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SYMPTOMS OF AN INFECTION

– *This is what business leaders think about
19 elements of Finnish competitiveness*

SUMMARY

Finland's competitiveness is being weakened by an infection. When competitiveness is divided into 19 elements, corporate decision-makers think that only five of them can be regarded as strengths in international competition. Only two are expected to get stronger compared to our main competitor countries. Most of the competitive factors are expected to deteriorate in the next few years.

EVA measured the elements of competitiveness in a survey answered by 1 260 business leaders. The survey is based on a study by Harvard Business School (2011).

The results indicate that Finland's main strengths are property rights and the pre-university education system.

By far the greatest problem is deemed to be labour market rigidities in hiring new workers. Wages are not flexible enough with respect to productivity or market conditions. On the other hand, the government's recent decision to reduce the corporate income tax was exactly what business leaders had indicated they wanted to see when responding to the survey.

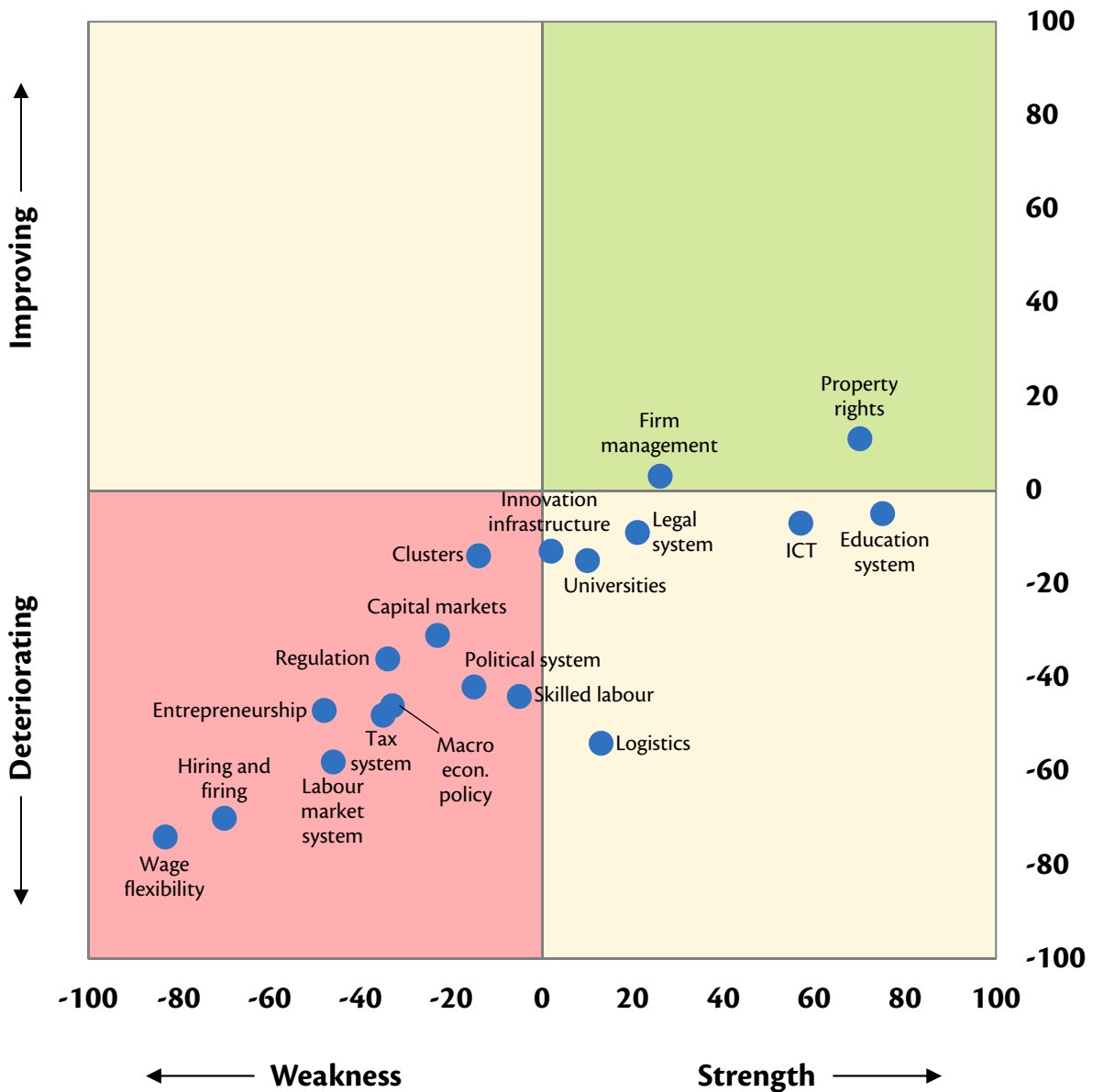
Large companies see the situation much more positively than small ones. Companies with operations abroad think the situation is better.

