SWEDISH
CORPORATE
GOVERNANCE BOARD

Annual report 2011

Contents

Foreword

The work of the Swedish Corporate Governance Board in 2010 was dominated by the launch of the revised Co de and efforts to influence the development of regulation at EU level. The background to this is that the recent development of Swedish corporate governance has been marked by the aftermath of the financial crisis and a number of initiatives from the EU.

As can be seen in this year's activity report, the Board has had reason to focus on two aspects of this development:

- The risk that the lessons from the poor corporate governance of some financial institutions – largely outside Europe – will lead to unquestioned generalisations and be seen as justification for significantly greater regulation of all European listed companies without much basis in empirical data;
- The importance when designing common EU regulations of respecting the different corporate governance traditions of European countries and many countries', (including Sweden's), well-functioning self-regulation systems, which may have a higher level of ambition and greater flexibility than legislation.

This annual report also presents the results of the surveys which make up the Board's follow-up of its activities. The survey of how listed companies applied the revised Code show that the Code in its revised form has worked as intended. The Code Barometer, which measures confidence in the way Swedish listed companies are run, shows slightly higher confidence among the general public and professional actors, apart from on the issue of executive remuneration.

As in previous years, the third section of the report consists of articles on issues relevant to Swedish corporate governance written by external contributors. The authors of these contributions are entirely responsible for the views presented in these articles, and the opinions and values expressed are not necessarily shared by the Board.

In spring 2011, Per Lekvall stepped down from his role as Secretary and Executive Director of the Swedish Corporate Governance Board and was replaced by Björn Kristiansson. Per Lekvall has contributed enormously to the development of corporate governance in Sweden, and on behalf of the Board I would like to express our heartfelt thanks. We are very pleased that he will continue to be a member of the Board. Björn Kristiansson has been a legal adviser to the Board on corporate governance matters and is a welcome successor.

Since its first publication in 2006, the Board's annual report has been a forum for information and discussion on the development of Swedish corporate governance. Its publication in English also allows actors in the international markets to remain informed about what is happening in this area in Sweden.

It is the hope of the Board that this annual report, as its predecessors in previous years, will contribute to increased knowledge and understanding of Swedish corporate governance.

Stockholm, June 2011

Hans Dalborg
Chair of the Board

I. ACTIVITY REPORT

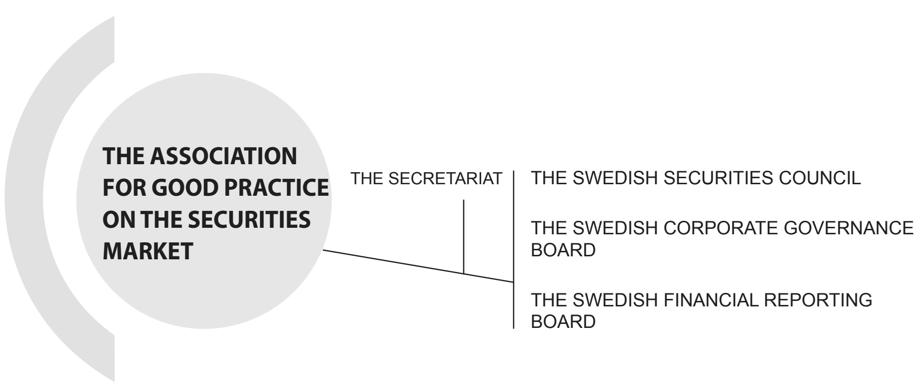
This part of the annual report describes the work of the Board during 2010–2011 and discusses current issues regarding the Code and Swedish corporate governance in general.

The Mission of the Swedish Corporate Governance Board

In May 2010, the role of the Swedish Corporate Governance Board was widened to include responsibility for issues previously handled by Näringslivets Börskommitté, the Swedish Industry and Commerce Stock Exchange Committee. Since that date, the mission of the Board is:

- to promote the positive development of corporate governance in Swedish stock exchange listed companies, primarily by ensuring that Sweden continuously has a relevant, modern, effective and efficient corporate governance code;
- to promote generally accepted principles in the Swedish securities market by issuing rules regarding good practice, such as rules concerning takeovers;
- and to promote knowledge and understanding of Swedish corporate governance on the international capital market while safeguarding Swedish interests within these areas.

The Board is one of three bodies that constitute the Association for Generally Accepted Principles in the Securities Market, an association set up in 2005 to oversee self-regulation within the securities market. The other two bodies in the association are the Swedish Securities Council and the Swedish Financial Reporting Board. The members of the association are a number of organisations in the private corporate sector that are affected by these issues. See illustration below.



The role of the Board in promoting Swedish corporate governance is to determine norms for good governance of listed companies in Sweden. It does this by ensuring that the Swedish Corporate Governance Code remains appropriate and relevant, not only in the Swedish context, but also internationally. The Board monitors and analyses how companies apply the Code through recurrent dialogue with its users in seminars, at working meetings and through structured surveys. It also monitors and analyses the general debate on the subject, changes in legislation and regulations concerning corporate governance, developments in other countries and academic research in the field. Based on this work and other relevant background information, the Board continuously considers the need for limited modifications to the Code or more general reviews of the entire Code.

The Board has no supervisory or adjudicative role regarding individual companies' application of the Code. Ensuring that companies apply the Code in accordance with stock exchange regulations is the responsibility of the respective exchanges. The role of evaluating and judging companies concerning their compliance or non-compliance with individual rules in the Code, however, belongs to the actors on the capital market. It is the company owners and their advisers who ultimately decide whether a company's application of the Code inspires confidence or not, and how that affects their view of the company's shares as an investment. Interpretation of the Code is not a matter for the Board either. This is the responsibility of are the Swedish Securities Council, which issues interpretations on request. This is discussed in detail later in this report, see page 24.

In its role of promoting generally accepted principles in the Swedish securities market:

- the Board monitors application of rules, including those concerning takeovers,
- it also monitors legislation and other regulation, as well as academic research into stock market issues in Sweden and internationally,
- in order to devise any rules or changes to existing rules that are deemed appropriate and ensure that these have the support and acceptance of the actors concerned.

The Work of the Board during the Year

During the first part of 2010, the Board consisted of the Chair, Hans Dalborg, the Deputy Chair, Lars Otterbeck, Lars-Erik Forsgårdh, Kerstin Hessius, Carola Lemne, Marianne Nilsson, Marianne Nivert, Michael Treschow, Lars Träff and Anders Ullberg, as well as Executive Director Per Lekvall. Kerstin Hessius and Marianne Nivert left the Board at the parent organisation's annual general meeting in May 2010 and were replaced by Eva Halvarsson and Caroline af Ugglas. Magnus Billing was also appointed as a co-opted member of the Board. Lars Thalén continued to act as a consultant and adviser on information issues and Björn Kristiansson acted as a consultant and adviser on corporate law.

The Board held four formal meetings during the year. Additionally, discussion and consultation between all or parts of the Board took place by e-mail and telephone when required.

The Board's work during the year is summarised below.

Follow up of the Code and Swedish corporate governance

Companies' application of the Code

In order to monitor that the Code is working as intended and to ascertain whether any modifications to the Code should be considered, the Board regularly conducts a variety of surveys of how the rules of the Code are applied in practice. The most important of these is its examination of Code companies' corporate governance reports, which it has carried out every year since the original version of the Code was introduced in 2005. Six surveys have now been carried out in this series, using a method that has been largely unchanged from year to year. This provides excellent opportunities for comparison during the whole period since the original Code came into force.

The 2010 survey was particularly interesting, as it covers companies' first reports since the revised Code came into force on 1 February 2010. In short, the results show that companies maintain a high level of ambition in their application of the Code. One pleasing finding was that the number of explanations of non-compliance with a satisfactory information content was considerably higher than in previous years. A new development was that the content of the corporate governance codes and companies' websites was examined against the background of legal and Code requirements. This revealed that companies still have some work to do if they are to fulfil all requirements concerning detailed information.

A detailed account of the 2010 survey can be found on page 15 of this annual report.

The Code Barometer, 2010

Another series of regular surveys conducted by the Board is the Code barometer. The aim of the Barometer is to measure how the Board is fulfilling its general goal of contributing to improved corporate governance in Sweden and thereby to greater public confidence in stock exchange listed companies.

The Barometer consists of two parts. The first survey is directed toward the Swedish public, while the second measures attitudes among leading actors in the capital market, and is geared toward chairs and CEOs of code companies, private and institutional owners of listed companies, CFOs, fund managers and chief analysts etc. The survey uses identical methods each time to facilitate comparison from year to year and show developments and trends.

The first survey was carried out in the same year as the code was introduced to provide a zero level for comparison. Further surveys were carried out in 2006, 2008 and most recently in autumn 2010. A summary of the results of the 2010 survey can be found later in this annual report, see page 25. A full report on both parts of the survey can be found on the Board's website.

Survey of the work and procedures of nomination committees

In 2010, the Board commissioned a survey to investigate how and how well Swedish nomination committees work. The Board has described how nomination committees are appointed and their composition within the framework of its annual survey of the Code, but there has been no detailed picture of the committees' internal workings and the pros and cons of the Swedish model as perceived by committee members. There has been increased interest, not least from abroad, in the Swedish method of nominating board directors, and the Board wished to contribute factual and empirical content to the debate.

The survey showed that Swedish nomination committees by and large work well and they have brought about significant improvements in the process of nominating board directors in listed companies. None of those interviewed in the survey felt that the Swedish model should be abandoned in favour of the internationally more widespread model which features a board-internal nomination committee.

At the same time, there is no shortage of question marks and room for improvement. These mainly concern how the model is applied in practice rather than its structure according the rules of the Code. One such issue is that the method used by many companies for appointing nomination committees tends to result in a small number of individuals sitting on a large number of committees. Some interviewees felt there was a danger that this could lead to the formation of a cadre of "nomination committee specialists", which they did not feel was to the benefit of the system. Further, there is the problem that shareholder representatives on nomination committees run the risk of becoming "insiders", which in turn can limit possibilities to trade in the company's shares. Many of the institutional investors on nomination committees do not see this as a problem however, even though it is obviously a problem they must be wary of. A greater number of nomination committee members who are formally independent of the shareholders might reduce this problem significantly, but this would require a broader recruitment of nomination committee members.

All in all, the Board feels that the results of the survey do not give reason to re-evaluate the Swedish nomination committee model or the Code rules which govern it, but they show there is room for improvement in how the model is applied in practice in some respects.

A full report on the survey can be found on the Board's website.

The revised Code

The 2010 revisions to the Swedish Corporate Governance Code came into force on 1 February 2010. Interim rules meant that certain rules did not need to be applied until 1 July 2010.

The reasons for the need to modify the Code so soon after the previous revisions had come into force were detailed in the Board's 2010 annual report. The main reason was Sweden's implementation of the EU recommendation of April 2009 concerning remuneration of directors of listed companies. Also, the code needed to be brought into line with new legislation regarding the implementation of changes to the EU's Fourth and Seventh Company Law Directives, the new Eights Company Law Directive and NASDAQ OMX Stockholm's removal of rules on director independence.

With regard to the EU recommendation on remuneration, the Board was in broad agreement with the principle views which formed the basis of the recommendation and found that these were already being applied to a large extent by well-run Swedish listed companies. The board was critical of the substance of the recommendations in many cases, which it felt were too far-reaching, too detailed and poorly adapted to Swedish circumstances. The Board therefore sought to fulfil the aims of the Commission's recommendation as far as it considered this possible and reasonable with respect to the interests of Swedish listed companies and the Swedish corporate sector while formulating the rules in a way it deemed compatible with Swedish legislation and Swedish conditions in general. This resulted in a new Code Chapter 9 on remuneration, (the equivalent of Chapter 10 in the previous version of the Code) and several important additions to Chapter 10 on information on company websites, (previously in Chapter 11).

Changes resulting from new EU Directives meant that certain rules concerning corporate governance reports and audit committees that had been included in legislation were removed from the Code without this resulting in significant changes for Code companies. Further, the Code's previous rules on criteria for assessing board members' independence were reintroduced with some minor adjustments. For companies listed on NASDAQ OMX Stockholm, the new criteria are applicable to individuals appointed to boards after 1 July 2010, meaning that they did not need to be applied to board elections held at annual general meetings in spring 2010. For companies listed on NGM Equity, the rules published in the Revised Code of 2008 apply, as NGM Equity listing regulations still contain rules concerning director independence and limitations to the number of members of the executive management on company boards.

Furthermore, requirements concerning information on company websites were expanded. A new rule requires boards to publish their evaluations of current variable remuneration schemes for the board and management and the application of the guidelines for remuneration prior to each annual general meeting. Another rule requires nomination committees to publish a statement on the company website ahead of the shareholders' meeting to explain its proposals in the light of what the Code says about board composition.

Although many Swedish listed companies are critical of the expanded regulation of remunerations in the revised Code, there has been broad understanding for the difficulties that the Board faced in trying to balance the EU's recommendations against companies' need for regulations that do not restrict their efficiency and competitiveness unnecessarily. Reactions that have been received so far indicate that application of the new rules has not led to any insurmountable problems. The Board's follow up of companies' application of the Code reveals, however, that many companies have not yet begun to apply the Code's information requirements on this matter.

Referrals etc.

A key role of the Board is as a referral body for legislation and the work of committees of inquiry in the field of corporate governance, both concerning the development of rules in Sweden and various forms of regulatory initiative form the EU.

The Board's recent work in this area has mostly been focused on initiatives form the EU. This is because the EU Commission has been intensifying its work to expand and harmonise regulation of corporate governance within the European Union in the wake of the economic crisis. This has led to a series of recommendations, green papers and directives on aspects of corporate governance in different sectors in the past two years.

In 2010, the Board has provided written comments on two green papers from the EU Commission. Additionally, the Board composed a memorandum on increased regulation of corporate governance in general, which the Commission was planning to present in spring 2011. These documents are summarised below.

Green paper on corporate governance in financial institutions and on remuneration policies

Although this green paper mostly applies to companies outside the Board's area of responsibility, the Board felt it appropriate to comment on certain general issues of principle concerning the proposals, as the issues raised were felt to have a broader bearing than just the financial sector and could therefore be expected to arise in a later green paper on listed companies in general.

The Board expressed the following views on the proposals contained in the green paper:

- The Commission has based its proposals to a great extent on sweeping and empirically unsound statements that poor corporate governance within the financial sector in general played a significant part in how the crisis developed and grew, if not necessarily its causes. It is the Board's opinion that far reaching and disruptive proposals of the sort presented in the green paper should be based on objective and methodologically reliable research and close analysis of the consequences that shows clearly that the benefits of the proposed regulations are greater than the costs involved for the companies concerned and for society in general.
- Self-regulation in the form of Codes based on the principle of comply or explain is a valuable comple-

ment to legislation and other mandatory regulation. It has made a significant contribution to improved corporate governance in a number of EU member states. To the extent that this method does not function optimally in all jurisdictions, efforts should be focused on addressing this rather than, as is sometimes heard from the Commission, questioning the basis of the system with calls for more mandatory regulation and tougher sanctions.
- When formulating common regulations for the European Union, the Commission should give greater consideration than previously to the different legal systems and corporate governance systems present within the Union. The board pointed out that the Commission's regulation in this area has so far largely been based on the Anglo-Saxon model of corporate governance, which differs in important ways from the models found in Sweden and a number of other member states. In Sweden, this has caused difficulties when implementing EU regulations in the national regulatory framework, which runs the risk of resulting in poorer rather than better corporate governance.

