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Will Swedish Manufacturing Business Put the Swedish Economy Out of its Crisis?

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WILL SWEDISH MANUFACTURING BUSINESS PUT THE SWEDISH ECONOMY OUT OF ITS CRISIS?

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WILL SWEDISH MANUFACTURING BUSINESS PUT THE SWEDISH ECONOMY OUT OF ITS CRISIS?

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A foreigner would normally associate Swedish manufacturing industry with a small number of very big, international companies. The rest of the Swedish economy, best known to foreigners is its huge public sector. This association is not altogether wrong. The large firms, more than in any other country, dominate the Swedish private production system. They are profitable, more profitable than average industry, partly because of their international success. This, however, is not altogether positive, because it mirrors another side of Swedish manufacturing; a small, not so profitable and not expanding small and medium sized business sector. The big firms, with a few exceptions (see Table 1 and 4) produce relatively mature products, notably for investment goods markets (cars, whiteware goods, etc).

More than earlier Swedish manufacturing is now in the economic political focus as the engine of growth on which politicians pin their hopes to get the rest of the economy out of its current deep recession. Will the big international firms do it again this time or are they leaving the country? What is the potential of small and medium sized firms to move the economy out of its recession? With open unemployment closing up with 10 percent and the largest public deficit in the industrial world, what has happened to Sweden? Is it no longer the attractive investment country capable of maintaining for ever stable economic growth and a prosperous welfare economy?

The Growth Engine

Large international firms have long dominated Swedish manufacturing industry (see Tables 2 and 3). No other country has so many large firms (compared to GNP) on the Fortune 500 list as Sweden (see Table 4). Until the mid 60s the big Swedish firms expanded through direct investments, mainly in Sweden. During the 70s a parallel expansion took place abroad, but foreign direct investments were predominantly market oriented, involving the building of an international network of production plants close to a dominant market. These foreign investments exercised a pull effect on more advanced Swedish production at home and on a growing group of subcontractors. The content of advanced, competence intensive production like product development increased in Sweden. Several studies from the IUI showed that the more advanced products the larger the propensity to produce in, and export from Sweden.

During the 80s acquisitions dominated. Increasingly during the 80s the foreign part of the Swedish multinationals became less and less dependent on their parents. To a not insignificant extent foreign production has become relatively more advanced than production in the Swedish parent, and rather than pulling Swedish domestic production foreign subsidiaries have begun to export finished goods back to Sweden¹. Throughout the postwar period Swedish competitive advantages have shifted from a base in basic industry production, via machine intensive volume production and inexpensive workers towards an effective use of a growing cadre of skilled workers. During the 70s the competitive advantage shifted further towards engineering intensive product development and technological product competition.

¹ Most of the circumstances related in this article come from recent IUI studies, notably *Den långa vägen*, published in August 1993, currently being translated as *The Long Road - The limitations and possibilities of economic policy to preserve Swedish welfare by reducing the welfare state to manageable proportions*.

The growth engine of an economy is founded on four kinds of investment; (1) new establishment, (2) reorganization and (3) rationalization of existing firms, and (4) disinvestment in the form of exit badly managed firms². During most of the post war period Swedish top level management exhibited excellence in managing growth through rationalization investment. The 80s exhibited big Swedish firms reorganizing into giant international businesses that developed, marketed and made products for global delivery. This innovative international reorganization pulled Swedish industry and the Swedish economy through an otherwise dismal period.

