

# What Do the Business Results for 2007 Reveal? A Macro-analysis Based on Company Balance-sheets

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## INTRODUCTION

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The basis for this analysis was provided by the aggregated balance-sheets of companies for the year 2007. The analysis essentially focuses on “macro-aims and character”, although little more than half of the national GDP is created in the business sector (specifically, 12,891.7 billion Ft of the total GDP for 2007 of 25,419.2 Ft). It is, however, evident that this is the most significant proportion (at least in relation to the most important features of economic activity) and so there is some value in examining the results from the perspective of total economic activity and in drawing conclusions for the economy as a whole.

The features of the analysis and the conclusions which can be drawn from the results are basically influenced by the fact that the database does not contain finely detailed data, but rather the total values of groups of businesses. The smallest of these in the database was the branch, and so we took this as a unit of calculation. One of the most important factors of the investigation was to examine who produces what, with what result and by how much does the latter add to the common budget based on a breakdown of the ownership of the branches.

We have differentiated between three forms of ownership: companies with domestic majority ownership, companies with foreign majority ownership, and state-owned companies.

(In this latter case we did not strictly apply the 50% rule, and we also regarded some typical sectors as state-owned if the branch level ownership ratio stood at some percentage points below the critical limit).

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## GENERAL BUSINESS OVERVIEW

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Table 1 shows in a comprehensive fashion the most important characteristics as broken down by owner and branch. The most striking – but scarcely surprising – oddity to be seen in the table is that foreign majority-owned companies provide half of the GDP (value added)<sup>1</sup> produced by companies (and a quarter of the total GDP), while they own only twenty percent of the companies and only 30% of employees are employed by them. More efficient production can be observed also in the fact that employees of foreigner companies produce, on average, more than 9 million Ft in new value, whilst in domestic business circles the figure is less than half of this at only 4.3 million Ft.

<sup>1</sup> It would be more precise to speak of value added produced by companies, but since the use of GDP is so widespread, even in professional standard language, we have no other option than to follow this less-than-perfect use of terminology.

Table 1.

	<i>Total companies</i>	<i>Foreign companies</i>	<i>Domestic companies</i>	<i>State-owned companies</i>
Number of businesses (%)	333 596 100.0%	64 615 19.4%	253 618 76%	15 362 4.6%
Employees (%)	2 242 179 100.0%	678 415 30.2%	1 322 211 59%	241 553 10.8%
GDP (billion Ft) (%)	12 891,7 100.0%	6 208,2 48.2%	5 750,1 44.6%	933,4 7.2%
GDP per capita ('000 Ft)	5 750	9 151	4 349	4 403
Fixed assets ('000 Ft)	27 475	60 643	12 192	15 836
Fixed assets-to-personnel cost* ratio	9.5	16.3	5.1	5.1
Personnel cost-to-GDP ratio	50.3%	40.7%	55.5%	71.2%
Exports as % of total sales	27.2%	40.1%	17.8%	4.7%

\* Personnel cost means the total of wages and salaries, related charges and the cost of fringe benefits.

Differences in the level of technical development among the sectors are shown by the very different range of fixed assets per capita and of the assets to personnel cost ratio (capital to labour). The per capita value of the fixed assets is four times higher in foreign-owned companies than in their domestic equivalents, and the capital to labour ratio is three times higher. The different developmental level is also shown by export sales: only 18% of the domestic companies' sales are exports, whilst in foreign-owned companies export sales as a percentage of total sales reached 40%.

The limited appearance of state-owned companies in terms of production and employment is not at all surprising and can be explained by the intensive privatisation carried out in earlier years. The state's role is, in any case, concentrated much more on non-market-related areas such as education, health-care, public administration etc. and so any significant participation in the corporate field is not to be expected. Furthermore, it cannot be regarded as in any way odd that the state-owned corporate sector has relatively low profitability (see the data in Table 2). State companies are basically not expected to be highly profitable, but to have a useful,

supplementary function in correcting the market. It should also not be surprising that state-owned companies receive the largest proportion of available subsidies on a per unit basis. At this stage of the analysis, we cannot judge the extent to which branch subsidies are necessary or unnecessary. However, we are convinced that the total ratio of state subsidies is too high, since it exceeds 6% of the value added (GDP). If we also add the tax allowances on a similar scale, the exaggerated and misdirected role of the state in business is even more obvious.

