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FOREIGN OWNERSHIP IN FINLAND – BOOSTING FIRM PERFORMANCE AND CHANGING CORPORATE GOVERNANCE

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ABSTRACT: During the last 10 to 15 years the ownership structure of Finnish business has changed in Finland perhaps more profoundly than in any other European country. Since the early 1990s both portfolio investment by foreigners and inward foreign direct investment (FDI) have grown rapidly. Helsinki Stock Exchange has become one of the most internationalised stock exchanges in the world. Cross-border mergers and acquisitions have increased too. In the 1990s, the number of inward cross-border deals in relation to DDP was the second highest in Finland among EU countries. However, the stock of inward FDI in relation to GDP in Finland is still slightly below the EU average. Growing inflows of capital and increasing foreign ownership have, to a large extent, had a positive impact on economic efficiency. The rate of return on capital has increased more rapidly in companies with high foreign ownership. The same applies to labour productivity. It is not clear, however, how foreign ownership has affected Finnish companies' R&D and their long-run growth prospects. Informal evidence seems to indicate that even in this respect the impacts of foreign ownership have been positive. Increasing foreign ownership and globalization of business have triggered major changes in corporate governance towards the US model.

Keywords: FDI, foreign ownership, economic growth, corporate governance.

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TIIVISTELMÄ: Yritysten omistusrakenne Suomessa on muuttunut viimeisten 10-15 aikana dramaattisesti. Ulkomaisten omistajien osuus pörssiyhtiöissä on kasvanut ja myös suorat sijoitukset Suomeen ovat lisääntyneet. Usein ulkomaisten yrityskauppojen kohteena ovat olleet teknologiaintensiiviset pk-yritykset. Ulkomaalaisten Suomesta ostamien yritysten lukumäärä suhteessa talouden kokoon on Suomessa ollut Euroopan korkeimpia. Suomeen tulleiden investointien kanta suhteessa BKT:een on kuitenkin vielä jonkin verran alle EU:n keskiarvon. Ulkomaisten investointien vaikutukset kotimaan talouteen ovat olleet pääosin myönteisiä. Yritysten tehokkuus on kasvanut: pääoman tuottoaste ja työn tuottavuus ovat suurempia yrityksissä, joissa on merkittävä ulkomaalaisomistus. Myös vaikutukset teknologiseen kehitykseen ovat tapaustutkimusten perusteella positiivisia. Olemassa olevan tiedon perusteella ei kuitenkaan voida tehdä varmoja päätelmiä ulkomaalaisomistuksen lisääntymisen pitkän aikavälin kasvuvaikutuksista. Ulkomainen omistus on muuttanut merkittävästi yritysten johtamis- ja valvontajärjestelmiä yhdysvaltalaisen mallin ja omistajavetoisen johtamisjärjestelmän suuntaa.

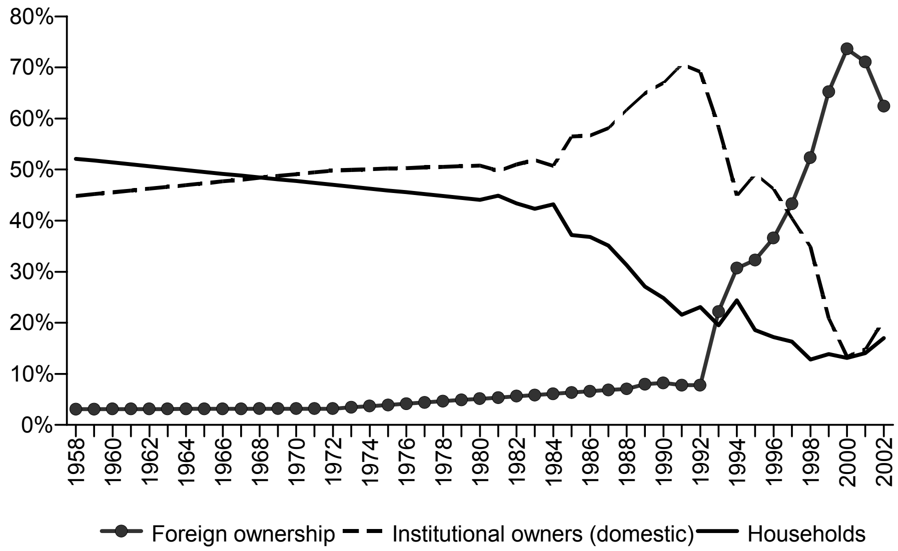
Avainsanat: Suorat sijoitukset, ulkomainen omistus, taloudellinen kasvu, johtamis- ja valvontajärjestelmät.

1. Introduction – posing the questions

During the past 10 to 15 years, foreign ownership in Finnish listed companies has increased rapidly and a large number of Finnish firms have been acquired by or merged with foreign firms. The share of the foreign ownership in the Helsinki Stock Exchange has increased dramatically since the early 1990s with foreigners holding some 70 per cent of Finnish market capitalisation by the end of the decade (Figure 1).

As a result, the Helsinki Stock Exchange has become one of the most internationalised stock exchanges in the world. Parallel to increasing portfolio investment by foreigners, inward direct investment has grown too, although at a much slower pace. The change in ownership structure that has occurred in Finland has perhaps been more profound than that experienced in any other European country.

Figure 1. Ownership in Finnish listed firms, percent of market capitalisation



Source: Ali-Yrkkö and Ylä-Anttila (2003)

The reasons for Finland's rapid internationalisation are obvious. Around the mid-1990s major Finnish firms and the economy at large were recovering from the most severe recession in the country's history - the economy was growing fast. The country and its firms were attractive investment targets. At the same time, financial market liberalisation, which began in the 1980s, was completed by lifting the remaining restrictions on capital movements. Foreign ownership of shares in Finland was fully deregulated in 1993 when Finland became a member of the EEA (European Economic Area) as a step towards membership in the EU and EMU a couple of years later. Furthermore, many Finnish firms – with Nokia in the forefront – were entering new growth industries such as ICT (information and communication technologies) making them attractive to overseas investors.

Globalisation of business is a two-way street. As Figure 2 shows the outflow of direct investments has by far exceeded the inflow. Portfolio investments by Finnish citizens and institutions have, instead, remained relatively modest. Globalisation of Finnish firms has taken place mainly through mergers and acquisitions (M&As), with an outcome of mixed Finnish and foreign ownership in many cases.[1] Hence, also outward FDI has contributed to increasing share of foreign ownership.

These drastic changes in ownership structure and huge fluctuations in capital flows have raised both concerns and lively debate among top executives, researchers, policy-makers as well as the public. What are the consequences of increasing foreign ownership? What does it mean when large part of the business sector is being controlled from abroad? Are foreign owners different from the domestic ones? Do they have different goals? Do foreign-controlled firms behave differently? Is there even a risk of direct transfer of income, jobs or domestically generated knowledge?

Contrary to fears expressed in public debate there is a growing amount of international evidence that foreign-owned firms perform better than the

[1] See Mannio et al. (2003).

domestically owned counterparts.[2] Differences in performance are found across industries, countries, and also at the plant level.[3] Studies of performance differences usually concern financial performance or growth and productivity performance. It is a widely held view that foreign direct investment and foreign-owned firms are beneficial for local economies. As such, there is a race among countries and regions to attract foreign firms, where some countries have developed different types of incentives for foreign firms, such as direct subsidies, tax relief or special services to help influence their location decisions.[4]

Why do foreign-owned firms perform better? Although the evidence that foreign-owned firms perform better financially and in terms of growth is unchallenged, we know relatively little about the causes and consequences of it. Ownership structure is a wider issue than merely its impact on performance. For a small Nordic country it is about how the capital market model is changing and how it affects various kinds of social institutions.