The revised industry sector

As in other industrial countries so called deindustrialization has been a cause for political concern. It is true that value added (See Figure 2), and even more so employment, in the statistically registered sector called manufacturing has been on a steady decline in most industrial countries. The statistical representation of the manufacturing sector in the national accounts of all countries (however), is seriously biased. Manufacturing industry has been constantly shifting its internal content of production towards competence intensive service production. Several IUI studies have demonstrated a positive relationship between the extent of such internal, competence intensive activities and firm profitability or productivity growth. It is, however, a matter of rather arbitrary organizational choice whether such service production (like software development) is carried out inside the firm or in subcontracted consulting firms. A true representation of the goods producing industry thus has to incorporate all related service production. This is particularly important for the simple fact that this service production (see *The Knowledge Based Information Economy*, IUI, Stockholm 1990) is mostly oriented towards quality improvements of the goods produced. With value added in related service

² For an explanation of this growth model in English see Eliasson, G. 1992, *The Economics of Technical Change - The Macro Economic Consequences of Business Competence in an Experimentally Organized Economy*, IUI Working Paper No. 349b.

production included the goods producing sector is raised to almost 50 percentage of GNP (see Figure 2) and shows no decline over the postwar period.

Small business and new establishment in decline

More worrisome than the decline in manufacturing as a percent of GNP is the steady decline in Sweden since the end of the war of new business formation (see Figure 3) and the slow growth in small and medium sized business, notably in the new technology areas of manufacturing and private service production.

The big firms will continue to dominate Swedish growth in the short-, medium and long-terms. However, by the experience of the past the big firms will stumble or fail at the rate of one or two per decade. For economic growth to continue, this impact has to be absorbed by a steady flow of new establishment and a rapid growth of many firms in the small and medium sized business sector. This compensatory growth has not been present in the Swedish economy for decades. Particularly serious for the very long term outlook is the decline in new business formation.

New business formation is subjected to very high failure rates. Those few firms that survive take very long to reach a size comparable to the existing big firms. Radical rejuvenation of industry occurs predominantly through new business formation. Hence the decline shown in Figure 3 and other related symptoms are alarming signals. They operate in the *very long-run* and the effects of what happened in the early postwar period are now beginning to influence macro-economic performance of the Swedish economy.

Will the large depreciation save the economy?

As demonstrated in the recent IUI assessment of the Swedish economic situation³ this long term development is largely due to a growing political influence on the Swedish economy over the entire post war period that has had adverse effects on incentives to work and to invest in the country. Correcting the negative forces operating on the economy requires radical political change; a decision process infected by conflicting interest groups, the results of which will take even longer to show. But the negative social results of the restructuring will be immediate. The very strong depreciation of the Swedish currency has given an immediate injection of profit stimulus in the export part of the manufacturing sector. This is however, a short term temporary consequence that raises both unwarranted hopes that the recession is permanently over and the risk of a negative inflation cost set-back. Will the big export companies, and the small firms interpret the short-term improvement as a signal to expand their long term investment commitments in Sweden?