The board also underlined the importance of safeguarding shareholders' rights to appoint boards whose responsibility is to manage their property. If these rights are restricted too greatly, there is a danger that shareholders' responsibility for the company is diluted, meaning that this responsibility must increasingly be assumed by the state. The Board also expressed strong criticism of many of the proposals concerning further regulation of remuneration in listed companies which were presented in a separate section of the green paper.

Green paper on auditors and auditing
This green paper also concerns issues that are mainly outside the Board's areas of responsibility, but also in this case, the Board decided to comment on certain general questions of principle. The comments were to some extent of a similar nature to those above concerning the green paper on the financial sector:

- The question of safeguarding proprietary rights and the owners' responsibilities that are linked to them was also the main issue raised by the Board here, in this case in relation to the proposal that auditors be appointed by the state, for example through a supervisory authority, rather than by the company's shareholders. The Board expressed strong criticism of such an idea, not least because it would mean transferring much of the responsibility for companies from owners to the state.
- Also in response to this green paper, the Board reiterated its demand for a detailed cost-benefit analysis as the basis for any major new regulation. Proposals that the Board expressed doubts about included the mandatory and regular rotation of auditors, the prevention of auditors providing non-auditing services to their audit clients and the requirement for listed companies to have two auditors , with the aim of reducing the dominance of the "the big four" in the auditing of large international companies. Although there is some sympathy for the intentions behind these proposals, the Board felt that there was a danger that they would lead to greatly increased costs and therefore place European listed companies at a competitive disadvantage compared with companies with other ownership models and with competitors from other parts of the world with often considerably less burdensome regulatory frameworks.

The Board's memorandum on proposed EU regulation of corporate governance of listed companies
The aim of this document was to make the Swedish government and other interested parties aware of the proposed regulation, which in some areas was quite far-reaching, that appeared to be on its way from the EU and to initiate a discussion on the issues in preparation for a possible concerted Swedish response to the proposals.

The memorandum, which was published in January 2011, is presented below in its entirety.

SWEDISH
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COULD EXPANDED REGULATION OF CORPORATE GOVERNANCE PREVENT NEW CRISES?

31 January 2011

Summary

Within the EU, there is an on-going discussion about corporate governance of stock exchange listed companies, with some far-reaching consideration of broader and tighter regulation. The issues involved include the role of the board of directors and the auditor, companies' risk management procedures and the exercise of shareholder power, but there is also a more fundamental discussion concerning self-regulation and the system of corporate governance codes based on the principle of *comply or explain*.

The Swedish Corporate Governance Board is concerned by this development, not only with regard to the maintenance of a strong, dynamic cadre of Swedish listed companies based on private ownership in a market economy, but also the defence of the role of self-regulation in the securities market. In the opinion of the Board, any regulatory system which is too far-reaching and insufficiently adapted to Swedish conditions risks damaging the dynamism and competitiveness of listed companies to the detriment of growth and the creation of new jobs in the Swedish economy.

However, these discussions are still at an early stage, and there is probably still room for member states and individual organisations at national level to influence the direction of any new regulation. The aim of this paper is to focus the attention of the Swedish government and other key stakeholders on the ongoing process and to urge consideration of a concerted Swedish response to counter any form of regulation that is not in the interest of the Swedish business community and society as a whole. The potential for a common Nordic approach to the subject might also be considered.

The Board is happy to participate in any continued discussion of these issues.

The ongoing discussion within the European Union

In the wake of the economic crisis, the EU Commission's DG Internal Market and Services has worked extensively to expand the regulation of corporate governance within the Union. This has resulted in recommendations on remuneration within the financial sector and of directors of listed companies; changes to a number of EU Directives to further regulate remuneration in the financial sector; a green paper on corporate governance within the financial sector; and a green paper on company audits. Another green paper on corporate governance of stock exchange listed companies is currently being prepared and is expected to be published in April 2011.

The material that has been made available so far and the discussions that have taken place at hearings and seminars on the subject of the upcoming green paper indicate that the Commission is considering a substantially expanded, and to a larger extent mandatory, regulation than previously. The issues under discussion can be divided into four main themes.

The exercise of shareholder power and the interplay between the board and the shareholders' meeting

The engagement of institutional owners in companies and the way they discharge their shareholder role is currently the subject of lively debate in the EU. A whole host of ideas and suggestions for increasing shareholder influence and facilitating the exercise of their ownership role in an active, informed manner have been presented. Many of these would hardly present any problems for Sweden, as shareholders in Swedish listed companies already have extensive rights and engage relatively actively in their ownership role. The type of regulation being discussed would to a great extent, however, be perceived from the Swedish perspective as unwarranted and unnecessarily prescriptive

The role of the board, its composition etc.

As well as issues concerning the tasks and responsibilities of the board, the Commission is considering limiting the size of boards and the number of directorships board members may have; requiring a certain degree of diversity and competence in the composition of the board, including greater gender balance; the use of external expertise to assess the work of boards; and the evaluation of chief executive officers. In addition, further regulation of the remuneration of board members is being considered, though much of this has already been implemented in Sweden, either through legislation or the Swedish Corporate Governance Code. There is also the question of whether a particular code of conduct for board members is required to assist them in the discharge of their responsibilities.

Risk management and the role of the auditor

In this context, measures to improve companies' procedures concerning risk management are also being discussed, e.g. the mandatory creation of a risk committee within the board and a requirement for companies to have a chief risk officer at executive level, possibly reporting directly to the board. Furthermore, there is discussion of the role of the auditor in the management of the company's risks, including the consideration of a requirement on the auditors to report to supervisory authorities in certain situations.

The role of self-regulation

Since the new Commission began its work at the start of 2010, the system of codes based on the principle of *comply or explain*, which to a great extent has provided the foundation for the development of corporate governance within the EU in recent decades, has been called into question. Instead, proposals involving more mandatory regulation with stricter supervision and tougher sanctions have been presented.

The Board is concerned about this development, particularly as the EU's regulation in this area is largely based on the Anglo-Saxon model of corporate governance, which differs in important ways from the Swedish/Nordic model. This means that the new rules are often poorly suited to Swedish circumstances. They also risk limiting the scope for the type of self-regulation within corporate governance that has so far been applied with considerable success in Sweden and other Nordic countries.

Against this background, the Board believes it is vital that Sweden considers the following issues in the continuing discussion of expanded EU regulation of corporate governance.

Expanded regulation is no guarantee against future crises

Corporate governance is basically about creating systems and procedures to ensure that companies are run in the interests of their owners, that the systems are well structured and that the governance is as transparent to the market and society as is feasible. The primary aims are to provide better opportunities for shareholders to exercise influence and to ensure that good governance contributes to the successful running of the company.

Poor corporate governance in the financial sector is frequently said to have played a significant role in the causes and development of the financial crisis, though this has not so far been substantiated empirically to any great extent.[1] What we see now, not least in the ongoing debate within the EU, is that this notion is being applied without much opposition to listed companies in general, and there is even less evidence to support this. There is certainly no shortage of individual cases in which poor corporate governance can be identified as one of the causes of the problems, but in the majority of cases, the

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[1] For an example, see Mülbert. P.O: *Corporate Governance of Banks after the Financial Crisis – Theory, Evidence, Reforms*, ECGI Law Working Paper No. 130/2009, April 2010.

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difficulties encountered by companies had other causes: the withdrawal of credit, the collapse of markets and a global recession – often in combination with a lack of business acumen and bad management. But there is little systematic evidence that it was companies with poor corporate governance – or companies acting under weak corporate governance regimes – that were hit hardest by the crisis, which should be the point of departure if it is the regulatory framework that is to be changed.

Many people also have exaggerated expectations of what can be done to prevent the failure of individual companies and avert economic crises through greater regulation of corporate governance. It is unrealistic to believe that good corporate governance can act as a guarantee against commercial failure. Key success factors for good business such as business acumen, sound judgement, strong leadership and personal integrity cannot be brought about by regulation. Instead, unnecessarily detailed attempts to prevent such problems through binding regulation run the risk of creating an illusion of strong action and may even counteract its aims by resulting in unclear responsibilities or overly complex decision making processes.

There is also good reason to draw attention to the danger that further comprehensive additions to EU conform regulation of members states' differing corporate governance legislation will lead to an impenetrable flora of mutually incompatible laws and rules to be applied in different jurisdictions by people who often have limited business experience and no personal responsibility for the financial consequences.

Shareholders' rights and responsibilities must not be eroded

The market economy system is founded on free enterprise, where individual entrepreneurs are given the opportunity to set up and run companies in order to achieve their aims in the manner they consider the most appropriate within the framework provided by society. The rights of the owners and their associated responsibilities play a key role in this system. If company owners' rights to control their property are limited too strictly, there is a danger that the creativity, initiative and ambition that are the foundations of the market economy's unique capacity to create wealth will be inhibited. In the longer term, such a development might also reduce the incentive for private owners to work proactively and take responsibility for their companies and thus force society to assume this responsibility.

The latest crisis has certainly shone the spotlight on the problem of "too big to fail" more brightly than ever before, particularly with regard to banks and other financial institutions, but in some case other types of company as well. This in turn has been seen as a reason to question whether the owners of such companies always have the will and the ability to assume their full proprietary responsibility in accordance with the rules of the market economy and if that might in some cases justify the state stepping in to assume some of this responsibility. This is a problem that concerns very few companies however, primarily within the financial sector, and a general set of regulations to rectify the problems of a small group of companies risks causing great damage to the vast majority of stock exchange listed companies.

In this perspective, there is good reason to pay close attention to certain aspects of the regulations now being discussed within the EU. These include rules for the composition of boards, their size and how their work is organised, as well as how various functions within companies are organised and run and how the role of shareholders is to be discharged. In the green paper on auditing mentioned above, there is also a proposal to transfer the responsibility for appointing auditors of listed companies from the shareholders to an external party, e.g. a supervisory authority.

The Board believes that many of these proposals, and especially if all are taken together, may lead to an erosion of proprietary rights and thus by extension an erosion of the owners' responsibility for listed companies, with potentially damaging consequences for the workings of the market economy.

In defence of Swedish self-regulation

In some EU circles, there is a belief that self-regulation is too toothless an instrument for the effective regulation of corporate governance. In particular, the system of codes based on the principle of *comply* *or explain* has recently been called into question, with increasing calls for more mandatory regulation and tougher sanctions.

Legislation and other binding regulation, however, can only define minimum levels for what is acceptable corporate governance, a threshold that all companies must clear at all times. Codes based on *comply or explain*, on the other hand, can set the bar higher and define not only what is acceptable, but also what is good – and even very good – corporate governance. Hence they can impose a level that not all companies will be able to attain at all times, or even have reason to attain, but one which provides a goal at which to aim.

It is therefore the opinion of the Board that a combination of legislation and self-regulation, in the form of a code based on the principles of *comply or explain*, is the most effective system for regulating corporate governance. Laws and other mandatory regulations set minimum requirements, while the code provides motivation for companies to develop and improve their corporate governance beyond these levels. In this respect, the development within Swedish corporate governance in recent years provides a case in point.

Against this background, it is vital that Swedish self-regulation within the field of corporate governance can be retained and developed further. Every attempt to turn back the clock should be strongly resisted.

Maintaining the competitiveness of listed companies

Swedish and European companies are competing in increasingly global markets, not least with companies from the emerging economies of the “new world”. This competition is growing ever tougher, and there are signs that Europe is beginning to fall behind. At the same time, companies from these new markets are often considerably less encumbered by different kinds of regulation than their western competitors.

Listed companies also find themselves in competition for key resources such as capital, technology and management competence with other models of company ownership, not least private equity companies. Such companies normally face less burdensome regulatory requirements in areas such as accounting, financial reporting and corporate governance than listed companies. There is a danger that this will reduce the competitiveness of listed companies when trying to attract the strategic resources necessary for their operations, which might in turn reduce the incentives for growth companies to list their shares on the stock exchange.

In the long run, such a development threatens access to strong and dynamic listed companies for risk capital in search of investment opportunities. This may in turn inhibit economic growth and hold back the creation of new jobs. Recent studies[2] suggest that the relatively weak market for IPOs on the American stock market in the last decade may have resulted in over 20 million fewer new jobs being created in the American economy.

Against this background, it appears counterproductive from a societal point of view to place regulatory burdens on Swedish and European listed companies without thorough justification, as these may lead to reduced competitiveness, both in global product markets and in relation to companies whose ownership form makes them unavailable for investment from the broader public. The opinion of the Board, therefore, is that the benefit to society of each new regulation must be carefully weighed against the costs that may be incurred as a result of reduced competitiveness for listed companies. The benefit-to-cost ratio requirement of any proposed new regulation should be set at a high level, with the burden of proof lying with those who advocate the regulation.

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[2] See Weild, D. and Kim, E., Grant Thornton LLP: *A wake-up call for America*, November 2009, and *Market structure is causing the IPO crisis – and more*, June 2010 respectively.

International work

As in previous years, the Board was an active participant in international debate on corporate governance issues in 2010, with the aim of promoting Swedish interests and increasing knowledge and understanding of Swedish corporate governance internationally. The board took part in several consultation meetings with representatives of the European Commission, both formal meetings organised by the Commission and informal meetings within the network of national corporate governance committees of EU member states. Through its close contact the European Corporate Governance Institute, (ECGI), a the highly respected research organisation, the Board also has access to the latest research findings, as well as seminars and conferences on corporate governance issues.

The Board also provided the material for Sweden's submission to the peer review group set up by the OECD to examine the role of boards in decisions regarding incentive systems and risk management in countries with different corporate governance systems. Sweden was one of five countries, (along with Brazil, Japan, Portugal and the United Kingdom), selected for analysis to examine how well corporate governance systems conform to OECD corporate governance guidelines. The group's final report was presented at an OECD conference in October 2010. The report and the ensuing discussion gave a very positive picture of Swedish corporate governance. There was particular interest in the Swedish nomination committee model, which was regarded as a viable instrument for increasing institutional investors' engagement in the running of investee companies.

Key issues for 2011

Issues previously handled by the Swedish Industry and Commerce Stock Exchange Committee

As outlined above, the Board assumed the responsibilities of the Swedish Industry and Commerce Stock Exchange Committee in May 2010. These responsibilities comprise the promotion of generally accepted principles in the Swedish securities market by issuing rules regarding good practice, including rules concerning takeovers. This means that the board must expand its intelligence capabilities to cover the whole range of securities market issues, not just matters of relevance to corporate governance.

