CoA NOTE M and P No. 10

THE COLLEGE OF AERONAUTICS

CRANFIELD

BUSINESS IN EUROPE NO. 2

- by -

Members of the Cranfield Management Development Programme No. 3

December, 1965.

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THE COLLEGE OF AERONAUTICS

DEPARTMENT OF PRODUCTION AND INDUSTRIAL ADMINISTRATION

Studies of two aspects of business in Europe

- by -

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Preface

The Cranfield Management Development Programme is an intensive ten week course for middle management aged 28 - 38. The courses which are held twice yearly started in 1964; the third of these MDP III was held from October - December, 1965. The members of the course are drawn from a variety of businesses and have previous experience in one or more of the main fields of business activity, e.g. general management, marketing, production.

As part of the course two weeks are devoted to studying business conditions in Europe. For this tour the members are formed into small groups who study particular projects.

MDP III were in Europe from 14th - 27th November, 1965 during which period the following cities were visited; Lyon, Zurich, Hanover, Rotterdam and Brussels. In each city discussions were arranged with a representative cross-section of the business community. These included British Embassy Staff, British Chambers of Commerce, local bankers, industrial companies, advertising agents, Trade Union officials, management consultants and British subsidiaries.

On their return from Europe a meeting was held at the Royal Overseas League in London where the members of the course presented their findings to a group of businessmen, and representatives of the Export Council for Europe and the Confederation of British Industries.

This report is split into two parts representing the work of the two project groups.

Course Members

Name	Functional Area	Company
J.D. Ballardie	General Management	Charter Consolidated Ltd.
R.J. Biddulph	Production	International Combustion Ltd.
P.C. Callow	Purchasing	Humber Ltd.
C.B. Daniell	Marketing	Van Den Berghs Ltd.
D.T. Delaney	General Management	Delaney Estates Ltd.
J. Plumpton	Marketing	Formica Ltd.
V.V. Ranade	General Management	Albright and Wilson Ltd.
J. Van Ingen	Accounting	Moore, Stephens Ltd.

EUROPEAN TOUR

Objective

During the two week tour of Europe, the group studied the effect on the marketing policy of the firms visited of the development of the European Economic Community.

Background of the visit

The group visited the following countries and companies and were spoken to principally by the individuals shown:-

	Company	Product	Personnel
France	Berliet	Heavy vehicles	P.R.
	Rhodiaceta	Synthetic fibres	P.R.
	Black and Decker	Power tools	M.D.
Germany	Volkswagen	Motor vehicles	Export Merchandising Manager
Holland	Shell N.V.	Oil products	P.R.
	Pakhuismeesteren	Wharfingers	Director Coastal Shipping
	Phillips N.V.	Electrical products Industrial and Consumer	Merchandising Co-ordinator
Switzerland	Sulzer	Heavy engineering	Technical Liaison
	International Watch Co.	Watches	Advertising Mgr.
	Bally Arola	Shoe Retailers	M.D. P. Assistant
	Banks		
Switzerland	Swiss Bank Corp.		Director
Belgium	Krediet Bank		Area Manager

Officials

British Ambassador to the Hague
Export Credit Council - Holland
Representatives from the E.E.C.

It should be emphasised that the group's views can only reflect the information they obtained from the individuals whom they met. Most of these individuals were drawn from the middle management of companies and their views may not be fully representative of the top management of the companies. It should be noted also that a considerable number of the individuals were drawn from the public relations departments of the businesses and not from the operating units.

Business Atmosphere in Europe

In spite of comments made both in France and Switzerland about the slowing down of business activity, the impression received was of general prosperity throughout the companies visited. Even in France much new construction work was to be seen. The only universal problem appeared to be a serious lack of both skilled and unskilled labour. In Germany, labour is being imported from Turkey, Greece and other Mediterranean countries. In Switzerland, with a population of seven million, there are nearly one million working people whose home is not in that country. Only in France did the labour position seem slightly better, partly due to the return of the Europeans from Algeria and to the fairly free movement of labour from French North African territories.

Current E.E.C. Position

At the moment, internal tariffs are 20% of the levels at which they stood when the E.E.C. was formed and it is still anticipated that by the 1st January, 1967 there will be no internal tariffs and standard external tariffs within the Common Market. Progress on harmonising legislation applying to trade and industry within the E.E.C. (such things as safety regulations, labelling, contracts, etc.) has not moved quite so quickly but it is hoped that if and when the present crisis can be resolved, swift progress can be made in these areas.

Any comments made by the group about the E.E.C. are based on the assumption that the present disagreement between France and the other five member countries can be resolved in such a manner that the E.E.C. remains an organisation in roughly its present form.