The model of corporate governance in Finland has been in transition over the past decade with the traditional Continental European system (stakeholder framework) giving place to the Anglo-American system. This shift has undoubtedly increased efficiency within the business sector, but it is not yet clear what kind of impact it has had on, e.g., the economy's long-run growth performance or national system of innovation. Some studies maintain that variations in national systems of corporate governance explain national patterns in foreign trade and technological specialisation.[5]

Innovation activities and the location of corporate head offices have recently been the focus of Finnish public debate. Both are crucial for promoting domestic value creation. Globalisation of business is potentially chang-

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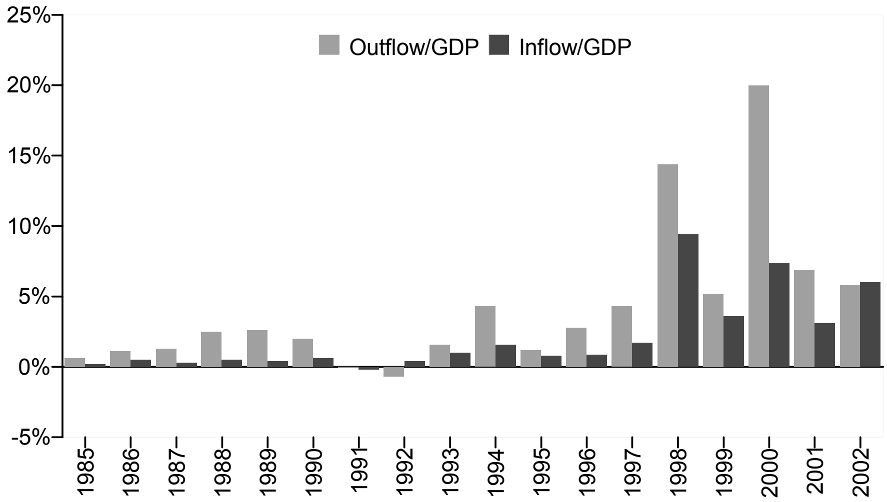
[2] For a review, see Jungnickel (2002). For the Finnish case, see Ylä-Anttila (2000).
[3] Pfaffermayr and Bellak (2002).
[4] See more about the race, and its causes and consequences, Oxelheim and Ghauri (2004).
[5] See Tylecote and Conesa (1999).

ing the attractiveness of smaller countries as a location for both innovation and head quarter activities.

Figure 2. Inward and outward foreign direct investment, % of GDP



Source: Bank of Finland and The Research Institute of the Finnish Economy (ETLA).

In the next section, we look at the transformation of the Finnish financial system and give a short historical review of Finnish economic developments, including an exceptionally severe depression of the early 1990s.

The third section summarises inward FDI and the role of foreign firms in the economy. To that end, we review the typical characteristics of foreign companies in Finland from the early 1800s to the present. This is followed by an overview of outward FDI and internationalisation of Finnish corporations in Section 4.

In Section 5 we analyse the performance of the foreign-owned and domestically owned firms in Finland. It turns out that foreign-owned companies perform better than Finnish-owned companies. We also look at how globalisation of business affects corporate governance and firms' goals: Are there differences in goals and governance? Are companies' announced goals and actual financial performance in line with each other? The largest Finnish companies have adopted the maximization of shareholder value as a major goal during the 1990s. On the other hand there seem to be significant differences between the objectives of foreign-owned and Finnish-owned companies. The change has coincided with increases in foreign ownership.

Section 6 discusses briefly decisions concerning the location of corporate headquarters – an issue that has raised a lot of public discussion in many smaller countries. Finally, section 7 concludes.

2. Finnish economy and financial system in transition

Background

Following the financial liberalisation of the 1980s, Finland experienced a major banking crisis and a collapse of its fixed exchange rate regime in the early 1990s. In addition, its economy underwent the most serious recession seen by any industrialised country since the Great Depression of 1930s.[6]

Table 1 shows some key indicators of the Finnish economy, which reflect structural changes and cyclical developments.[7] The economy posted rapid growth in real GDP during the 1980s. In many ways the recession that followed was exceptional, as Kiander and Vartia (1996), and Honkapohja and Koskela (1999) point out. Real GDP had never declined (on an annual basis) during the post-war period until the economic crisis of the early 1990s, when it dropped by over 10 per cent. Among the factors that contributed to the crises were a major downturn in the forest based industries, disruption in the eastern trade due to the collapse of the Soviet Union, a speculative bubble in the domestic securities and real estate markets, uncontrolled credit expansion and mismanaged financial liberalisation, which eventually led to a credit crunch and excessive private sector (both households and enterprises) indebtedness.[8]

The recovery, however, was pronounced, and the economy enjoyed strong growth through the rest of the 1990s. Over the same period, the structure of Finnish industry shifted from an emphasis in metal, engineering and paper manufacturing towards knowledge-based industries such as the ICT (information and communication technologies) industry. As a result, the driver of economic growth has moved from traditional factors of production to inno-

6 See, e.g., Kiander and Vartia (1996), and Honkapohja and Koskela (1999).

7 Besides the indicators shown in Table 1, the unemployment rate closely follows movements in the Finnish economy. The unemployment rate remained at low levels in the 1980s, but in the crisis of the early 1990s it exploded and rose to almost 20 percent.

8 Kiander and Vartia (1996).

vations. By the end of the 1990s, R&D intensity (R&D expenditure in relation to GDP) had grown well above three per cent, i.e., to one of the highest in the world.[9]

While until the early 1980s pulp and paper industry was by far the most important industrial sector, today the ICT sector is the most significant. In a decade, Finland went from being one of the least ICT specialised countries to becoming the single most specialised one. Currently the Finnish ICT sector, with Nokia as its locomotive, consists of some six thousand firms and accounts for some 10 percent of the country's GDP and about one fourth of total exports.[10]

This period also saw a reorganisation of Finnish financial markets. Still in the 1980s the Finnish financial system had a house bank structure, like the financial systems in Japan and Germany. By the end of the millennium the financial system had changed, with relationship-based debt playing a diminished role as a form of financing and the stock market gaining in influence.

Restructuring the financial market was integral to increasing the significance of high-tech industries and R&D investment. The role of small and medium-sized enterprises (SMEs) was also seen as important for both long-term economic growth and stabilising the economy after the crises of the early 1990s. Both of these changes created demand for new forms of financing and also for foreign capital.[11]

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[9] See Rouvinen and Ylä-Anttila (2003) for a more detailed description.
[10] Koski et al. (2002).
[11] For a detailed description, see Hyytinen and Pajarinen (2003).

Table 1 Finnish economy, 1980 – 2000

Average	Real GDP growth	GDP per capita*	Inflation
1980-1985	3.3%	9199	9.1%
1986-1990	3.3%	15061	4.9%
1991-1995	-0.6%	20263	2.2%
1996-2000	5.1%	26754	1.6%
Average	**Export intensity****	**Bankruptcies*****	**TFP relative to the US*****
1980-1985	30.9%	120	73%
1986-1990	20.5%	235	75%
1991-1995	25.5%	509	85%
1996-2000	32.7%	284	95%

* EUR m, current prices, ** % of GDP
*** Average number of bankruptcies per month
**** Total factor productivity of Finnish manufacturing, US = 100%, Maliranta (2001)

When the economic environment improved in the mid-1990s, stock market developments that had begun in the late 1980s re-emerged. In the 1990s, equity issuance on the stock market by non-financial firms increased, clearly outpacing that of financial institutions. IPO activity restarted immediately once economic conditions had improved. New companies were successfully listed on the Helsinki Stock Exchange. As Hyytinen and Pajarinen (2001) report, the venture capital market also grew.

