SUSTAINABLE DEVELOPMENT AND BUSINESS

Markus Kallifatides and Lin Lerpold (eds.)

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The mission of the Mistra Center for Sustainable Markets (Misum) is to strengthen Sweden's competiveness in sustainable markets, in part by supporting Swedish actors in these markets with both research findings and directly applicable solutions. The Mistra Center for Sustainable Markets is a cross-disciplinary and multi-stakeholder research, education and outreach center at the Stockholm School of Economics.

This book is dedicated to Marie Ehrling for her long commitment to enabling studies of management practice conducted by researchers at the Stockholm School of Economics. Her commitment to research has also greatly contributed to our mission of science-based education and, thus, our students' education. Marie has also acted as an important executive within the sustainability field. She is deeply knowledgeable of the dynamic nature between business and society, encompassing both challenges and opportunities, some of which this book addresses.

Contents

Acknowledgements

Every year since 1992, the SSE Institute for Research (SIR) has produced an Annual Book.[1] As a sign of the times, this volume marks the third time the book has been written in English rather than in Swedish, for several reasons. Firstly, the Stockholm School of Economics is the workplace of many academics who do not speak, read or write in Swedish, and the invitation to participate in the Annual Book was extended to all academics at the School. Secondly, this year's theme of sustainability is inherently global (as well as local), and we intend for as many people as possible to be reached by our efforts at approaching, and formulating, these questions. We therefore extend our sincere gratitude to Michelle Vessel for her suggestions on how to write in the English language. We also thank Petra Lundin for her graphic design of the book.

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Stockholm, December 2016

Markus Kallifatides and Lin Lerpold

1 Up until 2009, the Annual Book was produced by Ekonomiska forskningsinstitutet (EFI), the predecessor to SIR.

CHAPTER 11

Swedish institutional investors as large stake owners

Enhancing sustainable stakeholder capitalism

SOPHIE NACHEMSON-EKWALL

Introduction

This chapter focuses on the special role domestic institutional capital, collected in pension, state and private, and retail funds, might play as owners on the stock markets and how these, when seen as long-term engaged stakeholders, might contribute to building sustainable business models (Eccles et al. 2011; Gore and Blood 2012).

Institutional investors have emerged as the most important investor category in globalized capital markets, accounting for 40 per cent of the listed shares (OECD 2013). The value of long-term committed institutional capital has as a result become a central topic within both the corporate governance paradigm (Mayer 2012) and the sustainability discourse, with a number of calls for responsible engagement coming from international bodies.

Sweden is used as a case study. Strand and Freeman (2015) claim that Scandinavian companies are exceptionally skilled at implementing value-creating sustainable strategies based on cooperation with their stakeholders, and in the process creating a cooperative advantage. Here it is added that the Swedish shareholder-friendly corporate governance system enables owners to play a more active role as governors than is usually possible in other countries. Historically, however, regulations and norms have generally prevented domestic institutional investors from engaging more actively, as has been discussed in a number of policy reports highlighting concerns with the lack of long-term and committed institutional capital to small and mid-sized Swedish enterprises, or SMEs (Nasdaq OMX Stockholm 2013/2016; EU Commission Research and Innovation 2013; Confederation of Swedish Industries 2014: Nachemson-Ekwall

2016). At the same time, the role of Swedish institutional investors as stakeholders remains significantly under-researched.

This chapter aims to address and help to fill in this gap in the research. It is here suggested that if Swedish institutional investors develop and implement new policies pertaining to larger-stake investments, it could change the role these investors play in supporting companies' long-term strategies, while simultaneously bolstering their sustainability efforts. To understand this potential change, however, the meaning of long-termism and sustainability must be clarified.

Long-term capital is here defined as financial assets that are invested with a long-term horizon related to absolute return metrics connected to GDP growth. Access to this capital is important for a number of reasons:

- It supports investments and risk-taking. As such, long-term ownership matters for corporate value creation (Mayer 2013; Bolton and Samana 2013);
- It grants management the latitude to engage in the strategic work necessary to develop and maintain sustainable business models (Gore and Blood 2012); and,
- It supports the corporation's collaboration with the larger society by enabling stakeholders to play a role in the development of environmental, social and corporate governance, or ESG, standards and practices (Porter and Kramer 2012; Strand et al. 2014).

Sustainability is a multifaceted concept that involves ESG and institutional arrangements. As a result, sustainability can have a number of meanings depending on the context (Halme et al. 2009). Here I refrain from addressing the definition of sustainability *per se*; rather, the focus is on how a corporate governance system can support collaboration among stakeholders who wield influence over decisions that determine whether corporate value creation can be economically sustainable (for shareholders) and contribute to sustainability (in the interest of the larger society). As such, this chapter will consider how the design of a governance system might support or hinder the engagement of institutional investors as responsible long-term owners.

The chapter highlights the fact that Swedish institutional investors are deeply embedded in the country's welfare system. As a group, they constitute over

20 per cent of the ownership on the stock market. Yet domestic regulation and prevailing norms related to portfolio asset management have long prevented them from having a significant degree of involvement as corporate governors. Consequently, their potential role as long-term owners has been overlooked (Hellman 2005; Kallifatides, Nachemson-Ekwall and Sjöstrand 2010).

