



# Institutional Investors in Swedish Corporate Governance

Mikael Ehne



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## **Institutional Investors in Swedish Corporate Governance**

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## Förord/*Preface*

Mikael Ehne bedrev forskarstudier vid Handelshögskolan i Stockholm från slutet av 2013 fram till april 2018 då han avled.

Mickes idoga arbete om institutionella investerares betydelse och roll i bolagsstyrningen var mycket långt kommet och föremål för slutbehandling i handledarkommittén. I samråd med Mickes familj utges nu postumt Mickes utkast till avhandling för doktorsexamen. Jag hoppas att kollegor när och fjärran på detta sätt kan finna nytta i Mickes hårda arbete.

Mikael hade velat tacka Torsten Söderbergs stiftelse och Handelsbankens forskningsstiftelser för finansiellt stöd till forskningen, samt Sven-Erik Sjöstrand, Sophie Nachemson-Ekwall, Niclas Hellman, Tom Berglund och Matts Kärreman, för inspiration och handledning.

*Mikael Ehne pursued doctoral studies at the Stockholm School of Economics from the end of 2013 until April 2018 when he passed away.*

*Micke's conscientious work on the importance and role of institutional investors in Swedish corporate governance had come a long way and was the object of final revisions with the supervisory committee. In line with the express will of his immediate family, his manuscript for a dissertation is now published posthumously. It is my hope that colleagues at home and abroad will find his hard work useful.*

*Mikael would have wanted to thank the Torsten Söderberg foundation and Handelsbanken's research foundations for financial support, along with Sven-Erik Sjöstrand, Sophie Nachemson-Ekwall, Niclas Hellman, Tom Berglund and Matts Kärreman, for inspiration and supervision.*

Stockholm, 1 July 2018

Markus Kallifatides  
Director  
Center for Governance and Management Studies

# **Institutional Investors in Swedish Corporate Governance**

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# 1. Introduction

## 1.1 Background

Owners or shareholders play a central role in corporate governance regardless of whether one adopts a narrow definition of the subject matter, e.g. that it “deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment” (Shleifer & Vishny, 1997: 738) or if one takes a broader view, e.g. as Aguilera & Jackson (2003) who define corporate governance as “the rights and responsibilities of different stakeholders towards the firm” (Ibid: 447). In recent decades, one particular owner category has come to dominate the shareholder landscape in developed markets, namely institutional investors such as pension funds, asset managers, mutual funds, insurance companies and hedge funds (OECD, 2011)<sup>1</sup>. While similar in that they act as an intermediary shareholder and concentrate the holdings of the end-investors or beneficiaries on behalf of whom they nominally operate, these institutional investors are also very dissimilar when it comes *inter alia* to how they are regulated, how they manage their investment portfolios, what type of beneficiaries they have and their obligations towards them e.g. in terms of time horizons (Çelik & Isaksson, 2013). These differences as well as other factors make them appear to approach the topic of corporate governance very differently, with certain institutional investors such as activist hedge funds basing their entire business model on involvement in corporate affairs and others, such as mutual funds or insurance companies, being described as much more passive and reactive in their relationship with the corporations in which they invest (Ibid; Gilson & Gordon, 2013; Goranova & Ryan, 2014).

Just as categories of institutional investors differ between them, so too do the national ownership and governance contexts in which they operate, contrary to hypotheses on a global convergence towards a dispersed ownership model characterized by shareholder value maximization and market-based solutions to corporate governance (Hansmann & Kraakman, 2004), but in line with other theories about the persistent divergence of corporate governance and ownership globally (Aguilera & Jackson, 2003; Gourevitch & Shinn, 2005; La Porta et al., 1998; 1999; Roe, 2003). Corporate governance and control in Sweden, that is the context studied in this dissertation, has traditionally been dominated by shareholder spheres that have been able use various mechanisms such as dual-class shares, ownership pyramids and cross-shareholdings to vastly leverage the influence granted by their in comparison relatively modest capital investments (Agnblad et al., 2001). The dominance of these spheres has also been facilitated by the very shareholder-oriented nature of the Swedish corporate governance model, which grants far-reaching powers to shareholders and where controlling shareholders as opposed to the board and CEO typically assume responsibility for the long-term strategic direction of the firm (Sjöstrand et al. 2016; Skog & Sjöman, 2014). However, the ownership of listed Swedish firms has also in recent decades been characterized by a rapid rise in the shareholdings of institutional investors at the expense of all other owner categories (Statistics Sweden, 2017). This ascent of institutional investors has been suggested to lead to a control vacuum, where the governance model places a large responsibility in the hands of shareholders, but where many institutional investors may

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<sup>1</sup> Institutional investors are defined as legal persons investing on behalf of one or more fiduciaries in this dissertation.

not be well placed to assume this responsibility, paving the way instead for actors outside of the domestic equity market such as private equity funds and foreign direct ownership (Henrekson & Jakobsson, 2012).

## **1.2 Problem Formulation and Research Question**

There appears to exist a tension between the ascent of institutional investors as the dominant owner category on equity markets in the developed world on the one hand and shareholder-oriented governance systems that grant far-reaching rights to shareholders as opposed to other stakeholders on the other. The very shareholder-oriented governance regime in Sweden has arguably been designed with a different type of owner in mind, namely the owner spheres who traditionally have governed and controlled listed firms in Sweden (Ibid). As a result, it is questionable whether firms who find themselves owned wholly or mostly by institutional investors are able to thrive under a shareholder-oriented governance system such as the Swedish one, something that is strongly implied by the very few extant examples of such firms (Ibid; Holdings, 2018). This issue is of course not limited to the Swedish context, but rather highly relevant in other jurisdictions where the governance regimes also exhibit a shareholder orientation or are evolving in that direction due to efforts by policy makers and practitioners - i.e. most developed countries. Sweden has already enacted most of the shareholder-oriented reforms, e.g. shareholder influence over the board nominating process, that are currently fervently being debated in other jurisdictions, e.g. in the U.S. where the phenomenon is denoted proxy access (Becker et al., 2013).

The available evidence regarding the governance capabilities of different classes of institutional investors in different governance contexts puts further focus on the issue: “traditional” institutional investors such as pension funds and asset managers have been characterized as passive or reactive in their governance efforts and thus seemingly incapable at handling the larger governance role that is or would be ascribed to them under a shareholder-oriented governance regime. More proactive, “entrepreneurial”, classes of institutional investors such as activist hedge funds, meanwhile, appear to have an ambiguous impact on firms long-term value creation and the wider economy (Coffee & Palia, 2015; Goranova & Ryan; 2014). The combination of an unknown or ambiguous governance role for most categories of institutional investors, combined with a shareholder-oriented governance that places a large responsibility with these investors, in particular where there is no incumbent controlling blockholder, is the key issue underpinning this dissertation. The overarching question dealt with is the question of how well regulations and practices in the corporate governance arena, which shape the rights and responsibilities of different stakeholders, interact with the observed realities of the current capital markets. In my case this is translated more specifically into the research question of: *What are the firm-level effects of having a corporate governance regime that emphasizes the rights of shareholders over other stakeholder groups at the same time as there is a concentration of capital in the hands of institutional investors?*



## **2. Theoretical Framework and Literature Review**

### **2.1 Agency Theory and the Firm as a Nexus of Contracts**

The by far most common theoretical approach to corporate governance is grounded in agency theory (Jensen & Meckling, 1976; Fama, 1980) which stresses the supposed inherent conflicts of interests between shareholder-principals and manager-agents. The theory traces its roots to the reasoning of Adam Smith (1776) and later Berle & Means (1932) who were early to observe the potential issues involved when professional managers are running large corporations that are in turn owned by an increasingly dispersed group of shareholders. Why such corporations exist and how they can function in the face of the natural inclination of manager-agents to act in their own self-interest is the central focus of the theory (Jensen & Meckling, 1976). The characterization of the modern corporation applied in agency theory is based on the contractual or (interchangeably) contractarian theory of the firm, where the firm is conceptualized as a nexus of contracts between the factors of production (Ibid; Alchian & Demsetz, 1972). Applying a contractarian view of the firm as is done both in agency theory and its close sibling transaction cost economics (Coase, 1937; Williamson 1992) has strong implications for how corporate governance is understood in research and practice, as it removes emphasis from the firm itself, which is reduced to a “legal fiction” as in Jensen & Meckling, (1976: 311), and instead places it on the self-interested individuals entering the contracts as well as the contracts themselves.

An emphasis on the separation of ownership of control is the cornerstone of agency theory as formulated in Jensen & Meckling (1976). Since it is assumed that the other parties in the firm, e.g. employees, can establish complete contracts, e.g. for employment, the theory is firmly fixed on how the residual claimants, who cannot, can rely on the manager-agents of the corporation to act in their interest (Shleifer & Vishny, 1997). The key issue to explain in order to show why firms exist and are efficient is essentially reduced to a contractual relationship between two parties. Here the focus is on market-based mechanisms, those of bonding or incentives, e.g. share price contingent pay, and those of monitoring, e.g. by the boards of the directors or outside auditors, the costs of which are voluntarily carried by the manager-agent since they can be recuperated on the market because the shareholder-principals become more inclined to purchase the firms stock. These costs form the so-called agency costs, together with the deadweight loss resulting from the fact that the interests of the manager-agents and the shareholder-principals cannot be fully reconciled even through the available bonding and monitoring mechanisms (Ibid; Jensen & Meckling, 1976).

From this theory of the firm a definition of corporate governance as dealing “with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment” (Shleifer & Vishny, 1997: 738) follows logically. An emphasis on the share price mechanism has guided most empirical research within agency theory where a substantial body of literature consists of so-called event studies attempting to quantify the agency costs related to different corporate actions and arrangements by looking at the immediate market price reaction to their announcement, and equating or attempting to equate these short-term swings in share price with long-term value creation (Shleifer & Vishny, 1997). Notably, however, in order to hold, this link between short-term stock price increases and long-term value creation relies on

the assumption that markets are efficient (Zingales, 2000). Recent research on the short-termism of markets suggests that this may not always be an accurate description (Davies et al, 2014). Asker et al. (2015), for instance, show that listed firms tend to inefficiently under-invest when compared to matched peer firms that are privately owned and not listed on a stock exchange. This is attributed to firm managers that, under pressure from the demands of their shareholders, discount projects and prioritize distributions to shareholders too heavily (Ibid). Other recent studies also highlight similar tendencies for listed firms to underinvest in e.g. research and development in favor of near-term distributions to shareholders (Budish et al., 2015; Gutiérrez & Philippon, 2017; Kahle & Stulz, 2017). This prioritization of distributions to shareholders over investment in the real economy has been suggested to be unsustainable over the long-term (Lazonick & O’Sullivan, 2000). Agency theory and the view of the firm as existing to maximize value for current shareholders has also been criticized from other perspectives, ranging from its epistemological underpinnings (Donaldson, 2012; Fligstein, 2001), to its empirical validity (Daily et al., 2003).<sup>2</sup>

## **2.2 Expanding the View of the Firm and Corporate Governance: Stakeholder and Institutional Perspectives**

At the other end from agency theory when looking at the nature of the firm and corporate governance lies stakeholder theory (Donaldson & Preston, 1995) which takes direct issue with the singular focus on shareholders in agency theory. Stakeholder theory views the firm as “a constellation of cooperative and competitive interests possessing intrinsic value” (Ibid: 66). It also makes its normative assumptions explicit and states that stakeholders are defined by their interests in the firm, rather than vice versa, and that these are of intrinsic value, i.e. that non-shareholder parties such as employees and the communities in which the firm operates can have concerns that override those of shareholders. Proponents of stakeholder theory tend to uphold its ethical and moral superiority to the amoral view of business that supposedly results from running the firm only in the interests of shareholders (Freeman et al., 2004), while its critics suggest that the conflicting interests of different stakeholders make it impossible to manage the firm in all of their interests simultaneously (Sundaram & Inkpen, 2004).

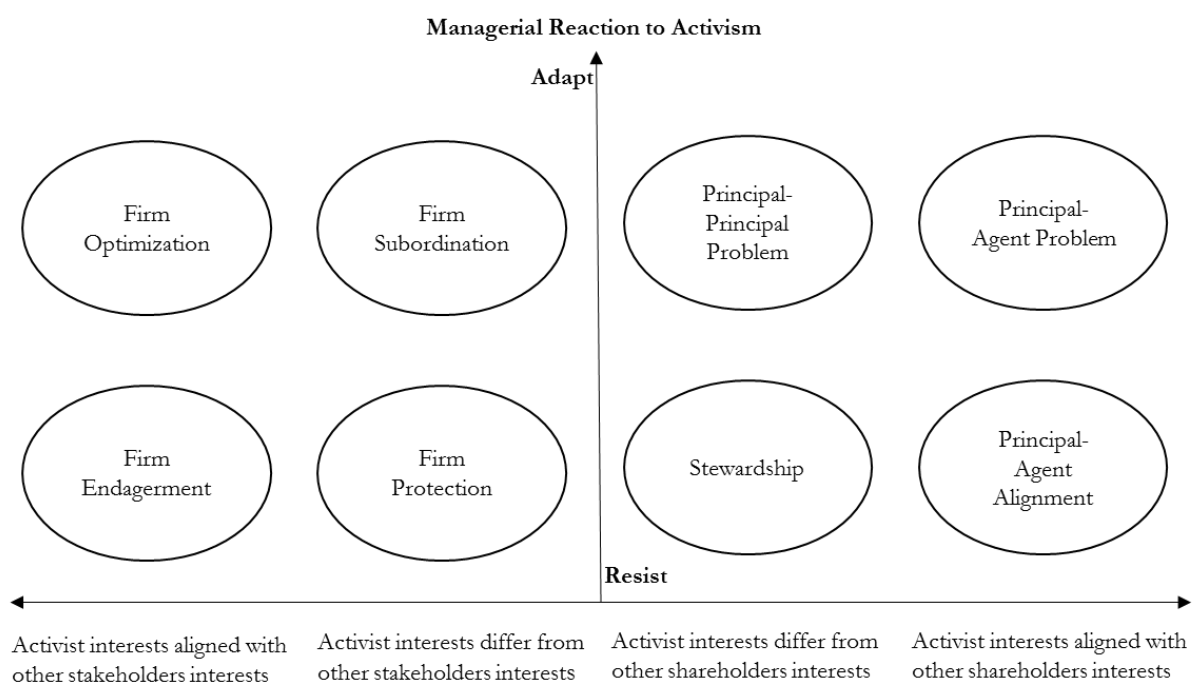
Despite these conflicts, stakeholder theory is a useful complement to neoclassical agency theory when looking at how institutional investors influence the corporations that they own. Including a stakeholder perspective allows one to drop the unrealistic assumption that all stakeholders such as creditors or employees are better off when the interests of current shareholders are served, or that their claims on the corporation do not matter. Specifically, in the context of shareholder activism (Study 2) Goranova & Ryan (2014) present a model where insights from agency theory and stakeholder theory are combined in order to get a more complete perspective on the potential outcomes of such activism. The model (Figure 1) illustrates how the focus shifts when moving from a neoclassical agency theoretical perspective in which the interests

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<sup>2</sup> Donaldson (2012) focuses on the normative aspects of the theory which its key proponents tend to characterize as positive (Jensen & Meckling, 1976: 310) but which in reality are filled with moral content, for instance regarding the supreme rights of shareholders and the authority of managers to act in their interests, which are not presented as a normative prescription, e.g. that it is desirable for managers to have authority to act only in the interest of shareholders, but as given facts.

of shareholder activists are always aligned with other shareholders and the only relevant issue to consider is how to get managers to comply with their demands (“Principal-Agent Alignment”), towards a scenario where different shareholders can have heterogeneous interests e.g. as regards the temporal distribution of returns (short versus long-term) thus leading to potential situations where managers are acting in the interests of short-term activist shareholders to the detriment of long-term shareholders (“Principal-Principal Problem”). Including a stakeholder perspective (left hand side of Figure 1) adds further dimensions to the analysis and allows one to consider the potential issues at hand if managers choose to subordinate the interests of the firm and other stakeholders to the demands of activists or other short-term shareholders that have interests that conflict with other stakeholders.

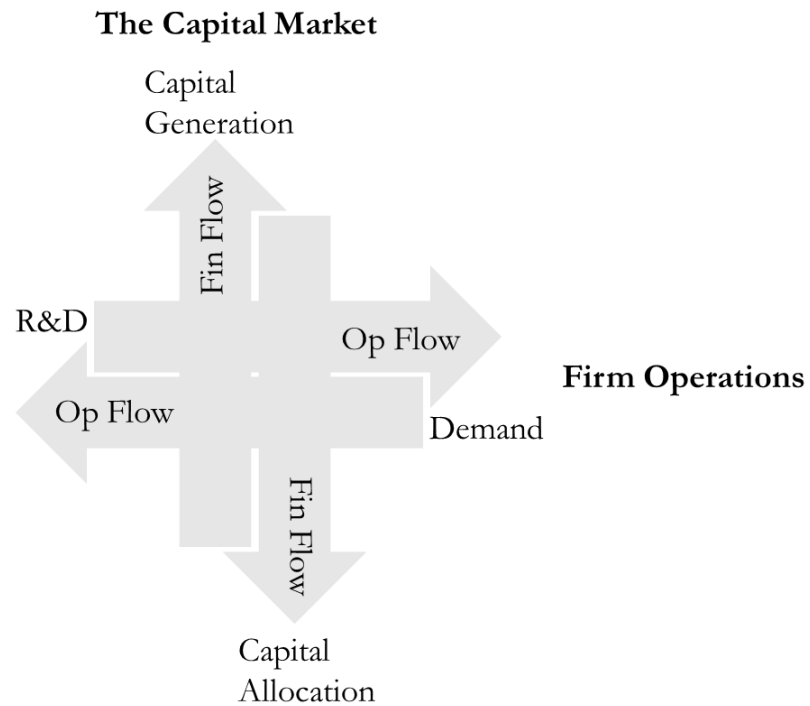
**Figure 1: Combining Agency Theory and Stakeholder Theory Re: Shareholder Activism**



Notes: Adapted from Goranova & Ryan (2014): 1253

Kallifatides et al. (2010) discuss these aspects more generally as they relate to the corporation and stress the differences both within the shareholder value perspective, between those who advocate the interests of current or short-term shareholders and those who expand the analysis to include potential future long-term shareholders, and between the shareholder and stakeholder value perspectives. They (see also e.g. Sjöstrand, 2016; Sjöstrand et al. 2016) extend this analysis to suggest that those who put the emphasis on current shareholder value (cf. neoclassical agency theory) view the corporation as a ‘financial unit’ (Kallifatides et al. 2010: 16) whereas those who take a longer-term shareholder value view or a stakeholder perspective are also concerned with the operations of the company. Thus, the view of the corporation is expanded from the black box or nexus of contracts view with its singular focus on the financial flow, to also consider how corporate governance affects the operations of the firm as illustrated in Figure 2, below.

**Figure 2: Two Corporate Governance Flows**



Notes: Adapted from Sjöstrand et al. (2016): 49.

It is stressed that corporations can be governed with more or less emphasis on either of these flows, and that the focus on the financial flow under so-called financial capitalism is simply an ideal type that can be contrasted with corporations that can and are instead governed with an operational emphasis, typical of industrial capitalism. Where the emphasis in corporate governance is placed at any given point of time and context varies (Kallifatides et al., 2010).

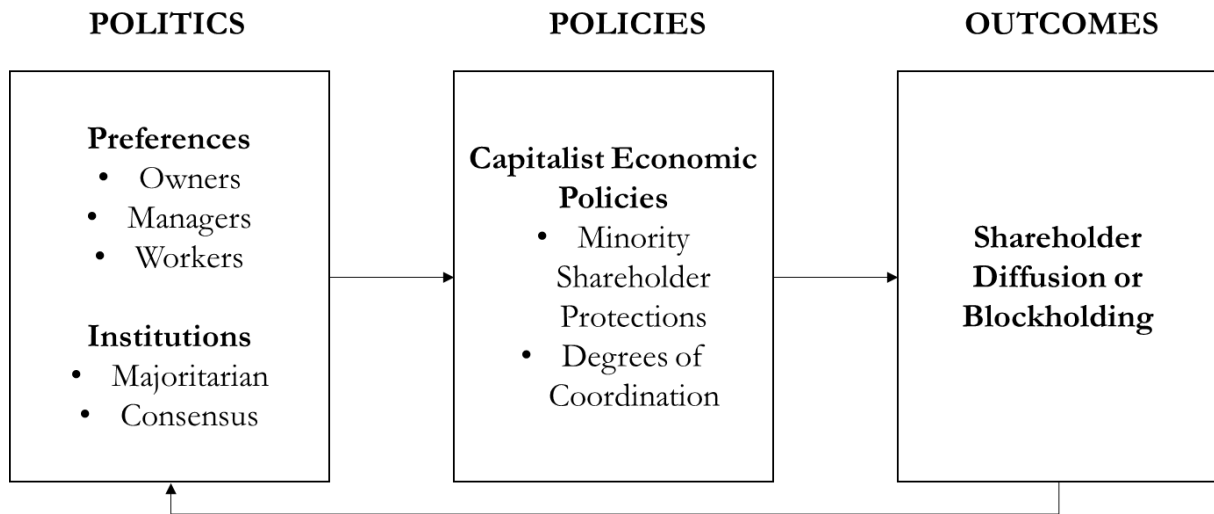
Institutional or neo-institutional theory (DiMaggio & Powell, 1983; Meyer & Rowan, 1977) also focuses on the importance of context in determining how organizations, including corporations, are managed. The theory has its origin in sociology rather than economics, and stresses how organizations adapt to the legally sanctioned (regulative), morally governed (normative) and culturally supported (cultural-cognitive) institutions of their environment in order to survive (DiMaggio & Powell, 1983; Scott, 2013). Rather than economic efficiency, the emphasis is placed on social legitimacy: those organizations that are considered legitimate by their institutional environment are those that survive and thrive (Ibid). Oliver (1991) synthesizes this view with that of so-called resource dependency theory (e.g. Pfeffer & Salancik, 1978) and provides the theoretical framework for the first study in the dissertation. She highlights how firms and organizations respond to institutional pressures on a scale from passive acquiescence to active manipulation, suggesting that these responses are determined by factors such as the perceived social legitimacy and economic fitness of conforming to institutional demands, the degree to which the organization is dependent on the stakeholders making the demands as well as how the demands are being enforced.

## 2.3 Convergence or Divergence of Corporate Governance & the Swedish Case

Recent predictions regarding the inevitability of a global convergence towards financial capitalism in the form of shareholder-oriented governance and dispersed ownership in line with the neoclassical agency model (Hansmann & Kraakman, 2004) have not been realized (Yoshikawa & Rasheed, 2009). Rather, multitudes of governance regimes and ownership structures have persisted, as predicted for instance in the varieties of capitalism literature (e.g. Hall & Soskice, 2001) and by scholars who stress the strong influence of politics on governance and ownership arrangements (Roe, 2003). Within the so-called law and finance tradition, persistent country-level differences in ownership concentration, with e.g. continental Europe exhibiting a high degree of concentration and the U.S. and UK being characterized by more dispersed shareholdings, are explained by country-level variations in investor protection (La Porta et al., 1998; 1999). It is claimed that weak *de jure* and *de facto* investor protection creates incentives for controlling shareholders to refrain from optimally diversifying their portfolios, because their controlling position gives them the ability to expropriate minority shareholders, so-called private benefits of control, and also because they fear that they will be expropriated themselves by a new controlling shareholder if they do (Ibid). The reason why there are country-level differences in investor protection in the first place are in turn explained by the legal family or tradition, with common law countries, e.g. the U.S. and UK, providing the best protections (Ibid).

Other scholars have taken issue with this distinction between controlling and dispersed shareholder systems and the characterization of the former as existing only due to poor regulations or regulatory enforcement. Gilson (2006), for instance, suggests that a country can exhibit elements of both systems, and that block holding does not necessarily result from “bad” law, but can be efficient and exist without private benefits of control being extracted from the minority shareholders using the U.S. and Sweden as examples. Gourevitch & Shinn (2005), meanwhile, highlight the role played by politics in determining the governance arrangements of a particular country (cf. Roe, 2003). Their model is based on three pillars (Figure 3) and integrates thinking both from the law and economics discipline, as represented by the degree of minority shareholder protection, as well as from the varieties of capitalism literature (Hall & Soskice, 2001) by emphasizing the degree of coordination, e.g. in terms of product-market competition and labor relations, in a particular country. It is hypothesized that those actors or coalitions of actors that succeed best in furthering their interests determine these degrees and in turn influence how corporations are owned and run. They emphasize that these coalitions are dynamic and change over time and that rather than converge, governance arrangements are bound to differ between countries.

**Figure 3: Political Model of Corporate Control**



Notes: Adapted from Gourevitch & Shinn (2005)

Aguilera & Jackson (2003) propose an actor-centered institutional approach that like Gourevitch & Shinn (2005) focuses on the interests of different groups, where the key constituencies shareholders, managers and labor have differing interests and form various coalitions in different institutional contexts. Both Aguilera & Jackson (2003) and Gourevitch & Shinn (2005) also stress the possibility of heterogeneous interests within the different actor categories, so that e.g. the interests of one category of minority shareholders (e.g. institutional investors) is not necessarily equal to that of other members of the same category (cf. Goranova & Ryan, 2014). While superficially similar, the main difference between the theories is that Gourevitch & Shinn (2005) stresses the economic interests of the different actors whereas Aguilera & Jackson (2003) add an emphasis on their social embeddedness and identities (cf. institutional theory).

When adopting a perspective that accounts for the different institutions and stakeholder or actor coalitions present in different contexts the persistent global heterogeneity of corporate ownership and governance becomes easier to understand, e.g. because different institutional set-ups increase or reduce the attractiveness of different governance mechanisms. The Swedish corporate governance system cannot intuitively be grouped together with the traditional stylized dichotomies of the “continental European” governance systems, referred to as coordinated market economies in the varieties of capitalism literature, characterized by a high prevalence of debt rather than equity finance, concentrated ownership and weak shareholder rights. Nor is it easily placed alongside the “Anglo-American” governance systems, referred to as liberal market economies in the varieties of capitalism literature, characterized by large and active equity markets, dispersed ownership and strong shareholder rights (Aguilera & Jackson, 2010; Hall & Soskice, 2001). Gourevitch & Shinn (2005) are mindful of this and elaborate on the Swedish ownership and governance model in this way:

*If Sweden does not perfectly fit the labor power model [where the economic interests of labor dominate], it also does not fit the investor model's trade-off between concentration and minority shareholder protections, both*

*of which are high, at 46.9 percent block holding and 54 on the 100 point minority shareholder protection index, respectively. Foreign portfolio investors are pouring into Sweden, now accounting for 32.5 percent of the market, well above the mean, and the ratio of market capitalization to GDP is fairly high, at 137 percent. But there are few signs of blockholders accepting a “good governance deal.” [i.e. selling their shares to diversify as predicted by LaPorta et al.] We see little sell-down of blocks in the biggest families such as the Wallenbergs, and periodic resistance to specific reform measures on their part. A relatively small group of block holding families continues to exercise voting control over large portions of the public market by virtue of complex pyramids and sharply skewed ratios of voting to cash flow rights; 55 percent of listed companies have such differentiated rights (as in voting A shares and nonvoting B shares). Gourevitch & Shinn (2005): 141*

It is important to realize this hybrid nature of the Swedish ownership and governance model (cf. Yoshikawa & Rasheed, 2009), where the formal governance arrangements are (minority) shareholder friendly but where there still exists a solid concentration of ownership primarily in the hands of incumbent block holders. The legal foundation of the Swedish Governance model is the Companies Act, which unlike its counterparts in e.g. the U.K. places supreme decision-making authority in the hands of shareholders (Swedish Companies Act, 2005) and which has been highly influenced by an agency theoretical perspective (Jansson et al., 2014). In the strict hierarchy prescribed by the Swedish governance model power emanates downwards from the shareholders via the annual general meeting towards the board of directors on which only one executive may serve (Sjöstrand et al. 2016; Skog & Sjöman, 2014).

