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LONG–TERM FIRM GROWTH AND OWNERSHIP ORGANIZATION – A Study of Business Histories

by

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ABSTRACT

This paper is concerned with ownership organization in the process of industrial growth and transformation. It stresses the difficulties of changing an established and successful pattern of behaviour. The meso-level of organization is used to interpret coordination of economic activities between micro-units. The importance of investigating if technological development is induced from the demand or supply side is stressed. The Swedish financial market for ownership and control and two major Swedish industrial branches: the forest industry and the engineering industry are analyzed. The slow development of an efficiency control function on the Swedish stock market is discussed.

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1. General propositions

This paper is concerned with the importance of ownership organization in the process of industrial growth and transformation. It is limited to the ownership and control over industrial companies[1]. Owners, managers and banks have created groups and net-works in order to reduce uncertainty and increase efficiency. When working properly, such groups combine efficient production with structural flexibility. Industrial competence, technological as well as organizational, can grow within such groups and it is possible to transfer this competence between different companies within the group. Owners and banks have the possibility to reallocate scarce resources (capital and managers) rapidly to promote industrial transformation. This ability must be based both on easy access to these resources and on a strategic position in the flow of information.

The successful growth of industrial companies, owner groups and networks around banks institutionalizes traditions and establishes power positions. Stability and predictability are preferred to experiments and radically departures which may devalue existing competence. Long-term successful owner groups are based on the ability to revitalize existing institutions through change of management philosophy, mergers and carefully cultivated contacts with other owners, banks and business life in general.

Historically, the Swedish market for ownership and control has shown a cyclical pattern of behaviour. The early 20th century and the 1980s are characterized by large-scale restructuring of industry and changes of ownership while the intervening period was dominated by stability and low market activity. This raises the question if the active market has played an independent role for restructuring industry and ownership or if it is a response to demands from the real economy on the financial sector. This paper suggests that the first wave was dominated by the demand for large-scale, integrated industrial organizations while the second wave was primarily an answer to a demand for improved efficiency within these organizations. It also argues that restructuring initiated from the industrial sphere or from owners with close ties to this sphere has been more successful than pure financially based efforts from outside. To start, some general propositions are presented to show the importance of understanding the historical dimensions of ownership and innovations.

A. Technological development is either induced from the demand side (demand pull) or from the supply side (technological push)[2]. It is important to identify which side has been dominant in a certain technical development because a demand pull creates a different set of priorities within a company than a technology push. Demand induced innovations usually create companies with strong marketing organizations while technically induced innovations usually result in companies with a dominant technical management. Both types of companies may initially be successful but in the long run they may have difficulties to continue innovative behaviour and growth. Long-term successful industrial companies are usually based on some kind of balanced combination of strong marketing and powerful technical management.

Owner activity could be important in organizing such combinations. It is also important to study if an owner has experience of technical development from the demand side or from the supply side as this experience probably will form his attitude towards the company. In the case that neither owners nor managers are able to achieve the necessary changes there is an obvious need for an outside control of efficiency.

B. Institutions (including owners and owner families) which have been created during periods of successful development have accumulated resources, prestige and power as well as positive experiences of a certain way of behaviour. As long as the external conditions have not radically changed such an institution may retain its dynamic performance but only on its established field. Such performance is fully compatible with reluctance towards changing the field of activity. Due to accumulated resources (profits, prestige and power) the successful institution also has a considerable ability to resist change. If it lacks the will to act dynamically the institution may in the end be destroyed by adverse external forces. Such a development may be prevented either by successful internal opposition or by successive adaption of new ideas and methods which may include mergers with other institutions. Active control and supervision from financial markets is one possibility for industrial companies to keep inertia at bay. It is however a possibility only as it requires financial actors who are interested in industrial transformation[3].

C. Ownership control is usually a result of successful entrepreneurial performance in the past. Ownership control must be based on capital accumulated either in a family or in an institution, either an industrial company or some kind of investment organization. The owners have acquired certain skills, experiences, traditions and prejudices during the accumulation of capital. Their behaviour as owners is guided and moulded not only by their view of the contemporary situation but also by these legacies of the past. (This phenomenon might with advantage be analyzed with transaction cost theory). They are rational but their rationality is bounded by their past. The market for ownership and control is therefore divided by historically and geographically determined borders. Crossing these borders may be an innovative activity in itself. In this paper, capital will be divided into mercantile, industrial and financial capital, according to the experiences and traditions of both owners and managers of the capital.

D. The meso-level[4] may be described as a level of action for several micro-units, a level constituted by transaction and information costs for these micro-units. A meso-level (which also could be described as a close-knit network of personal contacts) may be informal or institutionalized, it may be open for entry and exit of members or more or less closed. It is introduced here mainly to stress some basic similarities between informal networks and formal institutions; close contacts, mutual confidence, a common field for action. Such conditions are likely to improve the information flow about the future, minimize uncertainty and risks and create a favourable climate for investments and innovations.

Meso-levels may in a historical perspective be rising or declining, highly dynamic or well-established and undynamic. An efficient and dynamic meso-level gives the micro-units better opportunities by access to rapid information, positive incentives to innovations and investments and opportunities to co-operation with dynamic entrepreneurs. An inefficient meso-level shields the micro-units from valuable information, thus discouraging innovative efforts (the micro-units might have gained better information if they had had more contacts outside such a meso-level). Typical examples of meso-levels are close networks of co-operation between businessmen in a city or a region, cartels, companies with a common bank connection, companies with a common (minority or majority) owner or a large multi-divisional company. In an economic theory where risk, uncertainty and limited information about the future is stressed, micro-units might be presumed to handle these problems by attaching themselves to one or more meso-levels.

