HAS Centre for Regional Studies

Can medium-sized domestic enterprises reduce the FDI-dependency of Hungarian manufacturing?

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Gabor Lux
PhD, senior research fellow
Hungarian Academy of Sciences
CERS Institute for Regional Studies
lux@rkk.hu

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Main questions

- **Which way forward for Hungarian manufacturing?**
- Outcomes and limitations of the FDI-led development path
- The German „Mittelstand" model as a partial development alternative
  - The Hungarian ME sector
  - MEs in different regional contexts
  - potential development role: potential and barriers
- Background: research project on Hungarian MEs
- Context: varieties of capitalism debate, evolutionary economic geography

The „DME" variety of capitalism in Central European manufacturing

- Distinct variety instead of LME or CME model
- „Prefab", easy-to-adapt competitive advantages
  - technology transfer
  - modern mgmt. and QA principles
  - global market embeddedness
  - advantageous capital finance
- Divison of labour
  - from low towards mid-range jobs and activities
  - ongoing upgrading & growing factor intensity in select branches
  - emerging supply networks (FDI-based, PL: more domestic)
  - missing high-VA segments of the value chain, C&C, R&D and basic (vs. shop-floor) innovation, etc.
  - capital movement risks, crowding-out & congest. efffects
  - weak capital accumulation, growing social issues (out-migration)

The „DME" variety of capitalism in Central European manufacturing

- …successful sites build on local sources of competitiveness & **reconfigure** local socio-economic networks
- Path renewal vs. peripheral „hollowing-out"
- FDI dependency:
  - FDI in GDP (Nölke – Vliegenthart, 2007):
    - HU 52%, CZ 48%, SK 32%, PL 25%
    - reference countries: AT 23%, DE 16%
    - higher in manufacturing!
  - import content in manufacturing exports (2009): HU 52%, CZ 44%, SK 40%, PL 33%
- …and its increases after the crisis
  - Foreign added value in Hungarian manufacturing firms:
    - 2008: 60%
    - 2012: 66%
    - 2015: 70%
- Is the model successful? Sustainable?

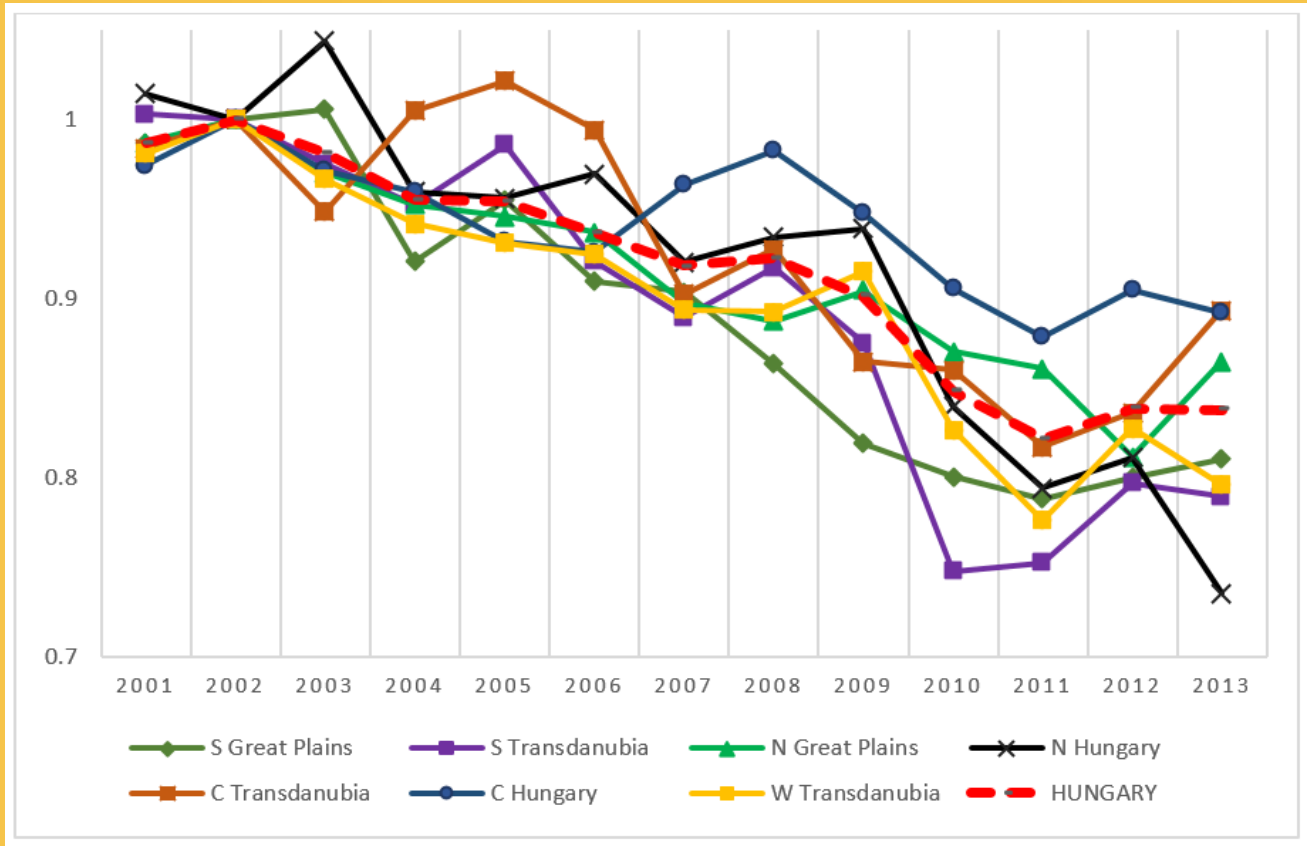
Growing scholarly interest in medium-sized enterprises

