Leveraging on Home Bias.
Large Stakes and Long-termism by Swedish Institutional Investors

Sophie Nachemson-Ekwall
Stockholm School of Economics Center for Governance and Management Studies
Sophie.nachemson-ekwall@hhs.se

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Abstract: Here we look at domestic institutional investors and their ability to refocus their investments strategy in the direction of more of long-term committed capital. Suggesting a reconceptualization of domestic institutional investors in the sense that they can leverage on information asymmetries connected to home bias, we complement conventional ideas on institutional investors' rational disinterest in engagement, turning to activists as the solution or a need for reregulation to enhance domestic long-term engaged ownership.

We conduct a mix of qualitative and quantitative research to illuminate how 18 Swedish institutional investors relate to expectations in the post financial crisis-era to engage in investee companies, both in relation to governance and sustainability issues. Sweden is interesting as it has a shareholder friendly governance system supportive of voice. Nomination committees for board enrolment are external and led by shareholders, and Swedish institutional investors usually participate. However, historically Swedish institutional investors have behaved as mainstream disengaged institutional investors.

The detected more focused investment strategies can, we find, primarily be explained through a (i) refocusing of risk-allocation mandates related to longer investments horizons, (ii) leveraging on home bias, and (iii) an owner-friendly governance model. Our research highlights the embedded character of domestic institutional investors' engagement. The study also nuances previous research on Swedish institutional investors passivity. With new norms, behavior changes.

Going forward, we argue that to foster engagement, policymakers should not only look towards changing regulation related to institutional investors but go deeper and look towards the governance-systems ability to engage minority shareholders, i.e. in the findings here, the role played by Swedish external nomination committees.

Keywords: Corporate governance, institutional investors, long-termism, portfolio allocation models, home bias, nomination committee

INTRODUCTION

Institutional investors, here defined as mutual, life insurance- and pensions funds, private, cooperative, and state owned, have emerged as the most important investor category on globalized capital markets, accounting for 40 per cent of the listed shares (OECD 2013).[i] Given that ownership matters for corporate value creation (Mayer, 2013) and that institutional investors play a special role as investors in the overall economy (Hawley and Williams, 2000; Davis et al., 2006; Rappaport, 2011), there is in the wake of the financial crisis 2008 a general call for more of institutionalized long-term capital to be committed to listed companies (Walker Report, 2009; Kay Review, 2012; OECD, 2012; OECD, 2013; EIOPA, 2013; Eurofi, 2013; COM, 2014; Nasdaq OMX White paper, 2016).

Here we take a special look at domestic institutional investors. These are special as they often invest with a considerable amount of home bias, i.e. they are overweight on the domestic market (Coval and Moskowitz, 1999). This is supported by information asymmetry (Akerlofs, 1970), lower asset management costs and lower transaction costs (Coval and Moskowitz, 1999; Ferreira and Matos, 2008; Dahlquist et al, 2003). It's a behaviour that builds on the theoretical foundation of people (including asset managers) being bounded rationally in the sense that there are other factors than pure economics that are included into the decision-making process (Simon, 1957).

However institutional investors, including domestic ones, often abstain from committing capital to large stakes due to portfolio allocation strategies (Abactsheer and Bauer, 2013), complex quantitative and qualitative regulation (Yermo, 2008; Stewart and Yermo, 2008), short-term evaluation metrics that promote value destructive index tracking and herding (Jackson and Petraki, 2008), a preference for exit over voice despite increasing concentration of stakes (Jackson, 2008), organizational setups that limits activities to intermediaries (Tilba and McNulty, 2013) or just a reflection of a rational choice of free-riding (Grossman and Hart, 1980). As argued here, this picture is incomplete; to explain a possible change in investing behaviour research must combine theory on home bias and rational

decision-making with governance research on institutional embeddedness and path-dependency (Granovetter, 1973; Aguilera and Jackson, 2003; Fligstein and Choo, 2005; Kallifatides, Nachemson-Ekwall and Sjöstrand, 2010).

Sweden is interesting as it has a shareholder friendly governance system supporting voice. The Companies Act has empowered the block-holder to dominate governance, moving the classic agency conflict between empowered management and distant shareholders (Berle & Means, 1932/1968), to asymmetry of influence between the majority and minority shareholders. Nomination committees for board enrolment, a fairly recent governance device in Western economies, are external and led by shareholders, and it is more or less standard procedure that one or two Swedish institutional investors participate, thus mitigating conflicts. However, for long Swedish institutional investors have behaved as mainstream disengaged institutional investors (Hellman, 2005; Kallifatides et. al. 2010; Nachemson-Ekwall, 2012, Nachemson-Ekwall and Mayer, 2017).

We conduct a mix of qualitative and quantitative research to illuminate how 18 Swedish institutional investors relate to expectations to become more engaged as corporate governors. We combine statistics on ownership on the Swedish stock exchange, public documents, and 46 interviews with Swedish institutional investors and related parties representing a unique sample of fourteen institutions. We reconceptualise investor domestic practises by using a three-phase model of the period 1990-2017. Looking specifically at the period 2007–2017, we find that close to 80 per cent of them have refocused their Swedish investment mandates away from more or less index-tracking strategies to strategies that commit more capital to larger equity stakes. Despite pursuing overall investment strategies that build on portfolio-allocation models and while still hampered by quantitative regulation with the specific aim of hindering activism and engagement, they can explain this action, we find, primarily through three claims: a (i) refocusing of risk-allocation mandates related to longer investments horizons, (ii) leveraging on home bias, (iii) an owner-friendly governance model. Overall investments on the Swedish stock market have not increased during the period.

In a previous article, Kallifatides and Nachemson-Ekwall (2016) suggest that both

owner rationale and the chosen time horizon for investments matter when it comes to engagement in governance. Here we add that in a setting with strengthened minority rights domestic institutional investors can, if they wish, already within limits of both current regulation and portfolio allocation models contribute to sustainable corporate value creation. Our research distances itself from academics that ask for new regulation (Yermo, 2008, McCarthy, 2014, Bolton and Samana, 2013; Mayer, 2013) or focus on shareholder activism as a solution of the ownership vacuum (Becht et al, 2010; Gilson and Gordon, 2013). The study also nuances previous research on Swedish institutional investors passivity (i.e. Hellman, 2005).

The rest of the article proceeds as follows: First we review the literature on ownership and control. We discuss how portfolio allocation models and regulation influence institutional investor engagement. We then introduce Swedish institutional investors as the research context. Following a presentation of research design and methods, including the value of qualitative study, we summaries the findings and present a reconceptualization of institutional investors' investment strategies. Concluding remarks relate findings to current academic research and policy debate.

CORPORATE GOVERNANCE AND INSTITUTIONAL INVESTORS

Corporate Governance and Control

Academics have studied the importance of ownership for corporate governance since Adam Smith (1776/1976) highlighted the difficulty in striking the right balance between different shareholder groups and management after a founding party leaves the scene. To assure long-term value creation, countries have protective devices in place such as support to long-term shareholders, takeover defence or measures to assure management independence (Mayer, 2015). At the same time, there is a common agreement among actors that liquidity is needed on global capital markets that can support both owners long-term and traders short-term (Tirole, 2006).

How different corporate-governance systems empower shareholders is well described in the governance literature (Shleifer and Vishny, 1997; Hall and Soskice, 2001; Becht et al., 2002). Agency-theory pictures the classic US-listed firm with many shareholders (Berle and Means, 1932/69) where a small and distant shareholder-

owner (principal) lacks ability or incentives to supervise the management board (agent). The Hirschman (1970) option for the "anonymous" investor to *exit*, *voice* or remain *loyal* is more or less limited to exit. Agency theory's focus on shareholders is often criticized, but that is because the discussion is often limited to the relationship between owners and management (principal-agent). There are other conflicts, such as the one emerging between different shareholder groups (principle-principle) where the question is how to strike the right balance between the controlling shareholders monitoring of the executive, in the interest of all shareholders, and the risk (cost) that the controlling shareholders exert private benefits (Gilson, 2006). There is also the stakeholder model, often associated with Western European or Japanese coordinated-market economies. Here power is exercised through corporate interlocks, financial institutions or the state. However, an increased market orientation of Western economies since the 1980s has made the shareholder-value model of governance the preferred choice and created active takeover markets. Given these differences, institutional theorists look to how governance is shaped by institutional embeddedness. Picturing three dimensions of corporate governance – capital, management and labour - Aguilera and Jackson (2003) stress the interplay of institutions and firm-level actors. Among other things this includes a countries property rights, financial system and inter-firm networks that shape the role of capital. Following Aguilera and Jackson (2003) we highlight three contingencies for institutional investor engagement – how well a given governance system support minority shareholders ability to exercise voice, reconsideration of asset-diversification strategies as well as the effect of regulation and codes.

