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IMPACTS FROM BUSINESS ENVIRONMENT AND CORPORATE STRATEGY ON FINANCIAL STRUCTURE

A Historical Perspective of Three Swedish Multinationals

Mats Andersson and Leonidas Tsagkalias

Graduate Business School
School of Economics and Commercial Law
Göteborg University
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Abstract

For decades companies had focused their efforts only on quantitative results, rather than on the quality of profits generated. However, the need to readjust to a more volatile business environment and the new strategic directions followed by companies made financial structure an issue of primary importance. Therefore the research question *how do business environment and corporate strategy impact financial structure* is formulated and the case study of Electrolux, SCA, and Volvo is designed, in order to identify the effects during the last thirty years.

In the first part of the thesis, a brief description of each of the three concepts is given and their interrelationship is shown. Referring to the business environment, two sets of factors are mentioned; macro environmental factors, which focus on economic, technological and political variables, and micro environmental factors, which refer to the industrial structure and globalisation. Then the concept of corporate strategy is discussed by presenting two different schools of thought, explicit and incremental strategic planning, and finally, the concept of financial structure is elaborated by analysing issues like the capital structure and the principal-agent theory.

In continuation, the thesis is dedicated to the presentation of the business environment, corporate strategy and financial structure of Electrolux for the examined period, followed by another part, where the impacts on the financial structure are analysed. The same procedure is repeated for SCA and Volvo.

In general, most of the findings indicate that business environment impacts financial structure mostly in economic terms, while the results from corporate strategy, usually linked to organic growth, acquisitions, related and unrelated diversification, and divestments, are different in the three companies. The determining factor is the existence or not of aggressiveness and opportunism, when implementing untested strategies.

KEYWORDS: Financial structure, Corporate strategy, Business environment, Electrolux, SCA, Volvo

To Elin

LT

Du tror väl inte
att det här med räkenskaper
är lätt?

Det är det inte alls.

Allt som har hänt under året
skall redovisas
och sammanfattas i en enda siffra,
och den skall vara riktig.

Det går ju inte!

Nej, det var ju det jag sa,
det är inte lätt.

Men alla företag gör det,
minst en gång om året.

Thomas Polesie

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Mats Andersson
mats@who.net

Leonidas Tsagkalias
ltsagkal@hotmail.com

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1 Introduction

Background

Many of the world's economists are trying to understand the genetic code that leads to success and keeps the corporation competitive in an era where investors are getting more sophisticated and demanding and markets are open to international competition.

For decades, companies had focused their efforts only on quantitative results, rather than on the quality of profits generated. An obsession with sales rather than profitability, absence of investor orientation and expansion through unrelated diversification were the characteristics that caused higher overheads, lower returns and jeopardised shareholders' interest.

Environmental changes, like the first energy crisis and changes in the international monetary scene, caused a shortage of resources and rising costs that emphasised the importance of effective and efficient use of assets. Companies were facing the challenge of readjusting to the business environment in the way that both investors would be kept satisfied and other constituencies, like employees and regulatory agencies, would not intervene.

As a result, financial structure became an issue of primary importance. The overall corporate strategy had a direct impact on the success of such structure plans, and consequently, on a company's viability in the long run, especially under volatile environmental conditions.

Cases of strategic and financial restructuring in American companies have been studied by Gordon Donaldson, who has adopted a historical perspective. This work represents the source of inspiration for carrying out a similar study in the Swedish framework, although less extensive and narrower in focus.

Description of Concepts

The above mentioned changing business environment in the 1970s had threatened many unprepared companies and emphasised that financial structuring should not be seen only as an one-off task, but as an important element of any business strategy that is continuously readjusting to the environmental requirements.

According to Donaldson (1994: 7), the concept of financial structure, among others, consists of the scale of investment base, the mix of active investments and defensive reserves, the choice of revenue source, the re-investment rate of earnings, the mix of debt and equity, the duration and nature of wage and benefit contracts, the degree, cost and nature of overheads, and the distribution of expenditures between current and future revenue potential.

On the other hand, the concept of business environment refers to the social, technological, economic, environmental, political, legal and cultural factors that affect the corporate and creates new threats and opportunities for the enterprise (Worthington and Britton 1997). For the purpose of this paper the concept of business environment will also encompass market and industrial structure.

Finally, business strategy is the comprehensive concept, which explains the raison d'être of the company, as well as the long-term directions that will be followed in order to meet the needs of markets and to fulfil shareholders' expectations (Johnson and Scholes 1999: 13–16). Furthermore, it determines vital issues like the statement of business mission, management's objectives for its shareholders, consumers, employees, and society at large, corporate and product-market strategies, and outlines for resource allocations (Donaldson 1984: 4–5).

Problem Discussion

The changes that took place during the last three decades pointed out the importance of financial structure. Did new strategic direc-

tions leave financial structure unaffected or more radical changes followed? And if this was the case, what elements of the financial structure did these strategies affect and to what extent? Furthermore, were these elements the same for all types of strategic choices in all companies and did they cause the same type of effects every time a shift had taken place?

Different companies emphasise different priorities; perhaps in one company management had stressed financial self-sufficiency, while in another, the asset factor had been emphasised. Does it mean that every company had a totally or partly different financial structure?

Apart from the corporate strategy, considerations referring to the business environment must not be ignored either. Hence, a new question is generated: What were the changes in the environment during the last thirty years that affected corporations? If these external factors are not identified, significant problems will arise that will be responsible for the inefficiency of the overall strategy.

Additionally, these macro and micro environmental factors influenced companies depending on the industrial sector and the markets within which they operate. Did these external factors impact all the elements of the financial structure of a company and to what degree did that happen?

Aim and Objectives

From the result of the above discussion the research question of this thesis is formulated: *How do business environment and corporate strategy impact financial structure?*

The outline of the key objectives to be covered in this thesis is given below:

- To introduce the concepts of business environment, corporate strategy, and financial structure and to show their interrelationship.

- To present the business environment, the corporate strategy, and the financial structure of three Swedish multinational enterprises over the last thirty years.
- To analyse the impacts on the financial structure from the business environment and the corporate strategy in each examined company.

Delimitations

The term business environment is used both in national and the international context, because the latter refers also to factors, such as international tax differentials, market imperfections, availability of capital, and generally foreign business norms (Lee and Kwok 1988).

For the purpose of this paper the term financial structure in the context of multinational firms refers to the structure of the group, because the structure of each affiliate is relevant only to the extent it affects the cost of capital of the consolidated firm; an individual affiliate does not have an independent cost of capital (Eiteman, Stonehill and Moffett 1998: 448).

Additionally, the focus of the analysis will be on capital structure, return on assets, and operating performance, rather than liquidity, cash flows, and return-on-equity. The selection of measures – both in absolute and relative values – depends on the purpose of the thesis, which differs from the objective of a creditor or a shareholder (Watts 1996: 449). Finally, the financial results will not be compared with other companies or with the industry average, because the aim is not to measure the performance of each of the studied companies against the others.

2 Methodological Considerations

Research Strategy

Among the available research strategies, case study has been selected as the most appropriate after considering the type of our research question, the extent that we control actual behaviour and events, and the nature of the events. To start with, our research question, *how* corporate strategy and business environment impact financial structure, will be answered by showing first *what* is the interrelationship between these three concepts. According to Yin, *what* questions tend to be exploratory, while *how* and *why* questions are more explanatory and likely to lead to the use of case study as research strategy (1994: 5–6).

We have decided to use case study because we deliberately want to cover contextual conditions, believing that they might be highly relevant to our phenomenon of study, or practically because we believe that the changing strategy and environment relate with changes in financial structure.

However, there is not a universally accepted definition of case study. For the purpose of our thesis more than one research strategy could be used because various strategies are not mutually exclusive and because the boundaries between strategies are not always clear and sharp. *"Even though each strategy has its distinctive characteristics, there are large areas of overlap among them"* (Yin 1994: 4).

Although the examined events are outside our control, they are not contemporary but historical. But according to Yin *"the historical method is dealing with the dead past – that is, when no relevant persons are alive to report even retrospectively what occurred, and an investigator must rely on primary documents, secondary documents, and cultural and physical artifacts as the main sources of evidence"*. He adds that "[a case study can] *deal with operational links needing to be traced over*

time, rather than mere frequencies or incidence" (1994: 6–8). Finally, despite the fact that the empirical data will be based exclusively on annual reports, archival analysis is not selected as research strategy, because this is more preferable for research questions like *who*, *where*, *how much*, and *how many*. Although each strategy has its own advantages and disadvantages, we prefer to use a clear and understandable one-way direction.

In our thesis the inductive approach, the way of discovery, is considered to be suitable, because a theoretical model will not be falsified or verified, although our goal is not to generate theory either, but to provide a basis for further research that could lead to a theoretical framework. Including a theoretical part in our thesis is not in contrast to this statement, because our research is not directly dependent on this theory. As Patel and Davidson state, in the case of inductive approach although the researcher does not have a theory as a basis for the research, he does not work completely unbiased (1991: 21).

Research Design

In order to answer our research question, it is necessary to conduct a study that extends over a rather long period of time. *"Only when thought succeeds in composing the multiplicity of events into a system within which the particular events are determined in respect to their 'before' and 'after', do phenomena unite into the form of a totality of intuitive reality"* (Cassirer 1957c, in Polesie 1991: 140). A period of thirty years has been selected, after compromising between time frame and level of detail.

Although the existing knowledge base of our topic is rich, it does not provide a conceptual framework. Such knowledge base does not help us to develop good theoretical statements. However, a strong guidance in determining what data to collect and ideas about how to analyse them, have been given by Gordon Donaldson's book *Corpo-*

rate Restructuring, recommended by our supervisor. This book was the latest of a series of books he has written on the subject of corporate finance, being professor at the Graduate School of Business Administration at Harvard University for several decades.

For measuring the quality of our research design, four tests have been implemented, according to Kidder and Judd (in Yin 1994: 33). Construct validity is established by giving the correct measures for studying the changes of the financial structure. They refer to the absolute values, indices, growth rates and ratios, whose method of calculation is presented below. Internal validity is not threatened because in our causal case study we will not exclude the existence of factors other than the identified ones. In terms of external validity, it can be said that a small number of cases offers a poor basis for generalising. But generalisation is not automatic and conclusions must be tested through replication of our findings, which are considered more convincing in our study because multiple cases are used. Finally, reliability is strengthened due to the documentation of the procedures followed.

Additionally, the validity and reliability of our thesis have also been tested according to Merriam's criteria (1994: 179). Firstly, although it was not possible to use several sources of information for triangulating, key informants have reviewed the empirical data. They are all working as senior managers on group level and have been selected on the basis of their knowledge in the strategic and financial issues of their company for the examined time period. Although some changes have been made after their remarks, we are solely responsible in cases of errors, omissions, or misunderstandings, because the text reflects our personal perception of the facts, which may not be the same as that of the informants. Secondly, we are trying to present the research design and the theoretical framework, in order to avoid biased conclusions. Thirdly, we will try to explain in detail the data collection method, and fourthly the research strategy has already been described in detail for making this

thesis reusable, if other students want to do further research in this field.

Data Selection and Evaluation

Although two different types of data exist, primary and secondary data, for the examination of this thesis' research question only the latter will be used. When using secondary data we have to consider if they are reliable, if there are any tendencies by the authors, or if there is a dependency on sources.

As the theoretical framework of the thesis normally influences the development of the research, the reliability of the used theoretical data has to be critically examined. It is quite important to have a look at the time when the literature was written, because this could have a major influence on the conclusions and statements. Most of the books used have been published during the last decade, but this does not hold referring to articles about financial structure, because the most important of them – on which the whole debate around capital structure is based – date back to the 1970s, and even the 1960s. However, it has been decided to include them, because the more contemporary ones do not cover the topic to the same extent. Furthermore, it can be said that the sources of theoretical data are independent and that different approaches are used representing authors who come from different schools of thought. There is no use in quoting two or more sources, if one of them quotes the other, even sometimes the bases for books or articles are the same.

Additionally, the decision to base the empirical part of our study on annual reports is the result of time restrictions and the need to use same kind of sources, both in terms of quantity and nature, for all examined companies. Alternatively, company biographies could have been used for the empirical part, but those found have not been examining the same time period, or they have been of *'advertorial'* nature.

The use of annual reports imposes certain advantages as well as restrictions. Each report is written a few months after the end of the fiscal year and as such it represents a contemporary source of data. The level of comparability is high, because audited financial results provide reliable figures, subject only to creative accounting and changes of accounting standards, which have been examined in cases of major fluctuations of results. Except that they are publicly available and formalised, they tend to be very informative around important issues of the corporate life, but in cases of large organisations, like the ones to be studied in this thesis, there are practical limitations referring to the level of detail.

On the other hand, although the content of annual reports is statutory, they are inferior sources of data in terms of objectivity. Being a means of communication between the company and its existing and potential stakeholders, annual reports give the subjective picture that the management of each company decides to show. Knowing that they are of apologetic nature when results are not flattering and full of exaggerations when returns improve, the adoption of a more critical assessment of information is imperative. Refining the content of the statements, or in other words separating facts from opinions, helps to achieve this. All these factors will be considered when analysing and drawing conclusions.

Alternatively, interviews could also have been considered. However, this idea was not finally materialised, because, apart from the practical limitations, we believe that it would not contribute in terms of comparability, given that different interviewees would have affected the documentation of empirical data unequally. As already mentioned, we prefer to use a clear and understandable research design.

Having decided to use different sources of data, our method can be termed both qualitative and quantitative. Whilst the theoretical data used are exclusively qualitative, the empirical data based on annual reports are highly quantitative, referring to the numerical in-

formation, and simultaneously qualitative in terms of strategies and environment described. This is in line with Yin (1994: 14) and with Starrin, who argues that quantitative and qualitative methods are complementary and are characterised by mutual dependence (1991: 13).

Data Collection

Referring to the theoretical data, as already mentioned, this thesis will be exclusively based on books and scientific articles. Seeking the literature has been done, among others, by using the computer systems at Göteborg University library, which has given us access not only to the locally provided books, but also to books from other Swedish universities. Additionally, databases like ABI/Inform Global, have been used for tracking articles among the vast volume of journals. The first step has always been a standardised wide research, within general keywords like strategy, finance, environment, structure, debt, returns, etc. Later, more specific research has taken place by seeking for phrases like corporate strategy, capital structure, assets base, etc.

Furthermore, the extracting of empirical data from the annual reports will be done in two parts. Firstly, the figures in the financial statements for each company will be passed on a worksheet, double-checked, and then used for producing the tables of *Key Figures* that represent the basis of our analysis. The key financial figures for each company, together with the balance sheets and the profit and loss accounts will be included as appendices, but in the latter case only for every five years due to practical reasons. In order to improve comparability, only occasional minor adjustments on the order of some disclosed items will be made. Additionally, the ratio values will not be copied from the reports, because different formulas are used from company to company and from year to year. (The formulas to be used in this thesis are presented below.) Figures expressing

amounts of money will not be adjusted for inflation over the years. It is considered that validity is not affected, because the purpose is not to directly compare performance over the years, but to scan major annual changes of the financial results; if comparisons between different years are needed, then annual percentage changes will be used. After working with the numbers, we will focus on the written text, both on the comments by the CEO or President *(koncernchefens kommentarer)* and the Board of Directors' Report *(förvaltningsberättelsen)*, where issues of corporate strategy and business environment are discussed.

At this point it must be mentioned that the empirical data of Volvo and SCA for 1985, are not based on the original annual reports, because they are missing from the university library. Although the financial results of that year have been found in the 1986 and 1987 reports, references to their environment and strategy for 1985 will not be made in the thesis.

Selection of Companies

Limited time resources and the level of accuracy required for each case dictate a relatively small number of examined companies. However, efforts have been made to select a representative set that would not consciously bias conclusions. The selection of three companies, Electrolux, SCA, and Volvo, has been preferred, because certain criteria are satisfied; among them, the fact that all three are large, mature, and publicly owned corporations based in Sweden and operating worldwide. That results in a higher level of comparability over the same period of time, because disorders arising from factors like the prevailing accounting standards and business environment are avoided to a great extent. Additionally, the examined companies represent cases where a wide range of strategic shifts during the last three decades have been experienced, which implies that they have '*an interesting story to tell*'. Finally, this compilation has been selected

for practical reasons, regarding the availability of the needed annual reports at the university library.