The share of foreign investment in Finnish stocks began to rise in 1993 and rose very quickly during the latter part of the 1990s. Foreign investors comprise mainly institutional investors, such as mutual and pension funds. The most important country of origin is the US. In the beginning of the 2000, about two thirds of the shares on the Helsinki Stock Exchange, as measured by market capitalisation, were foreign-owned. Notably, more than 90 per cent of Nokia's shares are owned by foreign investors. Yet, Nokia is regarded as a very Finnish company, since the company's head office is in Finland, its top management is made up of Finns, and most of its strategic activities, like R&D, take place in Finland.

3. Foreign firms and entrepreneurs in Finland – A short historical overview

Foreign investors, firms and entrepreneurs are not a new phenomenon in the Finnish economic history. Foreign entrepreneurs played an important role in Finland's industrialisation process and also as importers of foreign know-how. In the late 1800s and early 1900s, European entrepreneurs and artisans were widely mobile, seeking opportunities to apply their skills. In Finland, the food and wood working industries as well as trade and commerce benefited greatly from foreign entrepreneurs and expertise. Many industrial companies still in existence today were established by immigrant entrepreneurs. They brought their expertise to the country, but relatively little capital.

As a whole, however, the impact of foreign entrepreneurs and direct investments on the Finnish economy remained low compared to many other small industrial countries during the period before World War I. Foreign investment activity was also insignificant in the decades following independence (1917) and World War II. This had to do with the economic nationalism typical of a young country, and related reservations towards foreign capital, but also with Finland's small size and remote geographic location as a market area.

Direct foreign investment in Finland did not surge during the decades that followed WW II, even though elsewhere in the world enterprises were experiencing a strong internationalisation trend. After the war, foreigners saw Finland as politically uncertain. Strict currency and import regulations did not make investments any more attractive. In the late 1950s inward FDI was at the same low level as before the World War II.

Finnish attitudes toward foreign companies became more positive during the 1960s. Simultaneously, social conditions were stabilizing, as indicated by a decrease in the risk premiums of foreign currency loans.[12] However, the law restricting foreign ownership remained in effect.

Throughout the 1960s inward direct investment was around 0.2 percent of the gross domestic product (GDP). The modest volume of investment was due to the fact that a majority of the foreign businesses established in Finland were marketing and sales companies that operated on small capital.

It was typical of the newly established or acquired enterprises that a foreign, frequently multi-national parent company was the sole owner of the subsidiary. Joint ventures that also had Finnish partners were less common. They were established mostly when the law restricting foreign ownership posed limits on operating a business. The strategy of most businesses was to enter the growing Finnish market and compete there. Some enterprises exported their products further to Soviet markets, among others. A large portion of the businesses that engaged in exporting, imported the raw materials or semi-finished products they needed for production.

In the 1960s and 1970s, foreign companies were tempted by Finland's low labour costs relative to most other Western competitor countries. Some of those investors included Swedish garment companies and metal and electronics industries' assembly factories. The companies that came to Finland merely for the sake of the low cost of labour left the country very quickly in late 1970s and early 1980s, when the relative cost of labour began to rise.

Direct foreign investments began to increase in the 1980s. In relation to the GDP, the investments were still fairly small. The targets of investment began to be increasingly in buying and selling companies, especially small businesses with special know-how[13]. The most significant direct foreign investment in Finland in the 1980s was the deal between what was then Kymi-Strömberg and the Swedish ASEA, in which ASEA (later ABB) purchased

12 Hjerppe and Ahvenainen (1986).

13 Lovio (1992).

Kymi-Strömberg's entire electrical operations unit. This event was indicative of how Finnish attitudes toward foreign companies began to shift with the outward-directed internationalisation trend of Finnish industry itself.

The situation changed in the 1990s, as legislation restricting foreign ownership was repealed and measures were taken to attract foreign capital to Finland. A special agency (Invest in Finland), with the purpose to attract foreign firms, was established in 1992. Although attitudes toward foreign companies and ownership have changed very rapidly, questions and criticism have not entirely disappeared. Parliamentary discussions on repealing the law restricting foreign ownership in 1991 – 1992, and on the merger between the Swedish and Finnish paper companies—Stora and Enso—a couple of years later, are good examples of the rapidity of the change as well as of the critical attitudes that continue to exist.[14]

The 1939 law that restricted foreign ownership was liberalised step by step during the 1980s and early 1990s and finally overturned in 1992, a few years before Finland joined the EU. There was, however, strident criticism toward the development, particularly with regard to freeing up land ownership. According to a popular impression, foreigners were going to "rush to buy land at cut-rate prices". Such talk died down quickly. At present, the discussion has broadened to encompass the theme of globalisation, which is in some ways been rendered into concrete terms by several cross-border mergers and acquisitions (M&As). Border-crossing M&As are an essential part of the ongoing wave of globalisation. They are resulting in a new kind of tension between different management styles and corporate cultures, which could not be foreseen a few decades ago.

The national strategic significance associated with ownership has diminished in a fundamental way since the 1980s. Ownership has become more international, and international investors usually place only one demand on management: shareholder value. It has been recognised in the public debate

[14] See Väyrynen (1999), who records and analyses closely the rather heated debate surrounding the topic.

that from the national economy's viewpoint it is important where the companies are located, and where they invest – not who their owners are. For this reason, it matters whether Finland is seen as an attractive location for businesses and people alike.

Finland became much more attractive to foreign investors in the course of the 1990s as the remaining restrictions on capital movements were taken down and business sectors that had previously been protected in one way or another were opened to competition. EU and EMU membership implied that the country was part of a common market with free movement of capital, labour, and technology.

Indeed, cross-border inward investment has been quite high during the past ten years. In the 1990s, the number of inward cross-border deals (M&As) in relation to GDP was second highest in Finland among the EU countries (Figure 3). However, in terms of the deal value Finland is ranked much lower. Hence, we can conclude that Finnish transactions have been relatively small, i.e., target companies are, to a large extent, small and medium-sized enterprises (SMEs). [15]

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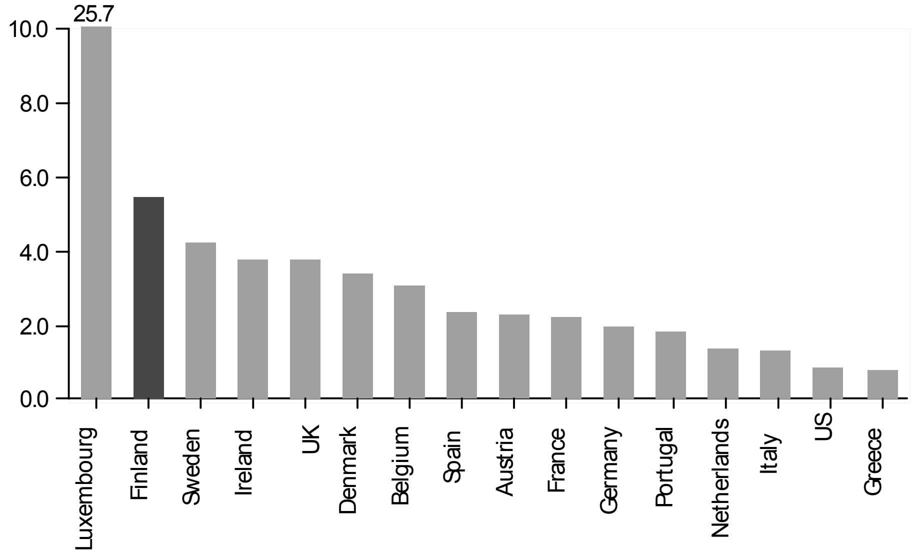
[15] See Ali-Yrkkö (2003).

Figure 3. Countries as cross-border M&A targets (1990-99)



Note: Data sources are OECD (2001) and the author's calculations. Countries as cross-border M&A targets is measured as the ratio of the sum of the number of inward cross-border deals during 1990-99 to GDP at market prices in 1999, mill. Euros.