The technical and competitive dominance of foreign-owned companies is also shown by profitability: net profit on sales, both before and after tax, is significantly higher here than in the domestic sector (ignoring the state-sector completely). However, it is interesting to note that this advantage starts to weaken if we look at profit in relation to fixed assets. Here, domestic companies showed better results. However, before any dramatic conclusions are drawn, it is useful to remember that domestic companies normally operate with a limited fixed asset base. These favourable results are undoubtedly due to this.

Table 2.

	<i>Total companies</i>	<i>Foreign companies</i>	<i>Domestic companies</i>	<i>State-owned companies</i>
Pre-tax profit as % of sales	9.7% (7.2%)	13.0% (9.4%)	7.2% (5.6%)	5.2% (3.3%)
After-tax profit as % of sales	9.0% (6.5%)	12.1% (8.5%)	6.6% (5.0%)	4.6% (2.7%)
Pre-tax profit to fixed assets (%)	10.2% (7.6%)	9.2% (6.6%)	14.6% (11.3%)	3.5% (2.2%)
After-tax profit to fixed assets (%)	9.5% (6.8%)	8.6% (6.1%)	13.4% (10.2%)	3.1% (1.8%)
Pre-tax profit deducting after-tax to pre-tax profit	7.1%	6.4%	7.9%	11.5%
Subsidies-to-GDP ratio	6.3%	1.2%	7.4%	22.7%
Tax allowances-to-GDP ratio	6.3%	8.3%	4.9%	1.3%

( ) In brackets we show the index adjusted for losses in non-profitable companies.

## TAXES, TAX ALLOWANCES AND SUBSIDIES

As already mentioned in the previous chapter, the superiority in efficiency of foreign-owned companies is also shown by their profitability, since their after-tax profit ratio exceeds 60%, even though they scarcely achieve a 50% share of production (see Table 3). What is actually paid as profits tax can easily be calculated from the company's balance-sheet as the difference between

the pre- and after-tax profit figures. Our calculation, however, produced the surprising result that the whole business sector paid some 450 billion Ft in profits tax, whilst, according to their pre-tax profit figures, they should have paid 1,250 billions in tax based on the  $16+4=20\%$  profits-tax rate. Therefore, nearly two-thirds of the theoretically due profits tax was not paid, and so businesses benefited from some 810 billion Ft of tax allowances.

Table 3.

	<i>Total companies</i>	<i>Foreign companies</i>	<i>Domestic companies</i>	<i>State-owned companies</i>
After tax profit* (billion Ft), % share	5 846.9 100.0%	3539.6 60.5%	2163.3 37%	144.0 2.5%
Profit tax paid (billion Ft), % share	448.4 100.0%	242.9 54.2%	184.4 41.1%	21.1 4.7%
Tax allowance (billion Ft), % shares	810.7 100.0%	513.6 63.3%	285.1 35.2%	11.9 1.5%
Subsidies (billion Ft) % shares	806.2 100.0%	71.4 8.8%	426.2 52.9%	308.6 38.3%

\* Comprises only the totals from profitable businesses.

Obviously, the extent of this is not a minor issue. The majority (more than 60%) of tax allowances were granted to foreign enterprises and only one third to domestic companies, although domestic companies employ more than the half of all employees. The level of allowances to state-owned companies is negligible.

