whereas private equity transactions tend to be funded by bank loan. **The part of the capital and loans by private equity investors used for buyouts that was received by former owners of the companies was not represented in the figures (or in the balance sheets of the companies)**. (See Table 4. for the distribution of the funding)

[8] In case of small and loss-making companies (VC category), the subordinated and long-term loans were almost exclusively from financial investors (even the JEREMIE regulations allowed up to 30% of shareholder loan).
In the PE category, during the loss-making period (after the crisis in 2008) the owners tended to provide "rescue" financing support, which was partly refinanced in the profit-making period from bank sources (e.g. NHP programme).

Table 4: *The distribution of the type of funding represented in the balance sheets of the Hungarian companies that received venture capital and private equity investment between 2009 and 2018 (HUF billion and percentage)*

			2009-2018 total (HUF billion)	Distribution (%)
Total investments (Capital increase + Subordinated and long-term loans)		VC+PE	378	100
		VC	123	33
		PE	255	67
Of which:	1. Capital increase	VC+PE	220	100
		VC	106	48
		PE	114	52
	2. Subordinated and long-term loans	VC+PE	158	100
		VC	17	11
		PE	141	89

Source: *Own calculation based on the Bisnode database*

The data on capital and loans contain the funding of new transactions and the financing of already existing portfolio companies from which the repayments (capital reduction, loan repayment) were deducted. The estimated amount of investment reported in the survey therefore excludes the amount of buyout transactions, which represent a much higher amount of individual investment than venture capital investment, and which did not flow to the firms themselves when they changed hands, but to their former owners. [9]

4. Investments in business sectors

Venture capital and private equity investments mostly impact those business sectors in which the portfolio companies operate. Therefore, the survey analyzed which business sectors were favoured by the venture capital and private equity management funds **during the decade** between 2009 and 2018. 1236 companies (777 direct portfolio companies and 459 subsidiaries) were assessed in the survey based on the Bisnode database, of which **25%** operated **in the ICT** (communications, computer and electronics), 16% in the business products and services, 15% in the biotech and healthcare, and 14% in the consumer goods and services sector. (See Table 5.)

[9] According to the database of Invest Europe, the total value of venture capital investments and buyouts between 2010 and 2018 was nearly HUF 410 billion. 660 companies of the 720 included in the database received venture capital investment amounting to almost HUF 110 billion altogether, and the value of buyout transactions with regard to 60 companies was nearly HUF 300 billion.

Table 5: *The number of portfolio companies in Hungary that received venture capital and private equity investments and the distribution of the investment values with regard to their business sectors, 2009-2018 (based on the Bisnode and Invest Europe databases; percentage and EUR million)*

Business sector	Number of companies receiving investment		Investment value	
	According to Bisnode-HVCA database (%)	According to Invest Europe database (%)	According to Invest Europe database (EUR million)	According to Invest Europe database (%)
Agriculture	0	0	1	0
Business products and services	16	16	76	5
Chemicals and materials	8	2	46	3
ICT (communications, computer and electronics)	25	29	392	24
Construction	2	1	4	0
Consumer goods and services	14	23	599	36
Energy and environment	3	4	268	16
Financial and insurance activities	10	3	95	6
Real estate	2	0	0	0
Biotech and healthcare	15	16	101	6
Transportation	4	4	70	4
Other	1	2	11	0
Total	100	100	1663	100

Source: *Own calculation based on the Bisnode and Invest Europe databases*

This sectoral distribution is similar to the proportions in the Invest Europe database in terms of focus. Enterprises in the ICT (communications, computer and electronics) sector are even more dominant, as they account for 29% of the domestic companies that received venture capital and private equity investments. According to the database of **Invest Europe,** which contains the investment values as well, nearly EUR 400 million was invested in the **ICT sector** that accounts for **24% of the total investment value of all sectors.** In line with the data of Invest Europe, the second most popular sector with regard to the number of investments was the **consumer goods and services sector**, which accounted for 23% of the total number of investments. The investment value was EUR 600 million in this sector, which accounted for **36% of the total investment value**. As for the number of investment transactions in the Invest Europe database, the **biotech and healthcare sector** clinched the third (shared) position by 16% and proved to be the fourth most funded sector by receiving over EUR 100 million. The energy and environment sector is ahead of the biotech and healthcare sector with regard to its investment value of EUR 270 million, however, the 4% share of the former sector regarding the number of transactions indicates that it has seen relatively larger individual transactions.

The database of Invest Europe regarding the number of investments and their values during the period between 2009 and 2018 can also shed light on the business sectors in which venture capital played a prominent role, and furthermore, which sectors were dominated rather by private equity investments, i.e. buyouts. (See Table 6.)

Table 6: *The distribution of companies in Hungary that received venture capital and private equity investment between 2009 and 2018 with regard to their business sectors (based on the database of Invest Europe, percentage)*

Business Sector	Share of venture capital investments of total investments (VC) (%)	Share of private equity investments of total investments (PE) (%)	Share of venture capital investment value of total investment value (VC) (%)	Share of private equity investment value of total investment value (PE) (%)
Agriculture	0	0	0	0
Business products and services	92	8	52	48
Chemicals and materials	71	29	8	92
ICT (communications, computer and electronics)	98	2	38	62
Construction	88	12	80	20
Consumer goods and services	86	14	10	90
Energy and environment	69	31	6	94
Financial and insurance activities	79	21	19	81
Real estate	0	0	0	0
Biotech and healthcare	97	3	54	46
Transportation	97	3	16	84
Other	75	25	78	22
Total	91	9	22	78

Source: *Own calculation based on the Invest Europe database*

According to the data of Invest Europe regarding the timespan between 2009 and 2018, **91% of the transactions were venture capital investments**, however, they only **accounted for 22% of the total investment value** of that period. Venture capital investments played a diminished role in the chemicals and materials sector, in which 70% of the transactions were such transactions, but they only accounted for 8% of the investment value. In the **ICT sector**, 98% of the transactions were venture capital investments, however, they only accounted for 38% of the investment value. The number of transactions and the investment value converged a lot more in the **construction sector.** The **energy and environment, chemicals and materials**, and the consumer goods and services sectors were dominated by private equity investments of relatively high amounts as they accounted for 90% of the investment value. The number of private equity investment transactions was the highest in the **chemicals and materials sector**, but it did not even reach 30% in this sector either. The significant differences between the values of individual transactions can be traced by the large deviations of particular transaction values from that of the average. (See Table 7.)

Table 7: *The average value of venture capital and private equity transactions in Hungary with regard to business sectors (based on the database of Invest Europe, EUR million)*

Business Sector	Average value of all venture capital and private equity investments (VC+PE) (EUR million)	Average value of venture capital investments (VC) (EUR million)	Average value of private equity investments (PE) (EUR million)	Average private equity investment as a percentage of average venture capital investment
Agriculture	0	0	0	0
Business products and services	0,6	0,4	3,7	925
Chemicals and materials	3,3	0,4	10,6	265
ICT (communications, computer and electronics)	1,9	0,7	48,8	6970
Construction	0,5	0,5	0,8	160
Consumer goods and services	3,6	0,4	23,5	5875
Energy and environment	8,4	0,7	25,2	3600
Financial and insurance activities	4,0	0,9	15,5	17200
Real estate	0	0	0	0
Biotech and healthcare	0,9	0,5	15,7	3140
Transportation	2,3	0,4	58,8	14700
Other	2,8	2,9	2,4	83
Total	2,3	0,6	19,7	328

Source: *Own calculation based on the Invest Europe database*

The average investment value per transaction was EUR 600 thousand in case of venture capital transactions, whereas the average investment value of private equity transactions tended to be nearly EUR 20 million. There were large deviations between certain business sectors. The average investment value of venture capital transactions in the ICT sector was EUR 700 thousand, however, the average investment value of private equity transactions almost reached EUR 50 million, i.e. the difference was nearly 70 times as much. There were large differences in the transportation sector as well, in which an average of almost EUR 60 million investment value regarding private equity transactions stood in striking contrast with a lower than EUR 0,5 million average in case of venture capital transactions.

5. The impact of the VC and PE sector on the labour market

According to the Bisnode database, the enterprises within the portfolios of the investors, with their portfolio companies and subsidiaries combined, employed **18 thousand employees** in total, which constitutes a **72% increase** in comparison with the 10,5 thousand workers employed ten years ago. (See Table 8.) The rise in the number of workers can be attributed partly to the differences in the staff numbers of the incoming and outgoing companies of the portfolios, and also to the expansion of companies remaining in the portfolios. The expansion represents the actual growth in the number of employees due to the increase in the available funds and the achievement of the desired expansion, and besides, it also complies with the expectations of the financial investors with regard to the transaparency and prudent operation of the companies. The expansion of the whole portfolio was 15% compared to 2017, while the companies that remained in the portfolio showed an increase of 12% in the number of their staff.

Table 8: *The number of employees at the portfolio companies of venture capital and private equity investors, 2009-2018*

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Number of employees at the portfolio companies and subsidiaries of VC + PE investors (1+2)	10507	10736	11398	9747	11014	13025	12174	15354	15710	18082
1. Portfolio companies	8333	8489	9004	6593	7336	9128	7789	10355	10823	11576
2. Subsidiaries	2174	2247	2394	3154	3678	3897	4384	5000	4887	6506
Change of the number of employees at the same companies (VC+PE) (previous year=100)	-	100%	101%	108%	110%	108%	94%	129%	101%	112%

Source: *Own calculation based on the Bisnode database*

The proportion of the workers employed by the domestic portfolio companies funded by venture capital and private equity displayed a considerable **rearrangement** during the 10-year span of the survey. The total number of employees at **companies funded by venture capital** accounted for only 8% of the total number of staff in 2009, however, their representation was over one-third of all workers in 2018. (See Table 9.) The number of staff at the portfolio companies that received venture capital investment **grew significantly quicker** than at enterprises in which private equity investors gained stakes. The elevenfold headcount advantage between the two groups of companies in the starting year in favour of private equity had shrunk to 1.6 times by the end of the decade.

Table 9: *The number of employees at the portfolio companies of venture capital and private equity investors and their distribution with regard to the types of investors, 2009-2018 (number of people and percentage)*

	2009 (Number of employees)	2009 (%)	2018 (Number of employees)	2018 (%)	2018/2009 (%)
VC (directly and at subsidiaries)	869	8%	6759	37%	778%
PE (directly and at subsidiaries)	9638	92%	11323	63%	117%
VC+PE (directly and at subsidiaries)	10507	100%	18082	100%	172%

Source: *Own calculation based on the Bisnode database*

The **average number of staff** of all companies funded by venture capital and private equity **considerably decreased** by the end of the 10-year term of the survey. The average number of workers per company was 175 in 2009, which declined to an average of 18 employees per enterprise in 2018. (See Table 10.) The process was noticeable in **both investment groups**. The average number of staff per company in case of companies that received venture capital investment decreased from 27 to 8, whereas that of the enterprises that were invested in by private equity declined from 344 to 100. On the one hand, the decline can possibly be attributed to the impact of the technological advancement resulting in the shrinkage of the funded companies, and on the other hand, to the narrowing range of attractive domestic companies for investors.

Table 10: *The average number of employees at portfolio companies of venture capital and private equity investors with regard to the types of investors, 2009-2018*

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2018/2009
VC average	27	28	23	18	19	16	13	9	8	8	30%
PE average	344	293	231	196	195	199	132	104	89	100	29%
VC+PE average	175	133	106	68	66	55	35	24	20	18	10%

Source: *Own calculation based on the Bisnode database*

6. The magnitude of the VC and PE sector based on revenue

The portfolio companies of venture capital and private equity investors **obtained** revenue in the range of **HUF 441 billion** in 2018, which constitutes an increase of **17%** compared to their revenue from the previous year. (See Table 11.) 97% of the revenue was generated by the companies funded by private equity in 2009. (The proportion of the revenue generated by the portfolio companies of private equity funds was even higher (99%) in 2009 in case the subsidiaries of the enterprises are not taken into account.) The aforementioned **considerable rearrangement** of the domestic venture capital and private equity over the ten years under review is reflected in the fact that only 60% of the annual turnover of all the portfolio companies was generated by the ones funded by private equity in 2018, whereas this ratio was 77% in 2009. The revenue of the portfolio companies funded by private equity dropped by over 50% in the meantime, whereas the turnover of the enterprises financed by venture capital grew significantly.

Table 11: *The revenue of the portfolio companies of venture capital and private equity investors and their distribution with regard to the types of investors, 2009 and 2018 (HUF billion and percentage)*

	2009 (HUF billion)	2009 (%)	2018 (HUF billion)	2018 (%)
VC+PE (direct+subsidiaries)	574	100	441	100
VC (direct+subsidiaries)	15	3	181	41
PE (direct+subsidiaries)	559	97	260	59
VC+PE (direct)	541	100	231	100
VC (direct)	6	1	121	53
PE (direct)	535	99	110	47
VC+PE (subsidiaries)	33	100	210	100
VC (subsidiaries)	9	28	60	29
PE (subsidiaries)	24	72	150	71

Source: *Own calculation based on the Bisnode database*

The **revenue per enterprise ratio** (HUF 441 billion/905 companies) was **HUF 487 million** among the portfolio companies of venture capital and private equity investors that disclosed their turnover data. There are large variations between the revenues of the enterprises.

The turnover per company ratio among the enterprises funded by venture capital was HUF 216 million in 2018 (HUF 181 million/839 companies), while the companies financed by private equity had a 10-fold higher turnover per enterprise ratio of HUF 3933 million (HUF 260 billion/66 companies) in the same year. The revenue growth rate of entepprises remaining in the portfolios of the investors slowed down following 2011 at a more moderate manner than the decline of the GDP. (See Table 12.)

Table 12: *The annual revenue change of the portfolio companies of venture capital and private equity investors, 2009-2018 (percentage)*

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue change of the same companies	-	112	123	110	113	113	118	106	98	113
Annual nominal change of GDP	97	104	104	101	105	108	107	104	108	110

Source: *Own calculation based on the Bisnode database*

While the median turnover of all the portfolio companies of venture capital and private equity investors was HUF 183 million in 2009, the median **turnover** was only **HUF 6 million** in 2018. The dramatic decline in revenue was partly due to the growing number of early stage, ”startup” venture capital investments. The percentage of enterprises earning HUF 0 in revenue increased to 30% by 2018 from 9% in 2009, and the number of holding companies also grew. The decreasing trend in the revenue of the portfolio companies of venture capital and private equity investors between 2009 and 2018 can be attributed to the combined effect of two factors. One of them is the **considerable increase in the number of early stage enterprises**, and the other is the successful **exits from large companies** by selling them to trade and stock market investors.

7. The impact based on value added

According to the Bisnode database, the total value added to the Hungarian economy of all the portfolio companies that received venture capital and private equity funding amounted to HUF 135 billion in 2018, which accounted for 0,31% of the GDP. (See Table 13.) The total amount of value added with regard to 2009-2018 was HUF 1 864 billion (0,57% of the GDP). The calculation of value added of the entepises that received venture capital and private equity financing was performed in an indirect way, i.e. in a simplified manner in which the material expenditure of the companies was deducted from their revenue.[10]

The value added ratio per enterprise (HUF 135 billion/887 companies) was HUF 152 million among the portfolio companies of venture capital and private equity investors that disclosed related data (887 companies). The value added ratio per employee decreased from HUF 10 million in 2009 to HUF 7 million in 2018 due to the growing number of early stage enterprises.

[10] The data calculated by this method can be compared with each other, however, it underestimates the actual amount of value added, because the early stage enterprises funded by VC (that do not earn any revenue) are represented by negative balances and their intellectual properties are not taken into consideration.

Table 13: *The value added and GDP contributions of the portfolio companies of foreign and domastic venture capital and private equity funds that invested in Hungary (HUF billion, percentage)*

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Value added (HUF billion) VC+PE (direct investment+subsidiaries)	110	123	133	135	177	333	273	172	272	135
Value added as % of GDP VC+PE (direct investment+subsidiaries)	0,42	0,45	0,47	0,47	0,59	1,02	0,78	0,48	0,69	0,31
Value added per company (HUF million) VC+PE (direct investment+subsidiaries)	1640	1272	1034	767	715	975	599	292	387	152
Value added per employee (HUF million) VC+PE (direct investment+subsidiaries)	10	11	12	14	16	26	22	11	17	7

Source: *Own calculation based on the Bisnode database*

8. The impact of venture capital and private equity investments on innovation

The database did not contain information about the patent applications of companies, therefore it was not possible to execute the internationally standard method of accounting for the impact of investments on innovation by considering the number of patent applications. In line with another approach claiming that the **ratio of intangible assets with regard to the investment assets or all assets** indirectly reveals the underlying rate of innovation, the impact of investments on innovation could be accounted for based on the Bisnode database. The relatively high rate of intangible assets tends to be the result of intense developmental and innovative activities.

The indicator considered to show the innovative content **was 8%** on average in 2018 regarding the analyzed portfolio companies (directly owned by investors or as subsidiaries), i.e. the indicator showed the proportion of intangible assets to all assets (See Table 14.)

Table 14: *The distribution of intangible assets of total assets at the portfolio companies of venture capital and private equity funds that invested in Hungarian enterprises, 2009-2018 (percentage)*

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Share of intangible assets of total assets (%) VC+PE (direct+subsidiaries)	10	9	8	12	12	8	6	8	7	8

Source: *Own calculation based on the Bisnode database*

9. The economic impact of the VC and PE sector based on tax payment

The HUF 39 billion paid as corporate tax, contribution, and tax on wage payments by portfolio companies in 2009 increased to nearly **HUF 47 billion** by 2018. The total amount of taxes (excluding VAT, local business tax, other fees, and taxes paid by management funds) paid by portfolio companies of venture capital and private equity management funds to the state budget amounted to **HUF 435 billion** during the ten-year period of 2009-2018. The overwhelming proportion (97%) of this amount of tax payment was related to staff expenses. The tax payment rate per employee decreased from HUF 3,7 million to HUF 2,6 million in the ten-year span during which the tax rates were lowered as well.

Table 15: *The annual amount of tax payment of the portfolio companies of venture capital and private equity management funds that invested in Hungarian enterprises between 2009 and 2018 (HUF billion)*

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2009-2018
Tax payment (HUF billion)	39	42	43	35	41	38	59	54	37	47	435
Of which: personal expenditure-related tax (HUF billion)	39	41	42	34	40	37	57	52	36	43	421
Average tax payment per company (HUF million)	586	427	329	134	162	109	126	91	52	52	
Tax payment per employee (HUF million)	3,7	3,9	3,8	3,5	3,7	2,9	4,8	3,5	2,4	2,6	

Source: *Own calculation based on the Bisnode database*

Summary

The survey conducted on the occasion of the 30th anniversary of HVCA has revealed that venture capital and private equity **played a continually growing role** in the Hungarian economy during the period between 2009 and 2018. By analyzing the various economic impacts of venture capital and private equity, the survey has concluded that the venture capital and private equity market played a growing role in facilitating the expansion of the Hungarian economy and creating new jobs between 2009 and 2018. Nonetheless, the survey has also shed light on the fact that the preferred business sectors for investments remained unchanged, even though the capitalization of the market grew extensively. As venture capital investments pose great risks when applied as means of development, it is practical to scrutinize the **efficiency** of the state in the application of venture capital as an economic development tool. At the times of economic setbacks, market participants are not expected to make a lot of new investments as they must focus on rescuing the companies they already have in their portfolios and try to compensate for their lack of growth. It is expected that the **significant amount of available capital in the market** will counterbalance the drop in new investments in Hungary, and besides, the **numerous rescue funds established by state actors** can also enable further investments.

The authors of the survey:

András Bodor	chair of the Education Committee of HVCA
Judit Karsai, DSc.	member of the Education Committee of HVCA, scientific advisor, Centre for Economic and Regional Studies, Institute of Economics
Milicsevics Milos, DBA, MBA	member of the Education Committee of HVCA, Central European University

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How do the Hungarian venture capital management funds appraise their own contribution to the success of their portfolio companies?

30

Judit Karsai, Dénes Nagy, Gergely Gazdag, József Török

How do the Hungarian venture capital management funds appraise their own contribution to the success of their portfolio companies?

What the term ”smart money” implies?

Introduction

”Smart money” has become a frequently used venture capital term, however, its meaning is still a little obscure. Initially, the phrase was used to describe the identification of the appropriate investment targets, whereas regarding investors, smart money denotes the underlying value added by them beyond the provided capital.

Investors that support enterprises in their early stage by taking high risk may have a large impact on the enterprise throughout its lifetime. The experiences regarding the actual contribution of venture capital funds have been mixed, i.e. **whether the emerging companies can get further assistance from them other than receiving capital**. In which fields can investors truly create value, and in what manner?

Our research[1] launched in 2020, aims to provide an overview of the role of the domestic institutional venture capitalists in supporting enterprises by answering the aforementioned questions. The portfolio companies of the venture capital management funds featured in the research account for over 60% of all the funded companies[2]. Consequently, the conclusions drawn from the interviews and the survey taken by the management funds may be considered **representative** regarding the Hungarian venture capital market.

The research is based on **the in-depth interviews** and the surveys by the leaders of enterprises and venture capital management funds based in Hungary. First, the revealed findings and hypotheses are **confirmed by the survey** taken by the executives of venture capital management funds. So far, the survey has been completed by 20 venture capital funds, and 25 executives of institutional venture capital investors have been interviewed.