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Figure 1 Finnish elements of competitiveness compared to advanced western market economies, %



EVA's survey on competitiveness is based on a study by Harvard Business School (2011). The survey has two identical sets of questions, the first of which measures the current situation while the second focuses on the future. The results of these sets of questions are synthesized into a single graph.

The first set of questions related to what respondents think about 19 elements of Finnish competitiveness compared to "other advanced western market economies, such as the other Nordic countries, EU countries or the United States." The possible answers were much better than average, slightly above average, average, slightly below average and much worse than average.

For each question the answers in the first two categories and the last two categories were added together. The shares of these two groups of categories were then calculated as percentages of all responses. Finally, the sum of the "above average" group was subtracted from the "below average" group. Thus we derived the ranking of one of the elements of competitiveness plotted on the horizontal axis.

In the second set of questions the respondents were asked to evaluate the same elements of competitiveness in the future. The options were *gain in competitiveness, no change in competitiveness or loss of competitiveness*. The responses were calculated in the same manner as for the first set and the responses

to the second set of questions were plotted on the vertical axis of the graph. The dots in the graph indicate the intersection of two coordinates.

The horizontal axis represents the present moment while the vertical axis depicts future development. The farther to the right a dot is in the graph, the stronger the respondents consider the element to be at the moment. The further to the left a dot is in the graph, the weaker the element is deemed to be.

Similarly, the higher up a dot is in the graph, the more the respondent thinks the element will strengthen in the future. The lower the dot is located, the more the significance of the element is expected to deteriorate.

The closer the dot is located to the centre of the quadrants, the more average the element of competitiveness is judged to be. This does not mean that the element would be meaningless, but rather that Finland is unlikely to gain or lose competitiveness relative to its main rivals.

In other words, Finland's success factors are located in the upper right quadrant. The lower right quadrant depicts deteriorating strengths. The upper left corner indicates the elements which are currently in need of attention, but are expected to improve in the future. The lower left corner is comprised of the weak points of competitiveness. This quadrant is in need of decisive and swift corrective actions. The survey respondents were asked to evaluate the competitiveness of the following elements:

Logistics infrastructure: e.g. high-quality highways, railroads, ports, and air transport

ICT infrastructure: high-quality and widely available telephony, Internet, and data access

Tax system.

Education system – includes primary and middle schools, high school and vocational schools (grades 1-12). The question addresses how easy it is to gain access to high-quality education (pre-university) and curricula that prepare students for productive work

Universities: High-quality universities with strong linkages to the private sector

Context for entrepreneurship: i.e. availability of capital for high-quality ideas; ease of setting up new businesses; lack of stigma for failure

Availability of skilled labour.

Flexibility in hiring and firing of workers.

Wage flexibility, i.e. whether wages are sufficiently flexible with respect to the market situation or personal productivity (*not included in the US survey*).

Innovation infrastructure, i.e. high-quality scientific research institutions; availability of scientists and engineers

Regulation: Effective and predictable regulations without unnecessary burden on firms

Strength of clusters, i.e. geographic concentrations of related firms, suppliers, service providers, and supporting institutions with effective collaboration

Quality of capital markets: Ease of firm access to appropriate capital; capital allocated to most profitable investments

Macroeconomic policy: Soundness of the government's budgetary policy and its relationship with monetary policy

Political system: Ability of the government to pass effective laws

Property rights, i.e. protection of physical and intellectual property rights and lack of corruption

Legal system: efficiency of legal framework: modest legal costs; swift adjudication

Firm management: Sophistication of firm management and operations: use of sophisticated strategies, operating practices, management structures, and analytical techniques

Labour market system, which is based on tripartite cooperation between the government and labour and employers' confederations and its impact on collective agreements (*not included in the US survey*)

In addition, open ended questions were asked about the following things:

- What is the single biggest disadvantage that prevents your company (or companies if you work as a consultant) from investing or creating jobs in Finland?
- What do you think is the single biggest disadvantage that discourages investment and job creation in Finland?
- What single change – such as a change in legislation or regulations – would you propose to the EU, government, Parliament or local authorities to improve Finland's competitiveness?
- What single concrete measure would improve your company's competitiveness in Finland?
- What solitary action by corporate management would improve the competitiveness of companies operating in Finland?