The origins of AB Electrolux can be traced back to the development of world's first household vacuum cleaner in 1912 and the launch of the absorption refrigerator in 1925. From the early stages the company grew fast, and in the quest for being the largest household appliance producer in the world, a large number of acquisitions were carried out, especially in the 1960s, 70s, and 80s. Over the time operations have comprised, among others, production of chain saws, lawn mowers, kitchen interiors and office machinery equipment. Today, Electrolux is the largest white-goods producer in several geographical markets over the world.

Svenska Cellulosa Aktiebolaget SCA was founded in 1929, although its history dates back to the 15th century, when the exploitation of the forests started in the Northern parts of Sweden. The company is a result of mergers between several forest companies established in that area. SCA has developed from a timber and pulp supplier to a producer of end-consumer products with focus on the paper, packaging, and hygiene products sectors. During that development it had been involved in other businesses like energy and manufacturing of machinery for pulp and paper production. Nowadays, SCA is among the leading European producers in both the packaging and hygiene products market.

AB Volvo was founded in 1915 as a subsidiary of the Swedish ball bearing company SKF, but started to manufacture cars in 1926, although originally the focus was on trucks. The company soon entered the sector of marine and aircraft engines as well as construction equipment and farm machinery. During the 1960s the Volvo group grew internationally and created a world-known brand in the transportation industry. After having made a detour into the oil and food industries in the 1980s, the company started to focus on its core business in the 1990s, although it sold off its passenger vehicles op-

erations to Ford Motor Company in 1999. The main product areas today are trucks, buses, and construction equipment.

Calculation of Numerical Data

Absolute values refer to the financial data that are produced by the accounting system of each company and presented in the financial statements. Absolute values can also be studied in terms of annual changes, expressed as percentage changes. As a result, the changes are presented both in terms of monetary units as well as in percentage. However, it must be kept in mind that a meaningful percentage change cannot be computed where an item has a value in a base year and none in the year after (Bernstein 1993: 79). The key measures that will be used for analysing the financial structure in the three companies are the absolute values of assets, equity, debt, sales, and operating income (returns), together with their annual growth rate expressed in percentage change, and their indices.

But absolute values of their own are of limited use, which makes the implementation of ratios compulsory. Consequently, there is the need to define how ratios will be calculated, because there is confusion in terminology among authors and analysts. There is no right or wrong definition of ratios, but it is a question of whether they are valid for a certain purpose; the difficulty lies in the accounting policies and the appropriateness of the figures from the annual report that affect the resulting ratios. For the purpose of this paper three ratios will be calculated, namely the debt-to-equity, return-on-assets, and return-on-sales ratio. The formulas of these ratios are as follows:

$$\text{Debt-to-Equity} = \frac{\text{Total Debt}}{\text{Total Shareholders' Equity}}$$

Total debt consists of current, long-term, and other liabilities and deferred income taxes, while total stockholders' equity refers to shareholders' equity and minority interest (Bernstein 1993: 615). For practical reasons total equity includes 70 percent of provisions, whilst the remaining 30 percent is added to the long-term liabilities.

$$\text{Return-on-Assets} = \frac{\text{Income After Net Financial Items} + \text{Financial Costs}}{\text{Total Assets}}$$

Income after net financial items is the operating income after depreciations and after adding possible nonrecurring items and financial incomes, such as interest income and dividends. Financial costs refer to interest costs and other financial costs. Total assets are the book value of both current and fixed assets at the end of the fiscal year (Rock 1995: 14).

$$\text{Return-on-Sales} = \frac{\text{Operating Income After Depreciation According to Plan}}{\text{Total Sales}}$$

Operating income is equal to sales after deducting operating costs and expenses. Depreciation according to plan is based on the estimated useful lives of the assets and finally total sales equal net sales.

3 Business Environment

The Concept of Business Environment

The increased uncertainty of the global business scene during the last decades has made managers more aware of the environmental forces that influence the corporate life. The level of environmental uncertainty, which varies for every industrial sector, can be determined by using two dimensions; firstly, the speed of change that determines how dynamic or static the conditions are, and secondly, the degree of the environmental comprehension that determines how complex or simple situations are faced by the organisation.

In order to make the understanding of the environmental factors easier, they are categorised in several ways, on the base of different criteria. The term macro environmental factors refer to factors linked to the environment of an organisation; it is the pattern of all the external conditions and influences that affect company's life and development (Mintzberg and Quinn 1992: 47). The most important of them are the economic environment, the political and legal environment, and the technological environment. On the other hand, micro environmental factors relate to the various characteristics of each industrial sector, e.g. market and industry structure, competition, etc. Respectively, these factors are the pattern of all the internal conditions and influences that affect the life and development of each industrial sector.

Perhaps the most significant factor in any compilation of environmental factors is the economic considerations. The economic health of a nation or a region, can be indicated by measures of gross domestic product, household and per capita disposable income, unemployment rate, investments, etc. Changes like the international trade and flow of capital follow cyclical patterns, which determine the demand and supply of most goods and services under periods of

prosperity and recession. As a result, economies throughout the world have been hit by shortages in a wide variety of commodities, like steel, oil, lumber, paper, etc. Although forecasting the fluctuation of demand in cyclical markets is difficult, because it requires estimations of many unpredictable variables, the strategy architect must have a thorough understanding of the effects of the economy on the industry and on his particular firm. The firm that develops plans, based upon the effects of economic considerations, has a distinct advantage over competitors who have not done so, and the advantage is greatest when the economic turn-around is higher.

Furthermore, the political environment of each country refers to the decisions taken by local and national governments in form of legislation that influence organisations. It also includes laws passed by supranational bodies, such as the European Union, which influence the competitive framework within which firms operate. Consequently, factors like the impact of national planning on corporate level, the involvement of local governments in private enterprises, changes of government policies on subsidies, tariffs, export financing, research and development funding etc. can affect the strategy of every company and pose tremendous threats to the validity of the current strategy.

Nowadays technological advances are continuously achieved in the business world, in such a way that what was important yesterday is of minor interest today. Technological factors are an important element of the macro environment, by creating new business opportunities e.g. the possibility to produce new products and services or improve the existing ones and find new forms of distribution. However, new techniques are not only an opportunity for the organisation to improve efficiency, but it can also be a threat; the development of the airline industry for example, caused a decline in the railway business. Keeping pace with the technological developments is a prerequisite for maintaining the competitive advantage over the competitors, especially in the high-tech sectors.

Referring to the micro environmental factors, different drivers of change, such as increasing convergence in markets due to an increasing standardisation of customer preferences and cost advantages have led to the increasing globalisation of markets. Moreover, the increased globalisation itself spurs further globalisation, since it puts pressure on more companies to become global actors (Johnson and Scholes 1999: 104–107).

When analysing the business environment an important factor that must also be mentioned is the competitive environment. Its importance is equally vital for all kinds of industries to the degree that determines the ease to enter and survive. According to Porter (1985: 65) there are five competitive forces that determine the structure of an industry, i.e. the intensity of rivalry among existing competitors, the bargaining power of customers, the bargaining power of suppliers, the threat from substitutes, and the threat from new entries. It must also be pointed out that there are industrial sectors where the level of competitive rivalry is extremely low; the terms of monopoly, oligopoly and oligopolistic competition, as adopted from the political economy, describe such phenomena. Finally, according to Donaldson (1994: 28) it is an axiom of competition that as share of market increases, it gets more difficult for the market leader to gain share of competitors' position; thus the growth rate of the market leader tends to be identical to the growth rate of the industry as a whole.

Interrelationship with Corporate Strategy

The firm continuously needs to adapt its strategy to the *ad infinitum* changing environment. Since in periods of economic decline resources are not readily available as in periods of growth, quick response by management to the new situation assures effectiveness and thus superior performance by taking advantage of new opportunities. When executives had failed to look beyond efficiency of the

functional activities of the firm like production, marketing and finance, they were hit by external shocks, threatening even the sources of competitive advantage and in the long-term the firm's survival. As Meier (1998: 16) puts it, there is no merit in having the captain of the *Titanic* optimise the arrangement of his deck chairs. The corporate strategy cannot be unrelated to the business environment.

The match between the environment and an organisation's resources is called its strategy (Hofer and Schendel 1978: 4). However, identifying the various environmental influences is a challenging task, because managers must create an overall picture emerging from the really important influences on the organisation. Every company operates in its own business environment, and over time the importance of different influences may change. After auditing the environmental influences management can construct possible future scenarios in order to determine how the corporate strategies might need to be adapted to the new reality.

4 Corporate Strategy

The Concept of Corporate Strategy

Since authors such as Peter Drucker in 1954 and Alfred Chandler in 1962 launched the concept of strategy, new analytic approaches and techniques have been evolved and a significant effort has been devoted to clarifying what strategy's real nature is, or in other words how it works.

Originally the concept of strategy was military related; the word strategy derives from the Greek word *strategos* (στρατηγός), referring to the role of a general in command of an army, and the Greek verb *stratego* (στρατηγῶ) describing generalship. By the time of Pericles (450 BC) it came to mean managerial skill (administration, leadership, orating, power) and by Alexander's the Great time (330 BC) it referred to the skill of employing forces to create a system of global governance. Nowadays greater attention is paid to the business dimension of the term. Amongst the many definitions given, is that of Quinn (1980: 5):

> *"Strategy is a pattern or plan that integrates an organisation's major goals, policies, and action sequences into a cohesive whole. A well-formulated strategy helps to marshal and allocate an organisation's resources into a unique and viable posture based on its relative internal competencies and shortcomings, anticipated changes in the environment, and contingent moves by intelligent opponents."*

Andrews (1980: 14) gives another definition, according to which:

> *"Strategy is the pattern of objectives, purposes or goals and major policies and plans for achieving these goals, stated in such a way as to define what business the company is in or is to be in and the kind of company is or is to be."*

However, as stated by Mintzberg in his book *The Strategy Process, Concepts and Contexts* there is no single universally accepted definition for the strategy concept, because the term is used differently by different authors and managers. Additionally, due to the fact that each strategy generates unique strategy situations, there are not common criteria that tend to define a good strategy (Mintzberg and Quinn 1992: 11).

Given that the concept of strategy is very comprehensive, a further analysis is required, in order to point out the differences and the similarities between goals, policies and programs. Goals (or objectives, purposes, missions) state what is to be achieved and when results are to be accomplished, but they do not state how the results are to be accomplished, for example create a balanced portfolio of product lines. Polices are rules or guidelines that express the limits within which action should occur, for example debt ratio less than 40 percent of total capital. Finally, programs express how objectives will be achieved within limits set by policy (Quinn 1980: 6).

In a more conventional language, a strategy sets what will be achieved (goals), how these will be accomplished (programs), and within what limits (policies). At this point a distinction between strategies and tactics need to be made. Strategies exist at many different levels in any large organisation. A company has several strategies, from corporate to business functional level. So what is a tactic for a chief executive officer, will be a strategy for the chief financial officer; the difference lies in the scale of action (Quinn 1980: 6).

Amongst the first authors who discussed strategic issues, like the formulation process, were Kenneth Andrews and Igor Ansoff; even if they disagreed on strategy's breadth and components, they agreed that the strategy formulation process should be formalised for several important reasons (Hofer and Schendel 1978: 16–17). Even though the evolution of new analytic approaches and techniques was impressive from the early days of strategic planning, this magic tool

that could help managers reach their desirable future status and anticipate forthcoming problems and difficulties, by programming set of actions in that direction, has survived much criticism, not only of methods and processes used, but also of its existence.

Paul Gaddis (1997) is one of the authors who wrote about the criticism on strategic planning or what he calls future-oriented management. In his article *Strategy Under Attack*, he identifies four different sources of assault. The first one stems from chaos, the instability and disorder of systems that makes predictability in turbulent environments impossible; thus converts managers' firm belief in cause and effect theory and from that moment on supports the fact that future is affected more by random and uncontrolled events rather than planning. The inherited culture is the second source; according to this view trying to comprehend the future is not plausible. Such cultural and religious traditions are less dominant nowadays and greater attention is paid to the linear, evolutionary and progressive notion. The third reason is incrementalism, namely the belief that corporates change gradually. And finally, the fourth force is related to short termism, the concept of gaining large returns in the short-term, in contrast with sustainable competitive advantage the in future. Since the main criticism arises from issues around the methods and processes of strategic planning, the focus is on chaos and on incrementalism.

The conviction that it is pointless to use formalised planning methods for determining long term organisational goals, due to the fact that the dynamic systems have very complex behaviour, explains the theories of chaos and self-organisation, which are encapsulated in the following statement by Stacey (1993: 11), one of the chaos theorists: *"There are conditions in which dynamic systems generate behaviour so complex that the links between causes and effect simply disappear."*

In other words, these long-term goals are never achieved, because of the unquestioned assumptions made, referring to the link between an action and an outcome.

The main critique of chaos theory arises from what Gaddis calls circular reasoning (1997: 42). In more detail, according to the chaoists, even if the organisational future is absolutely unknowable and that no one can direct or control it, managers can apply positive feedbacks to direct it. But success lies in a non-equilibrium state between ossification and disintegration and for a non-linear positive feedback system, that is chaos (Stacey 1993: 13).

A fundamentally different way of understanding strategic development is provided by those who say that planning in the long run is possible. Katz for instance, wrote about the contribution of strategic planning to the viability and success, focuses on two interrelated points. Firstly, company's control on its destiny can be achieved only through explicit and conscious planning, and secondly that strategy is subject to continuous modification (1970: 196–205).

More analytically, controlling organisations' destiny refers to the ability to secure long run profitable business development, and to the ability to co-ordinate action as companies get larger and to determine a basis for making trade-off decisions. Katz (1970: 346) is more than positive when he says, *"a company should never be without an explicit strategic plan."*

Explicit does not mean rigid and inflexible in any way; in contrast it refers to a set of management guidelines that allows adaptation to changes in the environment and also allows quick and effective responses. This must be conceived as a continuous process, especially in terms of strategy formulation, because changes are continuous too. The availability of such alternative courses of action, or alternative generation processes, or various scenarios is more important in periods of great uncertainty, for anticipating possible problems and opportunities.

However, the concept of explicit strategy is not without weaknesses. Firstly, it is based on predictions, which are time consuming and not accurate. Secondly, only formal sources of planning – like research reports – are used, although many studies have shown that the most effective managers rely on informal sources, like gossip. And finally it is based on the assumption that information is processed by formal systems; but in this way they could never internalise, comprehend and synthesise it (Mintzberg 1994: 110–112). *"To paraphrase Hayek, strategies may result from human actions but not human designs"* (Mintzberg, Quinn and Ghoshal 1998: 15).

In response to formal planning's failure, due to poor implementation, Quinn and Voyer introduced the concept of logical incrementalism (Mintzberg, Quinn and Ghoshal 1998: 110). Although formal planning is a useful tool for formulating organisational goals and objectives and for allocating resources, it focuses only on quantitative factors and underestimates qualitative aspects. That results in differences between the processes of management installed and finally used by managers and also between the intended and emerged outcome (Stacey 1993: 10). Instead of sequential planning mechanisms managers should use successive limited comparisons when building strategies in order to readjust continuously to environmental changes (Johnson and Scholes 1999: 43–56).

The concept of emerging strategy has been developed further by Mintzberg, who supported that strategy does not need to be deliberate, but can also emerge. Instead of first formulating and then implementing, the action can drive thinking and thus a strategy is emerged. The distinction between formulation and implementation usually results in unrealised strategies (Mintzberg, Quinn and Ghoshal 1998: 113).

In more detail, Mintzberg says that the pattern of strategic planning refers only to analysis and manipulation of numbers and lacks of real vision – synthesis. Analysis can help broaden the consideration of issues, can encourage managers to think strategically and

helps to specify a series of steps needed to carry out a vision; but analysis cannot replace strategic thinking in terms of creativity and intuition. The managers must synthesise what they have learned from all sources into the vision of the business and the whole strategy making process must be based on trial and experience (Mintzberg 1994: 107–114).