Impression of Member Companies

The following are impressions made on the group about member companies visited and their attitude towards the E.E.C.

VOLKSWAGEN - Manufacturers of cars and light vans

Basic information: During 1964 Volkswagen made 1.4 million vehicles. It holds 33% of the domestic German market for passenger cars. It exported approximately 400,000 vehicles to America, including the United States, and 320,000 vehicles to Europe.

It should be noted that within the European figure sales to countries within the E.E.C. are falling, while sales to countries in E.F.T.A. are rising.

Attitude to E.E.C.

Volkswagen clearly did not consider the whole of the E.E.C. as their home market. The reduction of tariffs was regarded as an incentive to sell within the Economic countries and little more. In fact, selling Volkswagens in France appears to have been 'written off' by the company after some unfortunate experiences.

A major motive appeared to be fear of the big American manufacturers. General Motors are being successful in increasing their share of the German market and there was some talk of the possibility of combining with Mercedes to form a combine strong enough to resist American competition. It may be significant that none of the executives concerned appeared to have considered combining with a French or Italian manufacturer.

The company appears to be basically product orientated except, possibly, in the United States. Much of their success throughout the world must be attributed to their extremely efficient after-sales service.

BERLIET - Makers of heavy lorries, buses, diesel engines, etc.

Basic Information: Will make 18,000 vehicles in 1965. Holds just under 50% of the French market for heavy lorries. Is just entering the market for lighter vehicles (5 tons). Subsidiary companies handle exports and are principally based in the French African territories, Spain and Portugal.

Attitude to E.E.C.

The E.E.C. has caused Berliet to be seriously worried about competition from Mercedes within the French market. In order to meet this competition, there was talk of a merger with another French manufacturer of heavy vehicles, such as Unic. Once again, no consideration appeared to have been given to combining with a German manufacturer of similar vehicles, if this should be necessary.

The Company clearly regarded France, and not the whole E.E.C., as its home market. As recently as the spring of this year when it launched what was believed to be a revolutionary new vehicle, the Stradair 5-ton truck, no attempt was made to promote the vehicle outside France although there was considerable promotion within the country.

SULZER - Heavy engineering

Basic Information: Sulzer, although they have large works at Winterthure, primarily rely on their designing ability for their heavy engines and other products. Use is made of these designs by licencees all over the world.

Attitude to E.E.C.

The E.E.C. in these circumstances has not affected Sulzer. However, they appear to be worried by the increasing nationalism of, particularly, France which may select a French-designed engine in preference to a Sulzer product for reasons other than purely those of efficiency and economics.

Incidentally, Sulzer have just perfected a new type of loom which operates without a shuttle. This was a product of 30 years development.

SHELL N.V. - Oil

Basic Information: No hard information was obtained about Shell's particular position within the Market but there is considerable confidence that world demand for energy based on oil will increase over the next ten years to a major extent. Shell's own forecast of the world oil requirements in 1964 and 1975 is shown below. These figures are in hard coal ton equivalents.

1964	1,700,000	45%	Oil
	1,200,000	33%	Coal
	700,000	19%	N. Gas
1975	3,050,000	52%	Oil
	1,500,000	26%	Coal
	1,050,000	18%	N. Gas
		1%	Nuclear

Attitude to E.E.C.

Shell and, one understands, the other oil companies, are extremely sensitive to the development of the E.E.C. There are two major problems:

1. There is a desire on the part of Germany and Belgium to protect their coal industries since neither of these countries has indigenous supplies of oil. Also, France appears to want to protect the Algerian oil production.

2. Most countries wish to have oil refineries within their boundaries and therefore there is a tendency to apply tariffs to finished and sem-finished oil products. Since large refineries are more economic than small ones and world demand for different fractions of the crude oil is not always consistent with the way that the oil breaks down on refining, Shell would like free trade in crude oil, semi-refined oil and all oil products throughout the world.

Even in Switzerland there is a move to set up a refinery within the country rather than to continue to import finished products.

PHILIPS - Electrical Goods

Basic Information: This large international electrical combine has interests throughout the world, except behind the Iron Curtain but 78% of its turnover is in Europe and a further 13% in the Americas.

The company is organised by product divisions (lighting, domestic appliances, radio, T.V. and record playing equipment, electron tubes, industrial components, electro acoustics, tele-communications and defence, industrial x-ray, pharmaceutical and chemical products, allied industries and glass, and music). These product divisions are directly responsible to the board of management. Also responsible to the board of management are the national management in each case. Both lines of responsibility appear to have accountability to some degree for profit and loss.