Owners usually attaches themselves to one or more meso-levels when they as economic actors try to minimize risks and uncertainty. It is therefore questionable to speak about <u>one</u> single financial market for ownership or control. The active owner may prefer to act in a limited sphere where he can establish intimate contacts with entrepreneurs, managers, customers and bankers. This sphere may be of the same analytical interest as the financial market. The implication of this is that owners who are parts of such meso-levels cannot be expected to act as <u>outside</u> controllers of efficiency within industry. Strong owners are not necessarily the same as a firm control of efficiency from the financial market. The same may to some extent be the case with banks with long-term relations with an industrial company.

2. The Swedish financial market for ownership and control. A historical overview

2.1. Early industrialization 1850-1890

The owners of capital in the early Swedish industry were predominantly of mercantile origin. Some of this capital was old and established, but in many cases it was created by new entrepreneurs during the early industrialization phase. The initiatives to start new industries often came from merchants who earlier had established market contacts with customers and sellers. A production unit might easily be inserted in such a mercantile network of contacts, provided that the technology did not prove to be too difficult. The merchants appear to have been at the optimal place between technology, raw materials and customers to get the best information about profitable investments in production facilities. Typical examples are the export merchants who invested in sawmills, forests and transport facilities for timber in Northern Sweden and the import substituting merchants who invested in cotton textile manufacturing, sugar industry or chemical products for consumers, usually after that they had marketed imported products of the same kind to Swedish consumers.

These industrial investments were part of marketing networks. They were predominantly low technology industries and seldom induced by new inventions or a genuine interest in technology. They were based on demand, not on technological push and successful innovations were organizational, not technological. Fortunes could be made by opening new markets, re-organizing the handling of money and credits or investments in natural resources. Fortunes were lost in technological development, high technology and capital-intensive production units. The existence of an independent "technological push" is in my opinion proved beyond reasonable doubt by the persistent efforts to experiment and invest in technical projects which for decades proved unfruitful[5]. The low profitability of such efforts for several decades blocked the way for owners with predominantly industrial interests.

This phase was dominated by family enterprises with none or little separation of ownership and control (management). Financial markets for ownership and control did hardly exist. "Business units" (design, production, buying, selling and financing) were not integrated into unified organizations and could not be bought and sold in one package on the market. "Production units" (factories, mills) could easily be bought and sold but the business units were the merchants personal property - often simply his personal network of business contacts - which seldom were transferred outside family and friendship connections. The exceptions were privately and municipally owned railways and the regional banks which were regarded as essential parts of the regional "meso-levels" which were very important in the 19th century.

Efficient regional meso-levels were essential for industrial entrepreneurs as they gave rapid access to other companies and businessmen who could supply credit, complementary industrial and marketing activities and risk-sharing through joint ownership. Such meso-levels could also be a sufficient base for the investment in transport facilities (railways and steamships) which were so important for 19th century industrialization. Large-scale, hierarchically organized, business companies with managerial staffs and close integration of technical development, production and marketing were practically unknown. The first large business organization, The State Railways, had to find its organization model and much of its managerial competence in the military sphere where large-scale organizational activities had a long tradition.

The development of publicly owned banks was a very important pre-condition for the future growth of financial markets for ownership and control. Their importance for industrial financing was still limited and their ability to exercise efficient financial control over industrial companies was small. Yet, they represented the first stage in the development of specialized financial institutions, and they learnt the public to deposit their savings in banks. The introduction of the limited corporation was another institutional change of importance for a future market for ownership and control. Normally, companies were changed into limited corporations with shares in order to reduce the owners risks, not to spread the ownership, but when the shares passed to a new generation the new legal form facilitated such a diffusion of ownership.

On the whole, however, financial markets in any normal sense of the word had little importance for ownership and control in industry. Instead, regional, non-differentiated markets for entrepreneurs, capital, credit, political influence and family alliances (including marriages) were the centres for meeting between innovations, company formation, finance and managerial activities. The control of industrial efficiency was largely achieved through social and economic stimuli to the family entrepreneur - he could rise in society through a successful business career. This does not mean that the control of industrial efficiency was slack or inefficient but it can hardly be described as a predominantly <u>financial</u> control.

2.2. The Great Industrial Break-through 1890-1920

The industrial break-through in Sweden not only meant that the importance of industry for employment and income became greater than the agricultural sector. It also meant a qualitative change in industrial and financial activities, changes which took place in several other countries at about the same time. Highly important for our theme was the birth of the modern large-scale industrial organization with professional management and integration of design, production, buying and selling[6]. This was a necessary precondition for the emergence of financial markets for ownership and control of industrial companies and the growth of owners and financial institutions acting on these markets. On the financial side, the industrial break-through culminated in the 1910s. That decade saw a great boom on the stock market and the concentration of banking into a system of three or four very large metropolitan banks[7]. These banks could act as new "meso-levels" - centres of networks involving several owner-groups and industrial companies.

Many of the new industrial companies were closely connected with a large owner, often a fairly new one, normally based in Stockholm, Gothenburg or southern Sweden. These new owners had varied backgrounds as financiers, industrialists or managers, sometimes also as merchants although this latter group were no longer dominant among the successful industrial owners. Older merchant capitalist families did not always disappear from the scene. Some of them had with the change of generations deepened their interest in production and turned into predominantly industrial capitalists. But the old regional "meso-levels" of merchant owners, regional banks and regional markets for industrial products had definitely declined in importance.