Drawing on novel research by Nachemson-Ekwall related to investments by 18 large domestic institutional investors, it is here suggested that Swedish institutional investors have embarked on a process of refocusing their domestic equity investment mandates since 2010, moving away from strategies that more or less amount to index tracking and towards strategies designed to commit more capital to larger-stake investments on the Stockholm stock exchange.

In-depth interviews with 40 institutional investment stakeholders reveal that these more focused investments are beginning to be evaluated with a longer time horizon, tracking absolute performance in line with GDP growth. The interviewees claim that this approach enhances returns and increases engagement, while at the same time leveraging the Swedish shareholder-friendly governance model and supporting corporations' commitments to sustainable investments.

To further our understanding of the drivers of this possible change, I devise a model of the Swedish version of the Nordic governance system by drawing on a number of research traditions.

Firstly, I look at the value of stable long-term owners within the corporate governance paradigm (Mayer 2013; Thomsen and Hansmann 2016). Nordic company law grants special treatment to large owners (Lekvall 2014). This view of the value of owners is complemented by research assessing stakeholder engagement in corporate governance as a means of limiting influence from owners that may tend to focus narrowly on maximizing (short-term) shareholder value (Stout 2013; Bolton and Samana 2013).

Secondly, I draw on a growing literature refuting a number of long-established concepts within the finance theory paradigm related to asset return, value creation and the role of fiduciary investors. This includes questioning the efficient market hypothesis (Kay 2012) and abandoning diversification and relative index tracking as an investment strategy (de Graaf and Johnson 2009; Petajisto 2013). Instead, the focus is placed on moving in the direction of engaged fund management, through which domestic long-term investment strategies become increasingly attractive.

Thirdly, I combine stakeholder theory (Freeman 1984) with governance research on institutional embeddedness (Aguilera and Jackson 2003). Scandinavian countries have developed a unique system of stakeholder capitalism wherein power over the business sector has long been shared among owners/managers, unionized employees and the state, making the Scandinavians an ideal model for Western coordinated market economies (Thomsen and Conyon 2012). However, with increased focus on shareholders and liquid capital markets, the degree of stakeholder cohesion has diminished over time (Andersson 2015).

The remainder of the chapter is structured as follows. First, I elaborate on three research traditions that, taken together, have long formed the basis of Swedish norms and regulations pertaining to the activities of institutional investors on the domestic stock market. Thereafter follows a description of the data describing Swedish institutional investors as stakeholders and their changing investment policies. I then suggest a reconceptualization of the role of Swedish institutional investors as long-term engaged owners in cooperation with other owners. In my concluding remarks, I argue that the inclusion of Swedish institutional investors as an additional owner group will revitalize and strengthen the Strand and Freeman (2015) discourse of Swedish stakeholder society, and in the process, support the re-creation of a cooperative advantage.

Firstly: Owners as stakeholder

Neoclassical economic theory assumes that firms maximize profits for their shareholder-owners. According to the stakeholder model, however, firms maximize value for all stakeholders. Both models have their own strengths and weaknesses, and these depend to a large extent upon the role assigned to owners in different jurisdictions. At the same time, large (and small) shareholders might either be very much involved in governance or not. Also, in both systems the degree of long-term commitment by key owners has often proven difficult to maintain over time.

Adam Smith (1776) highlighted the difficulty of striking the right balance between different shareholder groups and management after a founder leaves the scene. This is the simple agency conflict, wherein managers tend to position themselves as operating in a manner that is distinct from the influence of distant and anonymous shareholders, particularly in the standard conceptualization of the US Berle-Means firm (Berle and Means 1932; Fama and Jensen 1983).

To enhance management's engagement in value creation, many countries have protective measures in place to support long-term engagement, such as defences against takeover and standard practices to assure management/board independence (Mayer 2015). In governance systems where controlling shareholders have been assigned special legal rights (i.e., through favourable taxes or voting privileges) the agency conflict has not been resolved, but rather, has merely changed its constituent parties to impact the relationships between different shareholder groups (Burkart, Gromb and Panunzi 1997). This might result in a large shareholder diverting resources in favor of its own best interests (Gilson and Black 1995); or a minority shareholder might ride on the coat tails of a larger shareholder (Grossman and Hart 1980).

These owner conflicts are based upon a commonplace dilemma – the inability to strike the right balance between the interests and motives of short-term and long-term owners. A narrow focus on shareholder value might press a company in the direction of short-term decision-making (Jackson and Petraki 2011). Here short-termism is defined in the simplest manner as the innately myopic human preference for material gains today rather than in the future, even if the risk is the same (Haldane and Davies 2011). Such a narrow interpretation of shareholder value puts long-term (and hence, sustainable) value creation at a disadvantage, as it limits the amount of attention that management can pay to long-term investing (Stout 2013), as well as downplaying the company's contribution to social activities that promote an inclusive and cohesive capitalism (Jackson 2008; Jackson and Petraki 2011).

Within the corporate governance paradigm, the classic stakeholder proposition focuses on the company as a whole. Figure 1 illustrates how in order to create value, management must appeal simultaneously to customers, suppliers, employees, financiers, communities and managers (Freeman 1984). The classic stakeholder proposition is often criticized for a lack of clarity in terms of whose interests management should prioritize. Stakeholders, including owners, might have contradictory goals, and management's competing priorities are often difficult to evaluate and manage.