This organisation would seem difficult to operate but it is made easier by co-ordinators.

Attitude to E.E.C.

The responsibility by product division has undoubtedly led to Philips being a company which has taken most advantage of the conditions likely to apply in the E.E.C. The management of Philips are talking freely about rationalising production of certain goods in certain countries and have recently launched a new product throughout Germany and Holland using an identical product, advertising, merchandising material, etc. This appreciation of the E.E.C. may have been helped by the long term planning over 4 to 10 years carried out habitually by this concern.

BLACK AND DECKER - Power Tools

Basic Information: Black and Decker, France, is in effect, a subsidiary of Black and Decker, U.K., which, in its turn, is wholly a subsidiary of the United States company. The operation in France appears still to be fairly small, although no turnover figures were available.

Attitude to E.E.C.

Concern policy appears to be to set up subsidiary units including some production facilities in each country in Europe. Subsidiaries were set up in 1957 in Belgium, 1959 in Holland and Germany, 1961 in Switzerland and Italy.

There appears to be little interchange between the subsidiaries but about 80% of the parts and finished products sold in France were bought in the U.K. It would seem that there must be good reasons why Black and Decker have not rationalised their European production in one plant, thereby getting the economies of scale.

RHODIACETA - Synthetic Fibres

Rhodiaceta is a subsidiary of the large French chemical combine, Rhone-Poulenc S.A. It is the largest producer of synthetic fibre in France and is comparable with Courtaulds in the U.K.

Attitude to E.E.C.

The company is one of a number of subsidiaries in Europe making synthetic fibres. These companies are in Germany, the Low Countries and Italy. The subsidiaries gradually undertake more and more of the production of synthetic fibres as the demand for their products grows. It would appear a matter of concern policy that subsidiary companies are set up within the national boundaries of the E.E.C. countries rather than new boundaries being allocated regardless of national boundaries where it may be most commercially desirable.

Rhodiaceta appear to be seriously worried by competition from Dupont, who have established a new plant for synthetic fibre in South Germany, and from Courtaulds.

INTERNATIONAL WATCH - Watches

Basic Information: Makers of high class watches, sales represent .01% of Swiss watch sales, but 2% or 3% of sales by value. This company has achieved a steady 3% growth since the early 1950's. It is a privately-owned concern and few figures are available about its production.

Attitude to E.E.C.

The marketing of these very high class watches is not affected by the tariff barrier round the E.E.C., the maximum tariff being 3.5 D.M. a watch and the minimum price about 350 D.M. without tariff. The tariff is not, therefore, significant. The inhibition on sales in this company is the limited number of people prepared to pay the sort of prices charged for watches of this quality and the difficulty of obtaining skilled labour.

BALLY AROLA - Retail shoe company

Basic Information: This company is a subsidiary of Bally A.G. and operates 90 retail stores all within Switzerland. The concern buys about 80% of its stock within the Bally group. The long lead time on shoes makes the fashion shoe business difficult. Bally reckon with the fashions for shoes have to be made two years before they are in the shops and firm production orders placed nine months before. However, fashion shoes only represent 20% of their sales in Switzerland.

Attitude to E.E.C.

Since this is a retail company, the E.E.C. has not directly affected

Bally Arola. However, it is interesting that Bally are rationalising their production within E.F.T.A. particularly because of lower production costs in Austria and partly because of restrictions on imported labour in Switzerland. Recently, all Bally ski boots production was transferred.

Conclusions

Based on the relatively small number of companies visited and the short time spent with each and also because of discussions with various officials, banks, etc. the group came to the following conclusions:

1. that the majority of concerns within the E.E.C. have not yet come to regard the E.E.C. as the whole of their home market.
2. the E.E.C. will achieve nil internal tariffs and common external tariffs on or not long after January 1st, 1967.
3. the biggest inhibition to internal trade within the E.E.C. is not tariffs but variations in national regulations and design requirements.

Effect of these conclusions on British industry

1. If these conclusions are correct, it is highly desirable that the U.K. should start to harmonize its regulations concerning safety, labelling, etc., with those being developed by the E.E.C. so that if at some future date the country joins the Common Market, manufacturers will not be inhibited from taking any advantage from tariff reductions by design regulations.

2. Although price is always important in selling goods, it would seem to be less important in selling goods in Europe than providing designs which meet consumers' needs and are aesthetically pleasing. In fact, it should be possible to sell goods over the tariff wall provided they meet the consumers' requirements.