However, according to Ansoff (1991: 454–459) the concept of emerging strategy and incrementalism is inferior on five points. Firstly in terms of cost; for example in the case of acquisition, vast amounts of capital are required, so disinvestments from mistakes should multiply the costs and losses of the organisation. The organisation learning model used plays an important role; for example the rational model, that emphasises the importance of cognition, becomes important when the cost related to a failed trial is very high. Major research studies have shown better financial results are produced by the plant – rational model of learning – rather by the trial error approach – existential model – especially for mergers and acquisitions.

Secondly, Mintzberg fails to identify the organisation of context within such a model should be applicable. Mintzberg's prescriptive model is a valid prescription for organisations, which seek to optimise their performance in an environment in which strategic changes are incremental and the speed of changes is slower than the speed of organisational response.

Thirdly, Mintzberg fails to recognise that *"the level of environmental turbulence has become a driving force, which dictates a strategic response necessary for success."* The fourth point is that success is not always result of prior experiences. The validity of strategies used in past must be continuously examined; past success does not guarantee success in the future too, especially when same conditions do not hold. This is why strategies become obsolete and inappropriate in a changing world (Katz 1970: 197).

The last point of debate is the assertion of Mintzberg that in complex organisations it is not possible to plan and co-ordinate an organisation wide process of strategy formulation. The difficulty lies in the number of factors that the manager has required to co-ordinate, such as external environmental events, internal decisions, behavioural and power relationships and informational needs (Quinn 1978, in Ansoff 1991: 454). However, other researchers have shown that strategy formulation is possible within modern organisations of increasing complexity. The major benefit of strategic planning in complex organisations is that submitted objectives will not take precedence over total organisation objectives and that groups and individuals will perform better if they know what is expected of them; thus, the organisational effectiveness will be improved (Uyterhoeven *et al.* 1973, in Hofer and Schendel 1978: 6). Ansoff agrees with that and also supports the fact that formal planning blends creativity and rational analysis and it promotes organisational transformation in large firms (1994: 31–32).

From all the above evidence it is concluded that two major schools of planning – explicit and emerging strategy planning – are dominant; although each strongly criticises the other, there are organisational contexts where each process and method is valid. The importance and need of both ways for discharging strategic planning for the future – intuitive anticipatory planning or formal systematic planning – is recognised even by the most dogmatic ones, included Ansoff and Mintzberg. According to Hofer and Schendel (1978: 47–49) the difference between using explicit or implicit strategy derives from differences in the experience authors had. For example Ansoff developed more elaborate models of strategy planning, because his experience was within the field of complex industrial groups, like Lockheed Aircraft Corporation, while Mintzberg studied smaller and less complex organisations. The researcher always brings his own ideas and conceptual framework with him, which automatically influence the theories that were generated. This state is more or less

based on the issue of whether or not human beings can ever achieve any form of knowledge that is independent of their own subjective construction (Morgan and Smircich 1980: 493).

Interrelationship with Financial Structure

Although there is a tendency to use the terms structure and strategy interchangeably, it is necessary to make a distinction. Financial structure is by nature strategically passive, because it does not define a corporate strategy, but it is merely an instrument that is adjusted when a new strategic direction is set. Thus, one of the objectives of management is to gain control of this instrument in order to direct fundamentally the course of corporate fund flows in accordance with the strategic plans. *"It is not surprising that a new strategic direction shows itself first as financial restructuring even though the latter is merely a means to the end"* (Donaldson 1994: 7–8).

A new financial structure can be the result of a new chief executive, whose unique vision is reflected by a certain corporate strategy and financial structure. It is a fact that the elements of financial structure are the subject of constraint over extended periods of time imposed by a particular business mission and strategy; these elements are then reassessed in periods of leadership succession. However, structure is not always the result of a new business vision, but can be also marked by a confrontation from within the company. Tensions arising from eroding competitive position and financial performance produce intracorporate initiatives to change direction.

The interrelation between corporate strategy and financial structure is also shown when determining the discretion of management over the usage of corporate funds, as professional investors have reasserted their rights of ownership. Although in the past the business strategies had favoured corporate priorities at the expense of shareholders, the contemporary corporate governance system implies the level of reserves held at low rates, the liquidity rate, and finally the

sources of corporate funding, by increasing the stake of debt over equity. Furthermore, it indicates the reinvestment rate of retained earnings – by demanding higher levels of dividend payout and stock repurchase – and the level of diversification and focus on the core business – by emphasising quality over quantity of revenues, or profitability per strategic business unit over aggregate earnings (Donaldson 1994: 58).

Generally speaking, strategies that can have an impact on the financial structure are related to the determination of the specific product-markets and the timing of entry and exit. In more detail, corporate strategies are responsible for decisions of organic growth, divestures, acquisitions, and new product development in related or unrelated areas (see for example Donaldson 1984: 95–128).

5 Financial Structure

The Concept of Financial Structure

Although there is not a commonly accepted definition of financial structure, in this paper it refers collectively to the revenue structure (where the revenues come from), the cost structure (where costs arise), the assets structure (where the financial resources are tied up), and the capital structure (what the mix of debt and equity is). Despite this simplified formation for monitoring financial structure, the content of its elements is still complicated and not easily understood.

For instance, since Modigliani and Miller published their original article, based on some major assumptions that the firm operates in a perfect world of unlimited borrowing and constant demand, the existence or not of an optimal financial structure that maximises shareholder's wealth is among the most frequent theoretical debates.

In detail, the traditional approach to capital structure assumes that there is an optimal structure where a specific composition of debt and equity lowers the weighted average cost of capital (WACC), and hence increases the present value of the firm. Increased gearing will result in a higher average cost of equity due to higher financial risk, but the higher ratio of less expensive debt lowers the weighted average cost of capital. Despite that, at a level of high gearing the cost of capital will increase due to higher perceived risk of bankruptcy by both equity and debt holders.

In 1958 Modigliani and Miller on the other hand showed that there was no such thing as an optimal structure, given certain conditions, like perfect capital markets. Their theory was based on the assumption that the average cost of equity increases proportionally when gearing gets higher and not progressively, since no bankruptcy costs exist in a perfect capital market. This will also result in an un-

changed average cost of debt although the gearing is higher. The conclusion is that the increased average cost of equity is exactly offset by the higher ratio of cheaper debt; thus, the capital structure does not affect the weighted average capital cost.

Later on in 1963 Modigliani and Miller presented a revised theory on optimal capital structure, where they recognised the existence of corporate tax and the possibility of tax deductibility of interest, which radically changed the conclusion of their theory. They showed how increased gearing would increase average cost of equity as previously, but the increased level of debt would shield more income from taxation, due to the deductibility of interest, which in total would result in a lower WACC. They concluded that a company financed by 99 percent debt and 1 percent equity serves its shareholders better than one financed by 50 percent debt and 50 percent equity. On a practical level it is believed that the debt ratio at which the cost of capital is minimised ranges between 30 to 60 percent (see for example Arnold 1998: 774–775, and Watson and Head 1998: 211–220).

Referring to the criteria used for choosing between equity and debt, an empirical study by Marsh (1982) demonstrated that companies are influenced by market conditions or company's historical share price performance. Additionally, it was argued that companies make their choice of financial instruments as if they have targets for the composition and the levels of the long and short-term debt. The composition of debt will depend on the company's size, and asset composition, whilst target debt ratios are a function of bankruptcy risks and tax. In principle, companies should issue debt if they are below their target level and equity if they are above, taking also in mind the floatation costs.

In Marsh's paper a good review of previous studies is also given. Among others, some of the findings of Baxter and Cragg, saying that companies with high ratios of market capitalisation of total assets favour equity, are provided together with findings from several other

researchers, who support that the selection of debt depends on the level and structure of interest rates.

The choice between debt or equity is also discussed in Donaldson's article from 1961, where he introduces the concept of pecking order. His idea is based on the assumption that a company when raising long-term funding has a certain order of preference in choosing sources of funds. A firm would preferably choose internally generated funds or retained earnings before debts, and debts in preference to issuing new equity, since it is more costly to issue and negotiate debt than using the internally owned funds. Issuing new equity is even more expensive than debt, which makes debt more preferable to equity (Watson and Head, 1998: 221–222).

Furthermore, the concept of optimal financial structure is also related to the ownership structure that determines the sources of finance, in terms of bank involvement, the presence of state ownership and the family capitalism. Such factors have a direct effect on the reallocation of funds and on the level of cash flow, because they determine the extent that information problems occur between a group and its internal or external capital markets (see for example Bianco and Casanova 1999).

Such effects of the ownership on the financial structure had been identified early and as a result new theories have been suggested to explain the possible existence of an optimal structure. For instance, the concept of agency theory, introduced by Jensen and Meckling in 1976, according to which the financial structure choices in a firm are affected by the relationship between shareholders and managers. In brief, they pointed out that as the managers' share of total equity decreases, the cost to them of decisions that are not optimal for the other shareholders also decreases. This leads to increased agency costs in the form of monitoring managers or allowing them to make choices on the financial leverage – debt to equity ratio – that would not have been made by shareholders.

Although, the agency theory has been criticised by Seitz (1982), because it fails to explain the financial structure choices of corporations whose managers own a small percentage of equity, it has been supported by Hart (1995: 142–150), because it explains why firms issue hard debt, namely senior debt that can lead to bankruptcy in case of failure to make debt payments. A more descriptive view is presented, starting from the theory of optimal structure, that debt is good because it reduces corporate tax, but bad because it may cause inefficient liquidation. He states that a manager who is a significant shareholder will issue debt rather than equity to repay an amount owed if assets yield a high return, in order to avoid dilution of shareholder's equity. However, if the management does not hold any shares in the company, its remuneration depends only on *ex post* value of the firm; thus managers no longer have any incentive to issue debt rather than equity.

Furthermore, the financial structure is not only dependent on the relationship between the management and the shareholders; in cases where the head of a group holds a majority control share in the company, the main agency problem does not come from a conflict between strong managers and weak owners as Jensen and Meckling have put it, but instead from a conflict between *strong* blockholders and weak minority owners (Becht 1997, in Bianco and Casanova 1999: 1059).

Referring to the Modigliani-Miller theories on capital structure, Myers (1998) supports that there is not any evidence that more debt is preferred to equity, apart from the fact that there can be a moderate tax-advantage, given that the company can use the interest tax-shield, namely income to deduct the interest costs from.

Following this line of thought, he points out another type of cost of debt, which arises from the underinvestment problem. In a firm that faces financial distress there is the risk of underinvestments as well. This refers to a situation where neither the debt or equity security holders want to put in money, even in an investment that would

yield a positive return. The reason is that the debt holder will have problems to assess the risks in the investment project from an outside perspective, because he might be sceptical to whether the management works in the interest of the firm or only in the interest of the shareholders. The shareholders on the other hand, have no interest in putting in more funds in the distressed company, since the creditors will be the first ones to benefit from a positive return due to priority rules. The result is that an investment generating positive result is foregone, a fact that explains why companies dependent on growth opportunities preferably choose a lower debt ratio.

Interrelationship with Business Environment

Financial structures are shaped not only by the internal, but also by the external environment of the time. The financial structure must be realistically related to the world as it is – or is likely to be in the foreseeable future (Donaldson 1984: 13). Any stable structure in time outlives its relevance for the current environment. The fact that corporations go through restructuring processes is explained by the fact that the business environment is continuously evolving. Even if the change of the environment is a gradual process, which takes place in a time span of five to ten years, the response to change in structure is convulsive, which lead to tensions to change direction and priorities (Donaldson 1994: 8–9).

The financial structure can be the result of takeover attempts. When a bid is launched to acquire a company in order to reserve independence and control, heavy debt burdens are taken for acquiring a large share of other's stock, or in general for making a better offer to the shareholders.

Additionally, the financial structure is also affected by the environment in terms of availability of capital and level of financial risk. In more detail, international availability of capital would enable a firm to lower its cost of equity and debt and financial risk could be

decreased through diversification of cash flows that reduce their variability. Apart from those two variables, many empirical studies have concluded that the financial structure is also a function of cultural factors related to each country's environment (Eiteman, Stonehill and Moffett 1998: 436–441).

Other studies have identified significant industry differences in financial structure, although the firms within the industries studied were found to have similar debt ratios (see for example Schwartz and Aronson 1967, Scott 1972, Scott and Martin 1975, and Ferri and Jones 1979). However, the concept of industry specific structures has been criticised by suggesting that there are both industry and firm specific determinants of debt financing (see for example Belkaoui 1975, and Varela and Limmack 1998).

6 The Case of Electrolux

The Business Environment of Electrolux

The decade starting in 1970 was less than promising for the producers of white-goods and household appliances. The state of flux in the economy led to increased prices of raw material and salary costs in most of the western countries, while the level of competition and price control policies kept prices stable. This weak state of economy, which did not show any signs of improvement, deteriorated even more by the fluctuation of foreign currency and the energy crisis, although the effects were lower than in other industries. As a result the market in the United States, Japan, Germany, Great Britain and the Nordic countries stagnated.

Private consumption in several countries did not improve either at the end of that decade, because of the slow economic development, the rise in inflation, and soaring oil prices. Although the demand in Sweden was still low, local producers could increase exports, taking advantage of the depreciation of the Swedish krona, despite import restrictions set by many countries, due to trade imbalances.

The situation did not get better in the beginning of the 1980s; in contrast, it deepened even more because of the higher unemployment rate and higher salaries. Many consumer, industrial and semi-industrial markets shrunk, but signs of recovery started to appear in 1982, when the international interest rates started to fall.

However, the profitability of white-goods producers decreased because of higher competition in a continuously consolidating low growth market, and demand declined due to a lower level of new building activity. Furthermore, a weak US dollar affected exports to the American market, and profits sank because of low domestic demand.

At the end of the 1980s, the market of white-goods was global, with more similar consumption patterns and internationalised products across countries. However, the international markets were still stagnated, while the Swedish economy grew less than other OECD economies.

At the beginning of the next decade, the Gulf War weakened the world economy in general and Sweden faced a deep recession due to the dependence on exports to countries that were affected the most by the economic downturn, leading to the devaluation of the krona in 1992. The situation got better only in the mid 1990s, where growth in the United States improved and the European economy recovered. However, that period was also marked by turmoil in the currency market after the Mexican pesos crisis, followed by the currency turbulence in Brazil few years later, and the severe economic crisis in Southeastern Asia.

The Corporate Strategy of Electrolux

In the 1970s, the main objectives of the corporate strategy of Electrolux were the continuation of expansion and the improvement of efficiency through rationalisation programs. Having more than 50 percent of sales outside Sweden, the company acquired businesses all around the world, from Finland to Australia and from the United States to Singapore. At the same time, they launched new product lines and entered new product markets.

Sales had been exceeding expectations, efficiency had been enhanced by lower cost of administration after the introduction of computers, supply chains had been improved, and inventories had been reduced. Investments included acquisitions of freezer, steel sheets, and sales companies in Sweden, Denmark, Germany, Brazil and Canada.

The realisation that the domestic market was very small made Electrolux management concentrate its growth efforts outside Swe-

den, through organic growth, acquisitions, and participation in joint-ventures. Among the most important deals at that time was the merger with Facit in 1973, the Swedish office equipment company, aiming at reaching synergies between the two companies; Electrolux could overcome its undercapacity problems and had the know-how for new product development, while Facit would be able to produce some of the components that Electrolux used.

In the following years, confidence in related product diversification for spreading risks and coping with unanticipated economic turmoil, encouraged the company to continue investments, usually financed by debt raised in the international capital markets. Sales got higher due to the foreign subsidiaries' performance and the geographic spread of the company. However, in mid 1970s the costs of production increased more than expected, especially because of high material prices, despite the introduced rationalisation programs. The most important deals at that time included the acquisition of National Union Electric (NUE), the vacuum cleaner manufacturer (1974), the chain saw producers Husqvarna, Partner (1978), Jonsered, and Pioneer (1979), and Tappan, the manufacturer of white-goods in 1979.

Expansion continued, although, all subsidiaries did not perform well; among them Facit, which had continuously declining returns and all its factories in Göteborg were closed down. At this stage Electrolux was the leader in several markets – for example one of the two international dominants in the vacuum-cleaner market – focused strongly on marketing and automation of production, divested assets that were not needed, and continued to enter new markets.