First and foremost, developments in the field of takeovers need to be monitored closely, not least within the EU. Swedish takeover rules are largely based on the EU's directive on takeovers, which is due for review in 2012. The European Commission has therefore instigated a study of how the directive is applied in the member states. Developments in the United Kingdom also need to be monitored, as the UK Panel on Takeovers and Mergers is in many ways at the forefront of the development of takeover regulation in Europe.

The Swedish Industry and Commerce Stock Exchange Committee's takeover rules were revised and updated in 2009, and such a detailed review is not expected to be required in 2011. There is good reason, however, to form a working group in 2011 to analyse and propose some minor changes to the existing takeover rules. Such a review would need to pay close attention to developments in the United Kingdom, for example, on the issue of break up fees in transaction agreements, which are expected to be regulated more tightly than is the case today. Further, the bids that have been in place in the Swedish market in the past two years may lead to some changes in the regulatory framework, as could the Swedish Securities Council's approach to takeover issues during this period.

The Swedish Industry and Commerce Stock Exchange Committee previously also issued recommendations on other issues. Examples of issues previously subject to self-regulation included red flag rules, buy back of own shares and prospectuses. However, these recommendations have been superseded by legislation or stock exchange regulations. Even though the scope for new rules is becoming more and more limited as a result of harmonisation at EU level, issues may arise that need to be dealt with through Swedish self-regulation, and thus require input from the Board. On the other hand, the amount of work involved should not be exaggerated, as the majority of issues that come up today involve corporate governance, and in these cases, amendments to the Code would be more relevant. For issues of a more temporary nature or matters specific to a certain case, could the Swedish Securities Council can issue statements to remove uncertainty.

The European Commission's green paper on corporate governance in listed companies

As outlined above, the Board produced a position paper in order to attempt in advance to influence the proposed regulations concerning corporate governance that Internal Market and Services Commissioner Michel Barnier had announced would be contained in a green paper on corporate governance in stock exchange listed companies. The European Commission presented its green paper on a framework for corporate governance[1] in the EU on 5 April 2011, and interested parties were invited to submit comments no later than 22 July 2011. The proposals contained in the green paper were not as far-reaching as the preceding debate had given cause to

[1] Green Paper (COM(2011) 164 final) on the EU corporate governance framework, available at http://ec.europa.eu/internal_market/company/docs/modern/com2011-164_en.pdf.

believe, and on certain issues it seemed that the commission had taken account of arguments raised in the debate.

The proposals can be divided into three main areas. After an introductory question on whether the Commission should also regulate the governance of unlisted companies and should differentiate between large and small listed companies, there is a battery of questions concerning company boards – the tasks of boards, their composition, evaluation, remuneration, risk management etc. There then follows a number of suggestions, mainly concerning the internal governance of institutional investors, and finally, there is a section on the system of codes based on the comply or explain principle, the content of corporate governance reports and who should monitor the application of corporate governance codes.

The Swedish Ministry of Justice immediately requested comments on the green paper from interested parties, including the Corporate Governance Board, in order for the Ministry to be able to formulate an official response from the Swedish Government. The Board submitted a statement on the green paper to the Ministry on 20 April 2011.

In short, the Board's position was that the Commission had failed to show the need for further regulation of corporate governance of stock exchange listed companies, and that the degree of detail in the proposed rules was far too great, particularly with regard to company boards, where existing Swedish rules in principle already regulate the issues covered in the green paper. The Board supported a more principle-based regulatory framework in preference to the detailed proposals presented by the Commission, which were poorly suited to the circumstances of Sweden and many other European countries. The opinion of the Board is that the green paper provides no evidence for the need for further regulation, not least in view of the costs that the new rules would entail for companies. Furthermore, further regulation would impact companies' competitiveness compared with listed companies outside the Union, as well as in comparison with companies with other ownership structures, such as private equity.

The Board was therefore opposed to the majority of the proposals contained in the green paper. The full statement can be found on the Board's website.

The Board's next task is to write its own official response to the green paper to the Commission. As well as a more detailed explanation of the positions presented in its response to the Swedish Government, the Board should also raise the issue of institutional investors' corporate governance, not least the question of how technical obstacles to the use of their proprietary powers can be removed. The Board will then need to monitor other official responses to the green paper, as well as the Commission's continued actions regarding these matters. The possibility of new regulation cannot be ruled out, and this will then need to be implemented into the Swedish Corporate Governance Code, providing that the Commission does not demand legislation.

II. APPLICATION OF THE CODE IN 2010

The Board conducts regular surveys and analysis in order to monitor how the Code is applied and to evaluate its functionality and effects on Swedish corporate governance. As in previous years, the Board commissioned a study of each Code company's application of the Code based on annual reports, corporate governance reports and other relevant material. For the first time, the content of corporate governance reports has also been analysed in relation to the requirements of the Code and legislation. Another new aspect this year is an analysis of the corporate governance information on companies' websites. The survey was carried out on behalf of the Board by Nordic Investor Services. The results are summarised below. Also in this section, the Board presents the results of its Code Barometer, a regular survey of attitudes to the Code and Swedish corporate governance. Prior to the article on the Code Barometer, there is also a presentation of the Swedish Securities Council's approach to Code issues.

Companies' application of the Code

Executive summary

This year's follow-up survey of how companies have applied the Code is the first since the Code was revised in 2010. As in previous years, companies have shown a high level of ambition when it comes to applying the Code. A major change for the better is the improved information value of explanations of non-compliance, where the percentage of informative explanations has increased significantly.

Apart from this, no great changes have taken place since the previous survey, other than in areas where the regulatory framework has been changed. For example, the number of corporate governance reports that have been subjected to auditor review has increased from almost none to almost all, which is obviously a result of the legislative requirement for auditor review which came into force during the year.

This year's survey is the first to also include the content of corporate governance reports and company websites, and analysis of these showed there is room for improvement.

Aims and methods

The aim of analysing how companies apply the Code is to provide information in order to assess how well the Code works in practice, and to see whether there are aspects of the Code that companies find irrelevant, difficult to apply or in some other way unsatisfactory. The results provide a basis for the continued improvement of the Code.

This year, for the first time, the survey examined not only companies' application of Code rules, but also their application of the relevant legislation. Rules on reports concerning corporate governance and internal controls, as well as auditor review of these reports, were included in the Companies Act and the Annual Accounts Act from financial year 2010. This led to the removal or modification of a number of Code rules. The aim of this part of the survey is to build up a picture of how companies report their corporate governance.

The basis for the study is companies' own descriptions of how they have applied the Code in their corporate governance reports, in other parts of their annual reports and on their websites. For the first time, this year's survey examined whether the corporate governance information on companies' websites fulfils the

Code's requirements and whether corporate governance reports contain all the necessary formal details. No attempt is made to ensure that the information provided by the companies is truthful and accurate.

The target group for the study was the 252 companies whose shares were available for trade on a regulated market and were obliged to issue a corporate governance report as of 31 December 2010. Of these, 232 were listed on NASDAQ OMX Stockholm and 20 on NGM Equity.[1)] Of these, ten OMX companies and three NGM companies were omitted, because their fiscal year does not follow the calendar year, because they had not published their annual report for 2010 by the survey deadline of 30 April 2011 or because they were no longer listed on the stock exchange. This meant that the number of companies actually included in the survey was 239, of which 222 were listed on NASDAQ OMX Stockholm and 17 on NGM Equity. See Table 1 below.

Companies' reports on corporate governance

The Annual Accounts Act states that all stock exchange listed companies are to produce a corporate governance report. This year's reports are the first to be submitted in accordance with the statutes of the Annual Accounts Act. Both the Act and the Code state that companies are to provide information on their governance. According to the Code, any company that has chosen to deviate from certain rules in the Code, each deviation is to be reported, along with a presentation of the solution the company has chosen instead and an explanation of the reasons for non-compliance.

All of the companies surveyed submitted a formal corporate governance report. This is not surprising, since corporate governance reports are mandatory by law. As shown in Table 2 below, seven companies chose to publish their corporate governance report on their websites only, which was fewer than in the previous year. This does not contravene the Annual Accounts Act or the rules of the Code.[2)] Of the companies which include their corporate governance report in the printed annual report, fewer than half included it in the directors' report, while the remaining companies published their corporate governance report as a separate part of the annual report. See Table 3 below. The dramatic differ-

Table 1. Number of surveyed companies

	2010		2009		2008		2007		2006	
	Number	Percentage	Number	Percentage	Number	Percentage	Number	Percentage	Number	Percentage
NASDAQ OMX Stockholm	232	92%	236	90%	246	88%	106	92%	91	90%
NGM Equity	20	8%	25	10%	32	12%	0	0%	0	0%
Total target group	252	100%	261	100%	278	100%	115	100%	101	100%
Excluded [*)]	13	5%	8	3%	32	12%	9	8%	10	10%
Total companies surveyed	239	95%	253	97%	246	88%	106	92%	91	90%

*) Companies excluded due to fiscal year, annual report / corporate governance report not available or company no longer listed.

1) The Swedish Corporate Governance Code only requires Swedish companies whose shares are traded on a regulated market in Sweden to apply the Code. According to stock exchange regulations, companies whose shares are traded on a regulated market in Sweden are obliged to apply the Code through their general obligation to follow General Practice on the Securities Market. According to previous rules, non-Swedish companies listed on these exchanges had no such obligation. An instruction concerning this was introduced in 2010, see the board's website. This instruction means that from 1 January 2011, non-Swedish companies whose shares are traded on a regulated market in Sweden are required to apply the Swedish Corporate Governance Code, the corporate governance code of the company's domicile country or the code of the country in which the company has its primary stock exchange listing. If the company does not apply the Swedish Code, it is obliged to issue an explanation of any major non-compliance with the Swedish Code in or together with its first corporate governance report after 31 December 2011.

2) The Annual Accounts Act states that companies whose shares are traded on a regulated market are to produce a corporate governance report, either as part of the directors' report or in a document that is not part of the annual report. In the case of the latter, a company may choose to release its report either by submitting it to the Swedish Companies Registration Office together with the annual report or by only publishing it on its website. (The report must in fact always be made available on the company's website.) If the corporate governance report is not contained in the directors' report, the company may choose whether to include it in the printed annual report – this is not regulated by law or by the code.

ence compared with previous years is because auditor review of corporate governance reports is now required by law, no matter how they are published. In 2009, auditor review was only mandatory if a corporate governance report was included in the directors' report, which meant that most companies chose not to include it there. For more information on auditor reviews, see below.

According the Annual Accounts Act, a corporate governance report is also to contain a description of the key elements of the company's internal controls and risk management concerning financial reporting. An internal controls report was submitted by 235 of the 239 surveyed companies, which is 98 per cent. See Table 4 below. This percentage is in line with previous years. The internal controls reports vary in their scope, from short summaries within the corporate governance report to more extensive separate reports. Of the four companies that did not produce an internal controls report, three are listed on NASDAQ OMX Stockholm and one on NGM Equity.

Table 2. Has the company issued a corporate governance report?

	Number					Percentage				
	2010	2009	2008	2007	2006	2010	2009	2008	2007	2006
Yes	239	252	232	104	91	95%	100%	94%	98%	100%
No	13	1	14	2	0	5%	0%	6%	2%	0%
Of Yes answers – only on the company website	7	12	0	0	0	3%	5%	0%	0%	0%
Total companies surveyed	252	253	246	106	91	100%	100%	100%	100%	100%

Table 3. How is the corporate governance report presented?

	Number		Percentage	
	2010	2009	2010	2009
In the directors' report in the annual report	107	5	42%	2%
A separate report within the annual report	125	235	50%	93%
Only on the website	7	12	3%	5%
No corporate governance report published	13	1	5%	0%
Total	252	253	100%	100%

Table 4. Is there a separate section on internal controls and risk management?

	Number					Percentage				
	2010	2009	2008	2007	2006	2010	2009	2008	2007	2006
Yes	235	244	215	101	90	98%	97%	87%	95%	99%
No	4	8	31	5	1	2%	3%	13%	5%	1%
Total	239	252	246	106	91	100%	100%	100%	100%	100%

Auditor review of corporate governance reports is now mandatory according to the Companies Act and the Annual Accounts Act, which explains the increase shown in Table 5 below. Three companies have not had their corporate governance reports reviewed by their auditors (or not reported that this has taken place). Over 40 per cent of the corporate governance reports were reviewed in detail by the company auditors, while the rest were subjected to a general review. See Table 6 below. There may be reason to monitor whether this ratio continues in the next few years or whether there is a shift in either direction.

How companies applied the rules of the Code

Reported non-compliance

Companies that apply the Code are not obliged to comply with every rule contained in it, but are free to choose alternative solutions provided each case of non-compliance is clearly described and justified. It is not the aim of the Board that as many companies as possible comply with every rule in the Code. On the contrary, the Board regards it as a key principle that the Code be applied with the flexibility afforded by the principle of comply or explain. Otherwise, the Code runs the risk of becoming mandatory regulation, thereby losing its role as a set of norms for good corporate governance at a higher level of ambition than the minimums stipulated by legislation. It is the Board's belief that better corporate governance can in certain cases be achieved through other solutions than those specified by the Code.

Diagram 1 shows the proportion of surveyed companies that reported instances of non-compliance in the six years that the Code has been in place. The proportion of companies that reported more than one instance of non-compliance fell from 15 per cent to 11 per cent in 2010, meaning that the remaining 89 per cent of companies reported no more than one deviation from the Code rules. Instead, the proportion of companies reporting a single deviation from the Code rose from 35 to 39 per cent. This means that half of the surveyed companies reported no deviations in 2010, the same figure as in 2009.

A major change in companies' reporting of non-compliance occurred in 2008, but the rate of decrease of non-compliance has slowed significantly since then. The figure for 2010 corresponds in principle to the results in 2009, albeit with a small degree of movement from companies reporting more than one deviation to those reporting a maximum of one.

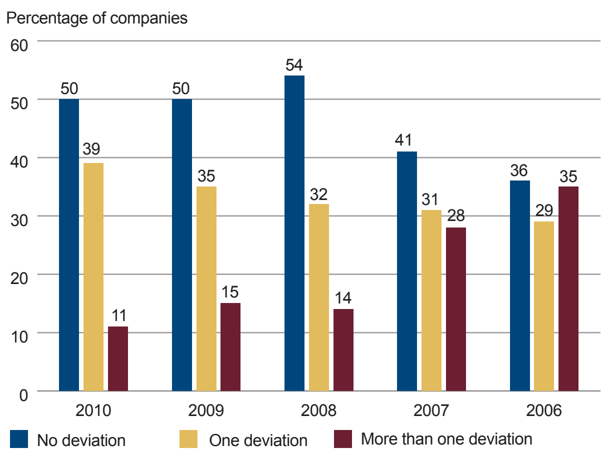
Table 5. Was the corporate governance report reviewed by the company auditor?

	Number		Percentage	
	2010	2009	2010	2009
Yes	235	6	93%	2%
No	3	226	1%	90%
No information/unclear	14	20	6%	8%
Total companies	252	252	100%	100%

Table 6. How was the corporate governance report reviewed?