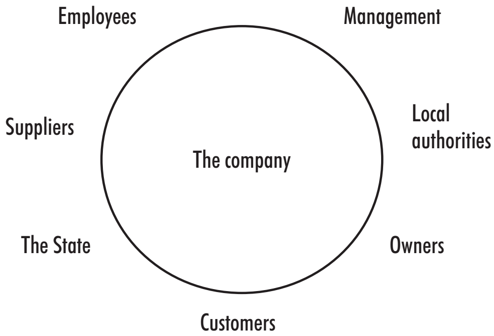


Figure 1: Freeman's stakeholder model (1984)

The way shareholder and stakeholder models are dealt with also differs in corporate governance systems around the world. In Germany, labour plays a central role; in France and Japan, the state has an elevated position; and in the US, the board's work is often reinterpreted as being supported by a charter from society, i.e. the 'license to operate' (Crane et al. 2014). In the UK, shareholders wield a great deal of power, but large shareholders do not control the board of directors. In countries that favour active engagement on the part of large shareholders, such as in the Scandinavian countries, domestic institutional investors are often subject to regulations that prevent them from becoming overly active (Pålsson 2012).

The original definition of a stakeholder was set forth by the Swedish management scholar Eric Rhenman in the 1960s. Rhenman allotted (Swedish) owners a special role as a stakeholder, legally supported by statutes, as well as conceding to a narrow profit maximization purpose of the firm (Carlsson 2013: 373–375). Rhenman's conception of the stakeholder model did not include different owner categories (the ideal owner was depicted as being a family, foundation or investment/holding company), nor did it consider investors' varying investment horizons.

However, following the move that began in the 1980s towards liberalization of Western economies in the direction of free market capital flows, the stakeholder proposition was abandoned in favor of a shareholder value focus, leaving more room for influence to be exerted by both passive and short-term oriented investors.

Sweden was in some ways more affected by this trend towards market liberalization than were other countries. The country has seen the rise of both an active takeover market – second only to the UK – and problems related to a lack of committed owners on the stock market (Henrekson and Jakobsson 2012; Nachemson-Ekwall 2012). At the same time, Swedish institutional investors have behaved as mainstream, disengaged institutional investors, pressing for buybacks and dividend payouts, as well as acting as sellers in bid situations (Hellman 2005; Kallifatides et al. 2010; Nachemson-Ekwall 2012). In this power vacuum, control has been transferred to private equity, foreigners (Henrekson and Jakobsson 2012) and activist hedge-fund investors (Kallifatides et al. 2010). As such, Sweden has experienced the same shortage of long-term committed capital as has been seen in a number of other European countries (EIOPA 2013; Nasdaq OMX 2016).

In summary, governance systems have generally not been designed to deal with domestic institutional investors as a specific owner category. As a result, a governance framework that favors stakeholder-engagement of shareowners will, in a country that embraces a liberalized free market economy, represent an easy target for influence from investors that might have interests that diverge from the corporation's strategy, including a diverging investment horizon. That makes those Swedish listed companies that lack long-term committed owners very responsive to the interests of institutional investors, with no consideration as to whether they are passive, short-term oriented or very active proponents of shareholder value.

The sustainable economic value of domestic institutional investors is discussed next.

Secondly: Domestic institutional investors as asset managers

The emergence of institutional investors with assets from citizen-savers and future retirees is deeply intertwined with the discourse of finance theory and the efficient market hypothesis (Fama 1965). Asset managers' logic of diversification relies upon mechanisms for monitoring portfolio performance relative to their peers, and this benchmark-driven approach to investment runs counter to the active exercise of governance rights.

Problems stemming from institutional investors acting more or less in the manner of passive governors have been identified in many countries, as discussed in a number of studies (Ambachtsheer and Bauer 2013; Tilba and

McNulty 2013). This behavior is due to factors such as complex regulations (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 an increasing concentration of stakes (Jackson 2008); and organizational structures that limit activities to intermediaries (Hellman 2005; Tilba and McNulty 2013). Alternatively, they may simply be a reflection of the rational choice of free-riding (Grossman and Hart 1980).

In the post-financial crisis era, the idea of index tracking built on rational portfolio diversification has been further challenged. British economist John Kay (2012) writes that this investment style runs counter to societal interests, as most clients, not least pension fund members, don't seek relative returns but rather are more interested in long-term absolute returns, which moves benchmark metrics more closely in line with overall GDP growth.

The real value of diversification and stock picking with the aim of beating the index, measured as annual returns to investors, can also be questioned. Studies show that most so-called active portfolios are at the most semi-active, costing money but adding little or no value (Ibbotson 2010; Rappaport 2012: 211). Studies also show full diversification can be reached with as few as 10 to 15 stocks, provided these are carefully chosen (Archer and Evans 1968). A more random selection results in 30 or 40 stocks (Statman 1987). Petajisto (2013) has studied how focused, highly concentrated funds outperform broadly diversified funds.