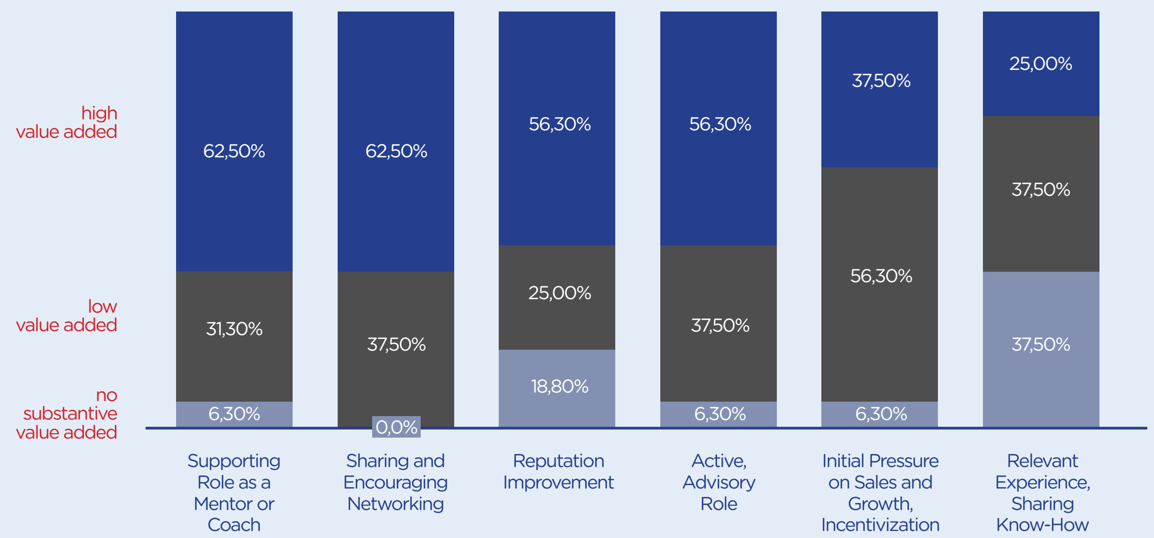
[1] The research was initiated by the alumni and current students of Széchenyi István College for Advanced Studies of the Corvinus University of Budapest and BME College for Advanced Management Studies with the aim of applying their relevant theoretical and practical knowledge to provide answers to the related questions and to share the findings with those interested in it. The participants of the research are as follows: Judit Karsai DSc., research advisor of the Institute of Economics, Research Centre for Economic and Regional Studies; József Török, Dénes Nagy, and Gergely Gazdag, alumni of the Colleges; Balázs Besenyei and Tibor Harsányi, current students of the Colleges.
[2] The number of companies funded through venture capital from 2009 to 2019 largely exceeds 800 according to the data of both Invest Europe (2020) and Rocket Shepherd (2020). (Invest Europe, 2020. https://www.investeurope.eu/research/activity-data/; Rocket Shepherd (2020): The Hungarian Startup Ecosystem: Past 20 Years 2020. December 31.)

In which fields and in what ways do the domestic venture capital investors help their portfolio companies?

According to the results of the survey, investors claim that their essential roles in assisting portfolio companies and creating value are their support as mentors or coaches, and the sharing of their own contact networks. The presence of an investor as a stakeholder develops the authenticity of a company as well. (See Figure 1.)

Nonetheless, the data of the survey also indicate that the value added from sharing relevant experience and know-how has a rather low average. The result is consistent with the findings of international researches. (See Luukkonen et al, 2013.)[3]

***Figure 1** - Self-appraisals of the venture capital management funds regarding the value added provided to their portfolio companies by type of assistance*



[3] Luukkonen, T., Deschryvere, M., & Bertoni, F. (2013): The value added by government venture capital funds compared with independent venture capital funds. Technovation, 33(4-5), 154–162.

Domestic early-stage enterprises that intend to grow quickly, i.e. start-ups, are currently in the greatest need of opportunities to acquire sales and marketing know-how and skills. (See Startup Hungary, 2021.)[4] These kinds of expertise are crucial in achieving one of the most important milestones of early-stage start-ups, i.e. product-market fit, which means the achievement of finding the way for their product to enter the market. Due to the limited amount of specifically relevant professional experience and the prevailing conformist attitude, it is not surprising that even the investors themselves claim that they are **unable to provide high value added in** these fields. Therefore, the high expectations by the entrepreneurs regarding the aforementioned are not reasonable either, as these competencies are supposed to be accessible within the portfolio company.

The self-evaluation of the investors shows that they can provide relevant assistance to their portfolio companies mostly with regard to **strategy, financial management, and company sale. Of these financial management is the most significant factor**. (See Figure 2.)

Figure 2 *– Self-appraisals of the venture capital management funds regarding their contribution to the area of operation of the portfolio companies*

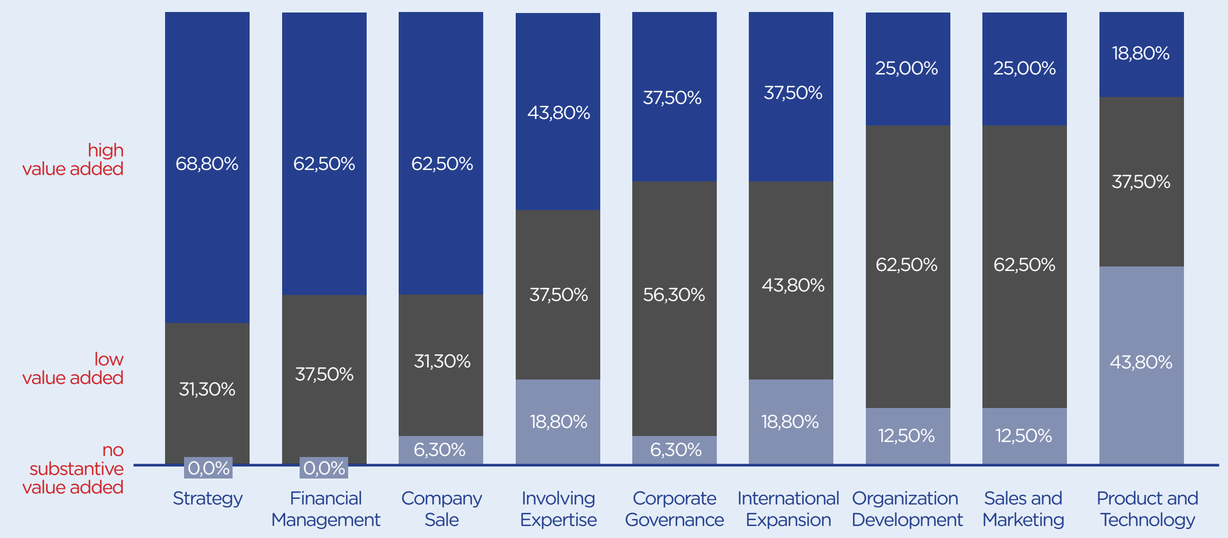
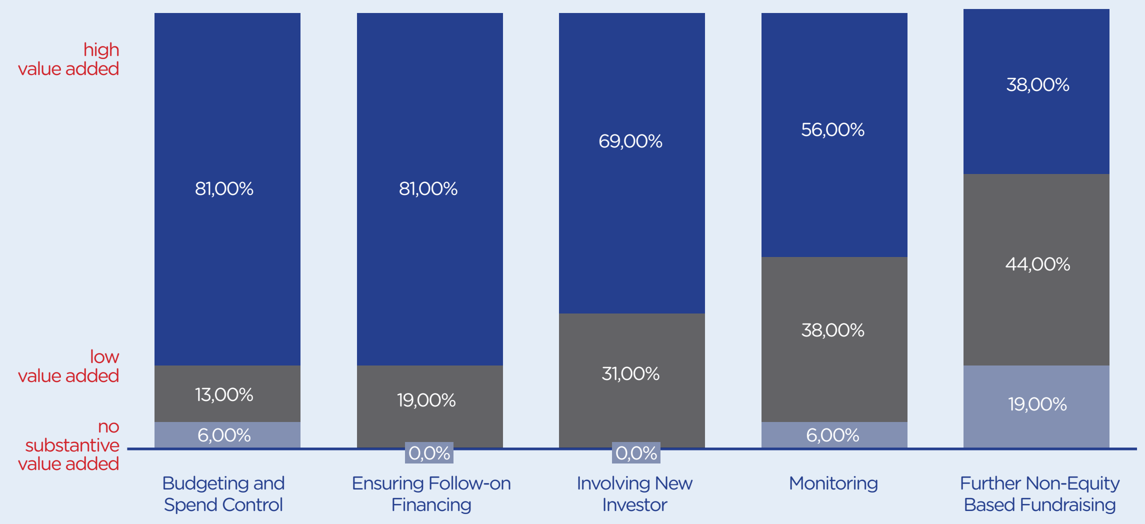


Figure 3 highlights the impact of the investors with respect to **ensuring follow-on financing** and involving **new investors.**

[4] Startup Hungary (2021): Hungarian Startup Report 2020. Startup Hungary, Budapest, 2021.

Figure 3 *- Self-appraisals of the venture capital management funds regarding their contribution to the funding and financial management of the portfolio companies*



Investors claim that they can provide a gradually increasing amount of value added to the portfolio companies due to the development of the ecosystem. The more successful companies and institutional investors can enter international circulation, the quicker and easier it will become to gain the required experience and know-how, which could translate into a **self-amplifying process**.

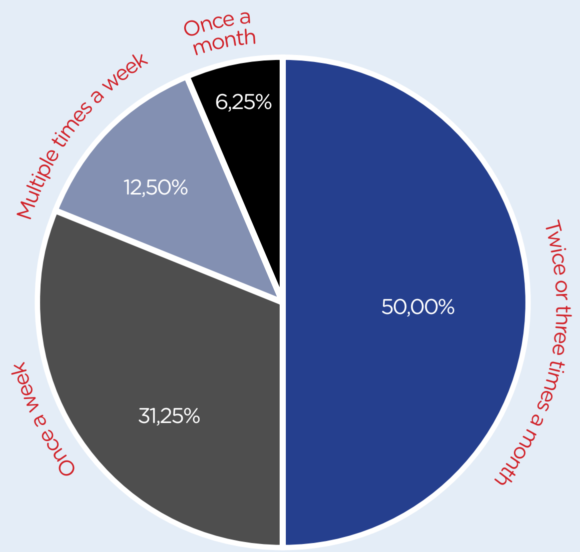
What determines the extent to which domestic venture capital investors can support their portfolio companies?

The available financial and human resources of a management fund certainly affect the degree to which it can support its portfolio companies. The survey examined the human resource capacity of the management funds and the frequency of liaison with their portfolio companies in order to pinpoint the interconnections of these two factors.

It may be concluded that there are significant discrepancies between the **human capacities** of the management funds. The proportion of portfolio companies managed by a member of staff ranges from 2 to 11, i.e. the median value is 5. According to experts' opinion, a portfolio manager can typically manage 5 companies with great care. The management funds may also be distinguished with regard to their sources and **composition of ownership**, which reveal **considerable differences** as well. A staff member of management funds handling private equity sources is responsible for managing 3 companies on average, a manager at a co-financed management fund from EU and state sources commonly takes care of 5 enterprises, and managers working at management funds receiving exclusively state sources are normally in charge of 8 firms.

The results of the survey show that the frequency of liaison with the management of the portfolio companies ranges from once a month to twice or three times a month. (See Figure 4.)

Figure 4 - The distribution of venture capital management funds with regard to the frequency of liasion (percentage) with their portfolio companies in the first six months after the onset of their investment



The respondents of the survey normally get in touch with their portfolio companies between 2-4 times following the onset of their investment period. Consequently, the international average of multiple meetings per week is not typical of domestic investors.[5]

The findings of the survey have clearly confirmed that the management and the founders, as well as the venture capital investors believe that the degree of cooperation between them, and the presence of mutual trust are essential factors, which can considerably affect the amount of value added that investors provide to the portfolio companies. All respondents considered this factor vital, with 81,25% of them marking ”strongly agree” as their answer.

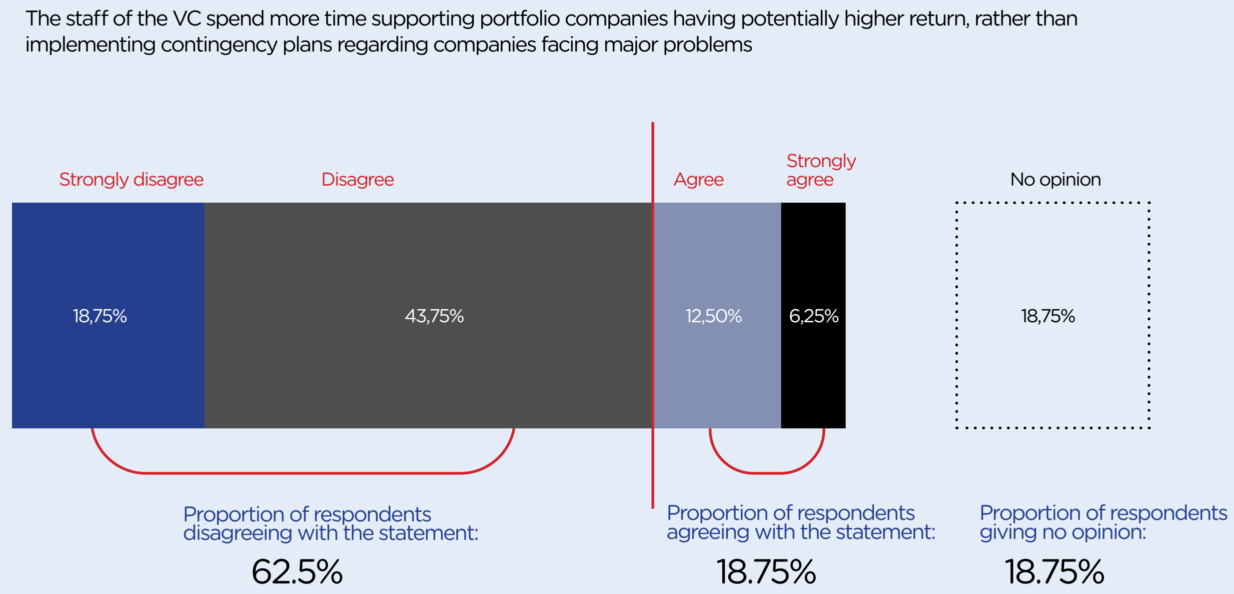
Both the supportive attitude of investors and the open-minded approach of the management of the portfolio companies highly influence how much potential is converted into synergies in the course of their collaboration.

Besides the aforementioned, the incentive scheme of the various stakeholders (leaders of the management funds, further colleagues and partners) also make a large impact on the investors' attitude, and consequently, on the degree of their successful participation in the portfolio company.

The answers to the interview questions reveal that venture capital management funds tend to devote more time to implementing contingency plans with regard to companies facing major problems, rather than supporting portfolio companies having potentially higher return. The results of the survey confirm this as well. (See figure 5.) This phenomenon indicates a certain risk-averse behaviour that is triggered by fear of failure, and moreover, it prevents the outstanding portfolio companies from making use of the precious time spent together with the senior executives of the management fund companies who could share their valuable know-how. Further research is needed in order to find out more about the reasons for this circumstance, as it is unclear whether the low exit multiples or the low number of valuable portfolio companies, or a certain combination of the two are to blame.

[5] Gompers, P. A., Gornall, W., Kaplan, S. N. és Strebulaev, I. A. (2020): How do venture capitalists make decisions? Journal of Financial Economics, 135(1), 169–190.

Figure 5 – The distribution of the opinions of the venture capital management funds with regard to whether the companies with high growth potential or the ones in need of contingency planning require more time



International outlook

According to international experiences, the **initial expectations** of the owners of portfolio companies regarding support and added value are typically **higher** than what they receive, which is confirmed by the domestic interviews as well. (See Forward Partners, 2021.)[6] Nonetheless, the level of development and characteristics of the Hungarian startup ecosystem must be taken into consideration in the assessment of the role of domestic investors along the findings mentioned earlier.

Currently, there is a low, but growing number of internationally successful start-up enterprises in the Hungarian market. In order to expand to become regionally and globally significant, they must get familiar with international markets and gain relevant know-how. Notwithstanding, only few entrepreneurs and investors possess this inevitable knowledge, and moreover, **gaining experience and training of entrepereneurs, as well as investors are rather time-consuming efforts.** There is a limited number of entrepreneurial teams and early stage enterprises intending to enter international markets in which the management has already completed an internationally successful exit and is ready to develop its next venture. As for institutional management funds, there is a lack of professionals (business angels) that possess relevant business development expertise and experience regarding early-stage enterprises, who could catalyze the growth of start-ups. As a consequence, joining the international business scenes and gaining relevant experience pose considerable challenge to founders.

[6] Forward Partners (2021): The Forward More Than Money Report 2021

The value added by the investors is substantially influenced by the **know-how, experience, and the social networks** of the personnel and partners of the management funds, with special emphasis on international experience and well-established international contacts. Co-investment projects with foreign partners could not only benefit portfolio companies, but also facilitate gaining international experience of the Hungarian management funds.

The continuation of the research and further results

Besides the results presented earlier, additional factors have been identified and analyzed that influence the value added by investors. Further findings of the research are going to be published after the conclusion of the second phase of the research work, which features the experiences and opinions of Hungarian startup founders, investment professionals, and external experts.

The authors of the article:

Judit Karsai, DSc.	member of the Education Committee of HVCA, scientific advisor, Centre for Economic and Regional Studies, Institute of Economics
Dénes Nagy	senior portfolio manager, Central Invest
Gergely Gazdag	founding partner, Patrimony Emdge Kft.
József Török	chairman of Foundation - Széchenyi István College for Advanced Studies

Interviews with the former HVCA chairmen

30

Interview with András Geszti
HVCA and the market 30 years ago

How did HVCA and the Hungarian venture capital and private equity market begin? What have been the most significant changes since then?

A lot of things have changed since that time, therefore certain explanations will be needed at times. I believe that the market has become a lot more sophisticated and well-structured, with all the participants being better prepared. Things were totally different when we started in 1991.

Who took part in setting up the market? Among others, the following people played key roles:

- Péter Róna, head of the largest investment fund at that time, who was already a very experienced businessperson.

András Geszti

- Károly Hübner, head of MAVA back then. Károly lived in the USA for a long time before undertaking to move to Hungary to teach. He was one of the key figures who was always happy to share his knowledge and willing to help. Having studied at the West Point Military Academy, Károly's path to the field of venture capital would not be considered obvious today.

- Gábor Miklós was the deputy head of the Foreign Trade Bank now known as MKB. A lot is owed to him, as they were the first bank in Hungary who were prepared to to invest in a venture capital fund.

- József Jankovich, whose status was amazing to us, as he was a close confidant of the Dutch Queen at that time. Qualified as a physicist, today he would be considered a business angel. He always faced problems head on, solved them in a short time, and went on to do other things immediately.

The list could surely be continued. It was a major experience for me to meet these people. It may be difficult to imagine today the extent to which Hungary was an ”outsider” in 1990 and 1991. These days, people come and go, travel frequently, study abroad, go to business schools. As far as I can recall, there was not a single member of our team back then who had completed business studies. Later it obviously changed as people with higher qualifications joined us. It was of utmost importance how willing people were to introduce us to the world of venture capital. Today this branch is totally different than in1991, when the main topic was privatization.

What were the first deals and investment conditions like? Drag-along and tag-along rights were probably unheard of back then, weren't they?

Obviously, we were not aware of the mechanics of this field. Moreover, we had to understand fundamentals such as what a "business case" was, what made an undertaking exciting, and what precautions we had to take. We learned about success factors, risks, and crucial determinants to be checked if the company was going in the right direction. Moreover, we had further challenges such as how and when to intervene in a company, and what to do after that.

There are two approaches I can remember. One of them stated that ”you are the management, and we are the owners. We tell you what to do, and if you do not act accordingly, we are finished.” The other one, which we applied, was the consensual approach. This meant that we planned for 3-5 years, but more likely for 5 years, and tried to bear in mind that if we overreacted immediately to every mistake and underperformance, then we should not be surprised , when the boot was on the other foot (i.e. the owners were in difficulty) if retaliation came. It would eventually lead to endless conflicts, arguments, and a great deal of wasted energy.

Obviously, we read professional literature on venture capital later on, which made us more competent in the field. Although it is not possible to do business while reading the books, this was in fact one of the models. On the other hand, we tried to rely on common sense, if there was such a thing (smiling), and started drafting notes on our ideas. We could compare these notes to a statement of facts used by lawyers rather than what today we call a term sheet. In any case, it gave us the opportunity to compare and contrast expectations and views, which certainly transformed and developed as the years passed.

Back then, the Hungarian legal system did not specifically regulate venture capital transactions. Consequently it was not by chance that most of the early transactions were concluded under foreign law, mostly that of the UK or one of the states of the USA. At that time, the law was constantly changing in Hungary, and the company law act was modified several times.

Initially, most of the entrepreneurs we met were foreigners. They knew what venture capital was and what it was meant to be for. The majority of Hungarian founders and entrepreneurs were not aware of this financial instrument, therefore they had to be encouraged to make use of it.

The following story was not one-of-a-kind at that time. There was a kind, likeable person, we even attended his wedding. Everything was going fine until we noticed that the turnover of his company was gradually decreasing. We were not that experienced then, so we failed to consider one factor. The reason for the decline in turnover was not that the products were not being bought in the same amount, but the fact that the depot of this company had two entrances from two different streets. We used the main one, where the customers were and where the entrance to the warehouse was. But part of the goods, quite a large part (smiling), was leaving the depot through the other entry point. The name of that company was almost the same as the one in which we were partners. We failed to include in the contractual terms, among a lot of other things, that no other company could be set up to sell the same goods from the same supplier and that they had no felixibility in deciding whether to distribute the products through the company in which we had ownership or via the one in which we had no stake.