In the beginning of the 1980s, Electrolux owned some 300 companies in 40 countries. Although, new products had been launched in all businesses, group's competitiveness deteriorated in important markets and demand was getting higher only in the United States and Canada. Furthermore, problems of excess capacity

threatened profitability, and programs to turn the situation around included reduction of the number of employees, and lower inventories. While acquisitions, like Gränges in 1980, were carried out, management focused on subsidiaries with developable products and on acquisitions of companies, whose assets could be divested for financing the restructuring, in order to strengthen the balance sheet and reach a favourable cost structure similar to that of major competitors.

In 1986 Anders Scharp succeeded the veteran chief executive Hans Werthén at the leadership of Electrolux. Soon the new management realised that it was difficult to keep competitiveness and profitability, because margins were still decreasing. However, at that time the previous strategy of geographic spread, organic growth and acquisitions, as a cheapest way of expansion, was retained. By the end of that decade Electrolux had bought about 200 companies in several different businesses, including Zanussi in Italy in 1984 and two years later White Consolidated, the third largest white-goods producer in the United States. Sales counted for SEK 85 bn, where 85 percent were outside Sweden, and operated worldwide, with North America representing its largest market.

Further deterioration of competitiveness due to increasing costs and salaries, low demand in key markets – like the United States and Great Britain – and price competition, led, in 1990, to the launch of a comprehensive restructuring program, including concentration on manufacturing, closing down of ten plants within household appliances, and divesture of the commercial services operations. In 1992, the restructured Electrolux operated in four main business areas, comprising household products, commercial equipment, outdoor and industrial products. In contrast with the previous decade, the focus was not on acquisitions any more, but on consolidation of the existing operations. However, selected companies, like AEG in Germany, were still acquired.

The next years were dedicated to continuing the process of internal efficiency improvement, strengthening the main business areas, creating a global structure, and increasing efforts in new markets in Eastern Europe and Asia. Despite competition, this restructuring process led to growth and better results. At the same time divestments of operations, especially within the industrial products sector, like Autoliv in 1995, Gränges in 1997, and of many other smaller companies, were carried out.

The efficiency efforts were further strengthened in 1997, when Michael Treschow took over, after Leif Johansson's six years as chief executive. Another two-year restructuring program was implemented, aiming at reaching an operating margin of about seven percent, return-on-equity of 15 percent, and a debt-to-equity ratio no lower than 1. The workforce was reduced by more than 12,000 employees, 25 plants were closed down, and total quality management projects were introduced. Finally, in 1999 joint-ventures continued, like the agreement with Ericsson and Toshiba for developing intelligent household appliances.

The Financial Structure of Electrolux

The debt-to-equity ratio in Electrolux was stable at 1 for the first three years, while from 1973 to 1979 the ratio stabilised around 2. From 1980 to 1985 and from 1993 to 1999 there were gradual falls from over 3 to 2 times, while for the years in between the value remained stable below 3. Referring to the equity growth, two situations can be identified throughout the examined period; either equal percentage increases of equity and debt around 15 to 25 percent, or negatively correlated shifts with differences reaching 50 percent in 1973 and 1974. Debt grew in Electrolux in two cycles: the first one between 1971 and 1975, and the second from 1976 to 1981, both ranging roughly between 80 and 20 percent. For the remaining years of

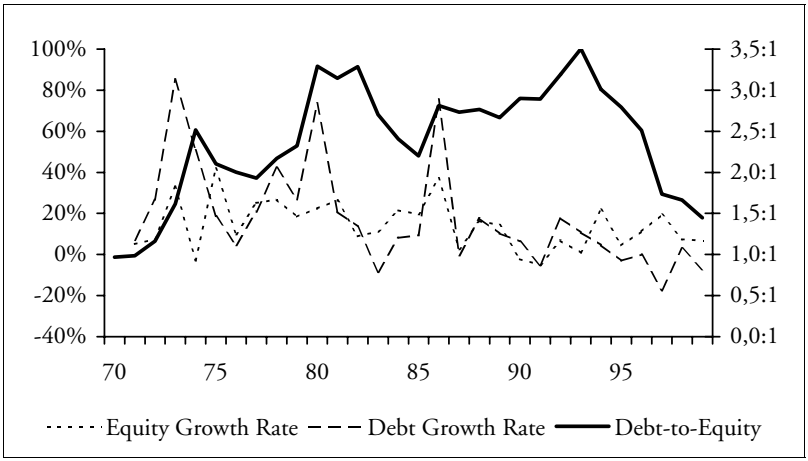

FIGURE 5.1 ELECTROLUX DEBT AND EQUITY 1970–1999
Source: Reconstruction based on Electrolux Annual Reports.

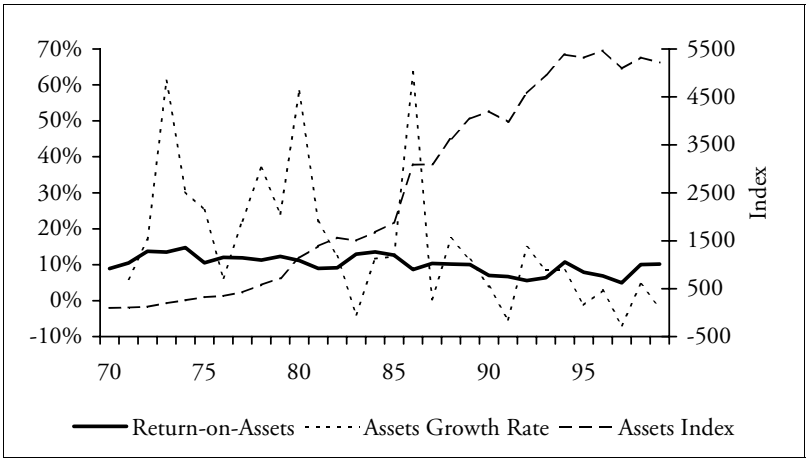

FIGURE 5.2 ELECTROLUX ASSETS 1970–1999
Source: Reconstruction based on Electrolux Annual Reports.

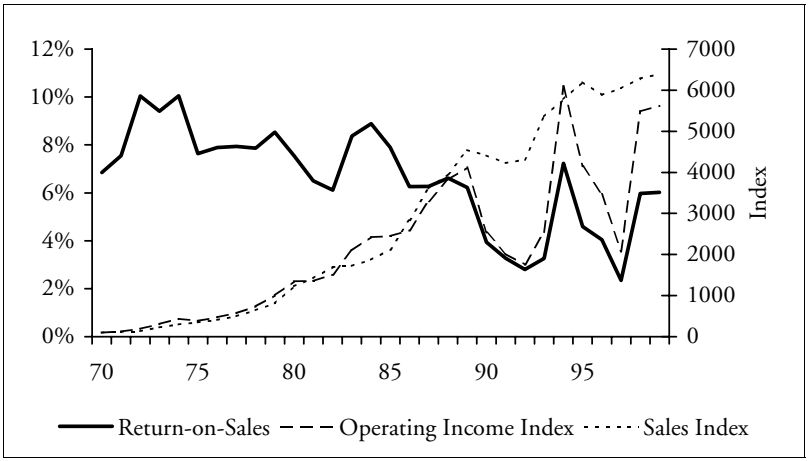

FIGURE 5.3 ELECTROLUX RETURN AND SALES 1970–1999
Source: Reconstruction based on Electrolux Annual Reports.

the examined period, debt grew at lower rates, around 10 percent, with two exemptions; one peak in 1986 and one low in 1997.

When studying the assets, it is realised that the decrease of assets book value was not a rare event, especially in the 1990s. Additionally, up to 1986 assets were characterised by years of very high growth around 60 percent, preceded and followed by years with decreasing growth rate of 35 to zero percent. Finally, after 1988 the growth rate did not exceed 17 percent, when not negative. With reference to the return-on-assets, in the first two decades four cycles can be identified, ranging from 8 to 12 percent on average. In the beginning of the last decade returns were diminishing until 1992 and then gradually increasing up to maximum 9 percent in 1999. The growth of sales until 1982 formed two cycles of six years, each characterised by a peak of circa 60 and a low of roughly 20 percent. A third cycle of lower magnitude dominates the rest of the 1980s, before lower or negative growths in the next decade, except in 1993, where the last increase over 20 percent took place. Return-on-sales

also showed a cyclical pattern of two long periods of almost ten years each. Both periods had a peak of three sequential years of 10 and 8 percent, and an average return-on-sales below 8 and 6 percent respectively, for the remaining years. However, in the 1990s increases were lower, around 4 percent, except in 1994 and the last two years, where the return-on-sales was stabilised at 6 percent.

Analysis of Electrolux

In the first two decades, one of the fundamental elements of the growth strategy within Electrolux was acquisitions, a fact that explains the radical increase of assets and the changes in the capital structure during this period.

The assets growth rate in Electrolux reached up to 64 percent in a single year, due to acquisitions of companies with comparatively large asset bases. Among them Facit that increased assets by 61 percent in 1973, NUE in 1974 (30 percent increase), Husqvarna and Partner in 1978, (37 percent), Jonsered, Pioneer and Tappan, in 1979 (24 percent), Gränges in 1980 (60 percent), Zanussi in 1984 (11 percent), and White Consolidated in 1986 (64 percent). For the years in between the asset growth rate was still positive, caused by a number of smaller acquisitions.

The strategy of acquisitions also affected the debt and equity mix. As the debt-to-equity ratio shows, all of the above mentioned acquisitions, except for Zanussi, resulted in a higher level of debt in relation to equity, with the debt growth rate increasing between 25 and 85 percent. This outcome occurred because either the acquisitions were financed by more debt than equity or because the capital structure of the acquired companies favoured more debt over equity – without excluding the possibility of both cases.

Additionally, the debt and equity mix is affected by the availability of capital. Credit restrictions in Sweden and the economic fluctuation in the 1970s, made Electrolux raise funds on the foreign debt

markets in 1970 to 1972 and in 1974. In the last case, the increase of debt by 50 percent is related to the acquisition of NUE in the United States, financed with foreign capital.

The increase of assets had impact on the level of efficiency in Electrolux. The return-on-assets still increased after the acquisition of Facit, but showed a slightly negative trend after the other major acquisitions in rest of the 1970s. In contrast, the acquisition of companies with divestible assets led to a three-year period of improved return-on-assets to around 13 percent, commencing in 1983 – a fact that also explains why the total asset growth rate increased by only 11 percent when Zanussi was acquired. The continuous acquisitions during the 1980s made the asset base increase more rapidly than income, which resulted in deteriorated efficiency in the use of capital.

During that period, acquisitions by Electrolux were accompanied by steep increases in sales because of the acquired market shares. In respect to the above mentioned acquisitions, the percentage sales growth varied from 26 to 68 percent, although the effect of acquisitions on the operating margin was not similar to the effect on sales. Except for the case of Facit, which was aiming at reaching cost synergies and improving return-on-sales, the rest of the acquisitions until the end of the 1980s were undertaken to increase sales volume, and generally led to a decreasing operating margin. It was not only the cost structure in these companies that was unfavourable, but the development of inflation and its impact on material prices also had a deteriorating effect on the relative gross profit.

Additionally, the introduction of rationalisation programs in the 1970s and the beginning of the 1980s aimed at lowering the costs of administration and making the supply-chains more efficient; for instance the first program, which was launched in 1970 and started to show results two years later and that in the 1980s which was followed by a significant increase of return-on-sales, by 2.3 percentage units, to 8.4 percent in 1983. However, in the beginning of the 1980s excess capacity problems caused by the investments made in the 1970s had

a negative effect on the Electrolux cost base and on the operating margin, which declined in 1980 and 1981.

The diversified revenue base during that period helps to explain the absence of negative effects on sales caused by cyclicalities in individual markets and the continuously positive percentage change of total sales growth for about 20 years, although sales were also the subject of the increased inflation rate and acquired market shares. However, as it is evident from the return-on-sales, the cost level – also affected by the factors mentioned above – failed to decrease and followed an almost parallel course relative to the growth of sales, due to the inability to achieve synergies between the diversified operations.

The high expansion rate of the first two decades did not hold in the 1990s; the strategic shift from acquisitions to divestments in order to restructure and consolidate the operations, led to low or even negative asset growth rates. For instance, the divestments of Autoliv and many small companies in 1995, which reduced assets by 1 percent, and Gränges that was distributed to the shareholders in 1997, led to a reduction of assets by 7 percent. The divestment of the commercial services and the closure of several plants within the household appliances business also contributed to that.

The gain generated from the sale of assets was then used for decreasing the level of debt, for example by 3 and 7 percent in 1995 and 1997 respectively; at the same time, the reduction of assets was followed by an increase of equity. In the early 1990s the decrease of assets is followed by some significant decreases in sales, but not by a respective reduction of costs. As a result, the return-on-sales fell in 1992 to as low as 2.8 percent, half the figure compared to five years earlier. However, in the rest of the years when assets decreased sales growth rate was still positive, because the loss of market shares after divestments was masked by increased sales in other business units and the one-off effects from the devaluation of the krona during 1993.

The result of less efficient use of assets started to show in the beginning of the 1990s, when the return-on-assets ratio reached its lowest levels around 6 percent, supported by the less favourable environmental conditions and the slow pace of refocusing on core activities. In total, returns declined generally relatively more than the asset base in the 1990s, and brought the return-on-assets to a lower level on average than in the previous two decades, despite the rationalisation programs launched in the mid and end of the 1990s, which were followed by comparatively significant increases in return-on-sales by 4 in 1994 and 1998.

7 The Case of SCA

The Business Environment of SCA

As a result of the early globalisation of the forest industry and the dominance of North American companies, the price of pulp, the raw material for paper production, is expressed and affected by the US dollar value. Consequently, the industry is directly affected by the world economic situation.

Within this frame of reference, the 1970s started with increasing demand for pulp and sawed timber, although high level of competition between American and European companies made it difficult to increase prices. Rivalry became more intensive when the US dollar was depreciated in 1972 and demand for forest products was stabilised. The following years the situation did not recover, because of the generally weak economy in the west European markets and because the industrial customers started decreasing their inventories. Concurrently, the dollar's strength did not fully benefit the Swedish companies, since the cost of production was higher in that country. The two successive depreciations of the Swedish krona in 1977 did not really change the situation, among others because of incurred losses on foreign debts. Only two years later, when the oil prices started to soar, did the Swedish forest industry get better competitive conditions, because of the comparatively lower costs of transportation.

A labour market conflict, together with weakened business activity in Europe and Northern America, and a depreciation of the krona in September 1980 marked the beginning of the next decade. In the following years the European economy recovered slowly until 1986, when it started to stagnate. On the other hand, during that period European producers were favoured by the strong dollar in 1983 and the commencement of toll-free paper export within the Euro-

pean Economic Community (EEC). However, a few years later toll-free exports came to mean higher competition in that common market and Swedish forest companies found themselves in a disadvantageous position due to higher labour costs.

The economic stagnation got deeper in 1991 and the conditions were unfavourable for the forest industry. A new depreciation of the krona made Swedish companies more competitive against the American ones, but competition in the European Union restricted price rises. In that decade the structural changes in the forest market led to fewer but bigger customers and suppliers. The political changes in Eastern Europe created opportunities for expansion in new markets, although the financial crisis in Southeastern Asia in 1997 had negative impact. Finally, when the decade closed, the state of economy got better.

The Corporate Strategy of SCA

At the beginning of the examined period, SCA already owned a long list of companies involved in the production of timber, pulp, and paper. Their strategy was focused on acquiring paper, paper refinery, and packaging companies, although SCA had also expanded in the energy industry. At that time, 75 percent of sales were outside Sweden, as a result of their long history as an exporter.

Horizontal and forward vertical integration was another main aspect of the strategy, although SCA also produced and traded machinery for the production of pulp through its subsidiary Sunds. Moreover, the transportation and distribution of SCA products were carried out by their own subsidiary, called SCA Transportation, offering services also to external customers. Concurrently, integration continued in 1974 by the acquisition of the forest company Björkå, and the building of two power stations. Additionally, in 1975 the acquisition of Mölnlycke, a company with its core business within the production of hygiene products, provided the basis for

entering the final consumer products market. This market, being less sensitive to changes in demand caused by economic fluctuations, would provide SCA with a more stable source of revenue and would allow it to spread risks. Despite the focus on hygiene products, Mölnlycke was diversified, incurring a part of its profits from unrelated areas, such as computer processing and boat manufacturing. Still, in 1976 forestry products counted for more than half of the total sales.