Foreign direct investment began growing rapidly in the world economy starting in the mid-1980s. In addition to the liberalisation trend in international capital markets, this had to do with developments in information and communications technologies and the services related to them. These developments made it possible for a geographically decentralised company to operate more effectively than before. In many sectors, competition turned global. In order to survive in this environment, many companies have chosen to strongly specialise and grow their core businesses. Consequently, firms have increased direct investment to expand their markets.

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Thus, the growth of direct investment in Finland has partly been the product of an international trend. However, an important factor attracting additional FDI into Finland has been the emergence of numerous technology-intensive companies, especially in the ICT sector, whose specialised know-how tends to draw foreign businesses. The motivation of the foreign companies to locate to Finland is no longer to benefit from their firm specific assets in the Finnish market, but rather to benefit by making the know-how of Finnish companies an integral part of their own operations.[16] Indeed, most of the Finnish companies that were acquired have benefited from the new ownership arrangement: as part of a multinational company, their technologies and products have found new, international marketing and distribution channels. Financial resources have also increased notably in many cases.[17]

Table 2. Some of the largest foreign subsidiaries engaged in industrial production in Finland in 2002

Foreign parent company	Country	Finnish subsidiary	Sector of industry	Employees in Finland
ABB	Switzerland	ABB Finland	Electrical engineering	9216
Kvaerner	Norway	Kvaerner Masa-Yards	Mechanical engineering	4610
Flextronics	USA	Flextronics Holding Finland	Electrical engineering	1710
Scottish & Newcastle	UK	Hartwall	Food and beverages	1457
Pilkington	UK	Pilkington Finland	Chemical industry	1400
Carlsberg	Denmark	Sinebrychoff	Food and beverages	1190
Siemens	Germany	Siemens	Electrical engineering	1097
Andritz	Austria	Andritz	Mechanical engineering	1080
Aker Yards	Norway	Aker Finnyards	Mechanical engineering	1010
Assa Abloy	Sweden	Abloy	Mechanical engineering	1002

Source: ETLA's business database

Direct foreign investments into Finland have also increased because big Finnish corporations have focused on their specific area of specialization. Many operational units that had to be unloaded might not have found an appropriate or interested buyer in Finland at the time of sale. The large proportion of mergers and acquisitions among foreign companies' direct investments in Finland is reflected in Table 2, which lists some of the largest subsidiaries of foreign MNEs that were engaged in industrial production in Finland in 2002. All (except Siemens) were acquired by foreign companies and, with a few exceptions, were originally part of a larger Finnish group prior to being purchased.

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16 See Pajarinen and Ylä-Anttila (1999).
17 Pajarinen and Ylä-Anttila (2001).

4. Outward FDI - internationalisation of Finnish companies

Still in the late 1970s, Finnish companies' international activities consisted mostly of exporting from Finland. Since the early 1980s, internationalisation has primarily referred to FDI. Today, large Finnish industrial corporations are highly internationalised—amongst the ten largest corporations, as much as 80 percent of total revenues comes from foreign sales and over 60 percent of production and personnel is located in foreign units (Table 3).

Many of these companies have considerable foreign ownership, which is integral to their foreign operations and financing. Practically all of them could be characterised as Finnish multinationals rather than domestic companies, although all have group head offices still in Finland. However, increasing foreign ownership has affected management practices and governance structures in many ways.

In the 1980s and early 1990s Finnish companies usually became international in separate stages. Simple international operations gradually progressed into more complex ones. Production units were first established in the most important export markets like Sweden and Germany. Later efforts were made to expand operations to other parts of Europe and North America. The pattern was clear—after several years of experience with exporting, companies moved on to more demanding forms of international operations, such as overseas production.

Today many companies begin targeting the world market at a very early stage. Companies in the high-tech industry in particular view the entire world as their potential market from the very start. As a result, foreign subsidiaries are already established during a company's product development phase. Previously, research and development abroad was carried out only after the company had acquired international experience through other operations.

In the course of the last 10–15 years, Finnish companies have internationalised into nearly all parts of the world, with Africa being perhaps the only exception. A majority of the investments of Finnish companies have gone to the EU region, mostly to Sweden and Germany, followed by North America.

Growth in foreign investment activity by Finnish companies can also be seen in the location of their personnel, with a significant portion of the largest Finnish corporations' labour force working outside of the country's borders. This trend has intensified drastically over the last fifteen years.

Table 3. Number of employees in large Finnish corporations in 1983 and 2002

	1983		2002	
Company	Number of employees	of which abroad, %	Number of employees	of which abroad, %
NOKIA	23651	17.5	51748	56.5
STORA-ENSO	15315	9.8	43853	66.5
UPM-KYMMENE	50061	9.4	35579	44.1
METSÄLIITTO	7891	7.5	30247	67.4
METSO	15371	12.8	28489	62.9
KONE	13137	66.2	35864	87.0
OUTOKUMPU	10089	1.4	21130	69.3
HUHTAMÄKI	4698	6.6	15909	95.5
FORTUM	7076	21	13118	43.3
RAUTARUUKKI	7712	1.6	12804	41.9
Total	162583	15.38	288741	63.4

Source: Ali-Yrkkö & Ylä-Anttila (1997), updated in 2002.

Summing up briefly, large Finnish corporations have experienced notable growth and other changes in recent years. Most of this growth has occurred abroad in response to the rapid expansion of international business operations, and all signs indicate that this tendency will continue to grow in the future. It appears that companies want to operate close to their customers, helping to attract a growing share of investments away from Finland. Inevitably, the ownership of corporations will also become increasingly international, with a bearing on companies' systems of corporate governance.

5. Firm performance and goals – does foreign ownership matter?[18]

Background

In this section we take a look at the effects of globalisation of business, ownership and corporate governance on firms' goals and performance. The globalisation of capital markets and ownership has triggered major changes in corporate governance towards the US model in most European countries, as discussed in the previous section. [19]

Empirical evidence on the effects of ownership structure and the nationality of ownership on firm's goals and performance is consistent with the view that ownership matters. Using data on European companies, Thomsen and Pedersen (2000) find that market-to-book value is higher in firms whose largest owner is a financial institution than in firms whose largest owner is a family, another firm or a government. Interestingly, the nationality of the firm's owners has an impact on these relations. The results by Griffith (1999) concerning productivity differences between domestic and foreign-owned companies in the motor vehicle and parts industry supports the view that foreign-owned firms have higher financial performance. Chibber and Majumdar (1999) focus on the influence of foreign ownership on the financial performance of firms operating in India. According to their results, foreign-owned companies, i.e., subsidiaries of foreign firms, outperformed domestic companies. Finally, raw data from Sweden[20] and Japan[21] suggest that in terms of return on equity, foreign-owned companies outperform domestic companies.[22]

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18 This section draws heavily on Ali-Yrkkö and Ylä-Anttila (2003).
19 See, e.g., Berglöf (1997).
20 See Statistics Sweden (1996), and Strandell (1997).
21 METI (2001).
22 Jungnickel (2002) provides a good review of most recent studies.

There is very little empirical evidence on the effects of foreign ownership on firm performance in Finland. Here we examine the effects of foreign ownership on the performance and goals of Finnish firms, and ask whether the internationalisation of ownership matters. That is, do foreign-owned companies perform better than or differently from Finnish-owned ones? Are there differences in goals and governance? Are the announced goals and actual financial performance in line with each other?

Table 4 illustrates the basic differences in the two types of corporate governance models – the Continental European/Japanese model and the Anglo-Saxon model. The message of Table 4 is clear. In the US and UK the shareholder perspective strongly dominates, while in Germany and Japan the stakeholder view seems to be prevalent.