I would sum up by saying that the most pleasant and surprising thing for me in the time that has passed since then is how much has changed for the better. It's much bigger, it's much cleaner, it's much more manageable. This is not what we were expecting. There had to be five of us to set up the association, because that was the legal minimum at the time, but it was hardly possible to find five players.

Can you recall a heartwarming story from the early days of HVCA?

One of our members called the event where we met ”kockázati tekések”, because we used to go bowling.This is a play on words because of the resemblance of ”tőke” (capital) and ”teke” (bowling). We used to play together as the small association at the time. There were teams and we played against each other. This was a very good opportunity to get an impression of each other, and to make it a bit more friendly, not just formal.

I would like to congratulate all of you on trying to make things even better and of a higher standard, sparing no time or effort in doing so. It cannot be easy (laughing).

The interview was conducted by Lénárd Horgos partner, Growth Financing | M&A, Absolvo Consulting

Interview with Nikolaus Bethlen

What are you doing nowadays Nikolaus? Could you please give us a quick update?

I've been playing with the idea of setting up something of my own for a few years now. I witnessed entrepreneurs being often hesitant to partner with private equity firms, given the perceived short hold periods and misalignment of values with multi-generation business owners. We have therefore set up an investment fund that is backed by industrial family money that is willing to invest into high quality companies for a longer time horizon to give us the flexibility to own companies for a longer period of 10-15 years in order to be a partner for multiple value creation cycles. With c.200M EUR capital commitments, we make investments of 10-50M EUR capital per deal, primarily in the DACH region out of our offices in Frankfurt. This is Comitis Capital in a nutshell.

How you see the industry now in Hungary compared to how it's been 10-15 years ago?

I am not as close anymore to the Hungarian industry as I used to, but I think generally my observation from afar is that the maturity of the market has increased, there is a larger number of capital providers and the market acceptance of the concept of private capital is also larger, in parts also driven by the EU programs, such as the Jeremie program.

Nikolaus Bethlen

There is a great understanding as to what private capital can do for you and how it can help your business grow faster over the next few years and there is more choice for entrepreneurs. We see growing markets, accelerated by the low interest policy, and private equity is today perceived as a safe haven for good equity returns and I think CE has benefited from that trend.

What are the main challenges the industry is facing in the next 2-3 years?

You know, one of the things that I see is still challenging in CE is the attractiveness to international, foreign funds and capital, I think this is something where the region has made great progress, and if you look at a country like Poland, I would say the risk premium that international investors give on Poland these days is probably very small, so it has become very well integrated mainstream market from that point of view. I think some other countries are not there yet. Poland obviously benefits from the fact that it's the largest country by far. The more years pass by, the more attractive the other countries will hopefully become as well.

HVCA's past and the future

I have plenty of great memories. Some of the members were more active than others, so I think it was a challenging time but very rewarding, because we made good progress in certain areas. I made great connections both professionally and personally, and I think some of the foundations that were laid are still in place today which is always very nice to see, people who are still there. It is good that there is continuity, that HVCA was able not only to attract but to keep the very bright and motivated, engaged people on board - that makes me very happy.

I benefited greatly from incredibly engaged board members, I think we had a good group of people that took proactive ownership of certain topics, be that Tüske Balázs, Ed Keller, yourself Lénárd, there was a great desire to improve the landscape. I don't think I needed to do anything other than convince some great people to join the board and channel the motivation and energy of Takács Zsuzsa (laughing). So in hindsight I do have excellent memories and look back to the time with great pleasure and great joy. I can only wish the current HVCA, board, members, and chairman the best of luck for the future.

I think the future is looking pretty bright because frankly we live in a very good time for private capital providers, Hungary and the region as economies continue to grow, there is at some point the kind of a second-generation entrepreneurs that will ultimately look for succession. There are very bright entrepreneurs, good ideas are coming out from the region, from technology and other sectors.

The future looks very bright for HVCA equally, and I think it will grow, because obviously as the private capital providers grow in size, the role in the economy will grow and will become more visible to the general public, so I can wish them the best of luck, perseverance and they are able to attract the good people as they have done over last years.

The interview was conducted by Lénárd Horgos partner, Growth Financing | M&A, Absolvo Consulting

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Personal viewpoints

Those who have shaped the domestic venture capital market in the last few years, and the ones expected to do so in the upcoming years

József Kövér
partner, 3TS Capital Partners

Interview with József Kövér

What is your first memory you can recall of HVCA?

I got involved with venture capital in the mid-1990s. As far as I remember it was András Geszti, the director of Euroventures at that time, who drew my attention to the association and its operations.

Do you remember your first concluded transaction as a venture capitalist? Year? Company? Amount of investment?

The first investment was made in Euronet in 1995. Soon afterwards, it had a successful IPO that provided a great exit opportunity to the investors.

What have been the most significant changes in the market in the last 20-30 years?

Today I think there is a strong startup culture, which obviously did not exist in the 1990s. Back then, the concept and the operation of venture capital had to be explained to the majority of entrepreneurs over and over again, as many of them were not aware of the meaning of this notion. It was the JEREMIE initiative that brought about a breakthrough in the gradual improvement in the awareness of investors of venture capital. Plenty of investments were made within this framework in a relatively short time, which resulted in making the existence and the principles of venture capital more widely known.

Which transaction was the most extraordinary of yours that you would share with us? (the most extreme structure, unusual field of business, interesting exit etc.)

On one occasion, regarding a very successful exit, a mere two weeks elapsed between the handover of the term sheet by the buyer and the financial close of the exit. It was the exceptionally short time period that made this transaction intriguing. I had never participated in such a rapid exit transaction before this one, and I reckon that it is not common with others either.

Who was the most impressive colleague/entrepreneur/founder that you got to work with?

I worked with late Péter Fodor for several years. Having spent some decades in Canada, he returned to Hungary and became one of the major investors in the Hungarian market. As I recall, Péter also worked as the chairman of the association for a while. I learned very much from him during our collaboration.

Could you think of a saying or catchphrase by someone that you like to cite as well?

It is hard to remember who I heard this saying from, however, the one I tend to use a lot is as follows: venture capitalists are essentially professionals working in HR. We are tasked with finding the people whose businesses are worth-investing in. Once we made a careful choice of the entrepreneur or founding team, it is almost certain that we will benefit from the deal as a well-prepared, experienced entrepreneur can readily handle the inevitable unexpected situations. All other factors are secondary to the HR issue.

Looking back, we can surely decide what was right or wrong, and yet, we still make mistakes. Has there been a recent blow that you would have invested in? Theranos? WeWork? The FYRE festival? Any other examples that you could have believed in?

When Groupon was established, its business model appealed to me very much. Although we have never invested directly in any clones of Groupon, one of our portfolio companies started such a business, which later proved to be a wrong decision.

What do you think will happen first in Budapest– a football team making it to the final of the Champions League or the establishment of a unicorn startup?

Unfortunately, football is not my cup of tea, but I definitely believe that we will see a unicorn startup from Hungary very soon. I use the name of the country instead of the capital on purpose, since there is a growing number of great startups established throughout the country. This particular unicorn may emerge from any garage without taking into consideration any geographical constraints.

Do you have a favourite film about the investment sector that you find realistic and tallies with your experience? Billions, The Wolf of Wall Street, Succession, Big Short etc.?

The film called Margin Call has made a lasting impression on me, which is about the financial crisis in 2008. It depicts the collapse of the house of cards in an intriguing manner.

József Berecz
venture capital consultant

Interview with József Berecz

What is your first memory you can recall of HVCA?

I heard about HVCA for the first time when I began working at the small fund (MAVA) that belonged to the Hungarian Innovative Technologies Fund (HITF).

Do you remember your first concluded transaction as a venture capitalist? Year? Company? Amount of investment?

The first investment of HITF was made in A.R. Hungária Kft. in 1998.

What have been the most significant changes in the market in the last 20-30 years?

The biggest change was triggered by the JEREMIE initiative, which boosted the Hungarian market after 2010. Prior to that, the few funds that were willing to invest in domestic companies mostly considered investments of over a million dollars in them, which were very rare even at that time. The JEREMIE programme initiated the establishment of the start-up ecosystem in Hungary, enabling entrepreneurs to have venture capital investments accepted. Nonetheless, it is problematic that the growth of the sector has been substantially fuelled by government funds up to now.

Which transaction was the most extraordinary of yours that you would share with us? (the most extreme structure, unusual field of business, interesting exit etc.)

Perhaps my most interesting transaction was literally an escape from an investment, which we made by hiding an investment in another company. This solution resembled a reverse IPO in which a certain firm is acquired by an existing public company, thus it becomes public as well. It was a tough transaction to perform, but a very interesting one.
I have taken part in several transactions in which the technology was way ahead of its time, therefore it lacked the demand from the market. For example, Flatstack was a chip that would have enabled devices to connect to the internet. Needless to say, the market did not respond well to this idea in 2000. Another example involves the situation when the technological development took another path, which resulted in the exclusion of the company's solution from the market. It was a firm called Laserbit Kft., which would have made internet connection available via infrared, for instance, between buildings.

Who was the most impressive colleague/entrepreneur/founder that you got to work with?

The person who taught me the most was Béla Szigeti, founder of Riverside, although when I worked with him, Riverside was still doing privatisation consultancy in Hungary. I also learned a lot from Gábor Kovács at Bankár Holding, who excelled at financial structuring.

Looking back, we can surely decide what was right or wrong, and yet, we still make mistakes. Has there been a recent blow that you would have invested in? Theranos? WeWork? The FYRE festival? Any other examples that you could have believed in?

I may have considered investing in Theranos as technology is still moving in that direction today. Moreover, I have participated in an investment project which aimed at developing, manufacturing, and distributing a compact, user-friendly analyzer that could be used with only a couple of drops of blood. (Norma Instruments)

What do you think will happen first in Budapest– a football team making it to the final of the Champions League or the establishment of a unicorn startup?

The answer is obviously the unicorn startup. There is never going to be internationally competitive football in Hungary.

Do you have a favourite film about the investment sector that you find realistic and tallies with your experience? Billions, The Wolf of Wall Street, Succession, Big Short etc.?

Billions is very good, but the personal elements were far-fetched at the end of the film. My favourite is Big Short, you can learn a lot from it. I am ready to watch it again any time, be it the twentieth time or so. What makes the terrible thing about The Wolf of Wall Street is that it really reinforces the truism that brokers don't really treat our money in fair way.

Can you name any current sectors/fields of business that will be mentioned in our 40 years yearbook as the big economic bubble that burst?

I am not convinced that the blockchain technology will be recognized by the market in the upcoming 10 years. Although I consider Bitcoin one of the biggest means of speculation today, we shouldn't ignore the underlying technology as a whole.

Personal viewpoints

Those who have shaped the domestic venture capital market in the last few years, and the ones expected to do so in the upcoming years

Péter Tánczos
director, Euroventures Advisory Kft.

Interview with Péter Tánczos

What is your first memory you can recall of HVCA?

Besides the fading memories, the one that I can clearly remember the time when I took on the role of treasurer when Viki Zombory was the chairperson of the association. (NB She has been the only woman chairperson of the association so far.) These were still the heroic times when accounting was performed in an A3 formatted general ledger and the transition to double-entry accounting was considered as the association's coming of age.

Do you remember your first concluded transaction as a venture capitalist? Year? Company? Amount of investment?

In fact, I can recall three "first" transactions. The first one I witnessed was the transaction involving Alfa, a wholesaler that dealt with chemical products and foodstuffs. In 1992 an equivalent of EUR 3-4 million was invested in the company in Hungarian forints. I kept track of the investment procedure from afar as an analyst working part-time besides university. Literally, I could observe the American lawyer (who probably earned about five times my monthly salary by the hour back then) working on the close of the transaction through a glass door at the office of one of our co-funders, surrounded by colleagues and a thick cloud of tobacco smoke.

The first time I had a professional role in a transaction was in 1995, which involved Hilltop, a wine producer and wholesaler, in which about the same amount of capital was invested. I have kept in touch with the founders of this family enterprise ever since. I was able to learn a lot about the various aspects of making investments and entrepreneurship as they were patient, kind, and receptive to cooperation. In 2000, my first own investment concerned Philos, a video game developer company, in which I made all the professional mistakes that you may think of. I learned a lot from it.

What have been the most significant changes in the market in the last 20-30 years?

It is difficult to decide which ones to highlight as both the demand and the supply have changed a great deal. Nonetheless, it is the change in the competence of management that may be pointed out. In the 1990s, outstanding international success could almost only be achieved by the leadership of foreign management and staff. By the 2000s, a group of Hungarian entrepreneurs and executives having international experience and fundamental leadership skills via multinational enterprises had been "created", who were able to represent high-growth enterprises authentically and help implement their emergence internationally. The last ten years have seen young executives who feel at home in London, Zürich or San Francisco and can consciously develop enterprises in the region utilizing comparative advantages and target potential customers. It is wonderful to support such young entrepreneurs in developing their ventures.

Which transaction was the most extraordinary of yours that you would share with us? (the most extreme structure, unusual field of business, interesting exit etc.)

We often mention BVfon, a company in which we invested in 2005. Headed by Csaba Kató, BVfon set up a landline phone infrastructure for inmates in prisons in Hungary and later in most European states within an EU framework with the aim of providing a specifically detailed and supervised communication service. Needless to say, there has not been any other venture in which the business model of a "locked-in customer base" was so meticulously implemented.

Could you think of a saying or catchphrase by someone that you like to cite as well?

We benefited very much from working together with a highly experienced colleague at 3i in the 1990s, who helped us with the investment committee of our first fund. We would often hear the following saying by him to tackle the challenging situation called "Conflict of Interest": "No conflict, no interest!".

Looking back, we can surely decide what was right or wrong, and yet, we still make mistakes. Has there been a recent blow that you would have invested in? Theranos? WeWork? The FYRE festival? Any other examples that you could have believed in?

I can think of one opportunity we would have wanted to invest in, however, we could not as our offer was not competitive enough. It has not turned out yet whether it will fail or not, but concerning our region and profession as well, I hope that we were not optimistic enough and it will be a success.

What do you think will happen first in Budapest– a football team making it to the final of the Champions League or the establishment of a unicorn startup?

There is already a unicorn (moreover, decacorn!) in Budapest, so the answer is straightforward. One of our investments, EPAM, is valued at USD 25 billion at NYSE. Few people know that at the time of its IPO in 2013 the Hungarian flag was on the facade of NYSE as well. Balázs Fejes is still one of the owners and executives.

Do you have a favourite film about the investment sector that you find realistic and tallies with your experience? Billions, The Wolf of Wall Street, Succession, Big Short etc.?

Although it is not about the investment sector, I consider the show called Dalfutár absolutely relevant in the sense that it gives a true insight into the biggest challenge of our profession, that is, teamwork. It depicts the complexity, challenges, enjoyment and success of cooperation between people coming from various backgrounds with different mindsets, tastes and aspirations. Our profession is about these too. I am a great fan of the show and we always look forward to watching the upcoming episode with the whole family.

Can you name any current sectors/fields of business that will be mentioned in our 40 years yearbook as the big economic bubble that burst?

I am afraid that there may be a list containing several items, however, the one I must definitely highlight concerns the battery technology of electric vehicles. I hope a breakthrough is yet to happen in this field of industry, which can further boost car-sharing solutions and significantly alter consumer demand that may result in the expansion and simplification of energy supply.

Personal viewpoints

Those who have shaped the domestic venture capital market in the last few years, and the ones expected to do so in the upcoming years

Dóra Szokolovszky

senior associate,
Euroventures Advisory Kft.

Interview with Dóra Szokolovszky

What is your first memory of HVCA? Do you happen to remember the first event you participated in?

My first memory of HVCA and the first event I took part coincide – it was the season-opening barbecue party in September, 2019. As a newcomer in the field of VC, it was a wonderful experience that everybody welcomed me very kindly. It was especially good to hear that Euroventures was highly praised at the event. I was looking forward to working with everyone in my new field.

Do you remember your first concluded transaction as a venture capitalist? Year? Company? Amount of investment?

It was not long ago, so I remember it very well. We invested EUR 3.5 million in Logiscool in the beginning of 2020. I am glad that this was my first transaction as I could learn a great deal from it and got to know an excellent team.

What trends do you forecast for the upcoming 10-20 years?

The growing importance of technology is noticeable in all sectors, therefore I expect it to happen in ours too. Investment decision making and the subsequent portfolio management take up a lot of time and human workforce, which could be made more efficient by optimizing processes.

There are softwares at hand today that can facilitate decision making and automate some processes, but there is room for development in increasing efficiency in other ones, therefore I expect such changes in the field of venture capital. It is uncertain whether investors are responsive to such technological advances. Meetings have been held online for over a year now, which have proven to be efficient by reducing idle periods and eliminating travel and catering expenses etc. On the other hand, we have experienced that the lack of impactful personal meetings hinders decision making, which makes longer online discussions necessary in a large number of cases.

Which transaction was the most extraordinary of yours that you would share with us? (the most extreme structure, unusual field of business, interesting exit etc.)

The regulations on social distancing had already been introduced before the beginning of the negotiations regarding our latest investment, so this deal was made exclusively online. It may have become common by now, however, it was unusual for me to ”shake hands” with the other party at the end of the transaction without ever meeting in person.

Could you think of a saying or catchphrase by someone that you like to cite as well?

One of my favourite sayings at the office is that ”I can contain my enthusiasm”, which is an expression with a twist to mean that you do not find something particularly intriguing.

What do you think will happen first in Budapest– a football team making it to the final of the Champions League or the establishment of a unicorn startup?

Unicorn startup!

Do you have a favourite film about the investment sector that you find realistic and tallies with your experience? Billions, The Wolf of Wall Street, Succession, Big Short etc.?

The film called The Social Network demonstrates how impactful intellectual capital may be and what controversial situations it may trigger if it is not handled with great care from the beginning.

Personal viewpoints

Those who have shaped the domestic venture capital market in the last few years, and the ones expected to do so in the upcoming years

Sára Szendrői
investment manager, Hiventures

Interview with Sára Szendrői

What is your first memory you can recall of HVCA?

I got acquainted with the basics of capital investment from a guide on raising capital published by HVCA.

Do you happen to remember the first event you participated in?

The first event I participated in was the Conference on CEE Private Equity, Venture Capital and Corporate Finance jointly organized by HVCA and Portfolio in 2017.

Do you remember your first concluded transaction as a venture capitalist? Year? Company? Amount of investment?

In my early years I was involved in some processes at Absolvo as an advisor. The first time I headed an investment project was in the growth area at Hiventures, when a firm called CX-Ray Kft. received capital investment in 2019. I have not had an exit yet, but I have been working on promising projects, so it should happen some time soon.

What trends do you forecast for the upcoming 10-20 years?

The acceptance of crowdfunding has been increasing in Europe and a growing number of startups and small enterprises make use of this type of funding. The European Parliament, partly in response to the impacts of the epidemic, has approved of the regulations that harmonize the requirements relating to crowdfunding platforms, which eliminates obstacles hindering international operations. Consequently, startups and small enterprises may reach out to more investors via engaging the public, and likewise, investors may choose from a wider range of projects to invest in.

Which transaction was the most extraordinary of yours that you would share with us? (the most extreme structure, unusual field of business, interesting exit etc.)

The most exciting case I have worked on so far was probably an IPO preparation. Eventually, the company did not go public, however, it was fascinating to keep track of the stages this startup was going through in the rare case of ”leveling up”. The project also involved the engaging task of reconsidering and negotiating investors' rights, also bearing in mind the priority rights to be waived in the event of an IPO.

Who was the most impressive colleague/entrepreneur/founder that you could get to work with? Could you think of a saying or catchphrase by someone that you like to cite as well?

I have met plenty of inspiring founders and investors, and the most thought-provoking saying I have heard is the following: ”it does not only take a groundbreaking idea to make a good investment”. Personally, I agree with this approach, because in the case of a project, the team is the first - and not the idea - that the investor invests in. We may often come across people with a plethora of great ideas that are supposed to solve all the problems out there, however, it is the team and the business plan that may translate theoretical brainstorming into successful ventures.

Looking back, we can surely decide what was right or wrong, and yet, we still make mistakes. Has there been a recent blow that you would have invested in? Theranos? WeWork? The FYRE festival? Any other examples that you could have believed in?

Probably, I would have invested in Theranos as a business angel. Venture capital investment often involves situations when you resort to intuition. These subjective expectations are indirectly validated by investors to a certain extent, especially at the seeding stage of a startup. Most founders, who have made something innovative, are unwilling to discuss the underlying technology or other details of their startup as they consider them business secrets. Consequently, investors may abandon the project because of the lack of information, thus they quit investing in a potential unicorn, or they try the product or service, investigate related patents and (professional) cooperations in order to find out about the authenticity of the project. However, this is only indirect validation.The history of Theranos clearly shows the underlying risks that pose a great challenge to investors in the early stage of startups and it makes me think of a saying as well that goes as follows: ”If you must lie, lie big”. In my opinion, this sentence sums up why Theranos could be ”successful” for so many years.

What do you think will happen first in Budapest– a football team making it to the final of the Champions League or the establishment of a unicorn startup?

I opt for the unicorn, as startups may be present in several industries and types of sports, therefore investors (supporters) do not need to stick to only one sport (e.g.: football), it may be any sectors in which the next unicorn appears. See, for instance, the women's handball team of Győr winning five Champions' League trophies.

