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Original scientific paper

FACTORS OF GROWTH FOR THE BIGGEST HUNGARIAN FIRMS

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Abstract

Since the beginning of the financial crisis, one of the key challenges of the economic policy has been to boost the growth of firms, particularly in the CEE region. Various research has showed that obstacles limiting and boosters enhancing companies' development potential differ across companies. This paper builds on both publicly available financial reports and a detailed questionnaire targeting the top 200 Hungarian firms with the highest sales in 2015. In top management's opinion, the level of technology, innovation and export position improved most in the years 2013 to 2015. At the same time, results show that beside market factors and challenges within companies' discouraging regulations, the limited amount of available trained workforce, high tax burden, and management capabilities are the major obstacles of growth. Even the biggest firms do not form a homogeneous group: constraints are different when controlled for export intensity, ownership, location, and strategic focus. So, access to financing is a real issue only with locally owned firms.

Keywords: *workforce, regulation, competiveness, export, ownership*

JEL Classification: *G32, L21, L25, H32, M21*

Introduction

Corporate growth is the driver of economic growth in any country. But to promote economic development, we have to see clearly what factors have a significant effect on business growth, so decision makers could contribute to increasing the GDP by influencing the key drivers. During recent years, convergence to Western Europe has gained a significant importance in the CEE countries, particularly in the EU member states. As Hungary has recently lost most of its impetus still present in the last decade, debates on causes and potential solutions have strengthened.

This paper aims to identify the key growth factors of the biggest Hungarian firms that are the main drivers of the local GDP. The objective of the research is to identify which of the factors earlier identified globally are relevant in the Hungarian economy today.

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It is particularly important to list the obstacles to growth to see who and how could improve the growth potential of the country. Once the key drivers are found, economic policies could be tailor-made to enhance the speed of development and optimise the use of scarce resources spent on business incentives.

In the first part, this paper presents the obstacles to business growth previously identified in literature. Then, after reviewing the sample used, the most important findings on growth factors of top Hungarian firms are presented.

Constraints in literature

Over the last decades, various theories were developed to explain the differences in the size of firms. While transaction cost based explanations and expansion trends explained by biological analogies were useful to describe the behaviour of a typical firm, those offered little help for elaborating country specific policies.

Before investigating drivers of growth, it is vital to define and understand growth itself. Literature on business growth usually focuses on changes in the amount of sales or sometimes, the number of employees, as these quantities are relatively easy to measure and publicly available. Though, in corporate finance, growth is more likely to be linked to the increase in profit, dividend, share price or cash flow. Based on possible sources of growth, usually extensive and intensive growth types are told apart. While the former would result from purchasing other firms or business units, the latter is linked to extending an activity already internalised or owned by the company. But even here, understanding growth could be more complex than that. Achtenhagen et al. (2016) underline that instead of applying the traditional external and internal growth strategy categories, a more detailed analysis of business growth would be welcome. Based on case studies of medium-sized firms, they identified eight different growth models on the pure organic to pure M&A scale showing that external growth is more complex than commonly assumed. Because of all this, instead of building one complex growth model, researchers started to focus on measuring individually the effect of specific factors either picked based on models of business economics and corporate finance or identified through case studies and deep interviews with top managers. Relevant variables usually mentioned could be grouped as outer and inner factors based on their relations to the given business entity.

Outer factors

The effect of financing opportunities is probably the most researched topic in this field. Serrasqueiro and Nunes (2010) analysed the relationship between growth opportunities and debt at 39 non-financial Portuguese firms for the period 1998-2006. When growth opportunities of firms are low and high, the relationship between growth opportunities and debt was found to be positive, while for intermediate levels of growth opportunities, a negative relationship was identified. They believe creditors recognize high growth opportunities, and debt is used to discipline managers when investment opportunities are weak. They also found that more profitable firms turn less to debt.

This implies that the importance of access to credit is not constant, rather it is more relevant when growth opportunities are great or very low, and when profitability is weaker.

Building on a sample of more than 6000 firms for 2007-2012 from the Emerging Europe, Leitner (2016) underlines that it was particularly the growth of the firms from the Western Balkan countries that was hit by the financing constraints originating from the financial crisis. She emphasises that exporting without importing, and boosting of innovation are recipes for fast growth in the whole area, while the importing-only business model, and, surprisingly, foreign ownership, both retard firm growth. (Contradicting Majcen et al. (2009).) The reason why the foreign ownership effect could be questionable was identified by Vukšić (2016). He showed that in Croatia the productivity of labour has not improved in either greenfield or (predominant) brownfield FDI investments, so no general improvement in competitiveness was to be experienced. This led to a conclusion that it is the type and not the owner of investment that drives growth.