Table 4. Differences in corporate governance

	Whose company is it?		Job security or dividends?	
	All interest groups'	Shareholders'	Job security	Dividends
Japan	97%	3%	97%	3%
USA	24%	76%	10%	90%
UK	30%	71%	11%	89%
German	83%	17%	59%	41%
France	78%	22%	50%	50%

Note: The data are based on a survey made among business executives, reported originally in Institute of Fiscal and Monetary Policy (1996).

The Nordic governance model has traditionally been akin to that in Germany/Continental Europe (and to some extent Japan). However, as a consequence of the rapid globalisation of capital markets and changes in corporate ownership, firms (and also the governments) are facing a "governance dilemma", namely whether to promote the adoption of the Anglo-Saxon model or to keep some of the features of the Continental European model.[23] Because the Anglo-Saxon corporate governance system emphasizes return on capital and equity more than the Nordic and Continental European systems do, this difference in goal setting may have an effect of firm performance.

[23] See, e.g., Holmström and Kaplan (2001).

Ownership nationality – why might it matter?

The effects of competition

Differences in operating environment may cause differences in firm performance. Perhaps the most obvious sources of differences are the degree of competition and firms' exposure to international markets, which may vary a lot across countries and industries. Differences in competitive environment are highlighted when restrictions on competition are removed in previously protected industries. The reason is, of course, that the restrictions have often been in place to protect domestic companies from foreign competition.

Porter (1990) points to the importance of domestic competition in creating a competitive edge in international markets. Protected and non-competitive home markets lead to inefficiencies and uniformity in firm strategies. The management literature provides strong evidence showing that a competitive environment leads to more efficient decision making structures and increases incentives to monitor costs.[24] The economics literature offers fairly little empirical evidence on the effects of competition on firm performance. The existing evidence points, however, in the same direction: Deregulation and a higher level of competition are associated with productivity gains.[25]

The effects of ownership change

Lichtenberg (1992) proposed that ownership change is caused by lapses in firms' efficiency. These lapses may be due to the incompatibility (or "bad matching") between a plant (an asset) and the characteristics of an owner (i.e. a parent firm). This argument, which is the key hypothesis of Lichtenberg's (1992) "matching theory", is based on three primary assumptions: i) Some owners have a comparative advantage in owning certain plants; ii) The quality of the match is a decisive factor in the decision to maintain the ownership of the plant; and iii) The quality of the match can be measured by productivity performance.

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[24] See, e.g., Caves (1980).

[25] For a review, see Allen and Gale (1999).

The matching theory of plant turnover does not assume that there are good and bad owners, but that there are good and bad matches. This view has two major implications: First, a poor match, which is indicated by a low level of current productivity, may lead to a change of ownership. Second, a change of ownership will lead to an increase in plant productivity. The quality of each match is assumed to be randomly distributed. Thus, given that the quality of the first match was low, the expected value of a new match (from an identical distribution) is higher.

In practice, many acquisitions are preceded by a deterioration in the target firm's economic performance. This deterioration may act as a signal to an owner that she/he is operating the plant less efficiently than an alternative parent would. Because the liberalisation of capital movements and capital markets has increased the potential for better international matches, a growing number of cross-border mergers and acquisitions is likely to follow. The primary motive of these transactions may well be related to the opportunity of profiting from differences in firm performance across countries.

The international trade and business literature refers to firm-specific assets or advantages and their transferability within multinational enterprises. As, e.g., Caves (1996) argues, firm-specific assets exhibit external economies because they are intangible and have characteristics of public goods. Firm-specific assets can be transferred with low cost within – but not between – multinational companies. This would lead to higher than average performance of affiliates of MNEs, since other (domestic) firms do not have access to these assets. It is simply a matter that specific skills and resources developed by MNEs can be exploited by the MNE network but not outside it.

Finnish ownership and globalisation of capital markets

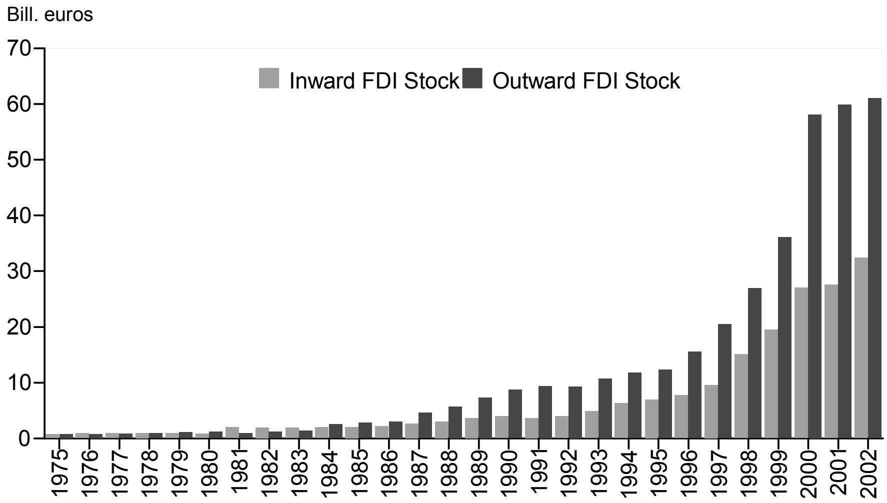
The ownership of major Finnish companies was for long concentrated, with founding families, banks, other companies or the state typically wielding considerable control.[26] In the 1990s, companies, their governance and operations changed remarkably. Cross-ownership diminished when banks and large industrial companies sold their shares of other companies. The privatisation of state-owned companies also proceeded fast during the past decade: in many cases, the buyer was a foreign firm or investor.

During the 1990s both inward foreign portfolio and direct investment grew rapidly (Figures 1 and 4). At the same time Finnish firms increased their investment abroad – mainly in the form of M&As, which also increased foreign ownership and the significance of international capital market in firms' financing.

As a consequence of the globalisation of Finnish capital markets, a number of changes in corporate governance have taken place. First, the supervisory board, which used to be quite common in large Finnish companies, is a rare bird today. Second, the board of directors no longer consists only of operating management. Third, a number of diversified companies have focused on their core competencies by selling off less strategic businesses. Fourth, as we will show below, companies have changed their targets. Shareholder value has become one of the key targets in most large companies. All these changes are consistent with the view that the nationality of ownership matters. How the increasing foreign ownership has affected the behaviour and performance of Finnish firms is considered in more detail in what follows.

[26] The number of listed companies was rather small, and banks served as a major source of finance to Finnish companies. These basic characteristics of the traditional system are described in more detail by Kasanen et al. (1996). Changes in institutional and legal settings in the 1990s are described by Hyytinen and Pajarinen (2003).

Figure 4. Stocks of inward and outward foreign direct investment in Finland, billions of euros at fixed 2002 prices



Sources: Bank of Finland and ETLA.

Empirical analysis using firm-level data

Differences in corporate governance, degree of competition, the ability to utilise the firm specific assets of an MNE network, and lapses in the matching of resources suggest that the nationality of ownership might cause differences in firms' goal setting and performance. In this section we examine whether firm-level data also supports the existence of such differences. We examine, in particular, whether there are differences between foreign and Finnish-owned firms in terms of their goal setting, investment rates, and financial performance.[27]

Data

We use two data sets on Finnish companies. The first data set ("Top 100") is derived from a database on the 100 largest Finnish corporations (ranked according to sales). The database covers the period from 1986 to 1998. However, due to mergers and restructuring we have comparable data over

[27] The causality might, of course, also run in other direction, i.e., companies with high financial performance are attractive investment targets for foreign companies and investors. Indeed, a previous study with Finnish data shows that foreign companies tend to acquire firms with higher than average rates of return. It is of interest to note that the difference in the rate of return between domestic-owned and foreign-owned companies seems to grow after the acquisition. See, Ylä-Anttila and Ali-Yrkkö (1997) and Ali-Yrkkö et al. (1997).

the whole period on only 50 corporations. The database includes information on firms' financial performance and corporate governance, such as ownership structure, organization, and what kinds of goals (shareholder value, growth, etc.) the companies have pursued.