Do you have a favourite film about the investment sector that you find realistic and tallies with your experience? Billions, The Wolf of Wall Street, Succession, Big Short etc.?

The film called The Hummingbird Project is not strictly about startups, however, the main characters of the film bear similarities to founders of startups. It is a very gripping film about two cousins aiming at setting up a fibre-optic network between Kansas and New Jersey in order to earn a lot of money. The film sheds light on the countless factors that such an extraordinary endeavour requires, that is convincing and mobilizing a lot of people, and creating an excellent team capable of implementing tasks within the available timeframe in order to beat rivals and stay relevant in the market. The film also demonstrates the degree of flexibility that founders must have and the inevitable sacrifices they are required to make. Nonetheless, having successfully fulfilled the aforementioned criteria, they may even fail due to unforeseeable hardships.

Can you name any current sectors/fields of business that will be mentioned in our 40 years yearbook as the big economic bubble that burst?

I consider bubbles as the natural "side effects" of economic development. Certain new technologies have such high potentials that numerous companies are captivated by them, however, it is only a handful of companies that succeed in setting up profitable enterprises making products or providing services that are highly demanded by the public. This phenomenon is typical in the startup sector, which means that 9 in 10 companies normally go bankrupt, making the remaining one expected to provide the return. Most startups in the trendy fields today are prone to fail, but the ones that succeed in meeting market demands, on the other hand, are going to disrupt their respective markets, be it green energies, fintech, or biotech.

Personal viewpoints

Those who have shaped the domestic venture capital market in the last few years, and the ones expected to do so in the upcoming years

Barnabás Horváth

associate Growth financing | M&A, Absolvo Consulting

Interview with Barnabás Horváth

What is your first memory you can recall of HVCA?

As far as I remember, I heard about HVCA for the first time with regard to Levente Zsembery, who taught me business evaluation at university as the CEO of X-Ventures and chairman of HVCA.

Do you happen to remember the first event you participated in?

My first event was a NextGen training on negotiation strategies, where I learned the entry pricing strategy, which I still use.

Do you remember your first concluded transaction as a venture capitalist? Year? Company? Amount of investment?

The first transaction in which I participated actively, not as a venture capitalist though, was one between Oriana International and Hiventures in 2018-2019, with a value of EUR 800k.

What trends do you forecast for the upcoming 10-20 years?

I believe that investors are going to specialize according to sectors, because a generation of founders/ entrepreneurs are going to opt for the roles of business angels and VC investors after their exits.

Which transaction was the most extraordinary of yours that you would share with us? (the most extreme structure, unusual field of business, interesting exit etc.)

There was one that I would not call a transaction, however, the sector was very unusual as it concerned a project in which a device capable of assessing the fertility rate of livestock on the spot had been developed.

Who was the most impressive colleague/entrepreneur/founder that you could get to work with?

István Simon, the CEO of Prefixbox. He is a resilient, down-to-earth thinker with great attitude, and besides, he is the innovator of the post-negotiation beer pub sessions.

Could you think of a saying or catchphrase by someone that you like to cite as well?

"Predictions are very difficult, especially if it's about the future." – Niels Bohr.

The interviews were conducted by:

Eszter Hubbes	partner, Hubbes & Kovács Atterneys at Law, Board member of HVCA
Levente Zsembery	CEO, X-Ventures, chairman of the Supervisory Board of HVCA

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Bence Katona, Sándor Buda

The role of the state in the development of the Hungarian venture capital and private equity market

The importance of the state in funding early stage enterprises

Early stage companies have difficulties in securing external funding due to the involvement of higher than typical risk factors. Such innovative, potentially high-growth enterprises need substantial capital investment, however, their early stage status, risky nature, and lack of satisfying guarantees make fundraising an arduous task for them. Fundraising is especially problematic for early phase companies (at the project idea phase), because market players tend to avoid making investments in companies involving high risk. Consequently, the state has a significant role in funding such enterprises.

An OECD study of 2014 points out that almost 50 percent of jobs are created by firms younger than 5 years old. Paradoxically, these are the companies that have to face the most business development challenges. Funding these enterprises is in the interest of the economy at large, therefore most states launch funding programmes, which aim to provide various kinds of financing and support for young companies. Besides launching funding programmes, the role of the state may take various other forms, which are as follows: favourable tax environment, administrative simplification and facilitation, mentoring programmes, entrepreneurship education, specialized trainings, funding to help bring projects to the market etc. This study focuses on venture capital programmes, and it is comprised of a global overview and a specific one pinpointing the state actors of the Hungarian venture capital market and the programmes backed by them.

The role of the state in the venture capital market - a global overview

The state started operating as a venture capitalist in the U.S. in the 1960s (small business investment companies – 1958). Initially, it only experimented with making venture capital investments as it was an unknown field, however, following the successful ventures of Apple and Microsoft, more and more states around the globe, such as Israel, Canada and later in Europe too got involved with their domestic venture capital markets.

The innovation gap in Europe was addressed by establishing state-supported funds, because the funding of projects during the incubation period and the regular capital injection were indispensable to increase the innovation performance. The governments realized that the market had failed to finance the early-stage projects and enterprises properly due to their high risk nature, however, they had tremendous potential for growth in emerging industries such as biotechnology, nanotechnology, and clean energy. As for Europe, it is primarily the German, Irish, and the Estonian models that are worth analyzing owing to the great achievements of their respective governments in the field of venture capital investments.

Owned partly by the Federal Republic of Germany, High-Tech Gründerfonds (HTGF) launched its first public- private fund in 2005 and funded early stage enterprises amounting to a total value of EUR 272 million. Further, two funds were launched in 2011 (EUR 304 million) and in 2017 (EUR 319,5 million), which have financed almost 600 enterprises. HTGF mainly invests in high-tech startups in the fields of cleantech, robotics, medicine, chemistry, and softwares. A large number of the fund managers are qualified professionals in the aforementioned fields, therefore they may not only provide financial help, but also relevant professional guidance and mentoring. The fund has around EUR 900 million under management and has exited from 120 projects.

Enterprise Ireland is a government agency that works independently from the state. Their portfolio of products ranges from company set up to supporting large enterprises, focusing on incentivizing export-related activities. They mostly provide non-refundable grant and voucher type of financial aid at pre-seed and seed stages, whereas a distinct fund has been established for capital investments (Seed and Venture Capital Funds), which operates as a fund of funds.

The Estonian Development Fund has set up a capital program called Early Fund II in order to provide financial support to startups. Prior to the establishment of the fund management company named SmartCap in 2012, the development fund managed the program directly. The subsidiary operates under an activity licence issued by the Estonian Financial Supervision Authority. Since its establishment, SmartCap has administered over 100 investments and it has more than EUR 80 million under management. Investments are made in various stages via co-investment projects by involving private investors. The organization is in touch with further members of the ecosystem such as accelerators, business angels, and private equity and venture capital investors.

In each year between 2010 and 2013, 30 percent of the capital raised of the venture capital funds in Europe was provided by government agencies. The involvement of governments gradually decreased as time passed after the start of the crisis. The proportion of the raised capital by government agencies amounted to 25 percent of the total raised capital in 2014 and 20 percent in 2015, however, their significance was still very high in comparison with other funding institutions. The state contribution of only EUR 650 million in 2007 had increased to EUR 1 billion by 2010 and it further grew to an annual EUR 1,5 billion from 2011 onwards, which indicated a trend contrary to the business cycle.

The rate of government resources in venture capital funding with respect to the number of companies that were supported in this manner was considerable not only throughout Europe, but rather worldwide. For instance, over 50 percent of enterprises supported by venture capital funding involved government resources in Canada. The rate of government funds in venture capital financing was around 35 percent in Germany and 25 percent in France and Belgium. Over half of the early-stage funding transactions were administered by hybrid funds in the United Kingdom, which invested government and private funds in combination.

State funding programmes are feared for the so-called „crowding out" effect, which means that such programmes may potentially force private investors out of the market rather than providing incentives to them. This aspect is based on the fact that a governmental entity expects a lower target yield than a private investor, because it also considers underlying impacts of its investment and is not necessarily concerned with the yield, but it rather tries to generate competition for private investors. Nonetheless, researches have revealed that the enterprises funded by both public and private sources tend to receive higher amount of investment than the ones that are financed by only one of the types of sources.

The beginning in Hungary (2000-2009)

The participation of the Hungarian state in the venture capital market resonates with the typical forms of government assistance in the Central and Eastern European countries and other European models, i.e. the provision of direct sources. The first institution that offered venture capital in the history of the Hungarian market was the Hungarian Development Bank and its affiliates.

The early birds were the subsidiaries of the Regional Development Holding, which provided loans, and to some extent, equity funding as well from 1999 onwards. At that time the main focus was on the companies in traditional industries, and the subsequent startup ecosystem did not exist in Hungary.

The institution called Small Business Development Company Ltd. must be mentioned. It managed and invested HUF 4,4 billion in mostly domestic small and middle-sized enterprises. MFB Invest Ltd. was created through the merger of the banking group's three companies as a real estate marketing and development corporation. It started the elaboration of the terms and conditions for venture capital funding in 2006, therefore it could enter the Hungarian capital market as a financial investor with profit-oriented approach. MFB Invest Ltd. funded investments from its equity and continued to focus on traditional industries.

The first representative of funds and fund manager companies were established. Both the owner and the investor of the funds was, indirectly the Hungarian state. The most significant ones were IKTA (IT Venture Capital Fund) and CELIN (Corvinus First IT Venture Capital). According to statistics, IKTA was founded with an initial capital of HUF 3 billion in 2002, and it invested in 11 companies until 2011 with an average amount of over HUF 200 million for each investment.

CELIN was established in 2005 under the management of the predecessor of today's Hiventures (Corvinus Venture Capital Fund Ltd.) with an amount of HUF 5 billion for a 15-year term. Several companies were funded in the first few months of its operation and the available capital for investment dynamically increased throughout the upcoming years. The amount of capital per investment ranged from EUR 80.000 to EUR 4 million. MFB Development Fund was founded in 2008. The aim of both funds was to provide equity financing to new small and middle-sized enterprises that were unable to attract market investors.

The first EU sources in the Hungarian venture capital and private equity market (2009-2015)

JEREMIE Programme

A new chapter began with the emergence of hybrid funds in the participation of the Hungarian state in the venture capital market, which clearly indicated a paradigm change in the field. Hybrid venture capital funding means a fund managed by private investors, who provide capital to enterprises through combining state and private sources.

According to the decision of the European Commission, part of the structural funds could be deployed to financial programmes (loan, guarantee, and venture capital). One of these initiatives was the JEREMIE (Joint European Resources for Micro to Medium Enterprises) Programme.

The JEREMIE venture capital programme gave rise to a novel model of state participation in the Hungarian venture capital market as an unforeseen amount of government sources was channelled into the early stage venture capital market backed by the structural funds of the EU. Unlike the earlier model of direct state participation, the new one meant that the state had a certain kind of indirect involvement, in which it provided the funds, whereas fund management was performed by market operators. Firstly, a holding company was established, after which the fund management companies were selected pursuant to a public procurement procedure.

The Hungarian state founded a company called MV - Magyar Vállalkozásfinanszírozási Zrt. (succeeded by the Hungarian Development Bank Ltd.) in 2007 in order to manage the JEREMIE programme as a fund of funds.

MV Zrt. signed the intermediation contracts with 8 venture capital fund management companies, who could invest HUF 45 billion in the following years (this was the first phase of the JEREMIE venture capital programme called Új Magyarország Venture Capital Programme). There were two sub-programmes, one of them (Joint Fund Sub-Programme) was aimed at supporting the companies of the convergence region from the sources of the Economic Development Operational Programme (GOP), whereas the sources of the other were available for enterprises in central Hungary from the Co- Investment Sub-Programme for Central Hungary Operational Programme.

The second phase of the programme began in 2012 (Új Széchenyi Venture Capital Programme). Both funds - Seed and Growth funds - aimed at supporting companies in the six convergence regions of the country from the sources of the Economic Development Operational Programme (GOP). The Growth Fund Sub-Programme was implemented through four invitations to tender from 2012 to 2014.

28 venture capital funds were set up within the framework of the two programmes, which were managed by 25 fund management companies. 8 of the funds were allowed to invest in early-stage enterprises, 4 in seed-stage companies, and 16 in growth-stage firms within the following amounts of investment:

- first round funds: EUR 1,5 million/enterprise
- seed stage: maximum EUR 300 000/enterprise
- growth stage: EUR 2,5 million in one year, which can be repeated multiple times

In line with the relevant guidelines of the European Commission, the investment period of the funds was modified to last until 31 May, 2016. The funds operated as pledge funds, that is, they did not receive all the financial resources immediately, but rather on a deal-by-deal basis. JEREMIE I. provided Hungarian enterprises with HUF 132 billion. At least 30% of the funds came from private sources, 85% of the state contribution came from EU funds, and 15% was provided by the Hungarian state budget funds. The fund management companies were backed by numerous incentives during the programme, such as taking over a part of loss on private investments, and the channelling of the amount of return over the margin requirements of state sources into private ones.

Besides the JEREMIE programme, Széchenyi Capital Fund Management Ltd. (SZTA) had an increasing significance in the Hungarian venture capital market from 2011.
SZTA is a completely state-owned investment company, whose appointed asset management entity is the Hungarian Ministry of Finance. 85% of the funds under the management of SZTA originated from the EU, and 15% from the Hungarian state.

The fund management company launched its first fund (Széchenyi Capital Fund) in 2011 in order to support domestic micro, small, and middle-sized enterprises with growth potential to facilitate their structural change, technological development, and expansion of business activities. The fund had HUF 14 billion at their disposal from the Regional Operational Programme and typically made fixed-term (usually 5-year term) venture capital investments primarily in traditional industries, and to a smaller extent, in innovative ones. The fund made investments pursuant to two state aid schemes in the following arrangements:

- De minimis aid scheme (EUR 75 000 – 200 000 investment)
  - small amount of capital investment
- Venture capital investment aid scheme (EUR 75 000 – 750 000 investment)
  - individual co-investment with private participation
  - co-investment based on a framework contract
  - investment in small startup companies

The sources of the new EU budget (2014-2020) and additional state sources join funding

One of the first calls for proposals in the new EU budget to support innovative enterprises was the so- called Gazelle Programme, coordinated by the National Research, Development and Innovation Office. Companies were not directly supported in this programme, because the funds were received by startup incubators, whose tasks were to develop the involved startups into companies capable of growing quickly, entering international markets, and attracting venture capital investments as well.

The total value of the domestic equity investment market classified as venture capital (pre-seed, seed, startup/growth stages) amounted to HUF 39 billion in 2015 in accordance with a survey conducted by MFB Ltd., which is similar to the records of earlier years showing an average of HUF 40 billion value per year. Nonetheless, private equity investments were not considered in this calculation, as this type of funding is not concerned with financing SMEs, but rather funding larger corporations and implementing buyouts.

A substantial dependence on EU sources arose due to the very low presence of foreign private sources and the insufficient domestic private sources (NB 95% of the aforementioned yearly investment value was funded through EU/state sources). Consequently, there was a lack of resources in the Hungarian venture capital market as the JEREMIE programme terminated in May, 2016.

Several studies and analyses were conducted in this period in order to quantify the market gap and ascertain whether state participation was justified in the venture capital market, and if so, then how much additional source would be necessary. Gap analyses showed that the funding gap was about HUF 36 million at that time on a yearly basis. As the appearance of a private equity fund with ample capital to invest was not likely, involving new participants in funding became vital during the funding period of the EU budget of 2014-2020.

Although there have been several instances of state involvement in the Hungarian venture capital market, it was in 2016 that a decision was made to unite efforts in creating a carefully orchestrated, comprehensive, and clearly structured platform, and Hiventures (a state-owned fund management company) was launched.

Hiventures Zrt.

Hiventures Ltd. was established with the aim of creating such a state-owned venture capital fund management company, through the extension of its predecessor's responsibilities and the increase of the capital under its management, which is capable of boosting the performance of the national economy through investing in pre-seed, seed, and growth-stage enterprises from state (MFB) and EU sources. It was a primary goal to promote innovation in Hungary, create professionally challenging jobs of high added value, and to introduce interconnected investment programmes, i.e., to ensure that Hiventures can fund an enterprise from concept stage to international expansion. The fund management company started its operation by managing HUF 55 billion capital, of which HUF 20 billion was provided by MFB Zrt., and the rest by the Economic Development and Innovation Oparational Programme (GINOP).

In the initial period, Hiventures tended to invest in innovative start-ups individually or as a co-investor. The scheme turned out to be a success, especially regarding the pre-seed phase, as concepts had not been funded earlier by venture capitalists. By the end of 2020, over HUF 38 billion had been invested in 344 portfolio companies, which made Hiventures the most significant funding partner of the Hungarian startup sector. Co-investor partners were involved regarding 53 portfolio companies of 344, which proves that the cooperation between state-owned and private investors have certainly intensified in the last few years.

80-90% of the total funds of HUF 200-250 billion in the venture capital market in 2018 was available for startups. Therefore, Hiventures responded to the market demand by launching a new programme for the Hungarian SME sector (KKVPRO). The programme has a source of HUF 31 billion from MFB, with the aim of supporting enterprises and their managements with non-family takeovers, domestic and international acquisitions to expand their businesses, improve their competitiveness, utilize their scale efficiencies, and invest in foreign companies. The mission of this new business branch is to provide the domestic SME sector with enough equity to develop, expand, and fund their operations. It further enhances the significance of the programme that it provides mezzanine financing, which had been unavailable in the Hungarian market earlier.

Domestic SMEs, startups, jobs, and households were strongly hit by the effects of the COVID-19 pandemic that appeared in Hungary in March, 2020. As part of the state aid package and in response to market demand, Hiventures launched its rescue programme for startups and SMEs.

At the same time, the business branch called INVESTPRO was launched as well, which provides private equity funding for large domestic companies in order to stabilize their operation, improve their competitiveness and continue to grow. The three main focus areas of the fund is restructuring, economy development, and financing M&A and real estate transactions.

Hiventures currently manages over HUF 155 billion, of which HUF 45,4 billion is from EU sources and the Economic Development and Innovation Oparational Programme (GINOP). The terms and conditions of investments are largely determined by the source of the capital. With regard to investments from EU sources, the regulations state that the funded projects must be implemented in less developed regions, i.e. projects in Central-Hungary must not be funded within this framework. There are fewer restrictions with regard to investments from state sources though, as these projects may be implemented in the whole territory of Hungary, including the central region too. A startup, even one more than 5 years old, may be funded (involving a co-investor as well) by up to HUF 1 billion, whereas with regard to the business branches KKVPRO and INVESTPRO, the maximum amount of funding may be HUF 15 billion. In the latter cases though, most transactions require own contribution and bank loan in order to set up the optimal funding mix.

By introducing funding solutions for SMEs and large companies, Hiventures became capable of financing the whole range of companies within Hungary. It must be mentioned, however, that when working out the investment policy of Hiventures, it was an important condition that its policy would complemented the investment policies of other funds managing capital from additional state sources (too).

Széchenyi Alapok Zrt. (formerly Széchenyi Fund Management Ltd.)

The investment policy of SZTA has changed considerably since its foundation. It has retained its business branch of funding conventional SMEs, and they have extended their portfolio to funding innovative enterprises and larger domestic and international projects.

The fund management company has nearly HUF 71 billion under management by its funds as follows:

- Széchenyi Capital Fund: the fund supports small and middle-sized enterprises with high growth potential nationwide, which need venture capital in order to be capable of expanding their businesses, increasing their market share and launching new products/services. Besides capital injection, the fund provides strategic business and financial counselling to foster the growth of the portfolio companies.

- Irinyi Venture Capital Funds: in line with the principles of the national strategy for developing industries (Irinyi Scheme), the funds support those small and middle-sized enterprises in the industry sector that are capable of growing. Funds are provided mostly to production and development companies with growth potential. The primarily targeted companies are the ones in the prioritized industries as specified in the Irinyi Scheme, such as Industry 4.0 developmental and digitalizational processes. Among others, the prioritized industries are the automotive industry and mechanical engineering, healthcare, chemical industry, ICT industry, green economy and energy industry, timber industry, food industry, defense industry, and the related ICT, digital, and Industry 4.0 developments.

- Carpathians Venture Capital Fund: the aim of the capital investments of the fund is to promote the international business activities of the Hungarian micro, small and middle-sized enterprises, with special emphasis on building lasting relations regarding production, service, research, development, and workforce training to benefit all parties. Funds are available for the domestic companies intending to expand in the neighbouring countries, as well as the innovative companies wishing to enter the Hungarian market.

- National Stock Exchange Development Fund: the fund, as an important vehicle in the efforts initiated by the Budapest Stock Exchange to develop the capital market, is tasked with supporting the small and middle-sized enterprises operating in Hungary that intend to go public.

- Blue Planet Environmental Protection Venture Capital Fund: the goal of the fund established in 2020 is to increase the potential of micro, small and middle-sized companies that apply innovative solutions to environmental protection.

MFB Invest Zrt.

MFB Invest Zrt. is a member of the MFB Group, which has managed several venture capital and private equity funds through its own management funds and has acted as a fund of funds since developing its strategy in 2017. The latter function is becoming increasingly prominent, that is, it implements funding more and more indirectly through private fund management companies.

Since its launch, MFB Invest Zrt. has funded nearly 80 enterprises with a total capital of HUF 77 billion. It is engaged primarily in financing and developing SMEs in their growth phase and large companies, greenfield projects, as well as development-oriented projects of national importance.