The rise of large, profitable, industrial companies into the first rank of power centres in Swedish business life meant a revolution for both owners and managers. These companies were often based on new inventions, complicated production processes and high technology. Several of them had become international with subsidiary companies outside Sweden. The successful companies were usually the result of managerial efforts to balance between the forces of demand and supply of new technology. To ensure the continued supply of new technology, the idea of carrying out research and development inside the companies was "invented".

The managerial staff of such companies consisted of several well-educated and well-paid persons who in an earlier generation would have felt a strong attraction to start their own family company. Now they had to give up such owner ambitions if they wished to be part of a well-disciplined hierarchial organization in control of modern technology. But if they were to develop their entrepreneurial abilities they must both be given a wide scope of action <u>and</u> feel the restraint of the financial market. This would have been their situation if they had been private entrepreneurs and one of the basic problems of large-scale management has been to foster and combine the entrepreneurial abilities of several individuals into a unified organization.

To control these new large-scale companies, new types of owners and managers were required. Not only were new abilities to organize and stimulate entrepreneurs required. The new industrial corporations were too large to be owned by a single family but the new stock market which developed during the period offered opportunities to sell the majority of the shares to the public and keep a controlling block of shares on a few hands. That also meant a new type of responsibility towards the public. Some owners and managers were more successful than others to fulfil that requirement.

Primarily however, the new financial market for ownership and control created <u>opportunities</u> for both managers and owners and new types of successful businessmen appeared. One type of owner concentrated their efforts on the financial aspects of ownership and control. They organized mergers and restructured companies and they arranged financing of company growth and promoted new inventions. Another type of owner, often overlapping with the purely financial capitalists, concentrated on selection of managers to the new industries. Conscious cultivating of contacts with the new managerial hierarchies in industrial companies gave this type of owner a certain latitude in selecting managers, an important power position when managerial skills were scarce. In other cases leading managers of the new type gained control over their companies by spreading the shares to the public without leaving any block of shares as a controlling instrument for an outside owner. The new industrial companies also began to act as owners themselves by acquiring other companies.

Finally there were still some traditional-style family companies among the large industrial groups. They usually had their origins in merchant and shipping houses where the owners had successfully grasped the essentials of modern industrial management and combined it with traditional marketing skills. The borders between these types of owners were far from clear-cut and several of the more successful of them could be placed in more than one group, a combination of abilities which were characteristic for the successful innovator.

A rather special case is the most important of all the owner groups, the Wallenberg family, which easily could be placed in all four groups. Using a large Stockholm bank as their base the family had at an early stage learnt how managers could rely on public confidence. At the same time the bank was run much as a family company and used to finance the family's extensive investments in industry. As industry owners the Wallenbergs were very active in financial reconstructions and promotion of new technology and they became masters in the art of managerial head-hunting. As these accumulated competences and experiences also have been transferred between generations the Wallenberg family has been able to maintain the leading position among Swedish industrial owners throughout the 20th century.

The Wallenbergs have shown the ability not only to promote new companies, handle acute crisis and keep an eye on the efficiency of production. They have also been able to break traditions and control managers in powerful industrial companies. This has usually been possible without endangering the basic loyalty of the managers to the owner-family. As their controlling position in terms of voting power often has been weak this points to that Wallenbergs have had something valuable to offer the managerial hierarchies. It is probable that their combination of active ownership and competence as bankers offered the industry an attractive form of contact with the financial market for ownership and control, a market which many industrialists otherwise looked upon with considerable distrust. In the hands of active owners the financial market could be an interesting partner, not only a critical examiner.

The new financial market for ownership and control without doubt had a very important role in the industrial break-through. It created opportunities for both rapid expansion and extensive restructuring of the Swedish industry. Through the market, family companies got a price tag which often was so tempting that the company was sold and transferred from a regional sphere of contacts to that of the metropolitan owners and banks. This often led to large-scale mergers and restructuring. Managers and owners with self-confidence could expose their companies to the control and scrutinizing of banks and stock market in order to get access to financial resources for expansion far beyond their own means. The monitoring function of the stock market had begun to work. There were reactions among shareholders against unsatisfactory performance (alleged or real) and hostile take-overs were not entirely unknown in this generally very turbulent phase of the stock market's history.

The base for the new financial market for ownership and control was a rapidly increasing enthusiasm for investments in industrial shares among the public. Savings which earlier had been invested in real estate, banks or small companies were reallocated to industrial companies whose shares were quoted on the Stockholm Stock Exchange, an institution which was reorganized along modern lines at the beginning of the century. But the bulk of the share-owners were of course not the actors on the stage. There were no important institutions or companies which specialized in stock investment as an end in itself. The actors on the stock market were predominantly of three types. One of these were owners who used the stock market to finance industrial empire-building or industrial restructuring. A second type was the industrial managers who spread the shares of their growing companies to many owners in order to avoid dominating owners. Finally there were the banks whose importance for the new financial market hardly can be overestimated.

The stock market was to a very large extent financed by bank loans with shares as security and the banks were very active in selling shares to the public. They arranged mergers, financed venture capitalists and bought family companies in order to get both more industrial customers and more shares to sell. The large metropolitan banks had close ties to most of the new owners as well as to the new companies and they were in the key position to coordinate the financial market for ownership and control. The market were far from a neutral market-place where many customers met on equal terms. On the contrary it is difficult to understand the stock market and the closely attached credit market without studying the entrepreneurial activities of a handful of financial actors who created them and used them. Their coordinating activities grew into a firm division of Swedish industrial enterprise into "bank groups", a phenomenon of great importance for the future.