Quader (2016) found a U-shaped connection between firms' size, age and growth rate when investigating 1122 listed UK companies. He also underlines the importance of internal cash flow generation. During years with low cash flows, the connection between growth and availability of external financing became stronger. The influence of internal cash flow generation was also higher for firms with more restricted outer financing sources. The validity of his results if well supported by Trefalt and Jagric (2014). The paper investigating Slovenian firms for the years 2004-2011 shows that access to outer financing only for larger firms reduces the importance of own cash flow generation when considering business growth. Based on a sample from Belgium, De Maeseneire and Claeys (2012) also conclude that the realisation of FDI projects and the growth of SMEs is limited by harder access to outer (both debt and equity) financing, making these projects and firms more dependent on their own internal cash flow generation.

Peev (2015) analysed determinants of firms' growth in ten European transition countries over the period 1996-2011. According to his results, the quality of financial intermediation is more important for firms' growth in countries with low quality of institutions. At the same time, the increase in private credit supply alone would not automatically result in faster growth: its effect is much stronger in countries with low governance quality. He also found that economic liberalization has no direct effect on firm growth. Instead, higher than average country governance indicators (Government Effectiveness, Regulatory Quality, Rule of Law, Control of Corruption) seem to promote growth.

When examining the former CEE and CIS communist countries over the years from 1990 through 2008, Cojocaru et al. (2016) concluded that the efficiency and competitiveness of the financial system is more important than the amount of private sector credit provided by the banking system. (A result similar to that of Peev, 2015.) They discovered a particularly strong link to interest rate spreads and bank overhead costs.

International integration of companies through trading is also a popular field in growth research. Were (2015) analysed the effect of foreign trade on economic growth globally for the period 1991-2011. He concludes that trade promotes growth only in developed and developing countries, while there is no effect for the least developed countries. As a main reason for this, the paper identifies the structure of FDIs arriving in those countries and proposes to change local investment promoting policies to receive real growth benefit from international trade. Besides that, high cost of doing business, lack of infrastructure, low quality of human capital, lack of both technological innovation and promotion of entrepreneurship is quoted as another reason. Silberberger and Königer (2016) found that both regulation and trade have a significant positive influence on growth. The effect of regulation was especially strong for countries with worse regulatory quality and middle-income level. Regulatory quality seems to have a decreasing marginal effect, but at the same time, the least developed countries do not seem to benefit from improved regulation. The role of education was found to be even more significant than that of trade, albeit mostly relevant for high-income countries. There is also no clear evidence of a direct effect of political institutions on income growth, but authors assume the effect to be indirect in the sense that countries with better political institutions will simply reform more and have better business regulation.

Lack of workforce is also an issue in the CEE region. Lazarov and Petreski (2016) highlight that the amount and quality of human capital could be a growth obstacle even in cases of high unemployment rates. In Macedonia, 12 percent of companies complained for inadequate workforce even though the average unemployment rate was 44.6 percent. Still, firms were unwilling to invest in training courses themselves. Bilal et al. (2016) examined the growth barriers of SMEs in China, India, and Pakistan. The availability of external financing had no effect on growth in China, but had positive effects in the other two countries. Besides that, infrastructure, workforce and corruption were identified as growth barriers. Innovation, one of the two mediators considered, promoted growth in all countries, while the other mediator, tax rate was found to have a contrary effect. Hanousek and Kochanova (2016) investigated the effect of bribery on firms' performance in Central and Eastern Europe. They showed that higher bribery level is linked to slower sales and labour productivity growth. At the same time, higher dispersion of bribery paid went hand in hand with better performance. This latter finding is explained by more efficient firms not paying bribes while less efficient ones using bribes to get forward once the bureaucratic system is open for that. In this case, bribing is not required but well received by public officers.

Garsaa and Levratto (2015) measured how the growth of firms reacts to reducing the rates of social contributions linked to labour. Based on their sample of more than 44000 companies from the French manufacturing industry between 2004 and 2011, such tax reductions promote especially the growth of already fast growing and large (over 50 employees) companies. While the effect was also positive for smaller and stagnant firms, the extent was far smaller calling for a more differentiated economic policy to promote growth. The definition of growth may be of high importance here, as Leitner (2016) showed that in countries of Emerging Europe, tax reductions promoted growth of employment only but not that of sales. At the same time, regulatory institutions, which help resolve insolvencies quickly and at low cost, were obstructive to both sales and employment growth. Analysing 162 countries over the period 2007-

2011, Messaoud and Teheni (2014) conclude that most regulation indices in the World Bank Doing Business Database are positively correlated to the average growth rate. These fully include areas like starting business, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency. The only exceptions were dealing with construction permits (three indices) and the time needed to register properties.