As opposed to all other developed markets, except Norway, board candidates are nominated directly by shareholders through the so-called nomination committee (Swedish Corporate Governance Code, 2015), further empowering shareholders relative to directors and/or executives. Unlike in e.g. the U.S. anti-takeover provisions are also virtually unheard of in the Swedish setting, which further serves to weaken executive autonomy and facilitate takeovers where the shareholder constituency is so inclined (Nachemson-Ekwall, 2012). Other relevant features of the Swedish governance system that highlight the concentration of power in the hands of shareholders as opposed to directors or executives include the fact that it only takes 10% of the share capital to call an extraordinary general meeting, that all shareholders can place proposals on the ballots for such meetings and that they are legally binding, unlike in e.g. the U.S. where they are often advisory, as well as mandatory one-year terms for directors and as such a lack of the staggered boards seen in the continental European or U.S. markets. Swedish legislation also complicates the issuance of equity-based compensation to executives by imposing super-majority approval requirements at AGM's (Swedish Companies Act, 2005: Ch 16) and taxing it at the marginal income tax rate rather than as capital gains (Henrekson & Jakobsson, 2012) which again de-emphasizes the position of executives in the Swedish governance system as opposed to e.g. the Anglo-American ones. Rather, the system firmly places governance and control in the hands of shareholders (Ibid).

Prior to the early 1990s, Sweden was very similar to the coordinated market economy stereotype: the stock market had a low valuation relative to GDP and listed firms investments were largely financed by retained

earnings and debt, as other sources had become heavily dis-incentivized by tax law and other regulations, such as foreign currency controls (Högfeldt, 2005). Ownership was very concentrated in the hands of a few block holders, to some extent for political reasons as the largely social democratic governments wanted control concentrated in as few hands as possible to ease influence and communication (Collin, 1998; Högfeldt, 2005). When the regulatory landscape was liberalized, starting in the mid-1980s and completed in the early 1990s, the importance of the stock market instead grew rapidly and foreign shareholdings increased dramatically (See Table 1). The extant shareholder spheres, which had previously more or less dominated the ownership and control of all significant listed firms, were able to maintain control of their existing holdings due to the concomitant use of differential voting rights, pyramiding through closed-end investment funds (CEIFs) and cross-holdings (Agnblad et al., 2001). Domestic institutional investors, at the same time, diversified their holdings outside of Sweden but still kept significant holdings within the country (Table 1).

**Table 1: Ownership (%) by Category and Total Market Capitalization (BSEK) for All Swedish Listed Companies 1990-2015**

<b>Year (End)</b>	<b>CEIFs</b>	<b>Domestic Institutional</b>	<b>Foreign</b>	<b>House-holds</b>	<b>Public Sector</b>	<b>Industrial &amp; Non-Profit</b>	<b>Market Cap (BSEK)</b>
<b>1990</b>	11%	24%	8%	18%	9%	31%	<b>554</b>
<b>1995</b>	7%	23%	30%	15%	8%	17%	<b>1145</b>
<b>2000</b>	6%	21%	39%	13%	9%	12%	<b>3639</b>
<b>2005</b>	5%	23%	35%	15%	8%	13%	<b>3627</b>
<b>2010</b>	5%	23%	38%	13%	7%	13%	<b>4342</b>
<b>2015</b>	5%	21%	40%	12%	4%	16%	<b>6078</b>

Notes: Ownership by owner category and percentage of total ownership (measured by capital *not* votes), and market capitalization of all listed companies in MSEK 1990-2015 (Statistics Sweden, 2017). “CEIFs” are closed-end investment funds. “Domestic Institutional” owners includes the traditional categories i.e. pension funds (e.g. the Swedish National Pension Funds), retail funds and life insurance. “Foreign” ownership is reported in aggregate and includes all ownership categories based abroad. “Industrial & Non-Profit” denotes the holdings of non-financial corporations and non-profits; the category is merged for data reasons.

Two-thirds of Stockholm Stock Exchange (SSE) listed companies have a controlling shareholder or shareholder group with 20% or more of the voting rights, and more than 95% a shareholder controlling 10% or more of the voting rights (SIS Ägarservice, 2014). [I will update these figures for end 2017] Thus, the vast majority of firms on the SSE are still controlled by an established owner sphere or other controlling block holder, a fact that is often downplayed or de-emphasized when looking only the raw numbers of ownership. It is important to stress the point there are very few listed firms on the SSE that lack a controlling shareholder, something which strongly suggests that the dispersed ownership model is not particularly viable in the Swedish setting. Henrekson & Jakobsson (2012) observe this and suggest that the established ownership spheres have been in decline in recent years. They also suggest that executive or managerial control with dispersed ownership as in e.g. the U.S. or UK has not replaced the old block holder model, because it is more or less precluded in Sweden under the current governance system and due to extant



societal norms as regards e.g. executive compensation. Instead, control models outside the stock exchange, namely direct foreign ownership and private equity, have been on the ascent (cf. Nachemson-Ekwall, 2012).

## **2.4 The Role(s) of Institutional Investors in Corporate Governance**

The ascent of institutional investors as the dominant owner category in terms of capital in the equity markets of the developed world has led to an intense debate regarding the governance capabilities of these investors and their influence over how listed corporations are run among both policy makers and academics (e.g. Davis, 2008; OECD, 2011). It is claimed that we are now in an era of fiduciary capitalism (Hawley & Williams, 1997) or agency capitalism (Gilson & Gordon, 2013) that is increasingly defined by this ownership development and its associated implications for corporate governance. Gourevitch & Shinn (2005) emphasize this when they write: “[R]egulations regarding the structure and function of pension plans and mutual funds are a central issue of public policy, with enormous long-term consequences for equity markets generally and corporate governance specifically” (Ibid: 292). The concentration of ownership in the hands of institutional investors have given them a sizable stake in most listed companies, but has not always produced a concomitant engagement in the governance matters of these firms (Davis, 2008). Several reasons for this have been presented, including but not limited to so-called free rider or collective action problems whereby diversified institutional investors are not sufficiently compensated for costly governance efforts (cf. Grossman & Hart, 1980); long and complex investment chains that create layers of agency problems and weaken incentives to monitor companies on behalf of the end investor or principal (Çelik & Isaksson, 2013); as well as the way many institutional investors are organized and manage their investments (e.g. Hellman, 2005; Tilba & McNulty, 2013).

Not all institutional investors are the same, however, and it is important to acknowledge how e.g. “traditional” institutional investors such as pension funds, insurance companies and asset managers, who are often the ones referred to when the term “institutional investors” are used, are markedly different from e.g. activist hedge funds (Çelik & Isaksson, 2013). Due *inter alia* to differences along key dimensions such as the investor's purpose and investment strategy, very different degrees of engagement in corporate governance can be expected between different classes of institutional investors. In Table 2, below, key differences are highlighted for four different kinds of institutional investors: the typical “traditional” institutional investor i.e. public pension funds, activist hedge funds, closed-end investment funds of the Swedish (see Section 2.3) and exchange-traded funds or ETFs. Such differences are also stressed by Gilson & Gordon (2013), who characterize traditional institutional investors as relatively passive or “reticent”, but also that there exists a supposed symbiotic relationship between these investors and more proactive classes of institutional investors such as activist hedge funds.

**Table 2: Corporate Governance Taxonomy of Institutional Investors incl. CEIFs**

Variable/Type of II	Public Pension Fund	Activist Hedge Fund	CEIF*	ETF**
<b>Purpose</b>	Non-Profit	For-Profit	For-Profit	For-Profit
<b>Liability Structure</b>	Long-Term	Short-Term	Long-Term	Short-Term
<b>Investment Strategy</b>	Multiple***	Active Fundamental	Active Fundamental	Passive Index
<b>Portfolio Structure</b>	Diversified	Concentrated	Concentrated	Diversified
<b>Fee Structure</b>	None	Performance Fee	None	None
<b>Social Objectives</b>	Yes	No	Yes	No
<b>Degree of Engagement</b>	Reactive Engagement	Proactive Engagement	Inside Engagement	No Engagement

Notes: Adapted from Çelik & Isaksson (2013) with slight modifications. \*Closed-End Investment Fund (see section 2.3). \*\*Exchange-Traded Fund financed by share lending. \*\*\*Often follows a passive indexation strategy but this can vary.

Empirical evidence regarding the degree of governance engagement among traditional institutional investors (the focus of Study 1 and Study 3) supports the notion that they are inclined to be more reactive than proactive in corporate governance matters. Tilba & McNulty (2013) studied UK-based pension funds and found that these almost always had a “disengaged” ownership style and often delegated their equity investment decisions to external asset managers that did not appear active in governance matters. Hellman (2005) demonstrated a similar pattern among traditional Swedish institutional investors and suggested that giving institutions a larger role in corporate governance may have negative effects, e.g. due to their short-term financial focus. Hendry et al. (2006) interviewed both institutional investor representatives and executives in British listed firms and found that market participants conceptualize traditional institutions as financial traders, with actual firm ownership viewed as “accidental, and practically irrelevant to the investors’ central function [i.e. to generate returns]” (Hendry et al., 2006: p. 1106). A large-scale survey by McCahery et al. (2016) also points in this direction by finding that exit, i.e. selling shares, and voting against management at general meetings are the most popular governance interventions.

Bengtsson (2005) presents somewhat contradictory evidence that traditional institutional investors in the Swedish setting do engage in governance, e.g. through nominating committee participation, but also concludes that this is motivated more by symbolism than economic substance. Nachemson-Ekwall (*forthcoming*) also suggests that the reactive nature of governance engagement among Swedish traditional institutional investors may be outdated, however, due to a concentration of ownership on the domestic market combined with renewed efforts at more proactive engagement, with the caveat that this is a nascent phenomenon. The quantitative empirical literature linking traditional institutional ownership to firm outcomes suggests that different categories of traditional institutional investors can have both positive and negative effects on e.g. earnings management and R&D (Bushee, 1998), risk-taking leading up to the financial crisis (Erkens et al., 2012), improvements in corporate governance in jurisdictions with supposedly poor practices (Aggarwal et al., 2011) and most recently that transient institutional investors worsen problems of short-termism in the capital markets (Asker et al. 2015). Conversely, recent evidence also

suggests that institutional ownership is causally related to improved corporate social performance (Dyck et al. 2016), in particular for institutional investors who are domiciled in a country with strong social norms.

The empirical literature on the engagement of activist hedge funds (the focus of Study 2) suggests that these funds are often successful in achieving their stated objectives, such as replacing board members or increasing leverage and dividends (Brav et al., 2008; Klein & Zur, 2011). There are also strong indications that activist hedge funds leverage on the presence of traditional reactive institutional investors, in the manner suggested by Gilson & Gordon (2013), garnering support for their stated goals (Brav et al. 2008). While there is little dispute that these activists have a beneficial effect on short-term stock prices (Coffee & Palia, 2015) the long-term effects are much more contested. Some suggest that activist hedge funds effectuate lasting positive operational changes in targeted firms (Bebchuk et al., 2015) while others that they effectuate wealth transfers from bond holders (Klein & Zur, 2011) or induce short-term market speculation that the targeted firm will be acquired (Greenwood & Schor, 2009). Such results cast a questionable light on the hypothesis of Gilson & Gordon (2013) that activist hedge funds and traditional institutional investors collaborate to improve governance across the board.

### **3. Summary of Research Papers**

The three studies forming the core of the dissertation all aim at answering the stated research question by empirically examining the interplay between different classes of institutional investors and listed companies in the Swedish setting. As the research question is highly outcome-oriented, emphasizing the potential consequences of a concentration of ownership in the hands of institutional investors under a shareholder-oriented governance regime, so-called variance studies that emphasize the relationship between independent and dependent variables are given precedence in the research design (Van de Ven, 2007). All studies are thus quantitative in nature, with the third study, which is exploratory, also containing a qualitative component. Sweden is considered a relevant institutional context to study because of the shareholder-oriented nature of the governance regime, answering recent calls to examine how legal rules that empower shareholders interact with shareholder activism (Aguilera et al., 2015: 535). Studying the case of Sweden can provide new insights on the impacts of shareholder-oriented governance reforms, but also on the impacts of differing classes of institutional investors in governance regimes characterized by blockholder control as opposed to markets characterized by management or executive control (e.g. the U.S.). The three studies each deal primarily with different categories of institutional investors: Study 1 and 3 consider the so-called “traditional” institutional investors: pension funds, insurance companies as well as fund and asset managers, with the focus in Study 1 being on the domestic traditional institutional investors (often referred to simply as “institutional investors”), while Study 3 considers the role of their foreign counterparts. Study 2, meanwhile, focuses on a more “entrepreneurial” class of institutional investors: hedge fund activists, both foreign and domestic. The first study, summarized in Section 3.1 and attached as Appendix 1, examines the role played by domestic institutional investors in the nomination committees of listed Swedish firms by looking at the link between domestic institutional investor participation in these committees and subsequent

appointments of women directors. The study builds on a hand-collected panel dataset of domestic institutional investor nomination committee participation and board gender composition in all continuously SSE-listed firms between 2005 and 2017. The second study, summarized in Section 3.2 and attached as Appendix 2, considers the role of hedge fund activists in the Swedish setting and how they have influenced developments in listed Swedish firms. The empirical material builds on a hand-collected set of 47 interventions (activist-firm pairings), where comparisons between firms experiencing an intervention and a matched sample as well as the entire population of SSE-listed firms have been undertaken. The third study (Section 3.3 and Appendix 3) deals with the specific sub-set of foreign (traditional) institutional investors. This is a mixed-methods study where the empirical material is based on thirteen mini-cases of large listed firms, which includes interview material with key executives, as well as a quantitative examination of nomination committee participation by foreign institutional investors in all SSE-listed firms. The studies are summarized in Table 2, below.

**Table 2: Summary of Empirical Studies**

	Study 1	Study 2	Study 3
Title	"Institutional Investors and Women on Boards"	"Hedge Fund Activism under Shareholder-Oriented Governance"	"Foreign Institutional Investors in Swedish Corporate Governance"
Research Question(s)	Have institutional investors been successful in promoting women directors through nomination committee participation? Are there differences between categories of investors? Is there a temporal effect?	What are the effects of hedge fund activism under a shareholder-oriented governance regime such as the Swedish one?	What role, if any, do foreign institutional investors play in the governance of listed Swedish firms?
Type of Institutional Investor Studied	Traditional Domestic	Hedge Funds	Traditional Foreign
Dependent Variable(s)	Board Gender Composition	Firm Financial Performance, Propensity for Takeovers, Other Real Variables	Nomination Committee Participation
Key Independent Variable(s)	Nomination Committee Participation, Institutional Ownership	Hedge Fund Activism	Institutional Ownership
Method(s)	Panel Regressions, Pooled OLS, Logit	Matched Sample Comparison of Difference-in-Differences (t-tests, F-tests, Wilcoxon), Logit, Panel Regressions, Pooled OLS	Mixed Method: Pooled OLS, Qualitative comparative mini-case study
Time Period Studied	2005-2017	2003-2012	2015-16 (Quant); 2013-14 (Qual)

### 3.1 Summary Study 1: "Institutional Investors and Women on Boards"

In this study, I add to the available evidence on the role of Swedish institutional investors in corporate governance by examining the link between their ownership as well as participation on the shareholder-constituted nomination committee and subsequent appointments of women directors in SSE-listed firms. Previous research on Swedish institutional investors has examined their nomination committee participation but focused on its relationship with firm valuation (as in Gianetti & Laeven, 2009) and other factors such

as the underlying motivations to such participation, e.g. whether it is driven by an economic or sociological reasoning (as in Bengtsson, 2005) but it has not considered whether the practice has contributed to board diversity. The few extant studies that do examine the relationship between institutional ownership and board gender composition in the Swedish setting, meanwhile, has utilized ownership only as an explanatory variable (e.g. Alimov, 2016; Gregorič et al., 2017). By including nomination committee participation, which is observable from public data, I circumvent a major issue in quantitative empirical research on institutional investor involvement in corporate governance, namely that much shareholder engagement and/or activism is undertaken in private and not something that can be extracted from archival data and modeled (Goranova & Ryan, 2014; McNulty & Nordberg, 2016).

In my analysis, I examine whether there is a link between institutional investors participating on the committee one the one hand, and the proportion of women on boards elected on the other. I also consider whether there are differences between different categories of institutional investors in as regards the impact on board gender composition, hypothesizing that certain classes of investors (e.g. pension funds) are more prone to promote women directors than others (e.g. asset managers). In order to gauge the influence of the institutional environment (e.g. Oliver, 1991; Scott, 2013) on both investor and firm behavior, I also split my analysis between two time periods that were characterized by differences in “coercive intensity”, that is between a time period where the issue of board gender equality was being the subject of proposed legislation and sharper formulations in the Code, and when it was not. My findings support the main hypothesis that Swedish institutional investors have had a positive impact on the proportion of women on boards of directors. I also find that this effect is primarily attributable to pension funds and insurance companies as well as that the effect was most pronounced during the years of increased coercive intensity.

### **3.2 Summary Study 2: “Hedge Fund Activism under Shareholder-Oriented Governance”**

My second study focuses on hedge fund activists. I outline the recent debate regarding hedge fund activism, in particular how the literature differentiates between whether activists contribute genuine value creation e.g. through operational profitability improvements and/or reductions of agency costs (Brav et al., 2008), primarily generate returns through speculation in and facilitation of takeovers (Greenwood & Schor, 2009) or mainly achieve wealth transfers from bondholders (Klein & Zur, 2011) and/or long-term shareholders (Bessler et al., 2015). I also highlight apparent institutional differences in the literature, where activists appear to be less successful in achieving outcomes, e.g. changes in firm financial policy or takeovers, in markets characterized by less of a shareholder-orientation, e.g. Germany and Japan (e.g. Buchanan et al., 2014; Drerup, 2014), and more successful in markets where there is more of a shareholder-orientation of governance and/or a higher dispersion of ownership, e.g. the U.S. (e.g. Becht et al., 2017).

My empirical data consists of a sample of 47 hedge fund interventions in Sweden over a ten year period stretching from 2003-2012. The analysis suggests that hedge fund activists tend to target firms that unlike most Swedish companies lack a controlling shareholder and very often use the opportunity to take a place

on the shareholder constituted nominating committee, allowing them to influence board composition. When comparing the firms that are targeted by activists with a matching sample of similar firms (cf. Klein & Zur, 2011) over a two-period and four-year period, I find few relevant changes in financial performance or other real variables. The most relevant change in the targeted firms is instead that they are acquired to a greater extent than their matched peers are. This is corroborated by a logistic regression covering all SSE-firms where there is a strong relationship between prior activism by activist hedge fund and subsequent acquisition. Conversely, panel regression analyses suggest that there is no such relationship between prior activism and subsequent firm performance. The findings are in line with the hypothesis that takeovers are the most likely outcome for firms targeted by activists in a shareholder-oriented governance regime such as the Swedish one, because it is the most profitable outcome for the activists and, in the absence of a controlling blockholder, it is relatively easy for them to achieve their preferred goals.

### **3.3 Summary Study 3: “Foreign Institutional Investors in Swedish Corporate Governance”**

In the third study, I examine the role played by foreign institutional investors in the Swedish governance context. The focus is as in Study 1 on the so-called traditional institutional investors, i.e. pension funds, mutual funds, insurance companies and asset managers. The study departs from the observation that there exists a tension in the relatively scant extant literature on foreign institutional investors in the Swedish setting. Whereas multi-country studies that include Sweden suggest foreign institutional investors have a beneficial influence on corporate governance, innovation and other firm outcomes (Aggarwal et al., 2011; Bena et al., 2017), other studies suggest foreign portfolio investors have no such beneficial impact (Fogel et al., 2013) and that foreign investors do not appear to be active in corporate governance as evidenced by their disinclination to participate on the nomination committee relative to e.g. domestic institutional investors (Gianetti & Laeven, 2009). In the studies that stress the supposed beneficial impact of foreign institutional investors, moreover, little is said about the mechanisms through which this occurs.

Because of the lack of previous studies on the actual governance involvement undertaken by foreign institutional investors in Sweden, and because research elsewhere (e.g. McCahery et al., 2016) shows that such involvement or engagement is often undertaken in private, meaning that public data may not provide a complete picture, as well as previous issues in particular in the ownership data of foreign institutional investors, my empirical approach is mixed with both a qualitative comparative “mini-case” which includes interviews with key investee firm executives as well as a quantitative investigation that examines the nomination committee participation of foreign institutional investors. The results from my qualitative analysis shows that these investors appear disinclined to involve themselves in the governance of their Swedish investee firms. This is corroborated by the quantitative results that show a striking difference in the propensity for foreign institutional investors to engage in the nomination committee as compared to their domestic counterparts.

## 4. Concluding Remarks

The main contribution of this dissertation is empirical. The three studies all contribute to the relatively limited extant evidence on the governance role played by different classes of institutional investors in a market characterized by shareholder-oriented governance, such as the Swedish one, in particular by considering the role of the shareholder-constituted nomination committee. The first study shows how the domestic traditional institutional investors active on the Swedish market have had an impact on the governance of listed firms by demonstrating that their involvement in the nomination committees are related to subsequent increases in the proportion of women directors. The second study shows how activist hedge funds also engage, but that the end result of their involvement in investee firms tend to be a takeover. The third study, meanwhile, suggests that foreign traditional institutional investors appear more disinclined to engage in governance matters, as evidenced e.g. by their reluctance to participate in the nomination committees of listed firms. As such, there appear to be clear differences in the level of governance engagement between classes of institutional investors as well as the firm-level effects of this engagement.

I also hypothesize and show in relation to Study 1 that there are differences also within the traditional institutional investor category, where pension funds and insurance companies appear more attuned to societal demands for gender equal boards, and that an intensification of these demands through the threat of state intervention and sharpening of the language in the self-regulative corporate governance code appear to have impacted their behavior. This has implications for policy *inter alia* because it suggests that firm and investor behavior, in this case as regards board gender equality, is impacted not only by formal legislation, but also by the threat of it. The findings also have implications for institutional theory (Oliver, 1991; Scott, 2013), as it shows how changes in the institutional environment affects the behavior of institutional investors and firms, in this case as regards board gender composition.

I conclude in the second study, meanwhile, that shareholder oriented governance reforms such as giving shareholders influence over the board nomination process can and are capitalized on by activist hedge funds, whose primary interest appears to be to have the firm acquired rather than making any operational improvements. That listed Swedish firms that lack a controlling shareholder are often targeted by activist hedge funds and later sold is one way to understand why the shareholder-oriented Swedish governance model does not seem to allow firms with dispersed shareholdings to exist independently (cf. Henrekson & Jakobsson, 2012; Nachemson-Ekwall, 2012). The findings of the third study, lastly, is the clearest indication that for certain classes of institutional investors, e.g. foreign traditional institutional investors, corporate governance is not a central concern and an expectation for them to assume a greater responsibility in this regard may be misplaced (cf. Tilba & McNulty, 2013).

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## **Institutional Investors and Women on Boards**

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# Institutional Investors and Women on Boards

## Abstract

**Manuscript Type:** Empirical

**Research Question/Issue:** A central question in contemporary corporate governance is if and how institutional investors act as engaged owners in their investee firms. In this study, I draw on institutional theory and the case of rapidly increasing female board representation in recent years in Sweden to show how and under which conditions such engagement can occur.

**Research Findings/Insights:** I hypothesize and demonstrate that engagement in the board nomination process by certain groups of institutional investors but not others are related to subsequent increases in the proportion of women on boards of directors. Through my longitudinal research design, I also hypothesize and show that strong recent institutional pressures for boardroom equality appear to have affected the behavior of the institutional investors in this regard.

**Theoretical/Academic Implications:** I contribute to institutional theory by showing that the positive relationship between institutional investor involvement in board nominations and subsequent appointments of women directors is stronger for categories of institutional investors that are more attuned to public demands for equality as well as when such demands are coupled with stronger coercive pressure.

**Practitioner/Policy Implications:** My results indicate that institutional investors can have an impact on board composition when they are granted influence over the board nomination process as they have been in Sweden. The study also highlights how the interplay between institutional investor engagement, self-regulation and the threat of binding quotas have contributed to more gender equal boards.

**Keywords:** Corporate Governance, Institutional Investors, Women on Boards, Institutional Theory, Investor Engagement, Nomination Committees

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## 1. Introduction

Institutional investors<sup>1</sup> own most of the equity capital in listed companies in the developed world (Organization for Economic Co-operation and Development [OECD], 2011) and how they behave as owners with regards to the firms in which they have invested has become a central focus of corporate governance research, practice and regulatory efforts – e.g. through so-called stewardship codes that seek to promote active ownership (McNulty & Nordberg, 2016). A complicating issue here is the fact that institutional investors are not a homogenous group and many factors influence how different institutional investors engage or do not engage in active ownership as well as whether such efforts have any palpable effects. Whereas certain niche institutional investor types such as hedge fund activists have been shown in the literature to be very successful in influencing corporate decisions to achieve financial returns in the short-term, it is much less clear to what extent, under which circumstances and with which outcomes so-called traditional institutional investors, e.g. pension and mutual funds, that hold the bulk of the capital, engage in governance efforts (Çelik & Isaksson, 2013; Goranova & Ryan, 2014; McNulty & Nordberg, 2016). A common view is that these institutional investors are passive or reactive in their approach to corporate governance and largely unsuccessful in influencing investee firms on their own (Gilson & Gordon, 2013). However, there has also for a long time existed contradictory evidence suggesting that certain types of traditional institutional investors (henceforth “institutional investors”) such as large independent public pension funds can influence corporate policies (Chen, Harford, & Li, 2007; Del Guercio & Hawkins, 1999). Recent evidence that deals with the social and environmental rather than financial performance of firms also suggests that institutional investors do have an effect on investee firms, at least when they themselves are domiciled in a country with strong social and environmental norms (Dyck, Lins, Roth, & Wagner, 2016).

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<sup>1</sup> I define institutional investors as legal persons investing on the behalf of one or more fiduciaries.

