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DEVELOPMENT OF EXPORT ORIENTED
INDUSTRIES IN ICELAND

Final Report

W. J. George Dziucielewski

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INTRODUCTION

An expert in industrial export policies, W. Y. George Dzieciulewski, was appointed by the United Nations Industrial Development Organization (UNIDO) to participate in a mission to Ireland in connexion with the preparation of a long-term development plan for manufacturing industry. His mission lasted approximately three and a half months, from 31 August 1972 to 27 October 1972 and from 27 November 1972 to 12 January 1973. His contribution to the development plan and his conclusions are outlined in chapters I-IV of this report. He also summarized the reports of other experts, incorporated their recommendations into the draft of the development plan and edited it.

I. CAPITAL MARKET IN ICELAND

When speaking with Icelandic businessmen one gains the impression that one of their major preoccupations is the lack of liquid assets. Both investment capital and working capital seem to be in short supply in manufacturing industry, and credit, when available, is expensive. This does not mean that there are no funds available in Iceland, but merely indicates that, for a variety of reasons, manufacturing industry has not been able to attract sufficient quantities of the available capital resources.

The need for capital

The growth of manufacturing industry is still a very new phenomenon in the Icelandic economy. Industry has grown as a result of tariff protection on an import-substitution basis and is becoming an increasingly important sector. Most companies, however, are still very small family-owned businesses or partnerships, whose ability to raise money is restricted by the credit worthiness of the owners, rather than that of the firms.

The opportunities for self-finance are limited by the family or partnership's savings and their income. Since the bulk of savings are usually used up in the establishment of the enterprise, only income from profits remains as a source for self-finance. Profits however, in the majority of cases, are not high enough to enable the entrepreneur to finance re-equipment, modernization or expansion.

The availability of capital

The level of private and public savings is quite high and would be more than sufficient to cover the needs for credit finance in manufacturing industry. Manufacturers have, however, to compete for these resources against all other credit users and especially the traditional industries, i.e. agriculture and fishing.

The fishing industry and agriculture, because of their long-standing importance in the economy, have traditionally received preferential treatment, both from the Government and from financial institutions. The bulk of available credit resources has therefore been allocated to these sectors on favourable terms. Manufacturing industry on the other hand has not been supported to the same extent.

Although there has been a marked improvement in recent years and particularly since 1969, traditional attitudes persist in Government, financial institutions and the public at large, which still tend to view the development of industry with rather mixed feelings. The terms and cost of credit for manufacturing industry are even today higher than for traditional industries. An example of this is the variable discount rate, which for agricultural and fishery products is 6 per cent rediscounted at 5½ per cent, whereas in the case of manufactured products it is at 5 per cent to 9½ per cent. Rediscounting for manufacturing industries was introduced in the autumn of 1972 for the first time.

Some 17 investment credit funds are in existence. The majority of these were established to canalize capital to the traditional industries and only 1 deals with the needs of manufacturers. An additional source of credit is the Nordic Fund, established in 1971. Although capital is available from this fund, few Icelandic entrepreneurs can benefit from it, as it is primarily aimed at the establishment of new enterprises rather than the improvement of existing firms. Furthermore, the minimum size of loan, about half a million United States dollars, is well in excess of what most Icelandic businessmen need or can justify in terms of viable projects. The banking system is therefore the chief supplier of credit to manufacturing establishments. Its loans are expensive, but not prohibitive. A far more serious factor that limits the availability of capital to individual manufacturers is the banks' inability to judge the credit-worthiness of the enterprise. Manufacturers as a group are reluctant to disclose their accounts, even to the banks, as a result of which their ability to borrow is restricted.

This attitude of secrecy, so common among small family businesses in all countries, is perhaps the main reason why no stock exchange exists in Iceland. Floating shares would, of course, be a cheap way of obtaining additional capital, but since this implies accountability to shareholders, the disclosure of accounts and a loss of control (even if only partial), few companies are interested in this type of development. The result is that, although the Central Bank has had the authority to organize a stock exchange for several years, no action has so far been taken.