Components of competitiveness: the Harvard Model

What are we talking about when we talk about competitiveness? In the public debate, we tend to get only approximate answers to the question of what kind of factors contribute to competitiveness and for which elements of Finnish society is the foundation the softest.

In October–November 2011 Harvard Business School carried out an extensive survey of American businesses (9750 responses), in which competitiveness was divided into 17 elements. The results of the survey were presented in a graph depicting companies' view of the position and trajectory of these elements. The resulting image is thus dynamic: it assesses also future developments.

EVA carried out a local version of Harvard's survey in February 2013. The survey was targeted at Finnish business executives and top management.

The survey was answered by 1260 persons, of whom the vast majority (1160, 93%) were CEOs, the rest being members of the Executive Board, Board of Directors or middle management. Some 493 (39%) of the respondents reported that their companies have operations outside Finland.

A few strengths, a lot of worries

Respondents were asked to take a stand on each of the 19 elements of competitiveness. The Finnish questionnaire included two questions that were not in the American version. The first is related to the Finnish labour market system, which does not exist as such in

the United States. The second relates to wage flexibility or rigidities with regard to the market situation or

Clear strengths emerge only on three points

personal productivity. These issues were thought to be of particular interest locally and this proved to be the case.

The survey results are brutally frank. Finnish companies think we have a clear competitiveness problem.

Clear strengths emerge only on three points: property rights, the education system (primary and middle schools, high school and vocational schools), as well as the ICT infrastructure. Two elements are deemed to be weak or budding strengths: firm management and the legal system.

Eight elements are considered obvious threats to competitiveness. Six elements are estimated to more or less average.

The picture becomes even grimmer when we turn to the future development of these factors of competitiveness. Only property rights are regarded as growing strengths. The development of the acclaimed Finnish school system seems to be levelling off, i.e. it will no longer be generating a new competitive advantage for us. The same is true of firm management practices and the legal system: both are considered to be strengths, but not major sources of competitive advantage.

The rest of the 15 elements are on a downward trajectory, either gradually (universities, innovation systems, ICT infrastructure, regulation, capital markets) or steeply (labour market system, logistics, and wage flexibility).

Anatomy of rigidities

The respondents were clear and decisive about what they think is the main reason behind the weakness of Finnish competitiveness. Some 85% of the respondents indicated that wage rigidity is a clear competitive disadvantage for Finnish companies. Only 2% of respondents disagreed.

Hiring and firing policies, i.e. the low level of flexibility, was deemed to be a burden on competitiveness by seven out of ten respondents. Practices were regarded as good or sound by one in twenty respondents (5%). Wage rigidity and hiring / firing practices were also the areas which were thought most likely to deteriorate in the future.

Wage rigidity is a clear competitive disadvantage

The same view was very apparent in the responses to open ended questions. Wage and employment rigidities were mentioned in the written responses as by far the greatest problem preventing the creation of new jobs in Finland. Some 36% of the responses referred to various forms of labour costs or employment rigidities.

“The current system works during a boom, but if we have to slow down a little bit, that is, putting people on leave or laying them off is as hard as moving a stone wall a metre. It's too much, hurts morale and employees lose their motivation. For this reason, everyone thinks twice before hiring more people,” said one respondent.

“Jobs will inevitably shift to firms offering temporary employees,” predicted another respondent.

Respondents were particularly annoyed by the increase of different types of paid holidays or paid non-work days.

Some 23% of the respondents saw financial problems and the weakened market as the greatest obstacle to new jobs. Taxation was identified in 15% of the responses, about 7% of the respondents saw excessive regulation as the cause.

When assessing the situation of competitive elements, taxation was viewed with nearly as much pessimism as labour market rigidities. In written responses corporate tax relief was a frequently repeated hope (the survey was carried out prior to corporate tax cuts carried out in the budget framework negotiations).

A second open ended question asked for suggestions regarding legislation or regulation reforms by the EU, the Finnish Government, the Parliament or the local authorities. Some 42% called for flexibility in employment relationships. Every third called for tax cuts. Reducing regulatory burdens was mentioned in about a tenth of the replies.

“Don’t do anything. You will break everything if you touch an engine you do not understand,” sighed a cynical respondent.

The third open ended question asked the respondents to present a concrete measure that would improve the competitiveness of the respondent’s company in Finland.