One reason that it is hard to establish and evaluate quantitatively the governance efforts undertaken by institutional investors is that most of it is done in private and that they only infrequently take public actions such as lodging shareholder proposals (McCahery, Sautner, & Starks, 2016). Facets of stewardship or active ownership are therefore difficult to observe and model and most research focuses only on momentary and confrontational public interventions while ignoring more collaborative and long-term initiatives (McNulty & Nordberg, 2016). In this regard, the Swedish governance context provides an opportunity, however, since unlike in virtually every other jurisdiction shareholders are routinely involved in the nomination of director candidates through shareholder-constituted nomination committees and any such participation by institutional investors is in turn publicly available information (Sjöstrand et al., 2016; see the Appendix for a review of the Swedish nomination committee system). An example of one of the very few quantitative studies that leverage on this fact is Giannetti and Laeven (2009), who show that Swedish public pension funds with significant ownership stakes in a firm choose to participate in the nomination committees of these firms and also that this participation is related to an increased market valuation. In general, however, very little is known about the impact that institutional investors have when they become engaged in the board nomination process, despite e.g. the fervent debate about the merits of granting shareholders a role in nominating directors and the rapid implementation to that effect of proxy access provisions in a large number of U.S. firms in recent years (Becker, Bergstresser, & Subramanian, 2013).

If we are to understand the effects of institutional investor participation in the director nomination process whether through nomination committees as in Sweden or through proxy access as in the U.S., a reasonable first step to examine is whether and how institutional investors affect the composition of the board of directors. One of the key parameters to consider in this regard, in turn, is gender (Adams & Ferreira, 2009; Byron & Post, 2016; Post & Byron,



2015). As in many other countries, Sweden has debated imposing board gender quotas in listed firms and as part of the preparatory work for recently proposed legislation in this regard an association representing the sixteen largest Swedish institutional investors (cf. the Council of Institutional Investors) replied that such legislation was unnecessary because the institutional investors had already been successful in promoting an increased representation of women on boards through their work in the nomination committees (Institutionella Ägares Förening [IÄF], 2016). However, while it is clear that the proportion of women on boards in Swedish listed firms has increased significantly during recent years, from 15.9% in 2005 to 32.2% in 2017 (Second Swedish National Pension Fund [AP2] & Nordic Investor Services [NIS], 2017), no one has previously established the veracity of this claim.

Most of the research on women on boards focuses instead on the relationship between changes in female board representation and subsequent changes in corporate outcomes such as firm financial performance (Adams & Ferreira, 2009). Only a few studies focus on the antecedents of female board representation, i.e. what determines the number of women on boards in the first place (Hillman, Shropshire, & Cannella, 2007), and even fewer consider the role of institutional investors in promoting women on corporate boards and provide conflicting empirical results in this regard (Dobbin & Jung, 2011; Farrell & Hersch, 2005; Gregorič, Oxelheim, Randøy, & Thomsen, 2017). In this study I draw on institutional theory in general (Scott, 2013) and the framework presented by Oliver (1991), in particular, to show how a strong institutional pressure for boardroom equality in recent years has resulted in rapid increases of female board representation in listed Swedish firms as well as the role institutional investors have played over time in substantiating these pressures on the firm level. Specifically, with cross-sectional time series “panel” data on all continuously listed Stockholm Stock Exchange (SSE) firms between 2005-2017 I show that institutional investors appear to have had a positive impact on female board representation; that this effect is only evident for pension funds and insurance companies,

who *inter alia* are more attuned to public demands for equality and have a more long-term investment horizon, as opposed to mutual funds and asset managers; and that this effect is most significant for the most recent time period in the study (2015-2017) when the institutional pressure for change arguably was the strongest.

The study continues as follows: I review the literature on institutional investors and women on boards in Section 2; Section 3 contains the theoretical framework, research design, hypotheses and operationalization of the relevant concepts; this is followed by the main results and some additional robustness tests in Section 4; I conclude with a discussion about the relevance and limitations of my findings in Section 5.

## **2. Literature Review**

### **2.1 Institutional Investors in Corporate Governance**

The involvement of institutional investors in the governance of investee firms is a complex issue with conflicting evidence regarding the antecedents of such involvement or activism, the process through which it is undertaken and which outcomes it entails for firms, investors and the broader society (Goranova & Ryan, 2014). The picture is even more complicated when looking beyond momentary interventions and considering how this involvement unfolds over time (McNulty & Nordberg, 2016). An important factor for this complexity is the heterogeneous nature of institutional investors: very large public pension funds are grouped together with small and unregulated activist hedge funds under this umbrella term despite the fact that these have vastly different motivations and capabilities as regards corporate governance (Çelik & Isaksson, 2013; Goranova & Ryan, 2014).<sup>2</sup> Another complicating factor is that their involvement in governance – if it occurs – is often done in a private and unobservable fashion (Goranova & Ryan, 2014; McCahery et al. 2016) and thus not easily

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<sup>2</sup> In this study, unless otherwise noted, I focus on the so-called traditional institutional investors: pension funds and insurance companies as well as mutual funds and asset managers (Çelik & Isaksson, 2013).

captured through statistical testing of archival data (McNulty & Nordberg, 2016). Thus, for this and other reasons, the empirical evidence on the involvement of institutional investors in corporate governance is decidedly mixed. Qualitative interview-based studies, for instance, strongly suggest that most institutional investors are run in a way that often does not involve meaningful involvement in corporate governance through voice (Hirschman, 1970) and that institutions are instead exit-prone financial traders who will sell their shares when dissatisfied with an investee firm (Hellman, 2005; Hendry, Sanderson, Barker, & Roberts, 2006; Tilba & McNulty, 2013). Quantitative investigations (for a full review see e.g. Goranova and Ryan (2014), pp. 1234-1240) on the other hand suggest *inter alia* that certain institutional investors such as pension funds can effectuate positive change. This can occur e.g. through shareholder proposals (Del Guercio & Hawkins, 1999) and in M&A situations (Chen et al. 2007). Conversely, other researchers have shown that transient institutional investors with high portfolio turn-over can exacerbate extant problems of short-termism in listed firms leading e.g. to inefficient cutbacks in R&D and other investments to benefit current earnings (Asker, Farre-Mensa, & Ljungqvist, 2015; Bushee, 1998). Research on the impact of institutional investors in terms of corporate social performance indicates again that certain types of institutional investors but not others have a positive influence in this regard (e.g. Johnson & Greening, 1999). Recent empirical work in this stream also indicates that societal norms shape the impact of institutional investors: ownership by institutional investors that are domiciled in countries where there are strong norms as regards social issues and the environment appear to have a significant positive causal effect on how these issues are dealt with in the firms in which they invest (Dyck et al., 2016).

There are a number of studies on the governance involvement of institutional investors in the Swedish setting specifically. Gianetti and Laeven (2009) utilize empirically the fact that nomination committees are constituted by shareholders in the Swedish setting and show two

important things related to this. Firstly, domestic institutional investor ownership (but not foreign) is related to participation on nomination committees in Swedish firms, i.e. the domestic institutional investors choose to become involved in the board nomination process as evidenced by their participation on the committees. Secondly, when pension fund ownership is interacted with nomination committee participation, there is a strong positive relationship with financial performance. Birkmose and Strand (2013), meanwhile, compare Danish and Swedish institutional investors and find that the Swedish investors tend to be relatively more active in corporate governance because they are able to participate on the board nomination committees. Additional research in the Swedish setting suggests *inter alia* that the domestic institutional investors participate in the nomination committees of investee firms, but that this engagement is a result of institutional pressures (cf. DiMaggio & Powell, 1983) to be seen as responsible owners rather than by discounting the net economic value of such engagement (Bengtsson, 2005); that domestic institutional investors frequently collaborate and that their ESG-related work is shaped by Swedish societal norms (Nyqvist, 2015); and most recently that the largest domestic institutional investors have begun to focus their shareholdings and orient themselves towards more active ownership and engagement on the Swedish market (Nachemson-Ekwall, *forthcoming*). Recent qualitative work on Swedish corporate governance more generally suggests that the domestic institutional investors are involved in the board nomination process but that the impact that they can have in the nomination committees is heavily impacted the presence or absence of large incumbent block holders who tend to control the nomination process when they have enough votes to secure the election of their preferred directors (Sjöstrand et al., 2016).

## **2.2 Women on Boards**

A fervently debated and frequently controversial topic related to board recruitment and composition is gender. Most of the research on women on boards has gone into investigating

the so-called business case for gender parity, i.e. whether it is beneficial for the firm as measured by financial performance or other similar outcomes that women receive equal representation on the board of directors. This research is inconclusive (Kirsch, 2017). Adams and Ferreira (2009) provide perhaps the most thorough study from a quantitative methodological perspective on this subject in the U.S. setting and find that the relationship between increases in female board representation and financial performance is negative on average. They attribute this to a supposed tendency for female directors to “over-monitor” (cf. agency theory) firm executives as they also find in other models *inter alia* that female board representation is related to an increased tendency to fire the CEO when a firm's stock underperforms (Ibid). Post and Byron (2015) provide a meta-analysis of this study and the 139 other studies they find that also deal with the ambiguous link between women on boards and firm performance. They conjecture and find that the legal and socio-cultural context in which the studies are undertaken have a marked effect on the results. When considering all studies without factoring in context, they find that the average effect of female board representation on market returns (e.g. Tobins Q) is near zero while the link with accounting returns (e.g. Return on Assets) is positive. The relationship with market returns improves, however, in countries that are characterized by a higher degree of gender parity. They conclude that: “[The relationship between women on boards and market performance] is more positive where there is greater gender parity, presumably because the presence of women on boards confers more legitimacy to firms in contexts where men and women have similar human capital [...]” (p. 1560). In a similar meta-analysis of 87 samples that deal with the relationship between women on boards and corporate social performance (Byron & Post, 2016) they find similar results. The baseline relationship between female board representation and corporate social performance is much stronger than for financial performance and this effect grows even more pronounced when country-level norms regarding

gender parity are considered. Thus, they again stress the important effect of the institutional environment in shaping the effect women on boards have over how firms are governed.

The Norwegian introduction of board gender quotas has recently been used in empirical research as a so-called “exogenous shock” to firm behavior in order to attempt to determine what effects legally mandated board gender equality may have on firm financial performance and other firm outcomes. Initial research on this topic appeared to show that board quotas had dramatically negative effects on firm financial performance and/or had led a record number of firms to take such drastic steps as changing their organizational form in order to avoid being subject to the quotas (Ahern & Dittmar, 2012; Bøhren & Staubo, 2014; Matsa & Miller, 2013). This research has however been disputed in particular on methodological and empirical grounds (Eckbo, Nygaard, & Thorburn, 2016). Quotas do not need to be implemented formally in order to have an effect on board gender composition; it has been shown that merely the “threat” of binding legislation can be enough to coerce firms into moving towards gender-balanced boards (Hinnerich & Jansson, 2017; Singh, Point, & Moulin, 2015). In the Swedish case this has been demonstrated by Hinnerich and Jansson (2017) who compare the board gender composition of listed and non-listed Swedish firms in the years after 2002 when the then deputy prime minister “threatened” all listed firms with a binding legal quota if they did not increase the proportion of women on their boards of directors from circa 5% to 25% of all directors. The authors found that the gender balance on the boards of listed firms increased dramatically while the same was not true for their unlisted counterparts despite the fact that no quota law was ever implemented.

Macro-level factors such as real or proposed quotas are only one part in understanding what explains the gender composition of boards (Kirsch, 2017). Hillman et al. (2007), using a resource dependency perspective, focus instead on industry- and firm-level explanations to see what variables are related to an increased probability of female board representation in the U.S. They find that firm age and size as well as board size and the number of director links a firm

has to other firms that also have female directors are significantly related to higher odds ratios for female director representation in their sample. Farrell and Hersch (2005) also consider the probabilities of female director appointments and find in their model that firm size and – importantly – ownership by institutional investors are significantly related to the probability that a female director will be appointed. The impact of institutional investors on the probability that a female director will be recruited is positive only under some specifications, and the authors crucially do not utilize a firm fixed effects model to control for omitted variable bias, however. Dobbin and Jung (2011) run a logistic panel model with firm fixed effects where they find that shareholder proposals lodged in U.S. firms by institutional investors that promote board diversity significantly increase the odds of female director representation, but that the ownership per se has no significant effect. Marquardt and Wiedman (2016) similarly investigate shareholder proposals on board gender diversity lodged by both institutional investors and other shareholder activists and find that firms targeted by these proposals increase their female board representation relative to matched firms.

Alimov (2016) examines if ownership by the four large Swedish national pension funds is related to subsequent increases in female board representation in Swedish firms between 2001 and 2012, i.e. an empirical setup similar to this study. In different panel regressions with ownership by these funds as an independent variable, he finds no significant relationship between pension fund ownership and the proportion of female directors. Recently published research that draws on institutional theory (Gregorič et al., 2017) to explain the antecedents of female board representation in the Nordic countries between 2001 and 2008 has similar findings as regards the role of institutional ownership. Ownership by institutional investors is only significantly related to female board representation when firm fixed effects are not included in their panel regressions, leading them to conclude that the relationship is spurious. They do find as in other studies that the proportion of female board representation of other firms in the same

industry has a significant and positive impact on female board representation, as does e.g. firm size.

### **3. Theoretical Framework and Research Design**

#### **3.1 Theoretical Framework**

Institutional theory (DiMaggio & Powell, 1983; Meyer & Rowan, 1977) offers relevant potential explanations for why firms with a large institutional investor base may have a higher proportion of women directors. Under institutional theory, organizations adapt to the coercive (e.g. regulation), mimetic (e.g. shared logics) and normative (e.g. social obligations) pressures of their environment as they strive to be considered legitimate by key stakeholders (DiMaggio & Powell, 1983; Scott, 2013). Early iterations of institutional theory are frequently criticized for their emphasis on stability and similarity among organizations, however, as well as, conversely, their de-emphasis on institutional change and the varying ability of different organizations to resist institutional pressures for conformity (Oliver, 1991; 1992; Scott, 2013). Oliver (1991) combines institutional theory with a resource dependency perspective (e.g. Pfeffer & Salancik, 1978) to highlight how organizations respond to institutional pressures for change on a scale from passive acquiescence to active manipulation, and suggests that these responses are determined by *inter alia* variations in the perceived social legitimacy and economic fitness of conformity (the “cause”); the degree to which the organization is dependent on the stakeholders from which conformity is demanded (the “constituents”); the degree to which the demands placed are consistent with organizational goals (the “content”); how the demands are being enforced, e.g. through binding legislation or voluntary adoption (the “control”); and the degree to which the organization is in a highly interconnected environment (the “context”; Oliver, 1991). Thus, *inter alia* according the framework, a firm that at a certain point in time perceives that it can gain both social legitimacy and economic efficiency from appointing more women to its board of directors, is being pressured to this effect by a



homogenous group of stakeholders on which it is dependent (e.g. institutional investors) and/or is being subject to or threatened with legally binding quotas to that effect by the government will be more inclined to have a gender balanced board of directors (and, of course, vice versa). In line with Oliver (1991), I propose in this paper that changes over time along these variables (e.g. increases in coercive pressures, variations in institutional ownership and control over the nomination of director candidates) have led certain firms to acquiesce to societal demands for gender equal boards to a greater extent than others. While the Oliver (1991) framework is less commonly applied to explain board composition than e.g. agency theory or stand-alone resource dependency theory, there have been empirical studies substantiating the theory in this regard in general (e.g. Luoma & Goodstein, 1999) and more recently as regards board gender composition specifically (Gregorič et al., 2017).

### **3.2 Hypotheses**

Different theoretical perspectives provide different predictions and motivations regarding why institutional investors would promote increases in the number of women on boards. The institutional investors may promote female director candidates because they believe that women will have a positive effect on the boards work and by extension corporate outcomes as predicted by upper echelons theory, in particular because Sweden is characterized by a high degree of gender parity (Byron & Post, 2016; Hambrick, 2007; Post & Byron, 2015). The same line of reasoning can be derived by combining gender differences and group effectiveness theories, which together suggest that gender equality in the boardroom may improve the internal functioning of the board (Nielsen & Huse, 2010). That the functioning of the board improves is the motivation that the largest Swedish institutional investors themselves provide when they claim to have worked for increased female board representation through the nomination

committees (IÄF, 2016).<sup>3</sup> In line with agency theory they may also be inclined (disinclined) to nominate women in firms that they believe need more (less) monitoring if one adheres to the view that female directors monitor firm executives more thoroughly (Adams & Ferreira, 2009; Chen, Leung, & Goergen, 2017; Gregorič et al., 2017). The institutional investors may also promote board diversity because doing so confers them legitimacy (Dobbin & Jung, 2011; Marquardt and Wiedman, 2016), something that may be particularly salient for institutional investors in Sweden where there has been a very fervent public debate about women on boards and frequent threats of legislation in this regard. It is therefore reasonable to expect that institutional investors may have acted to increase the proportion of women on boards of directors. I also suggest that their involvement in the board nomination process as evidenced by their presence on the shareholder-elected nomination committee must be taken into account. Firms that find themselves with a large constituency of institutional owners in control of the process of director selection will be more exposed to their demands for gender equal boards and more likely to acquiesce (cf. Oliver, 1991). If such institutional pressure exists there are also likely to be amplifying mimetic effects (DiMaggio & Powell, 1983), similar to those evident in firms with interlocking directorates (e.g. Greenwood & Hinings, 1996), considering that a small number of institutional investor representatives each serve on a large number of overlapping nomination committees. In order to investigate this, I formulate the following main hypothesis:

H1: Ownership and nomination committee participation by institutional investors is positively related to the proportion of women on boards in listed Swedish firms.

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<sup>3</sup> “The reasons for increasing the diversity [on the boards of directors] is that this leads to a breadth in the boards aggregated experience and knowledge base” (IÄF, 2016, p. 1; translated from Swedish)

Different institutional investors differ along many relevant dimensions such as whether they have a profit maximizing purpose, their liability structure (long- vs. short-term), the degree of their closeness to public and political interests and how they are regulated (Berglund & Alimov, 2017; Çelik & Isaksson, 2013). These differences, I suggest, can reasonably be expected to have a potential impact on the importance they attribute to achieving greater gender equality. Dobbin & Jung (2011), for instance, find in the U.S. that larger institutional investors who are more visible to public scrutiny are less likely to trade against firms who appoint female directors while the same is not true for smaller investors. Johnson & Greening (1999) hypothesize and show that ownership by pension funds but not other institutional investors such as investment companies is positively related to corporate social performance in general and the so-called “treatment of women and minorities” factor in particular. With a basis in signaling and institutional theory they suggest that “pension fund managers will see compliance with institutional norms of hiring underrepresented groups as signaling the population at large regarding firms’ reputation and legitimacy” (p. 568), whereas the same is not true of more supposedly short-term oriented investment managers. Public pension funds which have very long-term liabilities and whose end beneficiaries extend to more or less every adult who has ever had a taxable income may be more inclined to act in what they perceive as the public interest when compared with a for profit mutual fund, for instance. Fund and asset management companies that are run as subsidiaries to e.g. bank holding companies can also have conflicts of interests in that their parent companies may have significant business with the firm in which they have invested and/or where they serve on the nomination committee – something that can make them reluctant to push for governance-related changes (cf. David, Kochhar, & Levitas, 1998). In the terminology of Oliver (1991), there are likely to be differences in the strength of the institutional pressures between institutional investors because they view the potential social and economic gains from increased gender diversity differently. I therefore distinguish between

categories of institutional investors to see whether there are in fact differences between them as regards their impact on board gender composition. Based on this, I formulate the following hypothesis:

*H2: Ownership and nomination committee participation by institutional investors is positively related to the proportion of women on boards in listed Swedish firms. This effect is more likely for pension funds and insurance companies than for mutual funds and asset managers.*

Under an institutional perspective and in particular under the framework proposed by Oliver (1991), the demand for women directors on the firm level, such as it is, can vary *inter alia* with the degree of coercion, legal or otherwise, that firms are subject to from their institutional environment. In the context of Sweden, there has been considerable variation over time in coercive intensity as regards board gender equality. Hard legal measures for board equality were first proposed in 2002 by the then deputy prime minister, but as they were followed by rapid increases in average female director representation, no formal proposal for legislation was ever presented (Hinnerich & Jansson, 2017). The then deputy prime minister left her post for an ambassadorship in Brazil in 2003, the government changed from centre-left to centre-right in 2006 and the question subsequently more or less disappeared from the political agenda until the 2014 elections. After a long period of centre-right rule there was again in the fall of 2014 a centre-left government in place that was willing to propose a legally binding quota, which it also did in the beginning of 2017. Perhaps not coincidentally, in the second half of 2014 the body that issues the Swedish code of corporate governance also for the first time markedly sharpened the language regarding board gender composition in the Code and instructed nomination committees specifically to motivate their proposals for board candidates with regard to gender (Swedish Corporate Governance Code, 2015). Campbell (1996) proposes, also with a basis in institutional theory, that “corporations will be more likely to act in socially responsible

ways if there is a system of well-organized and effective industrial self-regulation in place to ensure such behavior, particularly if it is based on the perceived threat of state intervention [...]” (p. 956). I suggest that the strong intensification of coercive pressures during the period leading up until the 2015 general meeting season and continuing thereafter until the proposed quota legislation was withdrawn in the beginning of 2017 had a marked effect on the institutional investors’ behavior in the nomination committees and that there are observable differences in the relationship between institutional investor nomination committee participation and female director representation between this period and all the previous years in the study (2005-2014). Specifically, I propose the following hypothesis:

*H3: Ownership and nomination committee participation by institutional investors is positively related to the proportion of women on boards in listed Swedish firms. This effect is more likely for general meetings held during the years of increased coercive intensity (2015-2017) than those before (2005-2014).*

Institutional theory and the Oliver (1991) framework provides many more testable predictions regarding the firm-level factors that can influence the tendency for firms to accept or resist societal and/or economic pressures for gender equality. One common example is firm visibility as proxied by firm size, where more visible (larger) firms are thought to be more concerned with being seen as socially legitimate and thus more likely to appoint directors who are women (Gregorič et al., 2017; Hillman et al., 2007). Another prediction is that firms will (mimetically) appoint more (or less) women depending on what peer firms e.g. in the same industry have done previously as a certain level of female director representation becomes institutionalized. Because I emphasize the role of institutional investors in this study, I do not formulate formal hypotheses with regard to these factors, but I do include independent control variables that

measure these two factors, i.e. firm size and lagged industry-level board gender composition, in my regressions (see further Section 3.4).

### **3.3 Data and Methodology**

I have put together a balanced panel dataset consisting of the 145 firms continuously listed on the Stockholm Stock Exchange between the third quarter of 2004 and the general meeting season of 2017 in order to investigate the aforementioned hypotheses. As stated, nomination committees were formalized in the Code in 2004 and were widely adopted by listed firms to elect directors for the general meetings taking place in 2005. This is thus a logical starting year to examine. I have then extended the time period to the latest practicable year, which is for the nomination committees that were formed in the third quarter of 2016 to elect directors at the 2017 general meetings. While this methodology imposes a so-called survivorship bias on the sample, as firms that are delisted during the period are not included, I need a sufficiently long time period in order for there to be enough within-firm variation in the ownership, nomination committee and board variables, which all tend to exhibit only small changes between years, if I am to be able to control for omitted variable bias through a firm fixed effects specification (Wooldridge, 2010).

Information on nomination committee participation is not available in database format and I have therefore hand-collected this information primarily from annual reports but also from third quarter reports and press releases on the subject of nomination committee membership. I have been able to ascertain whether a firm has a nomination committee and which of the members of the committee represent an institutional investor for all 1885 firm-years except for two. Five of the 145 firms (65 firm-years) do not follow the self-regulatory Code recommendations and never have a nomination committee in place in any of the years of study and they have thus been excluded from the analysis. Institutional ownership data was supplied by the proprietary database Holdings, which aggregates ownership information on the Swedish market form

Euroclear. I include only domestic institutional investors because prior to 2015 aggregate ownership data on non-Domestic institutional investors is not reliable as these shareholdings are registered with local custodians and the reported figures are vastly understated. Thus, for my main analyses, I focus only on domestic institutional investors, but I also add the few non-domestic institutional investors who participate in the nomination committee work to two regressions in the robustness section to show that this does not influence my results (see Section 4.2). Board gender composition and other board variables are not available in a database format for Sweden so this data has also been hand-collected, primarily from annual reports and general meeting minutes. Here I have been able to determine the size and gender composition of the board of directors for all 1885 firm years.

To test the main hypothesis, i.e. whether domestic institutional investor ownership and nomination committee participation is related to increases in the proportion of women on boards, I run both pooled ordinary least squares (OLS) regressions with industry fixed effects (i.e. industry dummies) and cross-sectional time series panel regressions with firm fixed effects (cf. one dummy variable for each firm) with the fraction of female board representation as the dependent variable and domestic institutional ownership and nomination committee participation prior to the general meeting where the board is elected as the key independent variables. The firm fixed effects panel specification is the least biased because it controls for all unobserved time-invariant heterogeneity between firms, but it is also less efficient because it removes all the between-firm variation in the studied variables (Allison, 2011; Wooldridge, 2010). This typically causes coefficients and p-values to decrease in magnitude and, conversely, standard errors to increase, which should be taken into consideration when interpreting my results (Ibid). I cluster the standard errors at the firm level and run a cluster-robust version of the so-called “Hausman test” in order to ensure that fixed rather than random effects are appropriate for the panel regressions (Cameron & Miller, 2015; Wooldridge, 2010). To test

Hypotheses 2 and 3 I simply re-run the main regressions but split the ownership and nomination committee variables between categories of institutional investors for Hypothesis 2 and use time interaction (Allison, 2011), i.e. multiplication with time dummies, on the ownership and nomination committee variables for Hypothesis 3 in order to see if there is a relevant temporal aspect as hypothesized. Lastly, I test both hypotheses jointly by using both investor categorization (Hypothesis 2) and a temporal aspect (Hypotheses 3) on the independent variables of interest.

### **3.4 Operationalization and Variables**

Women on Board (*WoB %*) is the key dependent variable and measures the proportion of the board of directors elected during the studied years (2005-2017) that consists of women directors, i.e. I take the number of women directors and divide it with board size as in Gregorič et al. (2017). Other studies have used a logistic specification with a dummy variable indicating whether the board has one or more women (0/1) as the dependent variable (e.g. Hillman et al., 2007), but because almost all firm-years contain boards with one or more women in my sample this is not considered an appropriate approach here. In the Robustness section, (Section 4.2) I do utilize different specifications, however, and use instead as a dependent variable the number of women directors (*WoB #*) or whether the firm has two or more women directors (*WoB  $\geq 2$* ).

Institutional Investors in Nomination Committee (*II in Nom Com %*) is the key independent variable and measures the proportion of the shareholder-elected nomination committee (described fully in the Appendix) that is made up of institutional investor representatives. These committees are typically formed in conjunction with the third quarter reporting in the year prior to the general meeting and I thus take the number of institutional representatives in the nomination committee during the studied years (typically Q3 2004-2016 for the 2005-2017 general meetings) and divide it by nomination committee size. The motivation for this is as provided for in conjunction with my formulation of Hypothesis 1, i.e. because there are several



reasons to believe that institutional investors may have a positive impact on the proportion of women on the board of directors (Dobbin & Jung, 2011; Farrell & Hersch, 2005; Gregorič et al., 2017). While I believe that the nomination committee variable is the more informative one, because it directly captures formal involvement in the nomination process, I also as in previous studies (Ibid) include Institutional Ownership (*II Ownership %*) for the same reason as for the nomination committee variable. Because many Swedish firms have dual-class shares that create voting rights inequalities, and because director elections are decided based on votes at a general meeting and not capital ownership, I measure this as the proportion of the total voting rights held by the institutional investors rather than the proportion of capital. Like the nomination committee variable, I measure this at the third quarter prior to the general meeting (2004-2016) because I am interested in the influence that these investors have over the board nomination process, which formally begins when the committees are formed. As stated, I look only at domestic institutional investors for data reasons, but in the Robustness section (Section 4.2) I also add non-domestic institutional investors to the nomination committee variable to show that it does not influence my results.