Emergence of institutional investors

Governance systems have not been designed to deal with institutional investors' as a specific owners category. Institutions' logic of diversification relies upon mechanisms for monitoring portfolio performance relative to peers, and this benchmark-driven approach to investment runs counter to any active exercising of governance rights. Given that institutional investors are more or less organized the same way in all countries and they submit to the same idea of portfolio allocation models and diversification metrics there has not been a market difference between a US, UK based, German or Swedish institutional investor. Problems with the institutional

investors as more or less passive governors have remained the same and been discussed in a number of studies (Black, 1992; Romano, 2001; Hu and Black, 2006; Hellman, 2005; Ambachtsheer and Bauer, 2013; Tilba and McNulty, 2013).

Describing a "concentration without commitment paradox", Jackson (2008) highlights the lack of engagement in the case were institutional investors do take larger stakes, pointing at the free-rider dilemma where a costly activity by one portfolio manager (such as research, engagement and setting a proxy fight) benefits all other institutional investors just as much. For-profit institutions' compensation structure that promotes short-term asset gathering might also conflict with the long-term goal of the ultimate beneficiary (Monks and Sykes, 2002).

Tilba and McNulty (2013) use data from 35 in-depth semi-structured interviews with actors related to British pension fund trustees. They find that the vast majority of pension funds operate at a considerable distance from their investee corporations, having delegated pension fund investment management through a chain of external relationships involving actuaries, investment consultants, and fund managers. These pensions funds have neither interest nor ability to engage as owners.

Other studies focus instead on what has long appeared to be the solution to the lack of institutional investor governors – *shareholder activism* (Becht et al., 2010; Gilson and Gordon, 2013). These activists are usually organized in hedge funds, they have a focused investment strategy and own shares in a handful of companies, were they take a large stake to be able to influence the board. Gilson and Gordon (2013) argue that institutional investors' are not passively free-riding on the activist's work, organized as "rationally apathetic" in the traditional sense of Berle and Means' dispersed owners, but instead are "rationally reticent": the intermediary institutional holder will respond to activist proposals but are unlikely themselves to create them.

However, shareholder activism has generally not been able to trace exceptional performance (Romano, 2001; Bebchuk *et al.,* 2013) and there appears a lack of research that addresses domestic institutional investors engagement in a block-holder setting. How portfolio allocation models and regulation influence institutional-investor behavior is discussed next.

Risk-taking and portfolio allocation models

Since the 1980s, prudent asset management has been synonymous with diversification and risk allocation in accordance with the principles that follow from the adaption of modern portfolio theory (MPT) and the efficient market hypothesis (EMH) (Markowitz, 1952; Miller and Modigliani, 1958; Fama, 1970). Successful asset management is calculated mathematically as the relative performance of a portfolio of assets in relation to a selected benchmark or index.

Fund management is further divided into "passive" or "active". Passive funds hold all shares in an index ("index-trackers") or a virtual exchange traded fund (ETF). Active funds try to add value by beating the benchmark. A manager can do this by selecting individual stocks or tactical asset allocation that builds on factors such as overweighting particular sectors of the economy.

Although MPT is conceptually appealing it has shortcomings that are widely documented (Shleifer, 2000; de Graaf and Johnson, 2009; Heinemann and Davis, 2011). The theory presupposes that market actors are rational, fully informed and that occasional mispricing of shares is immediately corrected and the share price returns to its 'correct' value. But markets may misprice risk and enhance short-termism in the sense that money today is valued more than money in the future (Haldane and Davies, 2011). Such myopic behavior is enhanced by mutually reinforcing short-term expectations by companies, investors and other key actors in corporate governance (Jackson and Petraki, 2011). Markets where a critical mass of investors rely on the same MPT-metrics and share a preference for shareholder-value maximizing governance might even explode in a systemic failure (Davis et al., 2009; Haldane and Davies, 2011) such as the 2008 financial crisis. British economist John Kay writes that this investment style goes counter to societal interest as most clients, not least pension fund members, are more interested in long-term absolute return (Kay Review 2012) which moves benchmark metrics closer to the overall GDP growth.

The real value of diversification and stock picking can also be questioned. Studies show that most so-called active portfolios are at the most semi-active, index trackers

or closet index funds that cost money but add little or no value (Ibbotson, 2010; Rappaport, 2012, p. 211). Studies also question how much diversification is needed to deliver active, cost efficient management. Full diversification can for example be reached with ten to fifteen stocks provided these are carefully chosen (Archer and Evans, 1968). A more random selection gives 30 or 40 stocks (Statman, 1987). Petajisto (2013) have studied how focused, highly concentrated funds, outperform broadly diversified funds.

An additional issue relates to liquidity. Coffee (1991) and Bhide (1993) argue that there is a trade-off between engagement long-term and trading where liquidity is harmful to voice as it facilitates cutting and running. Liquidity also increases focus on market capitalization. Large institutional investors typically have a preference for large companies and this effectively locks out investments in smaller companies. In summary, a belief in the EMH has made many institutional investors focus on low-cost index tracking strategies and short-term evaluation measures. In the post-financial-crisis era, however, a growing number of academics support long-term investing and larger stake formation.

Here we wish to especially highlight the issue related to home bias and embeddedness where institutional investors have a preference for investing on the home market. There are theoretical merits for global diversification. Despite this, home bias exists and is supported by arguments such as better information, lower asset management costs and lower transaction costs (Coval and Moskowitz, 1999; Ferreira and Matos, 2008; Dahlquist et al, 2003). Domestic institutional investors can just like other domestic investors leverage on information asymmetries (Akerlofs, 1970) related to for example language barriers and better access to governance. It's a behaviour that builds on the theoretical foundation of people being bounded rationally in the sense that there are other factors than pure economics, like relationships and trust, that are included into the decision-making process (Simon, 1957). For a number of reasons, related both to ideas of diversification and different regulations (discussed below) domestic institutional investors have not in their investment strategies leveraged on the special advantage of this home bias. In general, they have invested in the home market index rather than in focused large and often less liquid stakes. In sum, there is a growing academic disbelief in the EMH and increased support for long-term

absolute return investing and larger stake formation. It can be hypothesized that this might leave room for more home-bias and engagement, when possible. How such a movement might be hindered or supported by regulation and codes is discussed next.

Regulation, hard and soft

As fiduciaries portfolio management obeys qualitative rules related to concepts such as prudence, loyalty and impartiality (i.e. Yermo, 2008). They also obey quantitative rules that regulate the allocation between different asset classes, countries, or exposure to certain companies. There are also regulations that reflect political worries that institutional investors might pursue goals that diverge from the long-term interest of the ultimate beneficiaries (Fligstein, 2001; Roe, 2003; Gourevitch and Shinn, 2005). This means that the investment behavior of domestic institutional investors reflects the positions they play in society.

When the US pensions plan from 1974, the Erisa-Act, stipulated that prudence in asset management implied diversification, this in effect limited influence from workers unions (McCarthy, 2014). The UK takeover regulations restrict the formation of concert parties, as such limiting the ability for institutional investors to form coalitions with other parties to influence governance activities. In the US, the management board controls proxy voting for directors on the AGM. In countries were shareholder power is strong, like in Sweden, ownership limits seem to prevent institutional investors from becoming too active owners (Pålsson, 2002/2012).

There are also different kinds of regulation hitting different investor types. Open-ended mutual funds that obey the popular European Ucits rules must invest in at least 16 stocks. Life insurance companies follow solvency requirements where market-to-market valuation work against investments in illiquid instruments and effectively limiting domestic share exposure (G30, 2013).

In the post-financial-crisis era a growing body of international actors argue for prudent asset management of long-term investments to be related to long-term commitment. Reports from OECD (2012), EIOPA (2013), and Eurofi (2014) all recommend a revision of capital requirements by pension funds, abandonment of

market-to-market valuation of listed stocks and the moving out of index-relative evaluations to more absolute evaluation. The UN Principles of Responsible Investments (UNPri) wish to see more long-term investments in innovation, infrastructure and SMEs. Engaged and active long-term asset management appears also to get an extra push by focusing on sustainability and ESG-factors (environmental, social and governance). In an analysis of 190 studies, Clark et al. (2015) finds a positive correlation between diligent sustainable business practices and economic performance. The British governance code, the former Combined Code, includes a section that advises companies on how to interact with its institutional owners (FRC, 2014) and has introduced a stewardship code (FRC, 2012). France and Italy has a system where domestic shareholders receive double voting rights after holding their shares over a longer time period (Bolton and Samama, 2013).