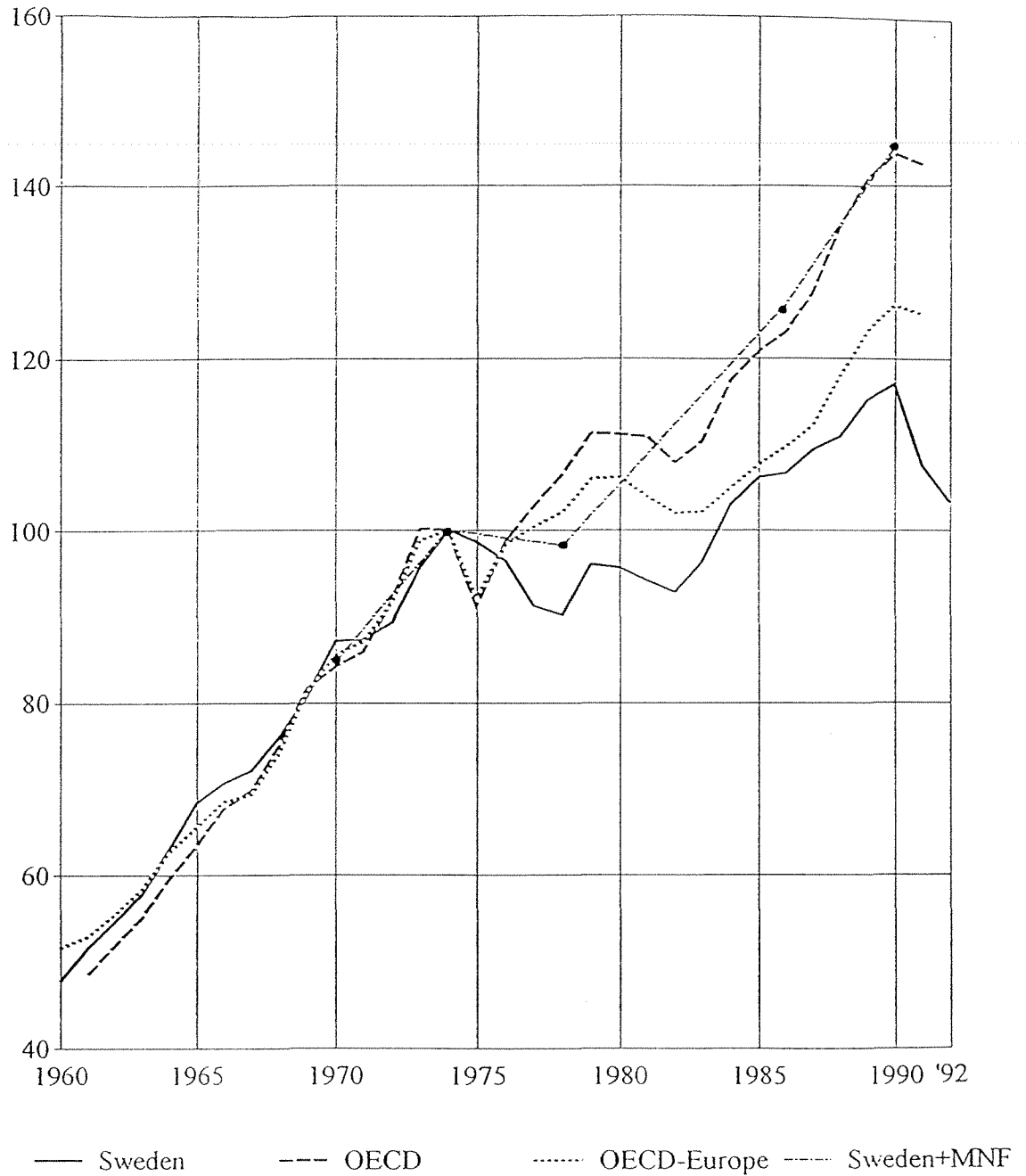
How to make Sweden again an attractive investment country?

Hardly. Getting the Swedish economy out of its current crisis requires far deeper structural surgery. Several analyses of the Swedish economy shows that two negative developments have paralleled the expansion of the public sector in percent of GNP and the increased political influences on the economy; (1) large firms have increased their rate of expansion abroad compared to the rate of expansion in Sweden and (2), the rate of new business formation in Sweden has declined and the rate of exit (divestment) of low performing units has declined. For Sweden to remain among the wealthiest industrial economies in the next century the conclusion is that these trends have to be

³ *Den långa vägen* (The Long Road) IUI, Stockholm August 1993.

reversed. Big multinationals will inevitably continue to *outlocalize* production. To fill the vacuum left new and small firms will have to expand significantly. To create the necessary incentives to make Sweden an attractive investment country again and to make room for this expansion, the public sector has to radically diminish its presence and raise its political capacity to wait for the positive results to emerge. This will not be easy for politicians now being faced with the 10 percent open unemployment rate associated with the first phase of the necessary structural reorganization of the economy.