To test Hypothesis 2, i.e. that different institutional investors differ in the degree to which they promote female directors, I simply split the institutional ownership and nomination committee variables categorically, i.e. into Pension Fund and Insurance Company Ownership (*Pension/Ins Ownership %*) and Mutual Fund and Asset Manager Ownership (*MF Ownership %*) as well as Pension Fund and Insurance Company in Nomination Committee (*Pension/Ins in Nom Com %*) and Mutual Fund and Asset Manager in Nomination Committee (*MF in Nom Com %*). For Hypothesis 3 I create two different time dummies, one for boards elected in the first ten years of the sample (2005-2014) and one for the latter period (2015-2017) where I argue that coercive institutional pressures for change are greater. I then multiply or “interact” (Allison, 2011) the institutional ownership and nomination committee variables with these time dummies in order

to see whether there are effect changes between the two different periods, resulting in four new variables: *II in Nom Com x 2015-2017*, *II in Nom Com x 2005-2014*, *II Ownership x 2015-2017* and *II Ownership x 2005-2014*. In order to test both hypotheses (Hypothesis 2 and 3) jointly I also combine these two approaches to create eight independent variables: one for institutional ownership and one for nomination committee participation as well as one for each category of institutional investor and time period like thus: *Pens/Ins in Nom Com x 2015-2017* for Pension Fund and Insurance Company in Nomination Committee during 2015-2017, the same for mutual funds and asset managers with *MF in Nom Com x 2015-2017*, and so forth.

I also include regular year dummies (year fixed effects) in all regressions to control for external events that are not captured by my other variables, e.g. the waxing and waning of the debate on and legal “threat” of gender quotas. While not feasible in the firm fixed effects regressions because they are automatically subsumed, I also include industry dummies in the pooled regressions to control for industry specific conditions that may affect board gender composition. As stated, I also control for firm size, operationalized as the natural logarithm of firm revenue or sales i.e. *Firm Size (LN of Sales)*, because larger firms *inter alia* “experience more pressure to conform to societal expectations” (Hillman et al. 2007, p. 944). I also control for mimetic influences as regards board gender composition on the industry level by adding an independent variable that measures the proportion of women on the board of directors among other firms in the same industry in the prior year, i.e. *WoB in Industry (Lagged %)* as in Gregorič et al. (2017), p. 276. I also add the age of the firm measured as the number of years since it was first listed on the SSE i.e. *Firm Age (LN of Yrs since listing)*; the financial performance of the firm as measured by Tobins Q, i.e. *Firm Performance (Tobins Q)* which is approximated by the firm’s market value to the book value of its assets; and the size of the board of directors *Board Size (#)* because these variables have for various reasons all been shown in the literature on women

on boards to influence board gender composition (e.g. Adams & Ferreira, 2009; Hillman et al., 2007).

Moreover, research on nomination committees in the U.K. and Australia, where they are a subcommittee of the board of directors rather than being constituted primarily by shareholders, has shown that the gender of nomination committee representatives appears to influence director selection in the sense that women representatives appear to promote women directors (Hutchinson, Mack, & Plastow, 2015; Kaczmarek, Kimino, & Pye, 2012). Because I want to see whether institutional investors have an impact on board gender composition irrespective of their own gender, I also control for the gender of nomination committee representatives by including the proportion of the nomination committee that is constituted by women *Women in Nom Com (%)*. In the Robustness section (Section 4.2) I also split the women representatives into two groups: those affiliated with an institutional investor and those who are not, because I want to further emphasize whether or not my results are driven by gender or the fact that they are institutional investor representatives. Finally, I control for *Blockholder Ownership (Votes %)* which measures the total proportion of voting rights held by the largest individual shareholder or shareholder group (typically an ownership sphere such as the Wallenbergs) because research shows that when such a block holder has a large enough stake in a firm they can run the board nomination process unilaterally, giving institutional investors little impact regardless if they would like to promote women candidates or not (e.g. Sjöstrand et al., 2016).

## **4. Results**

### **4.1 Main Results**

Table 1, below, shows that the proportion of women directors has more than doubled for the firms in the sample during the period studied, beginning at 16.1% of all directors in 2005 and ending at 32.8% thirteen years later (in 2017). I also include figures for all SSE-listed firms in each year (approx. 250) for comparative purposes. These are very similar to those for my panel

and indicates that my sample is roughly representative with regard to board gender composition. As a further comparison, I also include EU-wide figures on board gender composition.

---TABLE 1---

In Table 2, below, I present summary statistics and correlation coefficients for all the variables included in the main regressions. Notable here is the fact that the independent variable of interest, institutional investor participation in the nomination committee, has the second-highest correlation with the dependent variable. Only the proportion of women on boards in the firms industry in the previous year has a stronger relationship on a univariate basis. The institutional ownership variable, moreover, ranks below the nomination committee variable in explanatory power. For the average firm-year in the sample, the proportion of women on the board of directors is about one-fourth while the nomination committee is to roughly one-third composed of institutional investors. These proportions are not equally distributed within or between firms.

---TABLE 2---

The results of my main regressions investigating Hypothesis 1 are presented in Table 3 with the pooled OLS specification with industry effects as Regression 1 and the panel firm fixed effects specification as Regression 2. The results from these regressions suggest that nomination committee participation by institutional investors, *II in Nom Com*, is as hypothesized significantly and positively related to subsequent female board representation, although the significance and size of the effect diminishes when including firm fixed effects (from a p-value of 0.002 to 0.049), as is often the case (see Section 3.3). The institutional ownership variable loses its significance when the nomination committee participation variable is entered into the pooled OLS regression (Regression 1) and is never significant in the firm fixed effects regression (Regression 2). The results thus suggest that the institutional investors viewed as a group have had a positive impact on board gender composition, but also that this effect less

pronounced or non-existent when looking only at their ownership as opposed to their participation on the nomination committees.

The fact that the lagged proportion of women on boards among other firms in the same industry, *WoB in Industry*, is highly significant and has a large coefficient value in the firm fixed effects regression (Regression 2) further suggests that there is a mimetic or imitative effect on the industry level (cf. Gregorič et al., 2017; Oliver, 1991). That *WoB in Industry* is not significant in the pooled OLS setting is not because of its relationship with the dependent variable but simply because it has a very high collinearity with the industry dummies included there ( $VIF > 5$ ). *Women in Nom Com*, which captures the gender of the nomination committee representatives is also significant, which suggests that women nomination committee representatives promote women directors, but this may also be because many institutional investor representatives are women – a question I return to later (Section 4.2). The year dummies (not tabulated), which capture external events, tend to be highly significant, positive and economically meaningful in particular in the later years (i.e. 2015-2017) compared with the starting comparison year of 2005.

---TABLE 3---

Turning to Hypothesis 2, that is whether or not there are differences in the relationship with board gender composition between different categories of institutional investors, the results show that this is indeed the case (Regressions 3 and 4 in Panel A of Table 4) but again only when looking directly at institutional investor involvement in the board nomination process and not at their ownership per se. For space reasons I include only the independent variables of interest here, which show for both the pooled OLS (Regression 3) and the panel with fixed effects (Regression 4) that the relationship is stronger and more significant for the pension funds and insurance company representatives in the nomination committees. Indeed, under the least

biased specification (Regression 4), only the proportion of the nomination committee that is constituted by representatives from pension funds and insurance companies is (weakly) significantly related to subsequent board gender composition (p-value of 0.056). Thus representatives from these funds, which *inter alia* have less of a profit motive and more long-term obligations, appear to have acted to increase the proportion of women directors whereas the same is not true for the other institutional investors (cf. Johnson & Greening, 1999).

In Regressions 5 and 6 (Panel A of Table 4) I test the hypothesis (Hypothesis 3) that the effect institutional investors have had on board gender composition is stronger for the most recent period (2015-2017) than for the ten years prior (2005-2014) because the coercive pressures for change (e.g. quota threat and sharper formulations in the Code) are stronger then and because I suggest that the institutional investors have acted as to substantiate these increased pressures at the firm level. This hypothesis is also not rejected, but again only for the nomination committee variable and not for the ownership variable. The coefficient values are higher and more significant for the nomination committee variable for the final three years (*II in Nom Com x 2015-2017*) than for all of the ten previous years considered together (*II in Nom Com x 2005-2014*). Again, in the firm fixed effects specification (Regression 6) the nomination committee variable is only significant for the last three years (p-value 0.041) and not for the ten years prior. These results suggest that the institutional investors started to promote women directors through their work in the nomination committees only in the most recent time period when the coercive intensity regarding board gender composition was much higher than before. This finding is in line with the hypothesis of Campbell (1996) regarding the institutional effects of self-regulation and threat of state intervention.

---TABLE 4 ---

Finally, in Regressions 7 and 8 (Panel B of Table 4) I combine both institutional investor categorization and time interaction to test Hypotheses 2 and 3 jointly and find that, in the least biased fixed effects model (Regression 8), the only significant effect from nomination committee participation on board gender diversity comes from the pension funds and insurance companies that have sat on the committees that select director nominees during the general meeting seasons of 2015-2017. Moreover, this variable, i.e. *Pens/Ins in Nom Com x 2015-2017*, is significant at below the 0.01 level (p-value 0.009) and has an effect size (0.147) that is more than three times larger than when looking at all the institutional investors together for all the time periods (0.0424 in Regression 2). These results strongly suggest that there is both a marked difference between categories of institutional investors as well as a significant temporal effect during the years of increased coercive intensity as hypothesized in Hypothesis 2 and Hypothesis 3.

## 4.2 Robustness

As stated, the *Women in Nom Com* variable, which captures the gender of the representatives of the nomination committee, is significantly related to subsequent board gender composition in my main regressions (Regressions 1-8). This is in line with previous research on nomination committees of the traditional variety (Hutchinson et al., 2015; Kaczmarek et al., 2012). In the context of this study, however, it is important to disentangle the effects of gender from the effects of being an institutional investor representative as the two frequently overlap – many institutional investor representatives in the nomination committees are women and vice versa. In Regressions 9 and 10 (Panel A of Table 5), therefore, I split all women representatives into two categories: those who represent an institutional investor (*II Women in Nom Com*) and those who do not (*Non-II Women in Nom Com*). The results show that under the least biased fixed effects specification (Regression 10) only those women representatives who are also

representatives of an institutional investor have a significant relationship with board gender composition (p-value 0.014).

---TABLE 5 ---

Moving on, because I have excluded all non-domestic institutional investors from the analysis for data reasons (i.e. their ownership has not been reliably measured in Sweden prior to 2015), I add all non-domestic institutional investor representatives to the nomination committee variable (*II in Nom Com*), for which the data is available, in Regressions 11 and 12 and show that this does not impact my results (Panel A of Table 5). Finally, in Panel B of Table 5 I report results from an ordered logistic regression with the log odds of having a higher number of women directors as the dependent variable (Regression 13) and a conditional fixed effects logistic regression with the log odds of having two or more women directors as the dependent variable (Regression 14). The highly significant odds ratios in excess of 1.00 (95% CI for the *II in Nom Com* odds ratio begins at 2.60 in Regression 13 and 2.36 in Regression 14 with p-values of 0.000 and 0.002, respectively) in both regressions indicate that using an alternative (logit) specification does not influence my main result.

## 5. Discussion

In this study, I conclude that institutional investor engagement in the board nomination process has had a positive effect on female board representation in Sweden in recent years. I thus contribute to the literature on institutional investor engagement in corporate governance (e.g. McNulty & Nordberg, 2016) and to the literature dealing with the antecedents of female director representation (e.g. Gregorič et al., 2017; Hillman et al., 2007). By using institutional theory (Oliver, 1991; Scott, 2013) as a complement to traditional economic explanations for institutional investor behavior and director selection, I also show how institutional pressures for change manifest themselves at the firm level through the work of the institutional investors.



Specifically, I show that firms that have a large constituency of institutional investors that engage themselves in the board nomination process tend to appoint more women to their board of directors in particular when the institutional investors themselves are more attuned to public demands for equality (Hypothesis 2) and when such demands become increasingly hard to dismiss because of their coercive intensity (Hypothesis 3). This result holds both when testing the hypotheses individually and jointly.

There are several additional points and caveats to be made with regard to my findings. Firstly, my results indicate that, as has been suggested in critiques of the extant empirical corporate governance literature (e.g. Daily, Dalton, & Cannella, 2003), ownership is usually a much too crude independent variable from which to attempt to find effects on firm-level governance outcomes. Indeed, if I had attempted to gauge the influence of institutional investors on board gender composition only through ownership and without examining their involvement in the board nomination process, I would not have found any relationship when controlling for unobservable time-invariant firm-level heterogeneity. I am able to move beyond ownership in this study because nomination committee participation by institutional investors can be observed and modeled in the Swedish setting, but this does not mean that such relationships do not exist in settings where such a handy observable variable does not exist. It simply means that it may need to be captured through more creative methodologies than statistical testing with ownership as an independent variable.

Secondly, institutional investors are not a homogenous group and my findings indicate that only some categories of institutional investors, i.e. pension funds and insurance companies, have had an effect on board gender composition through their work in the nomination committees. In settings where the institutional investor landscape is more dominated by short-term institutional investors, it may not be reasonable to expect the same results. Indeed, granting institutional investors influence over the board nomination process may have other unintended

consequences, for instance when they are transient institutional investors (cf. Bushee, 1998) who may promote directors who pressure firms to inefficiently underinvest in favor of near-term earnings (cf. Asker et al., 2015) rather than e.g. work to increase board equality.

Thirdly, institutional investors appear to be particularly attuned to the coercive pressures of the institutional environment in which they exist regardless if these pressures come in the form of actual legislation or merely the threat of it. In this study, this was evidenced by the fact that their impact on board gender composition was much larger, and in fact, under the firm fixed effects specification, only existed, during the three out of thirteen years when the “threat” of a legal quota was the greatest. In relation to the framework of Oliver (1991), I thus show that firms that have a large constituency of institutional investors are more exposed to coercive institutional pressures but also that this can take more subtle forms than simply implementing the law on the books. Merely proposing or debating legislation can affect firm behavior, in particular for firms that find themselves with large institutional ownership. While I focus on an arguably benign example here, it is easy to see how legislative proposals and processes on the macro or institutional level that are not in the broader societal interest may create distortions in behavior on the firm level with less appealing results.

Lastly, considering that most listed Swedish firms appear to have acquiesced to demands for more gender equal boards from institutional investors and other constituents, a relevant future question is to what extent this has had other substantive effects on how firms are governed. Previous empirical research (e.g. Westphal & Zajac, 1994) dealing with how corporate governance reforms are implemented on the firm-level in the face of institutional pressures has shown that there is significant variation in the relative substance and symbolism of such implementation, with differences in particular between early and late adopters (see also Greenwood & Hinings, 1996). In this case, a central question is to what extent there are other substantive effects from the increased levels of female board representation observed. Are the

new women directors having an impact on how (e.g. early adopting) firms are governed, for instance in terms of CEO recruitment and other strategic decisions? Are some (e.g. late adopting) firms symbolically appointing “token” women directors to please their institutional investors and other constituents?

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## **APPENDIX: Nomination Committees**

This study focuses on the corporate governance system of a relatively small market, Sweden, and on a highly distinctive aspect of this governance system, the shareholder-constituted nomination committee. Swedish corporate governance is characterized by governance arrangements that are highly shareholder-oriented and hierarchical, more so than most other developed markets (for a review see e.g. Gourevitch & Shinn, 2005; Sjöstrand et al., 2016). The governance framework is codified both in law and through a self-regulatory governance code (“the Code”) that is applied on a comply-or-explain basis (Swedish Corporate Governance Code, 2015). Nomination committees of the Swedish kind were formalized when the first iteration of the Swedish Corporate Governance Code was implemented for larger listed companies in 2004 and are regulated on a voluntary basis through the Code. Highlighting the important difference between shareholder-constituted nomination committees of the Swedish kind and those found elsewhere, where they tend to be a sub-committee of the board and populated by current directors, Rule no. 2 in the Code states that “the election and remuneration of the board of directors and the auditor are to be prepared in a structured, clearly stated, *shareholder-governed* process” (p. 13). It explicitly forbids current members of the board of directors of forming a majority on the committee. Importantly for this study it also mandates that the names of the members of the committee and the identity of the shareholder that they represent should be made public at least six months before the annual general meeting where directors are elected (p. 14).

Although variations exist, in practice this has led to the so-called third quarter model, where most firms contact their largest shareholders before the third quarter report each year and invite them to form a nomination committee together with the chairperson of the board of directors. This committee is then tasked with proposing director candidates for the next general meeting. Below is an example from a typical large listed company in 2016:

*In compliance with the Swedish Corporate Governance Code and the procedures adopted by the AGM 2016, the representatives of the four largest shareholders, listed in the shareholders' register as of August 31, 2016, together with the Chair of the Board shall form the Nomination Committee. The members of the Nomination Committee for the AGM 2017 were announced on September 21, 2016, and they represented approximately 32% of all votes in the Company. Atlas Copco Annual Report (2016), p. 58.*

As such, most listed companies in Sweden have a nomination committee tasked with appointing board members and most members on this committee represent shareholders that are in turn identified by name. It is thus possible to ascertain whether e.g. an institutional investor that has a significant shareholding in a firm has chosen to participate in the board nomination process of that firm or if it has not. Rather than simply assuming a link between ownership by institutional investors and subsequent involvement in governance by implication, for which studies on corporate governance are often criticized, an additional indicator of the presence or absence of such engagement is therefore available that can be explicitly observed and modeled.

**TABLE 1: Proportion of Women on Boards (%) over time**

	This Sample	SSE-listed	SE Blue Chip	EU Blue Chip
2005	0.16	0.16	0.24	0.10
2006	0.19	0.18	0.24	0.10
2007	0.20	0.19	0.24	0.10
2008	0.21	0.19	0.27	0.11
2009	0.21	0.19	0.27	0.11
2010	0.23	0.22	0.26	0.12
2011	0.24	0.23	0.25	0.14
2012	0.24	0.23	0.25	0.14
2013	0.24	0.22	0.27	0.17
2014	0.26	0.25	0.27	0.19
2015	0.29	0.28	0.29	0.21
2016	0.32	0.31	0.36	0.23
2017	0.33	0.32	0.36	0.25
2005-2017	0.24	0.23	0.27	0.15

Note: This table shows the distribution over time for the proportion of women on boards in Sweden in the panel sample used in this study, for all SSE-listed firms (from AP2 & NIS, 2017) as well as for the largest listed “blue chip” firms in Sweden and in the EU (European Institute for Gender Equality [EIGE], 2017).

**TABLE 2: Descriptive Statistics and Correlation Coefficients**

Variable Name	Mean	Median	SD	Correlation Coefficients									
				1	2	3	4	5	6	7	8	9	10
1. Women on Board (%)	0.24	0.25	0.13	1.00									
2. II in Nom Com (%)	0.29	0.25	0.25	0.31	1.00								
3. II Ownership (Votes %)	0.14	0.13	0.11	0.24	0.63	1.00							
4. Firm Size (LN of Sales)	7.65	7.52	2.35	0.27	0.43	0.38	1.00						
5. WoB in Industry (Lagged %)	0.23	0.23	0.07	0.36	0.00	0.01	0.17	1.00					
6. Firm Age (LN of Yrs since listing)	2.81	2.77	0.66	0.12	0.04	0.06	0.40	0.34	1.00				
7. Firm Performance (Tobins Q)	3.07	1.99	3.67	0.11	0.06	0.06	-0.08	-0.06	-0.10	1.00			
8. Board Size (#)	6.75	7.00	1.62	0.19	0.31	0.31	0.62	0.08	0.37	0.02	1.00		
9. Women in Nom Com (%)	0.12	0.00	0.16	0.23	0.27	0.13	0.21	0.09	0.02	0.07	0.18	1.00	
10. Blockholder Ownership (Votes %)	0.31	0.26	0.20	-0.02	-0.04	-0.28	0.13	0.05	0.12	-0.10	0.00	0.02	1.00

Note: This table shows descriptive statistics and correlation coefficients for the variables included in the main regressions. The variables are as defined in Section 3.4. Financial data is from Compustat while ownership data is from the proprietary database Holdings. Data on nomination committees and board representation is hand-collected from a variety of sources, primarily annual reports.

**TABLE 3: Main Regression Results**

Variable Name	(1)	(2)
	WoB (%)	
II in Nom Com (%)	0.111*** [0.0283]	0.0424** [0.0213]
II Ownership (Votes %)	0.0245 [0.0545]	0.0315 [0.0638]
Firm Size (LN of Sales)	0.00598 [0.0046]	0.00204 [0.0036]
WoB in Industry (Lagged %)	-0.163 [0.1721]	0.398*** [0.1249]
Firm Age (LN of Yrs since listing)	-0.0172 [0.0110]	-0.0193 [0.0279]
Firm Performance (Tobins Q)	0.00342** [0.0014]	0.00207 [0.0015]
Board Size (#)	0.00279 [0.0041]	-0.0014 [0.0046]
Women in Nom Com (%)	0.0817** [0.0379]	0.0740** [0.0334]
Blockholder Ownership (Votes %)	-0.00225 [0.0332]	-0.0274 [0.0522]
Year Fixed Effects	Yes	Yes
Firm Fixed Effects	No	Yes
Industry Fixed Effects	Yes	No
Obs (Firm-Years)	1736	1736
R2	0.327	0.301

Note: This table contains the main regression results (Regression 1 and 2) that test Hypothesis 1, i.e. whether there is a relationship between institutional ownership and nomination committee participation and subsequent board gender composition. The variables for the regressions are as defined in Section 3.4. Regression 1 is a pooled OLS with industry fixed effects regression while Regression 2 is a panel regression with firm fixed effects. Standard errors are clustered at the firm level in all regressions and reported in brackets. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

**TABLE 4: Splitting Institutional Investor Categories and Including Time Interaction**

Panel A: Separate Analyses					Panel B: Joint Analysis		
	(3)	(4)	(5)	(6)		(7)	(8)
Variable Name	Women on Board (%)				Variable Name	WoB (%)	
Pension/Ins in Nom Com (%)	0.134*** [0.0353]	0.0523* [0.0271]			Pens/Ins in Nom Com x 2015-2017	0.223*** [0.0562]	0.147*** [0.0553]
MF in Nom Com (%)	0.0966*** [0.0340]	0.0378 [0.0242]			Pens/Ins in Nom Com x 2005-2014	0.109*** [0.0412]	0.0211 [0.0293]
Pension/Ins Ownership (Votes %)	-0.0838 [0.1295]	-0.0897 [0.1333]			MF in Nom Com x 2015-2017	0.0846* [0.0492]	0.033 [0.0471]
MF Ownership (Votes %)	0.0702 [0.0813]	0.0734 [0.0790]			MF in Nom Com x 2005-2014	0.0957*** [0.0362]	0.0316 [0.0252]
II in Nom Com x 2015-2017			0.139*** [0.0399]	0.0776** [0.0376]	Pens/Ins Ownership x 2015-2017	-0.0325 [0.1775]	-0.0833 [0.2300]
II in Nom Com x 2005-2014			0.0998*** [0.0304]	0.0261 [0.0223]	Pens/Ins Ownership x 2005-2014	-0.0814 [0.1597]	-0.032 [0.1474]
II Ownership x 2015-2017			0.105 [0.0831]	0.0897 [0.0987]	MF Ownership x 2015-2017	0.189* [0.1131]	0.177 [0.1317]
II Ownership x 2005-2014			-0.00883 [0.0617]	0.00303 [0.0638]	MF Ownership x 2005-2014	0.0276 [0.0975]	0.0157 [0.0780]
<i>IVs/Controls from Main Regr</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>IVs/Controls from Main Regr</i>	<i>Yes</i>	<i>Yes</i>
Year Fixed Effects	Yes	Yes	Yes	Yes	Year Fixed Effects	Yes	Yes
Firm Fixed Effects	No	Yes	No	Yes	Firm Fixed Effects	No	Yes
Industry Fixed Effects	Yes	No	Yes	No	Industry Fixed Effects	Yes	No
Obs (Firm-Years)	1736	1736	1736	1736	Obs (Firm-Years)	1736	1736
R2	0.329	0.301	0.332	0.309	R2	0.335	0.313

Note: This table contains regression results where I have split the institutional investor categories (Regression 3 and 4; Panel A) as well as used time interaction to highlight the temporal aspect of the relationship between institutional investor participation in the nomination committees and the proportion of women on boards (Regression 5 and 6; Panel A). I also combine the two approaches in Regressions 7 and 8 (Panel B). The variables are as defined in Section 3.4. The independent control variables are carried over from the main regressions (Regressions 1 and 2) and not reported for the sake of parsimony. In Regression 3 and 4, I split the institutional investors into two categories: pension and insurance vs. mutual funds and asset managers to test Hypothesis 2; in Regressions 5 and 6 use interaction with time dummies to test Hypothesis 3; and in Regressions 7 and 8 I use both categorization and time interaction to test both Hypothesis 2 and 3 jointly. Standard errors are clustered at the firm level in all regressions and reported in brackets. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

**TABLE 5: Robustness**

Panel A: Differentiating Women in NC & Including Non-Domestic II					Panel B: Logit Versions of Main Regression		
	(9)	(10)	(11)	(12)		(13)	(14)
Variable Name	Women on Board (%)				Variable Name	WoB (#)	WoB (≥2)
II Women in Nom Com (%)	0.110** [0.0445]	0.0832** [0.0334]			II in Nom Com (%)	7.388*** [3.8884]	10.19*** [8.2388]
Non-II Women in Nom Com (%)	0.105* [0.0580]	0.0751 [0.0594]			II Ownership (Votes %)	1.912 [2.0172]	1.597 [4.1035]
II in Nom Com (%) <i>including Non-Domestic</i>			0.114*** [0.0293]	0.0469** [0.0219]			
II Ownership (Votes %)	0.171*** [0.0535]	0.0745 [0.0604]	0.0179 [0.0560]	0.0229 [0.0648]			
<i>IVs/Controls from Main Regr</i>	Yes	Yes	Yes	Yes	<i>IVs/Controls from Main Regr</i>	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Year Fixed Effects	Yes	Yes
Firm Fixed Effects	No	Yes	No	Yes	Firm Fixed Effects	No	Yes
Industry Fixed Effects	Yes	No	Yes	No	Industry Fixed Effects	Yes	No
Obs (Firm-Years)	1736	1736	1736	1736	Obs (Firm-Years)	1736	1160
R2	0.305	0.298	0.33	0.301	Pseudo R2	0.266	0.439
					Wald χ2	423.31	133.59

Note: This table provides additional variations of the main regressions for robustness purposes. In Regressions 9 and 10, I focus on the women who sit on the nomination committee and differentiate female committee representation between those committee representatives that are also institutional investor representatives and those who are not. In Regressions 11 and 12 I include (the very few) non-Domestic institutional investor representatives to show that this does not affect my analysis. Regression 13 is an ordered logistic regression version of Regression 1 where the dependent variable is the log odds of a firm having a higher number of women on its board of directors. Regression 14 is a conditional logistic regression model with fixed effects where the dependent variable is the log odds of a firm having two or more women on its board of directors. For Regressions 13 and 14 I report odds ratios (“exponentiated coefficients”) on the main independent variable of interest i.e. “II in Nom Com (%)”. Values greater than one indicate that an increase in the independent variable is associated with a higher odds ratio for the dependent variable i.e. “having more women” for Regression 13 and “having two or more women” for regression 14. The number of observations drops in Regression 14 because all firms that always have less than or alternatively equal to or more than two women on their board of directors are excluded from the analysis. The other independent variables/controls are carried over from the main regressions (Regression 1 and 2) as before. Regressions 9 and 11 are pooled OLS; Regressions 10 and 12 are panel regressions with firm fixed effects; Regression 13 is an ordered logit w/ industry effects; Regression 14 is a conditional logit w/ firm fixed effects. Standard errors are clustered at the firm level in all regressions and reported in brackets. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

# Hedge Fund Activism under Shareholder-Oriented Governance

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## Abstract

**Manuscript Type:** Empirical

**Research Question/Issue:** I examine the effects of hedge fund activism in Swedish listed firms between 2003 and 2012.

**Research Findings/Insights:** I show that interventions by hedge fund activists are related to subsequent takeovers of targeted firms but not changes in financial performance or other firm outcomes. The activist funds leverage on the shareholder-oriented nature of the Swedish governance regime by participating in the board nominating committee, allowing them to influence board composition without the need for a proxy fight.