The second data set ("Top 500") consists of financial statement data on the 500 largest companies in Finland over the same period. The data allows us to make financial performance analyses, but does not include information concerning firms' goal setting or other measures of governance structures. As far as ownership structure is concerned, a distinction can only be made between foreign controlled (majority owned firm) and domestically owned firms. Approximately one third of these companies were foreign-owned, i.e., subsidiaries of foreign firms, in 1998. There is no data on the amount of foreign portfolio investment in this data set.

Foreign vs. domestic ownership

We start by examining whether the financial performance of Finnish firms differs from that of foreign-owned firms. To this end, we use the Top 100 data and divide firms into two groups on the basis of whether the foreign ownership in a firm is above or below 20 percent. As shown in Table 5, we use several measures of financial performance, including Economic Value Added (EVA). Unlike traditional measures of corporate profitability, EVA also takes into account the opportunity cost of equity capital.[28]

Many of the indicators of financial performance differ significantly between Finnish and foreign-owned companies. The biggest difference relates to EVA, which is on average much higher in foreign-owned firms. Even if we exclude the largest Finnish multinational firm—Nokia Corporation—from the sample, the EVA of foreign-owned firms remains two times

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[28] Unlike traditional measures of corporate profitability, such as net operating profit after tax, and net income, EVA looks at a firm's "residual profitability," net of both the cost of debt capital and the cost of equity capital (Grant, 1997). It is computed as follows: EVA = net result *minus* (riskless rate of interest *plus* beta *times* risk premium) *times* equity share, where the riskless rate of interest is measured using the treasury bond (5 years) yield in Finland (source: Bank of Finland), beta is measured using betas by industries (source: Finnish Economic Weekly (Talouselämä, 20/1997)), and risk premium is assumed to be 4.5 %.

higher than that of Finnish firms. Although the larger size of foreign-owned firms may explain the difference, this finding is not inconsistent with the view that foreign-owned companies yield more value added to their owners. The ratio of EVA to capital invested describes the efficiency of capital use. It too indicates that the foreign-owned firms outperform the Finnish ones. Moreover, it seems that foreign-owned firms have invested less and have a lower equity ratio than domestically owned companies. Due to the small sample size, these differences should be considered tentative.

Table 5. Performance by ownership (using Top 100 data, N = 199)

	Foreign ownership <20%, (n=121)	Foreign ownership >=20%, (n=78)	t-statistics	p-value
Return on investment	14%	17%	-1.687	0.09
Capital turnover rate	3%	3%	0.057	0.96
Equity share	47%	42%	2.389	0.02
Investments/Net sales	13%	8%	2.132	0.03
Operating income/Net sales	7%	7%	0.501	0.62
EVA, FIM mill.	79	447	-2.092	0.04
EVA/Capital invested	6%	9%	-1.647	0.1

Note: The data refer to 1997 and 1998. Capital turnover rate = the ratio of net sales to capital invested. The number of observations is 199, since the sample is based on the Top 100 in 1997, but the merger between IVO and Neste reduces the number to 99 in 1998. The t-statistics are used to test H0: Mean (Domestic-owned) = Mean (Foreign-owned). EVA without Nokia Ltd is 221 million FIM.

In order to overcome the small sample problem, we turn to the Top 500 data. Table 6 displays the results. Because we lack data on foreign portfolio investments in these companies, the definition of foreign ownership changes from what we used above, i.e. we look at foreign multinationals' subsidiaries in Finland where foreign ownership is more than 50 per cent. We use only EVA, the ratio of EVA to capital invested, and the conventional rate of return on investment as indicators of firm performance.

The message from the Tables 5 and 6 is clear. Foreign-owned companies have performed much better than domestic ones. Indeed, foreign companies created slightly negative value added during the recession (1991-1993), but the EVA performance of Finnish-owned companies during the same period was highly negative. The ratio of EVA to capital invested, which is less driven by differences in firm size, has averaged 1 percent in Finnish companies, while the same figure for foreign-owned companies is 6 per cent. The rate of return on capital invested in foreign companies is also higher than in Finnish-owned companies.

Table 7 reports the capital turnover rate, the ratio of investment to net sales, and the number of companies. It seems that Finnish-owned companies need far more capital to generate the same sales or value added as foreign-owned companies.

Table 6. Performance by ownership (using Top 500 data, N=5121)

	Finnish-owned			Foreign subsidiaries		
Year	EVA, FIM mill.	EVA / Capital invested	Return on investment	EVA, FIM mill.	EVA / Capital invested	Return on investment
1986	-27	-1%	8%	2	1%	11%
1987	10	2%	10%	16	7%	15%
1988	24	3%	11%	18	8%	17%
1989	11	1%	10%	12	6%	16%
1990	-24	-1%	8%	-1	0%	11%
1991	-71	-4%	6%	-3	-4%	8%
1992	-70	-3%	8%	-2	-3%	9%
1993	-32	0%	9%	1	2%	12%
1994	13	3%	12%	11	10%	20%
1995	36	4%	16%	23	12%	27%
1996	14	4%	17%	19	9%	24%
1997	37	5%	18%	24	11%	26%
1998	54	5%	17%	23	10%	24%
Total average	-4	1%	12%	12	6%	18%

Table 7. Investment by ownership (using Top 500 data, N=5121)

	Finnish-owned			Foreign subsidiaries		
Year	Capital turnover rate	Investment/ Net sales	Number of companies	Capital turnover rate	Investment/ Net sales	Number of companies
1986	2.5	11%	190	2.8	7%	39
1987	2.5	10%	249	2.8	5%	50
1988	2.4	13%	292	3.1	5%	58
1989	2.5	11%	318	3.2	6%	74
1990	2.6	12%	360	4.3	6%	88
1991	2.8	8%	399	3.6	6%	91
1992	3.5	10%	339	3.1	5%	77
1993	3.6	8%	334	4.9	4%	88
1994	4.1	7%	299	7.9	4%	93
1995	3.5	8%	289	6.7	3%	110
1996	5.5	8%	297	7.2	4%	115
1997	3.8	9%	286	6.3	4%	117
1998	5.2	10%	333	7.1	5%	136
Total average	3.4	10%	3985	5.3	5%	1136

As seen from Table 8, the hypothesis that there are no performance differences between domestic and foreign-owned companies is clearly rejected. Furthermore, the investment ratio of foreign-owned companies is lower than that of domestic-owned companies. Finnish companies are also on average more capital-intensive than foreign-owned companies. This finding does not change significantly even if the capital-intensive forest industry is eliminated from the data. In a previous study on the financial performance of Finnish companies[29], the industry differences between domestic and foreign companies were carefully controlled for. The result was that the industry differences did not explain the divergences in performance. The findings in Table 8 are consistent with our earlier results using the Top 100 data and the different criterion for foreign ownership.

Table 8. Statistical tests (using Top 500 data, N=5121)

	EVA	Return on investment	Investment/ Net sales	Capital turnover rate
t-statistic	-4.2581	-10.376	14.35	-5.07453
p-value	< 0.01	< 0.01	< 0.01	< 0.01

Note: t-test, variance unknown, H0: Mean (Domestic-owned) = Mean (Foreign subsidiary)

But why do these differences exist? Are Finns poor managers? Anecdotal evidence is not consistent with poor management. Case studies of firms that have been taken over by foreign firms show that the previous management has often been allowed to keep its position after the takeover. However, the performance of these firms has improved. These findings are consistent with the view that foreigners are more demanding owners than Finns, i.e., that more is squeezed out of the firm.

