

PER LEKVALL (ED.)

**THE NORDIC
CORPORATE GOVERNANCE
MODEL**

WITH COMMENT BY
RONALD J. GILSON

SNS FÖRLAG

»This is an important and influential book for three reasons. First, Nordic countries are important and currently upheld as a model for good corporate governance around the world. Second, the book is an exceptionally careful and thorough analysis of their governance arrangements. It combines an overview of the common features of Nordic countries'

governance with individual country details of their differences. Third, it provides real insights into the determinants of successful corporate governance. It points to three key components: diversity of ownership patterns including controlling shareholdings, independent boards, and strong protection of minority investor interests. The book deserves to be widely read and carefully studied by anyone interested in the design of corporate governance systems.«

Colin Mayer, Peter Moores Professor of Management Studies, Saïd Business School, University of Oxford

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with comment by

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is a non-partisan and independent non-profit organisation
that contributes to decision makers in politics, public administration
and business being able to make well-informed decisions based
on science and factual analysis. This is done through
research, meetings and the publication of books.

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Per Lekvall (ed.)

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TOMAS LINDHOLM
in memoriam
Instigator, initiator
and inspirator of this study

CONTENTS

Foreword 9

Executive Summary 13

CHAPTER I

Introduction 27

Background 27 · Purpose and scope of the study 30 ·

Project organisation 32 · Outline of the report 34

CHAPTER II

The Institutional Framework of Nordic Corporate Governance 36

The regulatory framework 36 · The market for publicly traded stock 42

CHAPTER III

A Consolidated Nordic Governance Model 52

The essence of the model 52 · An owner-oriented governance

structure 58 · Shareholder minority protection 87

CHAPTER V

The Nordic Model of Corporate Governance:

the Role of Ownership 94

By Ronald J. Gilson

An ownership model of corporate governance 97 · How the Nordic

ownership model of corporate governance responds to the agency

problems of ownership 99 · An ownership-based governance model in a

comparative perspective 105 · Conclusion 112

APPENDIX A

Corporate Governance in Denmark 115

APPENDIX B

Corporate Governance in Finland 168

APPENDIX C

Corporate Governance in Norway 201

APPENDIX D

Corporate Governance in Sweden 247

APPENDIX E

Ownership Concentration on the Nordic Stock Markets 280

FOREWORD

SINCE THE TURN of the century, there has been an increasing interest in the corporate governance practices of the Nordic region. This interest has been inspired by the rapid increase in foreign ownership on the Nordic stock exchanges as well as the active corporate governance regulation agenda of the European Union. This new EU-regulation has not always taken the specific features of the governance practices in the Nordic region sufficiently into account, which has created challenges for policymakers, owners and businesses in the region.

This has spurred a debate throughout the region regarding the possibility to define and describe a common Nordic corporate governance model. The first initiative for implementing this idea was taken by the Directors' Institute of Finland through its late chairman, Tomas Lindholm, who was a long-standing, keen proponent of Nordic cooperation within this field.

The idea was picked up by SNS, the Stockholm-based Centre for Business and Policy Studies, which decided to undertake it as a policy roundtable project within SNS. This book is the result of this roundtable.

The project has been made possible by financial support

from the Nordic Council of Ministers and the following companies and organisations in the four countries concerned: Axcel Fund, BA-HR DA Law Firm, Carl Bennet AB, Cevian Capital AB, Confederation of Norwegian Enterprise, Confederation of Swedish Enterprise, Danske Bank, Finnish Foundation for Share Promotion, Government Pension Fund Norway, AB Industrivärden, Investor AB, KPMG Finland, KPMG Sweden, Melker Schörling AB, Nordea Bank, Norwegian Corporate Governance Board, Roschier Attorneys Ltd, Swedish Corporate Governance Board, Solidium Oy, and Varma Mutual Insurance.

A considerable number of individuals from the four countries concerned have contributed to the execution of the project. First and foremost among those are the members of the Working Group, made up of leading experts from each country. Their names are listed in Chapter I of the report. This outstanding group of people has carried out the bulk of the project work and generously shared their profound expertise in the field. It has been a highly rewarding experience to work with this group, both from a professional and personal point of view. I am deeply grateful to all of its members for their strong commitment, outstanding contributions and boundless patience in dealing with the details of this study.

Furthermore, a Reference Group made up of high-level representatives of the business and financial sectors has been organised in each country with the task of acting as advisors to the country experts and reviewers of the consolidated report. These names are also listed in the section mentioned above. Their input has been invaluable to the project work, and I sincerely thank all members of these groups for the considerable amount of time spent on the study and their great willingness to share their views and experiences to the benefit of its quality.

