

The Swedish Corporate Governance Model

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Fundamentally, Swedish corporate governance resembles that of most of the industrialized world and is closely in line with key developments within the field during the past few decades. Still, because of specific circumstances regarding, for example, regulatory framework and ownership structure, it has some distinctive differences compared with governance practices in other countries, notably those with an Anglo-Saxon judicial tradition.

Rather than trying to convey a comprehensive picture of all aspects of Swedish corporate governance, the aim of this chapter is to highlight some distinctive features of the Swedish governance model.

6.14.1 Regulatory Framework

The regulatory framework for Swedish corporate governance is made up of legal requirements – primarily the Companies Act – as well as self-regulation, such as the Stock Exchange’s rules and the Swedish Corporate Governance Code.

The Companies Act has been subject to a thorough review during the past 15 years, and a new Act came into effect on 1 January 2006. Sweden therefore has a modern Companies Act, and the review, besides implementing EU directives, focused on shareholders' rights and corporate governance issues. In fact, many aspects of modern corporate governance that in other jurisdictions are regulated through corporate governance codes are incorporated in the Swedish Companies Act. Examples include matters of board composition, division between the positions of CEO and chairman, approval of principles for the remuneration of management by the shareholders' meeting and transparency towards the shareholders and the general public.

Since the early 1990s, certain aspects of modern corporate governance have also been introduced into the rules of the main Swedish stock exchange, the privately owned OMX Nordic Exchange Stockholm, such as requirements on the composition of boards and the independence of board directors. Today these provisions have also been adopted by the second stock exchange in Sweden, Nordic Growth Market (NGM), which means that all companies listed on a regulated market in Sweden are contractually bound to comply with these rules.

There is a long tradition of self-regulation in the Swedish private business sector. The prime manifestation of this in the field of corporate governance is the Swedish Corporate Governance Code, introduced on 1 July 2005. This code, which is based on the principle of 'comply or explain', resembles the codes of other EU member states, although it differs on some points, owing to the specific Swedish circumstances mentioned earlier. During its first year of application the Code was mandatory only for about the 100 largest companies on the OMX Nordic Exchange Stockholm, although in practice it was applied in full or part by many smaller listed companies too. However, on 1 July 2008 a revised version of the Code became mandatory for all Swedish companies listed on a Swedish regulated market, at present amounting to about 300 companies. The Code is administered by the Swedish Corporate Governance Board, an independent body within the Swedish self-regulatory system.¹

Other important aspects of the Swedish self-regulatory system in this field include the work of the Swedish Securities Council, which interprets and issues statements about the meaning of the concept of good practice on the securities market – which all listed companies

are contractually bound to follow – as well as the ownership policies issued by many institutional investors.

6.14.2 A Different Corporate Governance Structure

From a structural point of view the Swedish corporate governance model offers a third alternative to the so-called one-tier or unitary model, prevalent in countries with a predominantly Anglo-Saxon judicial tradition, as well as the two-tier model used in Germany and several other continental European countries. See Figure 6.14.1.

The Swedish corporate governance model is based on a hierarchical governance structure in which each governance body has far-reaching powers to issue directives to subordinate bodies and to some extent even take over their decision-making authority. With few exceptions, where the board has exclusive decision power or veto right, the shareholders’ meeting is sovereign to decide on any company matter, including – where appropriate – to issue express instructions to the board. In practice, however, such powers are rarely used in listed companies, where they would most likely trigger the immediate resignation of the board directors.

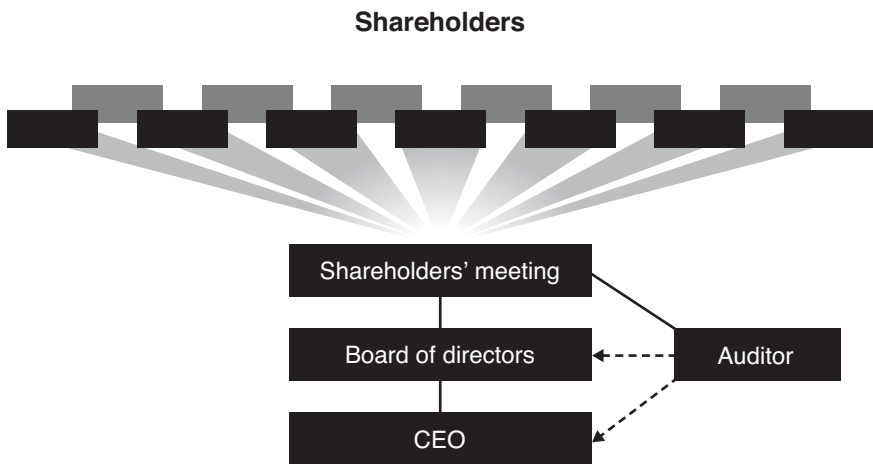


Figure 6.14.1 *The Swedish corporate governance model*

Source: Adapted from the Swedish Code of Corporate Governance, Stockholm, 2008 by permission