**Theoretical/Academic Implications:** The empirical findings have different implications depending on whether one views takeovers as a normal part of an efficient market for corporate control, or conversely acknowledges the potential issues involved in M&A transactions such as the potential of wealth transfers from other stakeholders to the target firm shareholders. The study also highlights how hedge fund activism works in a market that is characterized by an intermediate shareholder concentration and strong shareholder rights.

**Practitioner/Policy Implications:** Shareholder-oriented governance reforms such as giving shareholders influence over board nominations can and are capitalized on by activist hedge funds. If one is skeptical towards their influence, e.g. because their interventions tend to end in a takeover of the targeted firm, it is necessary to consider how regulation and policy can be developed to limit their power over listed firms, or vice versa.

**Keywords:** Corporate Governance, Shareholder Activism, Hedge Funds, Takeovers

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## Introduction

Hedge fund activism, here defined as cases where hedge funds<sup>1</sup> buy stakes in public listed companies with the explicit or implicit goal to influence their affairs in order to generate shareholder returns, has recently received a large amount of attention from academics, executives, investors and the business media. One reason for this is the increasingly ambitious interventions by activist hedge funds in larger U.S. corporations such as EBay, Yahoo, Apple and Allergan (see e.g. Economist, 2013; Foley, 2014). These interventions have also fueled an ongoing and rather acrimonious debate regarding the merits of expanding shareholder rights (Goranova & Ryan, 2014), with some highlighting the supposedly beneficial effects of hedge fund activism as an argument for empowering investors (Bebchuk, Brav & Jiang, 2015) and others conversely arguing that activist hedge fund interventions create little or no real value, exacerbate supposed short-termist tendencies in the capital markets and serve as a case in point for why listed corporations should continue to have some redress against shareholder influence (Allaire & Dauphin, 2014; Lipton, 2013).

In a recent summary of the available empirical evidence regarding hedge fund activism Coffee & Palia (2015) demonstrate that while there seems to be consistent empirical proof that activism creates superior stock returns in the short-term, much less consensus exists regarding the long-term effects of such activism. Rather, a large point of contention exists regarding whether the short-term stock price increases observed are related to positive long-term developments in profitability and other real variables in the targeted firms (as stated in Bebchuk et al., 2015) or conversely are the results of wealth transfers from bondholders (Klein & Zur, 2011), added market speculation in that the targeted firm will be taken over (Greenwood & Schor, 2009) or inefficient short-term responses to cutbacks in investment and R&D (Coffee & Palia, 2015). Although not always made explicit there is also a clear dividing line in the literature between those who adopt an agency theoretical perspective stressing conflict between shareholders and managers where activist hedge funds supposedly help keep the latter in line and create value for all shareholders in the process (Gilson & Gordon, 2013), and those who conversely entertain the notion that activists can create value for themselves by expropriating other shareholders and stakeholders (Goranova & Ryan, 2014).

Sweden has not experienced a similar recent spike in activism as in the U.S., nor for that matter an equally vivid debate regarding the merits of its shareholder-oriented governance model, but has seen a number of high profile cases of hedge fund activism spread out during the previous decade in particular by the Swedish activist hedge fund Cevian. Several of the largest listed firms on the Stockholm Stock Exchange (SSE) have experienced activist interventions, including among others Telia (Shellock, 2006), Volvo (Ibison, 2006), Swedish Match (Frick, 2007) and the since acquired financial conglomerate Skandia (Kallifatides, Nachemson-Ekwall & Sjöstrand, 2010). Unlike Swedish hedge fund activism in general, the latter case has

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<sup>1</sup> There is no clear definition of what a hedge fund is. I follow the four classification steps used in Brav et al. (2008) to define a hedge fund namely that “(1) they are pooled, privately organized investment vehicles; (2) they are administered by professional investment managers with performance-based compensation and significant investments in the fund; (3) they are not widely available to the public; and (4) they operate outside of securities regulation and registration requirements” (Brav et al., 2008: 1735).

also been studied in depth as part of a larger case study of the hostile takeover process in Skandia (Kallifatides et al., 2010). Among other things, this study demonstrated how activist hedge funds utilize the shareholder-oriented governance regime in Sweden to achieve their stated goals, i.e. a takeover in the case of Skandia.

In this paper, I provide the first quantitative empirical study of hedge fund activism in Sweden by examining all identifiable cases of activism between 2003 and 2012. I provide systematic descriptive data on the phenomenon but also and more importantly I look at the outcomes of activism in relation to its hypothesized effects and the previous empirical literature – e.g. whether activism is related to positive long-term developments in financial performance, changes in real variables such as payouts, investment and indebtedness compared to peer firms as well as how activism relates to takeovers. I find little support for the notion that hedge fund activists induce performance improvements or other changes in real variables. The most relevant development in the targeted firms is instead the much larger propensity for takeovers among firms targeted by activist hedge funds regardless if tested against matched peer firms or against all SSE-listed firms. The paper continues as follows: the next section summarizes the conceptual and empirical background on activist hedge funds including existing hypotheses on the effects of hedge fund activism; this is followed by a brief summary of the Swedish corporate governance and control context; I then present the methodology and data employed including the matching procedure and information on the variables examined, this is followed by the empirical results and analysis including robustness tests; a discussion concludes.

## **Literature Review**

### **Conceptual Background**

Activist hedge funds depend to a large extent on the actions or in-actions of other institutional investors such as pension funds, insurance companies, asset managers and mutual funds which together form the largest owner category in the developed stock markets (for data see e.g. OECD, 2011). This is not only because these investors often supply large parts of the hedge funds capital, but even more importantly because activist hedge funds rarely purchase enough shares in a target firm to have a controlling voting interest and as such more often than not rely on other shareholders in order to achieve their stated goals. Gilson & Gordon (2013) highlight the relationship between activist hedge funds and more traditional institutional investors, hypothesizing that proactive activist hedge funds have come to provide the relatively more passive and reactive traditional institutional investors with the means to effectively influence corporate affairs. In this agency theoretical depiction of the dynamic between activist hedge funds and traditional institutional investors, the end result of their collaboration is better monitoring of otherwise wasteful and ineffective managers and improved market efficiency. The argument can be summarized as follows. Firstly, traditional institutional investors – i.e. pension funds, mutual funds and the like – form the dominant owner category today but are due to their business model and other factors not optimally placed to monitor the activities of their investee firms. This gives rise to a market-wide ‘monitoring shortfall’ (Gilson & Gordon, 2013: 916). Secondly, activist hedge funds which specialize in monitoring investee firms can and do bridge

this shortfall by providing the reactive traditional institutional investors with governance options, such as alternative director candidates in proxy contests, suggestions for financial and operational restructurings, potential acquisitions and the like. “[G]overnance markets thus become more complete. The net result is better monitoring, and, perhaps, lower agency costs in the real economy.” (Gilson & Gordon, 2013: 917).

Goranova & Ryan (2014) provide a different conceptual framework in which to view shareholder activism in general and the financial activism by activist hedge funds in particular. They contrast the previous strict agency theoretical view of hedge fund activism, in which activism is characterized as benefiting all shareholders, with the possibility that the homogeneity of shareholder interests implied in this literature might not always be a correct description of reality. For instance, activist hedge funds may sometimes seek to profit in the short-term at the expense of long-term shareholders such as other institutional investors. While mindful of the real possibility that activism by hedge funds can be beneficial, they also include other stakeholders such as bondholders and employees in the analysis and emphasize how the actions of managers that are pressured by activist hedge funds can result in resources being transferred from the former to the latter group. To illustrate with an example: in the Gilson & Gordon (2013) view of hedge fund activism, a target firm reducing its investment and increasing its dividends after pressure from an activist hedge fund means that there existed a so-called “free cash flow problem” (Jensen, 1986) in the target firm whereby executives were diverting cash flow generated from operations to unprofitable projects. In the Goranova & Ryan (2014) view, it is instead emphasized that this increase in dividends *can* be congruent with the former hypothesis, but it can also mean that the activist hedge fund has succeeded in diverting resources away from long-term shareholders by reducing long-term investment, e.g. in R&D and the like, in favor of short-term payouts. Similarly, increased payouts can imply that the activist has succeeded in expropriating the firms’ bondholders by reducing the cash available for interest and principal payments.

### **Previous Empirical Studies**

A seminal study on activist hedge funds in the U.S. setting is Brav, Jiang, Partnoy & Thomas (2008). Among other things, they showed that activist hedge funds often did not take controlling positions when targeting a firm, the median maximum capital stake was 9.1%, and were more prone to invest in companies where the shareholder base consisted of a large amount of other institutional investors (cf. Gilson & Gordon, 2013). Brav et al. (2008) was also one of the first in a range of studies to emphatically show that interventions by activist hedge funds produce statistically and economically significant “abnormal” short-term stock returns in targeted firms around the date where the funds notify the market of their shareholding. There were also some, albeit not always statistically and/or economically strong, indications of improvements in operating performance as measured by Return on Assets (ROA) as well as changes in real variables such as dividends and leverage in the targeted firms, compared with matched peer firms in the years subsequent to the interventions. The authors argued that the observed positive stock returns represented value creation in the targeted firms, particularly due to reduced agency costs resulting from larger dividends and leverage (i.e. the so-called “free cash flow problem”). Klein & Zur (2009) similarly compared changes in company characteristics between firms targeted by activists and matched peer firms, finding no improvements in

operating performance (ROA) but found like Brav et al. (2008) that activist targets did increase both their leverage and dividends in the fiscal year following the intervention, relative to peers. Initially concluding that the positive stock returns they observed in this study were the result of reduced “free cash flow problems”, as leverage and dividends increased together with returns to shareholders, the authors later revised this conclusion in Klein & Zur (2011). Here they examined the impact of hedge fund interventions on both the shareholders and bondholders of a large U.S. sample of firms. For bondholders they found that targeted firms exhibited significantly *negative* excess bond returns around both the date when the activist stake was communicated to the market and the year after. The results for shareholder returns were the opposite and the authors found a significant negative relationship between shareholder and bondholder returns. Instead of attributing the shareholder gains to solving the “free cash flow problem”, they instead characterized activist interventions in firms with outstanding debt as wealth transfers from bondholders to shareholders, which in the sample resulted from significant increases in leverage and dividends in targeted firms as compared to a matched sample.

Greenwood and Schor (2009) examined hedge fund activism with the hypothesis that observed abnormal short-term stock returns in targeted firms were largely driven by the fact that many of these (over 25% in their sample) were acquired, and that the share price increases observed reflected the anticipation of a possible takeover premium. They found significant positive “abnormal” short-term stock returns when examining the full sample of firms, but on average no statistically significant short-term returns for the part of the sample where firms remained independent, as compared with those firms that were later acquired. This difference between firms remaining independent versus those that were acquired also held for returns over a longer period, where non-acquired firms again had no significant “abnormal” stock returns compared with large returns for those subject to a takeover (Greenwood & Schor, 2009: 368-370). The authors also examined the development of profitability (e.g. ROA) and other real variables in the surviving sample firms, but found no significant changes. In a separate analysis the authors also matched firms subject to an activist hedge fund intervention with similar non-intervention peer firms and found that there was a much larger probability of takeover within a one-year period for firms’ subject to activism (Greenwood & Schor, 2009: 372). The authors concluded that market speculation regarding a takeover of some targeted firms and later bid premiums, rather than expectations of e.g. operational improvements, were driving stock returns in conjunction with activist hedge fund interventions.

In a recent and widely publicized study with a sample based partially on the Brav et al. (2008) study and sharing some of the same authors, Bebchuk et al. (2015) examine the long-term (five-year) financial development in firms targeted by activists as measured by ROA and Tobins Q under the hypothesis that activist hedge funds drive effectuate financial and operational improvements in targeted firms. With several different specifications, they find that Tobins Q, as approximated by the market value of equity to its book value, has a statistically and economically significant positive development in the fiscal years subsequent to the intervention year. The evidence for ROA is more mixed in terms of both economical and statistical

significance (see e.g. p-values in Bebchuk et al., 2015: 24). The authors conclude that hedge fund interventions lead to long-term operational improvements in targeted firms' and that interventions curb the otherwise wasteful spending of executives. In an empirical rebuttal of sorts, Cremers, Giambona, Sepe & Wang (2015) employ the same dataset as Bebchuk et al. (2015) to examine whether the improvements in terms of ROA and Tobins Q found in the latter study are due to the improvement efforts of activists or simply due to activists targeting poorly performing firms' who later revert to the mean. Using a different matching procedure that accounts for the target and matched firms performance prior to the intervention, they find that this is the case, and question the veracity of the findings in Bebchuk et al. (2015).

Turning instead to Europe, Becht, Franks & Grant (2010) examined a sample of activist interventions in fifteen European countries including Sweden. As in the U.S. studies, the authors found statistically significant short-term stock returns around the interventions, the largest of which were for the eleven Swedish targets. The authors also analyzed stock returns around the announcement of intervention outcomes and found that firms announcing that they were to be acquired experienced the highest abnormal stock returns (cf. Greenwood & Schor, 2009). These findings were corroborated in a similar but larger and recently published international study spanning countries in Europe, the U.S. and Asia in Becht, Franks, Grant & Wagner (2017), who also found the largest returns to be associated with takeovers in general and in particular if they had been associated with other previous "outcomes" such as changes to the board. In the German context, Drerup (2014) examined both stock returns and developments in profitability and other real variables in targeted firms compared to peer firms, in conjunction with activist hedge fund interventions in Germany. He found significant short-term stock returns around the intervention announcement, but not during a longer period. He also found that financial performance as measured by e.g. ROA and Tobins Q, as well as other real variables, such as leverage and dividends, did not exhibit any statistically or economically meaningful changes as compared to matched peer firms. He concluded that activists targeting German firms unlike in the U.S. were unsuccessful in achieving their goals because the relatively high ownership concentration and weak shareholder rights made doing so much more difficult. Along the same lines Bessler, Drobetz & Holler (2013) found positive and significant short-term stock returns around the intervention date in a sample of German firms but that these returns did not hold up over the long-term, with the authors concluding that activist hedge funds tended to exit at temporarily inflated share prices.

Kallifatides et al. (2010) studied the hostile takeover of the Swedish insurance conglomerate Skandia. The case demonstrated how an activist hedge fund (Cevian) with only a minimal stake (3.4%) in the target firm was, with the help of other hedge funds and institutional investors, able to secure a seat on the shareholder-constituted nominating committee and later the board of directors, which was utilized to facilitate a takeover process by the South African financial conglomerate Old Mutual. Conversely, in the Japanese setting, Buchanan, Chai & Deakin (2014) document the largely unsuccessful attempts by activist hedge funds to influence corporate affairs there, which they attribute *inter alia* to the stakeholder-orientation of the

governance regime and the unwillingness of domestic institutional investors and company managers to act according to the agency theoretical tenets of shareholder primacy espoused by the Anglo-American hedge funds. This is in line with the findings of Becht et al. (2017) who find the lowest international returns to hedge fund activism, and the fewest “outcomes” (e.g. takeovers) to be in Japan. As such, the international evidence highlights how the ownership and governance regime in the particular institutional setting where activism is carried out affects the relative success of such activism. Achieving profitable (for the activist) “outcomes” (e.g. takeovers) appears easier in markets such as the U.S., with dispersed shareholdings, and Sweden, which gives shareholders wide-ranging powers e.g. to nominate directors, than in markets with relatively fewer rights for shareholders and/or a higher ownership concentration, e.g. Japan and Germany.

The available empirical evidence in support of the hypothesis put forward by Gilson & Gordon (2013) is mixed. The clearest indication that activism may be value creating in the real economy are the short-term “abnormal” shareholder returns generated around the disclosure of an intervention by an activist hedge fund, which has indeed been consistently demonstrated. That these short-term shareholder returns are related to subsequent actual value creation through e.g. operational improvements or a reduction of agency costs in targeted firms over the longer-term is however disputed. Indeed, much evidence (e.g. Klein & Zur, 2009; 2011) including the few studies undertaken outside the U.S. context (e.g. Drerup, 2014) contradict this thesis. Moreover, the notion that decreasing long-term investment in property, plant and equipment as well as research and development while increasing dividends and share buybacks is beneficial for the average listed firm because their executives are so prone to inefficient overinvestment, i.e. the “free cash flow problem”, runs directly counter to recent empirical evidence on the short-termism of capital markets which conversely suggests that public firms inefficiently *underinvest* when compared to similar private firms’ under many different specifications (Asker, Farre-Mensa & Ljungqvist, 2015) and seems like an increasingly outdated description of equity markets today (see also Gutiérrez & Philippon, 2017; Kahle & Stulz, 2017). The hypothesis that market speculation of a takeover and subsequent actual takeovers drive activism and the associated shareholder returns is particularly salient in the literature (e.g. Greenwood & Schor, 2009; Becht et al., 2010; 2017). While takeovers do not preclude value creation if the market for corporate control is efficient, the available empirical evidence (for a summary see Halebian et al., 2009) on this is decidedly mixed. Takeovers appear to create value for shareholders in the target firms, but the effects for acquiring shareholders and other stakeholders can conversely be negative. The net effects for the wider economy are not well understood at present (Ibid). The market for corporate control can also be inefficient from another perspective, as it can lead to a situation where countries with shareholder-oriented corporate governance regimes that empower activists and others to facilitate deals see more listed firms being acquired and de-listed for the simple reason that it is easier to do so profitably there than in markets that do not offer the same rights to shareholders. The net result being that firms are transferred from more open governance regimes to more closed ones (Nachemson-Ekwall, 2012).

## **Institutional Context: Sweden**

In order to understand hedge fund activism in the Swedish context it is important to understand how Sweden differs from other markets, e.g. the U.S., Germany or Japan, as regards corporate governance and control. The Swedish governance model is highly shareholder-oriented, evident in that large powers are granted to owners who unlike in many other jurisdictions are considered the ultimate principals of firms (Swedish Companies Act, 2005; Swedish Corporate Governance Code, 2010). This has several practical implications for activist hedge funds and the ease with which they can pursue their objectives, succinctly summarized by Becht et al. (2017) in their international comparison of shareholder rights relating to activist hedge funds. Relevant differences between Sweden and the U.S. state of Delaware, where most U.S. companies are incorporated, include *inter alia* that shareholders representing 10% of the share capital always have the right to call an extraordinary general meeting in Sweden as opposed to having the company's own bylaws determine the rules for convening a meeting; that shareholder proposals in the U.S. are not legally binding (precatory) and having them included in the proxy materials of listed companies is both legally challenging and expensive whereas all shareholders have the right to place items (including board candidates) on the ballot in Sweden where outcomes are legally binding; that U.S. companies can via a board decision implement a poison pill or shareholder rights plan severely limiting the abilities of an acquiring shareholder to accumulate shares over a certain threshold (often 30%) whereas in Sweden this is illegal; that board candidates are proposed by a nomination committee consisting of incumbent board members in the U.S. (and all other developed markets bar Norway) whereas this committee is constituted by shareholder representatives in Sweden; that the board can be staggered with up to three years tenure in the U.S. and board members can only be removed for cause whereas board terms are one year in Sweden and shareholders have the right to remove directors for any reason.

Viewed in isolation these governance differences suggest that Sweden should be very promising indeed for shareholder activists, but the prevalence of incumbent block holders that are able to block interventions in corporate affairs if they so desire qualify this picture (for a full review of the Swedish governance and control model see e.g. Gourevitch & Shinn, 2005; Henrekson & Jakobsson, 2012; Högfeldt, 2005). The influence of incumbent block holders has however declined in recent years (Henrekson & Jakobsson, 2012) and Sweden today exhibits a more intermediate level of ownership concentration (cf. Poulsen, Strand & Thomsen, 2010), with institutional and/or foreign investors holding increasingly large shares of the capital and votes in public companies (Jakobsson & Wiberg, 2014; Statistics Sweden, 2013). An activist targeting a firm would need the support of a large part of this institutional and/or international investor constituency if it sought to affect corporate outcomes against the wishes of an incumbent block holder, considering their relatively limited average ownership stakes of around 10%. Most activist interventions in Sweden, as the one in Skandia (Kallifatides et al., 2010), have however occurred in firms either lacking a block holder or where the block holder(s) control a relatively small share of the capital and/or votes, perhaps exactly for this reason. In sum, when looking at hedge fund activism in the Swedish context it is important to note that activists face relatively few legal or practical barriers to activism from the corporate governance regime,

which greatly empowers shareholders relative to boards of directors and executives, but that the ownership and control structure provides a major caveat in the form of incumbent block holders who can co-opt the activist.

## **Research Design and Methodology**

The purpose of this study is to examine the role played by activist hedge funds under a corporate governance regime that emphasizes the rights of shareholders but at the same time exhibits blockholder control rather than dispersed ownership, such as the Swedish one. More specifically, I am interested in examining the firm-level outcomes for listed firms in Sweden that experience an activist hedge fund intervention. I focus on how listed Swedish firms experiencing an intervention develop in relation to the hypotheses presented and examined in the previous literature. That is, I look at whether targeted firms exhibit financial performance improvements after the interventions; whether they exhibit changes in payouts and their balance sheets in line with the free cash flow hypothesis or, conversely, the hypothesis that wealth is transferred from bondholders and lenders to shareholders; as well as whether firms that are targeted by activist hedge funds tend to be taken over to a greater extent. The first hypothesis is derived from the claims made in Bebchuk et al. (2015) and elsewhere that the activist intervention lead to performance improvements. The second hypothesis is derived from both the free cash flow hypothesis and the claims of wealth transfers e.g. in Klein & Zur (2009; 2011) which make the same predictions as regards increases in payouts and balance sheet changes. The third hypothesis relates to takeovers and the findings of e.g. Greenwood & Schor (2009), with the null hypothesis being, finally, that there are no changes in targeted firms relative to non-target firms, as has been shown in the empirical studies of Germany and Japan (e.g. Bessler et al., 2013; Buchanan et al., 2013). More formally, the hypotheses I examine regarding firm outcomes can be stated as follows:

H1: Firms experiencing an activist intervention exhibit operational and financial improvements, as measured by Tobins Q and ROA, relative to non-target firms.

H2: Firms experiencing an activist intervention exhibit increases in dividends and repurchases, decreases in investment and liquidity as well as increases in leverage, relative to non-target firms.

H3: Firms experiencing an activist intervention are more likely to be taken over relative to non-target firms.

Given the shareholder-oriented nature of the Swedish governance regime and the relative ease with which activists can influence the board of directors, e.g. through nomination committee participation, and given the fact that takeovers are by far the most profitable outcomes for an activist hedge fund (Becht et al., 2017), I suggest that Hypothesis 3 is the hypothesis most likely to be true in the Swedish setting. Considering the limited powers of management relative to shareholders, the major limitation to activist influence in the Swedish setting is incumbent block holder opposition, and this can be circumvented by investing in firms where there is no incumbent block holder, or where the block holder has a relatively weak position. While



this limits the number of potential targets, as most firms have a block holder with effective control, it does not influence the ease with which the activists can achieve the most profitable outcome (Hypothesis 3, a takeover) in the firms which they do chose to target. In relation to this, I thus formulate a fourth hypothesis to incorporate this differential likelihood as follows:

H4: *Firms experiencing an activist intervention are more likely to be taken over relative to non-target firms.* This is the most likely outcome in the Swedish setting because it is the most profitable outcome for the activist and it is relatively easy for activists to achieve their preferred outcomes under a shareholder-oriented corporate governance regime.

Examining hedge fund interventions requires judgment calls, as there are no comprehensive databases of activist hedge funds or the interventions undertaken by them (Brav et al., 2008). I chose to construct my sample based on the same methodology employed in other studies (e.g. Brav et al., 2008; Becht et al., 2017), which is as follows. Starting with mandatory disclosures of ownership stakes exceeding 5% of the capital or votes in SSE-listed firms, which have to be centrally reported to the Swedish Financial Supervisory Authority (SFSA, cf. the SEC) since July 2007, and before that had to be disclosed by the companies themselves via press release, I filtered out all disclosures related to stock purchases by private individuals, companies, mutual and pension funds, insurance companies and other institutional investors and the like which clearly are not activist hedge funds. Based on the resulting short-list I then used information in web searches and news searches via the media databases Factiva and Retriever to determine whether the entity crossing the 5% disclosure threshold could be classified as an activist hedge fund.<sup>2</sup> To extend the sample further and capture cases where the 5% threshold was not crossed, I also ran the activist hedge fund names found while examining the mandatory disclosures through the Factiva database again to see if there were any relevant additional cases for inclusion. This search resulted in 47 activist hedge fund interventions in 29 different firms (see the Appendix for a list of the target firms). When comparing my sample of interventions to the Swedish sub-sample in Becht et al. (2010) I note that I have 36 more interventions in my sample (47) for the period 2003-2012 as compared to 11 cases between 2000 and 2008 in Becht et al. (2010). Still, due to the lack of systematic data and reporting requirements under the threshold of 5%, there is reason to believe I may have missed some interventions.

Unlike with Schedule 13D filings in the U.S., the SFSA like most European regulators do not require investors to state their intentions when disclosing a capital or voting stake surpassing the regulatory threshold (Becht et al., 2017). I therefore had to rely on information in Factiva and Retriever both to discern the activists stated intentions, if self-reported, and to examine what outcomes, if any, were produced during the investment period (cf. Becht et al., 2017; Drerup, 2014). As a result, there are several cases where I cannot impute the stated intentions of the activist. In order to determine the holding period of the activist

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<sup>2</sup> I also include two activists who are not technically activist hedge funds but have acted as such for all intents and purposes of the study: the Hermes UK Focus Fund studied in Becht, Franks, Mayer & Rossi (2008) and a high-frequency trading hedge fund that normally does not assume an activist stance but did so for the included intervention.

and the size of their investment stakes beyond the information in regulatory filings I primarily relied on a proprietary database provided by SIS Ägarservice (SIS Ägarservice, 2014; now known as Holdings) which tracked ownership information in SSE-listed firms up until 2015. Stock ownership information for international shareholders with nominee-registered shares such as many activist hedge funds can be imprecise and I therefore suspect there is some variance in this data. Stock market and accounting information used to construct the real variables for the target firms were primarily based on data from Compustat and secondarily from Thomson Reuters Datastream. I also collected data on takeovers and share repurchases from NASDAQ. All residual data e.g. board and nominating committee participation, was collected through Factiva, Retriever or a manual examination of annual reports and general meeting minutes.

