

Hungarian medium-sized and large enterprises in private ownership from the EU perspective

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SUMMARY

Authors give an overview of the history of the Hungarian economy and present current situation. The article focuses on economic circumstances established after the political change of the regime. This analysis gives an insight into the threats and opportunities of Hungarian medium-sized and large enterprises with special regard to our EU accession. A brief comparison of economic situation and conditions in other accessing countries is also to be found in this paper.

Key words: economic circumstances; threats and opportunities for Hungarian large enterprises in private ownership; change of the regime; competitiveness on international markets

INTRODUCTION

Changes in the 1990s have fundamentally *transformed Hungary's economic structure and modified its features characteristic before the change of the regime*. As part of the modernisation process, market relationships have been restructured (western dominance instead of eastern dominance), the structure of production has been altered (labour demanding production instead of raw material requiring manufacturing), the pace of technical development has increased, business forms have changed (partnership instead of company), the number of self employed enterprises has multiplied, however, the most significant change has been induced by the appearance of new owners, such as foreign investors.

a) The Hungarian economic transformation was rapid even in an international comparison. The advantage of a “modernisation performed on impulse” is the relatively short transitional period and the uninterrupted realisation of pressing economic corrections. On the

other hand, effectiveness was weakened by the lack of professional expertise, disorganised transformation and owing to the shortage of domestic savings, the dominance of foreign investors and foreign ownership stake.

b) The social and economic change of the regime has solved a great number of problems while it has brought much contradiction to surface. *Foreign investments helped Hungary closing up in the rank of national economies, although they also enlarged the economic and social gap inside the country*. Income originating from privatisation was primarily used to finance budgetary deficit and little was earmarked for improving operating conditions of the Hungarian economy. Economic stabilisation made business operations safer, however, due to the reorganisation programs, the number of bankruptcy and winding up proceedings were soaring, and so did unemployment. In order to create new workplaces instead of the ceasing ones, a large number of new enterprises was established, however,

they could hardly contribute to the increase of macroeconomic output since they were lacking professional experience and mobilizable resources.

c) Even if the open economic policy offered attractive opportunities to foreign investors, the new economic philosophy did not ensure the protection of domestic market actors. This resulted in an extremely contradictory situation, the effects of which have been

still present in ownership (foreign and domestic), structural (the proportion of raw material production, manufacturing industry and tertiary sector) and regional issues.

The numbers below demonstrate the result of economic transformation and the differentiation of economic actors.

Figure 1 Characteristics of partnerships, 2001
(financial sector excluded)

	Total number of partnerships	Partnerships		
		Exclusively domestic	Of foreign interest	Proportion of domestic partnerships (%)
Number of enterprises (pieces)	299263	273 644	25 599	91,7
Employees (person) 2 157 023	1 565 521	591 502		72,6
Net sales revenue (Billion HUF)	37 358,2	18 300,1	19 058,1	49,0
Export output (Billion HUF)	8 668,1	1 528,5	7 139,6	17,6
Profit before taxation	2 215,9	1 055,6	1 160,3	47,6
Loss before taxation	-861,4	-370,5	-490,9	43,0
Paid corporate tax	246	145,4	100,6	59,1
Capital subscribed	6 731,1	3 432,7	3 298,4	51,0
Equity	12 500,4	6 058,4	6 442	48,5

Source: figures are calculated on the basis of annual flash report by APEH-SZTADI, 2002

Judging by many other yet not discussed factors and results, it can be stated that *in Hungary foreign capital meant an important incentive of stabilisation and growth in the decade after the change of the regime*. Even nowadays, investments should be further stimulated by economic policies. While all governments of the past 10 or 12 years have devoted much attention to creating favourable circumstances for foreign capital, the other crucial segment of ownership transformation, *the evolvement and development of domestic private ownership happened in a rather spontaneous way*. This statement can be well supported by the repartition data of tax allowances in year 2000, which reveals an 88% proportion of foreign enterprises (see Figure 2.). It also needs to be emphasised that more and more importance has been attributed to the SME sector since the mid 1990s, however, due to bad figures of profitability and the undercapitalised character of enterprises did not enable the sector to take advantage of such “offered” benefits. (Measures of 2003 might be able to bring about significant changes in this field enabling enterprises to debit profit before taxation with developments and capital increase.)