There is also an emerging discussion of the meaning of prudence in governance. A report from the UK Law Commission (2014) claims that it is in line with prudent investment decisions to make investments that are based on non-financial factors, provided that they have good reason to think that scheme members share the concern and there is no risk of significant financial detriment to the fund (p. 135). This gives an asset manager a certain freedom for example to focus on sustainability and declining a (short-term attractive) hostile-bid offer on an investee company. In recent years there has been an increased number of media and company reports on institutional investors that take 10-15 larger stakes in a focused fund portfolio and investing with a sustainable commitment.[ii]

Consequently, domestic investment policies of prudent asset management is influenced by societal expectations, includes hard and soft laws and norms. Institutional embeddedness (Aguilera and Jackson, 2003) works as a driving force behind domestic institutional investors decisions to engage or disengage in the governance of investee companies. Here we bring to the discussion the possibility that Swedish domestic investors, if they choose to reconsider their investment strategies in the direction of taking larger stakes and invest more long term, might engage more as corporate governors than they did compared to previously and compared to their international counterparts.

RESEARCH CONTEXT: SWEDISH INSTITUTIONAL INVESTORS

Sweden has a high concentration of domestic institutional investors, controlling directly 23 per cent of the capital of the Stockholm Stock Exchange (Table 1). Foreign investors, with the great majority being institutional, control an additional 40 per cent, which means that universal owners own more than 60 per cent of the SSE. In 1990, the year before Sweden opened up for foreign direct investments on the stock exchange, Swedish institutional investors such as National Pensions Funds, (SNPFs or often addressed as *Allmänna Pensionsfonder*, AP1–AP4), life insurance and mutual funds controlled 28 per cent of the SSE and foreign investors close to 8 per cent.

Table 1: Ownership on the SSE

% Year	Corp's & Orgs.	CEIFs	Mutual funds	Life Insur.	SNPF	State	House-holds	Non-profits	Foreign	Billion SEK
1986	17	13	6	14	5	2	25	10	8	**500**
1990	23	10	8	14,5	6	2	18	8	8	**545**
1995	10	7	9	13	4	3	15	8	30	**1 200**
2000	9	6	8	10	4	5	13	5	39	**4 098**
2005	11	5	12	9	3,5	4	15	5	35	**3 054**
2010	11	5	12	9	3	4	13	4	38	**3 701**
2015	14	6	12	7,5	2,5	2	11	4	41	**6 071**
2016	14	5,5	12,5	8	2,5	1	12	4	39,5	**6 500**

Source: Adaption from Statistics Sweden (March 2017), Only capital, not voting power.
CEIFs (Closed-end investment funds; Investor, Industrivärden etc.)
SNPF (Swedish National Pension Funds, AP1–AP4)

While mutual funds have grown from 8.5 to 12 per cent, the SNPFs and life pension funds have reduced their exposure on the SSE from 6 to 2.5 per cent and from 14,5 to eight per cent respectively. Reregulation and the ability to investment abroad explain part of the change.[iii] In addition, when the state-owned AP-funds (Swedish National Pension Fund SNPF) were reformed in 2001 the Swedish stock portfolio of AP4 was split into four equal sized funds. Around the millennium, Swedbank became more diversified and European. At the same time Swedish institutional investors as a group, began to benchmark portfolio performance.

Consequently Swedish, institutional investors around the millennium moved from an asset management style where it was common for them to control collectively 15–20

per cent of capital in most large companies (Sundqvist, 1995) to portfolio diversification models and benchmarking against different indices (Hellman, 2005). The companies that previously had large Swedish institutions as minority owners include for example Ericsson (Skandia and AP had 9 % of capital), Electrolux (Skandia, AP4 and Nordea 15 %), Atlas Copco (Swedbank Robur 12 %), Astra (AP4 and AMF 8 %), Asea (AP4, SPP 9 %), Volvo (six institutions had 19 %), SSAB (5 institutions had 24%), Skanska (Swedbank Robur and AP4 21 %), SCA (8 institutions 26 %), Industrivärden (Swedbank Robur 17 % and 3 more 34 %) and Gambro (4 institutions 29 %). By 2005 all had sold down their holdings. Table 2 picture this change of investment policy related to reducing stakes in stocks on SSE, taking the examples of Electrolux, Ericsson, H& M and Sandvik.

Table 2: Changing stake-holding 1985–2015

Company	1985	capital (votes)	1995	capital (votes)	2005	capital (votes)	2015	capital (votes)
ELECTROLUX								
Largest owner	Asea	11.8 (48.9)	Incentive/Asea	5.1 (48.4)	Wallenbergs	24.8 (25.9)	Wallenbergs	15.5 (30.0)
	Wallenbergs	5.4 (45.8)	Wallenbergs	1.3 (45.7)				
Institutions	Skandia	3.9 (0.1)	Skandia	4.1 (0.9)	Alecta	2.6 (2.7)	Alecta	3.4 (3.9)
	Trygg-Hansa	3.5 (0.1)	AP4	6.6 (0.2)	AP2	2.6 (2.7)	Nordea	4.5 (3.8)
			Nordea funds	4.8 (0.2)				
Foreign		NM		41.3 (1.6)		29.7 (31.1)		47.1 (38.1)
ERICSSON								
Largest owner	SHB-group	3.9 (30.4)	SHB-group	5 (42.9)	SHB-group	3.7 (20.2)	Wallenbergs	5.3 (21.5)
	Wallenbergs	2.4 (23.3)	Wallenbergs	3.7 (42.0)	Wallenbergs	5 (19.7)	SHB-group	3.6 (20.4)
Institutions	AP4	2.4 (8.6)	Skandia	1.7 (5.0)	Skandia	0.9 (2.4)	AMF	3.2 (1.9)
	SPP	4.8 (2.3)	AP4	4.2 (1.1)	Swedbank	2.6 (1.7)	Swedbank	3.1 (1.8)
Foreign		35 (0.3)		45.1 (0.8)		44.9 (27)		62.2 (36.5)
H& M								
Largest owner	Persson	27.7 (67.1)	Persson	47 (74.2)	Persson	43.5 (72.5)	Persson	44.4 (73)
Institutions	Swedbank	17.7 (8.1)	AP4	5.1 (2.5)	Swedbank	2.8 (1.3)	Alecta	4.1 (2.09)
	SEB funds	4.9 (6.8)	Skandia	4.3 (2.1)	Alecta	2.4 (1.2)	Swedbank	2.3 (1.1)
	AP4	6.7 (3.1)			AMF	2.3 (1.1)	AMF	2 (1)
Foreign		NM		24 (11.7)		19.7 (9.6)		23.9 (11.6)
SANDVIK								
Largest owner	Skanska	21.8 (25.6)	Skanska-group	20.3 (26.1)	SHB-group	16.8 (18)	SHB-group	18 (18)
	Wall	5.2 (6.1)	SHB-group	7.1 (8.8)				
	Stenbeck	4.0 (4.6)						
Institutions	AP4	6.3 (7.4)	Swedbank	10.7 (10.9)	Swedbank	2.5 (2.7)	Alecta	4.8 (4.8)
			AP4	6.2 (7.8)	AMF	2.4 (2.5)	Swedbank	3.2 (3.2)
			SPP/Alecta	3.1 (3.8)	SHB funds	2.2 (2.4)		
Foreign		NM		14.8 (5.8)		37.8 (40.3)		30.3 (30.3)

Source: Aktieservice.
Gray area highlights time of large investments. Many of these investments included large voting power, which were not used for particular influence.

The evolving ownership landscape has had implication for Swedish corporate

governance. The Swedish governance regime is considered very shareholder friendly and open for takeovers (Kallifatides et al., 2010; Nachemson-Ekwall, 2012). It is based on a tradition of actively involved block holders where influence is enforced through the right to control the board chair and a system of differential voting rights. This legacy of the actively involved block-holders has historically been supported by a system of closed end investment funds (the so called CEIFs with the Wallenberg sphere and the Handelsbanken sphere) and crossholdings, which influence during the last twenty years, have diminished (Angblad et al., 2001; Burkart and Lee, 2008; Henrekson and Jakobsson, 2012). Thus, Swedish incumbent block-owners have, despite their decreased capital holdings on the stock market (and a high number of takeovers), been able to remain in the drivers' seat, supported both by the Companies act, and regulation limiting investments and voting by domestic institutional investors. The usually procedure up till the end of the financial boom year 2007–2008 was that Swedish institutional investors when they participated in nomination committees acted passively, either supporting larger shareholders (Hellman, 2005) or selling at times of takeovers (Kallifatides et al 2010; Nachemson-Ekwall, 2012). For long activism by institutional investors was limited to a few high-profile cases where media outcries were highly effective.[iv]

In the post-financial crisis era the influence of minority shareholders (likely to be institutional investors) is enhanced by the fairly recent formalization of a shareholder-appointed nomination committee made up of representatives of the largest shareholders (Swedish Code, 2015; Kallifatides et al., 2010; Nachemson-Ekwall and Mayer, 2017). A typical NC will be made up of one or two representatives for the controlling shareholder, acting as Chair and two or three institutional investors. These are likely to be Swedish. Foreign institutional investors usually abstain from participating. The general reason given is that they don't understand the model, there is a language barrier and there are problems related to allocation of time (Ehne, 2014).

