Importance of the financial situation for the growth of a forest machine entrepreneur

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What do we study and why?

- Large growth-oriented forest machine companies in Finland
- Point of view of growth and profitability
- Sector suffers from low profitability (Mäkinen, 1997; Kärhä, 2004), could growth be the answer?
- Study focused on growth, profitability and financial situation
Why growth is important?

- Forest machine companies are important employers in the rural areas in Finland.
- The growth of a company is also relevant to the growth of the national economy, competitiveness and rate of employment.
- “Much of the growth of industry comes from the growth of existing establishments, rather than from new ones” (Kumar et al., 2001; Mäkinen et al., 2002).
Forest machine sector in Finland

- The sector is mainly driven by small family owned companies owning 2-4 machines (harvesters and forwarders)
- Approximately 1700 forest machine companies operate in Finland
- The 10 largest companies in the sector have, on average, 22 forest machines
- The sector’s turnover is approximately EUR 500 million
Aims?

- Is it profitable to grow in the sector?
- If yes, how?
- What kind of role financial situation play in growth?
- What should be taken into account when considering growth?
- The sector
Theory of growth

- A company can grow basically by three different ways:
  - Organically
    - increasing output volume
      - most common, slow
  - Diversifically
    - increasing services offered
      - can raise the value of services, competitive advantage
  - By acquisition or merge
    - buying, selling and combining of different companies
      - risks, capital, demands much time and effort, fast
Definitions of the term entrepreneur have been abundant since Cantillon in 1725.

Schumpeter (1934) believes in "creative destruction".

Kirzner (1973) focuses on individual action:
- "…entrepreneurship is the discovery of hitherto unexploited opportunities."
- No need for new information - just differential access to existing information.
Research sample

- Largest limited companies in the sector which have had a growth in turnover since 2001
- 32 companies
- Financial statements from 2001 to 2006
- The research sample includes a significant part of the sector’s large growth-orientated companies in Finland
Research sample

The graph illustrates the trend in turnover and net profit over the years 2001 to 2006. The turnover (average) is shown using bars, while the net profit (median) is depicted with a line graph. The turnover values range from approximately 500,000 to 2,500,000, with a peak in 2005. The net profit values range from 2% to 10%, showing a decline over the years from 2004 to 2006.
Methods

- The companies were divided into three groups based on net profit and reserve in 2001
  - Profitable and stable (good prerequisites for growth)
  - Mediocre
  - Weak
- It was measured, how companies' financial situation changed during growth
- Financial situation was measured with net profit and reserve
Results

- Development of net profit ratio
## Results

### Companies in financial groups in 2006 (% of change since 2001 in parentheses)

<table>
<thead>
<tr>
<th>2006 (% change from 2001)</th>
<th>Profitable and Stable (16 companies)</th>
<th>Mediocre (7 companies)</th>
<th>Weak (9 companies)</th>
<th>On average (32 companies)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover ('000 €)</td>
<td>2720 (+85,0)</td>
<td>1602 (+98,0)</td>
<td>1602 (+60,2)</td>
<td>2142 (+78,6)</td>
</tr>
<tr>
<td>Net profit, %</td>
<td>5,9 (-49,1)</td>
<td>5,4 (+20,0)</td>
<td>-0,1 (-107,7)</td>
<td>4,7 (-34,7)</td>
</tr>
<tr>
<td>Equity ratio, %</td>
<td>56,6 (-6,3)</td>
<td>32,3 (-33,4)</td>
<td>11,4 (-20,3)</td>
<td>39,0 (-12,9)</td>
</tr>
<tr>
<td>Internal financing ('000 €)</td>
<td>524,0 (+20,2)</td>
<td>378,0 (+54,9)</td>
<td>269,0 (+25,7)</td>
<td>409,0 (+26,2)</td>
</tr>
<tr>
<td>External services ('000 €)</td>
<td>382 (+1217,2)</td>
<td>181 (+1408,3)</td>
<td>85 (+203,6)</td>
<td>251 (+904,0)</td>
</tr>
<tr>
<td>Reserve ('000 €)</td>
<td>125,4 (-18,0)</td>
<td>89,6 (+37,0)</td>
<td>-90,2 (-355,5)</td>
<td>56,9 (-33,2)</td>
</tr>
<tr>
<td>Personnel expenses as % of turnover</td>
<td>28,2 (-16,6)</td>
<td>31,6 (-8,9)</td>
<td>40,2 (+4,7)</td>
<td>31,3 (-10,3)</td>
</tr>
<tr>
<td>Depreciations as % of turnover</td>
<td>12,2 (-31,1)</td>
<td>18,2 (-14,6)</td>
<td>16,5 (-8,3)</td>
<td>14,1 (-23,0)</td>
</tr>
<tr>
<td>Interests as % of turnover</td>
<td>0,3 (-38,2)</td>
<td>1,2 (-51,9)</td>
<td>2,4 (-25,9)</td>
<td>0,9 (-29,1)</td>
</tr>
</tbody>
</table>
Findings

- Companies with good financial situation grew the most profitable
- They used much outsourcing
- Outsourcing is increasing rapidly in the sector
- Companies with weak prerequisites grew least profitable
- Growth seemed to emphasize the predominant financial situation
Discussion

- The sector offers growth possibilities
- Financial situation ok? - Then growth
- Outsourcing is new in the sector
  - In 2001 only 2% of turnover -> in 2006, 14%!
- The larger companies were more profitable – better market situation?
- Large difference between companies, why?
  - Services, machinery, labour, solvency…
Ideas for follow-up research

- Subcontracting – subcontractor
- Are there differences between the growth methods?
- Are the companies operating in one sector or does they offer wider scale of services
  - Is it profitable to diversity?
- Human factors behind the growth
- Customer – entrepreneur -relationship
Thank you

- Questions

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