- The German **Mittelstand**: a successful example of the „high road”
  - „the second pillar” of German manufacturing
  - specialisation on high-VA specialised goods for global niche markets
  - long-term strategic orientation, reliance on endogenous capital
  - reliance on skilled high-waged labour, long-term contracts, dual voc. training
  - **Geographies:** 70% found in small towns or rural areas, strong local network-building (clusters, chambers of industry & commerce, voc./higher ed, etc.)
- Adapting the model across Europe…
  - growing interest after the crisis
  - France, after the end of state-led „technological Colbertism”
  - Great Britain, in de-industrialised regions in the vacuum after large enterprises
  - Italy, as „the fourth capitalism”, 48% emerged between 2000 and 2012, 66% from consolidating industrial districts, 15% corporate spinoff (32% of 3200 MEs in Lombardia; good position of Emilia-Romagna, Veneto & Third Italy)

Adapting the Mittelstand model

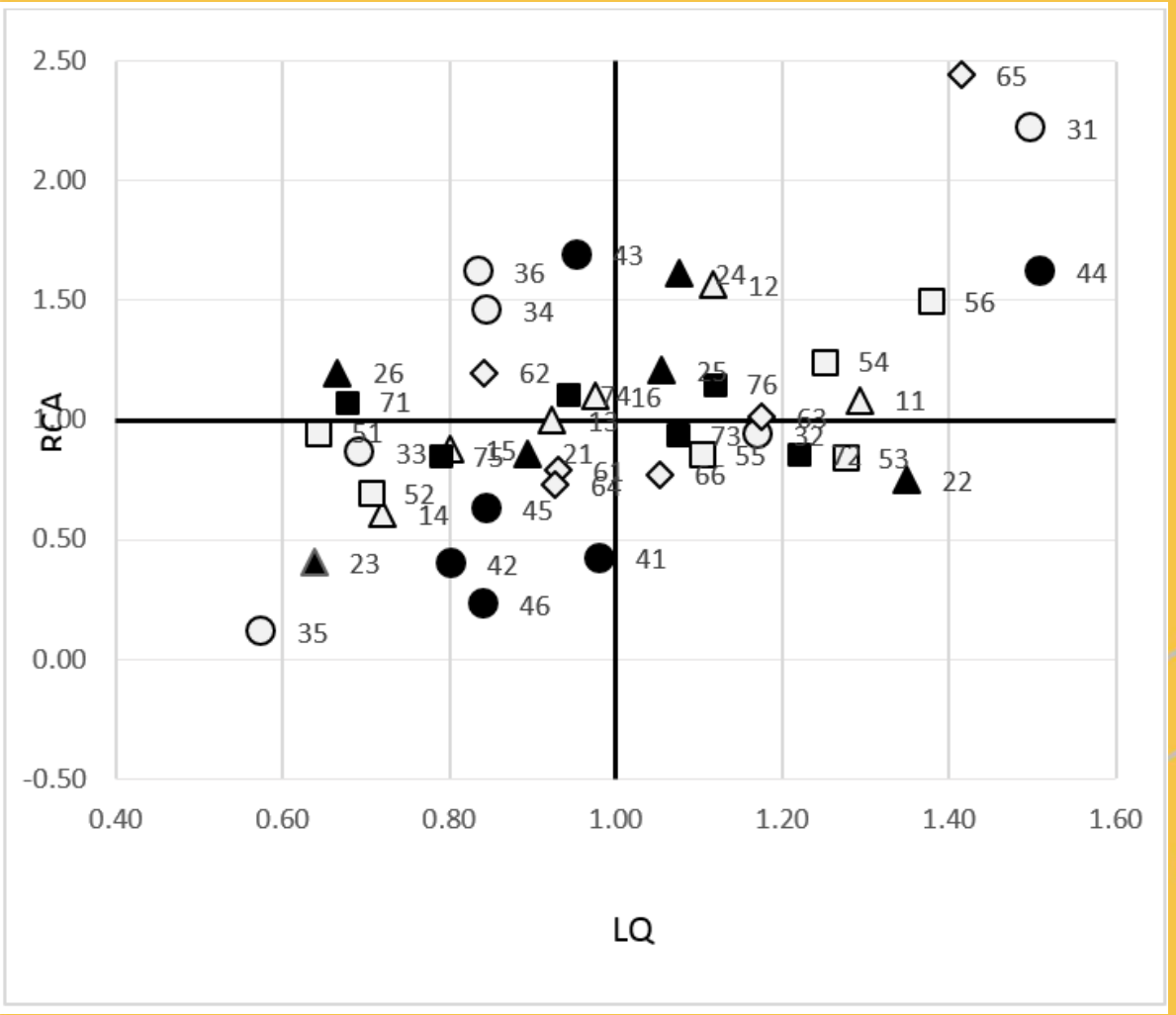
- in Central Europe?
  - dominance of micro-enterprises (HU 2014: 588k enterprises, 554k micro-, from remaining 34,600 → 29,250 small ➔ **only 4,500 medium & 867 large firms!**)
  - enterprises typically rely on generic, „soft" competitiveness factors (Szerb et al)
  - research should be extended to **potential MEs** (30 to 50 employees)
- In Hungary?
  - shrinking number of firms: 2000→3200 (250k workers), 2013→2700 (212k workers)
  - even geographies, follow pop. distribution ←→concentrated FDI-based industry
  - several MEs outside large city agglomerations, in towns and rural areas → can they reduce centre-periphery relationships?