Concerted activities among shareholders are thus encouraged rather than explicitly restricted as in the UK. There is generally high trust between majority and minority shareholders (Gilson, 2006; Sinani et al., 2008).

Nevertheless, the influence of Swedish institutional investors is limited. Part of this

can be related to an historical concern of center-right political parties that corporatist and national pensions funds, which play a large role in the Swedish welfare state, might take over the control of enterprises and socialize private businesses.[v] There has been a parallel concern that the four large banks that control mutual funds (Handelsbanken, Swedbank, SEB and Nordea) will act in the interest of their related ownership spheres rather than in the interest of their fiduciaries.[vi] Swedish legislation therefore caps the influence of both mutual-fund groups and the four SNPFs in a specific investee company to ten per cent of shares or votes. In addition, each SNPF may only own 2 per cent of the SSE. In practice, the SNPFs have pursued diversified investment strategies that have fallen short of these limits (as the cost of investing time and knowledge supersede the limited ability to allocate enough capital).

Private and corporatist pension funds have more freedom in making specific investments, but are limited instead by capital requirements (i.e. solvency rules such as stipulated through the IORP, 2003/2016). In general, Swedish life pensions have longer commitments than pension funds in continental Europe, thus giving them more flexibility to take on risk and invest in more volatile equities.[vii] Mutual funds are, in addition to the Ucits-directive, limited by a recommendation not to gain dominant influence over a company's management, generally perceived to mean 10 per cent of votes or shares (Law on investment funds 2004:46).

Also, control and engagement is often related to the presence of multiple voting stocks. Though there is no legislation actually hindering institutional investors from buying shares with multiple voting stocks norms and rational logics stops them.
Limits on control means that buying multiple voting shares will hinder some institutional investors from investing as much as they wish. Statutes claiming that investments should only focus on economic performance have also been interpreted as buying less liquid multiple voting stocks, as to gain influence, not being in congruence with prudent asset management. As a result, power exercise has historically been left in the hands of family owners, financial investors or activist block-holders.

Despite the above limits to universal shareholder engagement, Swedish institutional investors are active on the domestic market. All the large investors publish

stewardship codes, but there is no general one like the UK Stewardship Code (FRC, 2012). Institutional investors generally participate in self-regulatory bodies and on nomination committees (Nachemson-Ekwall, 2012). All large institutional investors have signed different international conventions and 12 are signatories of UNPri.

A few in-depth studies with both quantitative and qualitative data have been conducted to explain how Swedish institutional investors act on the domestic market within this regime and limitations. Using data from the mid 1990s, Hellman (2005) finds that institutional investors do not assume active ownership because they lack the organizational capacity or design to acquire adequate knowledge about specific investee companies. As in Tilba and McNulty's British study (2013), Hellman finds institutional investors designed for exit behaviour because of their dependency on external advisors and their over-emphasis on quarterly financial information.

Otherwise the general picture is that the activities by Swedish institutional investors on the domestic market are influenced by a quest for societal legitimacy (Bengtsson, 2005), and they are happy to form coalitions with other institutional investors (Jansson, 2007). They are also quick in their decision to sell during a bid, tracking relative stock performance on a short-term basis (Kallifatides et al., 2010; Nachemson-Ekwall, 2012). As a result, Swedish institutional investors have not been as active as corporate governors as the Swedish governance framework would seem to allow, governance usually allocated to the largest owner, which is likely to be a family, entrepreneur, CEIFs or an industrial owner, and the cases of shareholder activism limited to a few highly publicized cases.

A number of actors have highlighted the lack of long-term and committed institutional capital to SMEs, small and middle-sized Swedish enterprises (Nasdaq OMX Stockholm, 2013/2016; EU Commission Research and Innovation, 2013; Confederation of Swedish Industries, 2014: Nachemson-Ekwall, 2016). Henrekson and Jakobsson (2012) and Nachemson-Ekwall (2012) point to the large number of Swedish listed companies that are taken over by foreign companies. In 2014 the right-of- centre government asked capital-market actors to present ideas on how to enhance long-term ownership.

However, there appears now to be movement by institutional investors in the direction of long-term and committed investment practises. When the health-care provider Capio was reintroduced on the SSE in June 2015 four investors identified themselves as long-term, committed “anchor” owners, three of which were domestic Swedish institutional investors.[viii] Chinese owned Volvo Cars in December 2016, attracted SEK5bn of new Volvo preference shares from AMF, AP1 and Folksam, thus signaling expectations of a listing on Nasdaq OMX. In addition, the domestic ten per cent limit to voting rights by mutual funds is being tested. Mutual-fund groups can increase ownership by complying with an alternative investment-fund directive (AIFM, 2011) or by incorporating outside Sweden. Nordea has moved its legal entity to Finland. In summary, there are indications that a possible change in investment rationale might be on its way, thus creating conditions for novel qualitative research.

RESEARCH DESIGN AND METHOD

This study answer calls from Zattoni et al. (2013) for governance research to move away from agency theory’s preference for quantitative methods in the direction of collecting real-life data in order to incorporate social phenomena into corporate governance theory. Compiling an exhaustive list of Swedish institutional investors active on the SSE is fairly easy. Ownership of Swedish companies is registered through the Euroclear database. SIS Ownership Service, Aktieservice.se and Holdings.se compile all this data and offer a transparent view of all shareholdings and owners. The data provides a fifteen-years history and is updated on a quarterly basis. From this, we compiled a list of the 25 largest investors on the SSE. To get a full picture of the asset management strategies of the domestic institutional investors we compiled a parallel list of the 18 largest Swedish asset managers. Our final list of targeted institutional investors covered fifteen actors and one activist hedge fund, of which one declined participation. Together the group had approximately SEK600bn invested on the SSE, 17 per cent of the market capitalization. The numbers of investee companies were stratified on a 3% ownership level, the level usually called a stake in the international governance literature and a 5% level in line with stock exchange flagging requirements. Sample periods were the years 2001, 2007 and 2017, thus indicating possible refocus of the investment style in both the pre and the post financial crisis period.

Additional data on individual investments in different asset classes were compiled from public accounts. Following Bansal (2012), we made use of an eclectic search process in compiling material from each organization to enhance our ability to pose relevant questions during the interviews. Interviews were arranged with a total of 46 actors (Appendix A provides the list of respondents). Data was collected between December 2013 and January 2015. All interviews started with open-ended questions (Noaks and Wincup, 2004) that led answers on the key factors that govern the particular organization's decisions to invest or not in specific listed companies. 43 semi-structured discussions with 46 respondents occurred, lasting 40–90 minutes. More interviews would likely add scope but not contribute to the theoretical question: as such the study reached a level of saturation (Strauss, 1967; Eisenhardt, 1989). Appendix B provides the list of questions. Not all were posed to all respondents. Follow-ups were done in both 2016 and 2017.