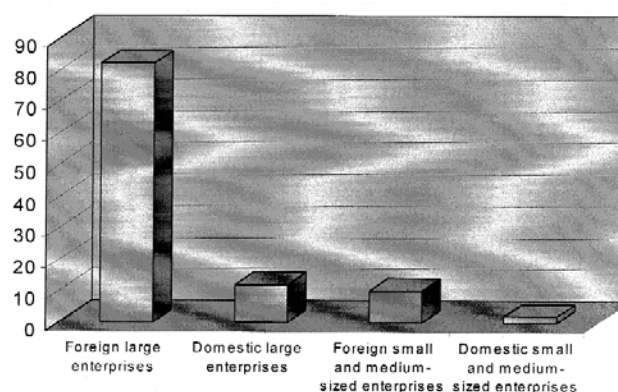


Figure 2.
Proportion of tax allowances in 2000.

The late modification in allowances concerning domestic medium-sized and large enterprises in private ownership resulted not only in a longer period of stabilisation but also in a greater relative and absolute backwardness in competition of such entrepreneurs. There is however a more

serious problem to tackle, namely the fact that *expectations of cooperation in manufacturing and distribution between domestic enterprises and foreign subsidiaries operating in Hungary have not been fulfilled.*

As a conclusion, it can be stated that the stabilisation of Hungarian corporate structure was completed by the end of the 1990s. Medium-sized and large enterprises in exclusive domestic private ownership have played a crucial role in the struggle for survival, in the process of reorganisation and in gaining ground of foreign enterprises. They well reflect the original ideas on privatisation as they are the best means of mobilising domestic micro and small enterprises due to their special character of having goods produced. In spite of their contradictory features, Hungarian medium-sized and large enterprises in private ownership have the best chance to take part in the international competition.

2. CHARACTERISTICS OF HUNGARIAN MEDIUM-SIZED AND LARGE ENTERPRISES IN PRIVATE OWNERSHIP

Hungarian medium-sized and large enterprises in exclusive private ownership can be considered the distinctive creations of privatisation as the majority of them were established on the basis of "remainder principle" since they are former state enterprises not having drawn the interest of foreign enterprises. Due to the lack of governmental subsidies, owners had no option but to fulfil reorganisation by own contribution and create a sustainable expansion path by themselves. Supports offered by the government only included allowances on special E-credit and on revenues originating from selling mobilizable assets.

Figure 3.

Proportion of large enterprises in private Hungarian ownership concerning total output of all enterprises in exclusive domestic ownership

	1997 (%)	1998 (%)	1999 (%)	1999 (%)	2001 (%)
Number of enterprises	0,27	0,25	0,23	0,22	0,20
Proportion of employees	22,3	21,6	21,1	20,8	20,5
Net sales revenue	28,6	28,7	29,0	29,6	30,1
Export output	61,9	63,4	64,1	65,7	66,1
Paid corporate tax	49,4	49,2	49,8	50,2	50,7
Profit after taxation	25,7	25,9	26,2	26,3	26,2
Capital subscribed	15,1	14,6	13,9	13,6	13,2

Source: Calculations are based on the annual flash report of APEH-SZTADI

As figures imply, domestic medium-sized and large enterprises have become a determining factor of the economy. According to Figure 3. and other database analysis, the following roles of such enterprises should be highlighted.

