Convergence of National Corporate Governance Systems: Localizing and Fitting the Transplants
CONVERGENCE OF NATIONAL CORPORATE GOVERNANCE SYSTEMS: LOCALIZING AND FITTING THE TRANSPLANTS

ULF LARSSON-OLAISSON

LINNAEUS UNIVERSITY PRESS
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The purpose of this thesis is to elucidate the phenomenon of legal transfers from the perspective of the dominant comparative corporate governance research paradigm. Drawing on legal studies and empirical observations, the thesis develops a terminology for understanding the legal transplant metaphor in comparative corporate governance and problematizes the debate on the convergence or divergence of corporate governance systems.

This purpose is achieved through five empirically-based articles that are included in the thesis. The first article concerns a change in the Swedish Companies Act that allows for stock repurchases. The second article discusses the voluntary and then mandatory introduction of nomination committees. The third and the fourth articles focus on the introduction of the Swedish corporate governance code. Finally, the fifth article discusses the role played by independent directors in the Swedish corporate governance setting.

The focus on legal transplants broadens the framework of comparative corporate governance in three respects. First, it develops and applies a clearer framework for distinguishing between accepted and rejected legal transplants (based on Watson, 1974, Miller, 2003 and Mattei, 1994), thus refining the debate regarding convergence or divergence of corporate governance systems (e.g. Hansmann and Kraakman, 2004, and Branson, 2001). Second, the empirical studies demonstrate how imported regulations can be "localized" (Gillespie, 2008a) by local regulators and/or "fitted" (adapted from Kanda and Milhaupt, 2003) by other local actors. The studies show that fitting often precedes localizing. Third, the thesis adds to a growing body of research (e.g. Buck et al., 2004; Lutz, 2004 and Collier and Zaman, 2005) emphasizing that convergence and divergence are not necessarily two empirically or analytically distinguishable processes. Rather, depending on the perspective of the scholar, convergence and divergence might refer to very similar – or even identical – processes. Finally, in focusing on the transplant process, this thesis offers a description and analysis of the role played by various key actors in the Swedish corporate governance system.
Abstract


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Finally, in focusing on the transplant process, this thesis offers a description and analysis of the role played by various key actors in the Swedish corporate governance system.
Acknowledgments

"Fortsätt när de lynchat sista hoppet
Fortsätt när allt du levt för räknats ut som ett skämt
Där under träden, bakom stängslet finns en stig för dig,
Fortsätt"

HH, 2010

It took me eleven years to write this dissertation. Contemplating this fact, with a personality predisposed for sentimentality, I could easily make this foreword somewhat over-pretentious, I would therefore humbly like to thank a long list of people.

First of all, thank you Lena, my wife, for everything, 'for better or worse'; and to Holger and Valter, for showing me that a dissertation is, after all, not all that important. To my mother, father and brother (and his family), thank you for supporting me, and for trying to understand. Also, my in-laws have been very helpful.

Second, my supervisor, Karin Jonnergård, not only provided continuous support, but took an active part in shaping how I understand the world. To Matts Kärreman, my second supervisor, who during the first half of this processes made me understand the difference between what a text says and what is understood by a reader. During the formal process of writing my dissertation, with examination and seminars, I received valuable help from Kristina Artsberg, Per-Olof Bjuggren, Sven-Olof Collin, Jaan Grünberg, Ola Nilsson, Micaela Sandell, Eva Schömer and Anna Stafsudd. For eloquently performed proofreading I like to acknowledge and thank Staffan Klintborg (Chapter Three, Four and Six), Lori Linstruth (Chapter Five) and Steven Sampson (Chapter One, Two, Seven, Eight, Nine and Ten). Certainly, I take full responsibility for remaining errors.

Third, a grand thank you to all my colleagues, many of whom I also consider my friends, at the School of Business and Economics, in Växjö. Especially everyone at my department and the so-called Cosy-trap.

Finally, financial support has been provided from Handelsbankens forskningssifte (Jan Wallanders och Tom Hedelius stiftelse). Further, Växjö University, SNS and Crafoordska stiftelsen contributed.

Jönköping, 12 of September 2014

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Jönköping, 12 of September 2014
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1. INTRODUCTION AND BACKGROUND

This dissertation describes how corporate governance regulations move from one national corporate governance system to another. Corporate governance regulations are defined as any form of recommendation or demand placed on listed firms and issued by a corporate governance regulator supported by an enforcement mechanism (including soft regulations supported by, e.g., comply or explain). Following Shleifer and Vishney (1997), ‘corporate governance’ is defined as ‘the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment’ (p. 73). Following this, a ‘corporate governance system’ is a national system of societal norms, regulations and institutions that supports the suppliers of finance and thereby ensures that the firms within the system will be financed. Thus, the corporate governance system is of national concern, as it affects how corporate operations are externally financed, the number of listed firms that exist in a country and how the firms can function. To move rules from one domain to another, or to transplant them as will be the preferred term for this project, is an important and common source of legal development (Watson, 1974; La Porta, Lopez-De-Silanes and Shleifer, 1999; La Porta, Lopez-De-Silanes, Shleifer and Vishny, 2000). Watson defines ‘transplant’ as ‘the moving of a rule or a system of law from one country to another, or from one people to another’ (1974, p. 21).