Investigating how firms targeted by hedge funds develop is not particularly informative without a reference point for comparison. As in previous studies (e.g. Drerup, 2014; Klein & Zur, 2009) I therefore constructed a matching sample where each targeted firm in the 47 interventions was paired with a non-target matched firm that was similar in terms of industry, size and book-to-market in the fiscal year immediately preceding the intervention (t-1). The matching was done in three steps. I firstly filtered for all firms in the same MSCI GICS Industry Group as the target firm. Secondly, I filtered for all the firms that were within a 50%-200% range of the targets size in terms of the market value of equity. Thirdly, I chose as a match the firm with the closest book-to-market ratio. If the second step failed, I chose the firm in the same industry group that was closest in size. There is one exception to this rule where the industry group only contained two firms that were vastly different in terms of size and the book-to-market ratio, in which case I instead undertook the same procedure but for the larger GICS Sector grouping. I matched with replacement (cf. Asker et al., 2015) meaning that in the cases where the match was acquired or disappeared from the sample I found a new match to replace the old one using the same criteria.

When choosing which specific variables to examine for the target and matched firms I considered the three hypotheses listed above (H1-H3). The resulting variable list and the exact definitions of the variables is presented in Table 1. Table 1 also shows how the variables are expected to develop according to the hypotheses, in line with the previous literature review. The first two variables (ROA and Tobins Q) relate to H1 and are expected to increase according to the hypothesis that hedge fund activists target underperforming companies and turn them around (e.g. Brav et al., 2008). The next five variables, i.e. the two Investment Ratios, the Total Payout Yield that measures dividends and share repurchases, as well as the Liquidity and Leverage ratios relate to H2. Under both the free cash flow hypothesis and the hypothesis of wealth transfers from bondholders and lenders it is predicted that investments will decline, payouts will increase and the company will adopt a more aggressive financial policy. Under the first hypothesis this is due to the current wasteful tendencies of existing executives, which the hedge fund interventions correct, while under the second hypothesis this is because the activist hedge funds institute aggressive short-term financial policies that benefit current shareholders at the expense of bondholders, long-term and future shareholders as well as other stakeholders (e.g. Coffee & Palia, 2015; Klein & Zur, 2011). Lastly I examine,

in line with the third hypothesis (H3), the frequency with which firms targeted by activists are acquired (“Takeover”), which is also considered the most likely outcome in the Swedish setting according to Hypothesis 4.

---TABLE 1 ---

I also indicate in Table 1 how the variables have been tested which for the seven continuous variables related to the first two hypotheses (all except Takeover) is through comparing the development in the variables between the targeted firms and the matched firms over the fiscal year immediately preceding the intervention (t-1) and one fiscal year after the intervention (t+1) as well as three fiscal years (t+3) after the intervention. Thus since the intervention year is year t, there is a two-year period between t-1 and t+1 and a four-year period between t-1 and t+3. I am able to compare over this longer time period since the sample period ends in 2012. Statistical difference between the two groups is tested both on a multivariate basis for all variables together and for the variables relevant to each hypothesis jointly through an F-test (two group MANOVA) as well as on a univariate basis through t-tests of means and Wilcoxon tests of medians for the individual variables. The last variable, Takeover, is dichotomous and cannot be tested in this way. Instead, I use a univariate Chi-2 test to examine differences in propensity for takeovers between the targeted firms and the matched firms over the same time periods. As a robustness test, I also run a multivariate logistic regression for all SSE-listed firms with Takeover as a dependent variable and the presence of an activist hedge fund as an independent variable, along with some standard controls. As a further robustness test, I also run multivariate panel regressions of Q and ROA for a large sample of SSE-listed firms with previous hedge fund activism as an independent variable while controlling for firm fixed effects. These regressions are specified as in Bebchuk et al. (2015).

## **Activist Interventions in Sweden: 2003-2012**

### **Description of Interventions and Target Firm Characteristics**

I observe a total of 47 activist hedge fund interventions on the SSE during the studied decade. As shown in Panel A of Table 2 the largest (12) and second-largest (10) number of interventions occurred in the pre-crisis years of 2005 and 2006, whereas there are notably no interventions during the crisis year of 2008. The entire temporal distribution of interventions is clearly skewed towards the beginning of the period and it is as such likely that the financial turmoil, and the pre-crisis exuberance, had an impact on the propensity for hedge fund activism. This is in line with previous studies finding a large drop in activism, and many loss making exists, during the crisis years (e.g. Greenwood & Schor, 2009). Panel B of Table 2 further shows the industry group distribution of intervention firms as compared to all SSE-listed firms (during the mid-year of 2007). Notable here is the relatively low propensity for activists to target firms in high technology industries, despite containing 22% of all SSE-listed firms in 2007 only three of the interventions (6%) are undertaken in the “Technology and Semiconductor” industry groups. Conversely, there is a clear overrepresentation of firms in the “Commercial and Professional Services” industry group among the activist targets.

---TABLE 2---

As demonstrated in Panel A of Table 3 the average (median) investment stake reached by the activist hedge fund in a target firm is 9.8% (9.9%) which is in line with previous studies (e.g. Brav et al. 2008) and suggests that activist hedge funds usually do not take controlling stakes, instead presumably relying on the cooperation of other investors, the targeted executives or both. Furthermore (not tabulated) only thirteen (28%) of the interventions were undertaken in a company with a block holder controlling more than 20% of the capital and/or votes in the company. This is notable since roughly two-thirds of all SSE-listed firms have such an incumbent block holder and implies that activist hedge funds tend to avoid firms where there is potential opposition from a potential block holder, as hypothesized. As also shown in the table, the average (median) ownership period of about 2.5 years or 983 days (two years or 743 days) is slightly longer than typically observed (Becht et al., 2010; 2017; Brav et al, 2008). My measurement period is however longer than in many studies since the sample period is ten years, 2003 to 2011, and I continue following the firms for three years after this, until the end of 2015. I also have a much smaller proportion of still ongoing interventions in my sample (three cases) since most interventions occur in the beginning of the period. In any case, this data shows that most interventions by hedge funds are not particularly long-term when compared to other influential shareholders in the Swedish context – even at the 75<sup>th</sup> percentile the ownership period is under four years.

---TABLE 3---

Panel B of Table 3 outlines the intervention objectives sought as communicated by the activist hedge funds. I was able to find one or more engagement goals in 35 out of 47 interventions, for a total of 76 objectives (the same intervention can have multiple objectives). The most common communicated outcome sought was changes to the target firms' capital structure, including dividends, leverage and share repurchases (cf. Klein & Zur, 2011) followed by changes to the target firms' board and strategy. An outright sale of the company was rarely publicly communicated by the fund as an objective (seven cases or 15% of interventions), but this does not mean that this is not in fact the ultimate motive since the end result of the intervention is often different from the communicated one in this regard (Greenwood & Schor, 2009). In a separate analysis (not tabulated), I also find that the activist hedge funds are very prone to take a place on the board nominating committee, which is constituted primarily by major shareholders in Sweden as opposed to members of the boards of directors. This was done in 36 (77%) of the 47 interventions. That a representative of the hedge fund assumed a seat on the board itself was less common and observed in 13 (28%) of the interventions. These figures should be interpreted together, however, since a board candidate proposed by the hedge fund while serving on the nominating committee does not necessarily need to be employed by the hedge fund or directly representing it to be sympathetic to its agenda or stated goals.

Table 4 shows mean and median values (Columns 1 and 2) for the targeted firms in the fiscal year immediately preceding the intervention (t-1) along the variables of interest as well as in terms of size (market

values and total asset values). I also compare the targeted firms to their respective industry groups (Columns 3 and 4) and to the matched firms (Columns 5 and 6) where I also include test statistics for differences in means and medians between targets and matches. I include the industry comparison in addition to the comparison with the matched firms since the matching criteria disturb the comparison for some of the variables (e.g. Tobin's Q). Table 4 tells us that the targeted firms have lower average dividends and share repurchases when compared both to their industry peers and to the matched firms as measured by the Total Payout Yield (columns 3 and 5) which is in line with the second hypothesis which suggests that an imperative for hedge fund activism is to increase payouts to shareholders. This difference is economically large with an average Total Payout Yield of 2.3% for target firms which is 0.7 percentage points lower compared to industry means and also compared to the average payout yield for the matched firms at a much higher 3.2% (difference significant at the 0.10 level). Somewhat counterintuitively the median target firm also has less liquidity than the average firm in the same industry (Column 4), which conversely goes against both the notion that targets are hoarding cash (the free cash flow hypothesis) and that hedge fund activists are seeking to shift wealth from bondholders to shareholders.

---TABLE 4---

There are only small differences in financial performance between the target firms and their industry peers in terms of ROA. The differences with the matched firm are economically larger but not statistically significant. In terms of Tobin's Q there is some underperformance for the median target firm on an industry adjusted basis. There are also statistically significant differences with regard to the matched firms along this dimension but this difference goes in the other direction – i.e. targets are performing better than peers – and since book-to-market is a matching criterion this only tells us that it has been difficult to find perfect matches given the limited number of listed firms on the SSE. It is notable that the average target firm is larger than the industry average in terms of market value. This may seem counterintuitive since activist hedge funds have tended to prefer to target smaller firms requiring lesser investment in the previous literature (e.g. Brav et al. 2008), however this can be explained by the fact that the average SSE-listed firm has a much smaller market value than e.g. the average U.S. listed firm examined in previous studies.

### **Developments in Targeted Firms and Matched Peers**

Table 5 presents the development of all the relevant continuous variables over the two-year period between t-1 and t+1 (Panel A) and over the four-year period between t-1 and t+3 (Panel B) for all surviving firms (36 and 31 firm-match pairs, respectively). The base mean and median values at the fiscal year preceding the intervention year (t-1) are given in the previous table (Table 4). The first two rows of both Panel A and Panel B tell us that there are no statistically significant differences in the development of the profitability ratios used in the previous literature, ROA and Tobins Q, over either the short- or medium-term for the surviving pairs. This is corroborated by a multivariate test of the first hypothesis where the means of ROA and Tobins Q are compared jointly for the targets and matches with no difference found. These findings

thus go against the first hypothesis (Brav et al. 2008; Bebchuk et al., 2015) which predicts financial and/or operational improvements in (surviving) targeted firms.

---TABLE 5 ---

In fact, the only statistically significant (both at under the 1% level) development we find for any studied variable is an economically very large increase of shareholder payouts as measured by the average and median Total Payout Yield between the fiscal year preceding the intervention (t-1) and the fiscal year subsequent to the intervention (t+1). The Total Payout Yield ratio increases in the average from its relatively low level of 2.3% to a much higher 4.1% and in the median from 2.5% to 3.0%. Thus, the targeted firms start out as having somewhat lower payouts in the average compared to peer firms in t-1 but see these figures climb rapidly while there is no such concomitant increase in the matched firms. When examining total payouts directly without scaling the variable this effect does not hold, however. Furthermore, the other variables related to H2 are not significant in univariate tests and there is no support for H2 in the multivariate test of all the relevant variables jointly, where the difference between the means of the targets and matches are not significantly different from zero.

Arguably, the most relevant finding in this analysis is instead the lack of statistical significance for any of the other variables on a univariate basis as well as the lack of significance when comparing the means between the groups for all variables (both H1 and H2) jointly over both time periods. In short, there are virtually no significant changes among the targeted firms compared to the matched firms across any of the variables. This can primarily be explained by two factors apart from sampling and measurement errors. First, it can be because activist hedge funds are unsuccessful in implementing changes in the firms that they target in the same manner argued by Drerup (2014) for his sample of German firms (H0). Secondly, it can be because the main objective of activist hedge funds is to effectuate takeovers and that there is very little else of import happening in the surviving firms as hypothesized (Hypotheses 3 and 4). This is in line with my results but it is hard to discern whether there are no actual changes in real variables or whether the lack of significance is because the power of the statistical tests are lowered too much due to the takeover-related attrition in the sample. Remember that the large number of takeovers among the targeted firms drops the number of target-match pairs to 36 over the two-year period and 31 over the four-year period. In either case, this is in line with Greenwood & Schor (2009) who find no meaningful developments in real variables for the surviving firms that are not taken over in their sample.

Panel A of Table 6 uses the same target-match pairs as in the previous analysis but instead of examining changes in profitability and other real variables shows the frequency at which firms are taken over from the target and matched firm groups over the two-year period (t-1 to t+1) and over the four-year period (t-1 to t+3). There is no equivalent attrition in this test since I can establish whether all of the 47 firms included in the sample at t-1 are taken over or not. Evident from this analysis and in line with Hypotheses 3 and 4 there is a highly statistically significant and economically meaningful difference in takeover propensity over the

two-year period where almost one fourth (23.4%) of the 47 target firms are subject to a takeover as compared to only two matched firms (4.3%). In a Pearson Chi-2 test of differences, this is statistically significant at below the 1% level. While marginally weaker in terms of statistical and economical significance this trend also persists in the longer run (t-1 to t+3) where sixteen (34%) of the target firms are taken over as compared to six (16%) of the matched firms. This is significant at the 1.5% level. These tests thus corroborate the hypothesis that activist hedge fund interventions often end in takeovers.

---TABLE 6---

### **Robustness Testing with Logistic and Panel Regressions**

Due to the apparent importance of the takeover hypothesis and to avoid any potential bias that results from the matching specification I also move beyond the matched sample and run a logistic regression measuring takeover propensity for all SSE-listed firms over a ten-year period. The intention is to further examine the hypothesis that there is a relationship between interventions by hedge fund activists and takeovers (H3). The dependent variable is (the natural logarithm of the odds of) whether a firm listed on the SSE is taken over during the studied period and the key independent variable is whether or not the firm has been subject to a hedge fund intervention in the current or previous year. The logistic regression equation is specified as

$$\ln\left(\frac{\rho_{takeover}}{1 - \rho_{takeover}}\right) = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots + \beta_k X_k$$

where  $\rho_{takeover}$  is the probability of a firm being taken over given that it has been subject to an activist hedge fund intervention in the current or previous year ( $X_1$ ) or dependent on the other control variables ( $X_2 \dots X_k$ ). I include the following control variables: size as measured by market value (Brar et al., 2009), industry dummies controlling for takeover activity within a firms' industry (Brar et al., 2009) and a firms' market-to-book ratio (Tobins Q) as a proxy for growth opportunities (Dong et al. 2006). I also control for temporal effects, e.g. takeover waves, using year dummies. Takeover prediction models are notoriously inept at actually predicting takeovers but since I am primarily interested in the relationship between the variable "Takeover" and "Activist Dummy" ex post facto the overall specification of the model is not as important as it would have been if I were interested in explaining all takeovers before they occur (cf. Palepu, 1986). The results of the logistic regression are presented in Panel B of Table 6. While the overall explanatory value in terms of the Pseudo-R2 of the model is low as in previous studies (0.082) there is a statistically and economically significant relationship between the presence of an activist hedge fund and a subsequent takeover as evidenced by the coefficient and p-values for the Activist Dummy which is significant the 1.4% level. The coefficient value of 2.705 indicates that, given the other control variables in the equation, the odds are much higher that a firm experiencing an activist intervention in the current or previous year will be taken over, although the results should again be qualified due to the low overall explanatory value. Viewed together, however, the tests in Panel A and Panel B of Table 6 strongly suggest that there is a meaningful relationship between activist interventions and subsequent takeovers in line with previous quantitative and qualitative evidence (Becht et al., 2017; Greenwood & Schor, 2009; Kallifatides et al. 2010).

As a further and final robustness test, I also replicate the methodology in Bebchuk et al. (2015) and run panel regressions for all firms that are listed on the SSE during the studied period with Q and ROA as dependent variables. The results of these regressions are reported in Table 7. I create dummies that capture the interventions as in Bebchuk et al. (2015) and use the same controls and firm as well as year fixed effects. None of the coefficients for the activist dummies in the ROA regression are statistically different from zero at or below the 0.10 level except for the third year activism dummy which is statistically significant at below the 0.01 level and economically significant. The coefficient value of -0.0513 indicates that the (surviving) targeted firms have a ROA that is on average 5.1 percentage points lower than the non-targeted firms three years after the intervention year. Profitability thus decreases rather than increases. For the Q regression, the activist dummies are only significantly different from zero in the year before and of the intervention. This only tells us that the firms were underperforming prior to the intervention but nothing about their subsequent development. Thus, the panel regressions indicate that there are no significant changes in performance post-intervention as measured by Q and ROA for targeted firms except for a relative decline in ROA after three years. This is in line with my findings using the matching methodology and again counter to the first hypothesis: if anything the performance of the targeted firms decline over time.

---TABLE 7---

## Discussion

My findings on the outcomes hedge fund activism in the Swedish setting suggest that the main effect of such activism is to increase the likelihood of a takeover in targeted firms both when measured against matched peer firms and when compared to all SSE-listed firms, in line with Hypothesis 3. Conversely, I find no improvements in financial performance as measured by ROA or Tobins Q over either the short- or medium-term (two and four years respectively) or any other relevant significant changes in real variables either when examined in a univariate or multivariate setting (Hypotheses 1 and 2). The findings on financial performance are also robust to examining all SSE-listed firms in a panel regression rather than relying on my matching methodology. Thus, my findings are in line with the previous literature that emphasizes the importance of takeovers in relation to hedge fund activism (Greenwood & Schor, 2009; Kallifatides et al., 2010). The findings are also in line with the notion that a shareholder-oriented governance regime such as the Swedish one offers hedge fund activists greater opportunities to achieve the for them most profitable outcome, a takeover of the targeted firm (Hypothesis 4), than in markets which offer fewer rights and opportunities for shareholders to shareholders and where results instead have shown that they often are unable to achieve their stated goals. The activists in the sample circumvented potential opposition from blockholders by often targeting the relatively few firms that did not have such an incumbent blockholder and they capitalized on the shareholder-oriented nature of the Swedish governance regime by seeking representation on the shareholder-constituted nomination committee, allowing them to influence the composition of the board of directors. There is as such arguably an institutional component to hedge fund activism where the potential impact of such activism differs between markets: in Sweden the primary



limitation appears related to ownership concentration as the number of firms activists can target without opposition from an incumbent blockholder is limited; in the U.S. (Delaware) ownership is more dispersed, but the relatively fewer rights offered to shareholders means it is more difficult and expensive e.g. to influence board composition, which must be done through a proxy fight rather than through participating on a shareholder-constituted nomination committee; in Japan both high ownership concentration and relatively weak shareholder rights appear to constrain the efforts of activists (cf. Becht et al., 2017).

Interpreting the broader implications of my findings regarding activists and takeovers depends on how one views the functioning of the market for corporate control. If it is efficient, e.g. because it disciplines underperforming managers, then the finding that activist hedge fund interventions lead to takeovers is of course to be viewed favorably. Conversely, if takeovers lead to substantial wealth transfers from acquiring shareholders and other stakeholders, then the findings are more troubling. There is no clarity in the existing research as to whether takeovers in general have such beneficial or negative effects (Haleblian et al., 2009). My results should however indicate to practitioners and policy makers that the issues of activist hedge funds, shareholder-oriented governance mechanisms such as involvement in board nominations, and takeovers are all interrelated phenomena that need to be considered together. Promoting the interests of shareholders when these come in the form of hedge fund activists does not equate to a promotion of long-term performance improvements in targeted firms, but rather primarily to an increased intensity in takeover activity with ambiguous effects for the real economy. More generally, it is important to be wary of how governance arrangements that increase the influence of shareholders can and are capitalized on by activist hedge funds that potentially have different interests when compared with other shareholders and stakeholders. Thus, if or when granting shareholders influence e.g. over the board nomination process or other facets of governance, it is perhaps useful to consider how one can differentiate between those shareholders that have an interest in the long-term viability of the firm and those that are more interested in near-term returns.

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## APPENDIX I: Tables

**Table 1: Summary of Variables Studied and Link to Hypotheses**

This table summarizes the variables I will be studying, how they are predicted to develop according to the hypotheses and informs about how they are tested and where. Return on Assets is defined as EBITDA scaled by lagged total assets (although strictly not correct from an accounting perspective this is how it is defined in the previous literature); Tobins “Q” is approximated by the market to book value of equity as in the previous literature; Investment Ratio 1 is defined as capital expenditures plus research and development expenditures scaled by lagged total assets and measures investment; Investment Ratio 2 is defined as the change in gross property, plant and equipment scaled by lagged total assets as in Asker et al. (2015) and also measures investment; Total Payout Yield is defined as the value of all dividends and share repurchases scaled by the market value of equity; Liquidity is defined as the value of cash and cash equivalents scaled by total assets; Leverage is defined as the book value of long-term debt and current portion of liabilities scaled by the book value of equity; Takeover is a dummy variable that takes the value one if there is a takeover. Data used to construct the variables was collected primarily from the Compustat Global Fundamentals Database but also Thomson Reuters Datastream (e.g. market values), Nasdaq OMX Corporate Actions List (e.g. repurchases and takeovers) and manual collection from annual reports for some missing cases. I exclude financial firms from the analysis when appropriate, e.g. for the Return on Assets variable. All variables are winsorized at the 1% and 99% levels for the entire SSE population to reduce the influence of outliers before being included in any analysis.

Hypothesis/Variable	Expected Development According to Theory		Tested how/where
	Efficiency/AT	WT/Short-termism	
<i><u>Hypothesis 1</u></i>			F-test for H1 in table 5
Return on Assets (H1)	+		t-test and Wilcoxon in table 5 Panel Regression in table 7
Tobins "Q" (H1)	+		t-test and Wilcoxon in table 5 Panel Regression in table 7
<i><u>Hypothesis 2</u></i>			F-test for H2 in table 5
Investment Ratio 1 (H2)	-	-	t-test and Wilcoxon in table 5
Investment Ratio 2 (H2)	-	-	t-test and Wilcoxon in table 5
Total Payout Yield (H2)	+	+	t-test and Wilcoxon in table 5
Liquidity (H2)	-	-	t-test and Wilcoxon in table 5
Leverage (H2)	+	+	t-test and Wilcoxon in table 5
<i><u>Hypothesis 3</u></i>			
Takeover (H3)	+	+	Chi-2 test in table 6 Logistic Regression in table 6

**Table 2: Temporal and Industrial Distribution of Interventions**

This table shows how the 47 interventions are distributed over the ten-year study period (Panel A) and over the different MSCI GICS Industry Groups (Panel B). I also include comparative figures for the Industry Groups for all SSE-listed firms' during the year 2007 i.e. at the approximate middle of the study period.

Panel A: Temporal Distribution of Interventions			Panel B: Industrial Distribution of Interventions			
Year	#	% of total	GICS Industry Group	#	% of total	% of SSE-firms
2003	3	6%	Energy	1	2%	2%
2004	4	9%	Materials	1	2%	4%
2005	12	26%	Capital Goods	6	13%	17%
2006	10	21%	Commercial and Prof. Services	10	21%	9%
2007	4	9%	Transportation	0	0%	1%
2008	0	0%	Consumer Durables & Apparel	2	4%	4%
2009	3	6%	Consumer Services	1	2%	2%
2010	4	9%	Media	4	9%	2%
2011	5	11%	Retailing	3	6%	4%
2012	2	4%	Food & Staples Retailing	0	0%	1%
<i>Total</i>	<i>47</i>	<i>100%</i>	Food, Beverage & Tobacco	4	9%	1%
			Household & Pers. Products	0	0%	1%
			Health Care Equip. & Services	0	0%	4%
			Pharma, Bio & Life Sciences	2	4%	6%
			Banks	2	4%	2%
			Diversified Financials	2	4%	10%
			Insurance	5	11%	0%
			Software & Services	0	0%	2%
			Technology Hardware & Equip.	1	2%	11%
			Semiconductors	2	4%	11%
			Telecommunication Services	1	2%	2%
			Real Estate	0	0%	6%
			<i>Total</i>	<i>47</i>	<i>100%</i>	<i>100%</i>

### Table 3: Holding Periods, Investment Stakes and Stated Purpose(s) of Intervention

This table shows the largest investment stake gathered by the activist hedge fund during the intervention in terms of capital or votes, whichever is highest, and the duration of their investment in the target company in calendar days (Panel A) as well as the stated purpose of the intervention as voluntarily communicated by the hedge fund (Panel B). Note that there can be more than one communicated purpose per intervention and that the stated purposes therefore sum to more than 47. Size and length of investment are primarily gathered through SIS Ägarservice, ownership flagging and media disclosures. The intervention purposes are gathered from press releases by the hedge fund and articles in the media gathered through Factiva and Retriever (there is no mandatory disclosure of investment purpose in Sweden).

Panel A: Investment Stakes and Holding Periods		
	Investment Stake	Duration (days)
Mean	9.8%	983
Median	9.9%	743
Standard Deviation	6.3%	840
25th Percentile	5.4%	370
75th Percentile	12.3%	1366
Minimum	1.1%	23
Maximum	27.6%	3403

Panel B: Stated Purpose of Intervention		
Stated Purpose	Number of Cases	% of total
Capital Structure Changes	17	36.2%
Changes to Board	15	31.9%
Changes to Strategy	14	29.8%
Restructuring	11	23.4%
Sale of Company	7	14.9%
Other M&A related	6	12.8%
Change the CEO	6	12.8%
<i>Total</i>	76	
<i>No Stated Purpose</i>	12	25.5%

**Table 4: Target Firm Characteristics at t-1**

This table reports descriptive statistics for the targeted firms across the variables of interest, as presented and defined in Table 1, at the end of the fiscal year preceding the intervention (t-1). I also include size in terms of the market value of equity and the book value of total assets in MSEK. Columns 1 and 2 contain the mean and median values for the 47 targeted firms. Columns 3 and 4 contain the mean and median values for the targeted firms on an industry-adjusted basis, where the industry mean value has been deducted from the target firms value. Columns 5 and 6 contain the mean and median values for the matched firms' and the t-statistic of a t-test for differences in means (in parentheses) and a Z-statistic for a Wilcoxon signed rank test for differences in medians [in brackets] between the matched firms and the targeted firms. \*\*\* = significant at the 0.01 level, \*\* = significant at the 0.05 level, \* = significant at the 0.10 level.