An additional issue relates to liquidity. There is a tradeoff between long-term engagement and trading where liquidity becomes harmful to voice, as it can lead to the adoption of a cut-and-run strategy (Coffee 1991). What's more, liquidity increases the focus on market capitalization, where large institutional investors typically prefer large companies, which effectively locks out investments in smaller companies. Changing the evaluation metrics employed would thus facilitate long-term investing and larger stake formation rather than passive diversification models.

Here I turn to issues related to the value of domestic capital. As noted, Western policymakers have had a propensity to advocate rational finance theory when organizing free markets. This paradigm claims that capital will flow freely across borders in search of the highest return. According to this view, the availability of domestic capital is irrelevant. The effect of regulation and tax systems can be disregarded, as capital is available on the scale of the global market. A possible shortage of domestic long-term and short-term capital will be fully offset by foreign capital.

But in reality, this appears not to be the case. Some companies will have difficulty attracting foreign investors, such as start-ups and family firms that are planning expansion or a change in ownership. These models do not account for the value of access to stable, long-term capital as management focuses on the strategic work necessary to devise sustainable and profitable business models (Gore and Blood 2012).

Novel research combining corporate governance with finance theory seems instead to suggest that capital is not neutral in a way that economists traditionally have interpreted as being economically rational. Rather, financial capital is invested in different ways with varying preferences related to chosen investment horizons. This research highlights that globalized and passive capital flows are often limited in their preferences (e.g., more interested in financing a fast-growing, high-tech start-up than a local dairy farmer); tend to invest with shorter-term investment horizons in the sense that they are designed for transactions (through different fund structures); and might even be value-destructive (e.g., preferring cash flow-strong companies rather than risky R&D endeavours or building a large factory, and as a consequence, reducing long-term focus on sustainability and value-creative growth).

This research underscores that domestic capital features an investment rationale that goes against classic finance theory. Institutional investors typically allocate between 30 and 50 per cent of their equity portfolio to domestic stocks. Consequently, despite the theoretical merits of global diversification, investing in the home market (i.e., home bias) continues and is supported by claimed benefits such as better information, lower asset management costs and lower transaction costs (Coval and Moskowitz 1999; Dahlquist et al. 2003; Ferreira and Matos 2008).

Summing up the second research strain addressed here, there is widespread agreement that long-term capital promotes value creation that is in the interest of society. Yet, financial theory has limits in its approach to capital as a rationally allocated resource. In practice, domestic capital is more likely to be invested in the long term in the investor's home market, explained by rational decision-making models. Since neither shareholder nor stakeholder propositions appear to offer a clear answer on how to create corporate value (in the long term), it appears that long-termism among domestic investors is an important signum among all categories of owners. Consequently, national policies that hinder domestic capital formation through the tax system or regulation risk creating a shortage of long-term engaged capital.

To bridge this gap, it is here proposed to look to institutional theorists to explain how corporate governance systems might be shaped by social embeddedness (Granovetter 1985). With this view, actors and their goals are not regarded as a given; they tend to be mediated through agency and to be complexly constructed by the positions upheld in society (Aguilera and Jackson 2003; Gilson 2006). The most important question, then, is how a particular category of actor – such as institutional investors – interprets and enacts its responsibilities as fiduciaries for policyholders and the ultimate beneficiaries (Kallifatides and Nachemson-Ekwall 2016). With this in mind, we turn to the Swedish institutional stakeholder setting.

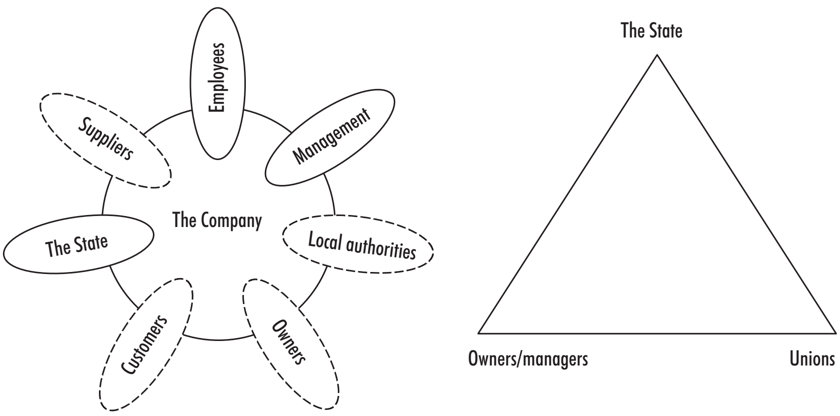
Thirdly: The cooperative Swedish stakeholder society

The Scandinavian stakeholder model represents a special form of corporate governance. A long tradition of social democratic governments, strengthened through a large tax-financed public sector, has produced egalitarian, high-trust societies (Sinani et al. 2008). These build on welfare states, concentrated ownership, strong labour unions, employee representation on the board, high taxes limiting private wealth creation, and modest executive pay, along with gender equality. The Nordic countries stand out as global leaders in social governance (Thomsen and Conyon 2014: 286). All Scandinavian countries score high on 'triple bottom line' metrics that combine economic, social and environmental factors (Strand et al. 2015).

Using Scandinavia as a model, Strand and Freeman (2015) highlight three fundamental ideas necessary to make 'stakeholderism' work: jointness of interest, a cooperative strategic posture, and a rejection of the narrow economic view of the firm.