These definitions of essential concepts place the topic of this book at the centre of the dominant comparative corporate governance research paradigm (e.g. Shleifer and Vishney, 1997; La Porta, Lopez-De-Silanes, Shleifer and Vishny, 1998; La Porta et al., 1999; 2000; Coffee, 2001; Hansmann and Kraakman, 2004). The theoretical and scholarly impact of this tradition is indisputable. Besides scholarly impact, this stream of research has also had wide-ranging policy implications relevant to most corporate governance systems. Over the past 15 years, this research tradition has had a huge impact on the way in which corporate governance problems are being defined for regulators, entrepreneurs, managers and suppliers of finance (both equity and debt). In this book the consequence of policy implications from the dominant comparative corporate governance research paradigm – a causal relation from corporate governance research to corporate governance reform – is not discussed per se; however, it is clear that

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1 The web of science citations for the above references add more than 4000, where La Porta et al., 1998; 1999 and Shleifer and Vishney, 1997 are the five most frequently cited articles in the area of corporate governance.

2 Although La Porta, Lopez-de-Silanes and Shleifer (2008), in one of their latest articles, claim that their work has ‘encouraged regulatory reforms in dozens of countries’ (2008, p. 61) and as reported by Siemens and Deakin (2010) ‘the EU Commission’s impact assessment on the Directive on Shareholders’ Rights explicitly referred to them in order to justify their recent reform’ (p. 4).
actual regulatory corporate governance reforms in Sweden (as well as the EU) are similar to what comparative corporate governance research would have recommended: more emphasis on minority shareholder protection so as to strengthen the capital markets and doing this by transplanting UK/US regulations (e.g. La Porta et al., 1998; 1999; 2000; Coffee, 2001; Hansmann and Kraakman, 2004; Fleischer, 2005).

The aim of this dissertation is to fill in a gap in the dominant comparative corporate governance research paradigm by discussing the concept of legal transplants. Theoretical inspiration for this study comes from the work of more empirically interested scholars working at micro level, such as Gillespie (2002; 2008a) and Kanda and Millhaupt (2003), in contrast to the more macro-oriented empirical research traditionally carried out within the dominant comparative corporate governance research tradition (e.g. La Porta et al., 1998; 1999). In this study, the focus is on Swedish corporate governance legal transplants from the Anglo-American corporate governance systems. The main finding of this book is that transplanted corporate governance regulations indeed change the receiving corporate governance system, although not always in the ways expected. Rather than universal solutions provided by comparative corporate governance research, such as strengthening minority shareholder protection by legal transplantation, contextual explanations are needed in order to understand why minority shareholder protection in the ‘donating’ system might become for instance minority shareholder vulnerability in the receiving system. A focus on the dynamics of legal transplants in the Swedish setting can shed light on the discussion of convergence and/or divergence in comparative corporate governance research. In fact, this book will demonstrate that convergence and divergence could be interpreted as being identical, depending on the perspective of the researcher.

This dissertation consists of five articles, all of which describe aspects of transplantation of Anglo-American corporate governance regulations to Sweden. The articles are integrated insofar as they all touch on regulatory change through transplant (the theoretical phenomenon); and observe this change in a national Swedish corporate governance system (the empirical object). The integration of the five articles is done in this introduction chapter and in the discussion chapter (Eight) and is concluded in Chapter Nine. Finally, some of the findings of this study stretch beyond comparative corporate governance, elucidating the specific features of the Swedish corporate governance system. These features will be discussed in the final Chapter Ten.

1.1 Harmonization, Convergence and Legal Transplants

The idea that the internationalisation of capital markets leads to harmonisation of corporate governance regulations appears to be taken for granted by most scholars and regulators. This Darwinist natural selection argument of the development of an economic system is attributed to Alchian (1950). In his discussion of profit maximisation, Alchian considered the economic system rather than individuals or firms.
He claimed that: ‘among all competitors, those whose particular conditions happen to be the most appropriate of those offered to the economic system for testing and adoption will be “selected” as survivors.’ (pp. 213-214). In a corporate governance setting, this would imply that a system based on second best corporate governance loses the firms due to capital starvation or because of migration (Coffee, 2001; Gilson, 2004). Only by keeping the firms can the system survive. Amongst Swedish corporate governance regulators, this view is typified by the following quote from the regulators drafting the latest Swedish companies act:

The Swedish business sector is very eager to obtain the same possibilities as in the other countries we usually compare ourselves with […] The committee understands their demands […] It is a disadvantage that Swedish firms do not have the same possibility (The Swedish regulator drafting a new company act, SOU 1997:22 p. 250, regarding stock repurchases, author’s translation).