A better balance and fairness was desired in the responses when public and private sectors are competing for the same market. The responses also wished for a better means of opening the public service sector to competition and, for example, expanding the use of service vouchers, i.e., “fair competition”, as well as cutting down on red tape and unnecessary regulation.

The responses reflected a chronic infection that is evident in Finnish corporate decision-makers’ irritableness and feeling that their country’s performance level could be better. This frustration is manifested in a strong distrust in the ability of the political system and labour market organizations to generate solutions to our most urgent problems. The formerly praised Finnish tripartite model is becoming a scapegoat.

On the other hand, the recent significant reduction in the corporate income tax to 20% is exactly the type of measure the respondents were hoping for. This measure should be the right medicine for the anaemic outlook that seems to be afflicting Finnish business life at the moment.

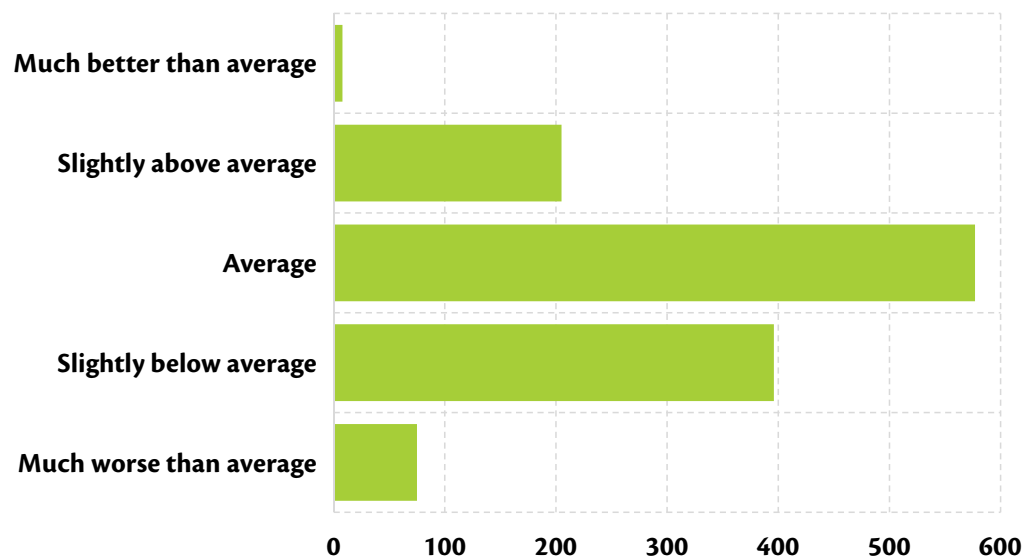
The formerly praised Finnish tripartite model is becoming a scapegoat

Size breeds optimism

The results indicate that the management of large companies have a clear tendency to see the situation – both in the present and in the future – somewhat more positively than their counterparts in small businesses. “Small” refers to companies with fewer than 250 employees.

When comparing the views of large and small entities, the greatest differences are related to regulation, hiring and firing, as well as taxation. Regulatory and tax disadvantages were thus experienced as visibly greater in small firms. When looking into the future the differences even out a little

Figure 2 Compared to other developed economies, would you say that in Finland, the business environment is ... (number of responses, total 1 260)



bit, but the greater optimism of larger companies is primarily linked to the capital markets. This may reflect the small businesses' tight situation in the credit and capital markets. Only in ICT infrastructure development do the large companies have bleaker views than their smaller siblings.

The overwhelming majority of companies that responded to this survey are small or medium-sized. Only about 100 Finnish companies employ more than 1 000 people, but the significance of these enterprises

The greater optimism of larger companies is primarily linked to the capital markets

for the economy and the business community is crucial.

Do the answers change substantially if enterprises' answers are weighted according to their size, i.e., according to the number of employees?

Yes, they do. Figure 3 compares the distribution of all of the responses (one company, one vote) and answers, which are weighted by the size of the companies (based on the number of employees). The figure includes the seven elements for which the