2.1 Their role in employment

Almost half of the 1000 large enterprises each employing more than 250 people has been in private ownership in Hungary. In year 2000, Hungarian large enterprises employed a total of 840 000 people out of which 260 000 were employed by Hungarian companies in private ownership while 350 000 employees worked at foreign enterprises. The employment of Hungarian large enterprises has been of significant macroeconomic importance both in the short and medium run, as they has been playing almost the same role as foreign enterprises. Taking the differences in national and foreign employment policy into consideration, the role of Hungarian enterprises in economic stabilisation has been surpassing that of the foreign ones.

2.2 Their role in export output

There has been a considerable difference in export output proportion of domestic and foreign enterprises, however, the dynamism of their growth rate has been quite the same in this field. Large enterprises account for 70% of total export output, out of which 60% has been performed by foreign enterprises. This can be traced back to the fact that subsidiaries of multinational companies have mainly been established in Hungary in order to make distributions on European markets. When considering the dynamism of growth in export proportion of Hungarian large enterprises, the situation is quite different. Between 1995 and 2000, the proportion of export produced by domestic large enterprises has risen from 20% to 38%. In other words, foreign enterprises have increased their export output from 44% to 64%, while an increase from 13% to 18% can be contributed to Hungarian enterprises in private ownership. It actually means that there has been no difference in export dynamism concerning these two categories as both groups have increased their export output by almost 50% in the past five years.

2.3 Their role in developing SME sector

With regard to dominant trends of purchase and distribution, the majority of enterprises in question belong to the sector manufacturing goods for export sales and using mainly domestic and import materials.

On the basis of their role in international trade, enterprises can be classified in four categories¹:

- Category I: goods are produced mainly of domestic materials and sold rather on domestic markets.

¹ Based on the research on domestic large enterprises carried out by Károly Lóránt, published in the special edition 2002 of the journal *Vezetéstudomány*, titled *The Hungarian industry: Historical past and new challenges* (A magyar ipar: Történelmi múlt és új kihívások).

Enterprises belonging to this category have the greatest importance concerning GDP output as 72% of employees, who are working for enterprises based on either double-entry bookkeeping or cash basis of accounting, are employed by them.

– Category II: goods are produced of domestic and imported materials and sold on export markets. Enterprises belonging to this category employ 11% of workforce and contribute to GDP output by roughly the same percentage. What is more important, they provide half of the export output and therefore have a positive balance of trade.

– Category III: is made up of enterprises producing goods from import to export and to export and to domestic markets

– Category IV consists of entrepreneurs manufacturing goods from import and domestic materials to domestic markets.

Besides improving the balance of trade, enterprises belonging to category II might be able to help domestic suppliers (mainly of category I.) to integrate into the world economy.

2.4 *Their contribution to budgetary revenue*

As it becomes clear from Figure 1 and 3, amounts paid into the budget by domestic large enterprises in private ownership has been exceeding their proportion in sales revenue and export. Owing to the lack of allowances, they mean a smaller “burden” for the government than other enterprises do. Compared to their direct roles, their indirect impact has been even bigger as they ensure a stable market for thousands of enterprises, this way enabling them to create favourable budgetary relations.

3. STRATEGIC CHARACTERISTICS AND POTENTIAL FOR IMPROVEMENT AMONG DOMESTIC LARGE ENTERPRISES IN PRIVATE OWNERSHIP

➤ *Their activities have been suppletory* therefore in case their circumstances of operation could be improved, they would be able to produce goods competitive enough for international markets as well.

➤ *Their structure of ownership and management has been balanced* and the realisation of development projects are not threatened by occasionally arising insecurity originating from personnel issues.

➤ In the long run, they might be *the main target and implementer of national economic policy*.

➤ The main challenges of EU markets, namely flexible expansion of production and inevitable restructuring of operation, can be faced exclusively by large enterprises of diversified activities. Without large enterprises, consequences of inflexibility need to be handled by economic policies themselves.

➤ Large enterprises in domestic ownership are “predictable” partners of the budget and are considered to be the most significant central and local taxpayers even in the long run.