The activities of MFB Invest Zrt. are based on three main types of investments. Individual equity investments are a priority, within the framework of which, besides individual investments of a strategic nature, the company makes market investments exceeding the investment amount of HUF 500 million (which are typically larger, prioritized investments of national importance).

As part of its fund of funds activity, MFB Invest Zrt. had subscribed ten non-self-managed non-exclusive MFB funds focusing on different sub-markets by 2020.

At the same time, further development of the fund management activity was an important step in the new strategy as well. As the first step, in 2019 MFB Invest acquired a new fund management company, FOCUS VENTURES Tőkealapkezelő Zrt., which enabled the management of thematic funds requiring special expertise.

In addition to its existing activities -market investments and fund management-, the company has focused strongly on the subscription of corporate bonds from 2020 onwards, as well as, to a limited extent, on the secondary market purchase of bonds issued by companies participating in the Bond Funding for Growth Scheme launched by the Central Bank of Hungary.

Yet another programme must be mentioned, City Funds (Városi Tőkealapok), which was launched by MFB Invest Zrt. in 2019. The aim of the funds is to support the most significant enterprises of domestic cities. Currently, there are funds in the following cities: Debrecen, Székesfehérvár, Veszprém, and Kaposvár. The funds are managed by Focus Ventures Zrt., a subsidiary of MFB Invest completely owned by it, and the sizes of the funds range from HUF 2 to 10 billion.

Crisis II-III, and IV. Programmes

Responding to the effects of the COVID-19 pandemic, MFB Zrt. initiated several programmes within the framework of the rescue programme launched by the government to boost the economy. The aim of the Crisis II, III, and IV programmes is to support SMEs and large companies in those investment projects and M&A transactions, which cannot be finalized, or can only be partly implemented by taking out loan.

EXIM Bank Zrt.

The bank mainly supports Hungarian companies in their export activities with its products (loans, guarantees, funds).

Exim Bank Zrt. has operated as a fund of funds investor in the last 10 years, and has made investments in numerous domestic and international funds (Chinese, Kazakh, Portuguese etc.). It does not conduct fund management tasks on its own. The aim of the domestic/regional funds is to help regional enterprises enter international markets, increase export activities, and expand.

International funds with the participation of Exim Bank:

- Sino-CEE- Fund,
- Kazakhstan Hungarian Investment Private Equity Fund C.V.,
- East-West Venture Fund,
- IFC FIG Fund,
- China CEE Co-Operation Fund,
- China CEE Co-Operation Fund II,
- Three Seas Initiative Investment Fund.

Domestic funds with the participation of Exim Bank:

- Colombus Private Equity Fund,
- Enter Tomorrow Europe Private Equity Fund,
- EXIM Cross-Border Fund,
- Portfolion Regional Fund,
- Portfolion Regional Fund II.

Intelligent Specialization Venture Capital Programme

The Intelligent Specialization Venture Capital Programme (GINOP 8.1.3/B-17) was announced in the autumn of 2018 in order to support the implementation of innovative projects mainly out of Central-Hungary, in less developed regions of the country.
The structure of the programme resembles that of the JEREMIE programme. MFB Zrt. acts as the fund of funds, whereas the management of the funds is performed by professional fund management companies appointed to the task by public procurement procedures.

Seven new funds were established within the framework of the programme, comprising HUF 9,34 billion capital from EU source, and a supplementary amount of (at least 23%) private source. Consequently, each fund can invest about HUF 10 billion in domestic micro, small and middle-sized enterprises after deducting their operational costs, amounting to a total capital of about HUF 75 billion.

It is an important rule that the supported projects should be in line with the National Strategy on Intelligent Specialization that specifies the paths for research, development, and innovation in Hungary.

Besides the ones mentioned so far, yet another fund was established (VEKOP 2.1.2-17), which has HUF 5,13 billion at its disposal from EU source, and a supplementary amount of (at least 40%) private source. The winner of the tender, Gran Private Equity, is the only fund that is allowed to fund projects in Central-Hungary as well. The seven GINOP funds may make investments of minimum HUF 200 million and maximum HUF 1,5 billion in a portfolio company. Technologically innovative companies with high-growth potential are prioritized. The funds are expected to invest in 150 innovative enterprises.

Incubators

State participation in the venture capital market is also present with regard to incubators. Incubators are complex facilities that help the establishment and development of start-ups, provide counselling, technical and professional background, as well as funding.

Numerous incubators have operated in Hungary since the early 2000s, which have been helped with their establishment and daily activities by public tenders. Due to the limitations of this publication, we would like to highlight the tender in the summer of 2020 called Startup Factory. The aim of this call for applications was to help existing incubators to gain support for their further operation. The total amount of available funds was HUF 2 billion, of which incubators were granted HUF 150-300 million individually.

Conclusion

In conclusion, the appearance and participation of the Hungarian state in the domestic venture capital and private equity market is in accordance with international practice. State funding regarding innovative enterprises at a very early-stage has been intense, which is in line with both the theoretical and practical principles that it is the phase in which enterprises are not commercially viable, therefore state assistance is highly required. It has been noted that capital investment in these companies makes a large impact on the national economy and its future potential. Provided that early stage startups are funded only on market terms, it will result in a suboptimal amount of investments entering the sector.

A rather developed startup ecosystem has been built in the last ten years with the active contribution of the state, which has undoubtedly created a better environment for establishing startups. This is demonstrated by the increasing number of patents and the appearance of internationally successful Hungarian startups.

The engaged participation of the state will be maintained in the future too. New sources are expected to be available within the framework of the 2021-2027 EU budget, as well as further domestic and state sources. Nonetheless, the role of private equity is expected to increase as the market is maturing, which is going to lead to the growing importance of co-investment structures involving state sources and private sources, which is very widespread in Western European countries.

The authors of the article:

Bence Katona CEO, Hiventures Ltd.
Sándor Buda cabinet director, Hiventures Ltd.

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Social impact investment

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The spread and consolidation of the socially and environmentally impactful investment approach can contribute greatly to achieving a sustainable and liveable world that can be passed on to future generations.
The results of social impact investment (SII) are more diverse than those of classic venture capital investment. The aim of SII funds is that companies funded by them generate measurable social and environmental impact alongside financial returns. SII is more than ethical investment, as ethical investors fund enterprises on condition that they do not cause harm to society or the environment while running their profitable operation.
The added value of SII is specifically that the positive impact on a certain target group is amplified by capital investment in a company that helps stimulate societal and environmental change.
Social impact companies are those established with the twin goals of making profit and having a societal impact. One important factor is that the social impact must be an indispensable element supporting the financial success of the enterprise.
Over the last few decades, numerous international organisations, and institutions (EIF, EVPA, GINN) have specified what constitutes a social undertaking and what defines a social impact investor. Their viewpoints have converged in the sense that achieving measurable primary social impact (direct and indirect effect) is considered a requirement. The exact concept of SII is still unclear to most economic entities, though.
Some of the first questions raised are as follows: who defines and measures the level of impact an investor expects, and which is more important, profitability or the social and environmental impact? Many questions the hierarchy of financial success and the social and environmental impact. From the perspective of impact investors, it is best if both conditions are fulfilled.

Impact Investment
Interview with Elemér Eszter

After graduating as a historian, Elemér Eszter studied political science and economics in the United States. He was co-founder of the biotech startup Cryo Innovation back in 2004 and he has been an active participant of the Hungarian investor scene ever since. The Social Impact Investors' Association (THBE) was established with 9 other founding members in 2015, which has developed into one of the major social organisations of the social impact investment ecosystem in Hungary. Elemér is the Chairman of the Board of Directors at Impact Ventures Ltd., which was set up in December 2018. Among several other occupations, Elemér is currently the Chairman of the Association.

Elemér Eszter

As a professional, you are the initiator and promoter of the impact investment approach in Hungary. Therefore, I believe that you have a critical opinion of the development of this economic sector.

As I was preparing for the interview, I visited the websites of some of the organisations linked to you. I came across the following quote on the website of the Social Impact Investors' Association:

"The Association was founded to promote the social impact investment approach in Hungary and the region, so every investment shall be made with the intention to generate measurable societal impact alongside financial return."

How can social and environmental impact be planned and measured?

The first question by smart inquirers is always as follows: "Okay, nice, but how is it measurable?". Impact investing and its measurement methodology have been examined extensively by researchers and scientists in order to find out how social impact can be measured. Despite great efforts, no clear-cut or universally approved methodology has been put forward yet. Needless to say, investment managers aiming for impact investing are anxious to find ways to measure and show the societal or environmental impact alongside financial return as defined in the vast majority of related technical literature. VC investors that do not use the impact investment approach, on the other hand, can achieve their goals simply by earning a 1.5 or 2-fold return on their investments.

Let me share a nice anecdote on this with you. The European Venture Philanthropy Association organised an event roughly three years ago that had a dedicated section called "How to measure impact". We were looking forward to it very much, as we expected we would finally be presented with a unified, or at least universally approved measurement methodology. Our expectations were not met, though, as the panel discussion featured about eight presenters who came up with as many attainable approaches, none of which could be put into practice.

It must be understood that the activities of impact investors are not limited to a strictly defined category. Impact investing may instead be likened to a path along which impact investors' undertakings range from donation and charitable activities to investing in enterprises that generate societal and environmental impact alongside financial return. Our team, Impact Ventures, is located in the middle of this path. Our investment policy states that the two purposes, generating societal and environmental impact and financial returns, are equally important. The English term to describe this is shorter and more expressive – they are an "inbaked part of each other".

I would like to mention one more aspect. Our team has been consciously striving to make impact investments since 2015. We have set up a dedicated management fund and a specific association (THBE) to assist impact investors and management funds. We started off by visiting two of the major social investment management funds in Germany as we wanted to learn from them how to do things right. We gained a lot of knowledge from Munich-based BonVenture, and from Ananda Impact Ventures, which has headquarters in Munich and London. Among other things, they let us know how they measured societal impact. Independently of each other, they both claimed that there was no standardised methodology, as impact can only be measured deal by deal and KPI by KPI, i.e. each company requires a specific KPI system.

As for two of the best-known investment projects of Ananda, the software development company Auticon and the Hungarian Lego trading company WLWYB, which employs people with autism, the KPI system is very straightforward – it measures how many people with autism can be employed, as they are members of a social group that the labour market does not provide enough jobs for. Regarding another iconic investment, Open Bionics (which developed a 3D printer capable of manufacturing bionic limbs at affordable prices), the impact can be measured simply – how many disabled people can gain access to bionic limbs that they could not otherwise afford. Moreover, another measurable result could also be the number of people who can produce bionic limbs for themselves due to the accessible technology, as otherwise they would not be able to afford to buy them.

It must be noted that there are often heated debates during the negotiations about investment decisions with regard to whether there is a proper impact in the first place, whether it can be duly measured, and whether the positive effects truly outweigh the negative ones.

Am I right that one of the most important goals is to set up a coherent system that can measure impact?

It would be great, but it is difficult to achieve. Stemming from the changeable nature of the lifecycle and development of the enterprises that generate the impact to be measured, it would be a truly arduous task to set up a contrasting system of measurement capable of comparing impact at SMEs in totally different sectors. Furthermore, it would be an absolutely unrealistic goal to create a measurement method that could be used as a standardised system internationally, similarly to balance sheets or reports that are interpreted in the same way all over the world.

ESG, with regard to large corporations, achieves this goal properly, but it cannot be adopted for measuring the impact of investments in early-stage enterprises within the VC size range for the aforementioned reasons. Societal impact can only be measured deal by deal according to individual, specific aspects.

Consequently, it is essential that each management fund creates its internal methodology for measuring impact, which is then consistently used to select their portfolio companies and during the tracking and monitoring of the investment project.

There is one more important topic that we have touched upon. The overall impact of each investment must be examined from several viewpoints in order to avoid a "negative impact", i.e. when a positive impact in a certain field interferes with another one, thus generating a negative effect.

An interesting example of this is when German investors were planning to build care homes in Hungary for German patients. The positive impact was obvious – job creation and higher salaries for Hungarian carers and nurses. Nonetheless, the negative impact of this project would have been that healthcare workers in the Hungarian healthcare system would have been enticed to quit their jobs, which would have adversely impacted the standard of the Hungarian healthcare system.

Do you think that the attitude of impact investors is generally different from that of venture capitalists who do not specifically consider such factors?

The operation of an impact venture capital fund manager with regard to its methodology and working mechanism is identical to that of a classic VC fund manager. An additional factor is that when selecting the portfolio companies or during portfolio management, environmental and societal aspects are not external decisive elements independent of financial returns. Conversely, they are considered as crucial as the financial return on investment, i.e. the financial return and the societal and environmental impact generated by the portfolio company are equally appreciated. The properly applied venture capital methodology makes the portfolio company internalise self-sufficiency, survival techniques, and stability. Likewise, the social issue solved, or the societal impact generated should have long-term beneficial implications.

Should we be afraid of impact investing possibly becoming too trendy among investors, or should we embrace the increase in the number of impact investment projects?

The fact that the methodology of "giving back to society" has been institutionalised is clearly beneficial, as this system is smart, transparent and onerous, therefore it constitutes a much more complex ecosystem than classic donation. Supporting an economy that invigorates life also entails long-term planning and the more people who work in it, the better it will be. The terms "greenwashing" and "impactwashing" are already well-established, though, to describe projects that are neither green nor impactful in reality, but only pretend to be such. I regard them as a necessary evil, which is unavoidable in the expansion of the market segment. All things considered, the impact investment approach is likely to become mainstream, although it currently accounts for a tiny proportion (about 2%) of transactions in the VC sector. Each trend that has the effect of increasing the market share is beneficial. ESG funds have been spreading at a faster pace than dedicated impact funds, especially due to the reasons we mentioned at the beginning of our discussion. Measuring the activities of ESG funds and showing results is easier, which is not a problem as the impact investment funds will definitely benefit from the emergence of ESG funds.

What is the current situation in Hungary?

There is plenty of room for improvement on an institutional level. There are only two dedicated impact investment fund managers in Hungary – SUSTERRA Capital Partners Fund Management Ltd. and Impact Ventures Fund Management Ltd. It must be noted that Impact Ventures was the first impact investment fund manager established in Central and Eastern Europe, even ahead of neighbouring Austria. The EIF (European Investment Fund) is one of the investors in Impact Ventures, which is the largest institutional investor operating as a fund of funds in Europe. THBE is still the only association in the region established with the stated goal of representing impact investors. The good news is that there are a lot of high-net-worth individuals and business angels in Hungary who have strived to achieve the aforementioned goals, provided support, and managed NGOs for many decades. By taking them into consideration as well, we are approaching, or surpassing in my estimation, the 2% market share earlier mentioned on an international level.

The interview was conducted by Eszter Hubbes
partner, Hubbes & Kovács Attorneys at Law, Board member of HVCA

ESG – Profit and sustainability hand in hand

Interview with Attila Chikán Jr.

Attila Chikán Jr. has been the CEO of ALTEO since its establishment in 2008. Under his leadership, ALTEO has become one of the leading energy service providers in Hungary.

He received his degrees from the University of Economics of Budapest and the College of Foreign Trade. Active in addressing sustainability issues, the CEO is the President of the Business Council for Sustainable Development in Hungary (BCSDH).

Since 2019, Attila Chikán Jr. has been a Member of the Supervisory Board of UNICEF Hungary, which is one of the largest and oldest organisations promoting the welfare of children. As a professional, public figure and active influencer on sustainability issues, he has a topical blog called Chikansplanet.

Thank you very much for agreeing to an interview. Sustainability is at the heart of your personal convictions and is one of the cornerstones of the corporation you manage; therefore we can discuss what it means to you and your company, and how an investment can be financially successful and socially impactful at the same time.

What are the primary decisive factors when considering whether an investment fits your portfolio?

To my mind, being committed to sustainability as an investor means that sustainability aspects are taken into consideration beyond the goal of net financial return. Sustainability is a complex concept, so we look at its various aspects and how they can be measured.

Attila Chikán

Needless to say, there are countless ways to measure it. There is an environmental aspect that we can also call ecological footprint reduction, and obviously, there is a substantial societal aspect that considers people's quality of life. The latter aspect incorporates fair employment and wages, equality between genders and social groups of people, part-time employment, having children, and the promotion of healthy lifestyles, etc. An investor is considered committed to sustainability if one or more of the aforementioned aspects are positively impacted by the investment alongside financial return. The figures on financial return are not to be ignored, though, and therefore an investment must have a positive financial result.

It is crucial that an investment be sustainable as well as successful from an environmental, societal and economic perspective. These perspectives are interrelated; therefore, they cannot be separated and are not meant to be considered in isolation. In our interpretation of sustainability with regard to investments, there may be some that prioritise societal aims, and the fundamentally environmental investments may also have a socially beneficial impact. Nonetheless, financial return is essential in all cases, as an investment that does not fulfil the return requirements of investors in relation to the degree of its risk is neither marketable nor sustainable, regardless of its positive environmental or societal impact. Expectations may vary among the different types of investors. However, as a listed company, ALTEO cannot ignore the aforementioned aspects of risk-return ratio and financial sustainability.

Firms have realised that the steps taken to achieve sustainability should be measured, and the performance of companies has to be screened and assessed accordingly. Being an investor and a listed corporation trying to attract other investors, ALTEO is involved in both ends of the qualification spectrum. Consequently, we must operate successfully from both perspectives. We consider ESG[1] criteria when making investment decisions, and we would also like ALTEO to be considered worthy of investment based on ESG aspects by investors as well.

The prioritisation of environmental impact is determined by our main activity, but the societal impact of our investments and operation is also taken into consideration. This can be achieved by considering all factors, such as being an employer that is committed to fair employment and ensuring that the activities of corporate social responsibility are aimed at supporting causes that make a large social impact. This approach applies to me as an individual and to ALTEO as well, which is why I have taken on the task of being a Member of the Supervisory Board of Unicef Hungary.

ALTEO is managed completely in line with the ESG governance criteria. There is not merely a marginal, meaningless department dedicated to this task, but instead the whole corporation operates with this strategic approach. The leadership of the company is committed to the ESG governance criteria, there are specific colleagues responsible for supervision, integrated reports[2] are published, and we have a sustainability envoy whose task is to monitor the activities of the corporation with respect to the fulfilment of the ESG criteria alongside our main goals. ESG is a relatively new concept in the field of company assessment. Our goal this year is to obtain an ESG certification from a specialised certification organisation.

So a company cannot qualify as an ESG-compatible enterprise only by making renewable energies the core activity of its operations?

Renewable energy production is one of the most important business sectors of ALTEO, but it is only one of the elements of fulfilling the sustainability goals. Renewable energies are currently not viable on their own, therefore the other business segments need to be strengthened too.

[1] https://alteo.hu/sustainability/with-energy-in-mind/esg/?lang=en
[2] https://alteo.hu/sustainability/sustainability-reports/?lang=en

The whole industry of renewable energies must be promoted; our newly introduced services all serve this purpose. The Control Centre, which was established in 2013, tackles the unreliability of renewable energy provision resulting mainly from energy production and provides essential services to the electrical grid. ALTEO conducts R&D activities on a regular basis, and it has begun the scheduling of its solar power plants. Consequently, we have contributed considerably to the integration of weather-dependent renewable energy production into the electrical grid through the equalising and scheduling services of the Control Centre, which can also facilitate the marketability and prevalence of renewable energy production within the energy sector in Hungary.

Besides the environmental impact, the other two sustainability aspects are related to the energy industry too, as ensuring the security of supply is a crucial societal aspect and the financial impact can be interpreted as cost efficiency. We enable these by the provision of our services; therefore, our operational model is not only about investing in renewable energies, but about the whole service system. Our aim is to set up long-term partnerships with large Hungarian corporations and municipalities, as on contractual terms of 10-15 years both the return objectives and the long-term sustainability goals can be ensured.

Let's discuss the topic of ESG certification a bit more, as its importance has been growing in Hungary as well. What are your forecasts regarding this field?

The same applies to ESG as to other aspects of sustainability. ESG may constitute a competitive advantage for those who care about it and a disadvantage for those who disregard it. ESG may be perceived as a threat as well as a motivational force.

Research in the USA, which is unfortunately not available in Hungary, has found that the firms that prioritise ESG aspects perform significantly better in the capital market – they earn higher returns as the market puts a price tag on their growth potential as well. Investors can receive higher returns on investment in companies that perform well according to the ESG criteria too.

That is why we have prioritised ESG in our corporate culture and acted as pioneers in compiling an integrated report which increases the value of the company. It is absolutely worth investing energy in operating a company with such policies.

I would like to make an additional remark regarding "threats". It is expected that by 2025-2030, depending on the specific investment strategy, most investors will be investing exclusively in ESG-certified securities. From that time onwards, ESG certification will no longer constitute an advantage, but will be a requirement.

Finally, what are your views on the current regulatory environment in Hungary? Are additional supporting measures needed or is the framework satisfactory?

I believe that if the processes that have been launched in recent years can stay on the right track, then the situation is fine. There is no need to invent new things, but the ongoing processes must be implemented appropriately, i.e. drafting domestic ESG certification appropriately. The Green Bond framework is a good vehicle and international practices must be monitored and implemented if possible. The Central Bank of Hungary and the Budapest Stock Exchange (BSE) have done a tremendous job of managing these processes. The circular economy has attracted increasing attention, also in connection with the new waste management law. In conclusion, we are on the right path, and we must focus on executing our tasks with the best possible results.