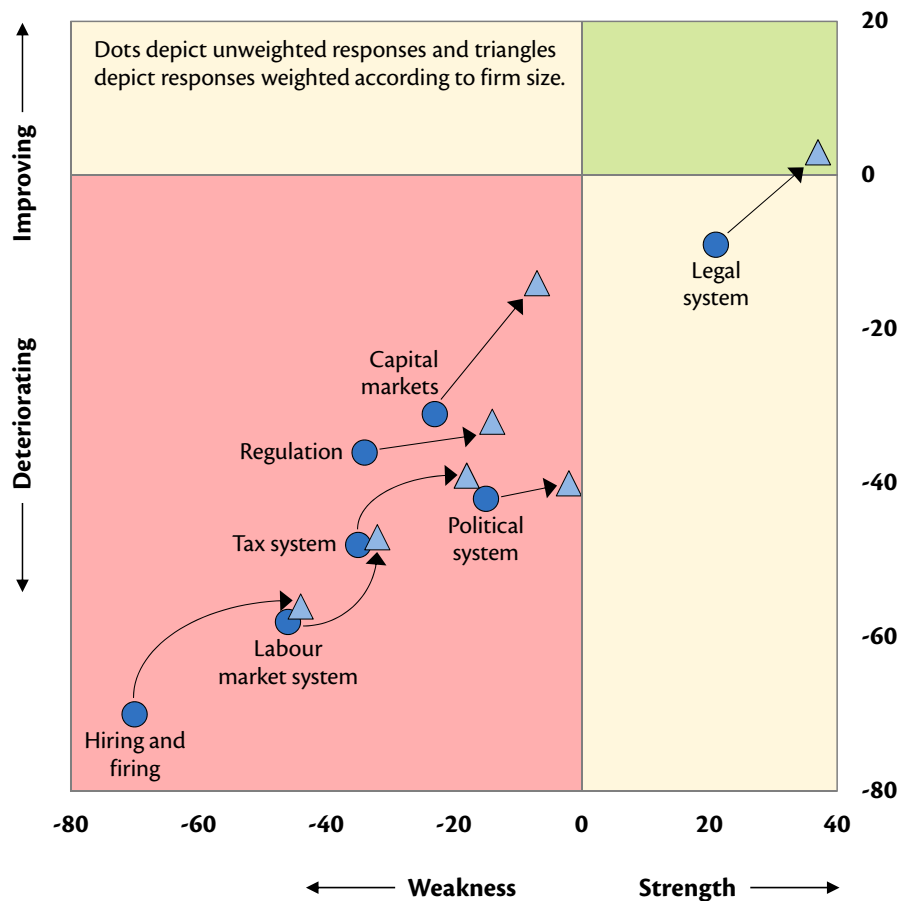
weighting of the size of the company changed the results significantly.

The results show that increased size means increased optimism.

Small businesses experience hiring and firing as a greater strain on competitiveness than large ones, but the views of large businesses cannot be called particularly optimistic. For a small company just one problematic recruitment can be fatal, whereas big businesses have an altogether different tolerance. In large companies global competition also creates a different starting point in the wage policy. Furthermore, in deadlock situations logistic chains can be re-designed and production can be transferred to a foreign unit.

The maligned labour market system is seen as slightly more positive in larger companies than in the smaller ones. The Finnish trade unions have sometimes recognized the significance of large corporations. For example, in some industrial disputes they may be treated as a special case if the industrial action jeopardizes a large company's future investments in Finland.

Figure 3 How answers change when the firm size grows, %



Regulation pressures are felt to be less severe in large companies. Taxation is considered less problematic and even the political system appears to be a little brighter in large companies. The more favourable view of the

Regulation pressures are felt to be less severe in large companies

A small service business owner is much more at the mercy of local and national decision-making.

Even the weaknesses of the justice system are more painful to small businesses. A big company usually has more legal muscle, a better chance to safeguard themselves with experts and lawyers than a small company. A single Administrative Court decision can be fatal for a small company. For large international companies, very few court decisions can be described as being of fatal importance.

It is also not much of a surprise that a large company has an easier time operating in the capital markets. In open ended responses the difficulties of funding were mentioned, as stated before.

On the other hand, a larger company is a former small business, i.e. a business competition success story. It may be normal kitchen sink psychology that winners' views of their environment will have more emphasis on opportunities than obstacles.

International perspective eases anxiety

As a sweeping generalization it can also be said that Finland appears to be a better place for companies that are active also internationally. Pessimism is therefore most pervasive in domestic enterprises or else the foreign experiences of companies operating abroad make them less critical about Finland's shortcomings.

Pessimism is therefore most pervasive in domestic enterprises

Also companies operating abroad ranked seven of the current state of elements more favourably than companies operating only domestically. The main differences were related to logistics, hiring and firing and property rights.

Growing businesses saw current conditions for entrepreneurship as more favourable than the others. Finnish support schemes are designed to foster growth and evidently the results show. Financially sound companies view availability of labour and the capital markets more positively than others.