"Bank groups" in 20th century Sweden have normally consisted of two types of owners and companies. Companies owned or financially controlled either by the bank, the owners of the bank or investment companies closely coordinated with the bank, have created a core, usually very stable over several decades. Around this core, an outer sphere of financially independent companies and owners with their bank affairs concentrated to one bank has created a network of interlocking directorships and business relations with other members of the same bank group. There were mainly two reasons for the owners and managers of these "outer sphere" companies to attach themselves to such a bank group. First, there might come a rainy day when they would need the financial support of their bank. Second, the bank groups seems to have worked as efficient meso-levels in Swedish business life. Through them the managers and owners received information and business contacts which lessened risks and uncertainty. Companies and owners within the group could trust each other and cooperate or they could at least trust that other companies in the group would not start fiercely competitive activities. Banks were often supposed to be reluctant to support a competitor to a faithful customer.

The banks, industrial companies and owner groups which emerged during the early 20th century and survived the vicissitudes of the 20s and 30s would hardly have been able to reach their power position without the rather sudden appearance of a very active Swedish market for industrial stocks. On the other hand, this market would hardly have been so flourishing without their activities; their large-scale introduction of industrial stocks on the market, the merger activity and the large-scale bank-loans with stocks as security. In this period of expansion and radical reorganization it is rather difficult to find out who exercised control over the efficiency of the industry. The banks and the owner groups were often so deeply involved in industrial activities that it is hard to say where their control function ended and their entrepreneurial activity in industry began. The first decades of the Swedish stock market were very important in terms of yearly turnover and the volume of issued stocks but the market was much more a market for ownership and power than financial control of industrial efficiency.

As the industry to such a large extent was in a stage of dynamic development such control from outside was difficult to arrange without a severe risk for curtailing innovative behaviour with an uncertain future. Arguably the control through involvement and partaking was more appropriate when most industrial organizations were young and involved in many high-risk development projects. To leave efficiency control to an elite of owners, bankers and engineers turned managers became a well-established Swedish tradition. There were no powerful institutions of investors outside this group who could lead the investing public in questions of efficiency control over industry. The main efficiency control came from within the establishment which after all consisted of several competing owners, bankers and managers who would take over the control from competitors who obviously failed.

2.3. Stabilization 1920 - 1970

The long term impression of this period is the stabilization of the owner and company structure which had developed during the industrial break-through period. There were of course some enters and exits of both owners and companies but the basic structure remained much the same. A study of large-scale enterprise during this period must concentrate on possible transformations within the companies, owner groups and bank groups, rather than on entirely new ventures. But it is also necessary to find causes for and consequences of the low degree of entry and exit. Did for example the financial market play any important role?

First it must be remembered that these decades were the great age of Swedish industry when its role as supporting pillar for the growth of welfare was undisputed and its high technology achievements were generally admired. Industrialists and engineers were respected and admired and they had a considerable latitude in forming a technocratic society witout being questioned. This attitude was predominant among politicians, trade unions and increasingly among the stock investing public. This public had also been taught in a hard way not to trust purely financial activities on the stock market.

Stabilization may be the long term impression of the period but to the contemporary observer the 1920s and 1930s were decades of dramatic turmoil on the Swedish stock market. There were dramatic shake-ups of the ownership structure caused by the depressions in the early 20s and early 30s and the special conditions created by the internationally financed Kreuger group. When the debris of these crisis had settled it turned out that the financially strong owners, bank groups and industrial companies of 1920 had survived while more speculative (and sometimes also more spectacular) owners were eliminated. Gone were also several older owner groups which had surfed on the expansive economy up to 1920 but which had not really been able to adjust to modern large-scale industrial conditions.

The stabilization was perhaps first of all based on a high degree of industrial self-financing, especially from the 1930s to the 1950s. This of course made the industrial companies insensitive to the stock market but the financial build-up in the industry was also based on the consent of the financial market which was content with fairly low dividends. This accumulation of resources within industry also gradually got political support through changed rules for taxation and depreciation of industrial assets. Innovative efforts were concentrated to established industrial organizations and few new large-scale enterprises grew outside these circles[8]. New companies remained small or medium-sized and towards the end of the period many of them were bought by large companies. In short, the stock market had delegated a considerable degree of its financioal control to industrial managers and the large industrial owners.

Very few new large owners emerged and the stir and curiosity usually caused by new performers on the scene was largely absent from the stock market[9]. This could of course be interpreted as a proof for that the existing owners and companies had been able to absorb the bulk of new entrepreneurial ambitions. As Swedish industrial performance during this period was generally satisfactory this must to some extent have been true. However, the ownership structure was markedly aging during the period and increasingly reflected history rather than future opportunities. Several of the existing owner groups were transformed from families into institutions, but the policy of these institutions were guided by family traditions. The relations between owners, banks and industry were dominated by continuity. Contacts established during the industrial break-through became networks with strong traditions. The absence of large-scale enterprises outside these established networks makes it at least possible to suspect that radically new ideas were not always pursued to the utmost. There are clear signs that the increasingly mature industrial organizations have remained dynamic within their established fields but relatively uninterested in radically new departures.