	2010	Andel
Detailed review	97	41%
General review	134	57%
Unclear	4	2%
Total	235	100%

Diagram 1. Companies per number of instances of non-compliance



2010: 239 companies 2009: 253 companies 2008: 246 companies 2005–2007: Average of 90 companies

A total of 160 deviations from Code rules were reported in 2010, which gives an average of 1.3 instances of non-compliance per company reporting at least one deviation, which is lower than the average of 1.4 reported in 2009.

Which rules do companies not comply with?
Table 7 shows the number of deviations per rule from which deviation was reported since 2008. The numbers correspond to the rule numbers in the current Code, with rule numbers from previous versions of the Code also shown for reference purposes. The five rules with which the most companies report non-compliance, see Diagram 2, are commented on in brief below.

As in previous years, the rule with the most instances of non-compliance was Code rule 2.4, concerning company chairs and members of the board on nomination committees. The most common form of non-compliance with this rule was that the chair of the board, or in some cases another member of the board, was the chair of the nomination committee. The most common explanation for this was that the person concerned was deemed to be the most competent and/or that a major shareholder was considered best suited to lead the work of the committee. In some cases, more than one of several members of the board who were on the committee were not independent of major shareholders, and in a small number of companies, members of the board formed a majority on

Diagram 2. Instances of non-compliance per Code rule

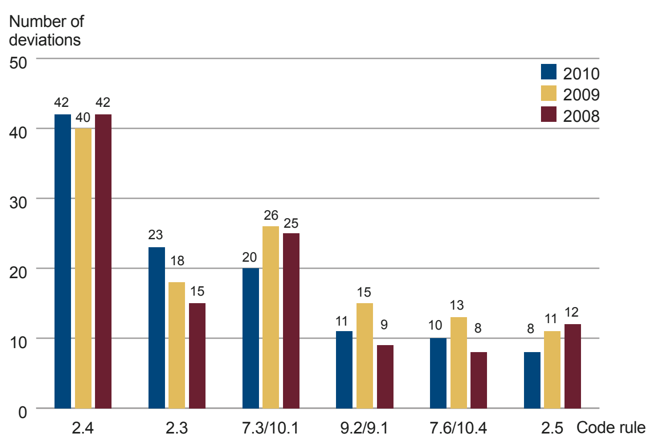


Table 7. Number of deviations from individual Code rules

Rule	2010	Rule	2009	Rule	2008
2.4	42	**2.4**	40	**2.4**	42
2.3	23	**10.1**	26	**10.1**	25
7.3/10.1	20	**2.3**	18	**2.3**	15
9.2/9.1	11	**9.1**	15	**2.5**	12
7.6/10.4	10	**10.4**	13	**2.1**	10
2.5	8	**2.5**	11	**9.1**	9
9.1	7	**2.1**	9	**10.4**	8
2,1	7	**4.2**	9	**4.2**	7
4.2	6	**1.1**	7	**1.5**	4
1.1	4	**10.3**	4	**1.3**	4
9.8 (new)	3	**2.6**	3	**10.3**	3
7.5/10.3	3	**3.1**	3	**10.6**	3
1.5	2	**8.2**	3	**2.2**	3
2.6	2	**1.3**	2	**3.1**	3
1.7	1	**1.5**	2	**4.4**	3
10.3/11.3	1	**10.6**	2	**8.1**	3
9.9 (new)	1	**2.2**	2	**1.1**	2
9.7 (new)	1	**4.1**	2	**11.3**	2
9.6 (new)	1	**6.1**	2	**4.3**	2
7.1	1	**8.1**	2	**6.1**	2
3.1	1	**7.2**	2	**8.2**	2
2.2	1	**1.7**	1	**7.2**	1
6.1	1	**10.2**	1	**4.1**	1
4.4	1	**11.3**	1	**2.7**	1
9.5 (new)	1	**4.3**	1	**11.2**	1
4.3	1	**4.4**	1	**10.5**	1
				10.2	1
				1.4	1
Total	160	**Total**	182	**Total**	171

the nomination committee. Non-compliance with this rule is most common in companies with strong concentration of ownership, often with the general explanation that it is otherwise difficult or impossible for a private individual to combine the roles of major shareholder and active owner through participation on the board and on the nomination committee.

Rule 2.3 showed the third highest incidence of non-compliance in 2009, but the number of companies reporting deviations from this rule rose from 18 to 23 in 2010, making it the rule with the second highest number of deviations. The rule concerns the size and composition of nomination committees, primarily committee members' independence. In almost every case, the non-compliance involves the CEO and/ or other members of the company's executive management being members of the nomination committee. The explanation given for this is that they are also major shareholders in the company. In a small number of cases, the nomination committee consisted entirely of representatives of the largest shareholders, so that none of the members fulfilled the Code requirement of independence in relation to the largest shareholder in terms of voting rights.

Rule7.3, (previously rule 10.1), concerning audit committees, accounted for the third largest number of deviations, down from second place in 2009. Of the companies surveyed, 19 chose to set up an audit committee with just two members rather than the Code's recommendation of three, usually because the board is small and/or because it is considered that this is the most efficient way to carry out the tasks of the audit committee. In one company, the whole board carries out the role of the audit committee, (which does not require an explanation per se according to the Code), without paying heed to the Code rule which states that the chief executive officer or any other member of the board who is a member of the executive management is not to participate in the work with these issues.

Eleven companies reported non-compliance with rule 9.2, (previously rule 9.1), regarding the establishment and composition of remuneration committees. In most cases, this involved the chief executive officer or another person that could not be considered independent in relation to the company and its executive management being on the committee. Also here, the most common explanation is that these individuals' competence or holding in the company justified their membership of the committee. Furthermore, seven companies reported non-compliance with the current rule 9.1, concerning the tasks of the remuneration committee, which was also previously part of the previous rule 9.1. Most of these deviations are from companies that did not have remuneration committees, which does not require an explanation, as rule 9.2 states that the entire board may perform the duties of the remuneration committee if the board feels that this is appropriate, providing that board directors who are also members of the executive management do not participate in the work.

The Code rule with the fifth greatest number of deviations, rule 7.6, (previously rule 10.4), concerns auditor review of the company's six- or nine-month report. Just ten companies reported non-compliance with this rule, compared with thirteen in 2009, usually with the explanation that the cost of such a review was not deemed justifiable given the size and complexity of the company and/or the quality of the company's internal controls. One of these companies reported that it intends to adhere to this rule next year.

Explanations of non-compliance

The standard of explanations of non-compliance is crucial to the success of a corporate governance code based on the principle of comply or explain. The quality of such explanations is for the reports' target groups to assess, primarily the companies' owners and other capital market actors. However, in order to be useful as a basis for such evaluation, the explanations must be sufficiently substantive, informative and founded in the specific circumstances of the company concerned. Vague arguments and general statements without any real connection to the company's situation have little information value for the market.

Last year's survey report showed substantial flaws in the quality of this information, both with regard to actually providing explanations for reported non-compliance and the information value of the explanations given. This also seems to be a problem for this kind of Code internationally. A major study of the implementation of corporate governance codes among EU Member States conducted in 2009 [3] concluded that the lack of explanations of reported non-compliance or their vagueness is one of the main remaining weaknesses of this form of corporate governance regulation, and that improvements in this respect are a high priority in its continued development. The European Commission is continuing to focus on this area and has proposed new rules in a green paper on corporate governance within the EU – see the Board's comments on this green paper elsewhere in this annual report. The green paper highlights the solution introduced into the Swedish Code in 2008, that each instance of non-compliance should not only be explained, but a description of the alternative solution should also be provided.

Swedish companies' reporting of non-compliance has improved since 2009. In total, 13 companies either failed to explain their reasons for deviating from a rule or provide a description of their alternative solution, compared with 19 companies in 2009, which is a fall from 13 to 11 per cent of companies that had reported deviations. Eleven companies failed to explain their reasons for not complying with a rule, (of which one company failed to explain two deviations), and five companies, (three of which had not explained the reasons for their deviations), did not describe their alternative solutions. This means that a significant number of companies do not apply the Code correctly and therefore do not fulfil the stock exchange requirement to observe Good Practice on the Securities Market.

As in previous years, an attempt has been made to assess the quality of explanations offered. This necessarily involves a large element of subjectivity, but as the evaluation has followed the same format and criteria each year, it is reasonable to assume that any observed trends are reasonably reliable.

The previous two years' analysis of explanations had found insufficient information value in over a quarter of explanations – 27 per cent in 2008 and 29 per cent in 2009. The Board is pleased to report that this figure has fallen significantly, and that just 24 deviations, 15 per cent of those reported, were unexplained or had insufficient information value in 2010. See Table 8.

The content of corporate governance reports

For the first time, the content of companies' corporate governance reports has been studied against the background of the requirements stipulated in the Annual Accounts Act and the Code. The Act requires, for example, that companies report which corporate governance code they apply. Every company stated that it applied the Swedish Corporate Governance Code. A general review of the reports also showed that companies seemed to fulfil all the requirements set out in the Act.

Table 8. The information value of explanations of non-compliance

	Number of explanations			Percentage		
	2010	2009	2008	2010	2009	2008
Good	43	50	49	27%	27%	29%
Acceptable	93	79	75	58%	43%	44%
None/Insufficient	24	53	47	15%	29%	27%
	160	182	171	100%	100%	100%

[3] Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States, conducted for the European Commission by a consortium led by RiskMetrics Group, pages 83–85 and 167 ff. See http://ec.europa.eu/internal_market/company/ecgforum/studies_en.htm.

Compliance with the detailed requirements of the Code concerning information was not quite as good, see Table 9. The 239 surveyed companies were required to provide information on 21 different details. On average, the companies provided 90 per cent of the required information, while 10 per cent was missing or too vague.

Corporate governance information on company websites

Also for the first time, a survey of corporate governance information on company websites was carried out. Whereas corporate governance reports describe the past financial and corporate governance year, (the corporate governance year is not a legal term, but applies to the time between two annual general meetings), the information on company websites is to be up to date, i.e. it is to be updated within seven days of any change.

The code requires companies to devote a separate section of their websites to corporate governance information. This requirement was fulfilled by 98 per cent of the companies surveyed. Four companies had no such section on their websites at the time of the survey.

The Code contains a list of information required on the corporate governance sections of websites. As well as the company's three most recent corporate governance reports and the auditor's written statement on the corporate governance report, the company's current articles of association are also to be posted. Four companies did not fulfil this requirement. Of the remaining 246 companies, 95 per cent posted their articles of association in the corporate governance section of the website, while the remainder made this information available elsewhere on their websites. Additionally, the Code requires companies to post information regarding the current board, the CEO and the auditor. This requirement was not fulfilled by all companies. See Table 10 for more detailed information.

The Code also requires the nomination to issue a statement when notice of a shareholders' meeting is

Table 9. The detailed content of corporate governance reports

	Yes	No	Partly
Does the report contain information on the nomination committee?			
Composition	231	8	0
Representation	210	27	2
Does the report contain information on board members?			
Age	230	8	1
Educational background	208	19	12
Professional experience	167	54	18
Work performed for the company	231	5	3
Other professional commitments	221	8	10
Shares in the company	228	9	2
Independence	220	18	1
Year of election	229	10	0

	Yes	No	Partly
Does the report contain information on the board			
Allocation of work	221	6	12
Number of meetings	238	1	0
Attendance	228	10	1
Does the report contain information on board committees?			
Tasks and decision-making authority	217	9	13
Number of meetings	181	28	30
Attendance	228	10	1

	Yes	No	Partly
Does the report contain information on the CEO?			
Age	228	10	1
Educational background	204	34	1
Professional experience	176	59	4
Professional commitments outside the company	155	78	6
Shares in the company	227	11	1

issued regarding whether it considers that the composition of the board is appropriate according to the criteria set out in the Code. Two thirds of the companies surveyed issued such a statement, and 92 per cent of these statements are considered to have sufficient information value, while 14 statements, the remaining 8 per cent, are not sufficiently informative. The Board finds it remarkable that over a third of companies did not fulfil the requirements of a Code rule that has been in force since 2008.

The previous version of the Code required companies to declare all share and share price related incentive programmes for employees and board members, a requirement that is also to be found in the current Code. Almost a hundred surveyed companies, which is nearly 40 per cent, published no information regarding such programmes on their websites. To a certain extent, this may be because some companies do not have such programmes, but the figure of 40 per cent still seems rather high. A new requirement in the revised Code that came into force in summer 2010 is that companies issue a description of any variable remuneration to the board and executive management. Only 40 per cent of surveyed companies published such information on their websites. It seems unlikely that 60 per cent of listed companies have no variable remuneration for executives and directors, so there is room for improvement on this point.

Finally, company websites are to provide information on the board's evaluation of remuneration etc. This is also a new Code requirement. Table 11 shows that around half of the companies surveyed have applied this rule, while the rest have work to do before 2012.

Table 10. Detailed information on company websites

	Yes	No	Partly	Not applicable	Total	Yes Percentage
Current board members	246	3	0	3	252	98%
Current CEO	241	6	2	3	252	96%
Current auditor	234	15	0	3	252	93%

Table 11. Information on company websites regarding the board's evaluation of remuneration matters

	Yes	No	Partly	Not applicable	Total
Variable remuneration programmes	99	120	5	28	252
Remuneration policy	122	103	0	27	252
Remuneration structures and levels	109	114	1	28	252

Swedish Securities Council statement on interpretation of the Code

The Swedish Corporate Governance Board is the body that sets norms for corporate governance of Swedish listed companies, but it does not have a supervisory or adjudicatory role when it comes to individual companies' application of the Code. The Bard occasionally receives questions on how the Code is to be interpreted. Although it tries to help companies understand what the rules mean, it is not the Board's responsibility to interpret how the Code is to be applied in practice. This is the responsibility of the market, after which the Board assesses how the Code has actually been applied and considers any adjustments that may be required as a result.

The Swedish Securities Council, whose role is to promote good practice in the Swedish stock market, is able to advise on how to interpret Code rules. This occurs when companies who would like advice on interpretation ask the Council to issue a statement.

The Swedish Securities Council has issued five statements on interpretation of Code rules. The oldest, AMN 2006:32, was issued in 2006 and concerned whether two shareholders were able to pool their shareholdings in order to be eligible for a seat on the nomination committee.

In the past year, the Council has issued four statements.

AMN 2008:48 and 2010:40: Statement AMN 2008:48 concerned a three year incentive programme for the executive management of a company. The shareholders' meeting would only decide on the terms of year 1, while the company board would be allowed some flexibility to decide on the terms for years 2 and 3. The Council found that the flexibility granted to the board was not compatible with Code rule 9.2, (which is no rule 9.7 in the current version of the Code), which stipulates that all share price related incentive programmes for the executive management are to be decided upon by the shareholders' meeting. This statement's conclusion was later developed and modified in statement AMN 2010:40, in which the Council changed its position concerning the programme's incompatibility with the Code. The possibility for the board to set the terms for years 2 and 3 was assessed against the prohibition to grant authorisation to the board, which is to be found in the "Leo rules" in Chapter 16 of the Annual Accounts Act, and the equivalent, expanded restrictions on authorisation in the Council's previous but still guiding initiative statement on incentive programmes, AMN 2002:1. The Council concluded that this was not a case of unpermitted authorisation of the board, either according to the Annual Accounts Act or according to AMN 2002:1. The Council added that the programme was also to be regarded as compatible with Code rule 9.7, which in the opinion of the Council is to be interpreted in this way. The Council did however add that the outcome of the programme is to be reported retrospectively to the shareholders.