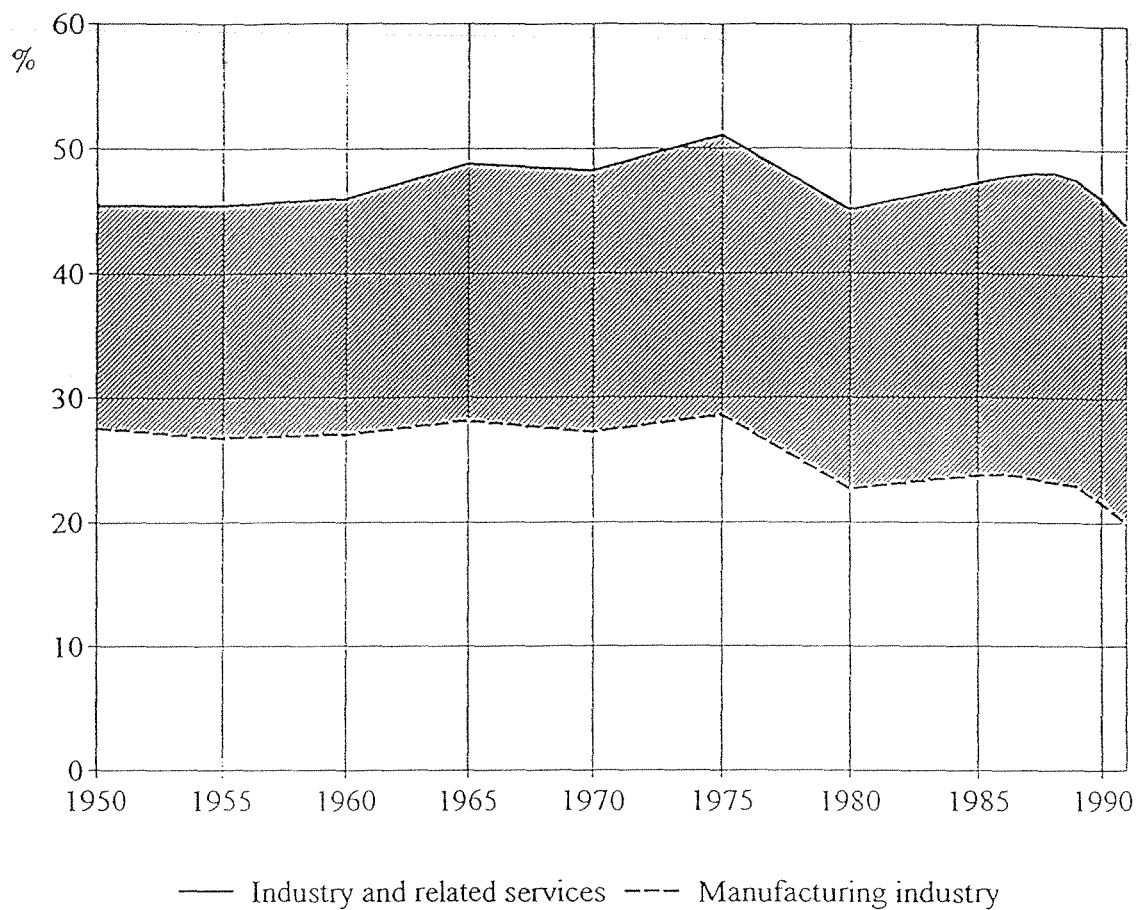
Figure 1 Manufacturing production in Sweden, Sweden and Swedish subsidiaries abroad, OECD, and OECD-Europe - 1960-1992.
Index 1974 = 100.



Note: Data for MNF are only available for 70, 74, 78, 86 and 90

Source: IUI and OECD.

Figure 2 The revised industry sector
1950-1991



Source: Eliasson, G., 1990. *The Knowledge Based Information Economy*, IUI Stockholm 1990, p. 79 and Sjöholm, K.R., 1993, "Den reviderade industrisektorn" in "Den långa vägen", IUI 1993.

Figur 3 New establishment in Swedish manufacturing, 1920 - 1991

Percentage share of new firms,
thousands of new employees.