Goals and ownership

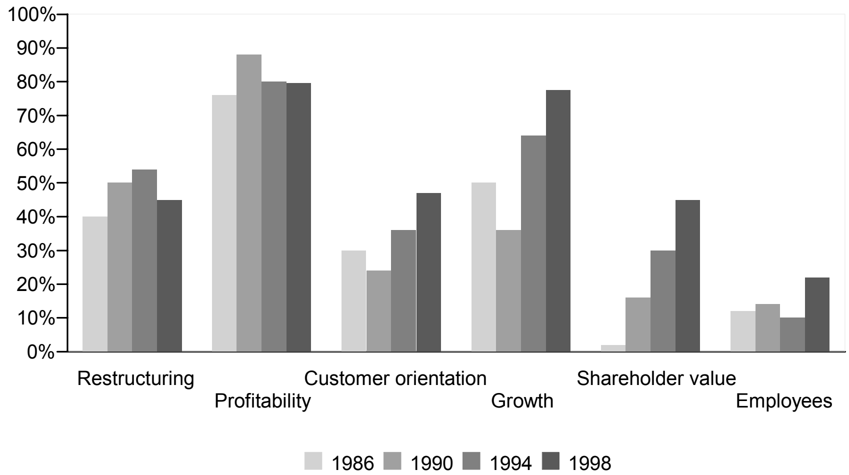
The annual reports of Finnish companies usually include a section describing their goals and targets. All companies state several goals. Figure 5 shows that profitability and its improvement were the main goals throughout the 1990s. Companies announced that they would either maintain profit

29 Ali-Yrkkö and Ylä-Anttila (1997).

performance at the same level as before or that they would try to improve it. Another goal, not shown in Figure 4, is improving the debt/equity ratio. Since the sample is small, any conclusions based on it should be regarded as tentative.

Furthermore, Figure 5 shows that, during the recession of the 1990s, companies became less interested in growing their business. This finding is not surprising, because growth was not a realistic goal in the depth of the recession. In fact, most companies tried to keep their sales at the same level as before. The goal of customer orientation also declined during this period. It may be that many companies were forced to concentrate on improving their financial position, such as debt/equity ratios, at the expense of other goals.

Figure 5. Goals of the largest Finnish companies, percent of companies



Note: The data are from the Top 100 data set and consist only of firms that mentioned their goals.

During the 1990s, firms began to increasingly stress their owners' role, announcing that they sought value added for their shareholders. By the end of the decade, almost half of the large companies stated shareholder value as one of their key goals. Shareholder value is, of course, closely related to other targets, like profitability and growth. However, stating it explicitly as one of the key goals sends a specific signal to current and potential owners, and is at least an indication of how shareholder value became an increasingly common goal of Finnish firms in the 1990s.

Table 9 shows how goals differ between Finnish and foreign-owned companies. The results in the table suggest that foreign-owned companies are more oriented to their customers, growth and shareholder value than domestic companies. To summarize, these results support the hypothesis that foreign and domestic-owned companies have difference goals.

Table 9. Comparison of firms' goals (using Top 100 data, N=199)

	Foreign ownership <20%	Foreign ownership >20%	t-statistic	p-value
Restructuring	38	38	-0.353	0.720
Profitability	76	67	0.406	0.680
Customer orientation	49	63	-2.721	0.000
Growth	63	73	-2.313	0.010
Shareholder Value	28	52	-3.990	0.000
Employees	38	29	-1.474	0.140

Note: See the earlier tables.

Summarising the differences

Our data show that shareholder value has been increasingly adopted as a major goal in most large Finnish companies since the early 1990s. This trend coincided with increasing foreign ownership in the Finnish business sector. Our empirical results suggest that ownership matters in goal setting. There are significant differences between foreign-owned and domestic-owned firms in terms of their announced objectives.

Furthermore, our comparisons suggest that foreign-owned companies have not invested as much as domestic companies. This partly explains why foreign-owned companies produce a higher rate of return on capital than domestically-owned companies. The difference applies not only to companies that are majority-owned and controlled by foreigners (subsidiaries of foreign firms) but also to companies with lower (but still significant) foreign ownership. Consistent with earlier empirical evidence, our analysis also shows that foreign companies perform better than Finnish-owned companies.

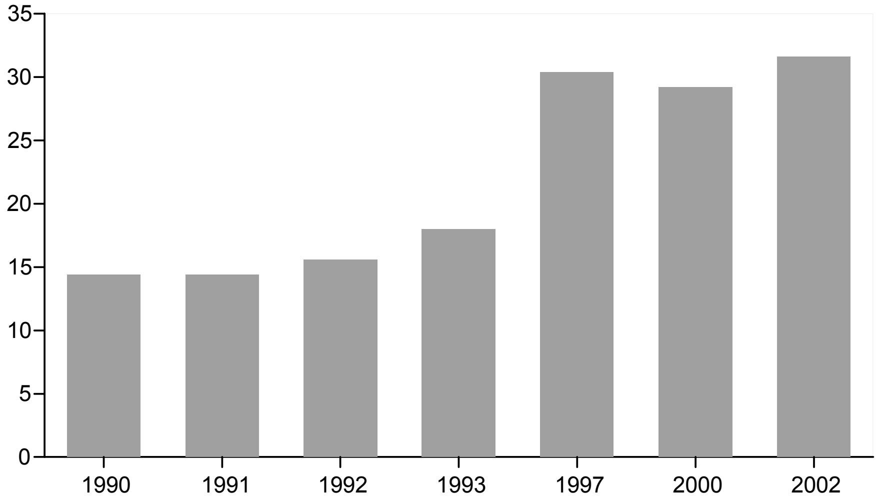
Taken together, evidence of this section suggests that increases in foreign ownership have improved the efficiency of capital use. The results also imply that in less integrated and partly protected markets it was possible to pursue other goals at the expense of the rate of return on capital. In the future, the nationality of ownership (domestic vs. foreign) in determining firm performance will probably diminish. Owners will pursue high rates of return irrespective of their nationality.

6. The location of corporate headquarters

Does increasing foreign ownership affect the location of headquarters? Does the relocation of headquarters have any impact on economic growth in Finland? Does it affect government tax revenues?

In this section we discuss the factors affecting the location of corporate headquarters of Finnish firms. This has recently become a popular subject since it is a strategic issue not only for firms but also for policymakers.

Figure 6. Percent of Finland's 250 largest firms with corporate headquarters abroad



Source: Ali-Yrkkö and Ylä-Anttila (2002), updated.

Figure 6 shows how the proportion of Finnish firms with corporate headquarters abroad has grown throughout the 1990s. In Finland, headquarter relocation activity has, in almost all cases, taken place as a consequence of international mergers or acquisitions. Thus, the existing headquarters of a foreign company that acquires a Finnish firm most often determines the location of the newly formed company. However, there are some cases in which the relocation decision has been made independently of the merger or acquisition. In these cases, the firms have been small or medium-sized and have typically operated in the high-tech industry. Small IT companies, in particular, tend to locate their head offices abroad, just to be closer to their markets and sources of international venture funding.[30]

Table 10. The largest Finnish firms that have relocated their corporate headquarters abroad

Firm	Where to	Firm	Where to
Ahlströmin leijukerroskattilat	USA	Servi Systems	Denmark
Nokian Paperi	USA	Sinebrychoff	Denmark
Kyrel	USA	Cultor	Denmark
Metsä-Serla Chemicals	USA	Nokian Kaapeli	Holland
Ojala-yhtiöt	USA	Leaf	Holland
Timberjack	USA	Ahlström Pumps	Switzerland
Martis	USA	Nokia-Maillefer	Switzerland
Sonera	Sweden	Hartwall	Great Britain
Enviset	Sweden, USA	Arctia (hotels)	Great Britain
Salcomp	Sweden	LK Products	Great Britain
Tamrock	Sweden	Asko Kodinkone	Italy
Assa-Abloy	Sweden	Andritz-Ahlström	Austria
STV	Sweden	Aker Finnyards	Norway
Leiras	Germany	Polarkesti	France
Marli	Germany	Transtech	Spain
Huolintakeskus	Germany	Lohja Rudus	Ireland

Source: Ali-Yrkkö and Ylä-Anttila (2002)

In 2002 the Confederation of Finnish Industry and Employers made a survey of factors affecting the location of headquarters. The results, presented in Figure 7, indicate that Finland's history, social stability and data communication links favoured locating headquarters there.