ME employment by region (2000–2013)



- (Relative) winners: metropolitan capital region (C Hungary), rebounding manufacturing region (C Transdanubia)
- Greater shrinkage in under-industrialised regions (S Great Plain, S Transdanubia), main industrial crisis region (N Hungary), and FDI-driven manufacturing region (W Transd.)
- Geographic distribution & crisis years show vulnerability to exogenous shocks

Comparison of LQ and RCA indices



Mapping region – industry combinations

- N Great Plain food industry
- N Hungary metal industry
- C Transdanubia machinery
- C Hungary electronics

These are path-dependent (historical) spec patterns! + Three regions have no effective combinations

- S Transdanubia, S Great Plain: de-industrialised, mixed structure
- W Transdanubia: most successful industrial region, high FDI investments (crowding-out & congestion effects)

Firm interviews: general results

- Typically family firms („garage”) + some post-socialist „survivor” firms, very little evidence of „gazelles”, „unicorns” or venture capital
- Slow, gradual growth in capital-poor environment, gradual acquisition of core staff, machinery, production site
- **Path-dependent development**, carriers of local skills and industrial history
  - Challenge: „carrying it forward”, **path renewal**
- Core comp. in niche markets (**Mittelstand**) vs. general goods (**Italian SMEs**)
- Competitive adv: flexibility, product quality, special competences
- Internationalisation is above average, **strong export orientation** towards DE, AT, IT, followed by domestic sales