The situation is totally different in the case of subsidies, the biggest proportion, more than half of all subsidies, were granted to domestic enterprises, and mainly to those with a large shareholding by the state. By comparison, foreign-owned companies did not even reach 10% in terms of subsidies, although some strikingly highly subsidised branches can also be found here. The major beneficiary of subsidies was the state company sector

since they received the most in relative, even if not in absolute, terms. This is clearly visible in the penultimate line of Table 2, where the ratio of subsidies compared to GDP is shown.

## PROFITABILITY AND LIQUIDITY

It is worthwhile returning to the issue of profitability although this has already been mentioned in connection with Table 2, where the figures of sales revenue- and assets-to-profit were published. The situation is better illustrated by the business management profitability indices (see Table 4).

Table 4.

	<i>Total companies</i>	<i>Foreign companies</i>	<i>Domestic companies</i>	<i>State-owned companies</i>
After-tax profits to registered capital	0.357	0.373	0.390	0.075
Value added to own capital	0.283	0.190	0.511	0.654
Value added to sales revenues	0.199	0.213	0.176	0.418
Current assets to short-term liabilities (liquidity)	1.28	1.30	1.19	1.63
Total liabilities to own capital	1.78	1.49	2.38	2.46
Liabilities to own resources	0.63	0.598	0.704	0.71

The primary role of the index calculated as a ratio of net profit and registered capital (first line of Table 4) is to measure the efficiency of share capital, the dividends paid being used to calculate capital yield. We, however, are not concerned with this, since only a negligible proportion of companies with majority domestic

ownership are currently traded on the stock market. Consequently, it is not surprising that domestic companies offer a higher yield than their foreign counterparts, since it is a fact that Hungarian businesses are heavily under-capitalised. The ratio of value added and own capital (the second line of the table) shows the

scale of value added which can be generated by the specific business sector from its own resources. The value of both the domestic and state business sectors is better than that of foreign capital since the percentage of “own capital” is very low. Furthermore, the value added compared to sales revenues can be regarded as an index of efficiency which shows the new value added by the sector. The index for state-owned companies was the best, due, on the one hand, to their relatively low assets-to-stock ratio, and, on the other hand, to the fact that they mainly undertake service-like activities where RMCs (raw material costs) are relatively low.

The quotient of current assets-to-stock and short-term liabilities is the liquidity ratio – which is higher than 1 if part of the current assets originates from own resources or from long-term foreign resources. Values below 1 indicate problems for the business and its management, since, in such a case, there are insufficient resources to cover short-term liabilities. Based on this, it is somewhat surprising that the liquidity ratio of domestic companies is not much worse than that of the foreign-owned companies with state-owned companies performing best in this respect. The critical value of the capitalisation ratio – that is, the quotient of total liabilities and own capital, is 2; if the value is higher than this, the burden of foreign liabilities can be very high. From the data in the penultimate row of Table 4, it is evident that both the state and private domestic business sectors are within the critical range due to the high ratio of foreign debt. The debt index shows the level of liabilities within total resources. The critical value here is  $2/3$  (two-thirds); a higher level of indebtedness is accepted as being too high, in which case disinvestment can cause a crisis.

From the last line of Table 4 we can see that domestic companies (both state- and privately-owned) are within this critical range and so are deeply in debt.

## THE INCOME-SIDE COMPOSITION OF GDP

With company balance-sheets we can also calculate value added (GDP) from the income-side. This is shown by the ownership sectors in Table 5.

A significant proportion of GDP is provided by two basic elements of income: wages and associated costs, and taxes (profits tax). Amortization is added to this in accordance with the principle of the gross account and subsidies as corrective factors. Based on the total number of companies, the total of wages and related costs amounts to one-half of the GDP, whilst profits-tax accounts for more than one-third. Nevertheless, there are significant sectoral differences behind these total percentages. In the case of state-owned companies, gross wages represent the majority of value added, whilst, with foreign-owned companies, they represent only 40%. The situation is exactly the opposite in respect of profits, in that in foreign-owned companies profit is the largest, whilst in state-owned companies it is the smallest. Naturally, the comparison is much more relevant regarding domestic and foreign businesses, but the differences here are also very significant. The wages-to-profit ratio is significantly lower in foreign-owned companies than in their domestic counterparts, and it is obviously the differences in profitability and in the assets-to-wages ratio which lie behind this.