Obviously, the country's high income tax rate and heavy taxation of personal stock options as well as promoting growth in subsidiaries favoured relocation of headquarters abroad. There were clear differences in responses depending on how globalised the firm in question was, with more globalised firms perceiving more advantages in locating their headquarters abroad.

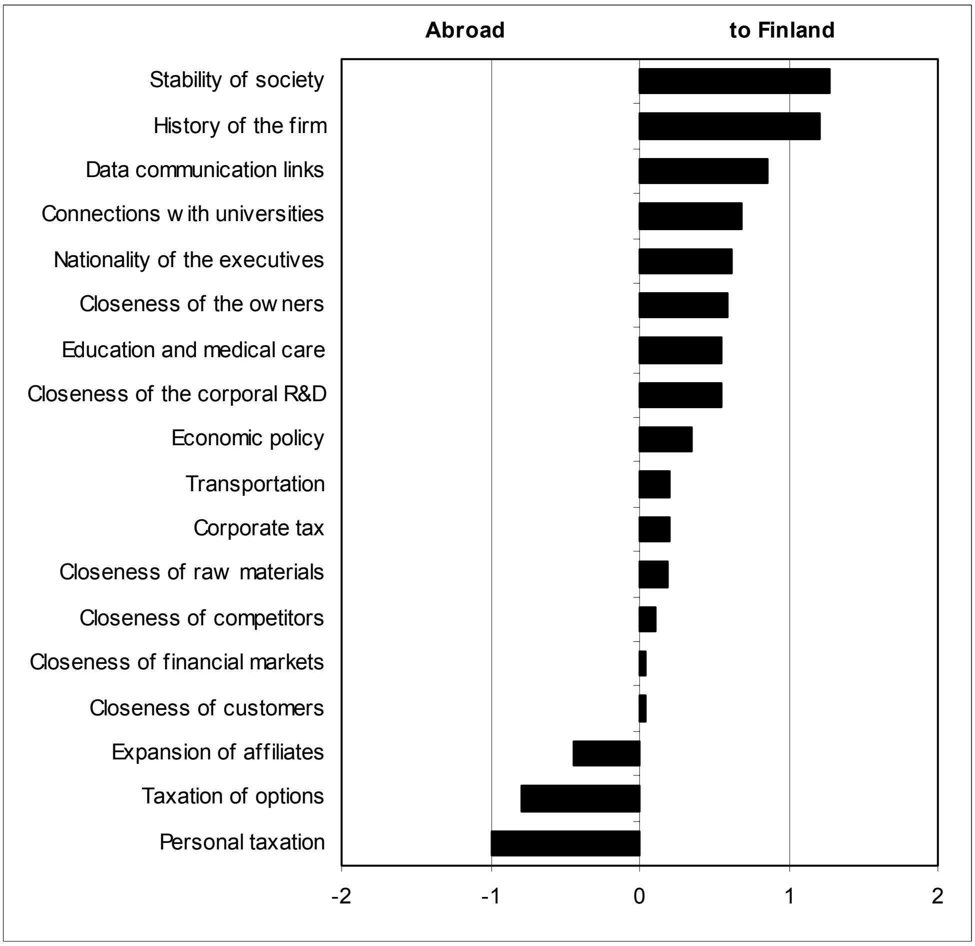
In addition, factors affecting decisions on headquarter location vary across industries. Especially firms in industries that need new capital may want to be

30 Ali-Yrkkö and Ylä-Anttila (2002)

located near main financial markets, such as New York and London, where many analysts, investment banks, venture capital firms, and other financial institutions operate.[31] This may help them become better known among investors and therefore increase their possibilities of raising new capital.

Problems in recruiting personnel may also have an effect on the location of corporate headquarters. Large multinational firms, in particular, operating in a small country may find it difficult to persuade personnel to move to remote peripheral areas.

Figure 7. Factors favouring the location of headquarters in Finland and abroad



Source: Ali-Yrkkö and Ylä-Anttila (2002).
Data: Confederation of Finnish Industry and Employers. Values scaled between –2 and 2. 2 is strongly in favour of locating in Finland, 1 is somewhat in favour of locating in Finland, 0 is neutral, -1 is somewhat in favour of locating abroad and –2 is strongly in favour of locating abroad.

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[31] Cf. Braunerhjelm (2004).

Even when large Finnish firms have headquarters in Finland, some operations take place elsewhere. For example operations related to finance and R&D are commonly undertaken both at home and in foreign affiliates' offices. Indeed, during the last five years the internationalisation of R&D has increased rapidly, bringing the share of R&D activity of Finnish industrial firms performed abroad up to around 40 percent in recent years.

The importance of corporate headquarter location

The internationalisation of headquarters and their possible relocation to another country raises the question of what effects this has on the Finnish economy. Because the definition of headquarters is far from unambiguous, the consequences of relocation are considered from the viewpoint of the parent company's actual physical location and the location of headquarter operations and the company's top executives.

The location of the parent company determines where the company pays corporate taxes. If the parent company of such a group moves to another country, the country it leaves will forgo future corporate tax revenues from that firm. Relocation may also have an impact on the firm's image. The presence of a large MNE head office may be of great importance especially in small countries. Undoubtedly, Nokia's success has generated huge positive external effects by enhancing Finland's reputation as a high-tech country.

As mentioned earlier, the relocation of Finnish corporate headquarters abroad has almost always resulted from a merger or an acquisition. This development will likely continue in the future. The location of corporate headquarters and the parent company is especially interesting when two equal firms merge. In this case, how heavily corporations are taxed may be an important factor influencing the decision.

Some of the largest Finnish firms could possibly relocate their headquarters abroad over the next few years without a merger or an acquisition. The globalisation of large firms already extends to sales, production, R&D and ownership. As a part of this globalisation trend and the decreasing importance of Finland as a factor and product market, some parent companies and top management may relocate abroad. The most likely host countries are the UK and the Netherlands.

7. Concluding remarks

There are both potential benefits and drawbacks of increasing foreign ownership. In the case of Finland, growing inflows of both portfolio and direct investment have had a positive bearing on economic efficiency. The rate of return on capital has increased more rapidly in companies with high foreign ownership. The same applies to labour productivity. It is also evident that Finnish firms that have been acquired by foreign multinationals have benefited from their global distribution networks and management capabilities.

It is not clear, however, how foreign ownership has affected Finnish companies' R&D and accumulation of other intangible assets and, hence their long-run growth prospects. Informal evidence seems to indicate, however, that even in this respect the impacts of foreign ownership have been positive.

Recent studies show that high technology in certain fields, such as in the ICT sector and paper industry, tends to attract foreign investment. Assuming that the technology base cannot be constantly upgraded and maintain its attractiveness, there is a risk that the accumulated knowledge may flow out of the country when the MNEs relocate their assets to increase the overall performance of the corporation. There is a constant race among countries and regions to attract high-tech firms and plants. These firms are not only important for purposes of technological infrastructure and taxation, but also for social and economic systems as a whole.

Increasing foreign ownership and the globalisation of business have profoundly changed many national institutions. They have triggered major changes in corporate governance towards the US model. Firms with significant foreign ownership more often announce that shareholder value is their major objective, and generate higher economic value added to their owners than Finnish-owned firms. It remains to be seen how these changes will affect the country's technological specialisation in the future – will they favour high-risk and high-tech activities or reduce long-term investment in R&D.

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