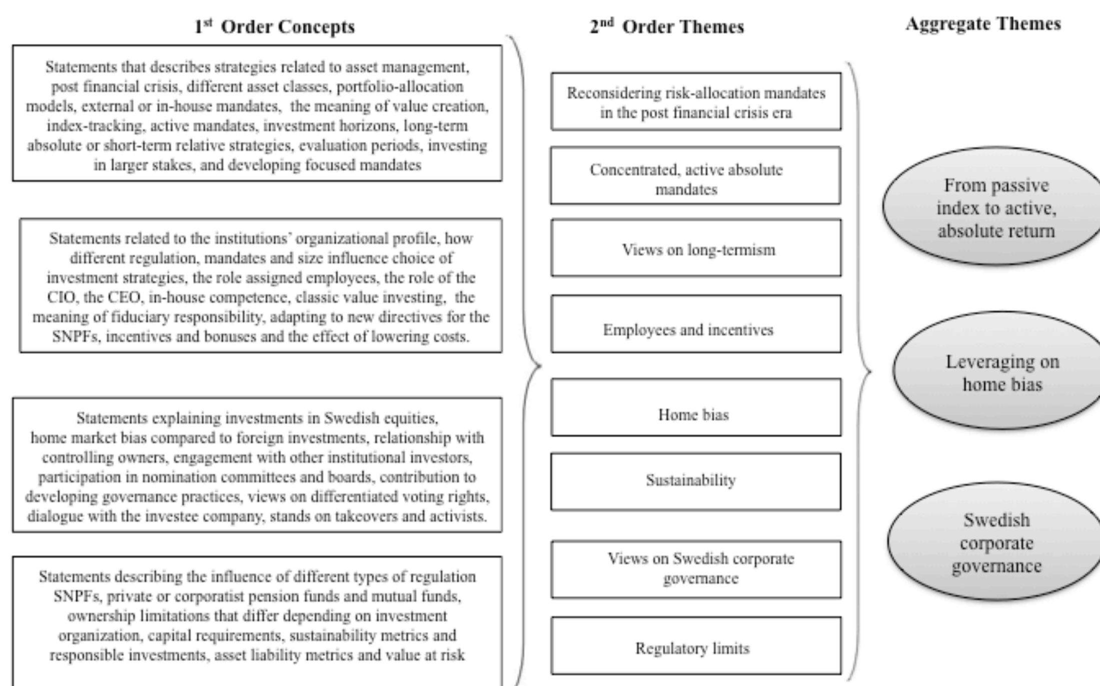
Data and Documentary Analysis

The digital recordings (and three collected only through note taking) were transcribed; 34 hours of recordings became 360 pages of transcriptions (Times New Roman; 12 point; single spacing). Using the NVivo research software we coded concepts and phrases into categories and topics to structure analysis. Figure 1 summarizes the coding schemes. First the texts were coded as first-order concepts using both phrases and related words to produce sixteen main categories (mother nodes) and 58 subcategories (daughter nodes).

These nodes can broadly be categorized into four topics to offer general insights into factors that either support or restrict the organization from taking larger stakes in domestic investee companies. In the next step of data analysis, we used both adductive and deductive reasoning to identify novel patterns and links in the material for comparison with the existing literature (Strauss, 1987: Eisenhardt, 1989) on asset-management strategies and institutional investors as corporate governors. In the process, it became clear that an organization's perception of long-term investing and value creation was not related to its specific role as a mutual fund, or fund for private or state-controlled pensions. Furthermore, in some organizations a large stake

commitment was anchored in a top down process; in others, it had emerged from an individual asset manager. The choice to invest in larger stakes reflected a combination of the profile of an existing asset portfolio, the risk-allocation metrics and evaluation periods, the role of the CIO, the educational background of the people employed and the access to capital.

Figure 1: Coding scheme



The multiple accounts and comparisons could then be streamlined into eight 2nd order themes. In the last iteration, the focus was moved to detecting arguments for, and relationships relevant to the development of a focused Swedish mandate. This emerged as three aggregate themes manifest as a 44-page document of quotation to be translated into English and double-checked with respondents.

All the institutional investors provided public documentation in the form of annual reports and accounts, performance evaluations and asset-allocation mandates. Most of them also provided material related to corporate governance policies, sustainability reports and participation in nomination committees.

An understanding of the influence of policies and regulations on asset management in different organizational setups was acquired by studying official material and policy documents (reports from OECD, G20 and EU). In relation to the retail funds documentation included the *UCITS IV Directive* (2009), the *AIFM Directive* (2013), *ELTIF* (2013) and *Law (2004:46) on Investments Funds*. In relation to the SNPFs, documentation included the *Law (2000:192) on Swedish National Pensions Funds* and the proposed reformation of the SNPFs (SOU 2012:53). In relation to the private life insurance and occupational pensions industry there was a need to understand solvency rules.

RESEARCH FINDINGS

In this study, we find that almost all the domestic institutional investors take larger stakes in investee corporations on the domestic stock market. Table 3 lists the stakes taken by the 18 largest Swedish institutional investors and their investments concentration in 2001, 2007 and 2015 as well as 2017. There are 250 companies listed on the SSE, large as well as midsized and small. In 2007 Swedish institutional investors held few stakes larger than a few percentages. Three had portfolios of around 30 or 40 stocks already before. Following the financial crisis (2008–2010), there appears to have been a re-concentration, albeit not to the levels seen before the millennium. Of the 18 largest Swedish institutional investors on the SSE, making up 21 per cent of the SSE's value, 15 have increased concentration. At the same time the overall presence on the SSE has been reduced by a few percentages (as shown in table 1 previously) indicating that the focus is probably higher. This includes Folksam and Skandia, both having made large investments in specific companies, the financial institutions Swedbank and Skandia AB. In 2015 only two had retained a dispersed investment portfolio.

Two have reduced holdings, AFA and Alecta. In the case of Alecta, the investment style had been to concentrate on larger stocks with the effect that stakes in specific companies have gone down (as shown in Table 3). Before the millennium Alecta held more than 60 stocks. By 2005 Alecta's portfolio had been reduced to 30 stocks. In 2015 over 98 per cent of its equity assets were allocated to 20 stocks.

Table 3: The largest Swedish institutional investors and their stakes on the SSE

		> 3%				> 5%						
2017	**Institutional Investor**	**2001**	**2007**	**2015**	**2017**	**2001**	**2007**	**2015**	**2017**	**Focus**	**B. SEK**	**No. stocks**
1	Swedbank Robur	50	57	89	139	27	29	55	102	+	213	213
2	Alecta pension & funds	29	21	18	22	7	15	9	12	+	152	36
3	AMF pension & funds	19	8	24	36	9	5	11	16	+	145	161
4	SHB funds	11	6	52	70	2	4	19	34	+	114	184
5	SEB funds	35	20	31	44	21	6	16	23	+	95	291
6	Nordea funds	14	25	46	49	4	8	26	31	+	69	198
7	SNPF4	7	17	36	55	0	8	15	31	+	58	135
8	Skandia life & funds*	43	32	12	16	15	26	6	8	(-+)	56	677
9	Didner & Gerge funds	-	16	19	26	-	7	9	13	+	49	71
10	Folksam ins +KPA**	0	0	1	1	0	0	1	0	(=)	46	50
11	Lannebo funds	-	15	50	46	-	8	32	37	+	44	97
12	Länsförsäkringar funds	3	21	24	24	0	5	14	19	+	43	243
13	SNPF3	2	3	5	9	0	0	3	5	+	38	155
14	Carnegie funds	-	6	10	19	-	0	8	16	+	34	67
15	SNPF1	0	2	3	10	0	1	3	6	+	32	26
16	SNPF2	5	4	10	14	0	1	5	6	+	30	159
17	AFA insurance	6	24	5	11	1	13	3	2	(-+)	30	60
18	SPP funds	-	-	0	0	-	-	0	0	=	29	77

Source: Aktieservice, 2007; Holdings.se 2016
* Bought Skandia AB for SEK 22.5 Billion in 2011, and sold off parts of the Swedish portfolio
** Bought 10 % in Swedbank for SEK 10 Billion in 2008

Interesting here is the enhanced focus that shows up when statistics also include 2017. The majority of the institutional investors have enhanced the focus further during the last two years, Swedbank i.e. moving from 89 holdings above 3 per cent to 139.

Overall, the concentration of stake holdings identified in Table 3 reveal how the allocation of capital and resources to committed and engaged stake holdings reflect a mixture of the organizations' individual preferences and related risk mandates that are limited by quantitative regulation. There are clear differences between the risk taking in life-insurance funds and the state-controlled pension funds on the one hand and the profit-driven mutual fund industry on the other hand, where responsibility for risk is transferred to the individual investor. In the SNPFs and the life-pensions funds, the board of trustees decide on the long-term goal, usually based on different types of asset-liability management studies (ALM-studies). The board of director sets a given risk mandate that might be stated, for instance, as: *"volatility might not exceed 10 per*

cent on a daily basis". In the private and corporatist life- and state pension industries, the CEO and CIO have been involved in the strategy for the allocation of capital to different assets (bonds, infrastructure, property, private equity-funds, stocks etc.). In the mutual fund industry, allocation appears instead be decided by the CEO and sales manager, and then approved by the board. All mutual funds have both index-mandates and active mandates with large stakes and stock picking.

The most relevant factors influencing these decisions are discussed below, starting with a description of how risk-allocation mandates have been refocused to enhance performance. We then move on to explain how the efficacy of engagement is contingent on the ability to leverage on home bias, an owner-friendly Swedish governance model and a quest for legitimacy in relation to regulation and sustainability.