	Targets		Industry Adjusted		Matches	
	Mean (1)	Median (2)	Mean (3)	Median (4)	Mean (5)	Median (6)
Return on Assets	0.124	0.131	0.016	-0.006	0.139 (-0.59)	0.169 [-1.17]
Tobins "Q"	2.905	2.124	-0.099	-0.284	2.334 (1.40)	2.036 [2.06]**
Investment Ratio 1	0.062	0.035	-0.002	-0.013	0.062 (0.03)	0.053 [-0.43]
Investment Ratio 2	-0.039	0.001	-0.054	-0.009	0.031 (-1.57)	0.003 [-0.99]
Total Payout Yield	0.023	0.025	-0.007	0.000	0.032 (-1.77)*	0.027 [-1.45]
Liquidity	0.118	0.075	-0.103	-0.048	0.120 (-0.08)	0.073 [-0.59]
Leverage	1.064	0.547	0.165	0.089	0.804 (0.69)	0.448 [1.05]
Market Value (MSEK)	21 959	3 953	5 245	-358	14 743	3 807
Total Assets (MSEK)	21 071	3 548	12 438	-143	8 598	3 146



**Table 5: Changes in Target Firm Characteristics between t-1 and t+1 and t+3**

This table shows us the developments/changes ( $\Delta$ ) in the variables of interest, as presented and defined in Table 1, between the fiscal year ending before the intervention year (t-1) and the fiscal year after the intervention year (t+1; Panel A) as well as three years after the intervention year (t+3; Panel B). Thus, columns 1, 2, 5, and 6 give us the mean and median developments in the targeted firms' while columns 3, 4, 7 and 8 give us the developments in the matched firms. In the columns for the matched firms I also include the t-statistic for a t-test in the differences in means between the target and matched firms (in parentheses) as well as the Z-values for a Wilcoxon signed rank test for the differences in medians [in brackets]. In the final three rows, I present the relevant F-statistics (in parentheses) and T2-statistics (in brackets) of a Hotelling T2-test (MANOVA for two groups) where the means of the relevant variables for each hypothesis as well as all variables for both hypotheses are jointly tested between the targets and matches for both time periods. There are 36 remaining intervention firms at t+1 and 31 remaining firms at t+3. \*\*\* = significant at the 0.01 level, \*\* = significant at the 0.05 level, \* = significant at the 0.10 level.

	Panel A: T+1 compared with T-1				Panel B: T+3 compared with T-1			
	Targets		Matches		Targets		Matches	
	Mean (1)	Median (2)	Mean (3)	Median (4)	Mean (5)	Median (6)	Mean (7)	Median (8)
$\Delta$ Return on Assets	0.009	-0.003	-0.011 (0.99)	-0.013 [0.69]	-0.018	-0.021	-0.035 (0.65)	-0.044 [0.67]
$\Delta$ Tobins "Q"	0.954	0.694	0.521 (0.94)	0.746 [0.36]	0.908	-0.048	0.537 (0.28)	0.499 [-0.26]
$\Delta$ Investment Ratio 1	0.016	0.000	0.006 (0.81)	0.005 [-0.73]	0.019	-0.003	-0.003 (1.36)	-0.004 [1.08]
$\Delta$ Investment Ratio 2	0.008	-0.001	-0.025 (1.04)	-0.003 [1.02]	0.000	0.003	-0.011 (0.40)	0.006 [-0.63]
$\Delta$ Total Payout Yield	0.018	0.005	-0.004 (2.32)**	0.000 [2.81]***	0.023	0.015	0.008 (0.89)	0.000 [0.70]
$\Delta$ Liquidity	-0.006	-0.005	0.005 (-0.53)	0.001 [-0.78]	-0.021	-0.022	0.014 (-1.23)	-0.004 [-1.51]
$\Delta$ Leverage	0.113	0.053	0.096 (0.10)	-0.015 [1.15]	0.572	0.057	0.401 (0.26)	0.002 [-0.05]
Multivariate test of H1	(0.74)	[1.51]			(0.16)	[0.33]		
Multivariate test of H2	(1.46)	[7.83]			(0.90)	[4.89]		
Multivariate test of H1 and H2	(1.17)	[9.08]			(0.70)	[5.59]		

**Table 6: Analysis of Takeover Propensity**

This table demonstrates the relationship between hedge fund interventions and subsequent takeovers in two different analyses. The first one, in Panel A, shows a contingency table for takeover propensity between the targeted and matched firms at t+1 and t+3, where we compare the number (and %) of firms’ that are taken over and delisted among the targeted firms and the matched firms’ in the sample, respectively. I also include the Chi-square values for testing the differences in takeover propensity between the two groups for the two time periods. Panel B moves beyond the matched sample and includes a logistic regression for all SSE-listed firms over the ten-year period where the dependent variable is the odds of being subject to a takeover. The independent variable of interest is the Activist Dummy variable, which assumes the value one if an activist hedge fund was invested in the firm during the current or previous year. I also include a range of control variables in the form of firm size in terms of Market Value, the firms Market-to-Book value of equity and industry as well as year dummies  
\*\*\* = significant at the 0.01 level, \*\* = significant at the 0.05 level, \* = significant at the 0.10 level.

Panel A: Takeover Contingencies for Targets vs. Matches			Panel B: Logistic Regression	
	Targets	Matches	chi2	(1)
Takeover at t+1	11	2	[7.23]***	Variable Name
	23.4%	4.3%		Takeover
Takeover at t+3	16	6	[5.93]**	Activist Dummy
	34.0%	12.8%		2.705**
				(2.45)
				Market Value (ln)
				0.809***
				(-2.79)
				Market-to-Book (ln)
				1.115
				(0.69)
				Year Dummies
				Yes
				Industry Dummies
				Yes
				Number of Obs
				2309
				Pseudo R2
				0.082
				Exp odds; t statistics in parentheses
				*** p < 0.10, ** p < 0.05, *** p < 0.01

**Table 7: Panel Regressions for Tobin's Q and ROA**

This table shows panel regression results for all firms that were listed on the SSE between 2002 and 2015 with Tobin's Q (Regression 1) and ROA (Regression 2) as the dependent variables. As in Bebchuk et al. (2015), I include as independent variables dummies for the years following the intervention by an activist hedge fund, where applicable. Thus e.g. the "Activist Dummy at t+3" is equal to one in the third year subsequent to the intervention and zero for all other firm-years. Firms that are not targeted have only zeros for all dummies. The dummies indicate how firms that are targeted compare to other SSE-listed firms at various points in time in relation to the activist intervention year (t). Variables are measured at the end of the year. I include firm fixed effects to control for unobservable firm characteristics that may influence Q and/or ROA. As in Bebchuk et al. (2015), I include the natural logarithm of the firms' market value and age (years since listing) as controls. Standard errors are clustered at the firm level. T-statistics are in parentheses. \*\*\* = significant at the 0.01 level, \*\* = significant at the 0.05 level, \* = significant at the 0.10 level.

Variable Name	(1) Q	(2) ROA
Activist Dummy at t-1	-0.895*** (-3.12)	0.00411 (0.25)
Activist Dummy at t	-0.997*** (-3.20)	-0.0167 (-1.56)
Activist Dummy at t+1	-0.0666 (-0.23)	-0.0131 (-0.78)
Activist Dummy at t+2	0.626 (0.86)	-0.0236 (-1.57)
Activist Dummy at t+3	0.568 (0.53)	-0.0513*** (-4.87)
Market Value (ln)	1.476*** (6.44)	0.0581*** (6.61)
Firm Age (ln)	-0.0647 (-0.13)	0.0465*** (1.74)
Year Fixed Effects	Yes	Yes
Firm Fixed Effects	Yes	Yes
Number of Firms	145	118
Number of Obs	2030	1652
R2 (within)	0.227	0.172

t statistics in parentheses

\*\*\* p < 0.10, \*\* p < 0.05, \*\*\* p < 0.01

## **APPENDIX II: List of Targeted Firms 2003-2012 (Alphabetical)**

B&B Tools

Boliden

Bong

Carl Lamm (Multiple interventions)

CDON Group

Cision

Cybercom Group

Eniro (Multiple)

Hallex

Intrum Justitia (Multiple)

Karo Bio

Lindex (Multiple)

Nilörngruppen

Niscayah Group (Multiple)

Nobia

Novestra

Pergo (Multiple)

Probi

Proffice

Sardus (Multiple)

Securitas Direct

Skandia (Multiple)

Swedbank (Multiple)

Swedish Match (Multiple)

TeliaSonera

Tethys Oil

Volvo (Multiple)

ÅF

Öresund/Creades

# Foreign Institutional Investors in Swedish Corporate Governance

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## Abstract

This study examines the role played by foreign institutional investors on the Swedish market. Foreign institutional investors have been described as having a beneficial impact on firm governance, investment and innovation, yet it is unclear through which mechanisms such an impact is substantiated on the firm level. Swedish corporate governance, meanwhile, is particularly shareholder oriented and thus offers relatively large opportunities for engagement by institutional investors. Using a mixed methods approach building on a qualitative analysis of thirteen mini-cases of large listed firms that includes interviews with key executives, as well as a quantitative analysis of nomination committee participation, I examine whether foreign institutional investors are directly engaged in the governance of Swedish firms. My results suggest that this is generally not the case. They are instead to be understood primarily as financial traders buying and selling shares, with a relatively low degree of direct involvement in governance compared to other shareholders, e.g. domestic institutional investors.

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## 1. Introduction

The way in which shareholders exercise their ownership rights with regard to the firms in which they have invested has come into renewed focus in the aftermath of the financial crisis. Particular attention has been paid to how a supposedly disinterested ownership behavior among institutional investors<sup>1</sup> undermines notions of stewardship and responsible ownership (Heineman & Davis, 2011; Kay Review, 2012; Çelik & Isaksson, 2013). This has also become an increasingly important issue for the investors themselves, with the CEO of the largest foreign institutional investor on the Stockholm Stock Exchange (SSE), BlackRock, recently highlighting the issue of shareholder engagement in an open letter to CEOs (Fink, 2018):

*We must be active, engaged agents on behalf of the clients invested with BlackRock, who are the true owners of your company. This responsibility goes beyond casting proxy votes at annual meetings—it means investing the time and resources necessary to foster long-term value. The time has come for a new model of shareholder engagement—one that strengthens and deepens communication between shareholders and the companies that they own. I have written before that companies have been too focused on quarterly results; similarly, shareholder engagement has been too focused on annual meetings and proxy votes. If engagement is to be meaningful and productive—if we collectively are going to focus on benefitting shareholders instead of wasting time and money in proxy fights—then engagement needs to be a year-round conversation about improving long-term value.*

In the Swedish context, it has been cautioned that the shareholder-centric Swedish governance model, which relies heavily on a notion of engaged shareholders, could be particularly sensitive to the increasing institutionalization of capital (Henrekson & Jakobsson, 2012; Kallifatides et al., 2010). Inquiries into the practices of institutional investors based on qualitative analyses of primary data both in Sweden (Hellman, 2005) and in the UK (Hendry et al., 2006; Tilba & McNulty, 2013) have further shown that the strategies and competences of institutional investors in general are more oriented towards portfolio management and financial trading rather than engagement and stewardship as regards the companies in which they are invested. Other studies based on quantitative analyses of archival data (e.g. Aggarwal et al., 2011; Bena et al., 2017) have contrarily inferred by implication that foreign institutional investors in general and U.S. ones in particular can have a beneficial effect in terms of corporate governance (e.g. as measured by a governance index), investment and innovation by modeling relationships between foreign institutional ownership and firm outcomes (Ibid). These investigations do not answer the question how ownership on the part of a foreign institutional investor translates into improved outcomes on the firm level, however, and this remains an open question in particular because most of the ownership engagement undertaken by institutional investors is done in a private and unobservable fashion that most often cannot be captured through statistical testing of publicly available information (McCahery et al., 2016; McNulty & Nordberg, 2016). Data on foreign institutional ownership in most countries, including in Sweden, is also unreliable due to a lack of

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<sup>1</sup> I define institutional investors as legal persons investing on the behalf of one or more fiduciaries. Unless otherwise noted, I focus in this study only on the so-called traditional institutional investors: pension funds and insurance companies as well as mutual funds and asset managers (Çelik & Isaksson, 2013).

uniform reporting requirements of beneficial owners, something that the authors of these studies themselves seem to acknowledge (Bena et al., 2017: 131). As such, there is a lack of clarity on the role played by foreign institutional investors in Swedish corporate governance.

In this study, I attempt to bridge this gap and to examine the question of what role, if any, foreign institutional investors play in the governance of listed Swedish firms. I use a mixed methods approach to answer this question and the study builds on two separate empirical analyses: one qualitative, inductive study building on thirteen mini-cases of large SSE-listed companies and one quantitative study that builds on analyses of nomination committee participation by foreign institutional investors on the SSE. I consider the qualitative part exploratory and I base a large part of that analysis on interviews with key executives in firms that all have a higher-than-average ownership by foreign institutions. As ownership data for foreign institutions has much improved in recent years and because there is an observable variable of governance engagement available on the SSE that is not available elsewhere, namely participation in the shareholder-constituted nomination committee, I also complement my qualitative work with a quantitative analysis of nomination committee participation by foreign institutions. My findings from both analyses suggest that foreign institutional investors active on the SSE are primarily to be understood as financial traders who are not directly engaged in corporate governance matters. As such, in the Swedish setting, any assumed links between foreign institutional ownership and firm outcomes would seem to have to result primarily from the buying and selling of shares.

## **2. Institutional Investors**

Institutional investors have become a central feature of contemporary corporate governance, with e.g. Davis (2008) recently defining the ownership and governance regime in the U.S. as a “new financial capitalism” with large institutional holdings but, in general, little involvement in corporate affairs, and with recent corporate governance-regulatory initiatives from the EU focusing heavily on institutional investor behavior in general and the proxy voting of these investors in particular (COM, 2011; 2012; ESMA, 2012; 2013). The available empirical evidence on the behavior and impact of institutional investors in various settings is however ambiguous. Quantitative studies examining the impact that institutions have in portfolio firms have garnered mixed results and furthermore outlined the heterogeneity that exists within the “institutional investor” category. Bushee (1998), for instance, found that U.S. firms’ with a large amount of transient institutional owners, defined as those with high portfolio turn-over, a short investment horizon and small stakes held, were significantly more likely to cut R&D spending for short-term profit – but also conversely that institutions in general had a positive impact. Findings along these lines were also reported for U.S. M&A by Chen et al. (2007) who found that only independent, defined as having no business relationship with the investee firm, institutional investors holding relatively large stakes for longer periods of time monitored the quality of M&A transactions, defined as post-merger performance and the propensity for firms’ to withdraw “bad” bids. Notably, institutional investors in general did not appear to induce such positive effects. Erkens et al. (2012), further, examined the role of institutions during the financial crisis and

found that financial firms' with a high proportion of institutional investors as owners took more risk (leverage) prior to the crisis, and suffered significantly larger (equity) losses when it culminated.

Aggarwal et al. (2011) examined cross-border investment by institutional investors and its potential effect on the governance practices and performance of portfolio firms' in a large number of countries, including Sweden. Governance was measured both based on individual governance attributes (e.g. board independence) and based on the RiskMetrics (ISS) Governance Index, which produces an aggregate percentage "score" based on forty-one different factors (Aggarwal et al., 2011: 179). The authors found that foreign institutional investment affected the index score as well as several of the individual attributes – board independence, board size, whether the Chairman/CEO positions were combined and whether the firm had a staggered or classified board – positively and significantly<sup>2</sup>. The effects were particularly strong if the institution was domiciled in a common-law country, e.g. the U.S. (cf. La Porta et al., 1998). The relevance of these results in the Swedish setting specifically is however questionable, both due to the use of the contentious<sup>3</sup> ISS Governance Index but also because two of the four significant individual attributes (combined Chairman/CEO and presence of a staggered board) intended to demonstrate good governance are not relevant in Sweden where boards are never staggered and those positions are never combined. Aggarwal et al. (2011) further demonstrated a correlation between foreign institutional holdings and firm valuation, measured by Tobins Q, concluding that these investors "export good corporate governance practices around the world" (Aggarwal et al., 2011: 178). However, as Fogel et al. (2013) point out, these performance results suffer from the potential alternative interpretation that foreign institutions simply self-select into firms' with better performance, i.e. an endogeneity problem. Fogel et al. (2013) examined foreign investment in Sweden alone, studying subsequent (accounting) performance changes in the years following an increase in foreign investment in a firm over a long period of time (1992-2008). They found that foreign investors purchasing larger blocks of shares and/or shares with surplus votes (A-shares) at the same time as the holding of an incumbent blockholder decreases was correlated with significant performance improvement in the following one to three years. This performance improvement largely comes from downsizing (Fogel et al., 2013: 11). Notably, they find no performance effects from foreign "portfolio" investors, i.e. from those foreign investors that do not take significant voting positions.

With some of the same authors as Aggarwal et al. (2011), Bena et al. (2017) studied the role of foreign institutional investors in a sample of 30 countries. They conjecture and find that foreign institutional investor ownership is related to subsequent increases in long-term investment and innovation and deal with the endogeneity problem of foreign ownership through instrumental variable modeling. The authors note, however, that their measurement of "foreign institutional ownership might be noisy owing to differences in

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<sup>2</sup> The reported economic effect of foreign institutional investment on the governance index appeared rather modest, with a ten percentage point increase in foreign institutional investment being associated with a 0.35 percentage point increase in the governance index score (Aggarwal et al., 2011: 164).

<sup>3</sup> The authors are aware of this criticism and motivate their testing of individual attributes partly based on the contentious nature of the index (Aggarwal et al., 2011: 155). One main contention as regards the index is the weak relationship/causality between many of the index attributes and firm performance (see e.g. Bebchuck et al., 2009).



mandatory portfolio holdings disclosure rules across countries, as well as recoding and classification mistakes”. Moreover, both Bena et al. (2017) and Aggarwal et al. (2011) assume a link between foreign institutional ownership and firm outcomes without specifying how exactly ownership translates into changes in firm behavior, i.e. the mechanisms for how foreign institutional investors induce changes in the behavior of their investee firms. Gianetti & Laeven (2008) compare domestic pension funds and foreign investors on the SSE to see if there are differences in their degree of ownership engagement and if this is related to differential effects on firm performance. They do this by examining participation on the shareholder-constituted nomination committee, as this is thought to be an indicator of whether the investors are engaged in the governance of their investee firms or not. As such, they explicitly model a mechanism for governance engagement rather than simply assuming it from ownership. They find that foreign investors in 2005 were not appointing representatives to the nomination committees, whereas the converse is true for domestic pension funds who both appointed representatives and whose ownership and nomination committee participation was related to a higher market valuation (Ibid: 4122-4124). They do not differentiate between categories of foreign investors (e.g. institutional or not), however.

The available qualitative evidence strongly suggests that most institutional investors do not seek an active ownership or governance role, with their focus and expertise instead lying in valuing and trading shares (Hellman, 2005; Hendry et al., 2006; Tilba & McNulty, 2013). Tilba & McNulty (2013) studied UK-based pension funds and found that the lion’s share of these had a “disengaged” ownership style and often delegated their equity investment decisions to external parties that did not appear active in governance matters. The authors concluded that current market practices led to an emphasis on trading, not active ownership, and that recent initiatives (e.g. the UK stewardship code) geared towards institutional investors may be misguided. Hellman (2005) demonstrated a similar pattern among Swedish institutional investors and suggested that giving institutions a larger role in corporate governance may have negative effects, e.g. due to their short-term financial focus. Hendry et al. (2006) interviewed both institutional investor representatives and executives in UK listed firms’ and found that market participants conceptualize institutions as financial traders, with actual firm ownership viewed as “accidental, and practically irrelevant to the investors’ central function [i.e. to generate returns]” (Hendry et al., 2006: p. 1106). The authors questioned the notion that a larger concentration of ownership in the hands of institutional investors would improve firm-level governance, since they in general lacked an inclination to act as responsible owners and only appeared to have a superficial interest in corporate governance.

Studying the activism of a large number of Swedish institutional investors, Bengtsson (2005) found that domestic institutions did engage in corporate governance to some extent (e.g. through GM and nominating committee participation) but suggested that there may be explanations for this above and beyond the economic benefits of governance engagement, particularly as the relationship between improvements in governance and improvements in financial performance was considered vague or non-existent by institutional investor representatives. He conjectured that the domestic institutions decision to take a seat

on the shareholder-constituted nominating committee often resulted from convention and rules-of-thumb rather than a case-by-case calculation of the economic benefit related to such participation (Bengtsson, 2005: 203). McCahery et al. (2016) surveyed 118 predominantly Dutch institutional investors and their attitudes to corporate governance. Results showed that exit, i.e. selling shares, was the most preferred option for institutional investors when firms' underperformed (80% of respondents), followed by votes against management at a general meeting (66%) and informal contacts with management (55%). Investors were significantly less inclined to prepare an independent opinion for upcoming general meetings in portfolio firms' domiciled outside the institutions home market (McCahery et al., 2016: 34), implying that they were less concerned with governance for cross-border investments.

Institutional investors that vote at a general meeting without preparing an in-house opinion instead tend to rely on proxy advisors, something that appears particularly common in cross-border institutional investment and governance activities (COM, 2011; 2012). A factor apparently driving such outsourced voting practices are regulations applicable for most institutional investors based in the U.S. which stipulates that the concept of fiduciary duty they are subject to also includes a duty to vote shares in all portfolio firms, including foreign ones (Belinfanti, 2009). Several U.S. studies (Bethel & Gillan, 2002; Cai et al., 2009; Choi et al., 2010; Iliev & Lowry, 2014; Malenko & Shen, 2016) have examined the phenomena and their results suggest that proxy advisors impact the way U.S.-based institutional investors vote, although they reach different conclusions on the size and causality of this influence. Malenko & Shen (2016), the most recent of these studies with a more robust quantitative methodology than many other studies, finds that a negative recommendation from the largest proxy advisor (ISS) on average leads to a 25% reduction in support for U.S. say-on-pay proposals. Recent evidence from fourteen European markets, excluding Sweden<sup>4</sup>, on the role of the two largest proxy advisors (ISS and Glass Lewis) corroborate these findings although find a smaller impact on institutional shareholder voting, at around 10% for when both advisors issue a negative opinion on an agenda item (Hitz & Lehmann, 2017). In another European study Schouten (2012) examined proprietary voting data from four large European institutional investors with a self-described active governance style and found that the propensity for a fund to deviate from the voting recommendations of their proxy advisors and vote independently was greater *inter alia* when voting in domestic as opposed to foreign firms, thus suggesting a relatively larger role for proxy advisors in cross-border investments.

### 3. Swedish Corporate Governance & Ownership

The impact institutional investors can have over how an investee firm is governed is determined *inter alia* by the degree of powers granted to shareholders by the national corporate governance system of the firm. In Sweden, these powers are substantial (Sjöstrand et al., 2016; Skog & Sjöman, 2014). A prime example of the relatively large powers granted to shareholders is the aforementioned shareholder-constituted nomination committee, which unlike in other markets is an external organ typically consisting of the three to five largest

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<sup>4</sup> It is virtually impossible to conduct studies on the influence of proxy advisor recommendations on shareholder votes in Sweden because formal votes with counting are rarely held and results are almost never disclosed (Eckbo et al., 2010).

shareholders and the board chair (Ibid). Shareholders are thus formally in control of both the election *and* the nomination of directors, giving them a greater opportunity to influence board composition than elsewhere, e.g. in the U.S. where similar proposals to grant investors influence over board nominations at the expense of incumbent management has been met with resistance (Becker et al., 2013). Boards are also non-executive, with only one member of the management team, typically the CEO, allowed to serve as a director (Sjöstrand et al., 2016). These and other factors, such as an apparent societal unwillingness to accept the type of heavily incentivized and powerful CEOs seen elsewhere, result in a governance regime that strongly emphasizes the power of shareholders relative to management (Henrekson & Jakobsson, 2012).

The potential impact of institutional investors is however greatly attenuated by the fact that non-institutional blockholders still have control over most listed corporations (Skog & Sjöman, 2014). Swedish corporate ownership is characterized by what best can be described as an *intermediate* level of ownership concentration (cf. Poulsen et al., 2010). Almost all larger companies have a controlling blockholder with more than 20% ownership, but the vast majority of firms lack a majority shareholder controlling more than half of the outstanding shares or votes. Typically, the largest shareholder is a listed closed-end investment fund belonging to a shareholder sphere (e.g. the Wallenbergs), with such owners *effectively* controlling around half of the total market value of the SSE in 2010 (Henrekson & Jakobsson, 2012). Notably, this figure is down from eighty-three percent of the total market capitalization in the early 1990s (Ibid). Combined with decreasing direct household investment in the stock market, it follows that institutional capital – both domestic and foreign – has grown in importance; institutions are often the only significant shareholders next to the controlling blockholder(s) in a given firm. At present ten of the twenty largest shareholders on the SSE are institutional investors as defined in this study (i.e. a pension fund, insurance company or fund or asset manager), whereof five are foreign (Holdings, 2018). In sum, the typical Swedish firm tends to have a substantial incumbent blockholder, but also substantial minority holdings by institutional investors both foreign and domestic.

## 4. Qualitative Study

### 4.1 Study Design

The aim of the qualitative part of the study is to generate an empirically valid and theoretically sound proposition on the role of foreign institutional investors in Swedish corporate governance. As such, I used theoretical rather than representative sampling when selecting which firms to study (Eisenhardt, 1989). This means that instead of attempting to find firms or cases that are representative for all listed Swedish firms, I looked for the most theoretically interesting or extreme ones in terms of the research question (Ibid). This equated in practice to the following approach. I collected ownership statistics on all companies listed on the Large Cap section of Nasdaq OMX Stockholm from SIS Ägarservice (now known as Holdings). Subsequently, I removed all firms that were incorporated outside of Sweden, as I was interested in studying companies that adhere to relevant laws and self-regulation in the Swedish context specifically. To increase the theoretical relevance of the sample in terms of the research question, I then ranked the remaining firms

based on the proportion of ownership held by foreign institutional investors. Contact was subsequently initiated with all firms' where the ownership controlled by foreign institutional investors exceeded twenty percentage points, starting with the ones with the highest proportion. The logic was to choose the largest listed Swedish firms with the largest share of foreign institutional ownership because these firms were considered *ceteris paribus* the most likely to have elicited some form of governance involvement from the foreign institutional investors, which is what I am interested in examining.

Twenty-two companies were contacted via e-mail (a brief introduction combined with a more formal written request sent as an attachment), of which thirteen agreed to participate in the study. This amounted to a response rate of circa fifty-nine percent. Initial contact was in most cases made directly with the Vice President (VP) for Investor Relations (IR) or the Chief Financial Officer (CFO), in which the study was described and an interview was kindly requested. The anonymity and confidentiality of case companies and interviewees was also stressed in order to ensure higher participation rates and a more frank discussion. Several case firms' opted to also include in the interview the corporation's Chief Counsel, primarily because respondents deemed these to have valuable insight on foreign institutional investor participation at the firms' general meetings, which are typically handled by the legal department. The initial contact persons were selected because these executives were thought to have the most up-to-date and accurate knowledge as regards the company's foreign institutional investors (cf. Hendry et al., 2006).

To prepare for the interviews, I studied relevant public and proprietary information from the past five years for each case firm, namely ownership data (including trading patterns) of the foreign institutional investors; how the firms' nomination committee was constituted and whether foreign institutional investor representatives participated; general meeting minutes and, if reported, information on adverse voting (opposition) to board and/or shareholder proposals from foreign institutional investors. This information was incorporated in the questions asked in interviews and, as such, these varied to some extent between firms (for an example of interview questions, see the Appendix). The interviews were semi-structured, leaving room for respondents to elaborate on the issues deemed most relevant but with enough structure to ensure that interviews did not veer off topic. Interviews were made in person (six cases) or, if necessary due to scheduling or logistical issues, via telephone (seven cases) and lasted, on average, forty-nine minutes. All face-to-face interviews except one, where the recording equipment failed prior to the interview, were recorded and transcribed; during all telephone interviews and one face-to-face interview extensive notes were taken. Statements made by respondents were whenever possible triangulated using public information. In particular, I examined statements made with regard to shareholder voting by the firm's investors by comparing the information supplied by interviewees' with self-reported voting data from major foreign institutional investors where available.