The influence of inflation

The persistence of a fairly high rate of inflation, around 12 per cent per annum, has also influenced adversely the availability of capital. Rapidly rising manufacturing costs have put increasing pressures on limited resources of working capital, with the result that many manufacturers are no longer able to exist without borrowing. The existing price freeze, introduced with the aim of containing inflation, has, of course, put even greater strains on the manufacturer's ability to meet his day-to-day commitments from his own resources.

Inflation has also helped to develop practices that tend to limit even further liquid assets. Hedging against inflation, manufacturers and the community at large tend to overstock, invest in housing, furniture, office space etc., keeping liquid assets to a minimum.

Conclusions

Although there is no general lack of capital resources in Iceland, manufacturing industry still finds it difficult to attain access to sufficient funds to cover its short- and long-term needs.

Part of these difficulties stems from traditional attitudes, but industry itself is also partly responsible for its plight.

The disinclination to disclose accounts, justify proposed expenditures and provide financial institutions with the necessary background on which loan applications are assessed, limits the ability to borrow in many cases.

The Government and financial institutions are only now beginning to provide adequate facilities to finance the development of manufacturing industry and still display a marked preference in favour of traditional industries.

The opportunities for self-finance are small and are further restricted by the owners' preoccupation to retain secrecy, fear of losing control etc.

Inflation and controls have tended to restrict the already inadequate amounts of working capital by encouraging the spread of practices designed as hedges against inflation.

Finally, it can be stated that the capital market is only beginning to recognise the increasingly important role of manufacturing industry within the economy. This realization will undoubtedly bring the required changes in attitudes, procedures and priorities in the next few years which in due course will enable industry to finance its short- and long-term capital requirements on a more competitive basis than hitherto.

II. THE PROBLEM OF SMALL FIRMS

The very small average size of Icelandic firms and their large numbers within each industrial sector affect adversely their competitive position in both the Icelandic and overseas markets through a dissipation of manufacturing and marketing efforts. The classic long-term solution to this problem is the encouragement of mergers and amalgamations. This solution, however, can only become effective in the long term, and, in any case, is usually accompanied by social consequences which, in Iceland, may be unacceptable.

An alternative solution exists in the raising of efficiency of an industrial sector through intercompany co-operation. Since no single small company can afford the necessary human and capital resources to effectively design, manufacture, advertise, package and market its products, especially in export markets, co-operation in these fields can prove beneficial to individual companies and to the sector as a whole.

There are no hard and fast rules as to the best form or degree of intercompany co-operation as these can vary with each industry or product group. Experience in other countries has shown, however, that considerable benefits can accrue to enterprises employing this system. Most small companies need access to the following services to improve their efficiency: production planning, product design, quality control, advice on raw material purchase, product costing and pricing, technical services, financial and management consultancy and marketing know-how. These can be obtained at a far lower cost to each manufacturer on a co-operative basis.

An example of intercompany co-operation already exists in Iceland in the knit-wear industry. As a result of a large order for knitted woollen ladies coats from the United States of America, which no single manufacturer could supply due to their restricted output capacity, a joint effort was initiated. As a result of this the Iceland Import in New York, in co-operation with Alafoss, has sold some 40,000 coats in the United States.

In this case, Alafoss acted as the co-ordinator between the knitting factories, the sewing firms and as their purchasing centre. Alafoss bought the coats from the makers at a fixed price and sold them to Iceland Import, New York. Iceland Import, through its representative in Reykjavik, controlled the quality at its own cost prior to shipment to the United States.

Alafoss also provided the raw material, i.e. yarn, accessories etc., at a 5 per cent mark-up, guaranteed quality and, when necessary, provided credit of up to 3 months. The coats' designers, Fyngja Limited, received a 2.5 per cent commission.

In the above example, design, quality control, raw-material supply, short-term finance, costing, pricing and marketing have all been taken care of, leaving individual knitwear factories with only the task of production. Similar schemes suitably modified to suit other industries could also prove to be effective, provided the will to co-operate exists.