Reconsidering risk taking and concentration in the post financial crisis era

Almost all of the institutional investors in this study explain how poor performance during the years just before the financial crisis or as a direct result of the financial crisis 2008-2010 spurred a need to reconsider asset-management strategies. The CEO at a SNPF explains:

> *"Before active mandates and passive index tracking was mixed together and much energy was spent on the management of external and distant mandates. A decision by the organization to reduce exposure to one stock market, such as moving out of US stocks into Swedish stocks, would often distort alpha performance in some part of the portfolio. Moreover, external mandates did not produce real diversification. So, we began to reduce risk-taking and costs, firing the number of analysts. However, the result was still disappointing."*

Hence, in the aftermath of the financial crisis a number of different strategies have emerged. The interviewees describe a period of revising with a process testing different strategies over a number of years (absolute mandates, concentrated strategies, Swedish/foreign, index, external mandates/in-house, private equity, hedge-funds, tactical asset allocation, etc.). The boards of directors have initiated internal discussions about the competitive edge for their particular organization, about how risk is best handled in relation to obligations, and how various performance measures influence possible investment horizons.

Within life insurance and the SNPFs, the interviewees describe the new goals as a move away from *"a return of x % given as low risk as possible"* to a goal to *"maximize return within the limits of x % volatility calculated as an average of the whole portfolio."* One SNPF has reduced the number of stocks in the Swedish portfolio from 60-70 stocks in 2010 to close to 30 stocks four years later. The foreign portfolio has been reduced from 250 to 100 stocks. The CIO of this SNPF explains:

> *"The board and management discussed a set of investment beliefs, like a belief that financial markets aren't all together efficient. We no longer think that index investing is the optimal way to manage assets. We believe that active bets might lead to better performance. The board also relate the risk mandate to its long-term perspective. My job is to translate this risk mandate into operational decisions. One mandate focus on quantitative modelling and beta analysis; another on internal stock picking built up around engaged ownership and sustainability screening. We also have alternative investments where we leverage on our view of long-term investments and illiquidity."*

Two life-pension funds, both pursuing concentrated investments on the SSE, have strengthened their commitment to long-term investing. For these funds, concentrating investments to stocks in fewer large companies is associated with lower cost, lower turnover and increased time spending on learning each company. Both hold some thirty Swedish companies that have been chosen independently of any index. They have outperformed benchmarks over the past five years. The head of equities at one of these life insurers explains how it leverage on a focused mandate:

> *"We know our companies well; we want to be proud of them and feel confident with their performance long term. We also have a low turnover of only 20 percent annually, which means that the whole portfolio is changed every five years. Some positions we have had for a very long time. It all depends on how the underlying business performs. It is a very cost-efficient strategy that supports performance and makes us focus on long-term value creation rather than on expensive trading."*

The other life insurance company has concentrated 98 per cent of the assets allocated to the SSE to 30 stocks. The head of asset management explains:

> *"We were never an index tracker, but five years ago we had 60 stocks in our Swedish portfolio. Now we have 46 and I'd be happy if it was only 40. With fewer stocks governance becomes easier. It also reduces risk and it keeps the cost down. We can take large long-term bets on Swedish individual stocks. We are well capitalized and need not worry about short-term risks. If we need liquidity we can always reduce global portfolio instead."*

The bank-controlled mutual-fund representatives interviewed in the study all described themselves as being in a process of developing both more low-cost index-managed funds and more active long-term fund mandates. The chair of one bank-controlled mutual fund that has moved towards absolute investing explains:

"The (mutual fund) industry is used to benchmarking, but it didn't bring any real value to our customers. We became short-term. Now we focus on creating long-term purchasing power for our customers and to do that we have to create real value. Now we have to take larger bets and invest with a longer time horizon. We have moved from evaluating performance on one month or six month basis to evaluating performance over three or five years instead. The active stock mandate in Sweden has a five year investment horizon."

One SNPF has continuously held a large share of Swedish stocks, constituting 18 per cent of total assets. Around the millennium both the Swedish and the global portfolio were benchmarked against the main indices: it underperformed competitors. Now the global stock mandate is mainly passive and the Swedish mandate focused on stock picking. The person responsible for corporate governance at this SNPF explains:

"If we want to perform better long term, we need to be able to focus on absolute return and risk compensation instead. Today we have committed SEK 8 billion in capital to long-term investments in larger stakes. We don't track indexes any more. This gives us more flexibility. The investments can be in small, medium size and even large companies. The investment horizon is between three and fifteen years."

But a move into index investing can also bring with it larger stakes. If a fund is large, a more passive index strategy will lead to more investments in SMEs than previously, and given that institutional investors seldom buy SME stocks, a large fund will easily end up as one of the largest investor. A deputy CEO at one of the bank controlled mutual funds explains:

"Before we sat on 20 nomination committees but now we sit on 30 nomination committees. It feels strange since we have actually reduced exposure to the Swedish market. This reflects two strategies: more indexing, which means we become exposed to small companies that the other institutions shy away from, and we also started a specialized SME fund."

In summary, we observe a clear and significant connection between an effort to enhance performance in listed equity investing by reconsidering a one-sided dependency on the EMH and instead separating mandates into passive index investing, active tactical mandates and focused stock-picking mandates. It is this third strategy that over time has developed into larger-stake investing on the SSE. Next we explain how these focused strategies enable engaged investment strategies on the SSE.

Leveraging on home bias

Sweden makes up around one per cent of the global capital market. Yet domestic

institutional investors have allocated between 10 and 20 per cent of total assets under management to the SSE. Of the total stock mandate between 30 and 50 per cent is invested on the SSE. The mutual funds all have dedicated Swedish funds.

Regardless of which investments style, index, active, or engaged, all institutional investors in this study adhere to the standard description of the merits of home bias. The companies on the SSE are perceived as being well managed, and they deliver good performance over the long term. The head of stock investing at a life-insurance company with a more diversified strategy, explains:

> *"Our diversified asset portfolio is very Swedish. 70 per cent of assets are invested in Sweden. We have 10 % in Swedish stocks. We believe in home bias. We have been around for a long time; we know our companies, engage in corporate governance and can talk to the directors. I would describe us as hyper active on the home market. It pays off long term. And our property and bond portfolios are Swedish and very much of our private equity-portfolio. Outside Sweden my network is weaker. In Asia I am a nobody."*

All institutional investors highlight the close interaction between domestic institutional investors in the Swedish corporate governance model. Large shareholders are expected to be engaged and to coordinate activities. Everyone knows each other. A chair can easily get in touch with the five largest domestic investors whereas the foreign institutional investors are either disengaged or difficult to reach. The head of sustainability and governance of a bank-controlled mutual fund describes its role:

> *"We are neither passive nor incompetent. We have been practicing governance for twenty years now. When we make large investments, we engage long term. Sweden is in the forefront in this process. It is expected of us that we are engaged and responsible. See how much the media is writing."*

Swedish governance and the nomination committee

All the institutional investors in this study participate in the work of the Swedish model of an externally elected nomination committee usually made up of the four largest shareholders. Directorship is delegated to either controlling shareholders or independent directors. There is a widespread view among the domestic Swedish institutional investors that institutional investors should not sit on boards, and their classic position has been to see participation in the nomination committee as a responsibility carried out by a corporate-governance specialist, independently of the investment strategy of the asset manager. However, this seems to be changing now. In this study, only two of a total of eighteen institutional investors adhere to this classic

view. The rest present various approaches to the nomination committee. The deputy CEO of one of the bank-controlled mutual funds describe how the governance activities have evolved:

> *"We have an ownership policy that is cleared by the board of trustees once a year. Two board members work with governance, and they are also involved in some of the nomination committees. Every other year something controversial emerges and in that situation, we talk directly with the external trustees. We are much more engaged now than five years ago. Today we try to act proactively, before we were more ad hoc. We don't wish to become insiders, so the asset managers aren't involved. But I ask them for advice."*

A head of assets at one of the life-insurance companies explains how the Swedish governance models and participation in the nomination committee support large investments and activity without too much engagement:

> *"We make large long-term investments in good companies with good governance. It takes some time to build a position and we cannot just sell off. But we are not competent owners here either. We lack that organizational set up. We prefer companies that have a controlling shareholder. We want them to look upon us as a reliable partner that gives the board and management long-term support for their strategy. We don't like when the hedge funds or American asset managers ask for share buy-backs, increased leverage, higher payouts, takeovers or split-ups. Some of these become very upset when there is a rights issue. We prefer to own financially strong companies."*

All the institutional investors in this study that have combined increased stakes in specific companies and a longer investment horizon claim that it is valuable to increase engagement in the nomination committee. But engagement differs according to presence or absence of a large block-holder shareholder. This is explained by the head of Swedish-asset management at a bank-controlled mutual fund that has abandoned index tracking for larger stakes and is now involved in 20 nomination committees:

> *"We are very knowledgeable about the company and its strategy. If the company lacks a controlling shareholder, we receive help from a head- hunter in the search of a new director. If there is a controlling shareholder, he or she usually has a succession plan for the directors. Then I can focus on having a strategic discussion with the chair. I sit on the four nomination committees where our funds have their most important investments. I receive help from our corporate governance specialist. We meet once a month."*

A CEO of a mutual fund with a special focus on investing in small and midsized stocks explain how the fund managers think that the work in the nomination committee drives the value of the investee companies:

"We sit on 28 nomination committees. We are willing to be active and engaged. But we are not activists that are looking for a quick turn-around. It is those asset managers that have made the investments that are involved. It takes time and energy, but we think it is important and that it contributes to long-term value creation. We feel welcomed and we have a good network. We might get upset and write a letter to the board telling them that their strategy is failing and leave suggestions. Sometimes we change board members. But it is not what we are aiming for."

