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# *NORTH STARS: WHY ARE SWEDISH COMPANIES WORLD LEADERS?*

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Interview with Stephen Paice

MB Malcolm Borthwick

SP Stephen Paice

MB Hello, and thanks for joining us. I'm Malcolm Borthwick, editor of Intellectual Capital at Baillie Gifford. If you look down at Sweden from space, you can see two things, social democracy and the Wallenbergs. Or, so the Swedish saying goes, such is the significance of one of Europe's most powerful family dynasties. Without the Wallenbergs, for example, there would be no Atlas Copco, which is one of Baillie Gifford's longest held stocks. Atlas Copco is a market leader in compressors, pumps and power tools.

And it's one of many Swedish stocks held by Baillie Gifford. Stephen Paice is head of the European Equities team. Here's here to discuss family and founder led businesses and what makes Sweden such an exciting opportunity. But before we start the conversation, some important information. Please remember that as with all investments, your capital at risk and your income is not guaranteed. Stephen, thanks for joining us in the podcast.

SP Thank you for having me.

MB I'm going to start with an overarching question. Why Sweden?

SP The simple answer is that Sweden is just where we find the best companies. It's purely an output of bottom-up stock picking. And this stock picking and the philosophy that we have for picking what we call outliers, and these are the special companies that hopefully will go on to produce huge upsides for our clients. But when we look at these outliers, whether it's to do with the potential growth and the business models, corporate cultures or capital allocation, they're not just better than average.

These are the companies which lie at the extreme ends of the spectrum. And because of that we think that they're potentially able to generate extreme returns over long periods of time. And what we want to do is try and find those outliers and hopefully hold them forever. And when we've gone back and looked at where these big winners have come from in the past within Europe, Sweden punches



way above its weight in producing these fantastic companies. And I think it will continue to do so.

I also think that Sweden is a relatively small domestic economy. There's only about 10 million people in Sweden. But most of the companies in Sweden have already had that ambition to grow globally. So, while it's a small domestic market, all of these fantastic engineering companies and other Swedish outliers that we'll come onto hopefully speak about have internationalised that early stage.

The innovation is strong, not just in Sweden but right across the Nordics. So, whether you look at global innovation or competitiveness indices, Sweden ranks either at the top or near the top. And when you start to dig into some of these surveys, they have huge big lists of the variables that they track. But it's a combination of high levels of secondary and tertiary education, they have good funding for these start-ups in particular, lots of collaboration between businesses and academia. They rank highly when it comes to patent applications. And also, publication of scientific papers.

You've got high taxes which then feed into a broad and generous welfare system. So, when you combine all these factors together, it's enabled a lot of innovation to come through. And importantly, a lot of these companies do commercialise those innovations as well. So, lots of underlying reasons why Sweden has been such a fantastic place to find these outliers.

MB Let's talk more about Atlas Copco. Founded in 1873 in Stockholm, it will be 150 years old next year. Originally in its early years it provided equipment for building and running Swedish rail. It's an extraordinary company, what's the enduring quality of this company for you?

SP Atlas Copco is one of if not the best engineering company, and I would say in the world. And, as you said, it was founded in the 1870s and it started off helping Sweden build railroads. So, it had a lot of different expertise and technologies and products. But, over time it specialised in diesel engines and then really specialised on anything to do with air pneumatic power. So, it's air compressors and vacuum pumps now. And throughout their entire history they've had the involvement of the Wallenberg family which we mentioned at the start.

And one of the Wallenbergs, André Oscar Wallenberg who originally founded one of the largest Swedish banks a couple of decades before Atlas Copco, he was one of the founders of Atlas Copco. He helped Atlas Copco with funding, it nearly went bankrupt. He realised at the time that the management team wasn't very good, and he was able to bring in a much better management team. And throughout those 150 or so years, they have managed to adapt and provide the types of products and services that their customers desire and value a lot.

So, when you look at the outputs of the last 20 years, Atlas Copco, this is a compressor business, it has vacuum pumps for semiconductors and some other power tools. But over the last 20 years it's been able to grow organic sales. It's probably mid-single digits, high-single digits, it's able to supplement that with



acquisitions. And through fantastic service and aftermarket support for its customers, it's been able to improve margins. It generates 30% returns in capital. So, when you look at the outputs, at least, it's a fantastic looking business.

But it's the inputs which are much more interesting. And it is that long-term mindset that exists in the company. And the Wallenberg family have certainly been influential in a lot of the capital allocation decisions that have created a lot of value at Atlas Copco.