In June 2014, an early version of the report was reviewed at

the 6th Annual Workshop of the Nordic Corporate Governance Network, a network of Nordic academics within this field. I sincerely thank the organisers of the event for this opportunity and especially the discussant of our paper, Professor Trond Randøy, University of Agder, Norway, for his very useful remarks.

A crucial contribution to the study has further been provided by SIS Ägarservice through the special study on ownership structures in Nordic listed companies. I wish to thank its founding partner, Mr. Sven-Ivan Sundqvist, and his staff very much for excellent work.

Another contribution of utmost value to the study is provided by Professor Ronald J. Gilson, who as an independent author of Chapter IV of the report has taken an outside look at the Nordic model and reviewed its significance in a broader international context. On behalf of the project and all of us who have participated in the work, I sincerely thank Professor Gilson for his eminent contribution to the report.

I also wish to express my appreciation of the superb work of Mr. John Kokko, Korrelat Legal English AB, as language reviewer and editor of the report. Many thanks for highly stimulating and rewarding work together on these matters.

Finally, I wish to express my great personal gratitude to SNS for having undertaken this very timely study and for the privilege of having been assigned the responsibility as its project manager. I particularly wish to thank my main contact persons at SNS, Ms. Pernilla Klein, deputy CEO, and Ms. Caroline Schmölder, Assistant Project Manager, for their enthusiastic support and never-ending encouragement throughout the project.

There are a number of authors of different parts of this report. The »country reports« in Appendices A–D are written by the respective national expert teams, and Chapter IV, as just

mentioned, is authored by Professor Ronald J. Gilson. These authors are independently responsible for their respective contributions. Although, as explained above, I have had the privilege of unlimited support from an array of highly qualified experts, the ultimate responsibility as the main author and editor of the other parts of the report rests with me alone.

The mandate of SNS is to commission and present fact-based analyses addressing key issues in society. The organisation does not take a position on the issues and topics discussed in this book.

Gothenburg, Sweden, September 2014

PER LEKVALL

E X E C U T I V E S U M M A R Y

THE KEY OBSERVATION of this book is that the Nordic corporate governance model allows the shareholder majority to effectively control and take long-term responsibility for the company that they own.

The alleged risk of such a system – the potential that a shareholder majority misuses its power for its own benefit at the expense of minority shareholders – is effectively curbed through a well-developed system of minority protection.

The result is a governance model that encourages strong shareholders to engage in the governance of the company in their own interest, while creating value for the company and all its shareholders.

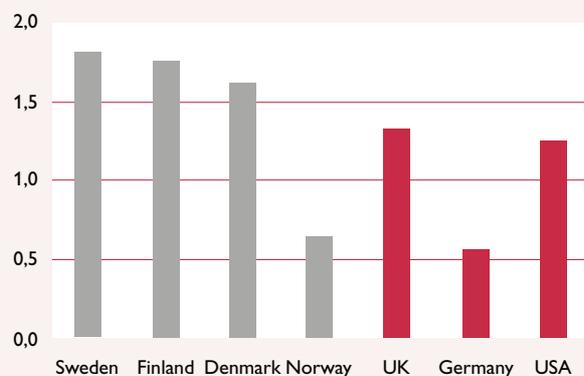
The Nordic supermodel

In recent years, the Nordic region has attracted considerable positive attention around the world. In a special report about the Nordic region published in February 2013, *The Economist* used the title »The next supermodel«, pointing to the fact that

the Nordic countries cluster at the top of global league tables of everything from economic competitiveness to social health.

The countries also stand out by being home to a notable share of world-leading companies, which by far exceeds the region's share of the world economy. About 60 Nordic companies qualify on the Forbes list of the world's 2000 largest publicly listed companies. This significantly exceeds the number for Germany, although the combined size of the Nordic economies is less than half of that of that country. The chart below shows the number of companies on the Forbes 2000 list in relation to GDP. All the Nordic countries except Norway

**NORDIC COMPANIES OVERREPRESENTED
AMONG THE WORLD'S LARGEST COMPANIES.**



SHARE OF the world's 2 000 largest listed companies in relation to share of global GDP.

COMMENT: The size of the oil economy distorts the comparison for Norway. Looking instead at the ratio between companies on the Forbes list in relation to population size, the number for Norway also exceeds those of the UK and the US.

have about three times as many companies on the list in relation to GDP as Germany and distinctly more than both the UK and the US.

