

Do Foreign Subsidiaries Improve Host Country Competitiveness? Insights from Hungary

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Introduction

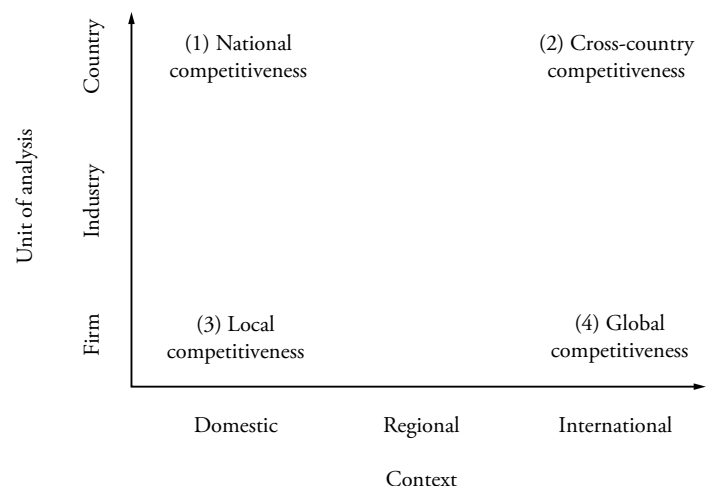
Boosting FDI and promoting internationalization are usually considered to be among the best ways to enhance the competitiveness of a country in the long run. However, the question arises if, after establishing a local subsidiary(ies), foreign firms (MNEs) will indeed create connections to locally-owned firms, and if these business connections can raise the general level of host-country efficiency and/or competitiveness. Recent results from our study of competitiveness show that policymakers in Central and Eastern Europe (CEE) should not be very confident of this. Instead, there is a threat that MNEs often operate independently of local firms, thus creating a dual economy that might limit rather than boost development of a given country. On the other hand, the classic view of a dual economy with highly developed foreign firms and underperforming local ones with outdated technology does not hold entirely either. Setting economic policy that enhances country competitiveness requires going beyond basic stereotypes to obtain a more detailed and nuanced picture. Our paper presents such a view for Hungary.

Dimensions of Competitiveness

Competitiveness might cover very different approaches: it may be addressed at a local, national, regional or even global level. For example, it is not trivial that an economy dominated by highly competitive firms at a local level would be competitive when compared to other countries. It is enough to think of countries with economies built on one single natural resource e.g. oil. Even if oil companies use the most developed technol-

ogy with high efficiency, the country itself would be lagging behind due to its dependence on commodity prices if public revenues are not spent to develop an “alternative” economy. To clearly separate dimensions, we developed a map of competitiveness investigations, inspired by Guerras-Martín et al. (2014) who applied a similar framework for mapping and classifying the schools of strategy research (Figure 1).

Figure 1. Classifying competitiveness investigations



Our approach uses two dimensions. The vertical axis refers to the two most widely used units of analysis: the national economy and the firm(s). At the former level of analysis, macroeconomics and international economics often serve as academic backgrounds. At the latter level, a firm is the micro-unit of pro-

duction bound by law. Amongst the most often used academic backgrounds we find firm theories, business and management studies, and international business research.

The horizontal axis indicates the context. Domestic context means that this approach takes the national economy as a standalone identity, mostly independent of its international economy context. This approach can be well interpreted in the case of the national economy, but nowadays its use is not evident when studying firms. Despite globalization, the institutional context for the firm is, to a large degree a domestic one, which sets out the same law compliance requirements to all registered firms in a given country. This context provides a meaningful approach, especially for the home-market oriented small firms. The international context approach means that we take for granted that there is integration amongst economic actors across borders.

Papers examining (1) national competitiveness focused on the time dimension describe the past, present, and future macro-economic performance of a country and their determinants (e.g. growth, productivity, trade, foreign investments, employment, educational level, R&D). Reports on national competitiveness agencies fall into this domain. The central research question is how and why a given country is competitive, or could be more competitive than it was.