SOME FACTORS INFLUENCING THE GROWTH OF INDUSTRIAL INVESTMENT IN EUROPE

Objective

This report deals, in broad terms, with:-

1. The sources of investment funds
2. The incentives to invest in expanded industrial capacity
3. The rate of growth of industry generally in the 5 countries - France, Switzerland, West Germany, the Netherlands and Belgium - visited by us during a 2 week tour ending On 27th November, 1965.

During this tour visits were made to some 16 firms and organisations, ranging from a large motor vehicle manufacturer to a chain of retail outlets for footwear, and from a continental based Company with world wide ramifications to the subsidiary of a U.S. manufacturer of powered hand tools.

The outlines of this report were determined by us prior to the tour; in the event, much of the information which we should have liked to obtain was not forthcoming for a variety of reasons - but mainly because the companies visited were for the most part private in character, and it is understandable that the executives with whom discussions were held were unwilling, or had no mandate, to divulge financial data; we also found that officials with whom discussions took place were often unable to deal with more specific points of company financial, investment; and taxation policy which we wished to explore.

But we were able to glean useful information in some countries from bankers and other sources, and we found that the reputedly secretive attitude of continental bankers has been overstated; short of providing stock market tips they were most informative and helpful. Naturally we found this lack of direct information on company operations unfortunate from our point of view, but there are lessons to be learned from our experience:

1. questions to be examined in foreign countries should be researched before departure from the U.K. A wealth of information is already available here.

2. an effort should be made to determine not only what information is to be sought abroad, but also what information the companies and individuals to be visited will be in a position to provide.

On this point, it should be recognised that accounts published by even large public companies on the continent are not designed to give information in the detail we are accustomed to, and indeed in most of the countries visited consolidated accounts are not required by law (although this will be changed in W. Germany after 1st January, 1966). By way of contrast, accounts published by Volkswagen are highly informative and provide a quantity of statistical data often not given by U.K. or U.S. companies in their annual reports. However, in the limited experience of our recent tour the Volkswagen position was quite exceptional.

There is evidence that European companies are beginning to recognise that this attitude of secrecy is not in keeping with present day trends and are increasingly tending to prepare annual reports on a basis more familiar to us in the U.K.

Our impression is that Switzerland is likely to lag behind in what is likely to be, in most of the countries, a slow process. This is felt to result from the tradition of secrecy surrounding all financial operations in that country - by 'gnomes' or otherwise - and whilst we would certainly not presume to criticise, it did appear unusual to us that a country regarded as one of the most stable financial centres of the world, and in many ways so progressive, should maintain this attitude in view of trends elsewhere.

In dealing with the question of growth of industrial capital investment in the countries visited we have had in mind particularly the financial incentives offered to British industry to encourage modernisation and expansion of plant. It is well known that investment allowances enable an industrialist to charge 130% of the cost of new plant and machinery against profits, with substantial tax reliefs in the first year of ownership. Indeed, a project set up in a Development area qualifies for accelerated tax reliefs which may be taken wholly in the first year of ownership. These are in addition to direct grants which may be obtained from the Board of Trade for 25% of the cost of new buildings and 10% of the cost of new plant for projects set up in Development areas.

It has been said that British firms have not made good use of these advantages, and we wished to establish whether, in view of the greater increase in productivity achieved by certain continental countries - notably W. Germany - during recent years, the fiscal policies of the various governments had been such as to account for this trend. In fact we found that the policy of our Government on these matters and the encouragements referred to above were regarded as exceptionally generous by industrialists we met on the continent.

Every country in Europe is attempting to increase its Gross National Product and the most direct way of doing so is to increase capital investment. The correlation between these factors is of importance. An O.E.C.D. paper has shown that between 1.72 and 2.63% of G.N.P. needs to be spent on capital investment in order to produce a 1% increase in the G.N.P. Thus, Belgium with a G.N.P. growth rate of just over 4% p.a. has a capital investment growth rate averaging about 10% p.a.

There are however other factors influencing the effect of investment on G.N.P. It is generally estimated that replacement investment to offset the scrapping of existing assets is about 10% of G.N.P. - although replacement requirements might be much less than this for fast growing economies. While investment in buildings has a degree of growth potential in terms of G.N.P., it is investment in plant and machinery which produces by far the greater growth. Desirably, at least half of total capital investment should be of this nature in order to provide impetus to the economy.

In an endeavour to trace the trend of capital investment by industry in Europe in recent years, we have compared national rates of capital investment with G.N.P., and we have reviewed these figures for each of the countries visited dealing with them under our comments on the respective countries. The G.N.P. per capita, and the capital investment per capita for the U.K. and the five countries visited are shown graphically for recent years in which figures are available in an appendix to this report.

France

In December, 1958, a Committee of Experts reporting to the Minister of Finance and Economic Affairs stated:

'For many years, all French problems will be problems of investment.'