The stock market declined from an important and dynamic innovation during the industrial break-through to a rather unimportant place for routine activity during the following half-century. The public interest for investments in shares was drastically reduced by the large crisis in the early 20s and the early 30s. Industry learnt to live without support from this market and when some public interest returned in the 50s and 60s the investment behaviour was very conservative. The once very important loans to finance stock investment had almost disappeared. Shares in well-established industrial companies with a long record of successful business dominated the market. New companies on the Stock Exchange list did usually not represent new entrepreneurial departures. Most of them were old family enterprises which tried to solve succession problems by going public.

It is far from clear if the stock market's low propensity to finance new entrepreneurs without a good historical record was a demand or supply problem, i. e. if such entrepreneurs were lacking or if the market was indifferent to their financial problems. At least during the 30s and 40s, when the banks had large deposit surpluses, new entrepreneurs probably found it easier to finance their companies through bank loans. In the 50s and 60s, investment companies began to actively scan the market for new inventions and new entrepreneurs. The financial conditions for innovators can hardly have been unfavorable, provided they were willing to expose themselves to the financial market for ownership and control. Some new entrepreneurs did of course appear but they were not able to radically change the existing structure of industry and ownership. A few of the internationally most successful Swedish companies founded after World War II - Rausing's Tetra Pak and Kamprad's IKEA - are notorious both by their absence from the stock market and their lack of interest in expansion outside their their origininal family company. They have grown large in spheres where no large companies existed but they have not changed the ownership structure.

The problem seems more to have been that the existing structures of ownership and industry moulded the Swedish industrial scene with perhaps <u>too</u> great efficiency. Existing companies grew and new small companies which suited the existing industrial structure easily found their sphere of action. If the close relationship between owners, bankers and managers were meant to reduce risks and uncertainty by mutual good behaviour it had been successful. The Swedish industrial scene by the 1960s was largely predictable which of course reduced uncertainty but also opportunities for change. Such opportunities might have been the challenges for entrepreneurs with radically new visions about industrial activities and industrial changes. Everything has its price and so has stability.

Swedish industry was of course not stagnating. Many companies performed well in an increasingly intense international competition during the 1950s and 1960s, although the profitability and especially the degree of self-financing were declining. What may have worried an observer during this period was the aging of the ownership structure and of the really large companies. Were they sensitive enough to new trends and were they prepared to admit new types of owners and managers? And were there any future for an active financial market for ownership and control? In spite of its now long history there were still no powerful organizations or individuals operating on this market which were independent of the established groups of owners, banks and industrial managers. The market had delegated the control of efficiency to an established elite which rejuvenated itself through a combination of inheritance and cooptation.

2.4. Radical change 1970 -

The last 15 years have seen large-scale restructuring of both the Swedish ownership structure and of the industry. The activity on the stock market has sharply turned upward and during the 1980s a boom of unique proportions has transformed this market into a highly important scene for entrepreneurial activity. Financial capitalism is flourishing in a way unknown since the early 20th century.

On the negative side several old owner groups have disappeared, some in connection with crisis which may have had their origins in an aged and undynamic ownership structure. On the other hand, several new large owners have emerged, usually with a background in finance and real estate. Institutional ownership of stocks has increased dramatically and some of these institutions are independent of or only loosely connected with the old established interests. There has also been a large number of mergers, restructuring and changes of ownership in the Swedish industry. In the 1970s there were traditional structural rationalization mergers or restructuring caused by acute crisis. In the 1980s new tendencies have appeared. First, questions of ownership, control and power are discussed on the stock market with an intensity unknown for generations. A large number of ownership transactions are carried out where the industrial logic are rather difficult to detect. Second, industrial companies are increasingly divided into smaller profit centres (divisions, sub-companies) and such organizations are easily separated from the mother company.

One consequence is that the role of owners and managers are merging into one. Complex industrial organizations which in earlier decades only could be managed by technically trained specialists are increasingly becoming accessible and transparent for owners/managers with a general training in management and finance. It may be more than an accident that the financial market for ownership and control has been activated at about the same time as managers increasingly control their subordinates by dividing companies into profit centres. This means in practice that the managers are acting as owners. They regularly check the performance of their divisions, they hire and fire their managers and they may even exercise the owner's right to exit by selling a division to another owner/manager. Their behaviour comes close to the ideal text-book behaviour of the rational owner on the financial market for ownership and control.

Why have this activation of the owner/manager role and the financial market for ownership and control taken place at about the same time? One possible answer is that the active financial market has increased the demand for efficiency in the industry, but this does not explain why these changes have taken place. One very tentative answer to that question is that the traditional power position of the industrialists and the engineers has been eroded. They are under attack from a public opinion which questions the social value of boundless technological development and their capability to earn money are questioned by the capitalists. Undoubtedly the large fortunes in recent years have been earned in finance, real estate (i. e. by inflation) and rapid and radical reorganization of existing industrial companies. For a new generation of owner-capitalists, industry and technological development are no longer the self-evident centres of entrepreneurial activity.

The financial markets have lost much of their earlier respect for industry and technology and increasingly analyse industrial activities in organizational and marketing terms. This may explain the increased use of financial type of control both inside and outside industrial companies with much emphasize on information and organizational achievements. <u>If this interpretation is correct an activated market for financial control of efficiency may have had its main effect in stimulating the industrial companies to reorganize themselves into organizations for efficiency control.</u> We are in some respects back to the early industrial phase where production was subordinated to mercantile capital and industries were cells in a mercantile structure of business life. In the future industries may be part of organizational structures without any definite commitment to branch or even to industry as such. In these structures the activities can easily be interchangeable while the structure and its network of contacts with other organizations remains the same. In that case we are witnessing the development of the real managerial or organizational capitalism where capitalists with predominantly organizational experiences will be in control. The future for technological creativity and innovations may remain the subject for speculation if these tendencies will continue.