(2) Cross-country competitiveness studies focused on a horizontal comparison of past macro-level economic performance and its determinants in an international context. They use comparable data and datasets on national economic performance. Two well-known examples for this are the competitiveness rankings prepared by IMD World Competitiveness Center (IMD 2016) and World Economic Forum (WEF 2016). Instead of longitudinal analyses, we focus on whether a country is (and how it could be) superior to other countries.

The concept of (3) local competitiveness is aimed at firms. Economic performance and influencing factors (e.g. profitability, productivity, competitive advantages, and exports) are defined accordingly. Examples thereof are research on firm-level advantages and firm renewal, or the contributions of intra-firm activities (e.g. marketing, HRM) to firm-level advantages and their renewal. The related research papers aim to identify the most competitive strategies (like various economic policy measures) within a country.

Finally, (4) global competitiveness compares firms across borders emphasizing that those are present on the same (global or regional) market. Key business activities and their performance measures (e.g. exports, imports, MNEs, and foreign subsidiaries) are selected to track the ability to sell on foreign markets. The main question to answer in these papers is how and why a given firm is better than its counterparts in the same market including firms from other countries.

Our recent research connects the traditional research categories by analysing firms based on both (3) local (growth, productivity, employment, TFP) and (4) global competitiveness capabilities (ability to export). We also aim to both identify best practices for managers at companies and to come up with a recommendation for national economic policymakers to boost (1) national competitiveness.

Dataset and Methodology

Firms with foreign majority ownership are usually assumed to distinguish themselves by close links to foreign markets and better productivity than locally-owned firms. This stereotype is underpinned by the fact that in 2012 foreign-owned firms (most of them MNE subsidiaries) altogether created 51.8% of the Hungarian added value while being responsible for 58.4% of country-wide import and 53.6% of the total export.

To examine the relationships among ownership, efficiency, productivity, and export, two of the authors of this article (Juhász & Reszegi, 2017) collected the publicly available annual reports of Hungarian non-financial firms with at least 20 employees in 2010 for the period 2008–2011. They also added information on ownership and employment from Bisnode Hungary database. The resulting sample included firms with continuous operations and positive owners' equity throughout the period analysed. Companies included declared clear ownership information (no offshore firms) and published full (non-simplified) annual reports in line with the Hungarian Accounting Standards. Companies in the process of legal transformation (e.g., due to mergers and acquisitions, bankruptcy) and those owned by the state or municipalities were excluded. These restrictions required omitting micro firms and small firms that published simplified statements, so it is very likely that the sample significantly over-performs the average of the whole corporate sector.

Altogether 4,641 companies remained in the sample, and 1,875 were foreign-owned. Sample firms made significant contributions to the Hungarian economic performance. They accounted for 39.6% of employment in the for-profit sector and 52.9% of employment in the manufacturing sector in 2010. In the period from 2008 to 2011, these firms provided 70.9% to 72.9% of the total Hungarian exports.

Key Findings

Our results show that it would be a mistake to consider the Hungarian economy as one homogenous entity. Telling apart locally- and foreign-owned firms is a vital distinction, but not a sufficient one, as we identified several layers of duality. Based on our analyses, even the group of foreign-owned firms is heterogeneous. The relative level of wages was identified as the key variable for separation. The firms that pay less than the aver-

age salary in their industry to (probably) low-skilled workers had an added value that is just around the mean of the locally-owned firms. Thus, these firms were not particularly (3) locally competitive. In contrast, foreign-owned firms with a wage level above the sectoral average (a proxy for highly skilled workers) can be characterised by an added value per employee that is two or three times higher than that of the below-average-wage firms, considering both foreign and locally owned ones.

Foreign firms with a highly trained workforce stand out by far regarding the efficiency of capital usage, productivity, and wage level (2.0-2.5 times the country average). These companies added a considerable amount to Hungary's GDP. Most foreign-owned firms have high export intensity (a hint to (4) global competitiveness), and that of the low-wage foreign companies is particularly high. The median foreign firm had at least two-thirds of its sales coming from international markets, and the average is also above 50%.