Table 5.

	<i>Foreign companies</i>		<i>Domestic companies</i>		<i>State-owned companies</i>		<i>Total</i>	
	<i>billion Ft</i>	<i>share</i>	<i>billion Ft</i>	<i>share</i>	<i>billion Ft</i>	<i>share</i>	<i>billion Ft</i>	<i>share</i>
Wages	1932.8	30.6%	2448.3	43.5%	542.5	78.9%	4972.8	39.0%
Social security payments	593.8	9.4%	742.2	13.2%	165.1	24.0%	1516.0	11.9%
Net profit	2490.3	39.5%	1637.7	29.1%	64.4	9.4%	4218.2	33.1%
Profit tax	246.1	3.9%	187.6	3.3%	14.4	2.1%	455.1	3.6%
Amortization	1116.7	17.7%	1037.1	18.4%	210.0	30.5%	2375.9	18.7%
Subsidy	-71.4	-1.1%	-426.2	-7.6%	-308.8	-44.9	-806.2	-6.3%
Total*	6308.4	100.0%	5626.7	100.0%	687.6	100.0	12731.8	100.0%

\* Totals are different from those of previous tables since branches with negative value added were eliminated.

The branch differences are even more pronounced if we compare data as per capita value added rather than on total value added (see Table 6).

*Table 6.*

'000 Ft	<i>Foreign companies</i>	<i>Domestic companies</i>	<i>State-owned companies</i>	<i>Total*</i>
Wages	2 826	1 852	2 403	2 218
Social security	868	561	731	676
Net profit	3 642	1 239	285	1 881
Profit tax	360	142	64	203
Amortization	1 633	784	930	1 060
Subsidy	-104	-322	-1 368	-360
<b>Total</b>	<b>9 224</b>	<b>4 256</b>	<b>3 046</b>	<b>5 678</b>
<i>Net national</i>	<i>3 950</i>	<i>3 471</i>	<i>2 116</i>	<i>3 301*</i>

\* Foreign share has been taken into account with 70% weighting in net profit.

By employing one person, foreign capital produces twice as much GDP (value added) as do domestic companies, and exactly three times more than state-owned companies. At the same time, on a per capita basis, the taxes (social security and profits tax) paid by foreign-owned companies amount to 1.2 million forints, by domestic companies to 0.7 million and, by state-owned companies to 0.8 million. Furthermore, foreign-owned companies pay fifty percent more in wages to their employees than do their domestic counterparts and 17%

more than state-owned companies. Based on these facts, one might conclude that employment should mainly be encouraged in foreign-owned companies, since this produces the highest returns in GDP, wages and tax revenue.

The matter, however, is not so simple, and it is evident that per capita values are high in foreign-owned companies since they employ only a limited number of people (the capital-to-labour ratio is high), by the technique of employing the cream of the labour market. Consequently, the costs of creating a new job are much higher than in other fields. In the previous era, the state provided a 10–20 million Ft subsidy to foreign-owned companies to create one job, recouping this through tax revenue over 10–15 years. One job could be created by a much lower (3–5 million Ft) subsidy in domestic companies – meaning a quicker (5–7 year) repayment period to the state budget.

Finally, a further point for consideration in respect of the success of foreign and domestic companies would be: how large is the proportion of income created which is truly expendable? The NNI (Net National Income) indicator answers this question by subtracting amortization and owner-related income (in our case, the profit) of foreigners from GDP. The last line of Table 6 contains the adjusted index. It is clear that the difference between the ability of foreign and domestic companies to produce income decrease greatly in this case, and, if we take into account the significant job creation subsidy given to foreign-owned companies, the scales clearly come down on the side of domestic companies.