4. MAIN FACTORS OBSTRUCTING THE OPERATION OF DOMESTIC LARGE ENTERPRISES IN PRIVATE OWNERSHIP

➤ They *play an immense role in employment*, however, fiscal charges on labour (social security contribution, rise in minimum wage, public health contribution, etc.) have been threatening their competitiveness.

➤ *Constant lack of capital* has been impeding technological developments and the improvement of product range. Owing to the lack of working capital, financing their production process is more expensive compared to competitors that are supported by loans and guaranties of their parent companies.

➤ Due to the lack of working capital, domestic large enterprises are less capable of cooperation in production and distribution. The lack of medium-sized enterprises being responsible for transmission results in their inconsiderable cooperation with micro and small enterprises.

➤ Besides undercapitalisation, assets of large enterprises in exclusive domestic ownership are underestimated, therefore depreciation calculated on the basis of low value of assets does not provide the necessary expenditure for replacement.

5. OPPORTUNITIES AND THREATS OFFERED BY INTERNATIONAL PROCESSES

According to analyses on world economy, the next 2 or 3 years will be characterised by economic recession. Growth has still been determined by US performance, however, latest prognoses assess the pace of economic growth to fluctuate in an even wider band, namely between 2 and 4%. The continuous American upturn of the ‘90s is not likely to reappear and *a more volatile and smaller American and world economic growth are expected in the coming 2 or 3 years*. As for the 15 EU member states, the impact on GDP growth performed by their exporting outside the EC is predicted to lessen. It is needless to say that balance also requires similar effects on import as well. Therefore sustainable growth in the EU is more and more dependent on whether internal resources- and investment-based development are increasing and whether closing up by modernisation is introduced. In this respect expectations are high, as this way chances of domestic enterprises could be well improved. This positive vision of opportunities can be realised only in case Hungarian enterprises adapt to the EU-like process of modernisation and to programs of development and investment.

Due to the fact that the period of economic recession has been longer than expected, the pace of international cash flow has slowed down while the flow of working capital in year 2001 dropped by one third compared to the average value of previous years. Declining interest of capital holders is likely to appear with delay in the Hungarian economy as well, therefore a higher price of supplementary capital needs to be taken into consideration.

In the period of 1995 and 2001, more capital left the 15 EU member states then flown into them. (Only a tiny proportion of capital outflow were aiming at accessing countries, the majority of investments were improving operational circumstances of developed regions in hope for quicker return and access to advances in technology.) In order to finance EC programs of internal modernisation and to better retain capital, most EU member states (e.g. Germany, Ireland, France) have resorted to tax reduction, which might result in further deceleration concerning the flow of working capital.

According to international experience, the role of large enterprises has continuously been increasing, and they have the best chance of strengthening their market position even if highly esteemed “support programs” are not aiming at them. A further international characteristic that cannot be ignored when making comparison with transitional countries is the fact that private ownership has always been present among competitors, original accumulation of capital started much earlier and governments have always played a significant role in improving operational circumstances of private enterprises.

Ways and means in the EU for implementing facts mentioned above:

- > Supporting research and development, encouraging innovation
- > Promoting presence in foreign markets by preferential export loans, by offering support for entering new markets, by supporting exhibitions abroad, by giving subsidies for market research and by popularizing industrial trademarks
- > Subsidizing employment
- > Site and regional development
- > Supporting capital increase
- > Loan guarantee
- > Allowances on investments (tax refund)
- > Preferential loan for investments and working capital
- > Infrastructural developments
- > Public procurement
- > Creating networks for transmitting technological knowledge and market information
- > Offering help and advice on organisation issues
- > Supporting environment friendly technology

It is unquestionable that EU practices for promoting competitiveness should be investigated in details by Hungarian regulators, furthermore all techniques accelerating the pace of closing up among domestic medium-sized and large enterprises should be put into practice.