Capital-intensive companies, however, consider the macroeconomic and legal framework as being less favourable than other companies. They were also the most inclined to believe that these factors will deteriorate in the future.

Pillars and pitfalls of competitiveness

The replies can be grouped into three bunches that could be called "pillars of competitiveness", "hand-brake policies" and "hopelessness of the labour market system"

Corporate management believes that our competitiveness hinges largely on property rights and education as well as the relatively well functioning legal system and modern business management.

Answers to the open ended question about the education system were critical mostly about the theoreticalness and the poor linkage to practical working life, i.e. that the vocational education and training providers "are not familiar with companies' working practices and ways of operating."

"We have to train professionals with academic degrees to be able to work ourselves. It takes 2-3 years, during which time the employee generates losses for the company," remarked one of the respondents.

Corporate executives' views of whether their own business practices are up to date are relatively favourable. Strategic methods and market analysis techniques stand up relatively well to the challenges posed by rival countries.

Corporate executives' perception of the Finnish ICT level is relatively positive, but the future trump card is not really that one either. The future prospects for communications are viewed as being not very bright, which may be affected by the recent discussion on problems with poor compatibility of public information systems. Logistics is still our strength, but its situation is expected to deteriorate.

Toward the bottom of the list are a few well-known suspects: the confederations of labour and employers and the government. The elements most directly belonging within the sphere of politics (effectiveness of the political system, the soundness of macroeconomic policy, effectiveness and predictability of regulations, tax system) constituted a surprisingly tight bundle in the responses. There is widespread cynicism in Finnish business circles about the ability of politicians to solve the problems of competitiveness.

Some respondents wondered about the disturbing, even destructive tone of Finnish political debate. The unholy alliance between politicians and the media

creates a negative atmosphere that undermines faith in the future.

The responses are a wake-up call from one significant group to the political system. This pessimism is affected by the slowness and uncertainty of the government’s economic policy-making – the general perception that the government feels its economic policy mandate is weak and that the disagreements within the government are just too drastic and transparent.

The respondents were asked whether the ability of Finnish companies to compete in international markets in three years will be the same as now, much

/ slightly worse than now or much / slightly better than now. Of the 1 260 respondents nearly two-thirds of respondents (62%) thought that the situation after three years will be slightly worse than at the present time, 148 respondents (12%) thought that the situation will be “much worse”. Only one ultraoptimist was found in the bunch. About one-third thought that the situation would remain the same as now (Figure 4).

A variation of the same question was asked regarding companies’ ability to maintain their current salary and benefit levels three years from now. Most responses were very similar to those for the previous question, but slightly more pessimistic.

Figure 4 Are companies operating in Finland able to compete in the international market after three years ... (number of responses, total 1 260)

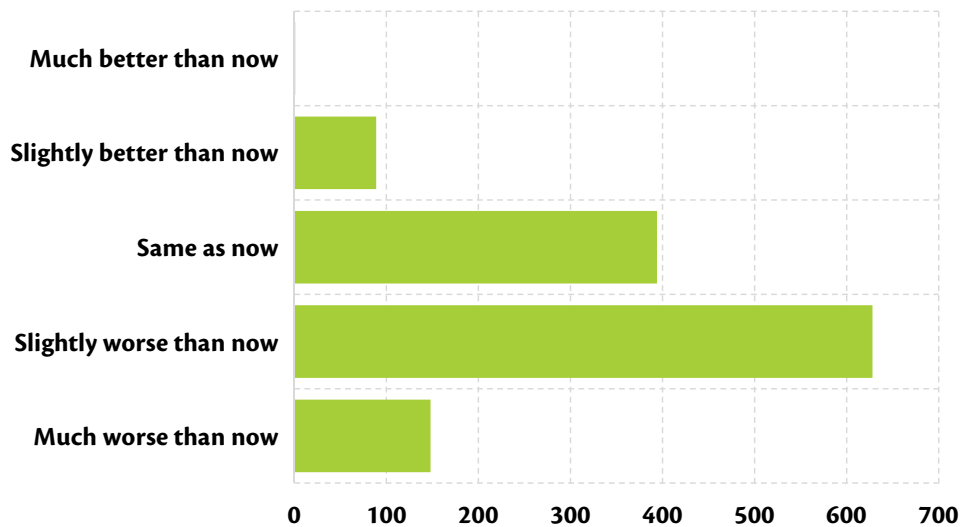
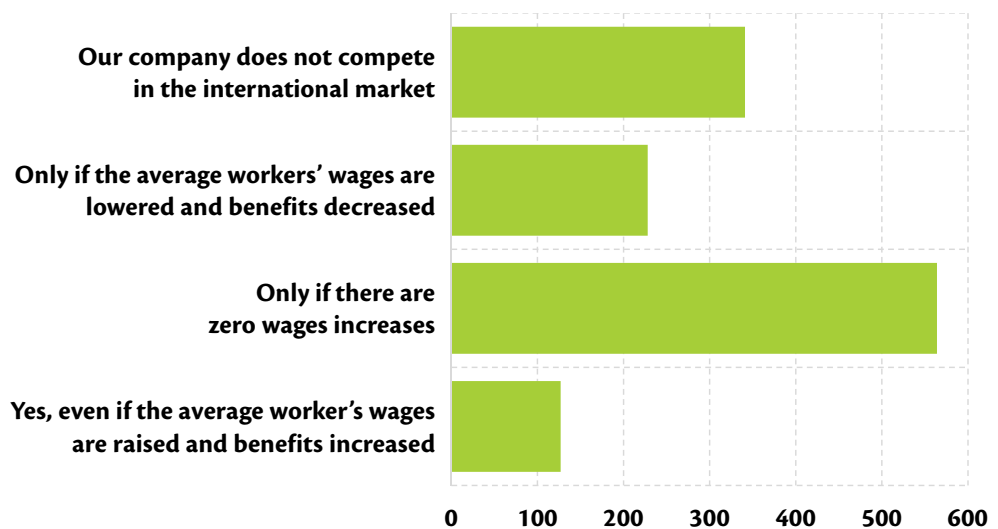