In 1979 SCA's focus was on expansion in the paper and hygiene businesses and invested a large amount in rebuilding the Östrand mill, together with other investments of about SEK 3 bn in machinery and buildings in 1980. Furthermore, the divestment of unrelated businesses began with selling off holdings in Bahco and Multidata, while a strategic partnership with the German paper producer PWA was signed, in order to gain knowledge in the fine paper sector.

Supported by higher returns over a long number of years, huge investments were decided on, in the beginning of the new decade. A revaluation of fixed assets was made in the energy company Bålforsens Kraft, resulting in strengthening the consolidated balance sheet by SEK 400 m in 1981.

Mölnlycke provided SCA with potentials of great expansion in the division of hygiene products. However, given that the Swedish market was too small, profits depended on exports. Also, due to high costs of transportation, the need to establish local production plants appeared.

During the 1980s the divestments of unrelated businesses continued as well as extensive acquisitions and other investments in all units of SCA, except for Sunds, where 50 percent of the shares were sold off in 1987. Profitability kept improving, especially because of Mölnlycke's performance.

In 1989, Sverker Martin-Löf succeeded Bo Rydin as CEO. Under his leadership, the strategy of vertical integration toward the end customer needs, and domestic and international expansion were continued, for instance in 1990 by the acquisition of Reedpack in

the United Kingdom that strengthened SCA's position within the EU in the packaging and recycled paper sector. Since then SCA was the leader within packaging and hygiene products in Europe that was considered its home market.

Although there was a need to spread risk, expansion to unrelated sectors was consciously rejected because diversification was not in line with the strategy of SCA. A restructuring program between 1990 and 1993, aimed at taking advantage of synergies from acquisitions and improving efficiency, led to reduction of the working force by 6,000 and divestment of non-strategic operations, including the sale of the energy business for SEK 6.4 bn in 1992. This strategic decision led to improved profitability and continuation of the investment level at a rate of 2 bn per year.

The result of the long relationship between SCA and the German paper producer PWA led to the acquisition of 75 percent of that company in 1995. Additionally, Kimberly-Clarks tissue operations in the UK, together with other companies in Eastern Europe were also acquired.

By the end of the decade, after selling off the last non-strategic divisions, Mölnlycke was solely a hygiene products company and counted for a big part of the group's profits that were the highest ever. The century ended with SCA issuing new shares of SEK 4.6 bn, used for future acquisitions and for the formation of MoDo Paper, between SCA and Holmen, for the production of fine paper.

The Financial Structure of SCA

In the first four years of the 1970s the debt-to-equity ratio was around 2 times and decreased until 1975 to 1.25, followed by a stable period of minor shifts in the 1970s and 1980s. In 1990 the ratio increased to 3 times, but then decreased during the rest of the decade

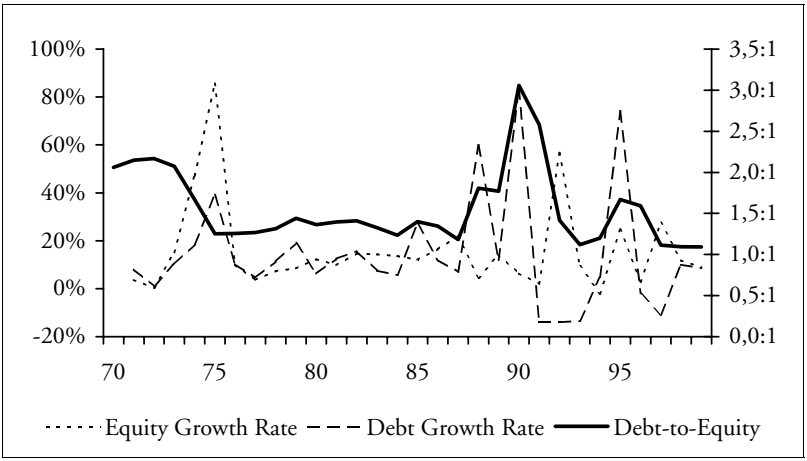

FIGURE 6.1 SCA DEBT AND EQUITY 1970–1999

Source: Reconstruction based on SCA Annual Reports.

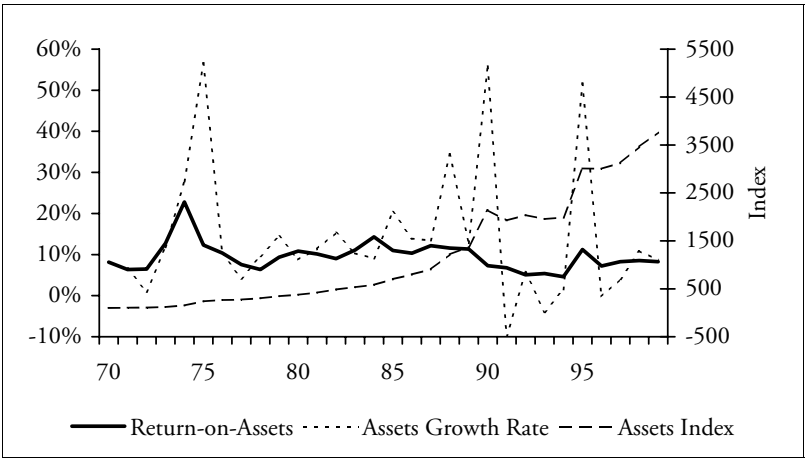

FIGURE 6.2 SCA ASSETS 1970–1999

Source: Reconstruction based on SCA Annual Reports.

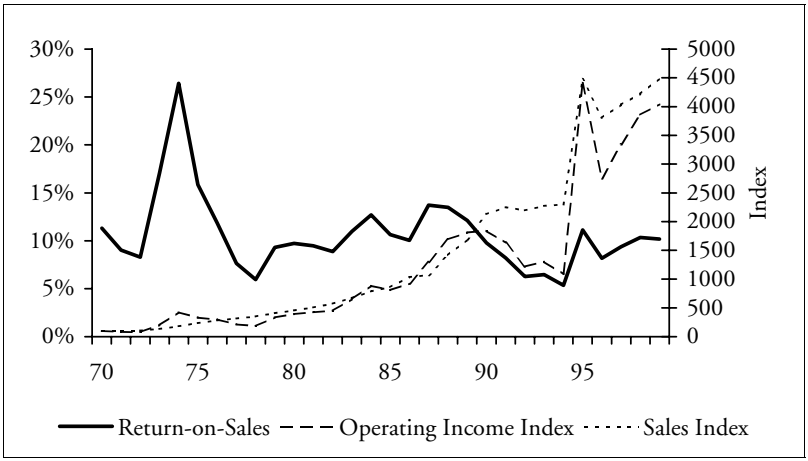

FIGURE 6.3 SCA RETURN AND SALES 1970–1999
Source: Reconstruction based on SCA Annual Reports.

with the exception of 1996, when it reached 1.7 times. Finally, in 1999 the debt-to-equity ratio was 1.1 times.

In relation to equity growth, two major increases can be identified between 60 and 80 percent. Apart from that, values lay between 10 and 15 percent, except for some years of insignificant or negative growth, especially in the last ten years.

The debt growth in SCA increased between 1972 and 1989 from 10 to 15 percent, and fluctuated between 1991 and 1999, ranging between minus 14 to 10 percent. Exemptions can also be seen, especially in 1975, 1988, 1990 and 1995, with values between 40 and 80 percent.

Assets in SCA developed unevenly throughout the examined period, with a three year peak of circa 60 percent and generally modest growth of 15 percent for the remaining years. Nevertheless, the last decade was dominated by low or negative values, up to 10 percent in 1991.

Generally speaking, return-on-assets ranged between 5 to 10 percent with a maximum increase up to 23 percent in 1974. In more detail, there were two three-year periods of low values, in late 1970s and early 1990s, surrounded by years with higher returns. Between these two periods the return got highest, reaching 14 percent in 1984.

Sales growth in SCA can be divided into three phases; the first one until 1979, with a succession of increases and decreases in sales growth between 2 to 36 percent, the second one from 1980 till 1990 with relatively constant growth lower than 20 percent, and finally the third one from 1991 till the end of the examined period with low growth of only 5 percent. However, there were some noteworthy exceptions like the 95 percent increase in 1995.

In the first five years, return-on-sales was volatile with changes from 8 to 26 percent units, while the fluctuations got more moderate between 1975 and 1986 with values of circa 10 percent. In the following three years, return-on-sales increased almost by 4 percentage units, succeeded by another four-year period of lower results below 10 percent. Lastly, the ratio seemed to stabilise around 10 percent in the end of 1990s.

Analysis of SCA

In SCA the main aspect of the strategy throughout the years was growth, either horizontal or vertical. In the first two decades, the assets growth rate was continuously positive, reflecting the expansion of the company. Apart from organic growth and acquisitions of small companies that affected the value of assets by about 10 percent, there were deals that radically redetermined the asset structure. For instance, in 1974 the purchase of Björkå resulted in an increase of total assets from SEK 2.7 bn to 3.5 bn and in 1975 the acquisition of Mölnlycke that raised assets by 57 percent.

However, the way these acquisitions had been financed depended on the size of the deal. Small deals that caused increases of assets lower than 10 percent were financed primarily by one part equity and two parts debt, while larger acquisitions resulted in radical increases of equity. The purchase of Björkå was financed by roughly SEK 400 m equity and 340 m debt, or in comparative terms equity increased by 47 percent against an 18 percent increase in debt. This is even more obvious in the acquisition of Mölnlycke one year later; equity increased by 86 percent, while debt only by 39, representing SEK 1.1 bn and 0.85 bn respectively. Given that the debt-to-equity ratio remained stable around 1.3 on average from 1975 to 1987, it can be said that SCA followed a conservative debt policy, which explains this selection of the debt and equity mix in acquisitions of companies with relatively high capital bases.

The low sales growth in the beginning of the 1970s was followed by a low return-on-assets ratio and a comparatively unfavourable cost structure, caused by the impact of competition on sales. However, the acquisitions carried out between 1973 and 1975 improved income from operations; return-on-sales for that period increased by more than 5 percentage units to an average of 16.5 percent, except in 1974, when Björkå was acquired and the ratio reached 26 percent. This irregularity occurred despite the increase of sales, because returns doubled; at the same time profitability rose only, for that year, by 10 percentage units, mainly due to the steep increase of the financial income. Conversely, one year later, when Mölnlycke was acquired and the sales growth increased almost equally as in the case of Björkå, the respective change of the return-on-sales ratio was approximately half. The difference is that although Mölnlycke contributed to sales, the cost increase was higher that year. Correspondingly, the return-on-asset was also half in comparison with Björkå, because the increase of assets was double at the time that returns decreased.

The focus on expansion in the paper and hygiene products businesses led to the gradual divestment of unrelated areas, starting in the late 1970s. As shown by the assets growth rate and the debt-to-equity ratio, these divestments, including the sale of 50 percent of Sunds in 1987, did not have obvious effects on the asset base and the debt and equity mix, because they were masked by acquisitions in other fields and extensive investment programs in the existing mills, especially in the beginning of the 1980s.

Additionally, sales after the divestments in the late 1970s did not show any decline since the divestments did not occur simultaneously and represented only minor revenue sources, but in contrast sales continued to grow in the 1980s too. On the other hand, the return-on-sales ratio fell to a lower level around 9 percent, where it remained until 1984, because this period was marked by high production costs and losses from currency fluctuations.

Profitability for the same period followed a parallel stable course with the growth of assets, with small annual anomalies, because of the absence of major deals that could increase the asset base. The divestments carried out at the end of the 1980s together with the contribution of Mölnlycke slightly increased revenues and consequently the return-on-sales to roughly 14 percent, while return-on-assets remained unchanged.

A more aggressive debt policy was followed by the new management at the end of the 1980s and the beginning of the 1990s. In more detail, when acquisitions amounting to SEK 3.4 bn were carried out in 1988, debt increased by 60 percent; similarly, when Reedpack was acquired in 1990, the deal was exclusively financed with debt that radically changed the capital structure of SCA and the debt-to-equity ratio peaked at 3 times.

Although assets growth was high between 1988 and 1990, return-on-assets remained stable due to the concurrent increase of returns caused by strong sales, except for 1990, where the ratio got drastically lower together with return-on-sales, since the acquisition of

Reedpack increased assets by 55 percent but did not change sales to the same extent.

For the rest of the decade, SCA returned to a more moderate debt level by reducing debt by about 14 percent per annum for three years, with the debt-to-equity ratio reaching 1 in 1993 compared to 3 times in 1990. The divestment of the whole energy business in 1992 that amounted for more than SEK 6 bn did not show any big increase in assets, but the debt-to-equity ratio was reduced from 2.6 to 1.4 times. That indicates that the income made was mainly retained in equity, which increased by almost 57 percent, and partly reduced debt by 14 percent, in accordance with the debt reduction efforts after 1990 for improving debt capacity.

However, the effect of retaining SEK 6 bn as reserves at the same time as reducing the revenue sources shown in the decline of the return-on-assets ratio from 7 in 1991 to around 5 percent the next three years. It improved again in 1995 when PWA was acquired and the reserves were actively employed, although the consolidation of this company caused a temporary increase in debts and assets by 74 and 52 percent respectively. This shift was exceptional, and the previous mix of debt and equity was retained until the end of the examined period.

Sales growth in the 1990s was modest, about 5 percent when not negative, because of the weakened demand, except for the almost doubled sales related to the acquisition of PWA in 1995. The level of demand also had impact on the return-on-sales, which was only half compared to the end of the 1980s, although it got better in the rest of the decade.

8 The Case of Volvo

The Business Environment of Volvo

The beginning of the 1970s was a challenging period for the international automobile industry. A predicted long-term stagnation had succeeded the economic boost of the previous decade and both North American and European manufacturers were facing increasing competition and low returns. In Sweden, the overheated economy directly affected employment, while at the same time the vehicles market size was getting smaller, due to higher interest levels and governmental credit restrictions.

Despite the efforts for closer co-operation with the EEC markets, crises in many countries led to higher trade barriers. For the first time after the post-war era the effects of foreign currency fluctuations were becoming obvious again, influencing the level of profitability in several companies all around the world.

In 1973, while the economy was going through a transition period from recession to boost, the international business environment got more hostile due to the oil crisis. Although short periods of recovery for the automobile industry could be seen, inflation was still high and competition was getting more intense. Demand increased seriously only in 1977, following the depreciation of the Swedish krona, and generally speaking, only when the world economy stabilised at the end of the decade, despite the Iran-Iraq war, and the international currency market tension, due to the big deficit differences between the United States and Europe.

In the early 1980s the forecasts were not very optimistic either. An economic setback in Europe, higher inflation and oil prices, as well as labour conflicts and raised VAT in Sweden made margins even slimmer than before. When the conditions finally improved, after inflation decline and a stronger dollar against the Swedish krona in

the mid 1980s, western automobile manufacturers had to face problems of continuous overcapacity and for first time shrinking market shares, because of their disadvantageous competitive positions against the Japanese rivals.

The situation did not change much throughout the 1990s, marked by the crisis in the Persian Gulf and the political changes in Eastern Europe. The longest period of the car market stagnation since the Second World War, the turmoil of the world economy, and high competition could only be outweighed by the benefits of the depreciated Swedish krona in 1992.

The Corporate Strategy of Volvo

Volvo in the early 1970s consisted of six major business areas, namely passenger vehicles, trucks, busses, marine and industrial engines, construction equipment and farm machinery, and aircraft engines. From the beginning the emphasis had been on the promotion of exports, especially to the United States, that represented the biggest market. The company already operated subsidiaries in many countries including the United States, Belgium, Finland, Germany, Norway and Canada.

Since that period the focus was much on long-term expansion and on investments in resources, as a means to increase sales. New products had been developed in all areas, mainly in the passenger vehicles, production had been improved by the introduction of computers, and new production plants had been built in Sweden and abroad. Among them the plants in Torslanda and Kalmar as well as in Peru, Australia, and Indonesia. The expansion and investment in resources also meant aggressive acquisitions of both related and unrelated business in Sweden and abroad. At the same time the company promoted balanced investments between product groups, in order to decrease the dependence on sales from passenger cars, although the percentage of sales for the different product-group units

was uneven and cars counted for about 60 percent of the total revenue.

Concurrently, the company was continuously looking for strategic partners, in order to decrease the high costs of research and development. For instance, since 1971, Volvo had formed a joint venture with Peugeot, the French manufacturer, for the development of car engines.