Here we hark back to the initial ideas of the stakeholder proposition as it was formulated in the 1960s. Carlsson (2013) writes that the original purpose of Eric Rhenman was not to invite all stakeholders to participate as corporate partners. Rather, the model was developed for the Swedish Employers Industries Association (today the Confederation of Swedish Industries), as a means of limiting the political movement then underway towards socialization of Swedish industry in the interest of one particular stakeholder, the labour unions. Rhenman (1964) cites organization scholars such as Chester Barnard, Herbert Simon, and Philip Selznick to argue for the view that profit maximization was not the purpose of the firm (Carlsson 2013: 373–375). The success of the Rhenman stakeholder model thus lies in its ability to mitigate, rather than eliminate, the conflict between worker unions, the state, and management (Carlsson 2013). This is illustrated through a number of building blocks in Figure 2, beginning with the classic Rhenman stakeholder model (Level 1), and then moving on to the tripartite stakeholder dialogue between unions, the state and owners (Level 2).

LEVEL 1: RHENMAN'S STAKEHOLDER MODEL — LEVEL 2: THE TRIPARTITE STAKEHOLDER DIALOGUE



LEVEL 3: AN OWNER SUPPORTIVE CORPORATE GOVERNANCE FRAMEWORK

	Families/investment companies	Institutional investors
Regulation	Companies Act grants special rights to largest shareholders	Limits on size of stakes
Voting	Supported by multiple voting stocks	Generally not expected to buy power
Board	Usually controls the chair and dominates nomination committee	Influence through participation in the nomination committee

Figure 2. The Swedish tripartite stakeholder dialogue (1964)

Long-term owners are designated a special role in this stakeholder model (as shown in Level 3). Nordic corporate governance is based on block holders, where influence is enforced through the right of the dominant owner to control the board chair, a system of differential voting rights, and the existence of a close and cooperative relationship with the unions (Angblad et al. 2001). However, there are clear differences in ownership models among the Scandinavian countries. In Denmark, control is often secured through industrial foundations, whereas Norway leans heavily toward state ownership (Thomsen and Conyon 2012). Sweden has a history of companies being controlled by families and heavy involvement by banks, working through closed-end investment funds (or CEIFs, with the Wallenberg SEB bank sphere and the Handelsbanken sphere) and crossholdings, the influence of which has diminished during the last 20 years.

Also, in Sweden, the use of multiple voting stocks is higher than in its Nordic neighbours (Henrekson and Jakobsson 2012; Lekvall 2014). This had the effect of keeping Swedish industry in the hands of stable owners, while at the same time leveraging on openness to free trade and a clear embrace of the movement in the 1980s towards liberalization of the market economy (Nachemson-Ekwall 2016).

Swedish institutional investors play a large role in the Swedish welfare state. The four Swedish National Pension Funds (SNPFs) originated through a series of pension reforms in the 1950s, when it was decided that the state should provide basic pensions for all citizens. To this was later added a layer of occupational pensions and illness-protection funds (AMF, Alecta, and AFA, as well as Folksam). In addition, four banks (Handelsbanken, Swedbank, SEB and Nordea) control the four large retail fund houses.

Scepticism towards domestic institutional involvement in the business sector has always been a political matter, with concern from the center-right political parties that corporatist and national pension funds might take over the control of enterprises and socialize private businesses. There has been a parallel concern that the four large banks that control mutual funds will act in the interest of their related ownership spheres rather than in the interest of their fiduciaries.

The agency conflict between empowered block-holders and minority shareholders (likely to be domestic institutional investors) has thus remained an important feature of Swedish corporate governance. There is a generally high level of trust between majority and minority shareholders (Gilson 2006; Sinani et al. 2008). Concerted activities among shareholders are encouraged. The influence of minority shareholders (i.e., Swedish institutional investors) is enhanced by the recent formalization of a shareholder-appointed nomination committee made up of representatives of the largest shareholders (Kallifatides et al. 2010). This model is unique in an international context.

This Swedish respect for large owners, passive support from minority institutional investors, and a healthy relationship with both the state and labour unions thus seems to have allowed Sweden to develop many highly profitable, well-run companies (Henrekson and Bergh 2013). The country's active takeover market has long symbolized the Swedish openness to restructuring and globalization. Where an implicit support from the labour unions have leaned on good unemployment schemes from both the employers and the government and the expectation of new jobs being created in more value-creative industries (Henrekson and Jakobsson 2013; Andersson 2015).

However, as previously indicated, there is a less rosy story that runs parallel to this narrative. Swedish corporate investments in R&D and machinery have fallen, industrial jobs diminished, and youth and migrant unemployment have been cemented at a high level (Andersson 2015; Nachemson-Ekwall 2016). Also, after years of high taxes, family ownership has been falling, and with domestic institutional investors continuing to act in a markedly passive manner, the opportunities for private equity, foreign industrial owners and foreign (passive and short-term) institutional investors has grown (Henrekson and Jakobsson, 2012). The Swedish capital market thus has features generally associated with 'value-destructive short-termism' (Stout 2013; Jackson and Petraki 2011). With the engagement and commitment by the 'old' families gone, it seems that the tripartite Swedish version of the Rhenman stakeholder society is losing cohesion. Societal legitimacy is disappearing. It is in this context that the possibility of a changing approach to engagement on the part of domestic institutional investors should be seen.