The main disadvantage of intercompany co-operation is that the small manufacturers are controlled by a larger one, i.e. Alafoss, and thus lose some of their independence. Such loss, however, is only illusory since, without co-operation they may remain fully independent, but bankrupt. This order of coats would not have been delivered if a co-operative effort had not materialised.

III. THE ICELANDIC WOOD-INDUSTRY - 7

The demand for wood in Western Europe is increasing and traditional suppliers are experiencing difficulties in supplying this demand. The distances from forest to user are increasing and transport costs mount as trees are felled in inaccessible areas. Northern USSR has vast forest resources but suffers from ice-blocked harbours eight to nine months per year, and can therefore only export a portion of its potential as buyers are unwilling to stock a one-year supply.

Iceland with its ice-free harbours, geothermal resources for drying and its position in the North Atlantic is an ideal staging port for this wood. Large quantities of logs could be shipped to Iceland during the summer from Murmansk and could be stored, dried, cut and re-exported to Western Europe during the closed season of Arctic ports.

The existing system

The non-existence of indigenous forests with commercially exploitable timber resources has forced Icelandic wood-using industries, i.e. construction, furniture and fixtures, to rely on imports of this essential raw material. In the absence of rational purchasing policies, however, wood and wood products are imported at prices that are considerably higher than those prevailing on international markets. Icelandic wood-using industries are thus placed at a competitive disadvantage with respect to their raw-material costs that can account for as much as 42 per cent of total cost as, for example, in the furniture industry.

Several factors contribute to this unfavourable situation; foremost among these is the fragmentary structure of the wood-using industries in Iceland, e.g. the furniture industry, including fixtures, consists of some 320 separate firms. The vast majority of these firms are very small, one-man businesses. A large proportion of them import their own wood supplies. The resulting small orders deprive Icelandic importers of all bargaining power and usually restrict their sources to traditional suppliers, who, in many cases, are not the cheapest. Since the purchasing of raw materials is a highly specialised function requiring specialized knowledge and skill to obtain optimum prices, it is not surprising that the prevailing ad-hoc system cannot achieve these results.

A large factor that perpetuates this situation is the existing system of price controls. This system was introduced as a means of limiting mark-ups on imported raw materials thereby restricting price rises. In practice, however, the effect of these controls has been the opposite, especially in the case of wood imported by timber merchants. Since the mark-up is pegged at 15 per cent there is an inducement to buy at the highest f.o.b. price thereby maintaining profit per shipment. This is the main reason why 80 per cent of furniture manufacturers persist in the direct import of uneconomical quantities of timber for their own use, despite the fact that this ties up considerable amounts of their own scarce capital and management resources.

Ireland's adherence to the European Free Trade Association (EFTA) and its current negotiations with the European Economic Community (EEC) will undoubtedly remove the existing tariff protection that wood-using industries enjoy in the Irish market. All opportunities to reduce manufacturing costs must therefore be taken to retain or create a competitive position for Irish products. The introduction of a more rational, efficient and above all specialized wood-purchasing system would be an invaluable aid to the lowering of manufacturing costs. The need for the establishment of a specialized wood import centre is therefore quite apparent.

The wood import centre

The primary function of such a centre would be to pool the demand for wood imports and provide the specialized skills required to obtain rational and efficient low-cost purchasing. Bulk buying with its accompanying bargaining advantages would replace the present small-lot ordering. This would also result in reduced shipping and handling costs. Buying at source instead of from middlemen would further reduce costs.

Apart from central, specialized buying facilities, the centre could also provide storage, drying and eventually pre-processing such as saw-milling, surface heat-treating etc. Once sawing, cutting and preparing facilities are established, sawdust and chips would become available for the manufacturing of chipboard. Thus the centre would not only provide an efficient centralized buying agency but also contribute to the establishment of new industrial facilities, which offer new employment opportunities and save foreign exchange.