Garcia-Posada and Mora-Sanguinetti (2015) tested the effect of the judicial system on business growth in Spain. The paper underlines that one should not consider the overall functioning of courts, rather the focus should be on procedures the firms may face in case of conflict. According to their result, it is the efficiency of the declaratory stage, i.e. when fines are set, that promotes economic growth, while efficiency of the execution stage (when and how payment is to be made) has no impact. They showed that increased efficiency of the declaratory stage does not only promote the growth of incumbent (already existing) companies, but it also boosts the number of new entrants, while it has no effect on exits. Hence, according to their results, increasing judicial efficacy would improve welfare, regardless of its impact on the average firm size.

Benos et al. (2015) checked how geographical proximity of dynamic areas influence local growth in the EU. The paper concludes that entities surrounded by fast developing regions are more likely to grow faster than otherwise. Not only geographical, but also economic and technological linkages implied strong cross-regional spillovers, so authors recommend to give priority to higher physical and human capital investment in lagging regions across the EU.

Researches of growth obstacles do not only answer questions, but also tend to raise some. Lee et al. (2013) underline that the effect of big firms and SMEs on the economic growth is significantly different. Based on their results, big businesses have a significant effect on the extent and stability of economic growth all around the world. According to their results, these effects remain significant even if controlling for their influence on SME activity. At the same time, while the absolute presence of big firms (measured by their number) has a positive effect on economic growth, the relative presence of big businesses within the national economy (measured by their sales over GDP) is negatively linked to it. This result clearly contradicts the general argumentation for supporting SMEs in the first line as those would employ most of the people in any economy and determine the competitiveness of the country. It seems that some kind of equilibrium should be maintained – the exact values of which are still unclear.

Another issue is raised by Niţoi and Pochea (2016a). They tested the convergence in ten emerging countries within Central and Eastern Europe. The paper refuses the hypotheses of general convergence and identifies countries that outperform in some industries while underperform in others. When testing the convergence of financial markets in the region, Niţoi and Pochea (2016b) state that there is no single convergence pattern for these markets and during the period 2007-2014, disparities even increased. In both pieces of research, some specific countries may show convergence from one point of view and diverge when considering several others. This implies that industries within the same country may follow very different

development patterns raising the need for country and industry specific mapping of growth factors at the same time. It also seems that we have to set some kind of preference among industries when promoting economic growth. How that should be done is yet unclear.

Inner factors

In her classic article, Penrose (1955) called attention to internal (unique) factors that may hinder the growth of a company regardless of the outer environment like a pattern of a given industry in the economy. To explain the differences among firms operating under similar circumstances, she lists (1) planning capabilities, (2) availability of unused capacities, (3) limits on managerial resources, (4) limits of demand, and (5) diseconomies of scale as potential factors that may explain the disparities in the development of sales or employment. The importance of inner factors implies that just by changing the environment we may not see all firms growing faster, and companies developing more rapidly under given conditions may be superior to others in these unique characteristics. It seems that these inner factors have not lost any of their importance during the last decades. Majcen et al. (2009) focused on five CEE countries to show that the main drivers of productivity growth at foreign owned manufacturers are corporate governance, market orientation, and production capabilities. According to their findings, the higher the level of overall control and control of marketing and strategic functions at a local subsidiary, the higher the entity's productivity growth. While they found no regional differences, subsidiaries with higher proportions of sales to foreign parent companies and businesses in low-tech sectors showed higher improvement. A positive connection between foreign equity stake and increase in efficiency was also identified.

D'Souza et al. (2014) concentrated on 27 Eastern European and Central Asian countries to identify growth obstacles of companies. According to their results, newly founded firms experienced higher financial, corruption, and legal burdens than privatised firms; still the former outperformed the latter group. The authors explain this phenomenon by the organic (and thus stronger) profit motive of the newly founded companies. This once again underlines the importance of inner factors, and assumes some kind of path dependency.