The interview was conducted by Eszter Hubbes
partner, Hubbes & Kovács Attorneys at Law, Board member of HVCA

Balázs Bozsik

The results and challenges of the ESG integration of the Budapest Stock Exchange (BSE)

The consideration of sustainable finance and ESG criteria in the process of making investment decisions and improving corporate operations is not a new trend. Capital market professionals were ready for the turnaround in 2007, but the global financial crisis in 2008 postponed the change. It took over 10 years for ESG to become the most popular investment buzzword, but the transition was threatened by an unprecedented stock market price drop. Luckily, the COVID-19 pandemic did not prevent the transition, but accelerated it.

The ESG aspirations of the BSE are largely determined by the commitments it made in the Sustainable Stock Exchanges initiative (SSE). In line with the pledges made in the SSE, stock exchanges provide their listed companies with guidance on ESG reporting. Topical meetings on ESG issues are held, training is provided and ESG indexes are launched by stock exchanges, and they also display the existing ESG index ratings of their member companies. Furthermore, stock exchanges conduct ESG product and market development activities on which they report annually to the SSE partnership community. The BSE also takes part in the EU regulatory process regarding ESG issues, and as a member of the Federation of European Stock Exchanges (FESE), it participates actively in the Sustainable Finance working party. The EU Taxonomy Regulation, the Non-Financial Reporting Directive (NFRD) and the sustainability-related Disclosures Regulation are related to the activities of the aforementioned working party. The implementation of the EU Green Deal programme is supported by these elements, and they ultimately increase the competitiveness of EU capital markets.

The most important result of the ESG-related tasks of the BSE was the publication of its ESG Reporting Guide for issuers on the Budapest Stock Exchange in the spring of 2021. The compilation of the Guide was preceded by a public consultation in 2020, which means that it was published as a result of extensive professional work and collaboration. The purpose of the Guide is to help those BSE-listed companies that are partly compliant with ESG transparency to get started with their ESG reporting routine. The Guide is publicly available in Hungarian and English. There are several professional events in 2021 that will facilitate a better understanding of the recommendations made in the Guide and provide assistance in launching ESG projects. The objective of the Guide is to present the advantages of using ESG, as the issuing of sustainability reports is not an additional burdensome task, but rather an opportunity that can be seized. The recommendations and the best practices included in the Guide may benefit all Hungarian enterprises, not only listed ones, as the BSE has been committed to dispensing advice on responsible company management for a long time.

The growing interest in ESG and the specification of regulations will help clarify the currently unclear situation, and the quality of ESG data and comparability of ESG evaluations will improve quickly. ESG-related non-financial reporting will be integrated into the International Financial Reporting Standards (IFRS) in the medium term, and the ESG certification system for investment products will be standardised.

Besides its institutional role, the BSE is a medium-sized enterprise that is currently planning to go public. It will underpin its own operational and investor needs with a sustainability report and ESG reporting. The most important tasks in the initial phase of the ESG transition are sensitisation, education and appropriate strategy-framing. The first two items have already been completed by the BSE, as ESG events are regularly held and 4 related courses and a degree programme are available at the Budapest Institute of Banking (BiB), which is the educational subsidiary of the BSE. The Budapest Stock Exchange takes part in the strategy-framing process via the Central Bank of Hungary, as a member of the entities forming the Sustainable Capital Market Strategy that was launched by MNB and EBRD in collaboration. The strategy-framing process is scheduled to conclude in 2021 and will be presented at an international conference.

The author of the article: Balázs Bozsik advisor, Budapest Stock Exchange

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Jenő Nieder, Zoltán Farkas

Corporate Venture Capital – Global and CEE trends

Corporate venture capital funds: from the 1960s to our time

Corporate venture capital and private equity funds have been around for a long time. Large corporations in the US, such as GM, DuPont, and 3M, acquired stakes in emerging, innovative enterprises through venture capital funds in the 1960s.[1] Initially, corporate venture capital investments were propelled by the high cash position and strategic diversification of corporations, and the potential of the nascent IT industry.

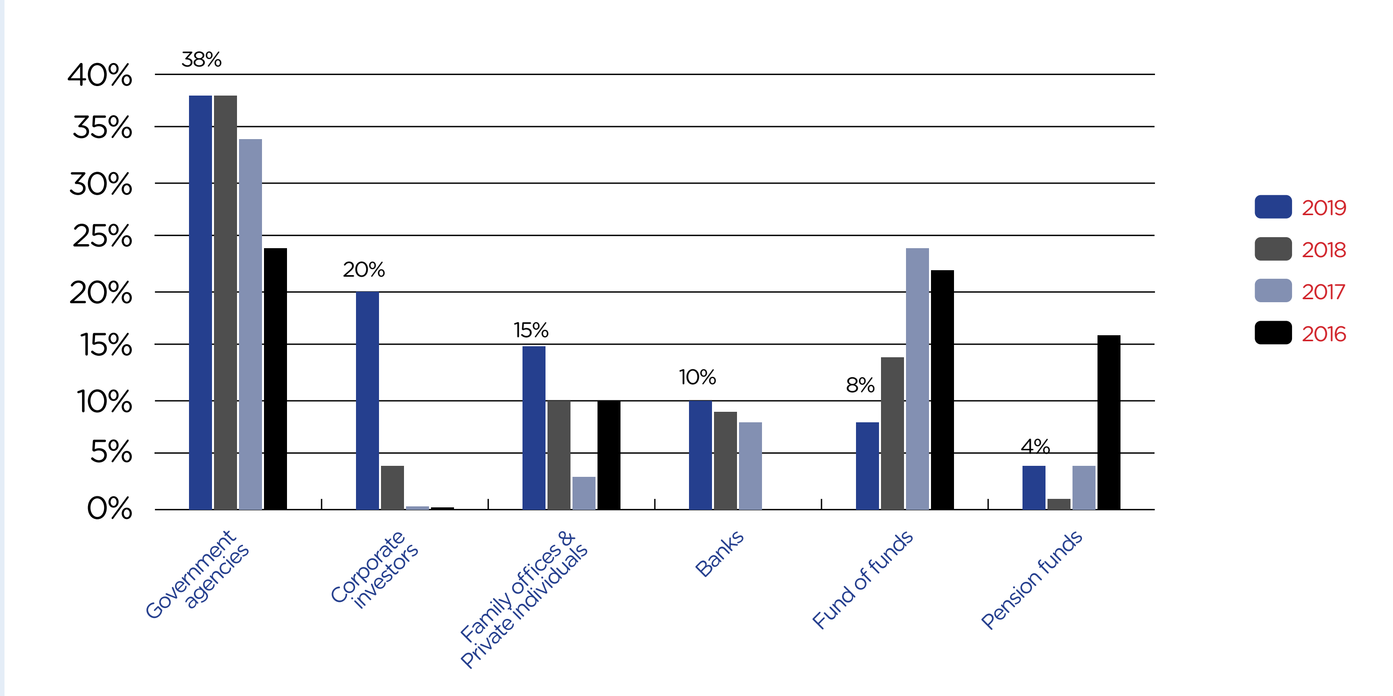
There was a growing tendency of corporate venture capital 50 years later in the 2010s as well. The increase of CVC investments was over 400% between 2013 and 2018.[2]

Corporate venture capital in the CEE region and Hungary

Venture capital and private equity fund managers in the CEE region raised a total of EUR 1.4bn from investors in 2019 - less than 1.3% of the total European volume (EUR 109bn). Funding from CEE-based investors was the primary source of funds in 2019, accounting for 73% of the total capital raised.[3] Government agencies were the largest source of capital in the CEE region (38%), followed by corporate investors, accounting for 20% of the total funds.

[1] Source: CB Insights https://www.cbinsights.com/research/report/corporate-venture-capital-history/
[2] Source: TechCrunch https://techcrunch.com/2020/05/26/how-to-approach-and-work-with-the-3-types-of-corporate-vcs/
[3] Source: Invest Europe https://investeurope.eu/media/3225/central_and_eastern_europe_activity_report_2019.pdf

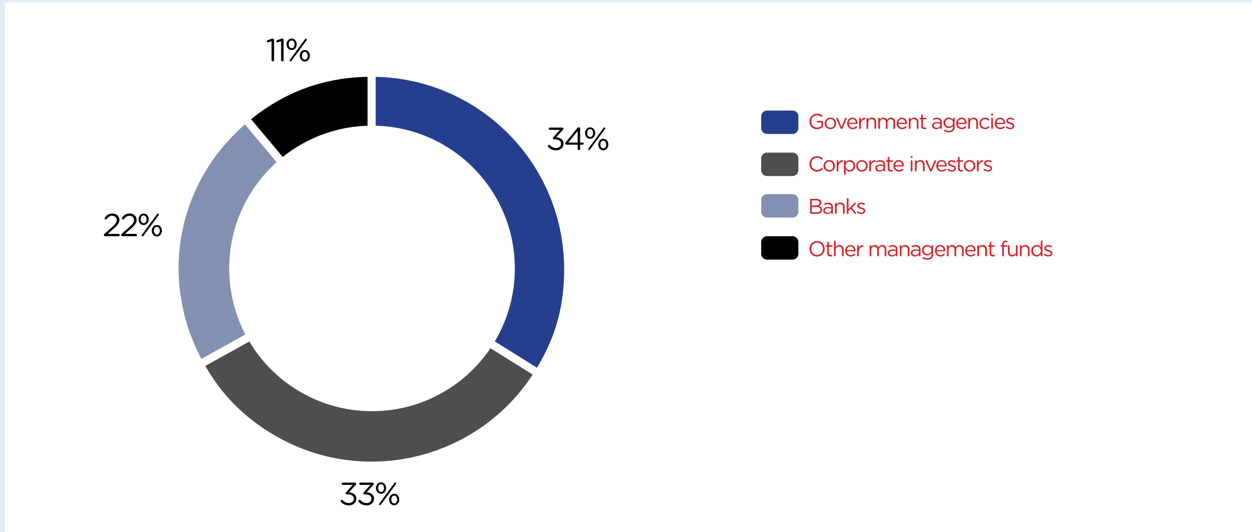
Main sources of capital raised by venture capital and private equity funds in teh CEE region



Source: *Invest Europe*

The 20% share of corporate capital in 2019 represents a significant increase compared to the 4% in 2018 and less than 1% in 2016-17. The share of corporate investors in venture capital and private equity funds in Hungary showed an even larger increase, i.e. it reached 33% in 2019, surpassing the regional average.[4]

The distribution of the source of capital in Hungary according to the types of investors in 2019



Source: *HVCA*

[4] Source: HVCA Investment Monitoring Report 2019

The driving forces and goals of corporate venture capital funds

The investment strategies of corporate venture capital funds typically differ from that of government funds of state sources and institutional investors operating fund management as their main activitiy at the parent level. In case of corporate venture capital, a corporation acquires stake indirectly in a small, innovative target company. The growing market share of corporate venture capital funds can be attributed to the fact that large corporations have realized a greater need for innovation in the fast-paced technological ecosystem in order to stay competitive. Acquring stakes in innovative startups operating in flexible corporate cultures helps achieve this aim. Corporate venture capital funds are not only established in the fields of IT and biotechnology. Among others, Coca-Cola, E.On, and Wal Mart have invested in startups. There are two additional driving forces of their investments; (1) the costs of unsuccessful innovations do not appear in the corporations' balance sheets due to the investment structure, therefore the management may not suffer any reputational damage; (2) as a result of co-funding, rather than internal financing, a smaller amount of company funds is necessary.

Corporate investors vary on a large scale with regard to their size, growth profile, and market, whereas corporate venture capital funds operate under two sets of objectives – strategic and financial.

1) Strategically-driven CVC investments are made to access new clintele, markets, technology and business models, which can increase the revenue of the corporation. Strategic CVC investments may also be made to cut costs; the corporation can internalize development capacity, service or technology through its investment. Strategically-driven corporate venture capital funds seek to ensure the utilization of synergies between themselves and the new ventures. It often happens that a corporation is not only the investor of a target company, but also its purchaser. The acquisition of the target company by the corporation providing the funding is a typical exit strategy for the founders of startups.

Globally significant strategically-driven corporate venture capital funds include GV (formerly Google Ventures), Intel Capital, Salesforce Ventures and Baidu Ventures. As for the CEE region, Fidiasz EVC (an investment fund affiliated with construction chemicals manufacturer Selena Group) and Hubraum (early stage investment company and incubator affiliated with Deutsche Telekom) are the best examples, of which the latter has an office in Poland as well.

2) Financially-driven CVC investments are made to maximize the return of the corporation by either selling its stake in the target company or through the initial public offering of the enterprise. Financially-driven corporate venture capital companies have higher autonomy than their strategically-driven counterparts as they may make decisions on their own regarding which target company to invest in. Financially-driven CVC management companies may successfully make use of the financial stability, market awareness, networking, and brand image of the parent company when providing help with pitching to their target companies.

The predominance of financial targets over strategic targets

CVC management funds are seen to be set up for strategic purposes, but over the years the fund manager becomes increasingly independent of the investor's core business and makes investment decisions on a standalone basis, based on expected financial returns.[5] Dell Ventures and PortfoLion may serve as the best examples for presenting this transition internationally, as well as locally in Hungary. Dell Ventures was set up with the goal of increasing the revenue of the parent company, however, they have made a gradual transition to making their investment decisions in digital enterprises based on the expected amount of return they can earn. PortfoLion, the venture capital and private equity branch of OTP, was established in 2010 in order to faciliate the appearance of OTP in a new asset class and to utilize probable potentials of strategic cooperation between investment projects and the bank. PortfoLion makes its investment decisions as an independent entity, and its employees are incentivized through gauging the financial performance of the management fund.

According to the research of the Harvard Business Review,[6] half the CVC management funds considered the financial measures of cash-on-cash return and internal rates of return as the primary factors. More than 40% of the management funds include financial returns in key employee performance and compensation reviews. The measurement of synergies between the target company and the corporation is a complex challenge, whereas financial metrics provide a straightforward framework for assessment. The financial indicator-based incentive systems, set up by corporate investors, have induced a change in the investment approach of management funds, i.e. shifting from their original strategically-driven nature to one that is mainly influenced by financial drives.

The decreasing importance of strategic goals may be illustrated by the findings of the Harvard Business Review revealing that 25% of CVC management funds do not take any board seats on portfolio companies, and 70% of them said that corporations had no interest in acquiring the start-ups they funded. Some startups may be concerned about losing their independence due to the dominant corporate image of large firms. The researchers also found that the majority of CVC management funds partner with each other when making investments. Through this practice, called deal syndication, investors reduce risk, however, they have less control and a weaker strategic position.[7]

Being unable to position themselves as either strategically or financially-driven investors due to the dual establishment of their strategic goals and financial KPI-sytem, corporate venture capital investors face a risk. Consequently, CEOs of strategically-driven CVC management funds have a key role in reducing this risk, i.e. by emphasizing the strategic goals and the identity of the parent company, they may prevent the management funds from becoming entrapped within the limits of financial KPIs.

[5] Source: Harvard Business Review https://hbr.org/2016/11/corporate-vcs-are-moving-the-goalposts
[6] Source: Harvard Business Review https://hbr.org/2016/11/corporate-vcs-are-moving-the-goalposts
[7] MIT Sloan Management Review - „Making Corporate Venture Capital Work" - Patrick Flesner, Michael Wade, and Nikolaus Obwegeser June 18, 2019 - https://sloanreview.mit.edu/article/making-corporate-venture-capital-work/

The authors of the article:

Jenő Nieder deputy CEO of PortfoLion (member of OTP Group), Board member of HVCA

Zoltán Farkas senior investment analyst, PortfoLion

Corporate venture capital in Hungary

Interview

with **Miklós Németh** Executive Director of the Specialised Lending Directorate of OTP

and **Ádám Balog** President of the Executive Board of MKB Pannónia Management Fund, former CEO of MKB Bank

OTP and MKB were two of the first Hungarian banks to invest in venture capital and private equity funds in the domestic market. What motivated you to enter the market by investing in a fund and launching an accelerator programme?

MN Banks are fundamentally aware of the risks related to lending, venture capital is not in their main focus. A certain programme or framework with good conditions was necessary for them to switch to another kind of risk analysis, i.e. the JEREMIE programme of the EU. Obviously, it was also important to create the resourcse side, so that banks could allocate their own resources beside it as investors to explore these previously unknown types of risk. The undertaking did not only involve fundraising though – an independent organization requiring new competences was established. Recruiting experts with a completely new approach was inevitable as high risks also entailed high expected return. The first signs of the synergies and benefits of the system were palpable in the Digital Venture Capital Fund.

ÁB In accordance with Miklós, I would like to add that venture capital has become very popular in the last 10-15 years. You may join such projects that are unavailable in the course of the conventional operation of banks, however, these projects are not so significant from the funding point of view as the total amount of investment is low compared to the general transactions of any bank. What was more of a priority in the initial phase was to be able to participate as an equal partner in the negotiations later on, when the larger fund managers and more complex financial operations come in, with the right knowledge from the banking side. It may also be noted that the capital of banks do not automatically become venture capital with regard to EU sources, i.e. it is rather an opportunity for banks to provide capital on better conditions than that of earlier financial vehicles.

It is apparent that both OTP and MKB thrive to achieve as diversified market presence as possible. To what extent can venture capital and private equity financing help diversification?

MN In the initial phase, it was clear that banks were testing the venture capital and private equity market by investing small amounts of capital. Our funds have grown considerably since that time, we are well past the testing period. A great deal of expertise is required for our daily operation now, and venture capital and private equity transactions have gradually become prioritized within the bank.

ÁB We felt a certain need for entering this market as one of the leading banks in Hungary, even as an activity of ”corporate social responsibility”. We have surely expanded since entering the market.

Have there been any expected results regarding these programmes such as affiliating with portfolio companies that may need lending solutions later on, which could complement the core business of the bank? Have there been precedents for this?

ÁB In the beginning, there were some related ideas, but the time has not come for this stage yet.

MN In our case it is the other way round. Initially, there was less expectation of a close connection. Then, it was a certain organic development that brought about professional connections with the Digital Fund, or relations with the Green Fund and Regional Private Equity Fund due to the scope of funding operations. The former is a venture capital investment project in which we are minority stakeholders, with international target markets and high risk, therefore high return expectation as well. The latter is a conventional, leveraged private equity operation supported by the bank, which made our synergies merge very strongly.

More and more sectors are going digital, will this have an impact on traditional asset-based lending? Is the banking sector expected to shift its focus to the new types of financial structures?

ÁB Not quite. It is hard to imagine that banks would start funding IT project companies of low asset requirements directly. A parallel system of the two kinds of businesses is a lot more probable.

MN There has been somewhat of a transition to investments in intellectual property (mainly IT projects) through funds from the earlier practice of performing exclusively asset-backed financing. I do not believe that banks would develop to form the backbone of the system of this type of funding, especially with regard to the conventional, collateral-based banking activities.

Has it ever happened that you had to compete against an equity partner, i.e. there was a competitive situation between private equity and bank financing?

ÁB There have been a couple of particular cases when during the negotiation about the actual conditions of the transaction it turned out that the other competitor was a private equity investor. Nonetheless, it is not common at all.

MN It is so atypical that I cannot even give an example of it.

How has this type of funding changed within your banks since you entered the market?

MN This segment of OTP has been growing ever since it entered the market in 2010. I do not only mean the amount of capital under management or the investment range, but also how conscious we are about these transactions. Segmentation is crucial, that is, the different approaches we address the target companies through the Digital Fund or the Green Fund, the distinction between venture capital and private equity, or deals that require closer cooperation.

ÁB We are also becoming more and more conscious about the amount of capital we allocate in funds managed by us or external management companies and syndicates. I see a growth trajectory for the future with regard not only to the allocated capital, but also in terms of the assets and the energy allocated.

Have you identified such a trend that will surely change the funding needs of enterprises or the attitude of banks towards IT companies within the next 5 years?

MN Certainly, digitalization that is happening at an incredible pace. As it usually is with all trends, we expect some kind of transformation or change of direction. It is probable that the final result will be a certain "third path" that we have not even thought about.

ÁB I believe that there is going to be a trend reversal. I expect that risk taking is going to reduce in these sectors as the momentum of the IT market slows down and the market consolidates, which entail that those enterprises are going to be sustainable that may also be funded easily through conventional financial vehicles as well.
We will definitely learn a great deal from what we have gone through so far. For us, it was a period of experience, learning cannot be spared. I usually claim that we are still folks of Széchenyi, as we are experts on loans, but, we used to read about capital by Marx, which means that there is a lot to pick up in this field.

MN We have got similar experiences, especially with regard to the countless number of data mining and analyst companies. It is now hard to keep record of how many approaches there are to examine a problem, and when we start using the collected data indeed.

ÁB It often happens with corporate clients even in the state of crazy abundance of capital that the targets of projects would require even more financial resources. It would be great if capital market thinking was stronger in Hungary, and not only venture capital and intriguing IT projects would get all the attention, but also private equity transactions. Even 10-20 % of equity can significantly increase the authenticity of a project.

MN I completely agree with you. I see many cases where IT companies relying entirely on their uniqueness receive funding (either venture capital or loan) earlier than manufacturing companies. Owners are absolutely reluctant to let any funds take minority, let alone majority ownership in their companies, even though this is the barrier to their development in a large number of cases.

The interview was conducted by Jenő Nieder deputy CEO of PortfoLion (member of OTP Group), Board member of HVCA

Interview

with Ábel Galácz
founder and CEO of Lead Ventures (the largest investors of Lead Ventures are MOL, MFB, and Eximbank)

Zoltán Bánfi
CEO and member of the Board of Solus Capital (member of MKB Group)

and András Molnár
CEO of PortfoLion

How did you manage to convince your investors to join this market when you launched the management funds?