The organization of a wood import centre could take one of several forms:

- (a) Existing timber importers could pool their resources and thereby create a central buying organization. There is, however, no incentive to do so under the existing system of price controls.
- (b) An association of wood-using manufacturers could establish the centre. This would ensure cheaper wood imports but would need a considerable amount of goodwill and co-operation between its members. The necessary capital to finance the venture may also be difficult to raise.

(c) The Government could establish the centre. This would have the advantage of access to capital but entails the danger that the imposition of Government administrative practices could stifle the efficiency of the centre.

The best solution probably lies in a combination of private initiative with government involvement and active support. The establishment of a wood import centre is envisaged in three phases.

In phase one, the centre would work as a super importer, using the advantages of enhanced bargaining power and building up experience and know-how in the wood business. Apart from obtaining wood and wood products at competitive prices, the centre would provide storage facilities to enable it to re-sell to Icelandic users from stock. During this phase the centre would be in direct competition with existing importers (merchants or manufacturers) and would have to prove its ability to obtain cheaper raw materials. It should be able to obtain a 5 per cent share of total wood imports within one year of its establishment and would therefore require covered storage space of some 3,500 m³. The capital required for office facilities, establishment costs, storage and materials-handling equipment is estimated to be about IS 48 million.

In phase two, the centre's activities would be expanded through the establishment of a saw-mill. Wood in the round could now be imported and processed locally. Assuming that the centre accounts for 80 per cent of total wood imports at this stage, indoor storage space would have to be augmented to 8,500 m³ and 300 m² of outdoor storage space provided. Equipment for sawing, cutting, boiling and drying of logs must be installed. The bulk of the capital requirement for this expansion should be financed from the Centre's own resources.

In phase three, the Centre develops into a full-fledged service centre for the wood-working industries in Iceland. The Centre would perform all the more difficult tasks such as wood curing, drying, surface heat-treatment etc. This would give Icelandic manufacturers access to advanced equipment, the purchase of which individually, they would be unable to justify in economic terms. The ultimate aim of the Centre should be to strike a balance which will give the optimum division of work between manufacturers and the Centre.

Conclusions

The existing highly inefficient system of imports indicates the need for a wood import centre. The benefits arising from the establishment of such a Centre far outweigh the moderate capital requirements. These include:

Lower priced raw-material supply to user industries thereby strengthening the competitive position of these industries

Foreign exchange savings as a result of cheaper supply and lower shipping and handling charges

The creation of 60 to 80 new jobs

The provision of storage and processing facilities to customers thereby releasing capital in the user industries currently tied up in raw-material stocks and storage and improving their often critical working capital position

With the rather weak structural position of the user industries, Government help in the establishment of the Centre will be required in the following fields:

Provision of a suitably located site with easy access to harbour, power facilities and near to the majority of potential customers

Provision of electrical and geothermal energy at favourable prices

Provision of finance during the period of establishment through direct grant or government-guaranteed loan facilities

Possibility of providing government-owned buildings, e.g. unused barrel factories, as storage sheds

The saw-mill and cutting facilities of the Centre would produce 3,000 m³ of good-quality sawdust and wood shavings. Another 6,000 m³ could be collected from the wood-working and building industries; 30,000 m³ could be made available from sawing of all logs for domestic use in the construction industry. This gives a total of nearly 40,000 m³ of wood waste available for use in the manufacture of chipboard, particle board etc.

IV. EXPORT OPPORTUNITIES IN VARIOUS INDUSTRIES

Metalworking Industry

Size and structure

The total number of firms in the metalworking sector is about 1000 of which 700 are shipyards. The majority of these firms are small and engaged in fitting ship service activities, i.e. ship repair, garage work, machine servicing and maintenance etc. Only a few produce items that are marketable in export.

The total number of man years employed in this industry in 1960 was 1,000,000. This number has increased substantially however, as a result of increasing job opportunities created by growing demand in recent years.

The total output of this sector as measured in terms of value added per man year is low e.g. IKr 265,000 in 1961.

If one discounts shipyards, ship repair, maintenance and service workshops, only some 300 to 400 man years are currently employed in the production of marketable metal products. These include: ventilation channels, radiators, lamp posts, hydraulic winches, steel doors, nails, fishing gear, electric reels, stoves, freezing plant equipment, prefabricated structural steel and structures, hose and pipe fittings and nozzles.