Volvo's expansion plans were financed primarily by the issue of bonds, both in Sweden and other European capital markets, and secondarily by increasing equity, which was considered a base for further debt loans. Having a further credit capacity of USD 100 m allowed management to speak about retaining Volvo's independence.

This strategic mix had been retained until the end of that decade. Increased sales supported by strong exports and new qualitative products, funds raising in the domestic and international capital markets through the issuance of bonds and equity, continuous investments in Sweden and abroad in related and unrelated sectors, and constant search for synergies and joint-venture partners.

In the 1980s, Volvo was a diversified industrial enterprise, with an international dimension. The previous strategy was retained, a fact that led to greater investments in a number of unrelated industries, such as the oil, paper, food and pharmaceutical sector. Among others, the acquisition of Beijerinvest in 1981 – the largest ever business transaction carried out in Sweden at that time – shareholdings in Atlas Copco and Stora in 1982, Saga Petroleum in 1983, AB Cardo, Sockerbolaget, and Sonesson Pharmaceuticals in 1986, Leyland in 1988, and Hertz in 1989.

Most of these acquisitions had a short life of two to three years under Volvo's ownership, before being sold again, usually at a profit. At the same time Volvo's ownership structure was getting more complicated after the listing of the company on NASDAQ and on the Tokyo, Paris, London, and Frankfurt stock exchanges, and the ac-

quisition of 15 percent of its shares by Renault, the French government owned group.

From the mid 1980s till the end of the decade the company had a broad business base, with vehicles, food, and oil representing the three biggest sources of profit. Despite rationalisation programs and increased sales, high salaries, soaring costs of research and development, low oil prices, and internal inefficiency were blamed for the falling profits, while both related and unrelated expansion in all sectors continued, sometimes even by hostile takeovers.

The beginning of the 1990s was marked by the succession of Pehr G. Gyllenhammar, after twenty years of leadership of Volvo, by Christer Zetterberg. The new CEO followed his predecessor's strategy of cost minimisation and efficiency improvement by focusing on the core businesses, without any significant effects on the course of the company, except for the sale of Procordia, and the strengthening of the ties with Renault that could have led to the creation of Europe's biggest industrial group.

When Sören Gyll took over the company two years later, despite the overcapacity problems, margins finally started to improve as a result of drastic reduction of the workforce and closure of the production plants in Uddevalla and Kalmar. However, in 1993 the long awaited merger with Renault, led by Gyllenhammar, failed, after rejection of the plan by the board of Volvo, and a merger deal with Procordia was blocked, after the intervention of the Swedish government.

In order to improve the low results, Gyll followed a strategy strongly focused on the core operations of Volvo, namely the vehicle businesses, combined with a conservative debt strategy that aimed to cover capital needs through the release of assets. An eight-step program for concentrating on the transport industry included the set up of a subsidiary company, called Fortos Group, with the mission to manage unrelated companies before their divesture. Within a few years a number of firms like Swedish Match were divested, and

Volvo's shareholdings in AB Custos, Investment AB Cardo, Hertz, and Saga Petroleum were sold off.

These divestments provided Volvo with about SEK 34 bn, which was used for strengthening the balance sheet, improving competence, and developing new products. A ratio of 50 percent equity to total assets was a precondition for still being an independent transportation company, according to Volvo's strategic analyses. Until Gyll was replaced by Leif Johansson in 1997, the company followed a strategy that emphasised geographic balance and marketing. New customer groups had been targeted through the launch of new products, and selected companies in all major businesses had been acquired.

Johansson in his first year of leadership sold all the remaining unrelated businesses, including Pripps, and shareholdings in SAS, Renault, and Pharmacia-Upjohn. At the same time acquisitions, like that of Samsung Excavators, and expansion in all businesses, were carried out in several countries, following the strategy of growth. Finally, in 1999 the passenger car business was sold to Ford Motor Company for cash, which was then used for launching a bid for Scania and for repurchasing Volvo shares.

The Financial Structure of Volvo

In Volvo the mix of debt and equity varied over certain periods, with the total capitalisation of the company up to 1999 continuously increasing at different rates, although rare exceptions of stability in the mid 1990s can be observed. The respective growth of equity, which was not always parallel to the growth of debt, was ranging basically below 20 percent, with some negative rates between 1990 and 1994. At the beginning of the examined period, the debt-to-equity ratio was around 2, while between 1975 and 1980 the ratio ranged between 2 to 2.5 times. From 1981 to 1988 a gradual decrease reaching 1.5 is observed, followed by an increase up to 3 in 1993 and a gradual

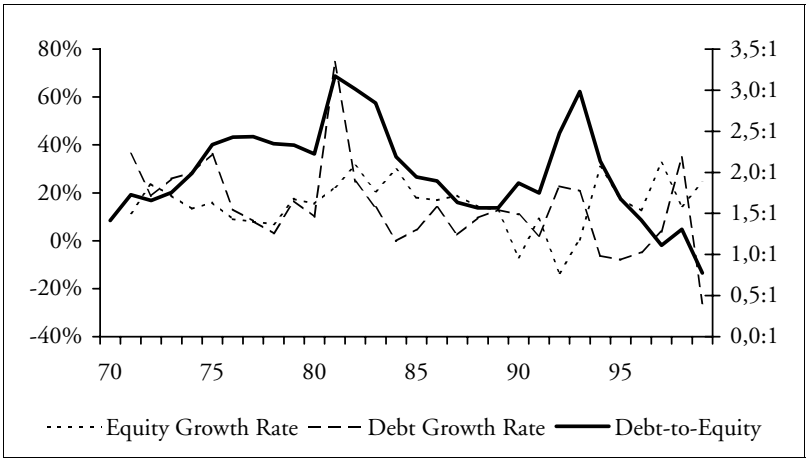

FIGURE 7.1 VOLVO DEBT AND EQUITY 1970–1999

Source: Reconstruction based on Volvo Annual Reports.

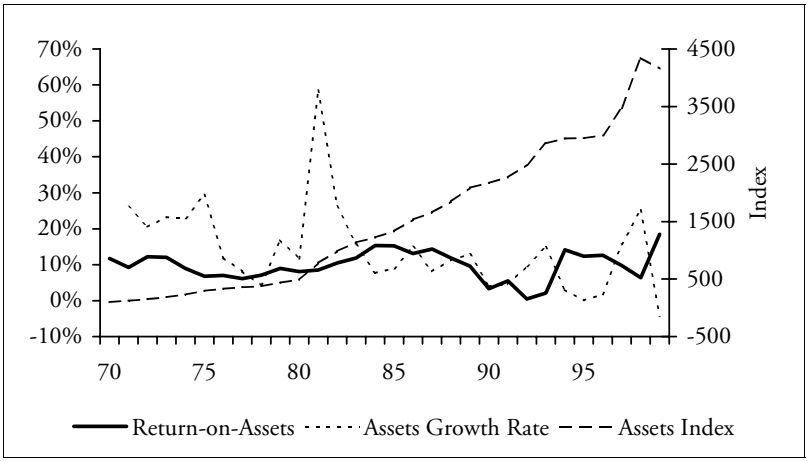

FIGURE 7.2 VOLVO ASSETS 1970–1999

Source: Reconstruction based on Volvo Annual Reports.

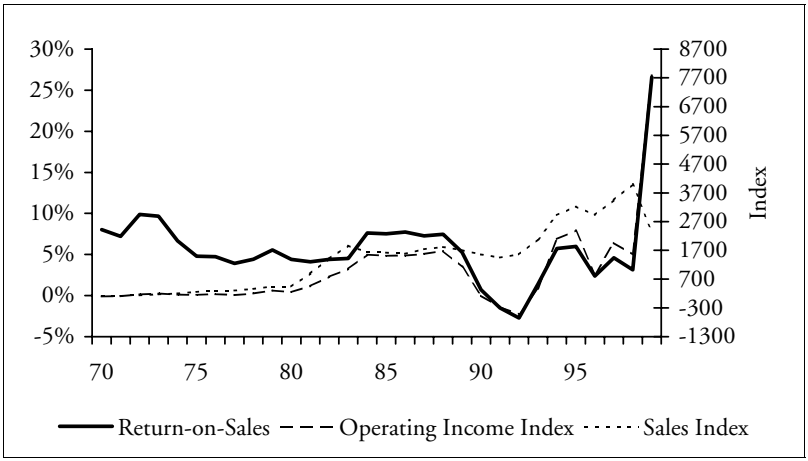

FIGURE 7.3 VOLVO RETURN AND SALES 1970–1999
Source: Reconstruction based on Volvo Annual Reports.

decrease down to 1 in 1998. For the first time the debt-to-equity ratio fell below 1 in 1999.

The debt growth in the first five years was circa 30 percent, while from 1976 to 1980 the growth rate fell close to 10 percent. An unusual increase of 75 percent took place in 1981, followed by a steep decrease down to zero in 1984. In the subsequent years up to 1997, the rate did not improve significantly, floating between 8 to minus 8 percent, except in 1992 and 1993, when it was circa 20 percent. Finally, in the last two years the trends were opposite, with a 35 percent increase in 1998 and a 25 percent decrease in 1999.

Although the growth rate of assets tended to be positive throughout the years except in 1999, two major phases can be identified; first, between 1970 and 1982 with assets below SEK 50 bn and second, between 1983 to 1989 with assets up to SEK 100 bn. In the mid 1990s the growth rate was close to zero percent, while it increased again in 1997 and 1998, before the first drop in assets growth the year after.

Return-on-assets in the first eight years was gradually decreasing, succeeded by a steady increase until 1984. However, the next period from 1985 to 1992 was characterised by a gradual fall from 5 to minus 0.5 percent. Finally, in 1994 there was a sudden increase up to 14 percent, decreasing up to the end of the examined period, except in 1999.

Sales during the 1970s grew steadily by roughly 20 percent, except in 1977, and in 1980, where growth remained stable. In 1981 sales doubled, followed by a three-year increase and a long period of sales stability until 1992, below SEK 100 bn. From 1993 and for the next five years sales were double the previous period, until reduced by 40 percent in 1999.

Return-on-sales during the first eight years, commencing in 1970, ranged between 5 to 10 percent with better performances before 1975. Two periods followed: the first up to 1983 with values around 4 percent and the second up to 1988 with values around 7.5 percent. The next five years, starting from 1989, a dramatic downward from 5 to minus 3 percent took place, succeeded by a return back to values of 5 to 4 percent. Finally, in 1999 an unusually high increase to 27 percent occurred.

Analysis of Volvo

The expansion strategy of Volvo in the first half of the 1970s is translated into plant investments, which contributed to the 25 percent increase of assets per annum. In contrast, the strategy of investments in production resources was completed in 1975, which affected the assets growth in the second half of the 1970s; growth was still positive, but did not exceed 10 percent, namely less than half compared to the previous period.

In the first five years, expansion was primarily financed with debt, which led to a gradual increase of the debt-to-equity ratio between 1970 and 1975 from 1.4 to 2.3 times. This ratio level was then kept

stable until the end of the decade, which indicates that the capital structure was intentional and that management did not have any plans for changing the debt-to-equity mix.

The increase of assets between 1970 and 1975 was accompanied by an almost parallel annual growth of sales around 21 percent and a positive development of return-on-sales until 1973. However, the oil crisis and high inflation had a negative effect on sales until 1980, with the first signs of deterioration appearing in 1974. Overcapacity, due to the investments in the early 1970s, emphasised fixed costs and resulted in almost half return-on-sales around 4.5 percent between 1975 and 1983. These investments also had an impact on the return-on-assets ratio; in the first five years the return was around 11 percent, while for the rest of the decade it was almost half because of the cost development.

The beginning of next decade was marked by the disproportionate increase of assets by almost 60 percent in 1981, due to the acquisition of Beijerinvest, and by 26 percent the year after, when shares in Atlas Copco and Stora were acquired. In real terms, by the end of 1982 the value of assets was double compared to two years earlier. While the Beijerinvest deal led to the highest debt-to-equity ratio for the examined period, the rest of the deals resulted in a percentage increase of equity higher than the respective increase of debt.

Although the level of sales in these two years considerably improved, the return-on-sales remained around 4.3 percent, because of the inability to reach synergies and generally reduce costs between the diversified business units. However, despite the increase of assets, return-on-assets marginally increased, because of higher financial incomes.

In the following years, the percentage growth of equity was constantly higher than that of debt, until 1989, when their percentage changes were equal. However, two events are noteworthy, although they did not cause any disruption to the falling course of debt-to-equity; the first one in 1984, when the difference between the growth

rate of equity and debt was the greatest, and the second one in 1986, when the difference was the smallest. These shifts are related to acquisitions and divestments; in 1984 the increase of equity by SEK 4 bn was influenced by the divestment of holdings in Atlas Copco, Stora, and Consafe, whilst in 1986 the acquisition of AB Cardo, Sockerbolaget and Sonesson Pharmaceuticals pushed debt growth more than equity growth, although the debt-to-equity ratio was still decreasing. Despite that, there were acquisitions between 1983 and 1989 that increased assets, but did not have an obvious impact on the capital structure, like the acquisitions of Saga Petroleum in 1983, Leyland Buses in 1988, and shares in Hertz in 1989.

In the period between 1984 and 1988, despite the negative sales growth, return-on-sales stabilised around 7.5 percent, reflecting the reduction of costs in relation to sales due to the coincident decline of inflation and the gains from rationalisation programs. Regardless of the increase of assets, return-on-assets also had a positive development, reaching 14.5 percent, because of higher incomes partly arising from the divestment of shareholdings during that period.

At the beginning of the 1990s, the succession of management meant a shift of strategic focus to the core businesses. During this period the assets growth rate was around 4 percent, except for 1992 when the krona depreciated and assets grew by 10 percent. That year, the capital structure was affected by the concurrent decrease of equity and increase of debt, with the debt-to-equity ratio reaching 2.5 times caused by the increase of debt in foreign currency.

In the first years of the 1990s, the revenue source shrank, because of the recession in the economy and the divestment of several companies. While the cost base remained stable, the sales level was affected, resulting in a negative return-on-sales. Additionally, despite the negative operating income, the return-on-assets ratio was still positive, because of the financial incomes from divestments.

In 1993 when the focus on core businesses became more imperative, an era of new divestments started. Although assets increased

that year by 15 percent, partly due to the sale of Saga Petroleum and AB Custos, in the next three years the annual growth rate was around 1.5 percent, because of the divestments of shareholdings in companies like Procordia, AB Cardo, Hertz, etc. In the period from 1994 to 1996, the impact of the divestments on the capital structure was shown on the reduction of debt between 5 to 8 percent, as well as on the increase of equity from 13 to 31 percent per year, which led to a falling debt-to-equity ratio.

In 1993, sales increased after the end of the financial turmoil and return-on-sales became positive again due to the beneficial results of restructuring on the level of profits. For the next five years, the return-on-sales shifted between 2.5 and 6 percent influenced by the divestments of shares in Renault and Pharmacia-Upjohn. Similarly, return-on-assets showed improvement supported by the continuation of the divestments and the strengthening of a more homogenous revenue base until the end of 1998.

After Leif Johansson took over, divestments were completed and contributed to the development of assets, by SEK 22 bn in 1997 and 41 bn 1998. These further divestments improved the debt-to-equity ratio even more, although debt growth rate stayed positive, especially in 1998, because of the new expansion plans that included acquisitions in the core businesses, like that of Samsung Excavators. The general state of economy was good and together with the launching of new car models, Volvo showed stronger sales in 1997 and 1998. The sale of Volvo Passenger Vehicles the year after significantly changed the capital structure, because part of the cash generated was used for paying back SEK 30 bn of debt, while the remaining 20 bn increased equity. This change led to decreased debt by 26 percent and bettered equity by almost the same percentage, resulting in a debt-to-equity ratio of about 0.8 times, the lowest ever for the examined period.

The divestment of the car business directly affected the revenue structure that was decreased by more than 40 percent, and at the

same time virtually boosted return-on-sales to 27 percent and subsequently return-on-assets to 19 percent, since the yield from the car operations was included in the operating income.

