
SHORT BRIEFINGS ON LONG TERM THINKING – EPISODE 26

Sweden: a smörgåsbord of innovation

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MB Hello and welcome to *Short Briefings on Long Term Thinking*. Thanks for joining us. I'm Malcom 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. It sits in the Baillie Gifford European Growth Trust and the European Fund, along with many other Swedish stocks.

Stephen Paice co-manages these investments. He'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's at risk and your income is not guaranteed. Stephen, welcome to *Short Briefings on Long Term Thinking*, and thanks for joining us again on 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 actually that Sweden is just where we find the best companies. It's purely an output of bottom-up stock picking. 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 upside for our clients. But when we look at these outliers, whether it's to do with the potential growth in 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. Because of that, we think that they're potentially able to generate extreme returns over long periods of time.

What we want to do is try and find those outliers and hopefully hold them forever. 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 has a relatively small domestic economy. There's only about 10 million people in Sweden. But most of the companies 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 on to hopefully speak about, have internationalised at a very early stage. The innovation is very strong, not just in Sweden, but right across the Nordics. Whether you look at global innovation or competitiveness in indices, Sweden ranks either at the top or near the top.

When you start to dig into some of these surveys, they have huge, big lists of the variables that they attract, but I think it's a combination of high levels of secondary and tertiary education. They have very good funding for these start-ups, in particular. Lots of collaboration between businesses and academia. They rank very highly when it comes to patent applications and, also, publication of scientific papers. You've got obviously high taxes, which then feed into a very broad and generous welfare system. When you combine all these factors together, it's enabled a lot of innovation to come through and, importantly, a lot of these companies to commercialise those innovations, as well. Lots of underlying reasons why Sweden has just been such a fantastic place to find these outliers.

MB Let's talk more about Atlas Copco. They're founded in 1873 in Stockholm, they'll be 150 years old next year. Originally, in its early years, they provided equipment for building and running Swedish Rail. It's an extraordinary company. That's the enduring quality of this company for you?

SP Atlas Copco is probably one of, if not the best engineering company in the world. As you said, it was founded in I think it was 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 and pneumatic power. So it's air compressors and vacuum pumps now. Throughout their entire history they've had the involvement of the Wallenberg family, which we mentioned at the start.

One of the Wallenbergs, André Oscar Wallenberg, who originally founded one of the largest Swedish banks, probably 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 weren't very good and he was able to bring in a much better management team. Throughout those 150 or so years, they have managed to adapt and provide the types of products and services that their customers really, really desire and value a lot.



When you look at the outputs, at least over the last 20 years, Atlas Copco, I mean 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, 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 on 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 I think 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 corporate culture within Atlas Copco, it's not just about innovation. Which maybe is itself an output, but it really honed and focused on decentralisation. And this is where you don't have to have a commanding control management team. They run a very flat, decentralised network of businesses. And each business within the Atlas Copco umbrella is empowered to make its own decisions. Each business has its own profit and loss account.

So you've got this fantastic organisation where employees feel empowered, they're loyal, so the turnover rates are very 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. When you put all these things together, again, you're seeing this wonderful story of one of the best run and most successful engineering companies in the world.

MB 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. 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. The last time I went to visit Investor, you get taken into this very grand office. It's very traditional, not any glass or metal, it's all mahogany. When you start talking to the management team, you glance up at the wall and you can see the portraits of the entire family. We're now on the fifth generation with Jacob Wallenberg and Marcus Wallenberg. But you can see all of their father's and grandfathers' and great-grandfathers' portraits on the wall.

You get that sense of history and the legacy, which they are there to protect and to maintain. I think it's that sense of their purpose and mission which is really striking when you get to meet these companies. 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 on to the next generation in a better shape than they inherited them. When you have that type of mentality, it lends itself to longer term and more valuable decision making, whether it's to put the customers and



employees first, to avoid that shareholder primacy. And to think about how best to generate value over very long periods of time.

I think when you ask, for instance, Jacob Wallenberg what he thinks of long-term investing, he says long-term investing is 50 years and beyond. 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 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 history. 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, Assa Abloy, Hexagon. And all of these companies have a family member on the board. All of these companies have a long-term owner who sits on the board, who's able to influence those capital allocation decisions.

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 transition towards a founder-run company, a lot of entrepreneurs are now sprouting up all across Europe. They're taking advantage of better funding. A much greater 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, I think 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. We now have a number of founder-run companies and they may have a slightly more ambitious outlook on life than maybe some of those other families. But we're starting to see more founder-run companies creep into those indices, which are a feature, if you look at something like the US market, for instance, where they have a much greater number of founder-run businesses who are also the CEO. We're starting to see this generational shift, where you've got multigenerational families also being joined by first-generation founder-run businesses, like Spotify.