Source: Braunerhjelm, IUI, Stockholm, 1993.

Tabell 1 Firm size distributions in manufacturing industry, different countries, 1984 - percent

	Small	Medium sized	Large	Total
Japan:	55	17	28	100
US	28	34	39	100
Germany	19	30	52	100
England	26	27	47	100
Switzerland	33	44	23	100
Sweden	24	14	62	100

Källa: Braunerhjelm, P., Nyetablering och småföretagande i svensk industri, in *Den långa vägen*, IUI, Stockholm, 1993.

Tabell 2 **The 10 largest Swedish firms accounted for
(percent)**

	1965	1970	1974	1978	1986	1990
Swedish exports	19	25	27	31	37	34
Swedish foreign employment	78	73	75	69	75	85
Domestic employment in manufacturing	16	19	23	24	31	27
- including also indirect – employment in subcontractors	-	-	-	31	-	
R&D in manufacturing	-	-	52	44	74	72

Source: Eliasson, G. 1993, Technology, Economic Competence and the Theory of the Firm, IUI Working Paper No. 385.

Table 3 The large firms; changes in the ranking order over 50 years - firms ranked by size of Swedish employment

Företag	1945	1983	1990	Rang	Rang	Rang	Year of Establishment
	Number of employees, thousand			1945	1983	1990	
Volvo		57.1	50.7	-	1	1	1926
ASEA	23.2	37.2	32.7	1	2	2	1883
Procordia	-	-	29.2	-	*	3	1970 ^{a)}
Electrolux	-	30.4	27.6	*	5	4	1910
Ericsson	9.8	32.7	26.6	3	3	5	1876
Stora Kopparberg	7.5	8.1	22.1	6	14	6	1288
Saab-Scania	-	32.2	20.5	*	4	7	1937/1891
Nobel	9.2	(9.9)	14.8	4	9	8	(1873)
				Bofors			
Trelleborg	-	(8.1)	13.4	*	13	9	1925 ^{a)}
					Boliden		
SSAB	-	14.1	11.5	-	7	10	(1978)
SCA	6.5	9.8	10.7	17	10	11	1929
Sandvik	5.9	10.9	10.5	14	8	12	1862
MoDo			10.0	*	*	13	1873
FFV	-	7.9	7.4	*	15	14	1943
Esselte	6.7		6.8	9	-	15	1913
Svenska varv	-	17.0	5.7	-	6		(1977)
SKF	8.5	8.2	5.0	5	11	*	1907
Arla	-	8.2	6.1	-	12		(1975) ^{a)}
Uddeholm	9.5	?	-	2			1668
Fagersta	6.4	?	?	8			17th century
Swedish Match	6.2	?	?	10	*	x	1917
Gränges	6.2	?	?	11	x	x	1896
Götaverken	5.8	?	?	12	-	-	1841
Husqvarna Vapenfabrik	5.8	?	?	13		x	17th century
Hellefors Bruk	5.3	-	-	15			

Source: Eliasson, G., 1984, Hur styrs storföretag?, IUI, Stockholm, Day-Eliasson-Wihlborg 1993, *The Markets for Innovation, Ownership and Control*, North Holland-IUI, 1993 and Jagrén, IUI 1993.

* means outside list

x means acquired

a) year of establishment through merger of older firms.

Table 4 **Number of very large firms in different countries**

Country	Number (among the 500 largest)	Number/GNP (Billion USD)
US	157	0,028
Japan	119	0,050
UK	45	0,050
Germany	33	0,026
France	32	0,031
Sweden	15	0,104
South Korea	13	0,070
Switzerland	10	0,067
The Netherlands	9	0,036
Italy	7	0,007
Finland	6	0,075
Norway	3	0,042
Denmark	0	0,000

Källa: Jagrén, L. 1993, De dominerande storföretagen, Chapter 3 in *Den Långa vägen*, (The Long Road), IUI Stockholm 1993.