6. REMUNERATIVE INVESTMENTS

Hungarian domestic large enterprises in private ownership are in favour of competition under equal terms. They do not lay claims to benefits destroying competition, however, they disapprove of all kinds of discrimination. With regard to the national economy, their different means of industrial policy can well be regarded as remunerative investments:

- > When assessing the situation of Hungarian large enterprises in private ownership, it is essential to take into consideration that their economic output has been

on the increase. Furthermore, the question of how domestic economic performance would change *in case this group of enterprises lost importance* needs to be thoroughly investigated. Another issue worth reflecting is the fact that enterprises of foreign interest have been excelling in technical development and profitability ratio while small enterprises have been prominent at improving employment. On the other hand, domestic large enterprises have been in charge of all these activities at the same time. They are the ones being present at technological and product research, playing an important role in effective employment while operating in a relatively profitable way.

Maintaining or rather gradually increasing employment should be a strategic objective both in the short and medium-term for a stable national economy. Numerous signs have been implying the fact that foreign enterprises, which are representing approximately 50% of large enterprises, are about to decrease the number of their Hungarian employees, which small and medium-sized enterprises would not be able to counterbalance. This problem could only be tackled by larger enterprises as experienced in the IBM – Videoton case.

> There is a strong relationship between employment and the overall willingness to increase export output of high added value. In case larger foreign enterprises partially cease their activities in Hungary, our export output also recedes as these enterprises are responsible for 70% of export. In order to handle this question, *enterprises in Hungarian ownership should gradually increase their export activities by using appropriate sources.*

> *Capital inflow, production-reallocation.* More and more factories have announced to close down, production relocation has been a regular phenomenon while capital inflow is said to be decreasing. Analysing the situation however sheds light to the fact that these cases can rather be explained by sectoral difficulties than by Hungarian economy becoming less attractive for foreign capital. The vagueness of European prosperity has undoubtedly affected the slowing down of industrial growth rate, especially in some key industries. On the other hand, interest in production outsourcing towards eastern countries is not diminishing among western European small and medium-sized enterprises. In this respect, Czech, Polish and Hungarian markets are given priority, therefore it would be worth launching a new campaign to popularize different forms of capital inflow. A Hungarian enterprise of average size should find it easier to build up a relationship as a partner or client with a small or medium-sized foreign enterprise than with multinational companies.

> *Research and development, services of higher added value.* So far assembly plants have mainly been founded by foreign industrial companies. Recently, there have been some signs of their establishing here activities of higher added value as well. R+D activities are much more sensitive to the general standard of economic and political confidence than to simple labour costs. This is the reason why helping knowledge-based activities to flow into the country is an important strategic objective. This way,

other factors weakening competitiveness (closing up wages, labour costs) could be counterbalanced. According to experience of previous EU enlargements, convergence of wages, consumer price level and fund pricing are inevitable, therefore it would be a mistake to take our advantage on wages that used to be characteristic in the second half of the '90s into consideration.

Results of R+D activities can be realised in the following fields:

a) Reorganising product structure in the *chemical industry* has been brought about by both environmental and economic factors. Programs are mainly focusing on knowledge-intensive volatile chemistry technologies and biotechnological developments based on renewable commodity resources. Reducing environmental load involve not only modernising production but also wrapping and other technologies of pesticides and insecticides and establishing green chemistry.

b) *Results of biotechnological research* help to produce different biomass-based additives besides generation of power. The production of volatile chemistry materials and drug intermediaries represent state-of-the-art innovation technologies. In order to further developing technologies needed for their domestic production, appropriate circumstances for implementing GMP (Good Manufacturing Practice) systems should be created.

c) Biotechnological procedures implying *further developments in cultivation and stock breeding* ensure the competitiveness of these products on international markets as demand for bio products has been skyrocketing and such technologies has been rapidly gaining ground all over the world.