There is also something of a unique culture or corporate culture within Atlas Copco. It's not just about innovation, which is itself an output. But it really honed and focused on decentralisation. And this is where you don't have to have a command-and-control management team. They run a flat decentralised network of businesses. And each business within Atlas Copco umbrella is empowered to make its own decisions. Each business has its own profit and loss account. So, we've got this fantastic organisation where employees feel empowered.

They're loyal, so the turnover rates are low. Most of the promotions come from inside. And you've got this long-term mentality where the focus is much more about providing services to customers and looking after employees. It's not about the Anglo-Saxon mentality of looking after the shareholder. So, when you put all these things together, again, you've seen this wonderful story of one of the best run and most successful engineering companies in the world.

MB And what strikes you about companies such as Atlas Copco when you go and visit them?

SP The last time I went, it was actually to meet Investor, which is the Wallenberg's holding company. And it's through this holding company which has been around for more than 100 years, where they own big chunks of individual companies, Atlas Copco being one of them. And the last time I went to visit Investor, you get taken into this grand office. It's traditional, it's not got any glass or metal, it's all mahogany.

And when you start talking to the management team there, you glance up at the wall and you can see the portraits of the entire family. And we're now on the fifth generation with Jacob Wallenberg and Marcus Wallenberg. But you can see all of their fathers' and grandfathers' and great-grandfathers' portraits on the wall. So, you get that sense of history and the legacy which they are there to protect and to maintain. And it's that sense of their purpose and mission which is striking when you get to meet these companies.

And it's very much a case of they're making sure that they're looking after these businesses. And they're making sure that they're going to pass them onto the next generation in a better shape than they inherited them. And when you have that type of mentality it lends itself to longer term and more valuable decision making. Whether it's to put the customer and employees first to avoid that shareholder primacy. And to think about how best to generate value over very long periods of time.



And when you ask, for instance, Jacob Wallenberg, what he thinks of long-term investing, he says long-term investing is 50 years and beyond. So, we should take inspiration from the people that we meet in Sweden that have been able to successfully influence and manage these amazing companies, just in terms of how long we should be thinking about in terms of our investment horizons.

MB And how influential are founders and family run businesses in some of the other Swedish companies you invest in?

SP When you look at the Swedish stock market, most of the companies that are large are traditional. These are companies that have 100 plus year histories. So, the two most valuable companies in Sweden at the moment are Investor, which is the Wallenberg holding company, and Atlas Copco, which is this 100 plus year-old engineering company. But even then, when you go further below that, you have companies like Sandvik, Volvo, Handelsbanken, ACE, ASSA ABLOY, Hexagon.

And all of these companies have a family member on the board. So, all of these companies have a long-term owner who sits on the board who's able to influence those capital allocation decisions. Now, having said that, we are starting to see a change. And this is not just within Sweden, this is right across Europe. Europe has lots of family controlled dynastic companies. But because we're seeing a much quicker and a transition towards the founder-run company, a lot of entrepreneurs are now sprouting up all across Europe.

They're taking advantage of better funding. A much great level of ambition, that we're now starting to see much younger companies come into the mix. Some of those are still private, Northvolt would be one Swedish one, Klarna is the most valuable private company in Sweden at the moment, set up by a founder. But then within the public equity side, you have companies like Spotify, which was set up by Daniel Ek.

So, we now have a number of founder-run companies. And they may have a slightly more ambitious outlook on life than some of those other families. But we're starting to see more founder-run companies creep into those indices, which is a feature if you look at something like the US market for instance, where you have had a much greater number of founder-run businesses who are also the CEO. So, we're starting to see this generational shift where you've got multi-generational families also being joined by first generation founder-run businesses like Spotify.

MB So, quick quiz, what did the adjustable wrench, the three-point seat belt, the pacemaker and Tetra Paks, widely used in food packaging, what do they have in common?

SP Well, I could take a guess.

MB Maybe a bit of a clue given the topic of our podcast.

SP Yes, could it be that they are all Swedish inventions?

MB Absolutely. Swedish inventions, or the commercially successful models have been



Swedish. What's interesting is a country with one of the highest social safety nets in the world has also got a huge culture of innovation. Why is that?

SP It's a good question, and it goes back to innovation, whether it's the regional level or a cluster, these are complex adaptive systems, so there are lots of variables which go into that. But beyond some of the things I mentioned earlier in terms of higher levels of education, funding, they have a supportive start-up ecosystem.

And particularly when you have role models like Daniel Ek and Spotify, and older companies like Ericsson for instance that have set up these ecosystems and have spawned lots of other smaller start-ups and, particularly in the case of Spotify, given start-ups a role model and the ambition to know that this is what they could achieve. So, beyond those softer factors, then there is things like government support. In the 1990s the government offered a tax break to all Swedish residents to buy PCs, personal computers.