3. Industrial transformation and the financial market for ownership and control: The Swedish forest industry

The large-scale Swedish forest industry has two distinct origins, separated by geography and traditions in technology and markets. Both lines of development started with innovative activities in the mid-19th century. In northern Sweden typically merchant capitalists began to exploit the virgin forests to supply the expansive western European markets with saw-timber. The innovations were largely organizational: the creation of new transport systems, timber-buying organizations and marketing contacts abroad. The industrial activity was limited to technically simple and financially rather cheap saw-mills. The great risks and opportunities were concentrated to forest owning and fluctuating markets. As should be clear from section 2.1. these timber entrepreneurs were typical merchant capitalists of the early industrial phase. Some of them were in fact the richest men in the country, mainly due to their early acquisitions of forests with rapidly rising values.

In southern Sweden a new paper and pulp industry based on the new wood pulp technology developed from the 1850s and onwards. Most of these companies were small and unprofitable and more fortunes were lost than created before the 1890s. The owners and managers were usually technicians or industrialists with a strong interest in the problems of the production process. In central Sweden (the Bergslagen area), the traditional district for the (largely forest-based) Swedish iron industry, some diversified companies developed when iron industries tried to find new uses for their forest resources. Some of these companies used their profits from the saw-timber boom for financing investments in steel production and experiments with pulp and paper.

They remained bastions for industrial capitalism, one of the few cases where early industrial windfall profits went straight into industrial development.

By the end of the 19th century this forest industry was ripe for a large transformation. The exploitation of virgin forests in the north had reached its end and at the same time the demand for pulp and paper increased steeply. Saw-timber production had (and still has) little of economy of scale and it was a decidedly low-technology industry. Pulp and paper production on the other hand proved to have very large economies of scale and the risks and opportunities were to a large extent technological. While the opportunities for the future was concentrated to the paper and pulp companies, which had the technological know-how, the capital from profits in the past was concentrated to the timber companies. Rich as they were, these companies were nevertheless often too small to become the rational base for a modern large-scale paper producer.

The situation required mergers of existing companies and transfer of advanced technology from southern and central Sweden to the north. It also required capital for investments although such capital was available in the northern companies. On the whole the forest industry around 1900 was a highly fascinating field for industrial and financial entrepreneurs with an interest in restructuring. But there were very large obstacles to pass and in the end much of what was done proved to be half-measures.

One obvious problem was that almost all forest companies in north and south were typical family enterprises. Owners with industrial traditions lacked capital and were often too much used to small-scale enterprises to become efficient managers of large companies. In the north, the owners were often used to rather large-scale activities, but they lacked industrial traditions. Besides, the pioneer generation of entrepreneurs in the north had now been succeeded by second and third generation owners, who generally were less dynamic. It is fairly obvious that an efficient market for ownership and control was necessary for a successful transformation of the forest industry.

The first two decades of the 20th century saw some promising restructuring but also several investments which proved to be unfortunate in the long run. Several small pulp and paper companies in the south changed owners and several mergers took place here. In central Sweden some large-scale investments in modern and rational production facilities were made by large companies with strong industrial traditions and easy access to the financial markets. These mergers and investments formed the basis for the Swedish paper industry for much of the 20th century.

In the north the development became dramatic. For a long time the great saw-mill owners had been negative or hesitant towards investments in pulp and paper. They now made frenetic efforts to regain lost grounds and added a pulp mill to their assets. They remained exporters of semi-finished products and it is probable that their lack of industrial traditions made their pulp production less economical than it might have been. What is obvious is that their pulp mills could have been more profitable if they had joined efforts and built large-scale plants instead of providing every large company with at least one and often two mills (usually one sulphite and one sulphate mill), sometimes only a few hundred meters from another company's similar mill. The motive was to show the company's ambition to remain independent, not any attempt to use a technology which had been developed in the company.

During the 1920s most of the surviving family companies in northern Sweden were severely hit by a financial crisis which finally eliminated their once very rich owners. The obvious reason were misjudgment of the post-war economic situation. A possible but historically uninvestigated additional cause for the exceptionally heavy crisis which hit these companies was the large investments in pulp production without sufficient industrial know-how. A large-scale merger of several of these companies followed in the end of the decade (the SCA company). In the end the financial markets for ownership and control had worked although it was the banking sector and Ivar Kreuger rather than the stock market which were the main actors. But from an industrial point of view it could be argued that it was too little and too late.

The basic investments in pulp mills in northern Sweden had been made in 1900-1930, before the mergers. It would take half a century to rationalize this industrial structure. Second, very few investments in paper production had been made in the north, in spite of the very good supply of pulp and cheap electrical power. Lack of industrial traditions were obviously the main reason but this meant that the companies and the whole area were tied to the production of semi-finished products, much more sensitive to depressions than paper production. Third, the mergers which had taken place were based on financial considerations, not on any plan for industrial restructuring. The further structural rationalization of the northern forest industry would be a long and tedious process where owner groups and bank groups proved to be very reluctant to change an established company structure. The process is barely completed in the 1980s and the restructuring of the production plants in accordance with the new company structures will probably last into the 21st century. The future position in this structure of some mills dating back to around 1900 is still under debate.