AM The EU funding programmes in 2010 were classically devised in order to channel private equity, which otherwise would not have taken this course, towards venture capital investments. The incentive scheme meant that every invested euro was accompanied by further two euros by the EU. I believe that OTP realized the potential of entering the market on good conditions with shared risks. The launch may have been facilitated by the fact that by that time OTP Fund Management and OTP Real Estate Management Fund had already been successfully operated in the previous 20 years.

ZB OTP had no choice but to enter the market due to its size and market share. As the market leader, OTP also had to take part in all the major economic recovery programmes[1]. As for Solus, it was a strategic decision by MKB and Takarék Group to join the field of venture capital some years ago. The arrival of Ádám Balog (Chairman and CEO of MKB Bank at that time) played a big role in this process, as his attitude and vision catalyzed the process. As later entrants, we could draw on the positive and negative experiences of the JEREMIE programme as well. We strived to create a framework for the whole lifecycle of a company by establishing Solus (formerly Primus) including incubation, as well as exit opportunities.

ÁG At the start of Lead Ventures I was still in charge of the management of MOL, therefore I would like to begin there. In simple terms, in the first 100 years of the oil industry there was no question of reinvesting the generated profit in the core business as it was thriving, therefore it was a clearly logical decision. The industry started showing some signs of change about 10 years ago, when such alternative investment opportunities were made available that MOL regarded as worth-considering. The strategy for 2030 incorporates a mindset that has two related paths: on the one hand, developments closely linked to the oil industry begun, such as a new manufacturing method of plastic (huge projects are underway), and on the other hand, we intended to seek closer ties with the innovative ecosystem. The latter induced the launch of Lead Ventures and entering the field of venture capital.

How did Lead Ventures start its operation?

ÁG It is very difficult to generate and sustain the venture capital and startup mindset within the corporate culture of a multinational firm that employs tens of thousands of people. Having seen best practices within the market and considering our possibilities, we thought that the most optimal path to success would be through becoming formally independent from the parent company and involving as many investors as possible in order to ensure professional independence and standalone decision-making. It has been proven over the last 2 years that the major investor of the funds, MOL, does not interfere with the activities of Lead Ventures or try to influence its strategy. Of course, industries such as mobility are among the focus areas, but not exclusively.

[1] Zoltán Bánfi was the Director of the Financial Consultancy branch at OTP Hungaro-Projekt Kft. at the time of the launch of the JEREMIE programme

What are the benefits of a corporate background?

ZB First of all, authorization. I would like to return to the role of Ádám Balog, who gave up on his position as Deputy Governor of the Hungarian Central Bank in order to work towards fulfilling his professional creed of increasing the significance of equity investments in Hungary, which can be largely beneficial to the country from macroeconomic aspects (in other parts of the globe the role of equity is much more significant, therefore there is room for improvement). There are a lot of synergies that we can merge with MKB, so we always keep an eye on their strategy. As for our professional freedom, unlike PortfoLion or Lead Ventures, we are somewhat more obliged to choose options within the limits of the numerous EU programmes that we participate in. We must spend more time in the market and increase the rate of private equity and state sources in order to change this situation.

ÁG We are particularly lucky regarding this. It would take 10-20 years for a management company to be authorized by its investors to enter international markets. We were able to skip this stage, we got the global mandate through which we could access the great deals from the very beginning of our operation. Countries in the CEE region have a lot of handicaps. There is a different kind of equity structure and it lacks the institutional background typical of the US that should be established here as well (state and EU initiatives are good, but not enough)- It's the entry of large profit-making companies that can create this base - and we are very much supported by the corporate background.

AM Capital and independence.
It is good to see that all three actors have in common that they are not subject to corporate expectations, politicization, that we have retained our professional independence, and that we have a secure hinterland. I believe that the framework has been laid precisely, and the target has been defined clearly – making money.

Is it advantageous or disadvantageous to have a corporate background? To what extent does the market identify VC with the large corporation?

ZB I consider the stable corporate background an advantage with regard to advancement, which can be of great use when building a sales pipeline. Related services provided by OTP and MKB, for instance lending solutions, may appeal to future partners considering cooperation.

ÁG There are pros and cons too, however, it is obviously an advantage that MOL has an extensive network of regional partners. It is a great benefit for us that they think about us as potential investors.

AM It is in the interest of PortfoLion and OTP as well that our independence is emphasized, which enables us to take an authentic stance when addressing the market. OTP also gives stability and a huge international network, being present in 11 countries in the region is a huge opportunity for many of our portfolio companies, but at the same time it does not mean that we as PortfoLion should put more focus on fintech companies for example. A disadvantage could be that due to a false identification of our activity with that of OTP by the market may restrict our room for manoeuvre.

How has the market changed in the last few years?

AM There are three main trends. Firstly, venture capital has been globalized at a very high pace in the last few years, with the emergence of many new „players" in the region, previously only active in developed markets, where there were typically 5-10 players. It is a great challenge to compete with them regarding structuring, as well as pricing. On the other hand, the private equity market is shrinking not only in Hungary, but also in the region due to the upsurge of venture capital. I feel that the method of seeking an equity partner has changed as well. It is actually a choice of partners, a choice of people, i.e. the other side has recognised that we are not talking about a balance sheet, we are talking about people business.

ÁG Budapest has finally been added to the map besides Warsaw and Tallinn, which has plenty of benefits. The appearance of giant Western firms, such as Partech, provides a lot of opportunities to Hungarian startups. I do not believe that the globally well-known venture capital companies have devised specific strategies for the CEE region. The current situation may rather be put down to their operation with an opportunistic mindset. This may change, however, see for example Estonia, where the process started in a similar way, and yet today venture capital has developed into a certain identity badge of the country. We are going to have to raise our game, and besides, the relating regulatory constraints must be loosened too.

ZB Besides the growing significance of private equity, the importance of the state is going to be higher with regard to the funding of venture capital funds, whereas the EU is going to provide very little capital in the upcoming 7-year-budget. I can confirm what Ábel has said, that is, the Hungarian VC industry must achieve the loosening of the constraints in order to succeed. Obviously, the official bodies and the owners must retain their powers of control, but they should not cause competitive disadvantages.

How would you describe your creed as an investor?

ÁG We start from a deeper in-house interest in the story and the team, enthusiasm, back-and-forth chemistry with the companies, which should stand the test of the first serious conversations (there have been companies that failed at this stage). Needless to say, our method also fails at times. At the beginning of the year we discussed which projects we really regretted not having implemented. Not each one of them would have turned out to be a huge success, so there are a couple of things I would do differently now.

ZB I believe that there is constant development, similarly to wine drinking; I used to love drinking fröccs (wine mixed with soda water) with rosé wine at festivals, today I would not be willing to drink rosé. I have always liked red wine, preferably the outstanding batches, and I have recently been tempted by white wine. We experience a similar evolution in the field of VC. For instance, we have gradually moved away from fintech as its market is saturated, the entry of emerging enterprises is becoming very challenging, and incumbent banks have been gaining an ever-growing share of the innovative enterprises. Therefore, we have started shifting our focus to private healthcare, which also proves that it is not only the inclination of the bank group that defines our orientation. Finally, I must say I completely agree with Ábel – the team is as important as the idea.

AM We distinguish between private equity and venture capital; we consider the former regionally and the latter globally. These two approaches and the market scaling define our mindset at PortfoLion.

The interview was conducted by: Jenő Nieder deputy CEO of PortfoLion (member of OTP Group), Board member of HVCA

A HARD NUT TO CRACK
- regulation of the venture capital industry and professional advocacy

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Dr Judit Budai, Dr Ákos Bajorfi

A HARD NUT TO CRACK - regulation of the venture capital industry and professional advocacy

1. Introduction

Venture capital is a very "hard nut to crack" for legislation that typically focuses on a single country as a territorial scope. Not only globally or regionally managed funds, but also local funds raise capital from foreign individuals or institutional investors and even foreign portfolio companies may be found among their investments.

For the venture capital industry, international "fund raising" (i.e. raising the capital of the fund by placing units in the fund) or cross-border "fund management" (i.e. investing the fund's capital) is essential.

The process of investing in portfolio companies is almost always lengthy, and these are usually individual, non-standardized decisions. The subjective factor is significant in making the investment decision, as in many cases the investment is made in outstanding individuals and innovative teams. Due to the length of the investment process and to allocate the risk of loss / reward, funds can invest in a relatively small number of portfolio companies, usually six to ten.

Investment management also requires constant personal contact between the other owners and managers of the fund and the portfolio companies in order to prepare for the exit (sale of the entire portfolio company or buy-out of the fund's shares) and to prepare for the termination of the fund, which is typically set up for an investment cycle of 6-8 years.

An investment is essentially a planned short-term "marriage" between a venture capital or private equity fund investor and a portfolio company, motivated by mutual success. The parties know in advance that the joint asset must be shared and that it is in the interest of each party to cooperate in working towards growth, which is defined in terms of the investor as an annual return expectation of around 20-25% of the original investment amount. The investment expectation must also bear in mind the reality that of the six to ten investments made, some will be loss-making, others will break even, but some may (hopefully) have exceptionally high returns. The average of these will give the return of the venture capital fund investors.

Since 2012, the HVCA Legal Committee has updated its Capital Raising Guide several times in a targeted effort to distribute this basic knowledge to a wide range of investors and portfolio companies, as well as to the government sector.[1]

[1] Capital Raising Guide 2020 (3rd updated version; https://www.hvca.hu/publikaciok/hvca-tkebevonasi-kalauz/); Capital Raising Guide 2018 Updated version 2 (https://www.hvca.hu/documents/TBKalauz_2018_IMPRIMATURA_Final_21_January.pdf); Capital Raising Guide 2016 (1st updated version; https://www.hvca.hu/documents/tbkalauz_2016_net.pdf); Capital Raising Guide 2012 (https://www.hvca.hu/documents/Toke-bevonasi-kalauz-2012.pdf) (last accessed: 7 June 2021)

2. The beginnings of local VC/PE legal regulations

The first attempts to regulate the venture capital industry in the Hungarian market only appeared in the 10th year of the market economy. It is not as if venture capital was completely unknown in corporate finance in Hungary before. However, in the first years following the change of regime, almost only international or regional fund managers were present as managers of international or domestic institutional or state-funded funds. These were for example the Hungarian American Enterprise Fund led by Charles A. Huebner, the First Hungary Fund led by Péter Róna, MFB Rt., as a state venture capital organization, and Euroventures, led by András Geszti, the founding father of HVCA, as a regional private equity fund manager.

The first regulatory attempt was Act XXXIV of 1998 on Venture Capital Investments, Venture Capital Companies, and Venture Capital Funds which states that "*The legal framework of the system of financial institutions operating in market economies has been established in Hungary, but the regulation of venture capital is still lacking. The shortcoming of the Hungarian capital market, which has serious economic consequences, is that it lacks the entities that could bring capital into promising start-ups and high-growth operating companies that carry higher investor risk than is generally accepted.*"

However, this regulation died in ashes, essentially without the authorisation of a single fund, fund manager or venture capital company, because the HUF 500 million capital requirement for the establishment of the venture capital company envisioned by the legislator was a high barrier to entry that the fund management industry was unable and unwilling to accept. The initiative was also hindered by the fact that the above-mentioned entity could only be established as a joint-stock company, despite the fact that, in the international practice at the time, "limited partnership" *(„betéti társaság")* formations that included both the fund and the fund manager, were common. The law introduced venture capital funds, along with venture capital fund management companies, as another possible form of operation (which was retained in subsequent legislation and has prevailed on the domestic capital market). However, even in this form, the legislator required that the nominal value of capital shares be paid in full at the time of registration, which was a significant disadvantage for potential investors. Legislators also wanted to help the new forms with a tax break – the corporate tax rate for both venture capital companies and venture capital funds was zero percent – but venture capital fund managers no longer received this benefit.[2] The limited pool of potential institutional investors did not help either.

As of January 1, 2006, Act CXX of 2001 on the Capital Market introduced the regulation of venture capital funds and fund managers; however, the increase in the popularity of the industry and the number of market participants was not due to this, but to the so-called "JEREMIE" programmes. From 2007 onwards, the EU's General Block Exemption Regulations allowed state aid for risk capital financing through the JEREMIE programmes in the 2007-2014[3] and 2014-2020[4] state aid programming periods.[5] EU state aid background rules have shed a large number of bureaucratic rules on the venture capital industry and have given a boost to industrial development by creating opportunities for state participation, as Judit Karsai's[6] research shows.

However, the capital markets and tax law background of private equity investment has continued to lag behind the EU, US, and other countries with more attractive regulations which provide fund managers with independent fundraising and investors with internationally recognized tax incentives for long-term and risky investment.

[2] Act LXXXI of 1996 on Corporate Tax and Dividend Tax. Section 20 (1) (e) of the Act (Effective as of: 16 June 1998).
[3] https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:214:0003:0047:HU:PDF (last accessed: 7 June 2021)
[4] https://eur-lex.europa.eu/legal-content/HU/TXT/HTML/?uri=CELEX:32014R0651&from=HU (last accessed: 7 June 2021)
[5] https://ec.europa.eu/regional_policy/archive/thefunds/instruments/jeremie_hu.cfm (last accessed: 7 June 2021)
[6] Judit Karsai: STATE PARTICIPATION IN THE HUNGARIAN VENTURE CAPITAL MARKET. Workshop discussion of the Subcommittee on Industry and Business Economics of the Economics Committee of the Hungarian Academy of Sciences on 31 May 2016. MTA KRTK KTI. https://slideplayer.hu/slide/11263274/ (last accessed: 7 June 2017)

3. The HVCA Legal Committee and the industry proposal package

The HVCA's Legal Committee, established in 2010, wished to help by changing this. Professional conciliation and advocacy work began on 4 July 2011, with the HVCA President at the time, Miklós Bethlen (Mid Europa), Allen & Overy, BDO, Ernst & Young, Mazars, Raiffeisen, the law firms Szecskay and White & Case LLP combining forces as a legal committee working on preparing a position paper. The first set of industry proposals was published by the HVCA in 2012 with the aim of initiating dialogue with the Ministry of National Economy.[7] This set of proposals laid down the directions towards which the HVCA would guide its professional advocacy activities in the coming years. The successful first package of proposals was soon followed in 2014 by a second.[8]

4. The role of the HVCA in shaping legislation

The first set of industry proposals from the HVCA was also prompted by the fact that, following the 2008 economic crisis, the European Union not only embarked on a reform of its financial supervisory system but also set itself the goal of re-regulating the capital market to create financial stability. On the basis of the Rasmussen report[9] , the European Parliament, in its resolution of 23 September 2008, called on the Commission to develop a harmonised framework for venture capital and private equity at EU level.[10] One of the main results of this initiative was Directive 2011/61/EU on Alternative Investment Fund Managers, better known as the AIFMD.[11]

a) The birth of the Kbftv.

The AIFMD was transposed into Hungarian law by the Hungarian legislator in February 2014 with Act XVI of 2014 on Collective Investment Schemes and their Managers and on the Amendment of Certain Financial Acts (Kbftv.). Prior to implementation, the Ministry of National Economy, which prepared the law, held consultations with professional organisations throughout the year 2013, during which the HVCA Legal Committee was able to actively comment on the draft wording of the legislation. The members of the legal and professional team reviewed the solutions of several Western and Central European countries (Luxembourg, Germany, Czech Republic) that had already transposed the AIFM Directive and formulated proposals for the draft legislation partly based on these solutions.
In drafting the Kbftv., the legislator accepted a number of the HVCA's conceptual proposals (e.g., a uniform regime for units, the concept of investment fund management, etc.), while for some more specific requests, (e.g., relaxation of the obligations placed on de minimis fund managers) it promised to examine them in more detail in the first amendment of the Kbftv.

[7] Industry package proposal 2012 (https://www.hvca.hu/documents/HVCA-Position-paper-HUN-Final_v3.pdf (last accessed: 7 June 2021))
[8] Industry package proposal 2014 (https://www.hvca.hu/documents/HVCA_Position_Paper_2014.01.06-final.pdf (last accessed: 7 June 2021))
[9] Report with recommendations to the Commission on transparency of institutional investors (A6-0338/2008 ; Rapporteur: Poul Nyrup Rasmussen; https://www.europarl.europa.eu/doceo/document/A-6-2008-0338_EN.html
[10] European Parliament resolution of 23 September 2008 with recommendations to the Commission on hedge funds and private equity (P6_TA(2008)0425 ; Procedure : 2007/2238(INI) https://www.europarl.europa.eu/doceo/document/TA-6-2008-0425_EN.html (status as at 07.06.2021))
[11] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

b) Amendment of the Kbftv.

Article 3(2) of the AIFMD exempts "de minimis" AIFMs (fund managers with assets under management of less than €100 million, or €500 million in the case of unleveraged funds and funds that are not redeemable within five years) from a significant number of AIFMD rules. However, in drafting the Kbftv, the Hungarian legislator transposed only some of these exemptions into Hungarian law.

The Kbftv. imposed a deadline of 22 July 2014 for existing venture capital fund managers to comply with the new rules. Given that HVCA members are essentially "de minimis" fund managers, the HVCA Legal Committee proposed amendments to the Kbftv. in spring 2014 to ensure that domestic fund managers are not subject to more obligations than other EU fund managers and thus do not face a competitive disadvantage.

The Ministry of National Economy accepted most of the professional proposals, and the amendment[12] , which entered into force on 15 July 2014, already exempted domestic "de minimis" AIFMs from e.g., the own funds requirement[13], the introduction of an electronic portfolio registration system, the obligation to regularly value assets, etc. It is worth highlighting that simplification of the rules on the management statute has also been achieved.

c) Recent developments in capital market regulation

The HVCA Legal Committee has continued to work actively with the help of Levente Zsembery, later Elemér Eszter, HVCA chairmen and Ibolya Pintér, executive secretary, to ensure that the domestic legal environment does not put venture capitalists at a competitive disadvantage in international comparisons.

(i) Special lending rules

Taking into account that venture capital funds and private equity funds often provide not only capital but also loans to their portfolio companies, the HVCA Legal Committee has repeatedly indicated to the legislator that special regulation is warranted in this regard. By 2015, it was possible to have the Regulation on Investment and Borrowing Rules, which is linked to the Kbftv., regulate the loan ratio that can be invested in companies, thus recognising the lending activities of the venture capital industry at the legislative level.[14]

(ii) Amendment of the Capital Market Act (Tpt.) due to the Prospectus Regulation

The Ministry of Finance has prepared a comprehensive amendment to the Capital Market Act (Tpt.) and a minor amendment to the Kbftv. in connection with the Prospectus Regulation[15] applicable from 2019, which again involved the HVCA in the professional consultation. In the course of the amendment, the HVCA Legal Committee made a number of proposals for the drafting of both the concept and the wording, several of which were explicitly supported by the MNB during the professional discussion and have been incorporated into the legislation, such as the exception that no investment service provider need be engaged if the prospectus is not published.[16]

[12] Act XXXIII of 2014 amending certain financial acts.
[13] This means that instead of the initial capital of EUR 125,000 pursuant to Article 16 (1) of the Kbftv., only the HUF 5 million subscribed capital requirement applicable to limited liability companies under the Civil Code shall be met.
[14] Section 35/A of Government Decree no. 78/2014 (III. 14.) on the investment and borrowing rules for collective investment schemes.
[15] Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market and repealing Directive 2003/71/EC.
[16] Section 23(1)g) Tpt. (Effective: from 26 December 2019, amended by Act CXVIII of 2019 amending certain acts concerning the financial intermediary system and public finances and economic stability.)

(iii) Distribution in kind of the assets of the fund on termination of the fund

The HVCA Legal Committee has proposed to the legislator that in the event of the dissolution of a venture capital and private equity fund without succession, non-financial assets (essentially shares in portfolio companies) could also be distributed in kind (subject to unanimous decision) to unit holders. This proposal has also been accepted by the Ministry of Finance, and the relevant amendment to the Kbftv. will enter into force in August 2021.[17]

d) Tax legislation for the industry

The HVCA Legal Committee reports its proposals to the competent authority not only for legislation in capital markets, but also in other areas of law. Thus, on several occasions, it has drawn the attention of the Ministry of Finance to the fact that the "special tax on financial entities" imposes an unnecessary burden on venture capital fund managers. On this issue, the HVCA has repeatedly submitted professional material, including a calculation of the macroeconomic impact of the abolition of the special tax and legal arguments to demonstrate that the special tax regime discriminates in its effects between market operators that can be considered a homogeneous group in their lending function. After years of persistent work, the special tax on venture capital fund managers will be abolished in 2022.[18]

5. Proposals for the future

The HVCA Legal Committee is constantly working to ensure that the legal and regulatory environment remains competitive. It has a number of forward-looking proposals, some of which transpose Western best practices, which it presents to the legislator with professional arguments. These include:

a) the removal of legal barriers to convertible loans as a first step to investment, including the domestic transposition of the "SAFE note", which would simplify the lending of venture capital funds to portfolio companies,

b) the introduction of funds in company form, along the lines of the Western European model, which would have the advantages of (i) more freedom to structure the fund, (ii) more differentiated allocation of investor rights, and (iii) the fund itself having the power of choice (e.g., the ability to choose/change its fund manager),

(c) abolishing the six-year time limit for the payment of the subscribed capital of venture capital and private equity funds and instead providing for the payment of the capital at the pace of the investments to be made, as is the practice in the international market, at the request of the fund manager.