Although there may be a variety of factors underlying this outcome, it is reasonable to assume that the way Nordic companies are governed has played a role in creating favourable conditions to build and develop world-leading companies. In a ranking of the efficacy of corporate boards, the World Economic Forum Global Competitiveness Report 2013–2014 ranked three of the Nordic countries among the six highest and the fourth as number 20, just ahead of the UK and Germany.

What is a ‘governance model’?

The purpose of this book is to identify the common features of the corporate governance systems of the Nordic countries and, on this basis, to define a common Nordic corporate governance model.

By *corporate governance* we mean the framework through which a company is governed in order to ensure that the company is run in the best interest of its owners. A *corporate governance model* is how this framework is set up for a certain type of company, e.g. a listed company, or a geographical region. It is determined mainly through three types of norm systems:

- *Statutory regulation* in the form of company law and other mandatory rules issued by the government or official authorities.
- *Self-regulation* defined and enforced by the business sector itself.
- *Informal norms and practices* that influence how corporate governance is carried out in practice. This type is of particu-

lar interest in the Nordic region due to the relatively strong and homogenous norms and value systems, combined with the high degree of social control typical of small communities that characterise these societies.

Why a book about Nordic corporate governance?

The book aims at providing a Nordic perspective on two key issues in the current European corporate governance debate:

LACK OF ACTIVE LONG-TERM OWNERS IN TODAY'S CAPITAL MARKETS. The perceived short-termism and lack of stewardship of institutional owners has resulted in a quest for policy solutions that would lead to more active owners with a long-term view of the companies they own. We believe that Nordic corporate governance, through its emphasis on tools and incentives for long-term active ownership, can provide a timely contribution to this policy discussion.

TIDAL WAVE OF EU-LEVEL REGULATION OF CORPORATE GOVERNANCE. These harmonisation efforts have made visible the considerable diversity of corporate governance systems in place among the EU member states. This book aims at promoting better knowledge and understanding of the Nordic corporate governance model within the EU and on the broader international scene.

Incentives and tools for shareholders to act as real owners

The fundamental principle of Nordic corporate governance is to provide the shareholder majority with strong powers to control the company while providing minority shareholders with effective protection against abuse of power by the majority. The system thus gives dominating shareholders the motivation and tools to act as engaged owners and take long-term responsibility for the company. The primary means to obtain this is a clear-cut and strictly hierarchical chain of command between the general meeting, the board and the executive management.

STRONG GENERAL MEETING POWERS. At the top of this chain is the general meeting, which is the company's highest decision-making body and the main forum for the shareholders to exercise their ownership rights. The Nordic general meeting has far-reaching powers to govern the company. This ensures strict accountability of the board to the shareholders and creates a strong incentive for a regular dialogue between shareholders and the board.

BOARD INTEGRITY VS. MANAGEMENT. The board is appointed by and fully subordinate to the general meeting. Except for employee representatives, boards of Nordic listed companies are mostly comprised exclusively of non-executive directors. An important implication of this is a clear-cut division of duties and responsibilities between a monitoring and strategically steering board and a purely executive management function. This division of roles also serves to strengthen the integrity of the board vis-à-vis the executive function.

SHAREHOLDER-ORIENTED AUDITOR. The external auditor (mandated by law and company statutes) is appointed by the general meeting. In the Nordic context, the auditor is primarily seen as the shareholders' instrument for reviewing the work of the board and management.

ENGAGED OWNERS. Especially in companies with a concentrated ownership structure, major owners generally take active part in the governance of the company, e.g. by taking seats on the board, being involved in the nomination of candidates for board assignments and maintaining ongoing contacts with the board. In Norway and Sweden, shareholder engagement in board nomination is mainly pursued through nomination committees predominantly made up of representatives of the largest owners.

Effective minority protection

The potential risk associated with a model that gives the shareholder majority far-reaching powers is that this power can be misused to extract private benefits for the controlling owner at the expense of minority shareholders. To provide safeguards against this, the Nordic corporate governance model includes a system of rules and practices that effectively protects the rights of minority shareholders from such abuse by the majority.

The most important of these minority-protection measures are:

1. *The principle of equal treatment of shareholders*, which prohibits the general meeting, the board or the executive management from taking decisions that unduly favour one group of shareholders at the expense of the company or other shareholders.