There have been no significant exports from this sector, except in a few isolated instances on a trial basis.

Competitive position

Price. The prices of locally produced metal products have achieved varying degrees of competitive power compared to imported equivalents. As a general rule, prices are competitive in the home market but profitability is low due to costly raw materials, high labour costs, low productivity and jobbing shop practices which ignore specialization, cost control and planning.

Quality. The quality of individual items is high but the lack of strict adherence to standards results in the manufacture of many items in batches that do not conform to tolerance limits.

... planning, delivery, and service. Manufacturers must also understand the requirements of the market for their products.

All these factors, however, must be considered in conjunction with the manufacturer's own resources. All these factors, as they manifest themselves, must be taken into account and a profit facility as early as possible. The manufacturer must also be aware of the selling price and quality.

Quality Assurance

The manufacturer must be aware of the quality of his products and must be able to identify the quality of his products. The manufacturer must be aware of the technical features of his products and must be able to identify the competitive quality of his products. The manufacturer must be aware of the quality of his products and must be able to identify the quality of his products.

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Leather Industry (Including other goods)

Size and structure

The leather industry is largely based upon the tanning of sheepskins. Small quantities of horse and cow-hides are also tanned but on a very limited scale. A revival of mink farming will add to the raw materials available for leather-product processing. There are four tanneries, three of which account for approximately

... percent of the total output of the industry. The total number of North American manufacturers producing leather goods in 1954 was 1,000.

The total number of manufacturers producing leather goods in 1954 was 1,000.

The value of leather goods produced in 1954 was \$1.5 billion.

The industry's production is concentrated in a few areas, varying in degree of intensity. The main areas are the United States, Canada, and Europe. The main areas are the United States, Canada, and Europe.

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Negative Aspects

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Export Possibilities

Raw skins, tanned skins, and leather goods are exported. The potential for increasing this export trade is great and product specialization or intensification. The extent to which this potential will be realized, however, will be determined by the raw-material supply and the product development especially in the leather-goods sector. Local raw materials can be augmented through imports. A large amount of hitherto only marginally exploited leather products is available for development.

Leather gift articles such as belts, leather-bound photographs and stamp albums, wallets, purses, handbags and travel accessories could be made in Iceland. The demand for these products has been expanding rapidly all over the world and good-quality products of distinctive design would find a ready market. The main advantage

of the new products of the industry is determined in the first place by the
products of the manufacturing industry. The main reason for this is that the
practical requirements of the industry are determined by the manufacturers of these
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products of the industry.

Competitive position

Text. Spinning and weaving of standard products are not competitive in price.
These functions only survive as a result of high tariff protection. If the tariffs
were removed, these products would become completely uneconomical by international
standards.

Text. The quality of exported items is acceptable.

Delivery. With the normal procedure of delivery, a very good law firm is acceptable.

Export opportunities

The export potential of the industry is very high, as the industry is highly competitive. In fact, the industry is one of the few in the world which is not competitive in the United States. The industry is highly competitive in the United States. The adaptation of furniture to the requirements of the foreign market is very important. A good market is to be found in the United States, particularly in the West.

Industry structure and organization

Size and structure

The furniture and textile industries are both highly competitive. The most part are engaged in the production of furniture. The industry is highly competitive and very small. In fact, the industry is one of the few in the world which is not competitive in the United States. The adaptation of furniture to the requirements of the foreign market is very important. A good market is to be found in the United States, particularly in the West.

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The industry is highly competitive.

The product range is very wide. The industry is highly competitive and very small. In fact, the industry is one of the few in the world which is not competitive in the United States. The adaptation of furniture to the requirements of the foreign market is very important. A good market is to be found in the United States, particularly in the West.

Small quantities of furniture are exported to a few markets rather than permanent bases.