In the light of this comment, figures relating to G.N.P. and capital investment are interesting - during the years 1960-64 G.N.P. rose by 46% while capital investment as a % of G.N.P. increased from around 18% to 21½%. The demand for capital has been increased by the rapid upward trend in the rate of growth of the French economy since the war and by investment priorities established by the French Economic Plan. Self-financing covered 72% of capital investment in 1959 but decreased steadily to 64% in 1962. We were told at Automobiles M. Berliet - largest manufacturer of heavy commercial vehicles in France - that they were still self-financing for about 90% of their requirements although we saw ample evidence of recent and extensive capital expenditure. Rhodiaceta - part of the Rhone Poulenc chemical group - were, according to their spokesman, still wholly self-financing.

Generally, issues of securities cover 40-45% of total outside long-term financing. The growth of long and medium term loans and credits has increased at a much faster rate than the issue of securities, and has more than doubled since 1960.

France has an inadequate supply of equities, partly due to the fear by majority shareholders of loss of control, and partly because the withholding tax on dividends at 24% compares unfavourably with that on bonds at 12%. In addition lack of information on corporate activities has been an inhibiting factor, as also has the cost of floating equity issues. An interesting point in French financing is the use made by the Steel industry and by a number of small and medium sized firms of so-called 'group issues' when several firms in an industry jointly raise funds.

Under the French Economic Plan, state grants of medium or long term loans may be obtained and direct investment encouragement may take the form of a reduction in the long term money rate for bond issues. There are also procedures whereby 50% tax exemption on certain new stock issues may be obtained, as well as partial exemption from taxes in the interests of industrial regrouping. There are also favourable financial terms aimed at encouraging a particular activity, or the development of a specific region. Special areas exist in W. France where plant and equipment premiums of up to 20% of cost may be granted.

The normal write-off period of depreciation for tax purposes is over 20 years on a straight line basis for buildings, and over 5 years for plant of which 40% may be written off in the first year; certain specific items may be written off over 2 years.

With Government consent, larger companies are able periodically to revalue their assets and revise or recommence depreciation write-offs on new net values; this was last allowed in 1962.

Switzerland

Much of industry in Switzerland is privately or family owned, and even large public quoted companies may have predominant family interests in control. The federal system concentrates much governmental power in the hands of the cantons and this tends to obscure much data which would have enabled us to gain a more complete view of industry as a whole.

G.N.P. figures indicate a growth of 50% since 1960 whilst figures for capital investment are indicative of the highest level of investment which we found in the countries visited; in fact an increase from around 23% in 1960 to 28% in 1963. However, because of internal measures taken last year to combat inflation we would not expect to see the level of capital investment continuing to rise at the same rate in 1964 and 1965.

The conclusions drawn from these figures confirm our own observations made during visits to Swiss factories - one concerned with the watch industry, and a second to a heavy engineering works. The bulk of the buildings plant and equipment seen was modern, and up to date manufacturing techniques, short of automation, were being used. According to spokesmen it is not expected in either of these plants that fully automatic techniques can be adopted to any great extent, but this outlook cannot be regarded as representative of Swiss industry generally. However, the fact that it has been necessary to expand the labour force by bringing in Italian workers seems to confirm the present intensive use of labour in many areas of Swiss industry. The fact that about 25% of labour is Italian in origin has created socio-economic problems which led to a federal decree in 1964 having the effect of limiting very strictly the admission of foreign labour.

The general labour shortage now being experienced should provide a powerful incentive towards capital investment.

Swiss firms tend to be self-financing to a very major degree and this arises no doubt, as the result of strong family influences which make profit retention more acceptable. Since it is possible to obtain full relief against taxes within the year in which capital expenditure is incurred, this materially assists self-financing. Recourse is also had to loans raised on the capital market and from banks - although the latter are generally short term by nature and used mainly on a revolving basis for financing of stocks. However, a shortage of capital has developed - evidenced by higher interest rates - due to an increasing demand for finance to permit the replacement of labour - intensive equipment by more costly labour-saving equipment.

Under present day conditions, Swiss industry is tending to move away from self-financing towards the raising of loan capital. We found little evidence of any trend towards equity issues, and a reason advanced by bankers for this is the existence of a form of capital levy encouraging secrecy as to a company's financial affairs, which if divulged publicly, might cause an upward movement of market prices of equities, thus involving shareholders in a greater burden. It is noteworthy that firms are permitted to invest in their own businesses that part of the contributions to employee pension funds which firms make themselves - judging by the figures we have seen the amounts involved may be quite substantial, and certainly this source of finance is commonly used.