Summing up the third research strain: a national corporate governance model built on owners embedded in a collaborative stakeholder society has difficulty creating sustainable corporate value when passive or short-term owner rationalities come to dominate.

It is in this context that the implications of a possible shift of activities by domestic Swedish institutional investors in the direction of larger-stake owners should be considered. In the post-financial crisis era, international actors have argued in favour of prudent asset management of long-term investments, as well as for a greater emphasis on long-term commitment. Reports from OECD (2012), EIOPA (2013), and Eurofi (2014) all recommend a revision of the capital requirements of pension funds, the abandonment of market-to-market valuation of listed stocks, and the shift of index-relative evaluations to a more absolute evaluation model. The UN Principles of Responsible Investment (UNPri) emphasize more long-term investments in innovation, infrastructure and SMEs. A focus on active, long-term asset management has also been bolstered by the growing interest in sustainability and ESG factors, i.e., supporting companies that are doing business in a way that demonstrates prudent stewardship of environmental resources in the interest of future generations and considers the social needs of workers and the local community.

Empirical research: Swedish institutional investors as large-stake investors

Sweden has a high concentration of domestic institutional investors, which directly control 23 per cent of the capital on the Stockholm Stock Exchange (SSE) (Table 1). Foreign investors, the vast majority of which are institutional and keen on tracking different indices, 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 the four large Swedish National Pension Funds, life insurance companies, and mutual funds controlled 28 per cent of the SSE, and foreign investors controlled close to 8 per cent.

At the turn of the 21st century, this began to change. While mutual funds have grown from 8.5 per cent to 12 per cent, the SNPFs and life pension funds have reduced their exposure on the SSE from 6 per cent to 2.5 per cent and from 14.5 per cent to 7.5 per cent, respectively. Reregulation and the ability to invest abroad account for part of the change.[1] In addition, when the SNPFs were reformed in 2001, the Swedish stock portfolio of AP4 was split into four

1 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 for 40 % of the assets in OECD in 2011 (Celik and Isaksson 2013: 9).

equally sized funds. At the turn of the millennium, Swedbank's retail fund Robur became more diversified and European, and the four new SNPFs began to benchmark performance. As a result, Swedish institutional investors moved from an asset management style where it was common for them to control a collective 15 per cent to 20 per cent of capital in most large companies (SIS Ownership Service, 1985–2015) to portfolio diversification models and benchmarking against different indices (Hellman 2005).

However, the move into global asset diversification models has been limited. Sweden makes up around 1 per cent of the global capital market. Still, Swedish institutional investors have allocated between 10 per cent and 20 per cent of total assets under management to the SSE Nasdaq OMX, which suggests that a considerable amount of home bias continues to exist. In the life funds, stocks generally make up 40 per cent of the total assets under management. Within these stock mandates, the exposure to SSE varies between 30 per cent and 50 per cent. The mutual funds all have dedicated Swedish funds.

% Year	Corps. & 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	40	**6 071**

Source: Adaption from Statistics Sweden (March 2016), only capital, not voting power.
CEIFs (Closed-end investment funds; Investor, Industrivärden, etc.)
SNPFs (Swedish National Pension Funds, AP1-AP4)

Table 1: Ownership on the SSE

Due to regulations, the influence of Swedish institutions has been limited. SNPF and mutual fund ownership in a company is capped at 10 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.

Private and corporatist occupational pension funds are limited by capital requirements (i.e., solvency rules such as those stipulated through the IORP, 2003/2016). Mutual funds are, in addition to the UCITS directive, limited by a recommendation that they refrain from gaining a position of 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 are often related to multiple voting stocks. No legislation prevents institutional investors from buying multiple voting stocks, but prevailing norms and rational logic prevent such an approach. Standard statutes stating that investments should only focus on economic performance have been interpreted as being inconsistent with buying less tradable stocks with high voting power.

Despite the above-stated constraints and limits, Swedish institutional investors engage in the domestic market. All publish stewardship codes, though there is no generally applicable code such as the UK Stewardship Code (FRC, 2012). Institutional investors participate in self-regulatory bodies and have roles on nomination committees (Nachemson-Ekwall 2012). All large institutional investors in Sweden have signed different international conventions and published sustainability reports and 13 are signatories of UNPri.

A few in-depth studies have been conducted to explain how Swedish institutional investors act within this regime and these 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. Hellman finds institutional investors focus on exit behaviour because of their dependence on external advisors and their over-emphasis on quarterly (i.e., short-term) financial information.

Activities by domestic institutional investors are also influenced by a quest for societal legitimacy (Bengtsson 2005) and are happy to form coalitions with other institutional investors (Jansson 2007). They are also quick 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, with governance instead often allocated to the largest owner. Instances of activism among Swedish institutional investors have been limited to a few highly publicized cases.

CHANGING INVESTMENT STYLE IN THE DIRECTION OF HOME BIAS

This combined quantitative and qualitative study indicates that there are indications that the presumed passivity of Swedish institutional investors is changing. The research covers ownership data from 25 large Swedish institutional investors on the Stockholm Stock Exchange during the period 2007–2015. Together, the group had approximately SEK 600 billion invested on the SSE, 17 per cent of the market capitalization. The numbers of investee companies were stratified on a 3 per cent ownership level, the level usually called a stake in the international governance literature, and a 5 per cent level, in line with stock exchange flagging requirements.