MB Wow.

SP And back then, that was innovative. And this helped the Swedes become early adopters of technology. And then a few years later, it was 1994, Stockholm built the world's largest Open Fibre network. And 100% of businesses and pretty much every home tapped into that. And that has been a massive benefit for these companies. So, you've got a lot of these things, you've got a collaborative culture, you've got the right long-term mindset, you've got support and you've got an empowered and innovative workforce as well.

So, when you combine all of these things, that's why we've seen Stockholm in particular being labelled as a unicorn factory. And at one point, Stockholm was producing more billion-dollar companies per capita than any other region in the world. And some of those companies you wouldn't have heard of, companies like King and Mojang. But if I say that they were responsible for producing Candy Crush and Minecraft, you might know of those products and those companies now.

But we also have Klarna, Spotify, iZettle and some companies which are focused at driving forward sustainability and decarbonisation in Europe as well. So, innovation in the future for Swedish companies is bright.

MB That cluster effect, fascinating. Malmö is pretty well known for gaming. How does that network effect grow in a hub like Stockholm?

SP It's the same for any cluster. And through serendipity, this is what happened in Silicon Valley as well, where you had positive feedback loops when companies started becoming successful. You only needed a small number of these companies to spawn a huge ecosystem. And with that ecosystem comes more funding, it comes with more employees moving there, it comes with knowledge sharing. It comes from learning from failure and success.

So, when you get these clusters, you have lots of positive feedback loops. And we have clusters all over the world. Silicon Valley is the most famous one, but in Sweden we've got the Medicon Valley, which is life-sciences. And a lot of



technology and gaming clusters for instance in Stockholm. And, again, it's to do with that network effect and the collaboration and the resources that these companies have at their disposal. And this all tips the odds of these clusters producing something amazing.

MB One of the questions I often ask to guests on the podcast is what the pandemic has changed your mind about?

SP That's a good question. There're two things. And one of them is that during the pandemic we weren't able to get out and meet some of these companies, we had to do a lot of these meetings on Zoom or Teams or some of these other platforms. And the relationships that you build up with some of the people I mentioned today are much stronger or much better following face-to-face physical contact and being able to spend time with them. Whether it's in a coffee shop or going for dinner or in their offices, it's so much more enjoyable.

But also, the quality of the interaction that you get with the companies and the people that really matter is much better when you're able to visit them. So, that's one takeaway. And the other one is just the flipside of that is that during lockdown we had a lot of time to think. And we work hard to reduce the number of meetings we have anyway. But it's making sure that we have enough time to think and to avoid this huge distraction which financial markets are constantly putting in your way.

So, there's a combination of things. It's trying to go out and meet more companies and continue building relationships. And it's also recognising that there's definitely a benefit to working from home. So, at the moment we've got a hybrid model where we spend, some people come in most of the week, others come in two or three days a week. But each of us needs to find the right balance and that optimal balance of working in quiet places that you can actually do some proper research.

But also have that time to talk to your colleagues and get those serendipitous ideas that you come across at the watercooler and so on. But it's a combination of those two things.

MB And with your time to think you had a reading day recently, didn't you, Stephen? Tell me about that.

SP Yes, so this is something that the team has done for 12 or 13 years now. And twice a year we'll spend about a week reading and unplugging and thinking about a couple of different topics. So, the reading day that we had last week, we went off to the Botanic Gardens, we hired a room there. And everybody had to write a couple of pages on the specific topics and books that we had to review. And the two topics last week were decision making, how can we get better at decision making? And how can we improve our awareness of cognitive biases?

And what else we could learn from an eclectic range of shareholder letters? This was a range of activist letters being sent to companies, it was shareholder letters written by CEOs and chairmen. And it was also some shareholder letters from so-called super investors. So, we put all these things into the pot, and we sit and



ruminate and think about how can we become better at investing? Which is what one of the most important ambitions that we have is. The performance hopefully comes after that.

But if we can focus on, how can we be the best investors in the world at our specified objective in terms of growth investing? That's what we need to focus on.

MB That's a great place to end the podcast, Stephen. Thanks for joining us.

SP Thank you very much.

MB And thanks for investing your time in this podcast. And if you've enjoyed the conversation, you can find other podcasts, films and articles that give you an insight into the companies we invest in that are shaping the future of the world. You can find these at [bailliegifford.com/insights](https://www.bailliegifford.com/insights). There's plenty to choose from, ranging from firms investing in education and electronics to robotics and rockets. And if you're listening at home, you're listening in a car, wherever you're listening, stay well, and we look forward to bringing you more insights in our next podcast.

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