Exploring the relationship between the presence of foreign-owned firms and the business dynamics in Hungarian agglomeration areas

Balázs Páger
research fellow
Centre for Economic and Regional Studies

The foreign-owned companies and their impacts on the various dimensions of the economy (both on national and sub-national levels) might be a crucial issue in those countries whose economy relies significantly on them, like Hungary but also other CEE countries (Sass et al., 2018; Gál–Lux, 2022; Götz et al., 2023). Reviewing the literature, several papers can be found that discuss the potential role of foreign-owned firms. In this way, these studies investigated the role of these companies in bringing in new knowledge and enhancing regional R&D (Varga–Schalk, 2004); their impact on the differences in growth trends among Hungarian counties (Lengyel–Varga, 2018; Zsibók–Páger, 2021); or their function in pursuing entrepreneurial activity in the national level (Acs et al., 2007). Still, studying the potential influence of foreign-owned companies on the business dynamics in the level of agglomeration areas might provide an additional part to the stream of literature investigating the overall role of foreign-owned firms in the Hungarian economy.

Entrepreneurship is widely believed to be an essential driver of economic development, employment, and productivity growth at the national and regional levels. Several studies proved that new firms positively affect economic development; however, the magnitude of the impact varies significantly over regions (Acs – Varga 2005; Acs – Szerb 2007; Fritsch – Müller 2004, 2008). The context has an important role, as it regulates the quality and outcome of the entrepreneurial activity (Acs et al., 2014; Szerb et al., 2019). New entry firms result from the interaction between individual attributes and the context (Stam 2010, 2015). Entrepreneurial behaviour and attitudes, together with the context, could lead to an increased level of new startups (Welter 2011, Zahra et al. 2014).

Regarding the impact of foreign-owned companies on entrepreneurship, a bunch of studies found somewhat positive impacts. These companies can increase the market demand (Ayyagari–Kosová, 2010). They bring the latest technology to the host country/region (Acs et al., 2007; Kosová, 2010; Bisztray, 2016), which might positively influence the local actors through knowledge spillovers. In addition, foreign-owned firms might indirectly support the development of individual entrepreneurial abilities through work experience and improved knowledge (Chowdhury et al., 2015). Moreover, they can also enhance the productivity of domestic firms (Apostolov, 2017).

However, other empirical findings showed that the role of FDI in promoting entrepreneurial activity and enhancing the number of new firms in the host countries is mixed and sometimes contradictory (Albulescu–Tamasila, 2013). The presence of FDI may crowd out local firms from the local markets (De Backer, Sleuwagen 2003; Kosová 2010). Foreign-owned companies might influence the level of competition regarding the level of labour concentration and wages

(Abolhassani–Danakol, 2019). In this way, they can attract scarce local resources (such as the qualified workforce) from domestic firms (Danakol et al. 2017). In addition, foreign-owned companies can also influence entrepreneurial activity by attracting graduates with well-paid and safe jobs for a highly educated workforce instead of starting their firms (Berrill et al., 2020). Moreover, the negative effect of FDI on domestic entrepreneurship seems stronger in relatively low-tech industries than in relatively high-tech sectors (Abolhassani–Danakol 2019).

Previous studies revealed a somewhat positive effect of FDI on the entry of new firms in the Czech Republic (Ayyagari – Kosová 2010; Kosová 2010) and the Visegrad countries (Wach – Wojciechkowski 2016), but the extent of this effect varied among the nations. Furthermore, the positive impact of foreign-owned companies on firm entry seems to be more significant in countries having relatively weak institutional backgrounds and political stability or providing less opportunity for human capital to acquire and develop skills (Kim–Li, 2014). Pavlinek and Zizalova (2014) found a low share of domestic suppliers in the total supplies of Czech-based foreign firms and diverse spillover effects from foreign to domestic firms. Domestic firms vary in capabilities and absorptive capacity, which, along with the particular nature of the contemporary automotive value chain, significantly influence their ability and potential to benefit from linkages and spillovers.

This study will contribute to this field by investigating how foreign-owned companies influence business dynamics in Hungary's agglomeration areas. Along with this research question, two preliminary hypotheses are structured. On the one hand, it is assumed that the presence of foreign-owned companies may support the entry of new firms due to providing opportunities for local suppliers (effects on related activities), and it might also offer demand for products and services in the region (effects on non-related activities). On the other hand, there is expected to be a spatial limit to this positive effect of entry. Hence, this impact might become weaker far from the centre of the agglomeration area. Building on a panel dataset of Hungarian firms provided by the Databank of the Centre for Economic and Regional Studies, the paper analyses whether the effects of foreign-owned companies on firm entries are negative or positive. In the frame of this investigation, we attempt to reveal both the cross-sectional (region, industry) impacts and the spatial effects.