Subordinate to the shareholders' meeting there is a unitary board. However, in contrast to the predominant situation in US and UK boards, Swedish boards are entirely or predominantly non-executive. In listed companies no more than one person from the company management may sit on the board. This possibility is used in half of the listed companies, usually by appointing the CEO a member of the board.

Subordinate to the board there is a single-person CEO function, legally defined in the Companies Act to be responsible for the day-to-day management of the company. Also by law, the positions of chairman and CEO may not be held by the same individual. The board may at any time dismiss the CEO without stated cause.

6.14.3 Concentrated Ownership

An important institutional precondition for Swedish corporate governance is the relatively concentrated ownership structure on the capital market. Whereas the majority of listed companies on the US and UK stock markets have a highly dispersed ownership structure, the ownership of many Swedish listed companies is – like the situation in many continental European countries – dominated by one or a few major shareholders. Such controlling shareholders are generally expected to take a long-term responsibility for the company by holding on to their shareholding even in rough times, when owners with a more short-term perspective tend to 'vote with their feet', and to take an active role in the governance of the company. In fact, the notion of widely dispersed ownership structures, resulting in what are sometimes referred to as 'masterless companies', is regarded with considerable scepticism on the Swedish capital market.

6.14.4 Strong Ownership Powers

Through the far-reaching authority of the shareholders' meeting, as outlined above, the Swedish corporate governance model provides the groundwork for the exertion of strong ownership powers. These powers may be further enhanced through the use of shares with multiple voting rights, so-called A and B shares. This system, which allows for high-voting shares with up to 10 times the votes of other shares, is currently in use by about half of Swedish listed compa-

nies. From a Swedish point of view the system is generally defended on the grounds that the principle of freedom of contract should be allowed to prevail for actors with full legal capacity on the capital market as long as the rights of all shares are fully disclosed. It is also seen to counteract a development towards increased ownership power of various forms of institutional investors, some of them with a relatively short investment horizon, at the expense of long-term 'flesh and blood' owners.

As has already been mentioned, it is not only tolerated but generally expected by other shareholders, as well as Swedish society at large, that a controlling owner will take a special, long-term responsibility for the company by holding on to his or her shares in less prosperous times for the company and by taking an active part in the governance of the company. The latter may involve not only the exertion of ownership rights at the shareholders' meeting but also, invariably, taking seats on the board of the company. Thus, Swedish rules of board independence requires only two board members to be independent of major owners (defined as owners of more than 10 per cent of the capital or votes of the company), whereas they require a majority of the directors to be independent of the company.

Another outcome of the Swedish belief in strong ownership power is the way the concept of nomination committees has been applied in Sweden. Contrary to the situation in most other countries, where the nomination committee is a subcommittee of the board, Swedish nomination committees are appointed by the shareholders and made up predominantly of major shareholders or their representatives. The rationale behind this is the belief that the board should not nominate its own members, but instead nominations should be made by a body representing the shareholders.²

The different role of the auditor as compared to that in some other countries is also an important feature of Swedish corporate governance. The auditor of a Swedish company is appointed by and reports to the shareholders' meeting, and has a duty not only to examine the annual accounts and the accounting practices of the company but also to review the performance of the board and the CEO (see Figure 6.14.1). As part of the report to the shareholders' meeting, the auditor is obliged to make a recommendation on the issue of discharge from liability of the board and CEO and to report the fact if any board member or the CEO has acted in a way that may give cause for liability for damages. This has important repercussions for the relationship between the auditor and the board.

Most fundamentally, it means that a Swedish board is not the issuer of the auditing assignment, but is subject to auditor review. It also means that neither the board as a whole nor its audit committee may issue instructions to, or otherwise try to influence the work of, the auditor.

6.14.5 Protection of Minority Rights

Balancing the strong ownership powers just outlined, the Swedish Companies Act provides for relatively far-reaching protection of shareholder minority rights. This is obtained primarily in three ways.