Competitive position

Price. Raw materials which are imported are sold at very competitive prices and thus raise the cost of the final product. Price control, intended to limit mark-up on imported raw materials and prevent price rises, had the opposite effect of discriminating against rational purchasing policies. It became more profitable for the importer to buy high-priced raw materials well above market prices rather than purchase at the lowest cost. The user, i.e. the furniture manufacturer, on the other hand thus finds himself at an automatic disadvantage. In various proportions both in home and export markets as the average materials costs of this sector are 42 per cent of the total costs.

Quality. The best Icelandic furniture compares favorably with imported products in quality. Most local products, however, do not reach this high standard.

Delivery. Delivery is made under the conditions of individual firms and very restricted.

Export possibilities

Although export possibilities are limited, some demand for special designs could find sale outside the island. The industry is very diversified in terms of the number of enterprises and in variety of products produced by each of these small manufacturers. Some specialization of products would greatly improve the viability of this industry and a greater range of product specialization is required. As an import-substitution industry, it is not an acceptable one which will continue to supply a high proportion of its needs.

Industry

Size and structure

Some of the firms are primarily engaged in the manufacture of plastic products from imported raw materials, i.e. PVC, and the majority of the firms are very small with a heterogeneous production.

Although the total number of employees employed in the industry (in 1968), it is one of the rapidly expanding industries in the island and has an output of up to 30 per cent per annum in some cases.

The value added per man per year is low (K\$1,000).

The current demand for capacity is not met and the demand is more for this output. The products range from toys, etc. to the more technical, e.g. existing products include insulating materials, pipes, fittings, etc. electrical line installations, light fittings, plastic boxes, bottles, containers, etc.

No direct exports of plastic products have been observed, but packaging material is sold to airlines, the duty-free shops at FVAP and the fish-processing industry.

Competitive position

Price. The industry has a small market in the island at acceptable prices but this position would alter if the current 10 per cent tariff was lowered. The 5 per cent import duty on raw materials, the duties on imported production equipment and the additional raw-material transport costs make Icelandic plastic products non-competitive in foreign markets.

Quality. The over-all quality of products is acceptable in the home market but is often lacking in competitive design.

Delivery. Due to the existing capacity of the factory in the home market, the demand for the product will not be met. Additional output, however, could only be met by increasing the output of the plant.

Export possibilities

Existing products are exported to various countries. In order to expand manufacturing in the home market, it is necessary to increase the capacity of the plant and high cost, low productive labour provide a competitive price for export markets. The only export prospects in this industry are for the manufacture of products with special design features which could be produced in the home market.

General statistics

Size and structure

This industry consists of two firms, the first of which started to manufacture lava ceramics on a handcraft basis. The company has now been converted to large production with Czechoslovak equipment.

In 1961 some 100 new products were produced, of which 80% were supplied by the large firm.

Total output was 8000 IKR, of which 6000 IKR of production was produced by ILIT.

The product range consists of mainly lava and ceramic articles, such as plates, ash trays, mantelpieces, lamps, etc.

Approximately 1000 million were exported in 1961, a further 1000 million sold to tourists and the balance sold in the home market.

Competitive position

Price. Being of a highly special design, these products are highly competitive and can obtain a price advantage through uniqueness.

Quality. The quality is good in both durability and design.

Delivery. The capacity installed is well below demand and therefore delivery problems for large orders could arise.

Export possibilities

These products are already exported both directly and indirectly and the potential demand is unlimited in the foreseeable future. The rate of expansion will depend to a large extent upon ability to supply this latent demand. The main markets are EFTA, EC and North America.

Size and structure

The total number of firms in the industry is approximately 100. The industry is highly concentrated, with a few large firms and many small firms. The industry is highly competitive and has a high level of technological sophistication.

Results are reported in the following table. The data are based on a survey of the industry under the following conditions:

Competitive conditions

Entry: The industry is highly competitive, with many firms competing for market share. The industry is highly competitive and has a high level of technological sophistication.