2. *Extensive individual shareholder rights* to participate actively in general meetings and to take legal action. For example, any shareholder may challenge a decision by the general meeting in a court of law on the grounds that it is illegal or in breach with the articles of association of the company. The court may then decide that the decision has no legally binding force.
3. *Majority vote requirements* of up to total unanimity for general meeting resolutions of particular potential detriment to the interests of minority shareholders. Examples of resolutions that require full consent are changes of the shareholders' obligations towards the company and compulsory redemption of shares.
4. *Minority powers to take action*. In a number of situations, the shareholder minority can force resolutions to be taken by the general meeting (see fact box below).
5. *Strict rules for related-party transactions*, that is business dealings between the company and counterparties related to the company (shareholders, board members, etc.). These types of transactions can be used to unduly extract money from the company. In the Nordic context, safeguards against this type of abuse are primarily based on the requirement that all such transactions must be made strictly on market terms.
6. *A high degree of transparency* towards the shareholders, the capital market and the society at large. Names and credentials of board directors as well as the CEO and other senior executives are to be found on the company's website. The remuneration of board directors as well as the CEO is disclosed in detail on an individual level. Share registers are generally public, which means that anyone can at any time have full insight into the ownership structure of any listed company.

R I G H T S

of minority shareholders to take action

- Shareholder minorities of 5 % (Denmark and Norway) or 10 % (Finland and Sweden) can require an extraordinary general meeting to be held.
- Except in Denmark, a minority of 10 % (5 % in Norway) of the shareholders can also require a minimum dividend to be paid out.
- A minority of 10 % in Sweden and Denmark (5 % in Norway) of the shareholders can, under certain circumstances, have the district court or a public authority appoint a second auditor.
- If a shareholder minority of typically 10 % (25 % in Denmark) believes that certain circumstances in the company should be subject to an in-depth investigation, it has the right to demand that the district court or a public authority appoint a »special investigator«, paid for by the company, with the duty to specifically examine these circumstances and report its findings to the general meeting.

Although each of these features of Nordic minority protection may not seem unique within a European perspective, together they make up an effective system, developed and refined through many years of accumulated experience, to counterbalance the strong powers that the governance model gives to majority shareholders.

Effectiveness of the model – research evidence

The ability of the Nordic corporate governance model to safeguard against the extraction of private benefits by controlling shareholders has been the subject of a number of academic studies. This body of research indicates that such misuse of power largely appears to have been successfully curbed in the Nordic markets.

For example, World Bank governance expert Tatiana Nenova has analysed the market value of controlling voting rights in 18 countries from around the world. The study showed that, whereas the value of control-block votes in relation to total firm value ranged from 5% to 30% in the other European countries studied, representing French, German as well as Anglo-Saxon judicial traditions, it was nearly zero in the Nordic region.

In short, Nenova concluded that in the Nordic markets the problem of controlling owners who misuse their power to extract money from the company at the expense of other shareholders was almost non-existent. Her explanation of this result was that the Nordic markets are characterised by a strict legal environment in the areas of investor protection, high-quality law enforcement and strict takeover regulation.

A tradition of self-regulation

Self-regulation is a long-standing tradition in many aspects of societal life in the Nordic countries. Where applicable, it is often preferred to legislation because of its greater flexibility,

generally better regulatory precision and higher acceptability among the actors subject to the regulation.

Since the early years after the turn of the century, corporate governance codes have been the main form of self-regulation within the field of corporate governance in the Nordic countries. At face value, these codes may appear to differ quite significantly. However, in terms of crucial substance matter they are all founded on common concepts and principles and resemble one another to a great extent.

All the Nordic codes are based on the comply-or-explain principle. This entails a strict requirement to apply the code properly and to provide explanations for any deviations. The general attitude of the bodies responsible for administering the code is to emphasise the importance of transparency towards the market rather than to promote strict compliance with the code. As long as there is transparency, companies are even encouraged to choose solutions other than those prescribed by the code.

Well-functioning code enforcement

An important aspect of corporate governance self-regulation is how the code is administered and how its implementation is monitored and enforced. The Nordic countries share a well-functioning system in this respect, in short set up as follows:

- *The national corporate governance committee* is the »law-maker« with the duty to administer the code and the authority to decide on its content, typically after consultation with the market.

- *The stock exchanges* supervise the appropriate application of the code by listed companies and have the duty to take action when they detect significant deviations.
- *The market participants*, i.e. the investors and their advisors, are the ultimate judges through their decisions to invest in or divest of companies based on fully transparent information about the governance practices of these companies.