As shown above, the legal regulation of the venture capital industry is constantly changing. The HVCA, as the only national professional body, monitors changes on an ongoing basis and sometimes initiates changes itself.[19] The HVCA Legal Committee will continue to maintain good cooperation with the legislator and will continue to make professional proposals to help the legislator and thereby improve the competitiveness of domestic conditions for venture capital investment.

[17] Section 77(1) Kbftv. (Effective: 2 August 2021, amended by Act LVIII of 2021 on legislative amendments for the purpose of harmonisation related to the regulation of covered bonds and other legislative amendments affecting the financial intermediary system.)
[18] https://m.hvg.hu/gazdasag/20210511_Adocsokkenteseket_jelentett_be_Varga_Mihaly (as on 7 June 2021)
[19] Today there are around 100 venture capital and private equity funds operating in Hungary. It should be noted, however, that while the increase in the number of venture capital funds is related to the changes in capital market and tax rules discussed here, the main reason for the creation of private equity funds in recent years has been rather the fact that the funds are not registered in the Register of Ultimate Beneficial Owners, thus their ownership structure can be kept hidden.

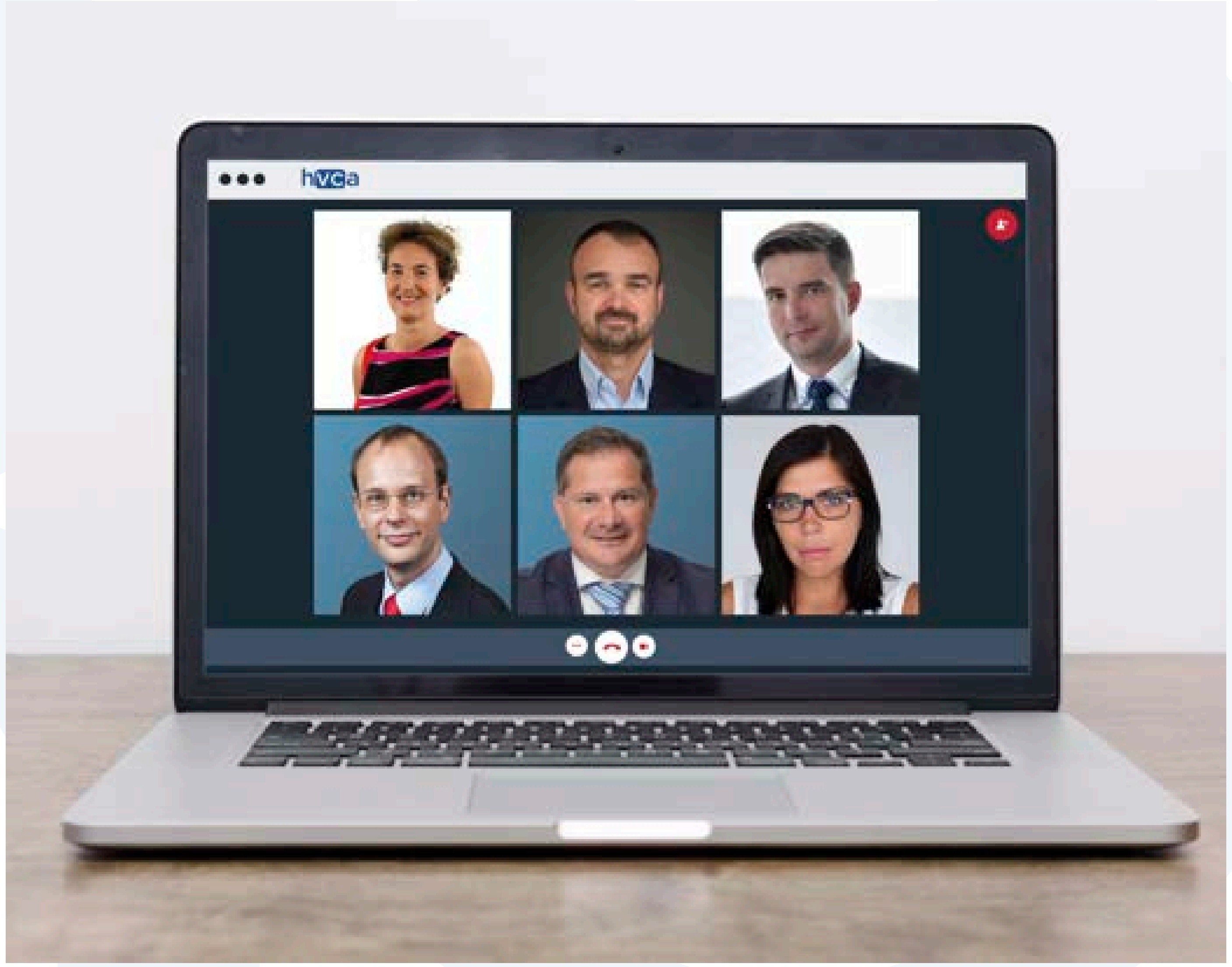
The authors of the article:

Judit Budai — partner, Szecskay Attorneys at Law, member of the Legal Committee of HVCA

Ákos Bajorfi — head of Corporate & Private Equity, Noerr & Partners Law Firm, Board member of HVCA

Chairs of the Legal Committee of HVCA since 2010

Judit Budai, Balázs Tüske, Ákos Bajorfi, Márton Eőrsi, Balázs Sahin-Tóth, Eszter Hubbes



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Website:	https://dbh-group.com

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Website:	http://hodleralapkezelo.hu

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Head of company:	László Czirják
Website:	https://ieurope.com/

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Website: www.mfbinvest.hu

Company name: OXO Ventures Zrt.
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Head of company: Péter Oszkó Dr.
Website: www.oxoventures.eu

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Head of company: Elemér Eszter
Website: www.pbgfmc.hu

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Website: www.portfolion.hu

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Website: www.szta.hu

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Address: H-1055 Budapest, Honvéd u. 20.
Head of company: Gábor Vitán
Website: www.venturio.hu

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Address: H-1134 Budapest, Váci út 45., G. épület
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Website: www.vespucci-partners.com

Company name: X-Ventures Kockázati Tőkealap-kezelő Zrt.
Address: H-1077 Budapest, Wesselényi utca 28., 1. emelet
Head of company: Levente Zsembery
Website: www.x-ventures.hu

Company name: Xanga Ventures Magántőkealap-kezelő Zrt.
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Head of company:	Richárd Végh
Website:	www.bse.hu

Company name:	Clairfield International Kft.
Address:	H-1055 Budapest, Kossuth Lajos tér 9.
Head of company:	Oliver Nemes
Website:	www.clairfield.hu

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Address:	H-1053 Budapest, Károlyi utca 12.
Head of company:	Erika Papp Dr.
Website:	http://cms.law

Company name:	Concorde MB Partners Kft.
Address:	H-1051 Budapest, József Attila utca 1.
Heads of company:	Kálmán Nagy, Gábor Szendrői
Website:	www.cmbp.hu

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Address:	H-1068 Budapest, Dózsa György út 84/C.
Head of company:	Balázs Bíró
Website:	www2.deloitte.com/hu/hu.html

Company name:	Dentons Réczicza Ügyvédi Iroda
Address:	H-1061 Budapest, Andrássy út 11.
Head of company:	István Réczicza
Website:	www.dentons.com

Company name:	DLA Piper Posztl, Nemescsói, Győrfi-Tóth és Társai Ügyvédi iroda
Address:	H-1124 Budapest, Csörsz utca 49-51.
Head of company:	András Posztl Dr.
Website:	www.dlapiper.com

Company name:	Equilor Befektetési Zrt.
Address:	H-1026 Budapest, Pasaréti út 122-124. Mozium Irodaház
Head of company:	Bálint Szécsényi
Website:	http://www.equilor.hu

Company name: Ernst & Young Tanácsadó Kft.
Address: H-1132, Budapest, Váci út 20.
Head of company: Botond Rencz
Website: www.ey.com/hu

Company name: Forgó, Damjanovic és Társai Ügyvédi Iroda
Address: H-1123 Budapest, Alkotás u. 17-19.
Head of company: Zoltán Forgó Dr.
Website: http://www.fdlaw.hu

Company name: H-ION Kutató, Fejlesztő és Innovációs Kft.
Address: H-1121 Budapest, Konkoly-Thege Miklós út 29-33.
Head of company: László Sándor Gencsi
Website: www.h-ion.hu

Company name: Hegymegi-Barakonyi és Társa Baker & McKenzie Ügyvédi Iroda
Address: H-1051 Budapest, Dorottya utca 6.
Head of company: Pál Takács Dr.
Website: www.bakermckenzie.com

Company name: Hubbes és Kovács Ügyvédi Iroda
Address: H-1092 Budapest, Ráday u. 26. 1.3.
Head of company: Tamás Kovács Dr.
Website: www.hklegal.hu

Company name: Impact Advisory Zrt.
Address: H-1061 Budapest, Andrássy u 11.
Head of company: Balázs Tüske
Website: http://impactadvisory.com

Company name: Invescom M&A Tanácsadó Korlátolt Felelősségű Társaság
Address: BudaPart Gate Irodaház, H-1117 Budapest, Dombóvári út 27. 2. emelet
Head of company: Zoltán Siklósi
Website: www.invescom.hu

Company name: Jalsovszky Ügyvédi Iroda
Address: H-1124 Budapest, Csörsz utca 41. 5. emelet, Gellért Torony
Head of company: Pál Jalsovszky Dr.
Website: www.jalsovszky.com

Company name: Kanadai Kereskedelmi Kamara
Address: H-1052 Budapest, Vármegye u 3-5.
Head of company: Nicholas Sarvari
Website: www.ccch.hu

Company name: KBC Securities Hungarian Branch Office
Address: H-1095 Budapest, Lechner Ödön fasor 10.
Head of company: György Herczku
Website: www.kbcsecurities.hu

Company name: KPMG in Hungary
Address: H-1134 Budapest, Váci út 31.
Head of company: Rezső Rózsai
Website: www.kpmg.hu

Company name: Magyar Export-Import Bank Zrt.
Address: H-1065 Budapest, Nagymező u. 46-48.
Head of company: Gergely Jáki
Website: www.exim.hu

Company name: Magyar Innovációs Szövetség
Address: H-1116 Budapest, Fehérvári út 108-112. 2 emelet (Nádor udvar)
Head of company: Gábor Szabó Dr.
Website: www.innovacio.hu

Company name: Magyar Telekom Nyrt.
Address: H-1097 Budapest, Könyves Kálmán krt. 36.
Head of company: Tibor Rékasi
Website: http://www.telekom.hu

Company name: Mazars Kft.
Address: H-1123 Budapest, Nagyenyed utca 8-14.
Head of company: Philippe Michalak
Website: www.mazars.hu

Company name: Moore Hungary Financial Advisory Kft.
Address: H-1138 Budapest, Váci út 144-150.
Head of company: Ákos Boross
Website: www.moore-global.com

Company name: Noerr & Társai Iroda

Address: H-1011 Budapest, Fő utca 14-18.
Head of company: Zoltán Nádasdy Dr.
Website: www.noerr.com

Company name: Polgár & Bebők Ügyvédi Iroda

Address: H-1011 Budapest, Szilágyi Dezső tér 1.
Head of company: Gábor Bebők Dr.
Website: www.ponteslegal.eu/locations/budapest/about-us

Company name: Pricewaterhouse-Coopers

Address: H-1055 Budapest, Bajcsy-Zsilinszky út 78.
Head of company: Nick Kós
Website: www.pwc.hu

Company name: Sárhegyi és Társai Ügyvédi Iroda

Address: H-1022 Budapest, Árvácska u. 6.
Heads of company: Zoltán Sárhegyi Dr., Beatrix Bártfai Dr.
Website: www.sarhegyi.hu

Company name: START Tőke-garancia Pénzügyi Szolgáltató Zrt.

Address: H-1037 Budapest, Szépvölgyi út 135.
Head of company: Csaba Zoltán
Website: www.startgarancia.hu

Company name: Startup Campus Inkubator Zrt.

Address: H-4025 Debrecen, Simonffy utca 4-6.
Head of company: Zsolt Kovács
Website: www.startupcampusin-cubator.com

Company name: Szecskay Ügyvédi Iroda

Address: H-1055 Budapest, Kossuth tér 16-17.
Head of company: András Szecskay Dr.
Website: www.szecskay.com

Company name: Trenkwalder Recruitment Kft.

Address: H-1139 Budapest, Balance Office Park, Váci út 99-105.
Head of company: Balázs G. Nagy
Website: www.trenkwalder.com

Company name: Trusted Adviser Kft.

Address: H-1082 Budapest, Baross u. 66-68. 3 emelet
Head of company: Zsolt Szovics
Website: www.trustedadviser.hu

Company name: Vistra Corporate Services Kft.

Address: H-1062 Budapest, Andrássy u. 100.
Head of company: Matty Ryan
Website: www.vistra.com

Company name: VJT&Partners Ügyvédi Iroda

Address: H-1126 Budapest, Kernstok Károly tér 8.
Head of company: János Tamás Varga Dr.
Website: www.vjt-partners.com

Company name: Wolf Theiss Faludi Erős Ügyvédi Iroda

Address: H-1085 Budapest, Kálvin tér 12-13.
Head of company: Zoltán Faludi Dr.
Website: www.wolftheiss.com

Membership of the Hungarian Private Equity and Venture Capital Association 2021

Individual members

Name: Ákos Mátés-Lányi Dr.
Company name: Mátés Ügyvédi Iroda
Title: lawyer
Phone: +36 30 949 3992
Email: akos.mates@avocat.hu

Name: Milos Milicsevics, DBA MBA
Company name: Közép-európai Egyetem
Phone: +36 20 348 1300

Name: Attila Ágoston Dr.
Company name: Közép-Európai Tőkebe-fektetési Kft.
Title: managing director
Phone: +36 20 934 2146
Email address: attila@goston.hu

Name: Gábor Baranyai
Company name: Central European University/CEU
Title: adjunct lecturer
Phone: +36 30 222 1925
Email address: gbaranyai@t-online.hu

Name: Attila Pintér Dr.
Company name: Dr. Pintér Attila Ügyvédi Iroda
Title: lawyer
Phone: +36 1 615 4383
Email address: pinter.attila@pinterlaw.hu

Name: Idikó Adamecz Rajné
Phone: +36 30 919 3782
Email address: ildikoraj@t-online.hu

Name: András Bodor
Title: VC & PE professional
LinkedIn: linkedin.com/in/andrasbodor

Name: Judit Karsai Dr.
Company name: KRTK KTI
Company address: H-1097 Budapest, Tóth Kálmán u. 4.
Title: scientific advisor
Phone: +36 30 816 4269
Email address: karsai.judit@krtk.hu

Name: Károly Szigeti
Phone: +36 30 242 7537
Email address: szigetik1965@gmail.com

Name: József Török
Title: Advisor to CEO (responsible for Fashion & Design Fund)
Email address: torok.jozsef@hiventures.hu
LinkedIn: www.linkedin.com/in/jozseftorok/hu

Name: Bence Katona
Company name: Hiventures Zrt.
Title: CEO
Email address: Katona.Bence@hiventures.hu

Name: Zoltán Krausz
Company name: V4 Solutions Kft.
Phone: +36 30 441 2358
Email address: zoltan.krausz@vallalatepites.hu
Website: www.vallalatepites.hu

Name: Andrea Újvári
Company name: Corporate Finance Advisors Kft.
Title: manager
Phone: +36 1 803 7846
Email address: ujvari.andrea@cfadvisors.hu
Website: www.cfadvisors.hu

Name: Miklós Zorkóczy Dr.
Company name: Zorkóczy Ügyvédi iroda
Title: lawyer
Phone: +36 20 250 2218
Email address: miklos@drzorkoczy.hu
LinkedIn: https://www.linkedin.com/in/miklos-zorkoczy-legal-services/

Contact details of the Hungarian Private Equity and Venture Capital Association

Hungarian Private Equity and Venture Capital Association

Address	H-1124 Budapest, Csörsz u. 41. Gellért Torony, 6. emelet
Website	www.hvca.hu
E-mail	hvca@hvca.hu
Phone	(+36 1) 920 2682

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Nikolaus Bethlen, András Geszti
HVCA Gala Dinner 2011

Nikolaus Bethlen, Margaret Dezse, Balázs Tüske
HVCA Gala Dinner 2011

Edward Keller, Balázs Tüske
HVCA Gala Dinner 2016

Nikolaus Bethlen, Judit Budai, András Szecskay
HVCA Gala Dinner 2011

Ibolya Pinter, Levente Zsembery
HVCA Gala Dinner 2016

Bálint Szécsényi, Elemér Gidófalvi
HVCA conference 2012

Tamás Fellegi
HVCA conference 2012

Csaba Lantos, Szabolcs Somlai-Fischer
HVCA conference 2012

Sponsors, speakers, Board members, Keynote speaker Nouriel Roubini
HVCA conference 2014

George A. Papandreou keynote speaker
HVCA conference 2015

György Cseresnyés
HVCA conference 2015

Sponsors, speakers, Board members
HVCA conference 2015

István Alpek
HVCA conference 2015

László Czirják, Pekka Maki
HVCA conference 2015

Lénárd Horgos
HVCA conference 2015

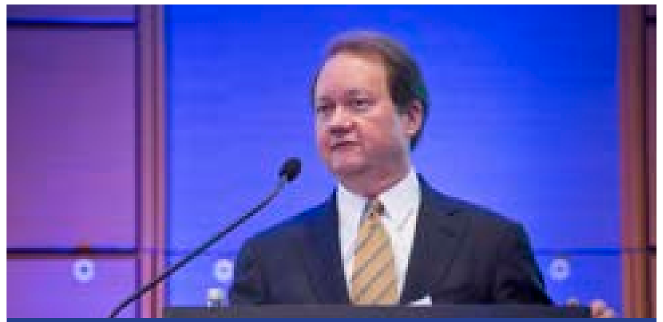
Edward Keller, Oliver Nemes
HVCA conference 2015

Zsolt Katona
HVCA conference 2015

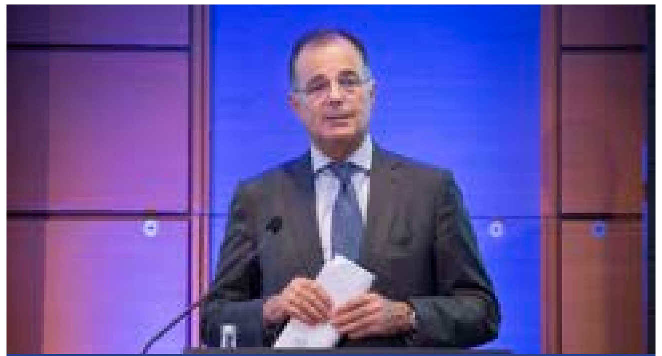
Margaret Dezse, Sándor Erdei
HVCA conference 2015

Zoltán Tóth, Zoltán Forgó, Zsolt Berta
HVCA conference 2015

Tamás Szalai
HVCA conference 2015



Joseph Andrew keynote speaker
HVCA conference 2016



András Simor keynote speaker
HVCA conference 2016

András Szombati, László Hradszki
HVCA conference 2016

Anikó Kircsi
HVCA conference 2017

Balázs Tüske, Zoltán Dömötör
HVCA conference 2017

Béla Lendvai-Lintner, Olivér Nemes, Zoltán Kovács
HVCA conference 2017

János Tóth, Gábor Lehoczky
HVCA conference 2017

Lénárd Horgos, Ibolya Pintér, Éva Réz
HVCA conference 2017

György Bacsa
HVCA conference 2017

Jenő Nieder, József Kövér
HVCA conference 2017

Hugh Owen
HVCA conference 2017

Gábor Baranyai, Judit Karsai, Balázs Sarlós
HVCA conference 2017

Michael Ignatieff keynote speaker
HVCA conference 2017

Júlia Király keynote speaker
HVCA conference 2017

Ákos Bajorfi, András Molnár, Péter Tánczos
HVCA conference 2017

Kornél Kisgergely
HVCA conference 2017

Zoltán Krausz
HVCA conference 2017

Zoltán Lengyel
HVCA conference 2017

Levente Zsembery opening speech
HVCA conference 2018

Thomas Tüske
HVCA conference 2018

Joerg Bauer
HVCA conference 2018

Robert Manz, Nikolaus Hutter, Cyril Gouiffes,
Elemér Eszter, Zoltán Krausz
HVCA conference 2018

Keynote speaker Christian Majgaard
HVCA conference 2018

Balázs Csűrös
HVCA conference 2018

Melinda Weber
HVCA conference 2018

Elemér Eszter opening speech
HVCA conference 2019

András Nemescsói
HVCA conference 2019

András Posztl
HVCA conference 2019

Eszter Hubbes
HVCA conference 2019

Cirill T. Hortobágyi keynote speaker
HVCA conference 2019

Balázs Tahy, László Csatári
HVCA conference 2019

Barna Balog, Barbara Ming
HVCA conference 2019

Gábor Bürchner
HVCA conference 2019

István Máté-Tóth
HVCA conference 2019

Zsolt Kovács, Krisztián Kőrösi, Richárd Illés
HVCA conference 2019

Thomas Howell, András Molnár, György Simó
HVCA conference 2019

László Hradszki
HVCA conference 2019

Péter Szabadhegy
HVCA conference 2019

HVCA General Assembly 2019

HVCA Board team building 2021
Dénes Szluha
Jenő Nieder
Zsolt Weiszbart
Ákos Bajorfi
Bence Katona
Eszter Hubbes
Ibolya Pintér