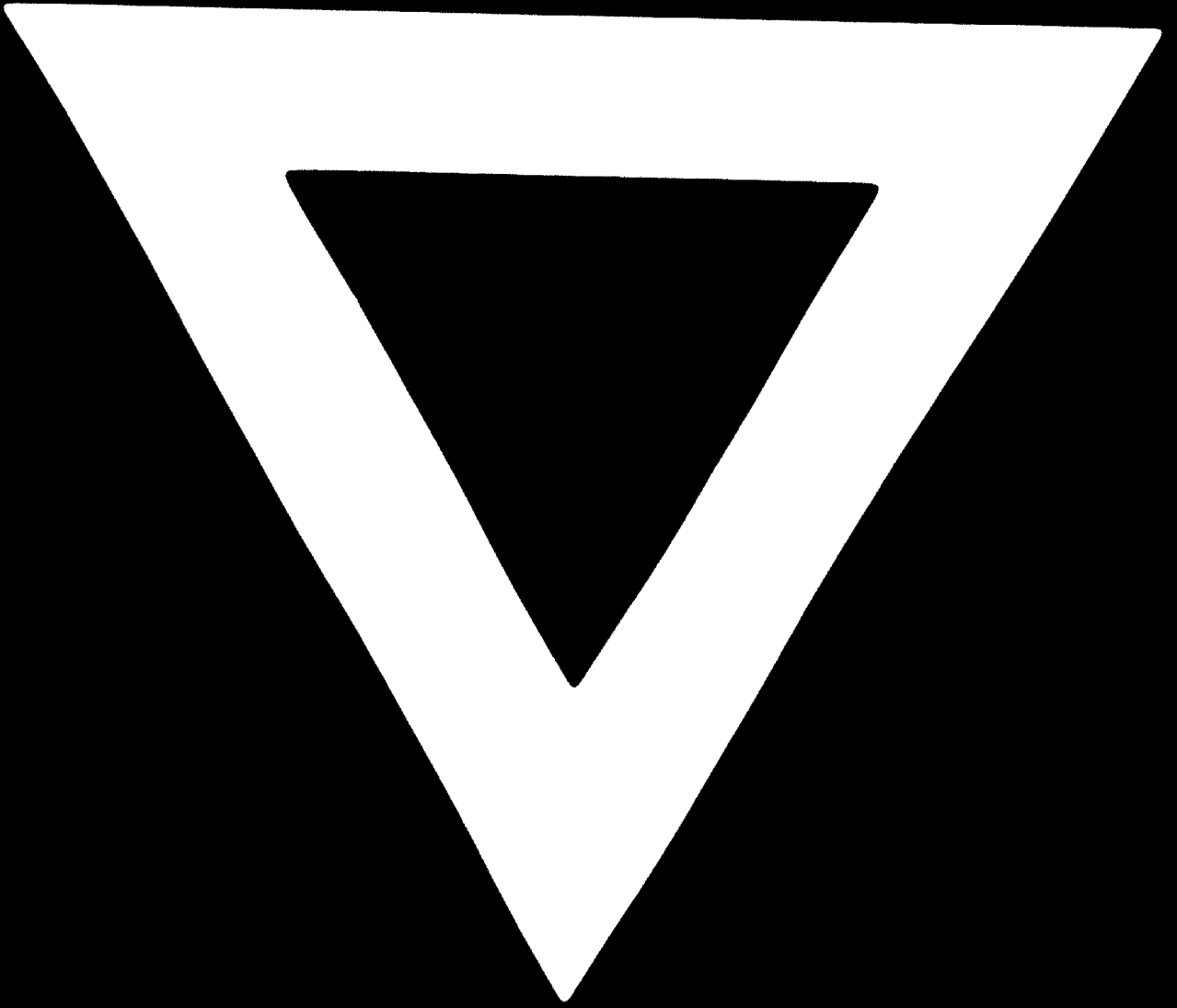
Quality: The industry is highly competitive, with many firms competing for market share.

Supply: The industry is highly competitive, with many firms competing for market share. The industry is highly competitive and has a high level of technological sophistication.

Export possibilities

Export possibilities are limited in this industry as a result of the high level of technological sophistication.





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