How is it possible that a locally (3) not (particularly) competitive subsidiary is competitive on the global scale (4)? Could that be only because they take profits out of their MNE network? If so, is it possible, for example for the locally-owned firms, to be competitive globally (4) without having access to such a network? This problem underlines also the importance of using different measures to judge the overall (3 and 4) competitiveness of a firm. At the same time, it raises the question whether we can measure the stand-alone competitiveness of a local subsidiary of an MNE at all.

According to Marin and Schymik (2015), the export market share of the median exporting firm in each of the seven EU countries (Austria, France, Germany, Hungary, Italy, Spain, UK) examined has at least tripled (in some cases it increased up to tenfold), if the firm combined decentralized management with relocation or outsourcing of their manufacturing to low-wage countries. They emphasize that the dynamic increase in Germany's export to China was due, after all, not to their reliance on cheap suppliers, but rather, to the growth in Chinese demand for production goods in which Germany had a comparative advantage. At the same time, the German economy is extending into cost-competitive markets by relocating manufacturing instead of exporting. Thus, relocation and outsourcing for these firms are not ways of entering new markets, but rather a method of cost reduction. This conclusion means that the major buyer of these foreign firms in low-wage countries is their group headquarters, so the high exporting activity has little to do with (4) global competitiveness. We believe this same process can be observed in Hungary from a bottom-up perspective.

When the data of the locally-owned firms were analysed, another kind of duality emerged clearly when the export intensity (once again a proxy for (4) global competitiveness) was considered. Those achieving more than 25% of their sales from for-

foreign markets were significantly more efficient, productive, and paid a higher average wage than companies in the same industry focusing on local markets. It is critical to see that the profitability gap between a typical export intensive local firm and an average foreign-owned one is quite narrow, while the former group may even over-perform the low waged foreign-owned companies regarding measures for efficiency and profitability ((3) local competitiveness).

Firms with Hungarian majority ownership and low export intensity (exporting less than 25% of sales) drop significantly behind. Their productivity is less than one-third of the foreign-owned high waged firms (subsidiaries). At the same time, this figure is enough to keep up with the least productive foreign-owned firms not only in productivity but also in terms of salary.

Summarizing the above, based on the data we cannot confirm that FDI in general adds to (1) national competitiveness. Therefore, one of the biggest challenges for policymakers may be the identified duality of foreign firms. Should countries offer incentives to both firms employing highly trained employees and firms with poorly trained workers? Foreign investors building on relatively cheap labour (a proxy of low-skilled workers) may increase the country-wide employment level, but for how long? Not only CEE, but also countries just recently joining the globalised markets inevitably face this challenge.

The new EU member states (e.g. CEE) see a continuous decrease in the growth rate of the added value content in their trade. This decrease is most explicit in the case of high-tech industries. At the same time EU-15 countries also signal a general decreasing added value trend, but in manufacturing and particularly in high-tech industries their added value is increasing (Leitner and Stehrer, 2014). This trend is in line with recent research findings, which suggest that export firms in the new EU member states focus mainly on low-added value activities while EU-15 countries retain the high-added value (e.g. R&D, strategic management) activities and jobs.

It is not only at the firm level that the revealed dualities raise challenges for policymakers. Wage inequality for the same job can be high both across regions of the same country and across different countries. Today, two similarly qualified blue collar jobs can have a wage difference of up to 200% within Hungary. This phenomenon signals a severe regional inequality and, in addition to its economic consequences, it may also lead to social tensions within a country.

Conclusions

Drawing from earlier research on strategic management, we suggest a new two-dimensional categorization of competitiveness approaches. Based on this model, the units of analysis

might be firms, industries, or countries, while the scope of investigations could cover a country, a region of countries, or the whole world.

The article also presents some of our recent findings in competitiveness research. We performed the analyses on a database, which contains both financial data of privately-owned firms and their ownership and employment information. The results suggest that there are several layers of duality within the Hungarian economy, one of which can be described by the ownership background. For the locally-owned firms, the primary line of division is export intensity, while foreign firms (subsidiaries) differ greatly based on their wage level compared to industry average. These lines of division do not correlate with ownership, which is usually considered to be the main reason behind the duality of firms. The size of the sample provides robustness and implies that the competitiveness approaches at policy level need to be more differentiated when focusing on diverse groups of firms.

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