A number of Swedish listed companies do lack a controlling owner. Less than 50 per cent have multiple voting stocks, implying that any investor that buys a large stake, no matter what the intention, will gain access to the board. Almost no initial public offerings, IPOs, include multiple-voting stocks. Two of the institutional investors in this study feel that they have a role to play in the interface between the private equity owners and the stock market. They are happy to take a large stake, like 7-8 per cent, in an IPO to become "anchor investor". The person overseeing ownership issues at one of the SNPFs explain:

"It is a dilemma when there are IPOs done by private equity as these companies lack a long-term, committed owner. We can buy a large stake, but we don't want to be the only large investor because then we will be sitting with all the responsibility. But I can see situations where we are two or three institutional investors that buy between 5 and 10 per cent each. We can have the same long-term view of the company and work together for a number of years. This has already been done in three IPOs."

A life-insurance company claims to be reconsidering bringing their own directors on board. It would be a logical development with an investment policy that is both moving towards taking larger stakes and increasing demand for owner engagement. The head of asset management explains:

"Twenty years ago institutional investors were pure financial players and could leave governance to families or investment companies. Now when we are increasing our stakes, we can't just sell of if there is trouble, especially if the company doesn't have a controlling shareholder. But we don't seek control because we influence for its own sake. As a large shareholder, we have a duty to act responsibly. It is a consequence of wanting to have a larger stake in a company. Today we have an internal list with around 20 companies that we are monitoring very closely. I don't exclude the possibility that we could be represented on the board of directors in some of these companies within five years or so. It's about a lot of money, it's a big responsibility and we have to build competence."

In the same vein, some of the institutional investors with more concentrated mandates see themselves as taking a more active role when controlling shareholders in the larger companies on the SSE wish to sell their shares. A head of global stocks, including Swedish, at a life insurer, explains:

> *"We have to start taking responsibility for the larger companies that have a controlling shareholder. Take (company name). When (the owner) wants to sell down, we institutional investors should be there and buy the shares. Today we are not. I can foresee a time when we could pool our resources together and make a joint investment."*

In summary, almost all our interviews with asset managers and CEOs indicate that the investment organizations, within the limits of their focused mandates, view themselves as capable of acting as long-term responsible owners on the SSE. They are keen to not be viewed as activists who would approach underperforming companies to instigate change and then sell at a profit. As 'engaged' investors they rather support management or other shareholders. They emphasize the high trust between the domestic institutional investors and the controlling owners. They attend AGMs and seldom vote by proxy. All oppose any suggestion that they might be either passive or behave as activists. Instead engagement appeared to be legitimized through skilful handling of regulation and codes. This is discussed below.

Legitimacy through regulation and codes

Here we show that the common view that regulation hinders engagement is more presumption than experience. We show that skillful agency might enable the development of asset-allocation strategies that both handle limitations and can leverage on the legitimacy embedded in a societal movement towards sustainability investing. Quantitative regulation limits both mutual funds and the SNPFs in their investments in specific companies. Two of the SNPFs identify the 10 per cent limit as the root cause of their diversified stock portfolio. At the same time, institutional investors that have chosen a more concentrated investment strategy claim to have developed different ways to cope with the limits. One such strategy is to incorporate the mutual funds in another country that has more flexible regulation.

A CEO of a mutual fund manager with a focused investment style describes what happens due to the combination of the Swedish 10 per cent limit and the Ucits regulation:

> *"Whenever we are successful in our stock picking analysis, our clients are punished by having to settle for less return. As soon as we reach 10 per cent exposure we have to adjust our portfolio allocation. Often, we have to sell down when we don't wish to. So, we usually stop buying a stock when we have reached 9.5 per cent instead."*

Another strategy is pursued through a focused life-science mandate by one of the SNPF. The fund's manager explains how a successful long term and engaged investment strategy can be developed within regulatory limits:

> *"I have to deliver absolute return, which is difficult since we can't take short-term positions, but it is not impossible. At the same time, life science and biotech are very volatile with high betas. So, I reduce volatility by investing in a global portfolio of large stable pharmaceuticals parallel to evergreens. But I am not allowed to own more than 10 per cent in a listed company, which means I have to take a small initial position that I can increase when the company reaches different milestones and needs more money. Today my portfolio consists of 30 % big pharma and 30 % large biotech with a positive cash flow. All are US based. The rest are SMEs, many are Swedish."*

All the institutional investors in this study claim to be working on strengthening their commitment to sustainability. Those that have more index investments commit more resources on screening methods for ESG than those institutions focusing on more active, long-term mandates. However, the institutional investors that have increased their commitment to taking larger stakes all think that an enhanced attention to ESG measures will contribute positively to long-term return. The head of Swedish stocks at one of the bank-controlled mutual funds that has moved away from index tracking into active investing in larger stakes explains:

> *"When we move our investment horizon from 2-3 years to 3-5 it pays off to spend more time on in-depth analysis. It makes it easier to integrate CSR and ESG measures. Companies that scores well on ESG measures deliver more stable cash flow, have lower risk for reputational damage and reduces the down side risk in our stock picking. ESG contributes to performance."*

Another CIO of a SNPFs explain how ESG screening has turned long term and engaged ownership into a pre-requisite for sustainable investing:

> *"Sustainable investing requires long-term commitment and engagement and that requires investment decisions that are made independent of indexes. That makes it more suitable to evaluate performance over a rolling five-year period than three years, as we did previously. Before, the analysts bought what they wanted and our sustainability team came afterwards to clean up. Now CSR has become an integrated part of the financial analysis."*

DISCUSSION

The empirical findings in this article challenge the view of inherited institutional investor passivity. To refine our findings, we present a reconceptualization of the discourse on institutional-investor rationale in a block-holder context that includes the

particular role these actors might play as long-term engaged domestic investors. In this framework, institutional investors' rationale develops through three phases (Table 4). In the first phase, broadly consisting of the period 1980–2000, the collectivisation of the Swedish capital market both took off and began to move abroad. There were investments in larger stakes in Swedish companies but engagement more or less consistent with the Hirschman (1970) loyalty analogy (Hellman, 2005).

Table 4: The evolving rationale of domestic institutional investors' buying of larger stakes in listed companies

Evolving discourse of larger stake

Actions behind larger stakes	Phase 1: ≈ 1980–2000 Home market focus	Phase 2: ≈ 1998–2010 Global diversification	Phase 3: ≈ 2010– Active & passive strategies
Domestic ownership	Large stakes In large companies	Reducing home presence, more diversification and smaller stakes	Large stakes in companies combined with a global or domestic index portfolio.
Regulation	Opening for foreign stocks in 1990. Ownership limits	Market valuation of life assets, Ownership limits	Actively managing of risk allocation in portfolio Ownership limits
Evaluation method	SSE main index	Benchmarking, annual peer comparison	Investment horizon 3–5–10 years, ESG-metrics
Governance activities	Patient and loyalty (Hirschman 1970)	Rational reticent (Gilson & Gordon 2011)	Engaged and responsible (Eccles et al 2011; Mayer 2015)

In the second phase, broadly consisting of the period just before the millennium and up to the beginning of the post-financial-crisis era, the globalization of capital markets was refined with the industry focusing on low-cost bench marking, index tracking and smaller stakes in each company, an investment strategy that both increased passivity regarding engagement in the value-creative governance process and left room for other ownership models, such as private equity firms, foreign investors or activist funds (Henrekson and Jakobsson, 2012). As corporate governors on the Swedish market, institutional investors adopted an investment style resembling a model of being 'rationally reticent' as described by Gilson and Gordon (2011).