AMN 2010:43: This statement concerns interpretation of the independence criteria in Code rule 4.4. The fourth bullet in this rule covers board members' independence with regard to clients, suppliers or partners who have significant financial dealings with the company. The question was about whether a board member who was simultaneously a member of the board of a major supplier to the company was to be regarded as independent, taking account of the fact that the supplier was large enough not to be dependent on having the company concerned as a client. The board member in question would therefore not be in a dependent position because the management would be able to terminate the relationship with the supplier. The Council did not issue a definitive statement on interpretation, but stated that the assessment regarding independence must be done case by case and consider all factors, including the factor cited in this case. The Council added that if a candidate for a position on the board is nominated by a shareholder rather than the nomination committee, the proposer is to conduct the initial assessment of whether the candidate can be regarded as independent according to criteria stipulated in the Code.

AMN 2011:03: The Council was asked whether a proposed salary increase for executives conditional on a sustained shareholding in the company needed to be referred to the shareholders' meeting. As the programme did not result in any dilution of the share capital and the costs for the company were likely to be insignificant – the company would only carry out some administration – the Council concluded that the Code rules concerning shareholders' meetings decisions on all share and share price related incentive programmes for board members and executive management were not applicable to this scheme.

The Code Barometer 2010

The Code Barometer is a regular survey of attitudes to the Swedish Corporate Governance Code and to corporate governance in Sweden. The aim of the survey is to measure how the Code is fulfilling its general goal of contributing to improved corporate governance in Sweden and thereby to greater confidence in stock exchange listed companies.

The Barometer consists of two parts. The first survey is directed toward the Swedish public, while the second measures attitudes among leading actors in the capital market. The survey uses identical methods each time in order to facilitate comparison from year to year and identify trends.

The first Code Barometer survey was carried out in autumn 2005, when the Code had just been introduced, in order to provide a starting point for later comparisons. Further surveys were carried out in 2006 and 2008, with the most recent survey taking place in autumn 2010. The results of the latest survey are summarised below, while more detailed reports on the 2010 survey can be found on the Board's website. Previous Code Barometer surveys were summarised in the Board's annual reports in 2007 and 2009.

Swedish public survey

Aims

The aim of the public survey is to measure confidence in how stock exchange listed companies are run, especially among the shareholding public.

A large majority of Swedish adults has an interest in stock exchange listed companies through direct or indirect ownership, including ownership through pension investments in Premium Pension funds, and these investments comprise a significant proportion of the ownership of Swedish listed companies. Swedish public opinion of how these companies are run is therefore a key factor in influencing their long-term ability to attract risk capital.

Survey method

As in previous years, the survey was carried out in the month of November through telephone interviews as part of NOVUS Opinion's telephone omnibus surveys. Sampling was made by telephone, and 1000 people were interviewed.

The target group for the survey is Swedish adults over the age of 16, divided into three categories reflecting share ownership:

- Direct owners of shares in Swedish listed companies. (These may also own shares through funds etc.)
- Owners of shares in funds but not direct owners of any company shares.
- Non-shareholders.

The following questions were asked:

Question 1. How confident are you that Swedish stock exchange listed companies are run well and in the interests of all their owners by their boards and executive management teams?

Question 2. In general, how well do you believe listed companies' boards and executive management teams run companies in terms of:

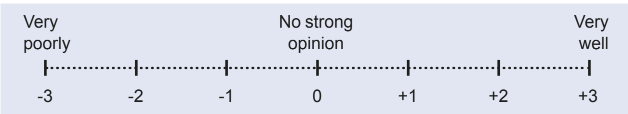
a) Running the companies on business terms in line with the interests of the general share-owning public?

b) The transparency, honesty and reliability of the financial information issued by companies?

c) The standards of ethics expected of stock exchange listed companies?

d) The remuneration levels of company executives in relation to the demands placed upon them?

The following scale was used for all questions, with slightly different wording of the extreme alternatives depending on the wording of the question:



Results

Diagram 1 summarises the results of the survey of the Swedish public. It shows that confidence has increased substantially in all of the areas surveyed, but is still very negative on the issue of executive remuneration. All of the improvements compared with the previous Code Barometer are statistically significant.

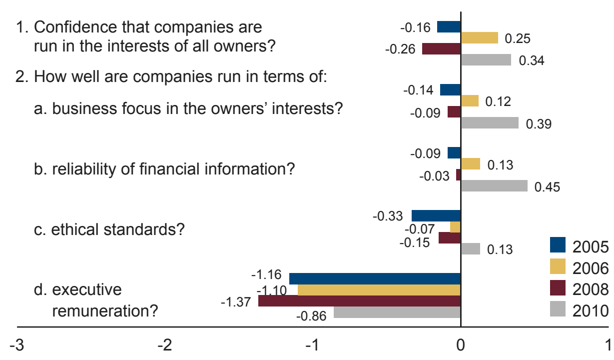
The results can be interpreted as showing a return to the positive trend of the early years of the Barometer following a dip in 2008, which was probably a reaction to the ongoing financial crisis at that time.

A general belief that companies are run in the interests of their owners has increased by more than half a point on the seven point scale, which is a statistically significant change, and is now at a higher level than in 2006. A similar increase in confidence that companies are run on sound business principles and that they produce financial information of good quality can also be seen. There is also an improvement in perceptions of companies' ethical standards, which shows a positive result for the first time, though the figures are significantly lower than for the first three questions in the survey, and there is considerable room for improvement of companies' reputations in this regard.

As in previous years, the issue which stands out is the question of executive remuneration. The results in this area have been very negative in every Code Barometer since the survey was first conducted in 2005. Even though the result in 2010 represents a considerable improvement compared with the previous Barometer, it is still negative by almost a full point. Companies therefore still have a long way to go before they can consider themselves as having the full confidence of the Swedish public on this issue.

Analysis of the results for the different groups surveyed, (which are not shown on the diagram below but can be seen in the full report on the board's website), shows that direct owners of shares are the most positive, indirect owners are slightly less positive. The least positive respondents are those who neither own shares directly nor through funds. On the issue of executive remuneration, however, all three groups were more or less equally negative.

Diagram 1. Average values 2005–2010, all categories



Capital market survey

Aims

The survey of the capital market is partly aimed toward companies that apply the Code and partly toward private and institutional owners, fund managers, analysts and other recipients of companies' corporate governance reports. The purpose of the survey is to measure these actors' confidence that listed companies are being run in the best interests of the owners. This has a great impact on the market's willingness to invest in listed companies and thus for their supply of risk capital.

Survey method

This survey took the form of a written questionnaire, which was distributed by e-mail in mid-November 2008. Reminders were sent by e-mail, with further follow-up by telephone. The target group was people in leading positions in companies and organisations that are affected by the Swedish Corporate Governance Code. Respondents were divided into three categories:

- Category 1 consists of major private and institutional shareholders, fund managers and other capital market actors, such as corporate finance managers and chief analysts of major investment banks and brokerage firms. It comprised 20 major private shareholders, the 21 largest institutional investors and 42 individuals from other categories.
- Category 2 is the chairs of companies listed on Nasdaq OMX Stockholm or NGM Equity. From this group, half of the company chairs were chosen at random to participate in the survey. Corrections were made to take account of the fact that some individuals were chair of more than one listed company or also represented major shareholders and were therefore in Category 1.
- Category 3 is made up of the CEOs of companies listed on Nasdaq OMX Stockholm or NGM Equity. From this group, half of the CEOs were chosen at random to participate in the survey.

Of the total sample of 247 people in the 2010 survey, 36 people could not be contacted. There were different reasons for this, for example that the person had left their position and was no longer a member of the target group. The actual sample therefore consisted of 211 people. Of these, 123 interviews were actually carried out, giving a response rate of 58%. A full breakdown of non-response in the different categories can be found in the complete report, which is available on the Board's website.

The following five questions were presented in exactly the same way as in the previous Barometers, making the results comparable from year to year:

Question 1. How confident are you that Swedish stock exchange listed companies are run in the interests of the shareholders?

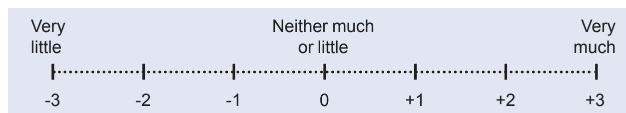
Question 2. How do you feel that corporate governance works in Swedish listed companies compared with those in other developed countries?

Question 3. What impact do you believe the Code has in facilitating Swedish listed companies' supply of Swedish and international risk capital?

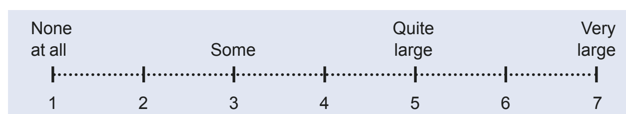
Question 4. Do you believe that the Code has a generally positive or negative impact on the companies that are obliged to apply it?

Question 5. Do you have any other comments regarding the Swedish Corporate Governance Code and its application? Please use this space to add any general or more specific points. We would also welcome any comments on the activities of the Swedish Corporate Governance Board.

The following scale was used for questions 1, 2 and 4, with slightly different wording of the extreme alternatives depending on the wording of the question:



As question 3 is formulated in such a way that all answers must denote some degree of positiveness, a scale using only positive responses was used:



Three new questions were added to the 2010 Code Barometer:

Question 6. The Code was modified on 1 February 2010, for example to include new rules regarding executive remuneration based on an EU recommendation. Do you think the new rules are mainly good or bad?

Question 7. Every year, the Swedish Corporate Governance Board publishes and annual report. The 2010 annual report was published in June 2010. Have you read it?

Question 8. What is your opinion of the information value of the 2010 annual report?

The first scale above was used for questions 6 and 8. The alternative responses for question 7 were:

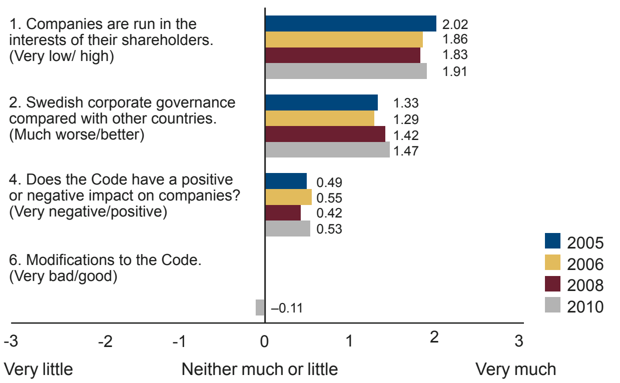
– Yes, I have read it
– Yes, I have leafed through it
– No, I haven't read it at all
– Don't know

Results

Diagram 2 illustrates the results for questions 1, 2, 4 and 6 for all respondent categories. It shows that the market has a generally strong belief that companies are run in the interests of their shareholders. The previously slightly downward trend has been broken. However, none of the changes between different Code Barometers are statistically significant.

Swedish corporate governance in an international context is also generally highly regarded by the market. The small rise in 2010 is not statistically significant however. Worth noting is the difference between the results of the respondent categories, which cannot be seen in the diagram below but is shown in the full report on the Board's website. A sharp increase in confidence from 1.40 to 1.89 among owners and other capital market actors, (category 1), contrasts with an almost equally sharp fall among CEOs, from 1.38 to 1.08. It is difficult to see a simple explanation for this difference.

Diagram 2. Consolidated comparison of reviews in the Code Barometer 2010 compared with 2008, 2006 and 2005; All categories



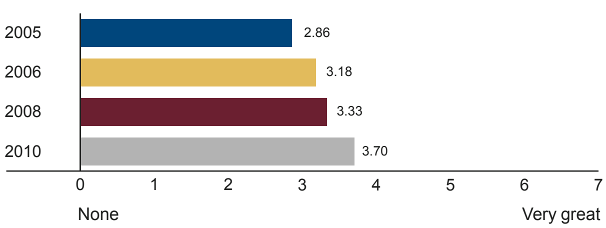
Question 4, on whether the Code has a positive or negative impact on the companies that apply it, also shows an increase compared with previous years. Examination of the results in the different respondent categories shows that the scores from company chairs have risen sharply, from 0.17 to 1.11, while scores from CEOs have fallen almost as much to a level below zero for the first time, -0.14. Both of these changes are statistically significant. Capital market actors show a rise from 0.54 to 0.86. Also here, it is difficult to see a simple explanation for the changes, even though the scores for CEOs may be linked to their more negative attitudes to the revisions to the Code than other categories, (see comments regarding question 6 below).

For obvious reasons, no comparisons with previous years can be made for question 6, which asks what respondents think about the revisions to the Code that came into force in 2010. The total result is slightly negative, -0.11. Again there are differences between the respondent categories. Company chairs are positive, (+0.35), CEOs are negative, (-0.48), and capital market actors are close to zero. It should be noted that the rule changes that are highlighted in the question are those concerning remuneration, primarily of the executive management, which were introduced as a result of an EU recommendation. The opinions given can therefore be assumed to be just as much about the recommendation as about how it was implemented in the Code. The comments received in connection with this question provide some support for this assumption, (see the full report on the Board's website).

Diagram 3 shows that confidence in the Code's importance for listed companies' ability to attract risk capital has increased each year since the first Code Barometer. The levels measured are not particularly high however, so the Code is hardly seen as a key factor in attracting Swedish and international risk capital.

Finally, the 2010 Code Barometer included two questions on the Board's 2010 annual report, which covers corporate governance year 2009-2010. The results for question 7 show that 21 per cent of respondents had read the report, 41 per cent had looked through it and 33 per cent had not read it at all. The remaining 4 per cent replied "Don't know". Once again, there were large differences between the three respondent categories, with 84 per cent of company chairs reporting that they had read or leafed through the report, but just 44 per cent of the capital market actors. The latter figure is notable because the owners of listed companies and other actors in the capital market can be regarded as the main target group for information on the Code and its application.

Diagram 3. The importance of the Code in attracting risk capital?



The information value of the report received an overall score of 3.63 on a scale of 1 to 7, which is just below the middle of the scale. Interestingly, the capital market actors gave a significantly higher score, 4.44, than the other categories' 3.96 and 3.10.

The full report includes comments that provide a more detailed picture of respondents' opinions regarding the different questions.

III. PERSPECTIVES

The Swedish Corporate Governance Board's ambition is that its Annual Report not only describes the work of the Board and how the Code has been applied during the past corporate governance year, but also provides a forum for discussion and debate on current corporate governance issues, both in Sweden and internationally. The Board therefore invites external contributors to publish articles and opinions within the field of corporate governance that are deemed of general interest. The content of these articles is the responsibility of the respective author, and any opinions or positions expressed are not necessarily shared by the Board.

This year's report contains three contributions.