Jeraj et al. (2015) focused on entrepreneurial-psychology. Based on a multi-country survey with a sample of entrepreneurs from Slovenia, USA and Serbia, the paper showed that openness (entrepreneurial curiosity) is positively related growth of the firm. Their results are reinforced and extended by Yazici et al. (2016). This latter paper investigated 92 independent hotels in North Cyprus to identify growth factors and a number of growth drivers that were categorised as entrepreneur specific (strategic) and stakeholder specific (tactical) factors. An important contribution of this micro level research was to raise the idea of separating company specific growth factors and key decision maker (management and owner) specific factors. This grouping may be less important for larger firms with several distinct levels of complex decision-making culture based on agreement of a team of specialists rather than a single individual, but smaller firms might leave some more space for human traits of top management members in the process. Table 1 summarises potential growth factors based on the

literature review presented. It is worth noting that most of the factors may have both positive and negative effects depending on their extent or value. Items appear in the table as originally tested in the articles quoted.

Methodology and sample

Based on the literature review, it is clear that the range of factors affecting the growth of firms may be different depending on their (1) size, (2) location, (3) ownership structure, and (4) foreign trade activity, among others. To investigate which of the factors listed are relevant for the leading Hungarian firms a detailed questionnaire was sent to 200 local companies with top sales in 2015. As the focus was on the biggest companies based on literature, decision maker-specific factors are less relevant. So, when collecting data, variables linked to factors included in the other three categories were also considered.

Data was collected by the business information provider Bisnode. Besides collecting financial statements and demographic characteristics of the firms, a detailed questionnaire with a detailed list of other potential growth factors was sent to top managers. Altogether 74 answers (response rate: 37 percent) were received. The aggregated performance of those companies accounted for 24 percent of total export, 26 percent of total EBITDA, 35 percent of total employment, 39 percent of total after tax profit, and 42 percent of total invested capital of the top 200 Hungarian firms. So, an average firm in our sample was exporting less and using more capital than the average of the leading 200 enterprises, while employment and profitability were almost at the expected level.

Results and findings

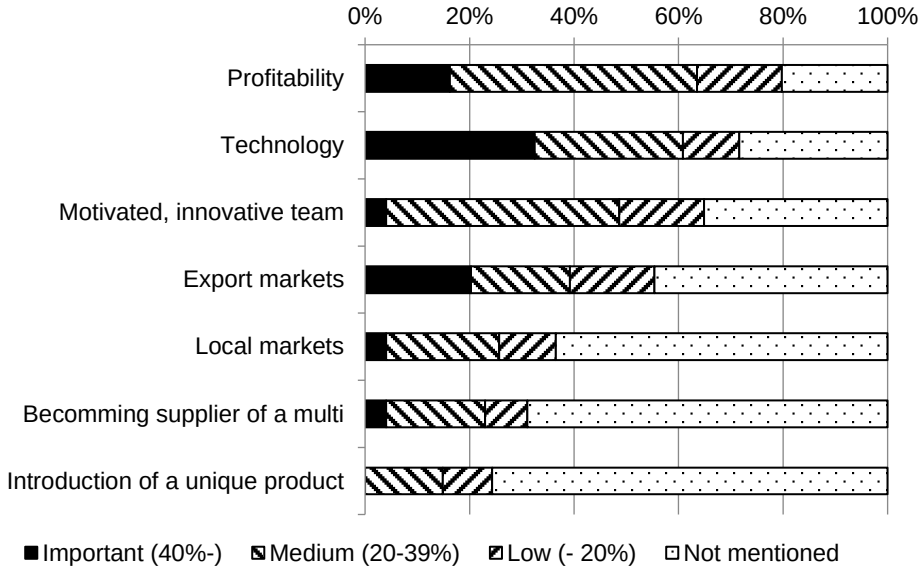
When asked about key success factors of the last three years (2013 to 2015), top managers had to allocate 100 percent across the listed items. Based on percentages, allocated items were grouped as important (more than 40% of success coming form that factor), of mediocre importance (20% to 40%), and of low importance (0% to 20%). Figure 1 shows how different factors scored across the replies.