Figure 5 Can your company in Finland succeed in international competition and maintain its current level of employment? (number of responses, total 1 260)



The executives were in agreement regarding the timely debate on wage moderation. Half of the respondents felt that the current level of employment can be maintained in their company only by following a zero wage hike policy. Only about 10% of the respondents thought that the average salaries and benefits of employees can be increased without hurting competitiveness (Figure 5).

Mirror image of Americans

When Finland's results are mirrored against those of Harvard Business School, the basic difference is clear. The dynamism of American society is reflected in corporate executives' perceptions of their own strengths and weaknesses. Even though the U.S. economy was at the time of Harvard's survey still

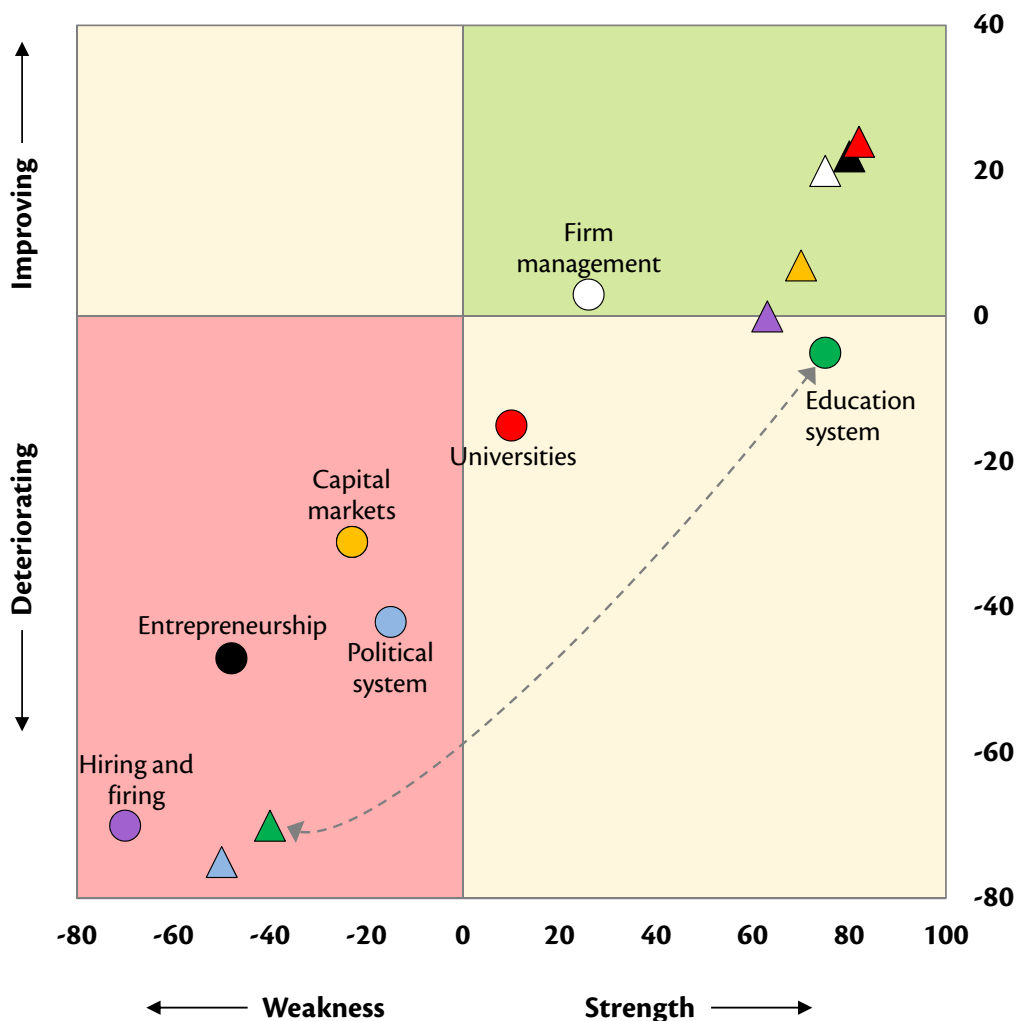
recovering from the effects of the financial crisis, the respondents ranked 11 of the 17 elements as strengths and as many as eight as strong and improving.