The main conclusion of the role of the financial market for ownership and control in the case of the forest industry is that it has worked but very slowly and obviously not efficient. One basic problem in the early 20th century was of course that many of the key companies were out of reach for this market. This points to a necessary pre-condition for an efficient financial market in industrial transformation: the assets necessary for the transformation (companies, plants, know-how) must be available on the market. Second, the established interests and traditions within an industry may be very difficult to eliminate or change rapidly. Long-term planning and methodical acquisition of assets and know-how from a position <u>within</u> the industry have proven more efficient in the long run than rapid action from an outside financial market. The three big companies which have emerged after a long process of mergers - STORA, SCA and MODO - are all the results of such activities from within the industry. One of them (SCA) had to work for decades with the financial and structural troubles of being the result of the great merger of northern companies in the 1920s. It is not entirely clear if this proves the insufficiency of the purely financial markets for industrial restructuring or if it only shows that the actors on that scene have been inadequate to the task.

4. High technology and the financial market for ownership and control: The Swedish engineering industry

The wide spectre of engineering companies - mechanical and machine engineering, electrotechnical industries, shipbuilding, car and truck manufacturing etc - are in Sweden usually brought under the general heading of verkstadsindustri. Most of the largest and most internationalized Swedish industrial companies belong to this group and their shares have during the 20th century been very important part of the Swedish stock market. Indeed they have grown into the very backbone of this market - a substantial amount of engineering industry shares are not lacking in any diversified investor portfolio. Few of these companies have any background as family enterprises and by any standard they must be regarded as typical public companies with a very large number of shareholders and various types of contacts with owner groups and bank group. For most of the companies this situation has remained much the same during most of the 20th century[10].

They may thus be interesting objects for studies of the efficiency of the financial market for ownership and control. We may at least presume that owners and banks have played the leading role in checking efficiency, appointing leading managers and formulating company policy. However, this leading role is not obvious at a first glance on the long-term development. Factors outside the control of financial markets were also at work.

To understand the balance of power it is first of all necessary to point to the high degree of autonomy which the leading managers have been able to maintain. During the first half of the 20th century manager dynasties were a normal feature among these companies. Presidents, vice-presidents and other leading managers were regularly elected among sons, sons-in-law, brothers-in-law and nephews to a dominating and successful company president. It is obvious that such a president had a decisive position in selecting and training young men to future leaders and that they often used this power to promote family interests. When the question of appointing a new senior staff member arose, owners often had no other choice than to take a relative to the president who had an excellent in-house training for the job. During this phase, management of large companies was a rather new and non-standardized skill, learnt inside companies and not easily transferred between companies of different character.

It is clear that the frequent existence of managerial family dynasties - which only is the most obvious sign of the strong position of managers - restricted the owners possibility not only to select new managers but also to change company policy and check efficiency. It is possible that the owners were reluctant to fight the principle of inherited power because they had often themselves inherited their power as owner. Whatever the reason, much of the power in Swedish engineering industry was concentrated to managers rather than owners and the prestige of these managers in the eyes of the public was very great. The usually strong financial position of the large companies has also made them dominant within the industry, often deterring small companies from making investments in competition with them.

The strong position of managers as a group survived the disappearence of the manager dynasties by the mid-20th century. The position of individual managers has noticeably changed however, especially in the 1970s and 1980s. Managers who are not outstandingly successful are no longer irreplaceable as they seemed to be some decades ago. Managerial skills today are also clearly transferable between companies, a fact which is shown by the very high frequency with which presidents and vice-presidents are rotating between companies. The opportunities for owners to select managers and influence company policy through changing the management have clearly increased.

Financial actors have of course never been powerless in situations where the managers failed. In case of acute crisis owners and - more important - bankers had to act in order to save the situation. Such situations, which usually resulted not only in new managers but also in the emergence of new owners, were rare among the large engineering companies and no really acute crisis has occured since 1932. Furthermore, some of the most difficult crisis among these companies (ASEA 1903, L M Ericsson 1932) were primarily caused by irresponsible actions from the owners. In medium-size engineering companies financial crisis have been quite common. It is of interest to note that their owners, bankers and managers often have turned to the leading companies in the branch and hoped to solve the problem with a merger. The financial market for ownership and control has seldom been the centre for such restructuring which rather has taken place on the market for the industrial products through competition or cooperation between the industrial managers.

The more subtle control which is necessary to check tendencies towards stagnation and lack of efficiency is more difficult to observe from outside[11]. It may be exercised through owners, bankers or the self-discipline which dependence on financial markets may inspire among managers. In a very long-term perspective some tendencies are observable among the large and persistently successful engineering companies with which we are concerned here. First, it is normal that the centre of power within the companies has shifted from time to time. Managers, owners and banks have during different period exercised a dynamic influence over the company. After a long period without change of leadership certain tendencies to stagnation are discernible while bursts of dynamic behaviour are observable after changes of leadership. We have to use such rather vague terms as "change of leadership" because it is far from always easily observable phenomenons such as a new owner or a new president which are decisive. A new president who has made his career within the company may be content with following traditions while an established owner suddenly may become active and take the lead without necessarily changing president. We have to observe changes from within the company to know more about the effects of financial markets.