I treated the thirteen firms as mini-cases and wrote up case documents for each firm (cf. Eisenhardt, 1989). These included the transcribed interviews or interview notes coupled with my own general notes and the collected archival data (e.g. on shareholder voting and nomination committee participation). I then looked

for all evidence of governance engagement by foreign institutional investors in each mini-case and coded each arena of contact (e.g., involvement in the general meeting was given one code, the nomination committee one, and so forth) for each firm. This coding resulted in four key arenas of contact as provided by respondents and the available archival data: the nomination committee, the general meeting, capital market days and roadshows as well as other informal contacts. Although not an arena for contact but rather for disengagement, I also included “exit”, or the selling of shares, because of its prevalence among respondents when asked to describe the governance engagement of their foreign institutional investors. Having coded the arenas of contact in this way, I proceeded to cross-case analysis (Ibid) by systematically comparing the degree of engagement by the institutional investors between firms within each arena. This included counting the prevalence of the phenomenon, e.g. the number of cases where informal contacts were mentioned, as well as qualitatively analyzing the degree of engagement within each arena across firms. For instance, I cross-compared what respondents had said about their informal contacts with institutional investor representatives to see how often these contacts amounted to the institutional investors attempting to gather financial information for valuation purposes as opposed to voicing opinions about the governance of the firm. The result of this inductive analysis is a testable proposition on the governance involvement of the institutional investors.

## **4.2. Findings**

### **4.2.1 Roadshows and Capital Market Days**

One of the most common contact areas between the case firms and their foreign institutional investors (FIIs) were regularly scheduled capital market days and roadshows. All of the studied firms most of their FIIs participated in these events. The focus of the events was according to a vast majority of respondents on supplying the FIIs with financial information during question and answer (Q&A) sessions. Roadshows were rarely arranged by the case firms or their investors themselves, but rather hosted by third parties such as investment banks. One respondent explained: “Yesterday, for example, [Investment Bank X] arranged an ‘investor’s day’, so we had seven one-to-one meetings with FIIs and a thirty minute presentation for a group of FIIs.” Another elaborated on what the focus of these meetings were: “Questions, questions, questions... they want to know about cash flows and business.” Seldom did the investors seem to engage in any governance matters during these contacts. In response to whether the FIIs provided input or wanted to discuss governance during such events one VP of IR responded: “Rarely do we receive any input. There is a lot of Q&A. Discussing corporate governance is extremely rare.” Another pointed to a FII lifecycle pattern: “If there is an established relationship, if we know them, opinions are more often provided. New investors want information, the in-betweeners want Q&A and the older ones give opinions”. But, this VP of IR added, “these opinions do not result in any impact on how the business is run, only in how we communicate.”

### **4.2.2 General Meeting**

As regards the second arena of contact between case firms and their FIIs, the general meeting, actual direct meeting attendance by FII representatives appeared by a large margin to be the exception rather than the

rule. This did not mean that FIIs did not vote at meetings, however. Rather, all our respondents except one stated that they tended to do so via a proxy representative – often a lawyer appointed by the local custodian bank. Many respondents stated that adverse voting during general meetings by FIIs occurred or had occurred in the past. Contentious issues often concerned the board, e.g. board discharge and election, executive compensation – and in particular proposals for equity-based incentive plans – and other equity-related proposals. Disclosures in the general meeting minutes and the FIIs own voting disclosure records corroborated this. These triangulation efforts also highlighted instances where the respondents appeared unwilling to acknowledge adverse voting. In one case, a respondent stated flatly that they had not seen any opposition from their foreign institutional investors, but this was directly contradicted by the general meeting minutes published by the case firm in which a large group of foreign institutional investors, voting as a bloc, had voted against the firms’ equity-based long-term incentive program just two years prior. Given the large amount of shares controlled by this bloc of foreign institutional investors, the program would even have failed were it not for the fact that the case firm, as is common, was using swap financing to circumvent the Companies Act requirement of nine-tenths shareholder (super-majority) support for such plans.<sup>5</sup> I inquired about this from another respondent whose firm also proposed similar swap financing, albeit in this case only as an alternative if the original proposal with the nine-tenths requirement failed. Regarding why they proposed swap financing of the plan only as a last resort alternative, the Chief Counsel of the case firm replied: “Banks are not known for doing things for free, are they? The truth is that this is much more expensive than simply issuing the shares directly to the employees [which would require super-majority approval]. This is why we only propose it as an alternative solution.” Another respondent, a VP of IR, expressed concern that it was hard to establish contact with their foreign institutional investors leading up to the general meeting, and again pointed to a long-term incentive program (option-based), for which they had had difficulty securing shareholder support. One of the respondents from one of the largest listed firms contrarily stated that they tended to have direct discussions with owner representatives prior to the general meeting. This was, she stated, the only time during the year when they heard from the owner representatives of their FIIs, and she exemplified with an apparent concern during the last general meeting with one director whom the owner representative from the FII considered “overboarded”, that is that the director served on too many boards at once. There was usually at least one FII who contacted the firm with such concerns prior to a general meeting, although most did not.

An apparently strong influence on FII voting from third-party proxy advisor recommendations in general and the ones from ISS in particular was suggested in many interviews. Several respondents stated flatly that most of their FIIs voted as a bloc based on ISS recommendations. Along these lines, a Senior Counsel remarked: “ISS is like a labor union but for shareholders [...] we always have discussions with ISS and other proxy advisors to avoid problems with regards to our [equity-based] incentive plan. The incentive plan [as opposed to other general meeting items] is what is relevant in these discussions as you need a super

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<sup>5</sup> With swap financing, only a two-thirds majority is required to finance an equity-based incentive plan.

majority”. Four other case company representatives stated that they frequently engaged in similar discussions with ISS, particularly with regard to incentive plan proposals, while an additional two stated that they were aware of such discussions but that they were carried out by the board chair. Several respondents stated that the fact that they had a blockholder controlling a large amount of shares meant that adverse ISS recommendations and related negative voting from foreign institutions was generally not an issue, and only became so for those items that, like the equity-based plans, require larger than regular majorities.

#### **4.2.3 Nomination Committee**

The nomination committee, tasked with drafting a sleight of director nominees for the general meeting, is another key potential arena for contact between FIIs and Swedish firms, as they are constituted by shareholders. However, despite often being entitled seats on the committee based on the size of their ownership stake, mandated company disclosures showed that only one FII among the thirteen case companies had chosen to participate in the committee work. When queried about this apparent underrepresentation of FIIs on their nomination committees, respondents stated that seats had been offered to the FIIs but that they had been declined. In one firm, one of largest FIIs had motivated this decision by reference to the minimal size of their holding in the case firm in comparison to their total portfolio. This lack of participation was notable in particular as several interviewees characterized the committee as the main channel for communication on governance issues with the domestic institutional investors, who according to the same disclosures routinely participated. In response to a question about their FIIs involvement in corporate governance, one CFO stated: “They [the FIIs] are not involved. Our [blockholders] sit on the board and our largest domestic institutional shareholders sit on the nominating committee, which are their main channels [for discussions on governance]. [...] [FII X] are not engaged and declined when offered to sit on the [nomination] committee.” A graded scale of governance engagement, starting in non-participation in the nomination committee and ending in actual board participation, was thus apparent in this particular example.

I queried another respondent, whose firm like most others exhibited an underrepresentation of foreign relative to domestic institutional investors on the nomination committee, about the reasons for this differential representation: “The foreign owners do not shown an interest. I think the composition of the nomination committee depends on tradition. We are happy that a lot of owners sit on the committee.” A CFO from another case firm pointed to an example where one of their FIIs previous had had a representative on the committee: “[FII X] used to have a representative. A Swedish guy who worked in London. I’m guessing that this particular fund took a place on the committee because this guy was there and knew the market and could easily cooperate with the others in the committee. If this guy did not exist then they would probably not have participated.” Tradition and chance thus seemed to play a role in determining why nomination committees in the case firms were long on domestic institutions but short on foreign ones.

#### **4.2.4 Other Informal Contacts**

More than half of the respondents stated that they had informal contacts with FII representatives. As with the roadshows and capital market days, these contacts rarely concerned governance issues, however. Rather, they were often event driven, e.g. resulting from a recently published analysis on the firms stock by an investment bank, or concerned “company visits”, where FII representatives traveled to Sweden to meet with executives or to examine the business of the firm to better understand it. The head of IR at one of the largest listed companies on the SSE elaborated: “We have some informal contacts, primarily with portfolio managers. For instance, [FII X] is coming here and will meet with a good group of executives [soon].” I asked respondents who pointed to having informal contacts with their FIIs regarding whether governance matters were discussed. The general response to this was no, although one respondent said that he was aware that such discussions were taking place but that they were performed by the board chairman and not him. Thus, it is possible that several more case firms were having such discussions, but that I was not able to ascertain this due to my selection of respondents.

#### **4.2.5 Exit**

Exit, that is selling shares rather than engaging, was cited by respondents as the most common approach to corporate governance among their FIIs. More than half of the respondents stated that FIIs would be inclined to sell their shares rather than engage in governance matters. When asked about whether their FIIs ever voiced opinions on governance or strategy matters, one CFO elaborated: “Opinions of this sort are rarely provided. If the [FII] does not have confidence in the way the company is being run they would rather sell their shares.” Several respondents that had stated that FIIs were inclined to sell their shares as opposed to provide input on company affairs stated that the firm almost never performed any post-sale analysis as to the reasons for why the FII sold shares. Moreover, several respondents described the trading patterns of FIIs as unrelated to the firm’s business. One example, from an IR Director: “We are not particularly concerned when, for example, [FII X] sells shares. Their decision to do so is related to the general business cycle and has nothing to do with us.” Another IR Director stated: “The sale of shares [by FIIs] is not informative from our perspective [...] it could be due to any number of reasons.”

### **4.3 Discussion and Proposition**

The inductive analysis of my theoretically sampled thirteen mini-case companies, which are among the largest firms on the Stockholm Stock Exchange and have the highest proportion of foreign institutional ownership, strongly suggests that the foreign institutional investors in general are financial traders who are not meaningfully engaged in governance matters (cf. Hendry et al., 2006; Tilba & McNulty, 2013). The most common direct contacts they have with investee firms are at roadshows and capital market days, typically arranged by investment banks, where the focus in contacts are on Q&A and the provision of information for valuation purposes rather than discussions on governance (i.e. as in Ibid). When they do engage in governance matters, e.g. at the general meeting, it is generally in an indirect manner as the governance function is typically outsourced to proxy representatives and proxy advisors (cf. Malenko & Shen, 2016; Schouten, 2012). Analysis of public records and discussions with executives regarding the nomination committees in the case firms demonstrate a similar pattern: only one foreign institution in the thirteen firms



had chosen to take a seat on the committee despite the fact that they were often entitled to a seat based on their often-substantial shareholdings (cf. Gianetti & Laeven, 2008). This was particularly notable as the nomination committee was characterized as a key arena of contact with other shareholders, e.g. domestic institutional investors. Respondents instead stated with some frequency that exit, i.e. selling shares, was the primary way that the foreign institutions dealt with governance matters: if they were unhappy with the way that the firm was being run, they would sell their holdings rather than attempt to intervene. Beneficial effects on governance, long-term investments, innovation and the like by foreign institutional investors, which have been suggested in the literature (Aggarwal et al., 2011; Bena et al., 2017), it would seem, would therefore have to largely be the result of such trading activities rather than any direct interventions on the part of the investors.

The qualitative study is however exploratory and it was sampled in a way, i.e. through theoretical sampling, that limits its generalizability and representativeness. The point of the study is as such not to draw a general conclusion on the role of foreign institutions in Swedish corporate governance but rather to formulate a proposition on their behavior that is empirically grounded, which can then be further verified through methodologies and sampling techniques that are more suitable for generalizations (cf. Eisenhardt, 1989). The main conclusion of the qualitative study is therefore a proposition that can be tested empirically:

P1: Foreign institutional investors are primarily financial traders. Given the same level of ownership, they are less likely to be directly engaged in corporate governance matters than other shareholders are.

## **5. Quantitative Study**

### **5.1 Study Design**

The point of the quantitative study is to examine the veracity of the proposition generated during the qualitative analysis. To do this, I use a country-specific observable variable of direct governance involvement: nomination committee participation. Because nomination committees in Sweden are constituted by shareholders and the names of the shareholders represented on the nomination committees are made public, it is possible to ascertain whether a firm's institutional investors have chosen to serve on the committee or not. From 2015, ownership data on foreign institutional ownership that is based both on local (Swedish) disclosure or flagging requirements *and* mandated self-reported ownership data from the investors themselves (e.g. in the U.S. the SEC form 13F) is also available in a single database (Holdings). This data is more reliable than what has been available previously, which tended to be based on only one of these sources. Nomination committees are constituted based on ownership, if a shareholder is among the largest three to four shareholders in a firm it will be asked to participate on the committee (see also Section 4.2.3). It is thus possible to examine whether or not foreign institutional investors are participating in the nomination committees when they have a substantial shareholding. Based on the qualitative analysis (Section 4), as well as previous research that compares the nomination committee participation of different classes

of domestic institutional investors and all foreign investors as a group (Gianetti & Laeven, 2008), I suggest that this is not the case, and from Proposition 1, I generate the following testable hypothesis:

H1: Foreign institutional investors are primarily financial traders. Given the same level of ownership, they are less likely to be represented on the shareholder-constituted nomination committee than their domestic counterparts are.

I choose domestic institutional investors as the comparator group of shareholders because they are most likely to be similar to the foreign institutional investors in all other respects. I examine nomination committees for the years 2015-2016 and for all firms that are listed on the SSE during these two years (242 firms or 484 firm-years). The reason for not going back further than 2015 is for the abovementioned data reasons, i.e. because foreign institutional ownership data is not deemed reliable to this. Nomination committee data for the dependent variable is hand-collected by counting the number of committee members and then classifying the shareholder each member is representing according to whether they are a foreign or domestic institutional shareholder or not. I operationalize ownership, i.e. the independent variable of interest, by looking at the number of votes (not capital) controlled by each category of shareholders at the end of the third quarter because this is how nomination committees typically are constituted. I include blockholder ownership and firm size as control variables as they are thought to affect whether or not the institutional investors assume a seat on the committee. While panel regressions with firm fixed effects would be the first choice to estimate the relationship between ownership and nomination committee as this is the least biased way (e.g. Allison, 2009), the time period is too short (two years) for there to be meaningful intra-firm variation in the ownership and nomination committee variables. Instead, I estimate the regressions using pooled OLS with industry fixed effects, with one regression for each category of shareholder (i.e. one for foreign institutions and one for domestic ones). I then compare the relationships between nomination committee participation and ownership by examining the coefficients and by simultaneously estimating both regressions and testing whether there is a difference in the relationship between the foreign and domestic institutions.

## 5.2 Findings

Table 1 shows statistics on ownership and nomination committee participation for the five largest foreign institutional investors (Panel A) and their domestic counterparts (Panel B). As this table makes clear, there is a striking difference in committee participation between the two classes of investors: among the largest foreign institutional investors only one, Sampo, whose ownership on the SSE primarily consist of concentrated holdings in the largest bank, has any representatives serving on a nomination committee. The domestic institutions, meanwhile, tend to appoint dozens of representatives each year. While having similar portfolio sizes and average ownership stakes, U.S.-based asset manager Fidelity is appointing no representatives while Swedish asset manager SEB had an average of thirty representatives per year in 2015 and 2016. This strongly suggests that there is a difference between foreign and domestic institutional investors in this regard.

---TABLE 1---

Descriptive statistics and correlation coefficients for the regressions on nomination committee participation are presented in Table 2 for each category of investors (foreign in Panel A and domestic in panel B). These statistics again demonstrate the striking difference in nomination committee participation between domestic and foreign institutional investors: the average (median) firm has a nomination committee with 2% (zero) representatives from foreign institutions but 31% (25%) domestic ones. This despite the fact that the differences in their ownership on the SSE is much lower, at 8% (4%) versus 16% (14%).<sup>6</sup> Since the committees are formed based on ownership, high correlation figures are to be expected between ownership and nomination committee participation. There is also significant correlation between foreign institutional ownership and nomination committee participation (0.35), however, this is half of that for domestic institutions (0.69), suggesting that the link is much weaker.

---TABLE 2---

Regressions 1 and 2 in Table 3 each measure the relationship between ownership and nomination committee participation for the two categories of institutional investors: foreign (Regression 1) and domestic (Regression 2). Institutional ownership is significantly related to institutional participation in the nomination committee in both regressions, i.e. both for foreign and domestic institutions, as is to be expected considering that the committees are formed based on ownership. What is notable is the marked difference in the size of the coefficients: 0.379 for the foreign institutions (p-value 0.000) and 1.469 (p-value 0.000) for the domestic ones. Thus, given the other variables in the regression, a one-percentage point increase in domestic institutional ownership is on average related to a 1.469 percentage point increase in the share of the nomination committee that is controlled by domestic institutions, whereas the same increase for foreign institutions is limited to 0.379 percentage points on average. This is a substantial economic difference. I also simultaneously estimate both regressions to see whether the difference is statistically significant, i.e. whether there is a difference in how ownership affects nomination committee participation for foreign and domestic institutions, and find that this is the case (p-value 0.000, chi-2 54.76).

---TABLE 3---

In sum, the quantitative analyses suggest that foreign institutional investor participation in the nomination committee is very rare and that foreign institutional ownership has a much weaker relationship with nomination committee participation than that for the domestic institutional investors.

## 6. Concluding Discussion

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<sup>6</sup> As stated, I focus only on “traditional” institutional investors, i.e. pension funds, insurance companies and fund and asset managers in this study. This means these ownership figures are not directly comparable to figures that include all types of institutional investors, such as private equity firms, hedge funds, sovereign wealth funds etc.

My findings from both the qualitative and quantitative analyses suggest that foreign institutional investors, even when among the largest shareholders in a firm, are to be understood primarily as financial traders filling a financial function, i.e. valuing portfolio firms' as well as buying and selling their stock (Hendry et al., 2006; Tilba & McNulty, 2013). Very little seems to suggest that these investors are willing to act as "stewards" in their Swedish portfolio firms by proactive engagement in how the firm is governed or managed. Rather, direct contact with portfolio companies appears aimed at extracting information about the business, presumably to improve the accuracy of the foreign institutional investors' investment decision. Compared to domestic institutional investors (cf. Gianetti & Laeven, 2008), the foreign counterparts are disinclined to participate in nomination committees. Part of this could be related to differing rationalities, as the governance participation of domestic institutions has been described as more related to tradition and a desire to be seen as a "responsible owner" (Bengtsson, 2005), while part may well be explained in economic terms – e.g. that SSE-listed firms are too small to be worth expending valuable (governance) resources on and/or and that the costs involved are perceived as too great, for instance due to the lack of geographical proximity. Regardless of the reasons for this difference, however, it is clear from both the qualitative and in particular the quantitative analysis that there is a marked difference between foreign and domestic institutions in this regard. Apart from being an indicator of a relative disinclination to engage in governance matters, this can of course also have effects on board composition, since selecting director nominees is the committee's main task. A relevant question is for example: when foreign institutional investors are underrepresented on the committee relative e.g. to their domestic counterparts, as the evidence show them to be, does this impact the internationalization of the board of directors?

Turning instead to shareholder voting, this the main way in which foreign investors appeared to apply pressure on firms or exercise voice. Opposition against various general meeting agenda items in general, and incentive plans in particular, was evident from both respondents and archival material in the qualitative study. The question here, however, is how much of this was attributable to actual involvement on part of the foreign institutions, as opposed to their proxy advisors (e.g. ISS), and also how much effect this adverse voting has on portfolio firms' in Sweden. As regards the former, many interviewees characterized the voting on part of foreign institutional investors as largely governed by proxy advisor policies. This is in line with the literature on proxy advisors, e.g. Malenko & Shen (2016) and Schouten (2012), who suggest that institutional investors are inclined to vote according to a pre-set proxy advisor policy in particular when the portfolio firm is domiciled in another country. It is not implausible that SSE-listed firms adapt their proposals to be in line with proxy advisor policies to some extent, particularly in the cases where there are a lot of foreign institutional shareholders and the vote requires a qualified majority (two-thirds) or super-majority (ninety percent) to pass. Firms appeared innovative in their strategies to circumvent such influence, however, for instance by flouting super-majority voting requirements mandated by law through expensive alternative solutions (i.e. swap financing of incentive programs).

Studies on the impact of foreign institutional investors, e.g. Aggarwal et al. (2011) and Bena et al. (2017) who conjecture that foreign institutional investors improve firm governance, long-term investment and innovation, have left the question about how these investors do so largely unanswered. In relation to my findings, I suggest that any such effects would largely have to result indirectly from share trading and related market mechanisms considering that the foreign institutions were disinclined to directly engage in governance matters, e.g. via the nomination committee. Research in the U.S. setting has shown that the selling of shares by institutional investors can influence how firms are governed, for instance as regards the propensity to fire the CEO (Parrino et al., 2003). But, there is less evidence on the role of the price mechanism as a governance mechanism in markets that are characterized by blockholder control, and on how share trading by institutional investors would induce firms to engage in more long-term behaviors, e.g. to become more innovative or improve their governance structures. Evidence conversely shows that transient investors who frequently trade shares have negative long-term effects for firms (Asker et al., 2015; Bushee, 1998). As such, while the buying and selling of shares by foreign institutional investors certainly affects the share prices of Swedish firms, it is still unclear whether it has any other substantive effects.

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## **APPENDIX: Examples of Interview Questions**

- Please describe your current duties at company X. What are your main responsibilities? How much time do you spend on interacting with shareholders?
- Are there any general differences in the behavior of your Swedish institutional shareholders as compared to their foreign counterparts?
- Foreign Institutional Investor X owns a lot of A-shares [supervoting shares], does this mean that they are particularly active in the governance of your firm as compared to other institutional shareholders?
- In your contacts with foreign institutional investors, is the focus more on disseminating information or soliciting input? [provided examples if required]
- In your contacts with foreign institutional investors, is the focus more on strategic or financial developments? [provided examples if required]
- How is information from contacts with institutional investors channeled back to the executive team and the board of directors?
- Foreign Institutional Investor X has for over a year been the second largest shareholder in your company, yet they are not represented on your nominating committee – unlike e.g. Domestic Institutional Investor X which owns less shares. Why?
- How common is it that foreign institutional investors participate in your general meetings, either themselves or through proxy representatives?
- Do you have any experience of opposition from foreign institutional investors at your general meeting, e.g. through against-votes or negative feedback?
- [if yes] Regarding what matter/matters is opposition most frequent?
- [if secondary sources indicate opposition] During the 20XX general meeting, several foreign institutional investors voted against your proposal on XYZ. Did you react in any way to this opposition, and if so, what did you do?
- Do you have talks with foreign institutional investors or their representatives before or after your general meetings?
- [if yes] What is discussed? Does the discussion ever impact policy (e.g. through the modification of proposals to be brought forward at a general meeting)?
- Do you have any discussions regarding corporate governance with your foreign institutional shareholders that are unrelated to the general meeting?

## Table 1: Five Largest Foreign and Domestic Institutional Investors

This table shows information on the five largest foreign institutional investors on the SSE (Panel A) and their domestic counterparts (Panel B). The data is averaged over the years 2015 and 2016. Portfolio Size is the total size of the investor's portfolio in MSEK, Avg. Ownership (%) is measured as average the fraction of voting power controlled by the shareholder and Nom Coms is the number of nomination committees on which the investor serves.

Panel A: Five Largest Foreign Institutions				
Name	Category	Portfolio Size	Avg. Own (%)	Nom Coms
BlackRock	Fund/Asset Manager	150 416	0.010	0
Vanguard	Fund/Asset Manager	146 061	0.010	0
Sampo	Pension/Insurance	77 855	0.162	1
Capital Group	Fund/Asset Manager	70 083	0.024	0
Fidelity	Fund/Asset Manager	50 578	0.014	0

Panel B: Five Largest Domestic Institutions				
Name	Category	Portfolio Size	Avg. Own (%)	Nom Coms
Swedbank Robur	Fund/Asset Manager	180 823	0.035	61
Alecta	Pension/Insurance	123 988	0.038	16
AMF	Pension/Insurance	120 465	0.017	26
SEB Fonder	Fund/Asset Manager	78 521	0.012	30
Nordea Fonder	Fund/Asset Manager	65 023	0.019	29

## Table 2: Descriptive Statistics and Correlations

This table shows descriptive statistics for the variables used in the regressions for foreign (Panel A) and domestic (Panel B) institutional investors as well as correlation coefficients. FI/DI in Nom Com (%) measures the proportion of the nomination committee that contains representatives of either owner type. FI/DI in Nom com (%) is their ownership measured as the fraction of voting power controlled in the third quarter of the year when nomination committees typically are formed. Blockholder Ownership (%) similarly measured ownership but for the largest firm blockholder. Firm Size is measured as the natural logarithm of market value. Nomination committee data is hand-collected, ownership data is from Holdings and data on market values from Compustat.

Panel A: Foreign Institutions							
Variable Name	Mean	Median	SD	Correlation Coefficients			
				1	2	3	4
1. FI in Nom Com (%)	0.02	0.00	0.07	1.00			
2. FI Ownership (%)	0.08	0.04	0.09	0.35	1.00		
3. Blockholder Ownership (%)	0.31	0.27	0.19	-0.07	-0.31	1.00	
4. Firm Size (LN of Market Value)	8.28	8.25	1.96	0.05	0.55	0.13	1.00

Panel B: Domestic Institutions							
Variable Name	Mean	Median	SD	Correlation Coefficients			
				1	2	3	4
1. DI in Nom Com (%)	0.31	0.25	0.26	1.00			
2. DI Ownership (%)	0.16	0.14	0.12	0.69	1.00		
3. Blockholder Ownership (%)	0.31	0.27	0.19	-0.01	-0.30	1.00	
4. Firm Size (LN of Market Value)	8.28	8.25	1.96	0.43	0.33	0.13	1.00

**Table 3: Regression of Relationship between Institutional Ownership and Nomination Committee Participation**

This table contains two regressions, one that relates foreign institutional ownership to foreign institutional participation in the nomination committee (Regression 1) and one that examines the same relationship for domestic institutions (Regression 2). The variables are defined as before (Table Y). The regressions are pooled OLS with industry dummies/effects and with robust standard errors clustered at the firm level.

Variable Name	(1) FI in NC (%)	(2) DI in NC (%)
FI Ownership (%)	0.379*** [0.0856]	
DI Ownership (%)		1.469*** [0.1165]
Blockholder Ownership (%)	0.0439* [0.0266]	0.257*** [0.0730]
Firm Size (LN of Market Value)	-0.00938*** [0.0028]	0.0324*** [0.0076]
Year Fixed Effects	Yes	Yes
Industry Fixed Effects	Yes	Yes
Obs (Firm-Years)	465	465
R2	0.259	0.584

Clustered robust standard errors in brackets

\* p < 0.10, \*\* p < 0.05, \*\*\* p < 0.01