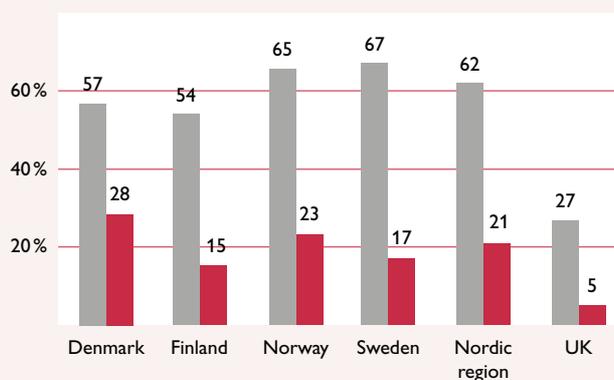
In the Nordics, the corporate governance codes are viewed as tools for on-going improvement of corporate governance practices by setting higher standards than the minimum levels required by law. These standards are to be strived for but not necessarily achieved by all companies all the time. With this approach, there is no point in aiming to achieve 100 % compliance with the code provisions. In fact, such an outcome might imply that the code is not challenging enough.

A model flexible to different ownership structures

The Nordic markets are generally characterised by a high degree of ownership concentration in listed companies. As shown in the chart below, for the region as a whole, close to $\frac{2}{3}$ of all listed companies have at least one shareholder controlling more than 20 % of the total number of votes, and about $\frac{1}{5}$ are under the absolute control of a single majority shareholder. The numbers vary between the countries, but they are all high in comparison with the UK, the European market most generally associated with highly dispersed ownership of listed companies.

This highly concentrated ownership structure of many listed companies has long prevailed and no doubt constitutes an important factor underlying the shaping of Nordic corporate governance. Yet, far from all Nordic companies have a controlling owner, as is also evident from the chart. On the contrary, there are many listed Nordic companies with as widely held shareholdings as are commonly found in markets generally associated with more dispersed ownership structures. That the model works well also under such circumstances is witnessed by the many successful Nordic companies of this kind.

MANY – BUT FAR FROM ALL – NORDIC LISTED COMPANIES HAVE A CONTROLLING OWNER



CONTROL OWNERSHIP in different markets. This graph shows the presence of control ownership in companies on the Nordic and UK primary stock markets in 2014. The bars indicate the share of companies with at least one shareholder controlling more than 20% (grey) and 50% (red), respectively, of the total number of votes.

In fact, the model is highly flexible, providing a generally shareholder-friendly governance framework that works well within a wide range of different ownership structures.

An ownership model of corporate governance

The book also includes a comment by Ronald J. Gilson, professor of Law and Business at Columbia Law School and Stanford Law School. Gilson's starting point is the classic notion that someone has to watch over management to ensure that it works diligently in the interests of the shareholders. To date, Anglo-American corporate governance has tried to solve this problem through a combination of organisational measures, e.g. by requiring a certain number of independent directors on the board, and external forces involving threats of hostile takeover of underperforming companies by firms with more efficient management. The problem, Gilson notes, is that both approaches have proved to be rather blunt instruments.

Gilson contrasts this with the Nordic model, which he describes as an ownership model of corporate governance, based on the »simple intuition that an active owner will be a more efficient and less costly monitor of management« than the techniques generally associated with dispersed-ownership models.

However, this approach gives rise to other problems by creating incentives for controlling owners to divert profits to themselves rather than sharing them with the other shareholders. Gilson defines three such agency problems of ownership and assesses their prevalence and ramifications in the Nordic context. His conclusion is that Nordic corporate governance

has been able to check these problems quite effectively, thus creating a governance framework that has fostered a remarkable number of globally successful companies. Gilson attributes this to a combination of effectively enforced legal rules and non-legal constraints on the possibility to extract private benefits in closely held companies.

Convergence of ownership patterns?

Gilson proceeds to examine the much-debated issue whether different national and regional governance systems will converge over time. Citing recent developments in the US as well as the Nordic markets, he sees no general trend towards such a convergence. On the contrary, both dispersed and concentrated ownership appear to be thriving in both market areas. Hence, Gilson argues, the relevant issue is whether we will see a convergence of ownership patterns within markets rather than between markets.

On this point the outcome is as yet unpredictable, with concentrated ownership becoming more common on the US market whereas a trend towards decreased control ownership may be foreseen in the Nordic context. A decisive factor, Gilson speculates, may be the increased importance of institutional owners on both markets and how those shareholders choose to exert their ownership power. For example, what might be the impact on the Nordic markets if minority institutional shareholders are able to join forces to form institutional block-holdings in companies with a controlling shareholder?