- The first article, by journalist Bengt Carlsson, is a report from a round table discussion by Anders Nyrén, Lars Otterbeck and Michael Treschow on the role of self regulation and other current corporate governance issues. All three participants had held key roles in self regulation on the securities market before leaving their posts in spring 2011. Anders Nyrén had been the chair of the Association for Generally Accepted Principles in the Securities Market since the establishment of the new self regulation structure, while Lars Otterbeck and Michael Treschow had both been members of the Swedish Corporate governance Board since it was founded in 2005. Lars Otterbeck was also a member of the Swedish Industry and Commerce Stock Exchange Committee for many years, and was chair of the Committee in its final years, before its tasks were taken over by the Board in spring 2010.

  The Board felt it would be interesting for a wider audience to benefit from these experts' collected experience of Swedish self regulation and the development of Swedish corporate governance, not least against the background of the EU's growing regulatory ambitions. Bengt Carlsson chaired a lively discussion, which is summarised in his article.

- The Swedish nomination committee model has long been a subject for debate in Sweden, and in recent years it has begun to attract international interest. To add further empirical fuel to the debate, the Board commissioned a detailed survey in 2010 to examine how nomination committees for that year's annual general meetings had worked. In short, the results showed that all interviewees felt that the Swedish model was better suited to Swedish conditions than the model commonly used internationally, in which the nomination committee is a sub-committee of the board. Even so, several areas for improvement of the Swedish model were identified.

  Against this background, the Board invited Claes Dahlbäck, who has long experience of both Sweden's and other countries' nomination committee models, to reflect on the differences between the two models and to offer his opinion on how the practical application of the Swedish model should be improved. The article takes the form of an interview with Claes Dahlbäck by Lars Thalén, the Board's communications adviser.

- In the third article, Rolf H Carlsson, a consultant with a wealth of experience of international assignments and the author of several books and articles on corporate governance, discusses how the meaning of the concept of corporate governance has changed and developed over the years. His point of departure is that corporate governance has two main purposes. It is to define the board's and the executive management's accountability to the company's shareholders and to create value for those same shareholders, and there should be a balance of emphasis between these two aims. Rolf H Carlsson's opinion is that the focus of how corporate governance is perceived and applied in practice has for many years been on how the board and management have complied with increasingly detailed legislation and regulation of what is regarded as good governance at the expense of its responsibility to create value. He therefore believes that this development should be reversed so that corporate governance focuses more on its responsibility for long term value creation, thereby achieving a better balance.

He introduces the concept of "real ownership", and sees it as one of the keys to greater focus on the value creation functions of corporate governance. He also analyses different possibilities and limitations of improving corporate governance through regulation, and sees self regulation as generally more effective than increasingly detailed and mandatory legislation.

The article ends with an appeal for a strong ownership role and an emphasis on self regulation, which are characteristics of Swedish corporate governance. He feels that Sweden should therefore be able to be at the forefront of a movement to change the perception of corporate governance in order to increase its focus on the value creation role.

A new wave of EU regulation creates problems for Swedish self regulation

Bengt Carlsson is a vastly experienced and highly respected finance and economics journalist. He is currently Chief Press Officer at Handelsbanken, but also has communications assignments from other parts of the corporate sector.

Sweden must have the strength to resist some of the tsunami of new legislation and regulation of corporate governance currently gushing from the EU. The question is where that strength will come from.

That is one of the main conclusions of a round table discussion on the role of the Swedish Corporate Governance Code in corporate governance and current corporate governance issues with three of Sweden's most experienced figures in the field:

Anders Nyrén: CEO of Industrivärden, one of the Nordic region's leading holding companies and chair of the board of the engineering group Sandvik.

Lars Otterbeck: former CEO of Alecta, which manages occupational pensions, and currently chair of the boards of Hakon Invest, a leading investor in the retail sector in the Nordic and Baltic regions and Skandia, a leading finance and insurance company.

Michael Treschow: – former CEO of leading industrial group Atlas Copco and Electrolux, the household and professional appliance group, and until recently the chair of the boards of telecoms group Ericsson and the Unilever group.

Together, they have over a hundred years' experience as members of executive management teams and boards. As well as this practical experience, they were also involved in the preparations, research, design and production of the Swedish corporate governance model. Inevitably, they have also been in the cross hairs when corporate governance has been the focus of criticism.

These are some of their experiences during this time:

Lars Otterbeck (LO): It is important to remember that self regulation did not begin with the Code. Corporate governance work began much earlier, and the Code was one of the results of this process. The code was also a result of previously anonymous capital, such as life insurance companies and pension funds, beginning to find its voice.

Michael Treschow (MT): The aim of the Code was to reduce the risk of legislation, above all in the wake of the problems surrounding Skandia. After that crisis, everyone understood that something needed to be done, otherwise the politicians would have taken control.

Anders Nyrén (AN): At the Swedish Commerce and Industry Stock Exchange Committee, there was some debate about whether we should be involved in the production of the Code. In the end, we decided to take part in the process. The problems at that time showed that the governance trinity – owners, management and auditors – did not work.

What was the situation in other countries?

LO: In the Code group, we often joked that Albania and Sweden were the only countries without a corporate governance code. That may have been the case, but we did have a good Companies Act.

MT: They have managed corporate governance without a code on the other side of the Atlantic.

LO: But with a lot of lawyers.

MT: That is why there are conflicts between the American view and that of Europeans. We Europeans have not pushed developments in the USA, where the law plays a much stronger part.

AN: There, "accepted practice" is anything that is not forbidden by law. And unlike here, there is no division between executive management and the board, as much of the management sits on the board – even though this has become less common.

MT: When I sat on American boards, I thought that the board acted more like cheerleaders for the management. There was good discussion of business issues, but no corporate governance. But in American culture, it is more accepted than here for people to be "difficult" by asking questions and speaking freely without anyone being offended, so it worked fine.

It doesn't work that way in Sweden. We all know examples of what people say, albeit discretely, if someone is seen as "difficult"

All three thought the Swedish nomination committee model was good, but that the committees could work better:

MT: Our nomination committee concept is well worth preserving, but having said that, I don't think we use the committees in the right way.

LO: Having nomination committees that do not only contain members of the board was an issue that the Swedish Shareholders' Association managed to get into the Code, having succeeded at Volvo. When the Code Group was looking at the various sub-committees of boards, e.g. for auditing and remuneration, the chair of the Group, Erik Åsbrink, saw clear parallels between the nomination committees, which should in part be outside the board, and his experience of the process of nominating candidates for various positions in political parties.

AN: I agree that the Swedish nomination committee concept is good, but not its practical application.

MT: Having nomination committee members who know what is going on in the company and who know about running businesses provides great benefit. We can always be accused of recruiting our pals, but I think we only have ourselves to blame for not taking this issue seriously. I also think it leads to a lack of diversity in candidates proposed for board positions if you have people sitting on ten or twelve nomination committees and a limited number of people to choose candidates among.

LO: When I was CEO of Alecta, there was not much interest in having people on nomination committees, as we didn't want to become "insiders". I think there are only two groups who have benefitted from today's system, major shareholders and board evaluators.

AN: In other countries, it is rare to find people whose responsibility is corporate governance issues, but Swedish pension funds have them.

What can be done to improve nomination committees?

MT: When I became a member of the board of Ericsson and chair of the nomination committee, I phoned a number of shareholders and asked them to appoint good people with the right experience and competence. Nordea found someone in the bank's network, Jan Belfrage, a former CFO at Aga and SKF, who was very good. Investor's representatives on the nomination committee included the former Ericsson CEO Björn Svedberg. During the years that such people were on the committee, its work had the proper focus.

The conclusion of the people around the table is that the Swedish concept of nomination committees can and should be preserved and promoted, but it can also be improved with regard to the knowledge and skills needed in different companies and industries.

LO: Nomination committees dominated by representatives of the owners was an issue that the Swedish Shareholders' Association fought for. It was good for representativeness. It is now time to see whether nomination committees' competence regarding their companies has suffered.

How much has the Code influenced the work of Swedish boards?

LO: Most major companies already worked that way, so they could tick off the points in the Code relatively easily. The Code has neither been positive nor negative for them, but it is useful in helping them to understand the necessity of transparency. The Code has had an educative impact, but it should be applied less slavishly.

AN: It has been good for smaller companies and companies preparing for stock exchange listing. And Code 2.0, the version we have today following the revisions and simplifications that were made a couple of years ago, is very good.

All three view the proposals for new regulation, not least those from the EU, with some concern.

AN: In the financial sector, there is more legislation and regulation in the pipeline than ever before. I asked someone for a summary of the changes that will impact Industrivärden and Handelsbanken and received a report 60 pages long. A 60-page summary!

MT: There is a major risk that the corporate sector will be unable to stand up against carpet bombing with new proposals by the EU and others. Everyone expects us to object and regards us as acting out of self interest, so protests will not be sufficient to resist these proposals.

LO: How did it come to this? I think one reason is that counting has become so easy. I mean that it's easy to input risks and probabilities into calculations and formulas. But in the end, people stop thinking for themselves. Self regulation is built upon common sense, for which there is less and less room.

MT: There are two options, either a system of self regulation that works or an admission that we can't manage it. Following the financial crisis, pressure from politicians and the authorities to restrain the markets is enormous. And the work of the EU in this field is heavily influenced by the French view, which is very centralist.

AN: No, this would never be happening if the United Kingdom were not suffering such problems in the financial sphere. And the proposals are written by people who have never been anywhere near the corporate sector.

LO: In Sweden, we adapt to EU regulations almost before they have been passed, even if they run counter to the principles of self regulation.

MT: That's the new global world. Politicians need to show they are doing something to bring the markets under control, and now we are at the height of the storm, there might not be very much we can do about it. But when things have calmed down, it may be possible to highlight some of the things that were not too smart.

The European proposals do not improve competitiveness with countries from other countries, while it is difficult to see who will come to the rescue.

LO: While Europe is regulating itself to death, what is happening to our ability to compete with the BRIC countries and others, who have a completely different approach?

AN: And on top of that, Europe has a weak banking system. So we seem to be doing everything we can to shoot ourselves in the foot.

MT: The USA has solved its banking problems, while China is just steaming ahead. In the end, we need to

compete with these countries and actually also have competent people on our nomination committees.

AN: The agency that would be able to handle some of these issues, the Financial Supervisory Authority, perhaps lacks the competence or resources. Furthermore, the Authority is currently focused on stability in the financial system. The Stockholm Stock Exchange and OMX are very good discussion partners, but are no longer as easy to talk to. There is no decisiveness at NASDAQ OMX in Sweden. That is to be found in the USA nowadays.

MT: It is also obvious that Sweden doesn't have major representation on the inner cabinet of the EU.

AN: Shareholder power is not a major issue for the Swedish government. It shows little interest in the Swedish corporate sector, as the issue is not a vote winner. The proposals coming out of the EU have been in the pipeline for a couple of years, so the first crucial step in being able to exert influence is knowing what is happening in the Union. As we are not part of the Euro zone, it's also obvious that Sweden is not at the head table.

The rules that already exist have unwanted consequences or can be difficult to enforce.

AN: Not many people realise that the SEC, the American financial authority, has a unit that monitors audit firms. That means that all companies, including Swedish ones, who engage one of the international firms can receive visits from the police to check their routines.

LO: Regulation and monitoring requires resources, both for the companies and the authorities, and it is costly, as one or two situations have gone badly wrong. The USA had Enron, for example, while in other cases, such as Skandia, it is about remuneration.

AN: But you can't legislate away poor judgement.

MT: Why are there therefore not more serious consequences, such as trading prohibition?

LO: The Swedish Economic Crime Authority and others have found it difficult to get convictions. The question is whether the fault lies in the laws or elsewhere.

AN: When I worked at Securum, the company that handled Nordbanken's bad loans, we investigated economic crimes at our own expense and handed the information over to the police. But there were still no prosecutions or convictions, due to a lack of resources, time or competence.

How can we prepare for this" tsunami of rules"?

AN: As I said earlier, a first crucial step is to find out what is happening in the EU. Perhaps it needs to be a point on the agendas of board meetings. Few people in companies and on boards know what is going on –

and before these issues become urgent, they are not regarded as important.

LO: The sheer number of proposals also makes it difficult. If there are 36 things in the pipeline that are going to affect us are, but none of them affect us now, it's difficult to maintain interest.

MT: As I mentioned before, the question is whether Swedish politicians can resist the tide. I think the Board should devote more time to gathering information on what is going on. Currently we act to late to be able to defend ourselves.

MT: The complexity has increased dramatically. When I was CEO of Atlas Copco, I was fairly familiar with accounting rules and how they affected the company. When I moved to Electrolux, there was no way I could keep up. What happened in between?

What could Sweden import from other countries?

MT: There is something healthy about the shareholders' meeting voting on the remuneration report, as they do in the United Kingdom and in Switzerland. In the United Kingdom, shareholders vote and the votes are counted before the meeting. This means that shareholders' meetings do not spend half their time dealing with remuneration issues, which can often happen here.

LO: Hopefully, the shareholders have also understood what they have voted on.

And is there anything that other countries can take from the Swedish model?

AN: When the Code was introduced, we ranked bottom in the ISS listing of corporate governance in different countries. So I visited ISS in Washington in order to describe how the Swedish model works, first lower down in the ISS organisation, but in the end I also spoke to the management. They were very interested, and actually said "Just think if we had this in the USA".

All participants in the round table discussion would like to have seen more deviation from the Code, with explanations.

MT: There are far too few explanations. There must be other ways of dealing with issues than slavish compliance with the Code – and companies can then explain. But that is part of the Swedish character: "If that's the way it should be done, that's the way it should be done". So we comply with the rules of the Code. But with more explanations, we could improve corporate governance still further.

LO: That is also the opinion of the Board. We have also said that there are too few deviations from the Code rules.

AN: I think the stock exchange listing agreement play a major part. It says that if explanations of non-compliance are poor, financial penalties can be imposed.

What do you think of the conclusions of Magnus Henrekson and Ulf Jakobsson, that the EU is harmonising the regulations with those of the United States and the United Kingdom in such a way that they clash with the control ownership model, featuring differentiated voting rights for different types of share, that is relatively common in Sweden? And that this, along with increased foreign ownership and the march of private equity firms, is diluting the importance of the Swedish stock exchange?

AN: It's very interesting.

LO: The Code is designed for listed companies. Private equity firms don't need to worry.

MT: But when they are preparing their companies for listing, they adapt to the Code.

AN: Most private equity-owned companies are sold to other private equity firms, and these actors are now the most active bank borrowers again. But the name "private equity" tells us that this ownership model is less open than that of stock exchange listed companies. They have few incentives to go public, either financial or regulatory. But there are other groups of owners outside the stock exchange that are growing. We now see considerably more private major shareholders than previously.

The discussion ends with a philosophical observation on the effects of rules and codes.

AN: The question is whether our children and grandchildren will want to work with these issues.

MT: Not if the environment is right. You need things that arouse your curiosity and that are not too wishy-washy.