First and foremost is the strict legal obligation of Swedish companies to treat all shares equally, unless otherwise prescribed in the articles of association (for example, they might prescribe shares with different voting rights). Furthermore, the Companies Act contains a strong general clause prescribing that the shareholders' meeting, the board or any other company body may not make a decision that might give undue advantage to some shareholders at the expense of the company or other shareholders. Any such decision would be legally invalid if challenged.

Second, individual shareholders have strong rights, by tradition inherent in the Swedish corporate governance system. Thus, most of the provisions of the EU Shareholders' Rights Directive have long since been included in Swedish legislation. For example, any shareholder, regardless of the number of shares held, has the right:

- to have items and resolution proposals included on the agenda of the shareholders' meeting;
- to ask questions at the meeting and have these answered by the board or the CEO as long as such answers can be given without causing harm to the company;
- to file counter-resolutions at the meeting;
- to exercise the voting rights of all his or her shares.

A weak point in this context has been the traditional requirement of presence in person or by proxy to vote at Swedish shareholders' meetings. This has caused practical difficulties for some shareholders, in particular for foreign institutional investors, to exercise their

shareholder rights. A first step to cope with this problem was taken with the new Companies Act, which provided for a form of postal voting by proxy. The next step will be taken with the implementation of the Shareholders' Rights Directive, which will probably open the possibility for companies to provide for postal voting fully in line with standard international procedures.

The third line of defence of minority shareholding rights is the possibility that minorities of various sizes can block certain resolutions at the shareholders' meeting, for example decisions regarding amendments of the articles of association, mergers and de-mergers, and changes in the share capital structure, and to force other decisions such as to call an extraordinary shareholders' meeting, to make a minimum dividend distribution and to appoint a special minority auditor and/or a so-called special examiner. The size of minority holding required ranges from a third down to 10 per cent for blocking certain shareholder's meeting decisions and for forcing the actions mentioned.

6.14.6 Far-reaching Transparency Standards

The Swedish self-regulatory system was early in adopting the requirements of openness to the shareholders and the capital market at large of modern corporate governance, in particular those dealing with the remuneration of board directors and top management staff. Many of these provisions have subsequently been taken over by law, whereas others are now incorporated in the Code. The current main requirements are in brief as follows.

By law, all remuneration of board members and the CEO of public companies, split into its main components, including pension schemes and severance pay obligations, is to be disclosed at an individual level. The law further requires guidelines for the remuneration of senior management of the company to be presented for adoption at the annual shareholders' meeting. Furthermore, the remuneration of this group as a whole, split into its main components, is to be disclosed in the annual report. The Code requires all share-related incentive programmes to be approved by the owners at the shareholders' meeting.

Additional key disclosure requirements are full disclosure of all related-party transactions, where related parties are defined as large shareholders, board members, the CEO, and employees of the

company and its group companies. In addition, large transactions with related parties require approval by the shareholders' meeting.

6.14.7 Future Challenges

As should be evident from this short account, Swedish corporate governance reflects certain circumstances regarding ownership structure, legislative tradition and other specific features characteristic of this market. At the same time, foreign ownership of Swedish listed companies has increased significantly during the past decade and amounts today to more than a third of the total stock market. The investors behind this development, mainly large institutional investors of British or US background, sometimes find it difficult to fully comprehend and appreciate some of the specific features of Swedish corporate governance.

In the long term this will place increasing pressure on Swedish corporate governance to adapt to 'international' – in reality Anglo-American – governance standards. In fact this process is already going on. On the other hand, it is of vital importance for Swedish corporate governance to be solidly founded in the preconditions prevailing in this market. This balancing act of adapting to international governance standards while maintaining a strong foothold in local traditions and market preconditions presents a key challenge for the future development of Swedish corporate governance.

Notes

1. See the Board's website: www.corporategovernanceboard.se.
2. For a more comprehensive discussion of this matter, see Lekvall, P (2008) *Nomination Committees in Swedish Listed Companies*. The International Corporate Governance Network 2008 Yearbook.

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The Swedish Corporate Governance Board is an independent, self-regulatory body, responsible for monitoring and fostering the Swedish Corporate Governance Code. It comprises 10 individually appointed, high-ranking representatives of the Swedish private business sector, with professional backgrounds ranging from board and management experience to private and institutional ownership. The Board is one of four bodies within the framework of the Association for Good Practice on the Securities Market, which administers the private business sector self-regulation in Sweden. For further information, go to www.corporategovernanceboard.se.