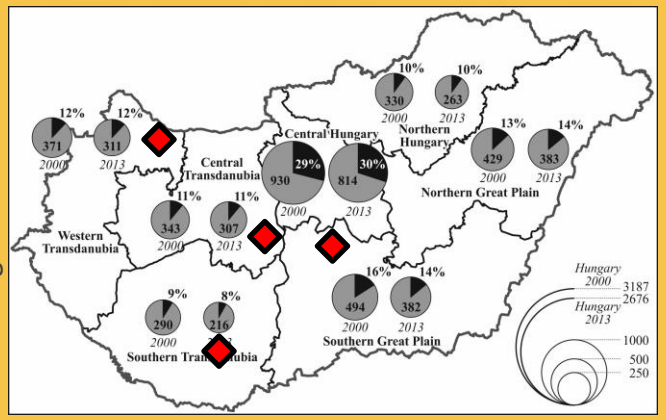
MEs in the local business environment

- Mostly satisfied with local business infrastructure
- A few MEs have expanded outside Hungary (Romania, Ukraine)
- Some senior executives have grown into the role of **local business leaders**
  - proactive role in **clusters**, local/regional **development coalitions** and **urban regimes**
- Another group is **„hiding"**, preferring minimal contact with the state
- These relationships show **strong differences** among case studies
- After long period of mutual isolation, **local cooperation is increasing** (defensive and offensive strategies)
- Complaint: **over-funding of multinationals**

Strategies & future orientation

- Ongoing, in-depth **restructuring** from contract manufacturing & generics towards higher-VA production, profile diversification in multiple companies ➔ Mittelstand patterns
- See future in automation, infrastructural development, continuous improvement
- Labour shortages mean **growth ambitions may remain unrealised**
- Some owners don't wish to grow (horizontal „division", firm networks)
- Challenge of generational change as „1990 entrepreneurs" retire ➔ keep it in the family, occasional promotion of SR managers or sale to external investors
- Two significant **growth barriers**, examples of failures
  - lower barrier (small enterprise ➔ ME)
  - upper barrier (ME ➔ large company)

Regional differences



- Paradox: strongest similarities to the German model were found in **peripheral** S. Transdanubia
- We found **much fewer** MEs in the W. Transdanubian case (crowding-out / congestion effects)
- Dunaújváros case: few MEs in a steelmaking town dominated by large enterprises ➔ stifling effect, low VA

- S. Great Plains Case: the emergence of a „hidden champion"
  - good fundamentals **+ positive exogenous shock** (Mercedes plant) + followup public investments ➔ „rising water lifts all ships"
  - diversified industrial structure, but stronger **light & food industry** traditions
  - these MEs have a lower resemblance to the German Mittelstand – less niche orientation, more emphasis on the domestic market

Conclusions

- MEs are a shrinking **and** consolidating part of Hungarian industry
- They represent **an early stage of high-road development**
- Benefits to reg. development: **capital accumulation**, strategic orientation, influence on local business environment
- Can't replace FDI, but can **diversify** and contribute to the **resilience** of minor cities & towns → (re-)specialisation, development coalitions, urban regimes
- In European context, these are still fairly young, fairly precarious firms
- Generational change, labour supply and I4.0 are the **main challenges**
- **Industrial policy** in Hungary can't create new national champions, but it can support the expansion and growth of MEs

Thank you for your attention!

Further reading:

- Lux, Gabor (2015): Minor cities in a metropolitan world: Challenges for development and governance in three Hungarian urban agglomerations. *International Planning Studies.* 1 – 2, pp. 21 – 38
- Lux, Gabor (2018): Industrial competitiveness: Beyond path-dependence. In: Lux, Gabor – Horvath, Gyula (eds.) : *The Routledge Handbook to Regional Development in Central and Eastern Europe*. Routledge, London - New York, pp. 29 – 46.
- Kovacs, Szilard – Lux, Gabor – Pager, Balazs (2016): Medium-sized manufacturing enterprises in Hungary: a statistical survey. *Studia Miejskie*. 24, pp. 59 – 71.