9 Conclusions

Findings in Relation to the Purpose

So far this thesis has analysed the implications on the financial structure as a result of the business environment and the corporate strategy in three Swedish companies during the last thirty years, after the respective concepts have been introduced. In this part the findings in relation with the purpose will be presented. Starting from the business environment, the effects on the financial structure can be seen in several forms in all examined companies. As expected, economic turmoil, caused by inflation or weakened demand, has a direct impact on revenues and the cost structure and consequently on the level of returns in relation to sales and assets. Similarly, currency fluctuations affect not only the level of cost and returns, but also the capital and assets structure, in case the companies own assets abroad or hold debts in foreign currency. The selection of debt or equity is subject to the availability of capital and credit restrictions, while business cycles and the industrial structure are partly responsible for the level of sales and profitability, especially in environments of price sensitive competition. Finally, the impact on the financial structure from globalisation and the political and technological environment cannot be identified in the annual reports, either because these factors cause minor implications, or because they evolve slowly over time.

Referring to strategies, diversification, realised through acquisitions of unrelated businesses, appears to affect the financial structure of the examined companies in similar ways. Both in the case of Electrolux and Volvo the level of sales does improve after the increase of the revenue sources. Although return-on-sales in these companies remains stable in the first years after the acquisitions, it declines in the long run, most likely because of the inability to reach cost syner-

gies between the diversified units. Assets growth, which obviously depends on the size of the transaction, is positively correlated with the increase of debt-to-equity, especially in the case of Electrolux. Additionally, in this company it is easier to see the signs of deterioration of return-on-assets after diversification. In SCA, the effects on the financial structure from diversification cannot be identified, because the unrelated businesses that Mölnlycke partly consisted of were of minor importance in relation to the rest of the group.

The strategy of growth through acquisitions related to the core business affects assets differently, depending on the size and frequency of the deals. The size of the deals also determines the source of finance; while in Electrolux large acquisitions were financed with debt and smaller ones with equity, an opposite policy that favoured equity was followed by SCA, until the succession of management. Consequently, the impact on the debt and equity mix is not similar in the two companies. In Electrolux the debt-to-equity ratio increases gradually after acquisitions, in contrast with SCA, where during the period of conservative debt policy the ratio is stable, while under the new management there are exceptional and temporal increases before returning back to the original levels. However, the change of debt-to-equity ratio is also subject to the capital structure of the newly acquired companies.

Another resemblance between all examined companies is the increase of sales after acquisitions, although the level of growth also depends on the prevailing environmental conditions and, in the case of Volvo, on the stage of the product life cycle of products that represent a considerable percentage of the total sales. Additionally, return-on-sales in the three companies increases only when cost synergies are reached with the acquired parties or when the profit margin of the purchased companies is higher than that of the group. Finally, the return-on-assets ratio is not only affected by the growth of assets relative to the growth of income, but also by environmental factors. Improvement of return-on-assets can be the result of liquidation of divestible assets possessed by the acquired company,

dation of divestible assets possessed by the acquired company, or the result of more efficient employment of the capital kept in equity as passive reserves when financing acquisitions.

When disinvestments are carried out the effects on assets are varying. In cases where gains from divestments are kept in equity as reserves, the effects on the assets level is not evident, except when the amount generated by the transaction exceeds the book value of assets. In contrast, divestments can also lead to a decreased asset base, as when the shareholders of Electrolux received the holdings in Gränges, and generally when the money from the sale of assets is distributed to the owners or used for paying back debts. Indeed, in the examined companies the reduction of the debt level and the consequent improvement of the debt-to-equity ratio are most of the times linked to major divestments.

On the other hand, the impact from minor divestments on sales is not clearly identifiable in the three companies. The reason lies in the fact that the loss of sales is masked by the overall improvement in the remaining businesses, but also because all divestments are not carried out simultaneously. However, when major revenue sources are sold off there is a significant loss of total sales. Additionally, return-on-sales are affected positively when operating income includes the income from disposal of companies, but negatively when sales are reduced, whilst the level of costs remains indifferent. Finally, the impact from divestments on return-on-assets is negative when the income is not utilised for investments with at least equal return as previously. In contrast, positive one-off implications can be seen in Volvo, where gains made from these transactions are included in the financial income.

Given that the strategy of organic growth was not carried out in isolation from other strategies, its contribution to the assets and sales growth is not obvious. However, there is evidence that large investments in existing operations result in temporal increases of assets

and in raise of costs, due to overcapacity under less favourable conditions.

Finally, the net effects of the rationalisation programs are not directly identifiable, because they often took place at the same time with divestments and related and unrelated acquisitions, which naturally re-determine the cost structure of the consolidated corporates that include research and development expenses for launching new products. In that sense, the ratio of return-on-sales and the absolute values of cost as an indication of the programs' efficiency may be misleading.

Epilogue

This thesis has attempted to unveil an objective picture of the relationship between the business environment, corporate strategy and financial structure, based on the subjective reality of each company as disclosed in the annual reports over the years. Having presented the facts with the minimum of comments, although no study is free of research bias, it is the time for some personal observations.

Once again the complex nature of strategy and financial management has been shown in this study, but as Polesie puts it, *"when companies are placed together* […] *and subjected to analysis, aggregate structures emerge"* (1991: 129). Having studied three companies from an aggregated perspective, both in terms of time and figures, and having linked the figures with the story of each company some tantalising questions are formulated and concurrently patterns appear that would not be visible if analysing numbers differently.

How come the timing of strategic shift was almost the same in all three companies, though they were different in size and they operated in different sectors? Why did all three decide to grow by acquiring companies with related or unrelated diversified operations? And finally, how can the coincident refocus on core operations be explained? This study does not answer the above questions, but it is a

beginning for this kind of research that could be enriched, if the data from the annual reports are complemented with interviews and other material, like internal documents.

In our perception, in the studied companies the environmental and strategic impacts on assets and sales had been successfully predicted by the management, considering that they achieved significant growth, both in size and revenues. But in many cases these companies failed to recognise the effects of their growth strategies on the quality of the generated profits, the indicator of healthy expansion potentials.

Electrolux manufactured and sold mainly durable goods in all major European and American markets, by using an inter-continental network of raw material and technology suppliers. SCA operated basically in Sweden as a first and second tier supplier for other industries, until it started producing consumer goods and settled local production plans abroad. Volvo, having the inheritance of a transportation company metamorphosed, to an international scale conglomerate and returned to its core businesses twenty years later.

In Electrolux a broader customer base, an extensive number of product-lines and geographically spread markets were perceived as the recipe for successful growth. SCA, a company that seemed proud of its financial self-sufficiency, reduced its core businesses from four to two and dodged the threats of economic turmoil through expansion towards the end customer market. Volvo wanted to avoid dependence on sales from the car business and entered unrelated areas, such as oil and food, basically relying on its debt capacity.

Identifying the factors behind the selection of strategies was not the topic of our thesis, but it became obvious that in cases where financial conservatism had been abandoned a shift towards aggressive structures followed, as part of a trial-and-error process. For instance, SCA followed a traditional financial structure, focused on slow but steady development of its core businesses, and did not participate in this process, while companies like Volvo grew opportunis-

tically in areas outside their traditional operations and experienced the consequences of unsuitable strategic selections.

Additionally, the extent that the environment was responsible for those results is of course not possible to tell accurately. However, during the study it became apparent that further research could be carried out to separate the effects of the strategic changes from the impacts of the environmental development and add more knowledge to practical and theoretical levels within the field of financial structure.

Studying companies in the same industrial field over the same period of time would provide a more complete picture by directly comparing the findings, given that the companies were subject to the same environmental conditions. Additionally, it should be useful to examine how the financial structure is influenced by the multiple constituencies and in particular by the ownership structure, and *vice versa* how the financial structure affects shareholders' wealth, according to the fluctuations of the return-on-equity ratio.

Another topic that was not covered in our thesis is how structures are affected by defending strategies under conditions of hostile takeover attempts. But more importantly, it should be studied how corporate identity, as a factor that determines the allocation of resources among product markets, the selection of the sources of finance and the level of diversification, has had an impact on the financial structure of Electrolux, SCA, and Volvo. We believe that for this purpose *Continuity and Change*, the study of our supervisor, will prove a priceless guide. Studies of this kind might seem problematic to carry out, because they cover a long period of time and because many different environmental factors co-exist. However, it can be a beginning of an in depth study for explaining vital aspects of the corporate development.

For the time being our study could provide the managerial audience with a reference for understanding the causalities on the financial structure deriving from the relationship with the implemented

strategies and the prevailing business environment over time. The recognition of the sources of disturbance, when strategies do not meet their qualitative financial goals, could help practitioners to improve strategic planning, or in other words the findings of our thesis would enable them to draw parallels to their own cases, even if the similarities are not automatically applicable. The academic readers could also benefit from the thesis because it presents a historical perspective of financial structure, describing the world according to the subjective reality of individual companies as documented in their annual reports, something that is not often met in the existing writings.

Strictly speaking the findings of our thesis are not applicable for other companies, because identical strategies and environmental conditions rarely, if ever, occur between different organisations. However, our counsel to all companies is clear: If tested strategies with known impacts on the financial structure are replaced by new ones, the preservation of the same quality of results is likely not to hold. In any case this does not mean that results cannot be improved, but that will happen only if companies are continuously modifying their structure to the conditions implied by the new strategic directions. But if the adopted strategies promote quantitative results through aggressive expansion and opportunistic attitude, then the structural adjustment will become a difficult task, due to the incongruence between qualitative and quantitative goals, and performance will decline, especially under less favourable environmental conditions.

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Appendix 1: Key Figures of Electrolux (Monetary values are expressed in million SEK. 1970 equals base index of 100)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
Debt-to-Equity	0,97	0,99	1,16	1,62	2,51	2,10	2,00	1,93	2,17	2,32	3,29	3,15	3,29	2,70	2,41
Equity	795	835	897	1195	1159	1645	1807	2261	2865	3393	4155	5250	5712	6356	7718
Equity Growth		5,1%	7,4%	33,2%	-3,0%	41,9%	9,9%	25,1%	26,7%	18,4%	22,5%	26,3%	8,8%	11,3%	21,4%
Debt	770	823	1042	1932	2915	3459	3617	4366	6213	7878	13677	16517	18766	17171	18563
Debt Growth		6,9%	26,7%	85,3%	50,9%	18,7%	4,6%	20,7%	42,3%	26,8%	73,6%	20,8%	13,6%	-8,5%	8,1%
Assets	1565	1658	1940	3126	4074	5103	5424	6627	9078	11270	17832	21767	24478	23527	26281
Assets Index	100	106	124	200	260	326	347	424	580	720	1140	1391	1565	1504	1680
Assets Growth		6,0%	17,0%	61,2%	30,3%	25,3%	6,3%	22,2%	37,0%	24,2%	58,2%	22,1%	12,5%	-3,9%	11,7%
Sales	1869	2122	2491	4182	5536	6425	7646	9239	12023	15137	22874	26595	31661	32146	34981
Sales Index	100	114	133	224	296	344	409	494	643	810	1224	1423	1694	1720	1871
Sales Growth		13,5%	17,4%	67,9%	32,4%	16,1%	19,0%	20,8%	30,1%	25,9%	51,1%	16,3%	19,0%	1,5%	8,8%
Return-on-Assets	8,9%	10,5%	13,8%	13,5%	14,8%	10,5%	12,1%	11,9%	11,3%	12,3%	11,2%	9,0%	9,2%	12,9%	13,5%
Return-on-Sales	6,9%	7,6%	10,0%	9,4%	10,0%	7,6%	7,9%	7,9%	7,9%	8,5%	7,6%	6,5%	6,1%	8,4%	8,9%
Operating Income	128	160	250	394	556	491	603	733	945	1291	1728	1730	1937	2691	3110
Oper. Income Index	100	125	195	307	434	383	471	572	738	1007	1348	1350	1512	2100	2427
Oper. Income Growth		25,1%	56,0%	57,3%	41,3%	-11,8%	23,0%	21,6%	28,9%	36,6%	33,8%	0,1%	12,0%	38,9%	15,6%

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Debt-to-Equity	2,20	2,81	2,73	2,77	2,67	2,90	2,89	3,19	3,50	3,01	2,79	2,51	1,74	1,66	1,45
Equity	9228	12664	12989	15092	17260	16871	16009	17087	17243	20995	21921	24380	29110	31260	33376
Equity Growth	19,6%	37,2%	2,6%	16,2%	14,4%	-2,3%	-5,1%	6,7%	0,9%	21,8%	4,4%	11,2%	19,4%	7,4%	6,8%
Debt	20296	35631	35481	41749	46038	48922	46320	54531	60404	63188	61235	61198	50530	52029	48268
Debt Growth	9,3%	75,6%	-0,4%	17,7%	10,3%	6,3%	-5,3%	17,7%	10,8%	4,6%	-3,1%	-0,1%	-17,4%	3,0%	-7,2%
Assets	29524	48295	48470	56840	63298	65793	62329	71618	77647	84183	83156	85578	79640	83289	81644
Assets Index	1887	3087	3098	3633	4046	4205	3984	4578	4963	5381	5315	5470	5090	5324	5218
Assets Growth	12,3%	63,6%	0,4%	17,3%	11,4%	3,9%	-5,3%	14,9%	8,4%	8,4%	-1,2%	2,9%	-6,9%	4,6%	-2,0%
Sales	39688	53090	67430	73960	84919	82434	79027	80436	100121	108004	115800	110000	113000	117524	119550
Sales Index	2123	2840	3607	3957	4543	4410	4228	4303	5356	5778	6195	5885	6045	6287	6395
Sales Growth	13,5%	33,8%	27,0%	9,7%	14,8%	-2,9%	-4,1%	1,8%	24,5%	7,9%	7,2%	-5,0%	2,7%	4,0%	1,7%
Return-on-Assets	12,7%	8,7%	10,4%	10,1%	10,0%	7,0%	6,7%	5,6%	6,4%	10,7%	7,9%	6,9%	4,9%	10,1%	10,1%
Return-on-Sales	7,9%	6,3%	6,3%	6,6%	6,2%	3,9%	3,3%	2,8%	3,3%	7,2%	4,6%	4,0%	2,3%	6,0%	6,0%
Operating Income	3137	3321	4225	4897	5281	3248	2588	2250	3265	7810	5311	4448	2654	7028	7204
Oper. Income Index	2448	2592	3297	3822	4121	2535	2020	1756	2548	6095	4145	3471	2071	5484	5622
Oper. Income Growth	0,9%	5,9%	27,2%	15,9%	7,8%	-38,5%	-20,3%	-13,1%	45,1%	139,2%	-32,0%	-16,2%	-40,3%	164,8%	2,5%

Appendix 2: Key Figures of SCA (Monetary values are expressed in million SEK. 1970 equals base index of 100)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
Debt-to-Equity	2,06	2,15	2,17	2,07	1,67	1,25	1,26	1,27	1,31	1,44	1,36	1,40	1,41	1,33	1,23
Equity	740	766	769	885	1303	2417	2660	2758	2961	3213	3608	3964	4548	5197	5904
Equity Growth		3,6%	0,3%	15,1%	47,2%	85,5%	10,1%	3,7%	7,4%	8,5%	12,3%	9,9%	14,7%	14,3%	13,6%
Debt	1523	1647	1666	1836	2174	3027	3341	3494	3891	4630	4923	5538	6412	6893	7281
Debt Growth		8,1%	1,2%	10,2%	18,4%	39,2%	10,4%	4,6%	11,4%	19,0%	6,3%	12,5%	15,8%	7,5%	5,6%
Assets	2262	2413	2435	2721	3477	5445	6002	6252	6852	7842	8531	9502	10959	12089	13185
Assets Index	100	107	108	120	154	241	265	276	303	347	377	420	484	534	583
Assets Growth		6,7%	0,9%	11,8%	27,8%	56,6%	10,2%	4,2%	9,6%	14,4%	8,8%	11,4%	15,3%	10,3%	9,1%
Sales	1473	1505	1577	1963	2670	3462	4173	4649	5150	5993	6739	7478	8464	9870	11568
Sales Index	100	102	107	133	181	235	283	316	349	407	457	508	574	670	785
Sales Growth		2,1%	4,8%	24,4%	36,0%	29,7%	20,5%	11,4%	10,8%	16,4%	12,4%	11,0%	13,2%	16,6%	17,2%
Return-on-Assets	8,1%	6,4%	6,5%	12,7%	22,8%	12,3%	10,4%	7,6%	6,4%	9,4%	10,8%	10,1%	9,0%	11,1%	14,3%
Return-on-Sales	11,3%	9,0%	8,3%	17,0%	26,4%	15,9%	11,9%	7,6%	6,0%	9,3%	9,7%	9,5%	8,9%	11,0%	12,7%
Operating Income	167	136	131	335	706	549	495	355	307	559	655	708	751	1085	1469
Oper. Income Index	100	81	79	201	423	329	297	213	184	335	393	425	451	651	882
Oper. Income Growth		-18,5%	-3,5%	155,6%	110,9%	-22,2%	-9,9%	-28,2%	-13,7%	82,2%	17,3%	8,0%	6,1%	44,4%	35,4%