The study shows that almost all the domestic institutional investors have begun to take larger stakes in investee corporations on the domestic stock market. Table 2 lists the stakes taken by the 18 largest Swedish institutional investors and their investments' concentration in 2007 and 2016. There are 250 companies listed on the SSE. In 2007, Swedish institutional investors held few stakes larger than a few percentage points. Three had portfolios of around 30 or 40 stocks before this time. Following the financial crisis (2008–2010), there appears to have been a re-concentration, albeit not to the levels seen before the turn of the millennium. Of the 18 largest Swedish institutional investors on the SSE, 15 have increased their concentration. As the overall presence on the SSE has been reduced by a few percentage points (as shown in Table 1), 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. Two have retained a dispersed investment portfolio.

Two companies have reduced holdings: AFA and Alecta. In the case of Alecta, the investment style has been to concentrate on larger stocks, with the outcome that stakes in specific companies have gone down (as shown in Table 2). Before the turn of 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.

2016	Owner	> 3% 2007	2016	> 5% 2007	2016	Focus?	No of stocks	Billion SEK
1	Swedbank Robur	57	97	29	67	+	173	171
2	Alecta	21	19	15	12	(–)	30	116
3	AMF pension & funds	8	29	5	13	+	139	116
4	SHB funds	6	47	4	19	+	269	93
5	SEB funds	20	28	6	12	+	233	70
6	Nordea funds	25	48	8	31	+	174	63
7	SNPF4	17	47	8	30	+	131	51
8	Skandia life & funds*	32	11	26	5	(–)	141	42
9	Folksam ins +KPA**	0	1	0	1	(=)	46	42
10	Didner & Gerge funds	16	17	7	12	+	64	37
11	Länsförsäkringar funds	21	22	5	16	+	192	37
12	Lannebo funds	15	43	8	36	+	88	35
13	SNPF3	3	5	0	3	+	116	31
14	SNPF1	2	3	1	3	+	28	31
15	AFA ins	24	5	13	4	–	43	29
16	SNPF2	4	8	1	6	+	134	27
17	Carnegie funds	6	14	0	8	+	56	25
18	SPP funds	"!	0	"!	0	=	71	24

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

Table 2: The largest Swedish institutional invsestors and their stakes on the SSE

The concentration of stake holdings identified in Table 2 reveals how the allocation of capital and resources to committed and engaged stake holdings reflect a mixture of related risk mandates that are limited by quantitative regulation. These decisions are subject to the organizations' individual preferences. On the SNPFs and the life pension funds, the board of trustees decide on the long-term goal, usually based on different types of asset-liability management (ALM) studies.

Half of the SNPFs and life insurance funds have both a passive global portfolio and an active Swedish portfolio, where the latter is evaluated with long-term absolute metrics usually described as a five-year investment horizon. All mutual funds have both index mandates and active mandates with large stakes and stock picking.

There is also public documentation from institutional investors that show that they are actively moving in the direction of long-term and committed investment practises. When the health-care provider Capio was reintroduced on the SSE in June 2015, three domestic Swedish investors identified themselves as long-term, committed 'anchor' owners.[2] In addition, mutual-fund groups can increase ownership by complying with the Alternative Investment Fund Directive (AIFM 2011) or by incorporating outside Sweden. The legal entity of the Nordea mutual funds has been reallocated to Finland, where owner limitations are more liberal.

The study categorizes the most relevant factors influencing these decisions along four parameters. First, the study observes a link between an effort to enhance performance in Swedish listed equity investing and a reconsideration of a one-sided dependency on diversification policies, leaving room for focused and larger stock-picking mandates.

One SNPF explains how the board no longer believes that financial markets are wholly efficient, and as a result no longer thinks that index investing is the optimal way to manage assets. Instead, the SNPF relates the risk mandate to the fund's long-term perspective. It has built a portfolio with internal stock picking built up around engaged ownership and sustainability screening, and it 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. It also has alternative investments where it leverages on illiquidity.

The chair of one bank-controlled mutual fund that has moved from short-term relative investing that was evaluated on a monthly basis to long-term to absolute investing explains:

> The (mutual fund) industry is used to benchmarking, but it didn't bring any real value to our customers. Now we focus on creating long-term purchasing power for our customers, and to do that, we have to take larger stakes that create real value over three or five years instead.

2 These include UN Principles for Responsible Investment (PRI), United Nations Global Compact, OECD Guidelines for Multinational Enterprises various initiatives on climate change and membership of different pressure groups such as the Carbon Disclosure Project.

The study then moves on to explain how the efficacy of engagement is contingent on the ability to leverage on home bias. The companies on the SSE are perceived as being well managed, and they deliver strong performance over the long term. A head of stock equity at a life insurance company explains:

> We believe in home bias. Seventy percent of all our assets are invested in Sweden. We have 10 % in Swedish stocks. We have been around for a long time; we know our companies, engage in corporate governance and can talk to the directors. It pays off, long-term. Outside Sweden, my network is weaker. In Asia, I am a nobody.

Also, 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 have been practicing governance for 20 years now. It is expected of us that we are engaged and responsible. When we make large investments, we engage (for the) long term. Sweden is in the forefront in this process.