Table 1. Factors influencing the growth of firms

Influence on company growth	Decision maker specific factors	Company specific factors	Economic factors	Regulatory factors
Positive	Entrepreneurial curiosity Autonomy Innovativeness Proactiveness Competitive aggressiveness Desire to be one's own boss Desire to succeed Active risk taking Motivation Education Management experience Family history Age of decision maker Prior sector experience Gender Network of contacts	Exporting only strategy Innovation (mediator) Good planning capabilities Availability of unused capacities Number of founders/owners Other business interests of the owners Family, "investing" friends Key employees, partners Firm age Location Size of firm Organisational culture	Absolute presence of big companies Importance of foreign trade in the country Availability of external financing, Efficiency and competitiveness of the financial system Proximity of rapidly developing regions	Level of education Favourable tax regime Country governance Efficient corporate juridical system World Bank Doing Business Indices
Negative		Customer concentration Supplier concentration Strong competitors	Relative presence of big companies Lack of workforce Low quality of human capital Limits of demand	Effective insolvency regulations Lack of infrastructure Lack of technological innovation Lack of promotion of entrepreneurship High cost of doing business Corruption

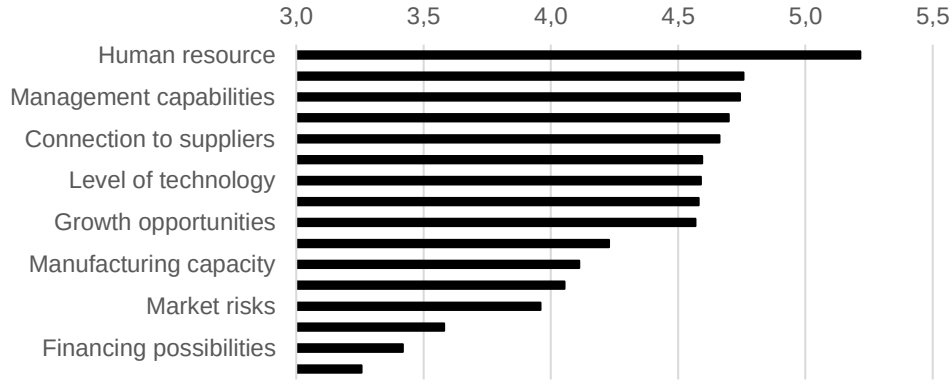
Source: Author, based on the literature review presented

Figure 1. Factors of success in the last three years



Improving profitability, technology, and motivated, innovative team were the most significant forces. It is worth noting that the two latter ones are inner factors, while the first one is more a result of different forces. Increases in export sales had greater effect than the similar success in local markets, while improvements in productivity and growth in number of export countries were not mentioned at all. When asked what parameters were to be improved in the coming three years to boost growth, human resources, regulation, and management capabilities were the most common answers. At the same time, highly likely thanks to the recent financial supporting program of the National Bank of Hungary and the low interest environment, financing opportunities needed the least improvement. While boosting export is one of the key focus of the current national economic policy, this idea seems not to play a very important role in the future of the biggest firms. (It is worth remembering though, that our sample had lower than average export performance within the top 200 companies.)

Figure 2. Changes needed in the next three years*



*Average values, Scale: 1 – no change needed, 7 – extreme changes needed

When asking about the obstacles of growth these companies are facing, an open-end question was also formulated to give room for inputs and not to limit them by a potentially incomplete list of choices. Room for up to three factors was provided.

The answers received were clustered into homogenous groups. Regulation and unfavourable state influence was the most important group (62.2 percent). Within this cluster, unfriendly regulations were mentioned by 47.3 percent of the respondents, while 14.9 percent complained about various state burdens and taxes. The second most cited problem was lack of trained workforce mentioned by 54.1 percent of the managers. 52.7 percent of them complained about some kind of market factors, like fierce competition, new competitor entering the market, disadvantageous macroeconomic conditions or changes and uncertainties in market conditions. Other important factors listed include inner factors (e.g. technology, innovation, management efficiency) accounting for 24.3 percent and financing issues marked in 21.6 percent of the questionnaires. Bribery that is often mentioned by the opposition as an important issue in everyday Hungarian politics was not mentioned at all.

Beside of being able to judge the importance of these factors a very important lesson learned from the answer was that decision maker specific factors (management efficiency), company specific issues (technology) could be just as important as economic factors (market conditions, financing, workforce availability) or regulatory problems (taxation, laws), whiles these inner factors are far harder to track and measure.At the same time, results show that not even the biggest companies in a given country form a homogeneous group when considering growth obstacles. When tested for location, ownership, and market focus significant differences were measured. (Table 2)

Table 2. Significant differences in growth factors*

	Outside the capital	In Budapest	Total
Unfavourable regulations	38.8%	64.0%	47.3%
	Foreign	Locally owned	Total
Difficulties in financing	17.3%	42.9%	22.7%
	Inner market focused	Exporters	Total
Shortage of trained workforce	33.3%	64.0%	54.1%
Inner obstacles**	12.5%	30.0%	24.3%

*Differences significant at 5 percent significance level. **Significant at 8.5 percent.