LO: What we will remember about the Code is that it reinforces and legitimises openness, which is probably a fairly Swedish characteristic. Our children are not going to find it terribly exciting. For them it will be quite natural.

Owner-led nomination committees better than self-appointed boards

Claes Dahlbäck, see fact sheet on page 40.

There is an international trend among stock exchange listed companies of boards becoming more powerful within the company and of their assignment becoming more demanding. The nomination process is therefore becoming increasingly important.

Claes Dahlbäck, a veteran of Swedish business with broad international experience, believes that the Swedish model of owner-led nomination committees gives Swedish corporate governance a competitive advantage.

In this interview, he compares the Swedish and American models and reflects on the development of the director nomination process and the work of boards.

What are the differences between American and Swedish nomination committees?

In the USA, board elections are prepared by a committee within the board. This mainly comprises non-executive directors. The background to this is the spread of ownership in major companies, the lack of what we in Sweden call control ownership and the number of passive institutional investors.

The short-term capitalism of detached shareholders took off in the second half of the 20th century when pension funds grew and replaced the small shareholder. They often engaged just eight or ten asset managers and as a rule replaced the two that performed least well each year. No manager wanted to chance failure, even if taking risks could have provided healthy returns. If they didn't stray far from the index, they would probably keep the client. The result was that executive management was given almost unlimited power.

It was not until the 1990s that CalPERS and other funds began to react forcefully. When the executive management of three major listed companies were thrown out in the same week, a new reality began to manifest itself.

How can boards in practice appointing themselves be justified?

The simplest argument is that the board has the required competence and the mandate of the owners, (through the shareholders' meeting), to run the company. It is therefore not unreasonable to assume that it has the competence and mandate to manage the nomination of candidates to the board.

What are the pros and cons of director-led nomination committees?

In one way the system works well. Members of the board really know the company and what it needs. They are all insiders already.

But this argument is only applicable when times are good. When a company has problems, the American model is not as good as the Swedish one.

And of course it is always a disadvantage that board members in reality appoint themselves. It is hard to believe they would vote themselves off. Such a system would be unthinkable outside the corporate sector.

Do you see any tendencies towards change in the American system, with greater shareholder influence?

One significant trend within corporate governance is that shareholders want more of a say on more issues. Active institutional investors in the United States are demanding "say on pay", division of the roles of CEO and chair and the possibility to force an extraordinary general meeting with the support of less than ten per cent of shareholders.

ISS, which advises institutional investors before AGMs in many countries, is becoming more proactive. It wants shareholders' meetings to have more of a say on elections and remuneration.

But I cannot claim that there is huge international interest in the Swedish model. The comments I have received when I have presented the Swedish Corporate Governance Code to American director colleagues have been positive however – "really good stuff".

What changes has the Swedish nomination committee model brought about?

As late as the 1980s, there was some truth to the assumption that boards were appointed by the guys when they were out hunting together. The largest shareholder could announce the names of new directors a week or even a day before the shareholders' meeting, and they were people the shareholder already knew.

In the circles in which I moved primarily, there was also a tradition of "jobs for the boys" to reward long and faithful service. People approaching the end of their CEO path were appointed to a few boards, which helped build up their pension. I think this was true for most of the corporate sector.

So nomination committees with several major shareholders were a revolutionary change?

No, more a logical outcome of other changes that had already been set in motion. Institutional investors started to raise their voices in the 1990s. There was a kind of institutional investor revolution. We weren't used to it, but it was welcome.

When I worked at Investor, four large institutional investors – Skandia, the Fourth Swedish National Pension Fund (AP4), SEB-fonder and Nordbanken Fonder, collectively known as the "gang of four" – went through the boards of all of our associated companies with us. We met a few times a year and looked at the companies. It was actually quite effective.

Then Percy Barnevik, who was chair of Investor, got really involved and ensured that we widened our search to bring more competence from other countries onto the boards.

There is sometimes criticism of the presence of institutional investors, "faceless capital", on nomination committees. But the Swedish institutions are not faceless. In most companies, there is little turnover of major shareholders. Swedish institutional investors tend both to be long-term owners and to have a long-term view of the future of companies.

So as a rule, nomination committees are pretty much in sync from the start. Companies use the Q3 model and representatives of major shareholders meet in October. There is often a great deal of continuity of both shareholders and people.

And how do these nomination committees work compared with previous models?

Today's nomination committees work much better. In the early days, I perhaps wasn't terribly impressed with the people some institutions appointed to nomination committees. Some representatives weren't of the required standard. But in more recent years things have improved enormously. People are knowledgeable and professional and I meet talented people who work very hard.

Describe the work of today's nomination committees.

Normally, the chair of the committee and the chair of the board meet to discuss how the work will be organised. The work of the committee normally begins with the chair of the board report on the current state of the company, the challenges it faces and therefore the competence needed on the board. The chair also goes through the latest evaluation of the board and provides his or her own assessment of the current directors. In my role as chair of a committee, I usually phone each member of the board to find out their opinions of the work of the board and their own situation.

The committee uses this input to assess the need for changes. There are often inherited needs from previous years that were not resolved. The committee looks at its own network to find candidates before calling in a headhunter. The process of finding a candidate can take three months. The committee wants to meet the candidate and the candidate often wants to meet the chair of the board and the CEO of the company.

It sounds like the chair of the board is fairly safe in such a process.

No, absolutely not. Normally, underperforming chairs or those who are approaching a "natural end" to their term are spoken to by representatives of the largest shareholder. And if that doesn't happen, the nomination committee meets without the chair of the board present.

What information and material do committees have during the process? Do they need external support?

One important source of information is the evaluations of the work of the boards, which nowadays are much more sophisticated. They are based on interviews by the chair with each member of the board and anonymous questionnaires covering a very broad range of questions.

I am a little sceptical about the new profession of board assessors that has grown up among headhunters. These people probably know much less about the company's situation and needs than the members of the board. And if they are to know just as much as the board, there will always be the issue of confidentiality. The members of a nomination committee often become insiders in practice and must be extremely careful. I don't want to widen that circle unnecessarily by bringing in external assessors.

So I am not thrilled with the idea of always bringing in external help in the evaluation process. It might be useful every third year, but otherwise a normal board can manage by itself.

But if the board evaluates itself, and that information provides the basis of the nomination committee's proposals, is the difference between the Swedish and American processes really so great?

Yes, there is a considerable difference. Here, it is the owners and the owners' perspective that dominates with regard to both nominations and remuneration. I can understand that some people regard it as "in-breeding" if a board conducts an evaluation of itself, but as each member of the board can offer opinions anonymously, I think the risk is relatively small. And if there is a risk, it's sufficient to bring in an external consultant now and then, not every year.

Do you see anything negative in the Swedish model?

There is often only one member of the board on the nomination committee, and that is normally the chair of the board. So there is a risk of one-sidedness. It would be good to have more than one person with full knowledge of how the board has worked.

As I said earlier, I meet competent representatives of all owners in major companies. Institutional investors' representatives know about crucial areas such as strategic matters, the challenges of international competition and remuneration issues. But I hear that there are still small companies with nomination committees whose competence is not entirely satisfactory.

How do you view the role of boards in global companies?

A dominant corporate governance trend, particularly in Anglo-Saxon countries, is that the balance of power in companies is shifting from the executive management to the board and the shareholders. Boards are in a stronger position today than they were just a decade ago.

A McKinsey study shows that governance by owners within private equity tends more than anything else to add value to the company compared with the situation in listed companies. They link this to the fact that private equity companies have smaller, better focused, more committed and higher paid boards rather than the large "foreign legions" and "transportation firms" found in listed companies' board rooms.

Is the same thing happening in Sweden?

The trends seen in private equity can also be seen in stock exchange listed companies, especially in Sweden. Boards are becoming more important, requiring more of their members and shrinking in size. Boards and directors are also watched much more closely by the media than before.

Nowadays, many people are reluctant to take on more than four or five board assignments. Not long ago, board members could have twice as many.

There is some criticism of the Code requirement for members of the board to be not only independent of the company, but also independent of dominant shareholders.

Even if there is a main shareholder who retains important tasks and duties, a stock exchange listing means they are using other people's money. So I don't think it is unreasonable that there are board members who are not dependent on such an owner. It means that we can be confident that there will be no abuses of power and that there is a clear focus on what is best for the company and for all shareholders.

You are familiar with how the private equity group EQT works in non-listed companies. How are suitable candidates for positions on boards selected there?

It is very hard work. You need a strong and extensive network. This is one of the most important tasks of the executive management and investment managers. But there is only one owner, so the process is different.

Do the boards work very differently to those of stock exchange listed companies with widespread ownership?

Very differently. The boards are more engaged and proactive. They usually meet at least once a month. The chair of the board and the CEO have almost weekly meetings with EQT's investment manager. With no road shows, no quarterly reports and no media attention to worry about, the board can really focus on the company's long term development.

Finally, the EU is threatening a quota system to increase the number of women on company boards. What is your feeling on this?

The need for the broadest possible range of competences is a vital shareholder interest, and this gives rise to the need for more women, greater international experience and other diversity on boards. The nomination process nowadays therefore strives to achieve a greater diversity of competences. Everyone knows that there are far too few women both on boards and in top management positions in the corporate sector, which is where the majority of board members are recruited from. The change is already taking place and cannot be stopped, but it will take time.

When recruiting new board members, women are almost always sought first, and there is justification for this. If all else is equal, female candidates are selected. But I have also heard some hair-raising tales of what can happen when there is a limited supply of candidates. We cannot have two categories of board directors, those elected for their professional competence and those elected to fulfil quotas.

Claes Dahlbäck has held a number of leading positions in Swedish and international companies in his almost forty years at the top.

After gaining his MBA at the Stockholm School of Economic in the early 1970ss, he was employed by Investor to be sent to New York as a trader. He was the CEO of Investor from 1978 until 1999, deputy chair of the board from 1999 until 2002 and then chair from 2002 until 2005.

He has sat on around twenty company boards, including ABB, Astra, Electrolux, Ericsson, Gambro, OMX, Saab Scania, SEB, SKF, Stora Enso, Swedish Match and the state-owned Vin&Sprit. He has been the chair or the deputy chair of several boards and has participated in nomination committee processes for a large number of companies.

His current assignments include a position on the board of Goldman Sachs. He is also the chair of EQT's investment committee.

Claes Dahlbäck was a member of the Code Group, which created and wrote the first version of the Swedish Corporate Governance Code in 2004.

Redirecting the focus of corporate governance

Rolf H Carlsson is active internationally as a consultant on ownership and board issues and author to a number of books and articles on corporate governance.

The term "corporate governance" can associate to how it is actually performed in companies but also to what could be called "the corporate governance movement" – including sets of international corporate government activists, legislators, regulatory bodies, code developers etc – making up almost an entire "industry" of its own. I see a growing tension in recent years between the latter and proposed regulations on the one hand and what is considered good governance and how corporate governance is actually practiced in Sweden on the other.

Swedish corporate governance – often referred to as "ägarstyrning", governance by owners – is based on a strong tradition of actively involved, leading and long term committed owners nominating and electing the board of a company. The board is accountable to the AGM (Annual General Meeting) and the CEO reports to the board.

The corporate governance movement originates in the USA and the UK in particular where it was initiated in the 1980s and took off in the 1990s. A major driving force behind the movement was the lack of owner/shareholder influence. Executive management, closely integrated with the boards of companies, has been in control. Repeated abuses of shareholder rights, spectacular frauds and mismanagement have turned corporate governance into a hot political issue in the United States as well as in Europe. As a consequence, politicians and regulators have applied their usual tool, legislation and an extension of the regulatory framework to remedy the situation. Within EU there has also been an ambition to introduce common rules for all the member states.

I have noticed two types of reactions to this development. One is a deep concern in Sweden that EU regulatory initiatives threaten the traditional Swedish model of corporate governance. The other is a general resentment of what is perceived as too much and too detailed regulation, taking away precious time from the boards to work on the business agenda of the companies.

This is in contrast to the Swedish Code of Corporate Governance which has been well received and applied by the companies.

To put the international development in perspective let us go back to how corporate governance was viewed by the committees that were set up in the UK in the 1990s.

The Hampel Report

When I started to focus on corporate governance in earnest in the 1990s inspiration and ideas could be found in the UK. With the British penchant for self-regulation some industry initiated commissions produced reports that got a lot of influence internationally. We have all heard about the Cadbury Report published in 1992 for instance.[1] Less well-known, maybe, is the third commission and its Hampel Report.[2] It had a significant impact based on that it summed up the recommendations of the earlier reports and provided the substantial input for the Combined Code, which was adopted by the London Stock Exchange.

The Hampel report on corporate governance stated – already in its first sentence: "The importance of corporate governance lies in its contribution both to business prosperity and to accountability".[3] So, corporate governance has a dual mission; it should look after how well a company creates value/serves its business prosperity purpose, and how well it meets its accountability requirements.

1) The commission was led by Sir Adrian Cadbury, former chairman of Cadbury Schweppes.
2) It was led by Sir Ronnie Hampel, retired chairman of ICI.
3) Committee on Corporate Governance. Final Report, London, January 1998.

Figure 1 The dual mission of corporate governance

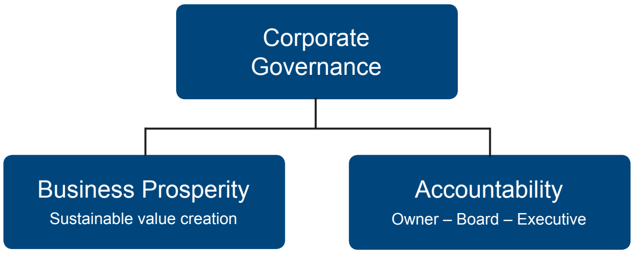
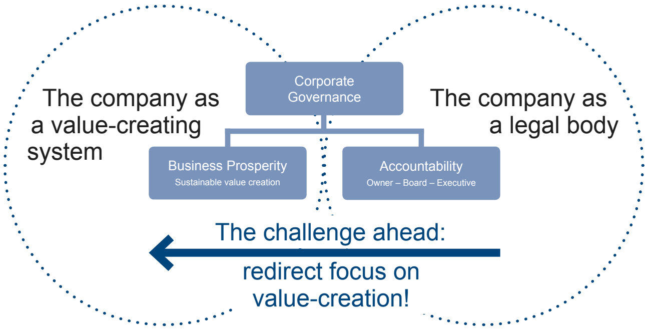


Figure 2 Redirect focus on value-creation



How can we include also the other side of the coin – the sustainable value creation – in the corporate governance debate?

Let us make a reality check at this point: how many of those concerned with corporate governance issues fully appreciate both criteria above? Far from everyone, most people seem to associate corporate governance only with accountability. Already the Hampel Committee made that observation saying that corporate governance activities and focus had been too much concerned about accountability at the expense of the prosperity/value creation aspects.

Obviously, this imbalance has not improved by developments since then.

Get more balanced – redirect focus on the value creation mission

The result is that the frame of reference dominating the corporate governance movement is rather lop-sided. Accountability and formal aspects are in the foreground. Legislators and regulatory bodies do not seem to fully appreciate the value creation aspects and the realities of companies.