Taxation rates vary from canton to canton and there is in addition a federal tax levied on companies which is limited at its top level to 8% of profits. There are 25 cantonal tax systems each differing from others and from the federal system; there are further variations by communes within each canton. The highest cantonal rate is 22% on profits but rates are as low as 2% in other cantons; however the latter are cantons with sparse populations and in which industry is unlikely to be located.

Federal German Republic

The rate of capital investment as a % of G.N.P. averaged about 22% during the late 1950's. Thereafter it continued at a rather higher rate rising to 26% in 1964.

W. Germany has made a remarkable achievement in face of the vastly reduced industrial capacity with which it was left after the cessation of hostilities in 1945. At that time there was virtually a complete lack of capital available to industry, and finance for new capital investment had necessarily to be provided out of retained earnings and revolving bank credits. There are many reasons for the emergence of this pattern at the outset and for its continuance through the years -

of major importance has been the need to finance a long term building programme, including housing, which has caused funds to by-pass the capital market to which industry would otherwise have had access. In turn, the demand for money for the construction programme has been large, and has caused high interest rates which have been unattractive to industry. Thus industry has followed a self-financing policy made possible by a high level of profits and special tax incentives. However, the situation has changed during the last 2 or 3 years, and the proportion of self-financing in relation to total investment capital projects has declined by some 14% - emphasising a trend which became evident somewhat earlier.

The case of Volkswagen, which we visited, differs somewhat from the general pattern inasmuch as during the years up to about 1960, when the question of its ownership was finally resolved, the firm retained the whole of its profits and used them to expand production facilities and techniques. Today, Volkswagen has some long term debt raised since 1960, but policy is to finance as far as possible from retained earnings the vast annual capital investment programme which continues.

Industry has made use of short term credits given by banks and other institutions on a revolving basis and this form of financing appears to have accounted for about half of new capital required; obviously there have been fluctuations in the total advanced but this source has been especially important during periods of rapid growth. However, the banks are loathe to provide long term credits and the present need to consolidate short term indebtedness is likely to lead to a substantial increase in the demand for long term capital from the capital market. It is said that, as a consequence, German companies tend to be under-capitalised.

In the sense that special and accelerated depreciation allowances, which qualify for tax relief, are available against investments in fixed assets, the Federal Government does offer some incentive to invest; however, these allowances have declined quite considerably in value since the early post-war years, but this has not affected the rate of new capital investment so far. The rebuilding of industrial capacity since 1945 has ensured that plant and equipment in factories is at least modern if not always fully automated and for this reason the policies of the Federal Government cannot be expected to incent industry to the same extent or for the same reasons as may be desirable in the U.K.

We suspect that, as elsewhere, inflation (and wage inflation particularly, as cheap labour originally came from the East and more recently from the South becomes absorbed into the general wage structure) will tend to erode profit margins and cause industry to compete more actively for funds from the capital market.

Holland

G.N.P. increased by some 41% between 1960-64, whilst as a % of G.N.P., capital investment increased steadily from 22% in 1960 to 25% in 1964.

Holland, the most densely populated country in the world, is now becoming increasingly industrialised while retaining an intense agricultural sector. Foodstuffs are still the second most important export and account for 30% of the total.

Dutch industry appears to have access to a fairly well developed capital market, which is however controlled to a large extent by a flexible governmental fiscal policy, very similar to fiscal controls adopted in this country, e.g. bank rate, open market operations and cash reserve policies.

Unfortunately our visits to business organisations in Holland were restricted to Philips at Eindhoven, Shell N.V. in Rotterdam, and Pakhuismeesteren also of Rotterdam. Both Philips and Shell are of course international organisations, and it is unfortunate that we were unable to glean financial information during our discussions. Pakhuismeesteren is a large warehousing and shipping organization with interests outside Holland. It employs substantial capital resources, but is family owned and hitherto has been self-financing; however, it has now reached such a size that much thought is being given to methods of raising capital in the future.

Our impression is that self-financing is somewhat less in vogue in Holland than elsewhere in W. Europe, and in any event we would expect financing in future to be carried out increasingly along the lines traditional in the U.K. As is well known, both Philips and Shell expend substantial financial resources each year and a large part of the funds required is available from international capital markets. Whilst by nature of the substantial amounts required such companies cannot make capital issues at frequent intervals, it is clearly beyond the capacity of giants such as these to finance their activities without recourse to the capital markets at least once in every decade.

The Dutch and British tax systems have marked similarities. The Dutch standard rate of tax is 45% on profits and various forms of accelerated depreciation and investment encouragement are given. Such encouragements can be, and are varied according to government policy from time to time. Similarly, various measures are taken by the government to encourage industry to areas other than the now heavily developed western coastal region.