Unfavourable laws and regulations were quoted by far bigger likelihood by firms headquartered in the capital. This could be most likely explained by the considerable differences in the industry structure of the two locations. Difficulties in financing were characteristic for locally owned firms (state owned companies were not considered), while shortage of trained workforce hit export oriented companies (achieving at least 25 percent of their sales in foreign markets). Probably one of the most interesting finding is that inner obstacles were far more likely to be identified by firms integrated to the international economy through their exports that might be more explained by the management culture than the actual abilities of the company. It is not very likely that non-exporting business have far less problems within the firm, rather companies with international connections are better in noticing their own disadvantages compared to rivals. This again highlights the importance a management culture in improving the performance of a business entity.

Conclusions and limitations

Based on literature a wide range of factors may potentially have an effect on the growth of companies for the years 2013 to 2016. One of the contributions of this paper is to group these factors into four categories underlining the importance of key decision maker specific and company specific characteristics that are harder to measure in contrast to market and macro factors more often tested. Another important result is that an order of relative importance of all the growth factors analysed was created instead of just listing obstacles and boosters. Besides, there are four important lessons to learn from the questionnaire bayed research performed among the biggest Hungarian firms.

(1) After the opinion of the top managers, the most important current obstacle of growth of the biggest companies is the state itself in Hungary. There is a lot of room for improvement particularly when considering current rules, regulations, and taxation. The influence on growth of these factors was earlier described by D'Souza et al. (2014), Messaoud and Teheni (2014),Garsaa and Levratto (2015), Bilal et al. (2016), and Silberberger and Königer (2016) for other markets.

(2) Asduring the last three years one of the key success factors was the more effective use of human resource, the current problem of missing workforce is a particularly severe one. It is not also workforce market conditions but also the abilities and knowledge of the employees and the management that calls for improvement. Still, just as Lazarov and Petreski (2016) state for Macedonia, even the biggest firms

usually evade spending on education of their current and potential employees in Hungary.The role of human factor was earlier presented not only by Penrose (1955), but also by Were (2015), Benos et al. (2015), and Yazici et al. (2016) more recently.

(3) Even the biggest firms do not form a homogeneous cluster. There are significant differences among those companies even in the importance of factors less influenced by individual characteristics (e.g. workforce shortage). Ownership, export orientation and location were all showing significant differences in some measures. While the importance of ownership was cited earlier by Majcen et al. (2009), Vukšić (2016), and Leitner (2016), export orientation was also highlighted as growth factor by Leitner (2016). Differences in location within the same country was less researched, but Benos et al. (2015) had similar results. At the same time it is highly likely that in our case it is more the difference in industry structure strongly linked to location that might explain the results of this paper.

(4) Not discovering inner obstacles of growth and neglecting exporting opportunities seem to be connected, at least among the biggest Hungarian firms. This underlines how important the corporate culture (decision making processes, striving for self-improvement) could be in explaining the extent of growth of a firm. This underlines that factors raised by Penrose (1955) are still relevant today, a result that was as also emphasised by Jeraj et al. (2015) and Yazici et al. (2016).

As all analyses, this paper has its limitations too. The research focus was on the biggest companies so results may not be valid for the whole Hungarian economy. Also the sample had less than average export performance, while capital employed was more than typical for the top 200 firms, what might hint to difference in industry structure. There could be also obstacles overlooked by the top managers answering. Also because of the sampling, this research could not trace factors effecting mainly or only growth of SMEs.

Due to the development process of this research field, a number of questions remain still without answer. We can not be sure that (1) the growth of one variable (sales, employment) automatically triggers the growth of all others (profit, cash flow, added value and GDP) leading to an increase in the general term. Also, because of usually not focusing on the process of growth rather than on the outcome only, it is yet unclear, whether (2) a given driver affects the intensive or the extensive growth opportunities (or any possible strategies in between on that scale) or all of those. Next, (3) different factors may promote growth of SMEs and large firms, but we still do not know which kind of growth is to be preferred. Also it has been shown that growth can take very different directions and speed for different industries even within the same country and under the same economic policy. It needs to be answered yet, (4) which industries to focus on when stimulating business growth. Finally, very limited research was made on (5) which kind of these growth strategies would be more advantageous for a country in the long run.

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