MB Quick quiz. What do the zip, adjustable wrench, the three-point seatbelt, the pacemaker and Tetra Pak, widely used in food packaging, have in common?

SP I can take a guess.

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

SP 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 that a country with one of the highest social safety nets in the world is also got a huge culture of innovation. Why is that?

SP It's a good question. Innovation, whether it's at the regional level or a cluster, these are complex adaptive systems. There are lots of variables which go into that. But, beyond some of the things I mentioned earlier, in terms of high levels of education, funding, they have a very supportive start-up ecosystem. Particularly when you have role models like Daniel Ek and Spotify, and older companies like Ericsson, for instance, that have set up these kind of 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.

Beyond those softer factors, then there's things like government support. In the 1990s the government offered a tax break to all Swedish residents to buy PCs, personal computers. Back then, that was quite innovative. This I think helped the Swedes become very early adopters of technology. Then a few years later, I think it was 1994, Stockholm actually built the world's largest open fibre network. And 100% of businesses and pretty much every home tapped into that. That has been a massive benefit for these companies.

You've got a lot of these things. You've got collaborative culture, you've got the right long-term mindset, you've got support and you've got a very empowered and innovative workforce, as well. When you combine all of these things, that's why we've seen Stockholm, in particular, being labelled as a unicorn factory. I think at one point, Stockholm was producing more billion-dollar companies per capita than any other region in the world. 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 very much focused at driving forward sustainability and decarbonisation in Europe as well. I think the innovation and the future for Swedish companies is very bright.

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

SP It's the same for any cluster. 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. 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. When you get these clusters, you have lots of positive feedback loops.

We have clusters all over the world, Silicon Valley is probably 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. This all tips the odds of these clusters producing something amazing.

MB There's also a focus in Sweden on sustainable development. Where do you see the opportunities there?

SP Sweden really is one of the global leaders when it comes to decarbonisation. And they have very ambitious targets, whether it's to cut emissions by almost 60% by 2030. I think they were one of the first to come out with a net zero ambition that's by 2045. It was, I think, the first country also to introduce carbon pricing and has actually got one of the highest carbon prices in the world. And these are some of the incentives you need to transition an economy. There's lots of technologies and behaviours which I think have started in the Nordics and Sweden, that are now diffusing across the world.

Then we have companies like Northvolt. It's a platform for manufacturing green and sustainable batteries. It was only founded in 2016, but I think that at some point in the near future, I don't know when that is going to be, I'm not going to put a specific target on it, it will be Sweden's most valuable company. The reason I think that is because it's going to be, hopefully, another great example of this next generation and breed of European company.

Then we look at who's involved and Northvolt has a couple of businessmen, Swedish businessmen, that really want to drive forward progress in decarbonisation. They attracted a couple of people from Tesla. We have the CEO and cofounder, Peter Carlson, who honed his craft at places like NXP, which is a semiconductors company, Sony Ericsson, but then, Tesla. So, he's learned how to execute and get things done at Tesla.

They have the right support in terms of the customers. They've build relationships up with BMW, VW, Scania, Volvo, all of those industrial companies within Europe. They've got the right product as well, importantly. So, Sweden generates most of its power by hydroelectricity. It's using that hydroelectric power to lower the cost curve for producing these batteries, but it's also put at the very top of the priority list, the sustainability of these batteries. It's fully circular and it's using as much recycled material as possible.

We've got this European champion in the making that hopefully by the end of the decade will be able to capture a huge portion of that very quickly growing market for electric batteries, but also, energy storage and a range of other industrial applications. Even if we look at the demand side for those electric vehicle batteries, the demand is going to be much greater than what we're currently forecasting. And we have lots of initiatives by governments to try and encourage, I think is the best way to describe it, electric vehicle adoption. A lot of these countries, Sweden in particular, want to phase out combustion engines.

I think Northvolt are in a fantastic place to provide Europe with its own source of green and sustainable batteries. They've got the right people involved, they've got



that long-term mindset, so it's just going to be really exciting to see this business grow. And hopefully we can stay along for the ride and be shareholders for 37 years, as we were with Atlas Copco.

MB That's a great place to end the podcast, Stephen. Thanks so much for joining us on *Short Briefings on Long Term Thinking*.

SP Thank you very much.

MB And thanks to you, the listeners, for investing your time in Short Briefings on Long Term Thinking. You can find our podcast at bailliegifford.com/podcasts or subscribe at Apple Podcasts, Spotify, or on TuneIn. If you've enjoyed the conversation, you can check out previous discussions we've had on the podcast, such as why private companies matter more, or how the messenger RNA vaccine could provide a solution not just for Covid, but for cancer and other diseases. There are 25 other episodes, so plenty to choose from. And if you're listening at home, you're listening in the car, wherever you're listening, stay well, and we look forward to bringing you more insights in our next podcast.

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