The third phase, which is the focus here, can be said to have begun during the final stage of the financial-bubble years, but the results in the form of a general increase of larger stakes in investee corporations on the Swedish stock market show up a few

years into the post-financial crisis era. This change in investment style hinges on a reconsideration of portfolio-allocation strategies that, in line with Petajisto (2013), has become more focused and manages to separate risk mandates for active and passive strategies better than before. In line with Eccles et al. (2011) it connects to sustainable-investment strategies that allow for larger stakes evaluated with a longer investment horizons and more capital available to illiquid assets in SMEs.

Factors that support universal investors in the development of this investment strategy are home bias, a shareholder-friendly governance model and rationally bounded decision making of asset managers. These factors work to enhance shareholder engagement in governance and collaboration between different shareholder groups, small owners as well as block-holders.

Our findings also extend on the Hellman (2005) analysis that builds on data from 1993 and 1995, as well as research conducted a few years after the millennium (Bengtsson, 2005; Jansson, 2007). Much has changed since then, regarding both the ownership of Swedish companies and the investment style of Swedish institutional investors. The very same institutional investors that supported activists during the boom years after the millennium (Kallifatides et al., 2010; Gordon and Gilson, 2011) are now more willing to hang-on and commit capital to long-term value creation. This also finds support in studies of the work of the external NCs, stating that Swedish institutional investors feel increased confidence in the board function, reduced both the free-rider and collective action problems and broken down the old boys' network (for an overview Nachemson-Ekwall and Mayer, 2017).

CONCLUSIONS AND IMPLICATIONS

Academics and practitioners struggle to develop ways to enhance sustainable corporate value creation (Mayer, 2013/2015). By leveraging on qualitative research methodology, this study is able to reveal a pattern of changes in domestic institutional investors' rationale for acting on a domestic stock market. In this case we address actors on a market with a shareholder-friendly governance framework where most companies – but not all – have a controlling shareholder. Suggesting a reconceptualization of this evolving rationale among domestic institutional investors,

we challenge both conventional ideas on rational disinterest in engagement and a need for regulation to limit domestic ownership. Rather, this study broadens the perspective on institutional investors that are willing to reconsider portfolio-allocation policies. In a setting with strengthened minority rights domestic institutional investors can, if they wish, already within limits of both current regulation and portfolio allocation models contribute to sustainable corporate value creation. This highlights the embedded character of domestic institutional investors' engagement (Fligstein, 2001; Roe, 2003; Aguilera and Jackson, 2003; Gourevitch and Shinn, 2005). Following Aguilera and Jackson (2003) we have especially highlighted three contingencies for institutional investor engagement – how well a given governance system support minority shareholders ability to exercise voice, reconsideration of asset-diversification strategies as well as the effect of regulation and codes. Our research distances itself from academics that asks for new regulation (Yermo, 2008, McCarthy, 2014, Bolton and Samana, 2013; Mayer, 2013) or focus on shareholder activism as a solution of the ownership vacuum (Becht et al, 2010; Gilson & Gordon, 2013. With new norms, behaviour changes.

The finding here can thus be especially important for policy makers across Europe that wish to enhance long-term engagement, where Sweden is no exception (Nasdaq OMX Stockholm, September 2013). With a focus here, on a purely Swedish sample, it would be fruitful to see further research on evolving rationalities among domestic institutional investors in other countries. How a more focused investment style contributes to both asset performance and corporate governance should be a lucrative avenue for research.

Findings that Swedish institutional investors when reconsidering long term investment mandates are moving in the direction of Hawley and Williams's fiduciary capitalists should be of interest for policy makers that wrestle with how to strike the right balance between large stake holdings and corporate governance policies. For example the limited efficacy of stewardship codes, such as the UK Stewardship Code (FRC, 2012), might not only be blamed on the organization with intermediaries of the British asset management industry (Tilba & McNulty 2013). The lack of British support for minority owner-engagement as corporate governors might be just as important. Going forward, we argue that to foster engagement, policymakers should

look towards the governance-systems ability to engage minority shareholders, i.e. in the findings here, the role played by Swedish external nomination committees.

Appendix A: List of interviewees from institutional investors

Type of organization	Position
SNPF A	CEO
	Com. Manager
SNPF B	CIO
	Owner Manager
	Director
SNPF C	CEO
	Com. Manager
	Asset Manager
SNPF D	CEO
	CIO
	Com. Manager
	Asset Manager
	Head of Legal
SNPF E	Ow/Com. Manager
	CIO
	Director
Total Assets, Billion SEK	**1 300**
Swedish Stocks	**133**

Type of organization	Position
Life Insurance V	CIO
	Asset Manager
	Owner Manager
Life Insurance W	CIO
	Asset Manager
	Com. Manager
Life Insurance X	CIO
	Ow/Sust. Manager
	Com. Manager
Life Insurance Y	CIO
	Asset Manager
	Sust. Manager
Life Insurance Z	CEO
Total Assets Billion SEK	**1 700**
Swedish stocks	**255**

Type of organization	Position
Retail fund K	CEO
	Asset Manager
	Owner Manager
	Owner Manager
	Director
Retail fund L	Owner Manager
	Owner/Asset Manager
Retail fund M	CEO
	Asset Manager
	Owner Manager
Retail fund N	CEO
Swedish stocks Billion SEK	**305**

Hedge fund manager
Head of pensions fund regulation
CEO of Proxy voting firm
Private risk consultant
Risk consultant, partner

Appendix B: English translation of interview protocol

Start recording

- Short introduction of the research project and role of the interviewee.
- Assure confidentiality and anonymity and that the interview only has an academic purpose.
- Ask for permission to record and stress that the recording can be stopped at any time.

Introduction

- What is your position, area of responsibility and to whom do you report?
- What is your background?

The organizations characteristic and governance

- Describe how this asset manager works?
- How does this organization differ from other asset managers (customers, risk mandates)?
- How is this reflected in how the organization allocates capital to different asset classes (debt, equity, property, P/E)?
- How is the performance of the asset portfolio evaluated (index, time horizon, risk metrics)?
- Where in the organization are the decisions made related to size of investments in specific assets and level of engagement?

Regulations and codes

- What are the most important regulations that the organization follows (law or codes)?
- What are the challenges going forward? (A private or corporatist pension fund) What do you think Solvency II and IORP will bring?
- How does regulation limit the return on assets or risk allocation mandates?

External expertise (actuarial, pensions expert, investment managers)

- Do you experience any built-in conflicts in the investment chain?
- What role do you play in the organizations investment process? With whom do you work?
- What role do you think that yours and other experts advise play?

Societal relationships

- What are the most important challenges for the savings industry?
- The most important challenges for the Swedish capital market?
- How do you relate to an increased societal quest for sustainability/ CSR-metrics?

Investments

- How are decisions made related to investing in larger equity stakes?
- Explain the difference between investing in different asset classes (such as property, foreign equity, PE, domestic and foreign?
- How are internal resources shared/ in heads between different investment strategies?
- Are incentive programs used?
- Challenges going forward?

Engagement

- How are the contacts with larger investee companies pursued?
- Described the engagement in nomination committees? Relationship to other investors?
- What is the active-mandate allocated to the asset manager and how is the board involved?
- How are the engagement connected to the commitment to policyholders?

Concluding remarks

- Anything you wish to add? Something you wish to ask?
- Thank you for your contribution.

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[i] In OECD countries this group of institutions more than doubled their total assets under management from USD 36 trillion in 2000 to USD 73.4 trillion in 2011. The group accounted

[ii] For example Canadian pension funds CPPIB, PGGM, the coordinator of the five state controlled Dutch pension funds, Generation Investment Management, started in 2004 by Al Gore, as chairman, and asset manager David Blood and Governance for Owners started in 2004 by former asset managers at Hermes, the pension fund of British telecom.

[iii] Swedish institutional investors were allowed to invest freely outside Sweden in 1989.

[iv] Among high profile cases are the halted Volvo-Renault deal (1993), the crash of the insurance company Skandia (2001), the ABB-scandal (2000) and lately, the criticized cross-holdings between Industrivärden and Handelsbanken (2015).

[v] This worry still prevails and can be related back to the intense debate of the planned introduction of the Swedish wage-earners funds in early 1980s (for an account see Nycander, 2008).

[vi] This would historically be especially relevant for Handelsbanken, SEB Group and Swedbank with their respective involvement in the financing of different parts of the Swedish industrial (HB and SEB) and corporatist sector (Swedbank).

[vii] This was highlighted in the Swedish public debate related to the introduction of the IORP Directive; SOU 2014:57 – En ny reglering för tjänstepensionsföretag (Fi2014/3021).

[viii] SNPF4, Swedbank Robur and Handelsbanken funds took 14 % of the stocks and the family trust af Jochnick an additional 6,5 % (Capio, press release, June 9, 2015).