Belgium

In Brussels, we visited the Krediet Bank, and discussed certain aspects of the E.E.C. with officials of that organization. We did not visit any trading companies and our comments are therefore rather general in nature.

During the 5 years to 1964, G.N.P. increased by 34% whilst over the same period capital investment as a % of G.N.P. increased from 17% to about 22½%.

As elsewhere, a characteristic of Belgian industry is that it has been very largely self-financing. During 1959-62, gross savings of business ranged between 88 and 106% of their total investments. This compares with France where the % has declined over the same period from 72 to 64%. The family ownership of many Belgian companies has reinforced this trend towards self-financing, as has the preference for liquidity. It follows that where external funds are required, securities suffer from lack of marketability, and although the pressure on banks and other financial institutions for loans - other than for short periods - has not been great, loans are relatively speaking a more important source of finance for Belgian companies than for their British counterparts in the past.

The prosperity for self-financing in Belgium is changing; the slower growth of the Belgian economy compared with its continental neighbours in recent years has been said to be the result of lack of private investment. The rate of stock issues and of recourse to financial intermediaries such as banks, has increased - and so have interest rates. In addition the lack of private investment has prompted the Government to make special concessions to give incentives to this activity.

In July 1959 for instance, two laws were passed, one to encourage investment by industry in general and the other to help investments in areas which were economically backward. Basically, under these laws, the state will consider granting a 2% rebate on interest charges on loans obtained to finance investments. This helps to account for the rise of £125 M in capital investments between 1960 and 1961. With the exception of development areas, this form of aid was restricted in 1964, and it is anticipated that the rate of capital investment will be lower in 1965.

Belgian tax rates are moderate in comparison with the U.K. with a standard rate of 30% plus 5% extra on retained earnings. This is one of the factors encouraging foreign companies to set up overseas operations in Belgium. Indeed it was reported to us in Switzerland that a number of foreign concerns were transferring their European offices from that hitherto most favoured nation, to Belgium. Although strictly outside the ambit of this report, it is obvious that the formation and growth of the E.E.C. reinforces the trend towards investment in Belgium as compared with Switzerland and the U.K. Nearly 40% of Belgium's total production is exported; it is therefore essential that its goods be produced competitively, and this in itself provides a further incentive towards investment in modern equipment.

Conclusions

Perhaps the feature which made the greatest impact upon us when we came to consider the background to the growth of industry in Europe in recent years, is the extent of self-financing undertaken in relation to capital investment. With this feature is allied the relatively few equity issues quoted on stock exchanges in Europe as compared with the large number of companies of all sizes quoted on United Kingdom stock exchanges. In analysing these peculiarities we conclude that the proportion of profits paid out as dividends by European companies is relatively low and that this accounts in part for the very low yields obtainable on equity securities; on the other hand, substantial plough-back of profits tends to increase equity values and again accounts for low yields. Whether or not this system always encourages optimum capital investment from the point of view of individual national economies is open to question, but it does, we feel, account to some extent for the shortage of capital which is now being felt by the countries which we visited. Obviously encouragement will have to be given to greater diversification in investment, and capital markets must adapt themselves to provide resources for the balanced growth of industry. The trend today is away from self-financing and on the assumption that this may lead ultimately to larger dividend distributions relative to profits, this trend may lead to less restricted capital markets able to provide resources at reasonable rates to well-conceived enterprises. In theory at any rate, this is the cornerstone of the United Kingdom capital markets which we feel offer vastly greater flexibility of sources to domestic industrial organizations seeking new money.