The Finnish and American responses often indicate views that are mirror images of each other (Figure 6).

One element that is perceived as a serious problem in the United States is unhesitatingly regarded by Finnish respondents to be our great strength: the school system. The American question referred to the so-called K-12 system. The abbreviation "K-12" means the whole time from the Kindergarten years through primary and middle school as well as high school.

Another instance of a mirror image finding, but one in the opposite direction, regards the element of flexibility of hiring and firing. When assessing the

Figure 6 Finland vs USA: Major differences in rankings of elements of competitiveness, %



The figure depicts some of the differences between American and Finnish respondents. Finland is marked with a dot and the United States of America with a triangle. For example, a green dot indicates the views of Finns on their education system while a green triangle denotes the views of Americans on their education system.

environment for entrepreneurship, the time span in the responses is exceedingly – worryingly – long. Although this is a question of opinions and mindsets, a negative perception of entrepreneurship conditions can have an impact on business growth and risk-taking.

The Americans felt that their key competitive advantages are the universities, context for entrepreneurship, management methods, innovation system, the protection of property rights and the functioning of capital markets. Of these, Finns recognized only protection of property rights as one of our strengths.

According to Harvard's findings, American companies experienced their greatest competitiveness problems with the political system and the tax code. The strong polarization of the political spectrum has made it difficult to get support for policy initiatives across the Democratic and the Republican party lines. If it is of any comfort to the maligned Finnish politicians, American cynicism of their political system's ability to function even exceeds that of the Finns.

It is said that pessimism is based on experience, optimism on wishful thinking. The sharp political polarization and difficulties in the decision-making system in the United States do not seem to erode confidence in the future. Finns seem to fear the possibility of disappointment than the sweetness of future profits.

The survey was conducted in February 2013. The necessary contact information for carrying out the survey was obtained from Fonecta's B2B register. Emails were sent to nearly ten thousand people representing firms with at least ten people and sales of at least one million euros in mainland Finland. If the CEO's contact information was not available, another person was selected as the company's top management representative. Fonecta data was supplemented with EVA registry contact information for two hundred executives.

The target group was not limited with respect to industry or other characteristics, but forms of companies clearly designated as governmental or union-related operations as well as non-profit-making activities were excluded. About a quarter of the e-mail addresses were obsolete, or the intended recipient could not be reached for other reasons. Seventeen per cent of the recipients opened the link in the e-mail and filled out the web form.

The characteristics of the respondents' companies do not differ significantly from the corresponding enterprise population for any key dimension. When dividing the responses according to company size, location, and other background information, we used Fonecta data as well as Statistics Finland's business register and the financial statement database of Asiakastieto Ltd.

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Finnish Business and Policy Forum

Finnish Business and Policy Forum EVA a pro-market think-tank financed by the Finnish business community. It is also a forum for forward-looking discussion for Finnish business leaders.

EVA's task is to identify and evaluate trends that are important for Finnish companies and the society as a whole. EVA aims to provide current information on prevailing trends as well as bring fresh ideas to public debate. EVA publishes reports, organises debates and publishes policy proposals.

Further information: www.eva.fi