The National Agricultural Informational System to be established is an Internet-based communications network aiming to spread and exchange agricultural information between the government and people. Creating a land-classifying system for registering data of agricultural production capacity and climatic conditions would contribute to arranging agricultural production and distribution in compliance with EU standards, while it would also be essential for a successful participation in EU applications.

d) The regional role of domestic aluminium production can be significantly increased and its long-term competitiveness can be insured by improving the processing standard of *aluminium semi-finished products* (cables and wires), by diversifying finished manufactures production, by proper salvaging of refuse complying with EU environmental regulations and by putting some other equipment into operation.

e) There has been a need for a technological change in the *machine and equipment manufacturing industry* in order to extend production capacity of environmental equipment in case they have the intension of meeting growing claims of industrial and municipal companies. Production technology of non-series equipment is in need of further development in case they want to boost profitability and follow consumer needs of higher and higher complexity.

f) Developing modern, energy-saving technologies for *steel constructions, power plant installations, public vehicles and energetic equipment* has been a basic requirement for keeping pace with increasing international competition.

g) Developing domestic production of *public transport vehicles* such as trolleybuses, trams and railway motor trains in order to better fulfil national demands.

h) In the framework of a incubator program for beginner entrepreneurs, it has been an objective to ensure proper circumstances for promoting modern IT products of small businesses and making them marketable. In connection with planned health care privatisation, homogenous processing and handling of hospital management systems and information are important issues to be tackled. Developing the information system of transport industry would enable the introduction of a travel card.

➤ *Integrating role for accelerating the development of SME sector.* With regard to the EU accession and the process of closing up, the first two categories introduced previously in this paper are playing a determining role. By their positive impact on employment, members of the first category using domestic raw materials for manufacturing, might be able to boost economic growth. Enterprises in the second category (high quality processing of semi-finished products made of domestic and import materials) could be responsible for improving competitiveness through expanding added value content and making progress in the filed of export economic efficiency. This sector is partially made up of small and medium-sized enterprises with 34 employees on average, where EU methods for supporting SMEs could be applicable. Furthermore, after Hungary joining the EU, these enterprises together with those of the first category could benefit from structural funds of the European Union. The other part of this group is formed by domestic large enterprises in private ownership, the success in world and EU markets of which are token for Hungary's technical and economic closing up. Dynamic developments of domestic large enterprises in private ownership have positive effects on small and medium-sized enterprises of the first and second categories, therefore developing large enterprises has multiplier impacts on both GDP and employment in the Hungarian economy.

7. CONCLUSION

Analysing domestic large enterprises in private ownership with regard to international tendencies has offered the following conclusion to both macroeconomic regulators and boards of management at large enterprises: a national economy cannot be competitive in the long run unless the majority of its enterprises is competitive enough; enterprises cannot be competitive unless their products meet the requirements of competition on international markets. It is essential to be aware of the fact that product competitiveness is determined by its added value and content of knowledge therefore all measures have to be subordinate to this matter.

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Zusammenfassung

Die Vergangenheit und die Zukunft der ungarischen Wirtschaft – mit Rücksicht auf die wirtschaftliche Umgebung, die nach dem politischen Strukturwandel entstand – wurden von den Autoren des Artikels vorgestellt. Die Analyse betont die Möglichkeiten und die Gefahren die vor den heimischen Mittel- und Grossunternehmen stehen, und widmet eine besondere Aufmerksamkeit den Folgen der Erweiterung der EU.

Összefoglaló

A cikk szerzői a magyar gazdaság múltját és jelenét mutatják be különös tekintettel a politikai rendszerváltás után kialakuló gazdasági környezetre. Az elemzés nagy hangsúlyt fektet a hazai közép- és nagyvállalatok előtt álló veszélyekre és lehetőségekre, valamint külön figyelmet szentel az Unió csatlakozás következményeire.

Kulcsszavak: gazdasági feltételek, hazai magántulajdonú nagyvállalkozások lehetőségei és fenyegetettségei, rendszerváltás, versenyképesség a külföldi piacokon.