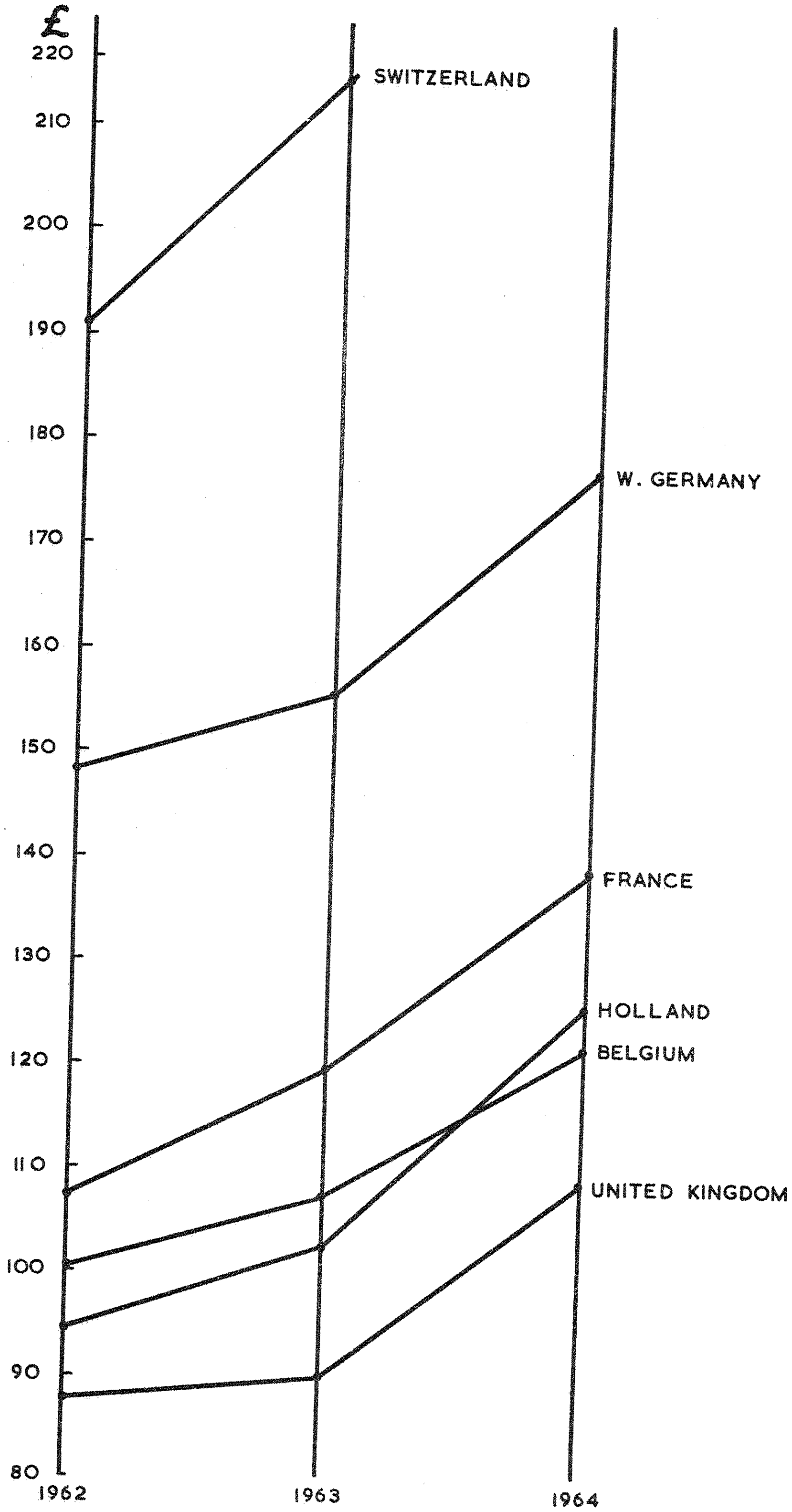
We do not pretend to have seen even a representative cross section of European industry during our very short tour and we accept that we may well have come into contact with more aggressive and modern industrial organizations than exist generally in the countries visited. Given this proviso, however, capital investment has proceeded at a rather more rapid pace than has been the case in the United Kingdom. At the same time we did not discover any direct evidence that modern techniques of evaluating capital projects are used to any major extent and indeed the remark was made more than once in discussions - 'If we need it, we buy it'. However, in all countries there was a sense of the need to reduce the labour content of production processes, and thus costs.

As far as we could discover taxation appears to have little direct influence upon investment decisions, although we suspect that the liberal depreciation allowances available in certain countries, for example, Switzerland, do have a bearing in this direction. One point upon which we have not yet touched is that in most of the countries visited it is possible for firms to do a deal with local authorities when they wish to set up or expand a factory in the local authority area; the latter is often willing to transfer land at a reduced sale price as an encouragement to the expansion of industry in its area - and will remit local taxes for a period until the new undertaking is firmly on its feet. It remains to be said however, that the areas in which this can be done are often unattractive from a labour or other viewpoint.

Finally, European countries have been able to raise their national incomes to a greater extent than has been achieved in the United Kingdom. Undeniably this is due in part to labour productivity being higher in Europe than it is here - for this, there are many reasons which are beyond the scope of this paper. At the same time, it is clear that a higher gross national product is materially dependent upon a high level of capital investment and this we suggest is fundamental to greater future achievements in United Kingdom industry.

APPENDIX 'A'

CAPITAL INVESTMENT (£) PER CAPITA



APPENDIX 'B'

GROSS NATIONAL PRODUCT (£) PER CAPITA