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Debt-to-Equity	1,40	1,35	1,18	1,81	1,77	3,06	2,58	1,41	1,12	1,20	1,67	1,59	1,11	1,09	1,09
Equity	6618	7708	9401	9823	11217	11936	12177	19091	20879	20443	25517	26237	33465	37424	40762
Equity Growth	12,1%	16,5%	22,0%	4,5%	14,2%	6,4%	2,0%	56,8%	9,4%	-2,1%	24,8%	2,8%	27,6%	11,8%	8,9%
Debt	9255	10368	11102	17744	19871	36493	31390	27008	23372	24485	42613	41757	37240	40949	44452
Debt Growth	27,1%	12,0%	7,1%	59,8%	12,0%	83,6%	-14,0%	-14,0%	-13,5%	4,8%	74,0%	-2,0%	-10,8%	10,0%	8,6%
Assets	15873	18076	20503	27567	31088	48429	43567	46099	44251	44928	68130	67994	70705	78373	85214
Assets Index	702	799	906	1219	1374	2141	1926	2038	1956	1986	3011	3005	3125	3464	3767
Assets Growth	20,4%	13,9%	13,4%	34,5%	12,8%	55,8%	-10,0%	5,8%	-4,0%	1,5%	51,6%	-0,2%	4,0%	10,8%	8,7%
Sales	12669	15304	15739	20911	24909	31366	33169	32364	33518	33872	66012	56093	59424	62196	66133
Sales Index	860	1039	1068	1419	1691	2129	2251	2197	2275	2299	4480	3807	4033	4221	4488
Sales Growth	9,5%	20,8%	2,8%	32,9%	19,1%	25,9%	5,7%	-2,4%	3,6%	1,1%	94,9%	-15,0%	5,9%	4,7%	6,3%
Return-on-Assets	11,0%	10,3%	12,2%	11,6%	11,4%	7,3%	6,8%	5,1%	5,4%	4,6%	11,2%	7,2%	8,3%	8,6%	8,3%
Return-on-Sales	10,6%	10,0%	13,7%	13,5%	12,1%	9,8%	8,2%	6,3%	6,5%	5,3%	11,1%	8,2%	9,4%	10,3%	10,2%
Operating Income	1349	1538	2159	2817	3019	3070	2723	2031	2172	1810	7350	4581	5568	6428	6733
Oper. Income Index	810	923	1296	1691	1812	1843	1635	1219	1304	1087	4412	2750	3342	3859	4042
Oper. Income Growth	-8,2%	14,0%	40,4%	30,5%	7,2%	1,7%	-11,3%	-25,4%	6,9%	-16,7%	306,1%	-37,7%	21,5%	15,4%	4,7%

Appendix 3: Key Figures of Volvo (Monetary values are expressed in million SEK. 1970 equals base index of 100)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
Debt-to-Equity	1,41	1,73	1,66	1,76	1,99	2,34	2,43	2,43	2,35	2,33	2,22	3,17	3,01	2,84	2,19
Equity	1950	2175	2692	3199	3627	4205	4583	4949	5291	6212	7169	8785	11533	13919	18066
Equity Growth		11,6%	23,7%	18,9%	13,4%	16,0%	9,0%	8,0%	6,9%	17,4%	15,4%	22,5%	31,3%	20,7%	29,8%
Debt	2754	3756	4459	5615	7210	9827	11122	12041	12421	14490	15950	27860	34742	39587	39563
Debt Growth		36,4%	18,7%	25,9%	28,4%	36,3%	13,2%	8,3%	3,2%	16,7%	10,1%	74,7%	24,7%	13,9%	-0,1%
Assets	4704	5931	7151	8814	10836	14032	15705	16990	17712	20702	23119	36645	46275	53506	57629
Assets Index	100	126	152	187	230	298	334	361	377	440	492	779	984	1138	1225
Assets Growth		26,1%	20,6%	23,3%	22,9%	29,5%	11,9%	8,2%	4,2%	16,9%	11,7%	58,5%	26,3%	15,6%	7,7%
Sales	5324	6104	7346	8986	10537	13692	15743	16168	19133	23472	23803	48017	75624	99460	87052
Sales Index	100	115	138	169	198	257	296	304	359	441	447	902	1421	1868	1635
Sales Growth		14,7%	20,4%	22,3%	17,3%	29,9%	15,0%	2,7%	18,3%	22,7%	1,4%	101,7%	57,5%	31,5%	-12,5%
Return-on-Assets	11,8%	9,2%	12,2%	12,1%	9,0%	6,8%	7,0%	6,1%	7,1%	9,0%	8,1%	8,6%	10,5%	11,9%	15,3%
Return-on-Sales	8,0%	7,2%	9,9%	9,6%	6,7%	4,8%	4,7%	3,9%	4,4%	5,5%	4,4%	4,1%	4,4%	4,5%	7,6%
Operating Income	428	439	726	866	703	657	744	634	849	1302	1046	1966	3335	4502	6628
Oper. Income Index	100	103	170	203	164	154	174	148	199	305	245	460	780	1053	1550
Oper. Income Growth		2,7%	65,3%	19,3%	-18,9%	-6,5%	13,2%	-14,8%	34,0%	53,3%	-19,6%	88,0%	69,6%	35,0%	47,2%

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Debt-to-Equity	1,94	1,89	1,63	1,57	1,57	1,87	1,75	2,48	2,98	2,14	1,68	1,42	1,11	1,31	0,78
Equity	21331	24942	29641	33888	38226	35591	38850	33640	33774	44170	51805	58380	77397	88602	110109
Equity Growth	18,1%	16,9%	18,8%	14,3%	12,8%	-6,9%	9,2%	-13,4%	0,4%	30,8%	17,3%	12,7%	32,6%	14,5%	24,3%
Debt	41462	47240	48421	53063	59917	66506	67898	83367	100742	94412	86894	82779	85898	115824	85503
Debt Growth	4,8%	13,9%	2,5%	9,6%	12,9%	11,0%	2,1%	22,8%	20,8%	-6,3%	-8,0%	-4,7%	3,8%	34,8%	-26,2%
Assets	62793	72182	78062	86951	98143	102097	106748	117007	134516	138582	138699	141159	163295	204426	195612
Assets Index	1335	1535	1660	1849	2087	2171	2269	2488	2860	2946	2949	3001	3472	4346	4159
Assets Growth	9,0%	15,0%	8,1%	11,4%	12,9%	4,0%	4,6%	9,6%	15,0%	3,0%	0,1%	1,8%	15,7%	25,2%	-4,3%
Sales	86196	84090	92520	96639	90972	83185	77223	83002	111155	155866	171511	156060	183625	212936	125019
Sales Index	1619	1580	1738	1815	1709	1563	1451	1559	2088	2928	3222	2931	3449	4000	2348
Sales Growth	-1,0%	-2,4%	10,0%	4,5%	-5,9%	-8,6%	-7,2%	7,5%	33,9%	40,2%	10,0%	-9,0%	17,7%	16,0%	-41,3%
Return-on-Assets	15,2%	13,1%	14,4%	11,9%	9,6%	3,3%	5,5%	0,5%	2,2%	14,1%	12,3%	12,6%	9,8%	6,4%	18,5%
Return-on-Sales	7,5%	7,7%	7,3%	7,5%	5,3%	0,7%	-1,5%	-2,7%	1,4%	5,7%	6,0%	2,4%	4,6%	3,1%	26,6%
Operating Income	6475	6494	6722	7208	4817	567	-1168	-2249	1548	8937	10239	3710	8418	6679	33249
Oper. Income Index	1515	1519	1572	1686	1127	133	-273	-526	362	2091	2395	868	1969	1562	7778
Oper. Income Growth	-2,3%	0,3%	3,5%	7,2%	-33,2%	-88,2%	-306,0%	-92,6%	-	477,3%	14,6%	-63,8%	126,9%	-20,7%	397,8%

Appendix 4: Summary of Electrolux Financial Statements million SEK

Consolidated Profit and Loss Account	1970	1975	1980	1985	1990	1995	1999
Sales	1 869	6 425	22 874	39 688	82 434	115 800	119 550
Operating Costs and Expenses	- 1 741	- 5 935	- 21 146	- 36 551	- 79 186	- 110 480	- 112 130
Share of Result in intressebolag						- 9	
Nonrecurring Costs							- 216
Operating Income	**128**	**491**	**1 728**	**3 137**	**3 248**	**5 311**	**7 204**
Financial Incomes	12	48	263	614	1 387	1 280	1 076
Financial Costs	- 27	- 176	- 988	- 1 175	- 3 226	- 2 575	- 2 138
Net Income After Net Financial Items	**113**	**362**	**1 003**	**2 576**	**1 409**	**4 016**	**6 142**
Extraordinary Incomes or Costs	3	- 5	51	176			
Net Income After Extraordinary Items	**117**	**356**	**1 054**	**2 752**	**1 409**	**4 016**	**6 142**
Appropriations	- 4	- 75	- 569	- 593			
Net Income Before Tax and Minority	**112**	**281**	**485**	**2 159**	**1 409**	**4 016**	**6 142**
Minority's Share in Net Income	- 1	- 5	- 11	- 15	- 98	- 69	38
Tax	- 48	- 171	- 133	- 749	- 570	- 1 199	- 2 005
Less Net Result in Companies Acquired During the Year		- 1	- 4				
Net Income	**63**	**103**	**337**	**1 395**	**741**	**2 748**	**4 175**

Consolidated Balance Sheet	1970	1975	1980	1985	1990	1995	1999
Current Assets	1 239	3 924	12 353	19 883	40 243	56 620	53 593
Long-term Assets	326	1 179	5 479	9 641	25 550	26 536	28 051
Total Assets	**1 565**	**5 103**	**17 832**	**29 524**	**65 793**	**83 156**	**81 644**
Current Liabilities	567	1 937	6 829	11 246	27 412	35 458	28 654
Long-term Liabilities	201	1 354	6 275	7 869	21 510	25 777	16 713
Total Liabilities	**768**	**3 291**	**13 104**	**19 115**	**48 922**	**61 235**	**45 367**
Provisions	**5**	**560**	**1 910**	**3 938**			**9 671**
Minority Interest	**9**	**55**	**76**	**134**	**306**	**617**	**825**
Shareholders' Equity	**783**	**1 198**	**2 742**	**6 337**	**16 565**	**21 304**	**25 781**
Total Liabilities and Shareholders' Equity	**1 565**	**5 103**	**17 832**	**29 524**	**65 793**	**83 156**	**81 644**

Appendix 5: Summary of SCA Financial Statements million SEK

Consolidated Profit and Loss Account	1970	1975	1980	1985	1990	1995	1999
Sales	1 473	3 462	6 739	12 669	31 366	66 012	66 133
Operating Costs and Expenses	- 1 307	- 2 913	- 6 084	- 11 320	- 28 296	- 58 662	- 59 400
Operating Income	**167**	**549**	**655**	**1 349**	**3 070**	**7 350**	**6 733**
Restructuring Costs					- 8		
Financial Incomes	18	122	270	394	469	296	322
Financial Costs	- 94	- 102	- 237	- 420	- 1 404	- 1 915	- 1 534
Net Income After Net Financial Items	**91**	**569**	**688**	**1 323**	**2 127**	**5 731**	**5 521**
Extraordinary Incomes or Costs	57	- 12	30	435	205		
Net Income After Extraordinary Items	**147**	**557**	**719**	**1 758**	**2 332**	**5 731**	**5 521**
Appropriations	- 64	- 356	- 389	- 1 360			
Net Income Before Tax and Minority	**83**	**201**	**330**	**398**	**2 332**	**5 731**	**5 521**
Minority's Share in Net Income	- 0	- 0	- 0	- 7	- 59	- 352	- 70
Tax	- 31	- 106	- 80	- 150	- 767	- 1 915	- 1 849
Net Income	**52**	**95**	**250**	**241**	**1 506**	**3 464**	**3 602**

Consolidated Balance Sheet	1970	1975	1980	1985	1990	1995	1999
Current Assets	847	2 535	4 322	6 610	15 455	20 180	22 871
Long-term Assets	1 416	2 910	4 209	9 263	32 974	47 950	62 343
Total Assets	**2 262**	**5 445**	**8 531**	**15 873**	**48 429**	**68 130**	**85 214**
Current Liabilities	448	969	1 777	3 939	19 216	17 063	17 646
Long-term Liabilities	1 025	1 452	2 268	3 723	17 277	25 550	24 216
Total Liabilities	**1 473**	**2 421**	**4 045**	**7 662**	**36 493**	**42 613**	**41 862**
Provisions	**166**	**2 021**	**2 926**	**5 311**			**8 632**
Minority Interest	**1**	**3**	**2**	**54**	**586**	**3 493**	**587**
Shareholders' Equity	**622**	**999**	**1 558**	**2 846**	**11 350**	**22 024**	**34 133**
Total Liabilities and Shareholders' Equity	**2 262**	**5 445**	**8 531**	**15 873**	**48 429**	**68 130**	**85 214**

Appendix 6: Summary of Volvo Financial Statements million SEK

Consolidated Profit and Loss Account	1970	1975	1980	1985	1990	1995	1999
Sales	5 324	13 692	23 803	86 196	83 185	171 511	125 019
Operating Costs and Expenses	- 4 896	- 13 035	- 22 757	- 79 721	- 82 618	- 162 487	- 118 465
Nonrecurring Costs						1 215	26 695
Operating Income	**428**	**657**	**1 046**	**6 475**	**567**	**10 239**	**33 249**
Restructuring Costs					- 2 450		
Financial Incomes	125	294	823	3 095	5 287	6 887	2 912
Financial Costs	- 94	- 450	- 861	- 1 805	- 3 731	- 4 078	- 1 565
Net Income After Net Financial Items	**459**	**501**	**1 007**	**7 765**	**- 327**	**13 048**	**34 596**
Extraordinary Incomes or Costs				- 163			
Minority's Share in Net Income					40		
Net Income After Extraordinary Items	**459**	**501**	**1 007**	**7 602**	**- 287**	**13 048**	**34 596**
Appropriations	- 216	- 441	- 874	- 3 330			
Net Income Before Tax and Minority	**243**	**60**	**133**	**4 272**	**- 287**	**13 048**	**34 596**
Minority's Share in Net Income	- 0	22	- 12	- 13		- 45	- 104
Tax	- 112	- 74	- 83	- 1 713	- 733	- 3 741	- 2 270
Net Income	**131**	**8**	**39**	**2 546**	**- 1 020**	**9 262**	**32 222**

Consolidated Balance Sheet	1970	1975	1980	1985	1990	1995	1999
Current Assets	3 242	9 644	16 993	41 682	53 189	76 141	89 750
Long-term Assets	1 462	4 388	6 126	21 111	48 908	62 558	105 862
Total Assets	**4 704**	**14 032**	**23 119**	**62 793**	**102 097**	**138 699**	**195 612**
Current Liabilities	1 875	6 175	9 737	26 856	48 712	59 769	47 900
Long-term Liabilities	406	2 583	4 498	9 285	17 794	27 125	32 514
Total Liabilities	**2 281**	**8 758**	**14 235**	**36 141**	**66 506**	**86 894**	**80 414**
Provisions	**1 577**	**3 563**	**5 717**	**17 738**			**16 962**
Minority Interest	**4**	**80**	**327**	**116**	**300**	**605**	**544**
Shareholders' Equity	**842**	**1 631**	**2 840**	**8 798**	**35 291**	**51 200**	**97 692**
Total Liabilities and Shareholders' Equity	**4 704**	**14 032**	**23 119**	**62 793**	**102 097**	**138 699**	**195 612**