Second, it seems obvious that the large engineering companies long-term position as public companies with most of their shares spread among many investors has had some effects on managerial performance. A manager who wish to remain independent of owner groups and banks must retain the confidence of the share-holders in order to keep company raiders away and to have access to a market for new issues of shares. Long-term mismanagement of the company is of course not compatible with such confidence. Unfortunately there are very little studies about this question in Sweden. A highly tentative conclusion is that industrial managers after all have been fairly efficient in maintaining efficiency and that this for a long time delayed the rise of an active financial market with independent actors for efficiency control from outside. From the break-through of large-scale industrial companies in the early 20th century and several decades ahead, the "visible hand" inside the companies may have had an advantage in checking the balance between technology push and market pull within high technology organizations. The large engineering companies may have been the optimal "meso-levels" for efficient development of the know-how which the merger of science and technology in the late 19th century had created. Control from outside through financial markets may simply have been uncompetitive - this seems at least to have been what the stock-investing public thought.

Third, most of the large engineering industries have during all or most of their existence had one or a few large owners who have had a controlling block of shares. This has not automatically meant that this block of shares has been in the hands of active owners who have exercised close control. In extreme cases the owner may be an institution where the president of the industrial company may be an influential person. In less extreme cases the owners may be far less enterprising than a dominant manager who consequently can act as the undisputed leader. But in several cases the owner has been active, enterprising and experienced. In the large Swedish engineering companies the Wallenberg group has grown into the undisputedly most influential owner with a conscious philosophy of how to exercise effective owner control, especially in high technology companies. In the long run, this growth of a professional owner has probably been the most important factor in balancing (not oppressing) the earlier extremely strong power of the managers.

5. The financial market for ownership and control - a final note

We are back to a basic argument of this paper. Financial markets for ownership and control cannot be studied without some knowledge of the actors on this market. This knowledge must contain a historical dimension as all actors on the market have a history, institutional and personal. Historical knowledge about the market also gives us perspectives on to which extent the market is something timeless and to which extent it merely reflects the conditions and power structure of contemporary society.

In a long-term perspective the Swedish financial market for ownership and control has had two periods of greatness. The first, from about 1900 to 1920, was dominated by the large-scale inflow of savings from the public to the rapidly growing industry. The stock market was thus a key instrument for financing the new Swedish industry without recourse to foreign capital. But as the market to a large extent was developed by the very actors who also created the new industry, no tradition of financial control of industry from outside by independent organizations (investment trusts, insurance companies, saving funds) emerged. In the stabilization phase, from 1920 and half a century onwards, no such tradition developed, neither did the institutional framework which might have given small-scale investors a voice in efficiency control. As most industries and banks had the majority of their shares spread among the public it is probable that the financial market had a disciplinating influence on their managers and main owners but this influence was very seldom visible in concrete actions from the market. The controlling blocks of stocks were often surprisingly small, a fact which illustrates the low degree of competition between owners.

The second phase of greatness for the Swedish market for ownership and control has been the 1980s. During this decade the questions of ownership and control of efficiency have been much more central than earlier. The number of actors who actively attempt to rearrange the ownership structure is limited but their influence have been considerable. Well-established industrial companies have developed into organizations for ownership and efficiency control and some of them have turned into aggressive restructuring actors themselves. Several old owner groups have disappeared while new owners are in an establishing phase. Other established owners, such as the Wallenberg group, have been forced to tighten the grip around their companies through substantially increased share-holding. The banks as institutions generally look as losers in influence in the long run.

What remains to be seen is to what extent this new market-orientated structure of efficiency control will survive a major turn downwards on the stock exchange. Arguments about the need for strong owners and managers with a long-term view of industrial development are frequently brought forward and they may easily become dominant if the market fails in creating long-term efficiency and dynamic transformation. Up to now, the new efficiency control has mainly improved static performance, the ability to produce and sell well-established industrial products.

NOTES

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1 This paper is mainly based on Glete (1987) which also have an extensive list of literature.

2 See for example Kamien & Schwartz (1982), pp. 22-23, 33-36, 58-64.

3 Stagnation phenomenons are of course very much discussed in the literature but we are still lacking any coherent theory about why stagnation occurs and how it could change into dynamic performance.

4 The term "meso-level" (a level between micro and macro) is taken from de Feyter (1982). It is used here in a much wider sense than by de Feyter.

5 Part of this behaviour may be explained as institutionalized as it reflects the old and well-established industrial traditions of the Swedish iron industry. Many technically skilled but financially unsuccessful inventors in the early industrial phase had connections with this industry.

6 See for example Daems & van der Wee (1974).

7 Stockholms Enskilda Bank (the centre of the Wallenberg Group), Skandinaviska Banken and Svenska Handelsbanken. A fourth possible contender for the position as metropolitan bank, Göteborgs Bank, had the size but lacked managerial skills and industrial contacts comparable to the other three.

8 It is typical that the two really large industries which have grown up after 1920, Volvo and SAAB, were founded as daughter companies to existing large-scale enterprises.

9 Ivar Kreuger's appearance in the 1920s is of course the major exception to this rule. The catastrophic end for the Kreuger Group in 1932 left a traumatic distrust against new actors on the Swedish stock-market.

10 The companies which are considered in this section are AGA, Alfa-Laval, ASEA, Atlas Copco, Bofors, Electrolux, L M Ericsson, SAAB-Scania, SKF and Volvo. The large shipbuilding companies are left out of the picture because they had no long tradition as public companies and their histories have ended in financial catastrophes during the 1970s which merits special considerations, too complicated for a short paper.

11 In my study of ASEA I have put special emphasis on the Wallenberg Group's strategy and attitudes as industrial owners.

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