A number of Swedish listed companies 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, e.g., 7–8 per cent, in an IPO to become an 'anchor investor'. The person overseeing ownership issues at one of the SNPFs explains:

> 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 percent 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 its 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 have a duty to act responsibly. I don't exclude the possibility that we could be represented on the board. It's about a lot of money; it's a big responsibility and we have to build competence.

Thus, almost all the interviews with asset managers and CEOs indicate that with longer investment horizons, they view themselves as capable of acting as responsible owners on the SSE. They are keen to avoid being viewed as activists who would approach underperforming companies to instigate change and then sell at a profit. As 'engaged' investors, they would rather cooperate and support management or other shareholders.

Finally, the study shows that more concentrated mandates leverage the legitimacy embedded in a societal movement towards sustainability investing. All institutions claim to have increased attention to ESG measures, and that this contributes to long-term performance. A head of one of the bank-controlled mutual funds explains:

> When we move our investment horizon to three or five years, it is easier to integrate CSR and ESG measures. We find these companies to deliver more stable cash flow (and) have a lower risk for reputational damage; and it reduces the downside risk in our stock-picking. ESG contributes to performance.

Summing up, the interviews with the representatives of the Swedish institutional investors indicate that almost all of them are committing more capital to large stakes with the aim of enhancing performance. In the process, they develop their role as active and engaged stakeholders.

Conclusion and reflections

Strand and Freeman (2015) claim that Scandinavian companies are exceptionally good at implementing value-creating strategies by cooperating with their stakeholders. In this chapter, it is shown that Swedish institutional investors in the post-financial crisis era both have an ambition to engage as supporters of long-term value-creative strategies and have developed investment styles to support it. This is done within limits of current regulation. In the process, they position themselves as partners to other controller-owner and the board, as well as other Swedish institutional investors, thus viewing themselves as embedded in the Swedish owner society, and, consequently, as part of the cooperative governance model. It can thus be argued that more engagement by domestic Swedish institutional investors can function as an enhancer of the Swedish companies' ability to leverage Strand and Freeman's (2013) 'cooperative advantage'. It is also suggested that this move can be supported by revisiting the Rhenman stakeholder ideas, but framing them in modern sustainability metrics instead of the classic tripartite network. The focus on the 'capitalist' owner is reframed as 'capitalists and institutional investors' working in cooperation.

To further the discussion, the stakeholder discourse on institutional-investor rationale is reconceptualised using a three-phase framework (Table 3). 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 institutional investments in larger stakes, but engagement remained more or less passive (Hellman 2005). Notably, sustainability and CSR did not play a role in this period.

In the second phase, broadly consisting of the period just before the turn of 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 benchmarking, index tracking and smaller stakes in each company, an investment strategy that enhanced passivity regarding engagement in governance. With Swedish traditional block-holders leaving the scene, other ownership models emerged, such as private equity firms, foreign industrial owners and 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', i.e., leaving engagement in the hands of other short-term investors (Gilson and Gordon 2011; Kallifatides et al. 2010). Sustainability still played a limited role.

The third phase, which is the focus here, can be said to have already begun during the final stage of the financial-bubble years, but the results – in the form of an increase of larger stakes on the Swedish stock market – began to show up a few years into the post-financial crisis era. This change in investment style hinges on a reconsideration of portfolio-allocation strategies. A large-stake strategy also supports governance engagement that leverages sustainability and ESG metrics.

EVOLVING DISCOURSE OF LARGER STAKES

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. Owner limits	Actively managing 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 and Gordon 2011)	Engaged, responsible (Eccles et al 2011; Mayer 2015). Cooperative (Freeman and Strand 2013)

Table 3: The evolving cooperative rationale of domestic institutional investors buying larger stakes in listed companies

As domestic institutional investors find themselves embedded in a Swedish stakeholder social context, I argue that when this shareholder group revises its roles as asset managers in the direction of more long-term mandates with more of a sustainability focus, the corporations will be pressured to act in line with both Mayer's (2015) value creation and Strand and Freeman's (2015) commitment to a Scandinavian-style collaboration between companies and their stakeholders.

My findings extend on the Hellman (2005) analysis that builds on data from 1993 and 1995, as well as research conducted a few years after the turn of the millennium (Bengtsson 2005; Jansson 2007). Much has now changed, regarding both the ownership of Swedish companies and the investment style of Swedish institutional investors.

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. Through moving part of the domestic institutional investors' assets into larger stakes that are evaluated with a longer time horizon, they have both increased commitment to the Swedish shareholder-friendly corporate-governance model and enhanced integration of sustainability and ESG metrics in the investment strategy. Here I argue that integrating sustainability metrics into investment decisions will limit political risk related to 'socialization' or 'protectionism'. This should open up for reconsideration the notion of loosening regulatory limits on ownership size.

This chapter, thus, argues that when asset managers' norms become (a) positive towards investing that is more focused on the home market and (b) this is combined with sustainability metrics and (c) an owner-friendly governance system, society can leverage on domestic institutional investors' embedded character in a value-creative and sustainable way that has previously been ignored. As a result, further research on Swedish institutional investors' ability to enhance a Swedish cooperative advantage should be promising.

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