So, for legislators and regulatory bodies, in particular, there is an urgent need to make corporate governance more balanced by applying a wider frame of reference and to redirect focus on what needs to be done to promote the value creation mission.[4)]

Figure 2 above help explain my point.

[4)] From early on I have seen this as my particular mission in the corporate governance discussion – referring to it as strategic corporate governance. As in the title of my book: Ownership & Value Creation; strategic corporate governance in the new economy, Wiley 2001.

The dual mission of corporate governance could be viewed as related to two different perspectives of a company, like two sides of a coin. Making such a distinction will facilitate an analysis of the two aspects. The accountability mission would correspond to seeing the company primarily as a legal body. Analogously, the value creation mission would correspond to the company being viewed as a system for value creation.

This is not the place for a thorough analysis of the two sides of the coin. However, before outlining some key elements of an alternative frame of reference – badly needed to make corporate governance truly effective – I would like to point out two crucial mementos regarding governance by regulation.

Prerequisites and limitations of effective regulation

To avoid any misunderstanding – I think good institutions and the rule of law are much desired necessities for a well-functioning free market – as well as for freedom overall. However, to introduce new laws is a demanding undertaking which must be exercised with utmost professional care, diligence, and clarity of purpose.

Law effectiveness

In order for a new law or regulation of some kind to be effective, it must also meet the following criteria

- To a large extent it should be a codification of what is already the best practice of the social body it is addressing. Attempts to impose new practice by means of regulation are bound to fail or would require very powerful means of implementation and harsh sanctions. That would also turn out to be counterproductive considering value creation aspects. Companies thrive on risk taking and innovativeness, i.e. they are highly dependent on freedom of action which is not the same as acting irresponsibly.
- An effective law must be in consonance with the values already embodied in society or values those concerned would like to see supported. Shared values emerge over time and as a result of shared experience, particularly of proven success, courageous acts, inspiration by role models, but also by overcoming difficulties and severe crises.

A good example in this context is the Swedish Company Act (SCA). It clearly defines the differentiated roles of the three key bodies in the governance of a company: the owners, the board and the CEO. It puts the owners on top – “in the driver´s seat” – and gives the AGM clear constitutional supremacy. It was based on best practice to a large extent, not least on the role model of Marcus Wallenberg Sr (MW Sr; 1864–1943), son of the dynasty founder, and the one who developed the industrial sector of the Wallenberg sphere. Not only did he play the role of an engaged and committed owner, he was also keen and never spared any effort to find the best man to be the CEO as well as to surround himself, often as chairman of the board, with competent board members of high integrity (he did not like “yes men”). In addition, a triggering factor for the SCA and a reason why it acquired such a distinguished quality was the ensuing trauma of the Kreuger scam and financial disaster in the early 1930s.[5]

The limits of governance by regulation

The theoretical advances made some sixty years ago by the science of systems analysis and cybernetics are good to keep in mind, e.g. on analyzing and designing control and regulatory systems. One of its fundamental postulates is called the law of requisite variety, outlining the prerequisites of control.[6] In ordinary language: if you want to control something, someone or a subordinate system you must be smarter than the object of your control. A frequent metaphor to drive home the case in point is the relation between a cat and a caught mouse. Whatever the mouse tries to get away with, the cat has superior means to stop it. The cat has requisite variety in relation to the mouse.

Should one lack requisite variety – what are the options? Basically, there are two:

- The option once applied by the Communist regimes: using sheer and brute force to impose, e.g. a preconceived economic plan with little regard for changing environments, what the citizens really want and without much individual adaptation, a “one-size-fits-all” dogma.
- The alternative option is self regulation, decentralizing power as much as possible and relying on a minimum of regulation to safeguard certain principles of an open market, competition, entrepreneurial freedom, ownership rights etc. In a wealth creating society, the costs of regulation should also be weighed against the benefits it brings. There are of course certain unalienable rights justifying the costs it takes to uphold them, but a cost-benefit analysis should accompany any new regulatory propositions.

Of course, the latter is the only option in a civilized society. This should also make it obvious that we need to focus on “first things first” – that companies are the vehicles for societal wealth creation by pursuing their endeavors of sustainable value creation.

[5] For more information about Ivar Kreuger, please see Wikipedia!

[6] Ashby, W. Ross (1956) Introduction to Cybernetics; Chapman & Hall, London.

An alternative and wider frame of reference: Putting the horse before the carriage – the mission of sustainable value creation

Sustainable value creation must be the primary concern of corporate governance because that is what a company is all about, because it generates the wealth of the society, and because it is so complex and demanding that we must see to it that companies are supported by the best prerequisites we can muster.

The amazing phenomenon of the modern company – a valuable and indispensable societal asset

Companies are extremely valuable societal assets – precious, yet vulnerable human and social creations. They are the vehicles for wealth creation for the economy and the society at large, given that they succeed in creating sustainable value. It follows that in pursuing the process of sustainable value the companies must play a plus-sum game with all its stakeholders, i.e. all other parties a company interacts with. Just remember that the future is not predictable. You never know what other company, potential customer or partner you will come across around the corner. You need to deserve the trust of all around you. In a plus-sum-game everybody wins – and the economy as a whole grows.

In addition to creating wealth by supplying consumers and the society at large with goods and services, companies have become indispensible social institutions. They provide employment, career opportunities, and social community to large parts of the population. Furthermore, they are social innovators, developing organizational solutions for how to coordinate and make productive a variety of resources – people, machines, input materials, equity as well as, and not least, knowledge.

The rest of the society has also benefitted from the social innovation achievements of the companies. Government agencies, non-profit organizations, hospitals and other institutions owe a lot of their management practices, personnel policies, organizational solutions etc to what the dynamic companies have come up with, driven both by intense competition and freedom to try new ways.

However, all the benefits created by companies cannot be taken for granted. Some companies succeed, but many fail at some point. So, let us take a look at what is required to succeed in the creation of a company as well as what it takes to achieve sustainable value creation.

A company starts and ends with an owner, with "real ownership"

Creating sustainable value starts with an owner – and if the value creation process fails, "the buck will stop" with the owner. Without an initial entrepreneur/founder/owner – often the same person – there won't be any sustainable value created at all. It is also that person who embodies the unique idea of how and with what to create and serve a new customer. The personal embodiment means that there are existential driving forces involved such as perseverance, a strong will to overcome upcoming difficulties and to see the process through to lasting results. Business success cases are rare, particularly the ones that have the potential to eventually become big corporations like IKEA, founded by Mr. Ingvar Kamprad and Tetra Pak (now Tetra Laval), started and developed by Dr. Ruben Rausing followed by his two sons, Hans and Gad.

So, the scarcest resource to be recognized by corporate governance is the committed, dedicated, competent, idea embodying owner and the long term committed equity capital that follows the owner. I like to call this type of ownership "real ownership".

While people, including "real owners", are mortal, companies can live forever. So, the transfer of ownership in due course becomes critical, not only the financial ownership, but everything the former, "real owner" stands for.

The different worlds of fundamental value creation and the stock market

"Real ownership" is very different from what one usually finds going in and out of the stock market – short term speculators, index chasers, and day traders. At best they contribute by mobilizing the overall supply of equity capital. Of course, corporate governance should see to it that their rights are not abused, but their role and importance for the fundamental processes of value creation cannot be compared with that of the long term committed owners.

While an invest/divest decision can be done by the blink of an eye in the stock market, the investments in fixed assets, organization and people to produce products and services are for the long term. To accommodate the vast gap between the two worlds we badly need the long term committed owners.

The purpose and goal of a company

Sustainable value for shareholders is often referred to as the goal of a company. However, you will only know in retrospect if that will be the outcome. For Swedish success stories like IKEA and Tetra Pak, it took around twenty years before they had achieved their full commercial breakthroughs. So, companies cannot be governed by shareholder value (Wall Street & co may disagree).

The most influential thinker on management of our time, Peter F. Drucker, suggests that the role of a company is to "create a customer".[7] The statement contains two messages: the role of a company is to serve customers but it should also make a difference by creating a customer that did not exist before. So, it is up to each and every company to define its own, unique idea of what new customers it should create – as did Mr. Kamprad for IKEA and Dr. Rausing for Tetra Pak etc. Sometimes such an idea is clear in the head of the founder/entrepreneur from the beginning – as in the case of Dr. Rausing.[8] In other cases the unique idea follows as the outcome of a learning process – as in the case of Mr. Kamprad.[9]

If a company offers products and services highly valued by its customers and manages to produce and deliver efficiently profitability will follow. The value of such a company will grow. So, sustainable value creation – hopefully and eventually – becomes the validation of a good company.

The challenges of eternal company life

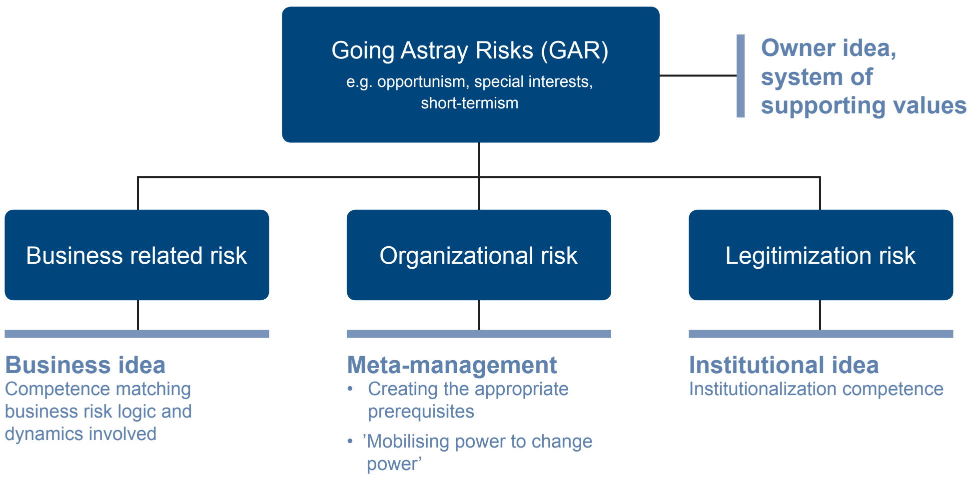
It is one thing to get a company started and to transfer ownership to a new dedicated owner. But what is required to keep the company going day in and day out in an environment characterized by *the process of creative destruction*?[10]

The intriguing interplay of taking risks and reducing/eliminating risks

Running a business is about taking risks, but it is also a matter of reducing and/or eliminating risk, the whole panorama of risk and the dynamics of risk. Based on my research and experience I have found it fruitful to distinguish four major categories of risk, one of which is different from the rest and the most fundamental. Figure 3 below will give an overview of the four types and the corresponding competence required to deal with each category. This intriguing and demanding topic should deserve a whole book. In this context, I can only try to give some hints about what is involved.

[7] Drucker (1909-2005) in his book The Practice of Management, New York 1954.
[8] Dr. Rausing was clear from the outset that he wanted to offer the type of milk packaging that eventually was achieved.
[9] Mr. Kamprad started his entrepreneurial activities selling a variety of products, e.g. seeds, pens, matches and similar, until he spotted the opportunity to take advantage of economies of scale in getting wooden furniture produced in Poland and selling them at low prices. He built IKEA from that and changed the entire furniture industry.
[10] Schumpeter, J. A.(1942) Capitalism, Socialism, and Democracy; New York: Harper & Row.

Figure 3 Reducing / eliminating risk – what competence?



GAR – Going Astray Risk – the most dangerous
GAR is the most dangerous because it threatens the very basis of the company, the owner idea. To eliminate this risk the owner idea and all the values to support it must be thoroughly infused into the organization of the company – from bottom up and through management, the board and the current owner(s).

The three other categories of risk
Business-related, organizational and legitimization risks have a cognitive character. It is a matter of identifying emerging new risks, of understanding the particular situation and position of the company. To see what needs to be done one must assess whether or not the identified risks threaten the business idea – the way the company has achieved its business success so far – or its institutional idea – the way the company has gained its legitimacy in the past. So, this is a demanding task, involving executive management as well as the board and the committed owner, the whole value creation hierarchy. The required board competence is multidimensional, in addition to a thorough understanding of the company, it should include an extensive experience, a wide frame of reference, conceptual skills, creativity, and a constructively critical mind to build upon input from executive management and contributions from fellow board members while adding individually independent views and judgments.

Risk elimination – a matter of meta-management by the value creation hierarchy
In relation to executive management, the board should have a stronger risk orientation – based on its longer and richer experience. Executive management should be driving and eager to extend the business while the board should make sure that executive management identifies all risks – both of new initiatives and, not least, of not taking initiatives to counter new competition, acquiring new skills and technologies etc.

Most importantly, the board should closely monitor the learning capability of the executive management and the entire organization. If *organizational learning* falters and the board finds that the cause of it goes all the way to the top, the CEO must be replaced.[11)] Together with the new CEO, very often even more drastic changes are needed. Such intervention by the board means that it exercises *meta-management*.[12] The board should not micro-manage the organization. It should only intervene when the prerequisites for executive management to carry out its delegated responsibility needs to be changed. Meta-management is thus a prerequisite for delegation. In particular, meta-management will be called for when emerging risks are threatening the very foundation of the company – its business idea and institutional idea respectively – when the really difficult decisions are facing the board!

At the top of the value creation hierarchy, the committed and competent owner must exercise meta-management in relation to the board.

Summing up the challenges of the corporate governance mission of value creation

I hope this paper has been able to convey some aspects of the crucial mission of governing our companies so as to boost sustainable value creation and the societal wealth that follows. I have only been able to scrap on the surface of the complexities of that demanding task, but hopefully I have provided some food for thought and some hints about how much more there is to know to understand and fully appreciate the amazing world of companies as vehicles for value and wealth creation.

Redirecting the corporate governance focus – the tall order ahead

Sweden should take the lead in an assembled effort to redirect the focus of corporate governance to the mission of sustainable value creation. We have a lot to be proud of regarding both sustainable value creation and the Swedish corporate governance model, but also a lot to lose if EU should succeed in imposing much additional regulation.

However, I must leave it to others and another context to discuss and suggest how to tackle this urgent and challenging issue. Just remember: when we defend the Swedish model, we fight for more than a Swedish special interest. Our cause will also serve to remedy a fundamental flaw of most corporate governance systems – the dearth of "real ownership".

[11] The concept of organizational learning was pioneered by SIAR (Scandinavian Institutes for Administrative Research) under the leadership of Eric Rhenman (1932-93) in the late 1960s as part of SIARs´ research program The problems of large organizations in a structurally changing environment. The concept refers to the capability of organizations to learn, to acquire new capabilities so as to adapt to and be able to cope with changing competitive environments. The concept is explained in Carlsson, Rolf H (red.) Strategier för att tjäna pengar; om affärsidén och andra SIAR-koncept. Ekerlids Stockholm 2000.

[12] See figure 3 and the "competence box" for a mini-definition of meta-management to cope with organizational risk.

If you have any questions or comments for the Swedish Corporate Governance Board, please feel free to contact us.

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