The European Union (EU) and its commissions striving for harmonised corporate governance regulations must also be understood as a consequence of economic Darwinism:

A dynamic and flexible company law and corporate governance framework is essential for a modern, dynamic, interconnected industrialised society. Essential for millions of investors. Essential for deepening the internal market and building an integrated European capital market. Essential for maximising the benefits of enlargement for all the Member States, new and existing. Good company law, good corporate governance practices throughout the EU will enhance the real economy: – An effective approach will foster the global efficiency and competitiveness of businesses in the EU (Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward, COM [2003] 284, emphasis as in original).

These two quotes appear to be representative of a consensual view among regulators of how diverse national corporate governance regulations are become more similar to each other as a result of financial globalisation. Regardless of whether this is ‘true’, ‘desirable’ or ‘empirically testable’, it is a basic assumption of this study that most actors responsible for the regulatory development of corporate governance subscribe to this consensual view.

The view of the regulators is also echoed in the work of the scientific community. For instance: ‘The internationalization of capital markets means that investment flows may move against firms perceived to have suboptimal governance and thus to the disadvantage of the countries in which those firms are based’ (Gordon and Roe, 2004, p. 2).

Further, a theoretical term for this harmonisation of national regulations in the face of globalisation is ‘convergence’, where the inefficient corporate governance systems converge on the most efficient system’s solution, or it will inevitable perish in the competition. The strongest argument made for global corporate governance convergence through regulation is usually attributed to Hansmann and Kraakman (2004), in their article ‘The End of History for Corporate Law’. Drawing on the historian Fukuyama (1992), who
claimed the end of history for different political systems by the overwhelming ‘victory’ of the liberal democracy following the collapse of communism in 1989-1991, Hansmann and Kraakman claim that the shareholder-centred model of corporate law is the only viable model. This implies that the more stakeholder-oriented models of continental Europe are in need of change. In the words of Hansmann and Kraakman: ‘the pressures for further convergence are now rapidly growing. [...] This emergent consensus has already profoundly affected corporate governance practices throughout the world. It is only a matter of time before its influence is felt in the reform of corporate law as well’ (2004, pp. 33-34).

Implicitly, there are two separate arguments in the Hansmann and Kraakman quote, and both arguments have consequences for the study of changing corporate governance systems. The first argument could be called the ‘convergence as an unstoppable force’ thesis and the second ‘convergence produced by regulatory reform’ thesis. For Hansmann and Kraakman, these are two versions of convergence: i) a theoretical claim as a positive stance, where the inevitable power of the global financial markets forces the inefficient corporate governance systems to converge on the efficient ones (compare with Alchian, 1950, above); and ii) a more or less normative claim where regulators of corporate governance are advised to reform local corporate governance systems in a specific direction before it is too late.

In this study, the consequences of the normative convergence school are examined in more detail, with a focus on the effect of regulatory changes on the Swedish corporate governance system. Two questions are pertinent here: How did regulators of Swedish corporate governance change the Swedish corporate governance system to make it more like the internationally regarded best corporate governance system? And what was the effect of these regulatory processes on Swedish corporate governance? Among the most influential scholars, the consensus is that the best corporate governance system is the Anglo-American (e.g. La Porta et al., 2000; Coffee, 2001; Oxelheim and Randøy, 2003; Hansmann and Kraakman, 2004). The Anglo-American corporate governance system, as the concept is used here, is a construct, and should not be confused with the actual corporate governance system in the USA or the UK. Instead it consists of a set of ideas of what constitutes good and efficient corporate governance (most often found in the U.S. and Britain), that is, it is a normative consensus among regulators and leading scholars.

This study does not concern itself with the normative debate of whether the Anglo-American corporate governance model is superior. This is an impossible question to answer without stipulating ideological or political views that are beyond the scope of this dissertation. In relation to this, it should be emphasized that the study does not intend to generate any normative claims or policy implications. Rather, the focus will be on understanding the processes whereby Anglo-American rules and regulatory practices are implemented into the Swedish corporate governance system. This is a process where policy implications based on strong theoretical claims (as convergence) are translated into actual practices by the regulators. This is a veritable minefield for those scholars who wish to avoid normative positions.
The last decade has witnessed a vast number of regulatory changes in Sweden, where Anglo-American rules and regulations have been grafted onto the Swedish corporate governance system. In this study, four cases of such grafting (in five articles) are described in order to shed light on the consequences of this process. The case examples are: i) removal of the ban for stock repurchases; ii) the voluntary and then regulated introduction of nomination committees; iii) the introduction of a Swedish corporate governance code; and iv) the definition of independent directors. The five articles stand alone as theoretical and empirical contributions to a more general understanding of changes in corporate governance, the premise being that there are general lessons to be learned from the implementation of Anglo-American corporate governance regulations in Sweden.

To capture this implementation of Anglo-American rules and regulations in the Swedish corporate governance system, the metaphor of ‘transplant’ is utilised (e.g. Watson, 1974; Kahn-Freund, 1974). The transplant metaphor, as will become evident below, is a much discussed metaphor in legal studies. In the dominant comparative corporate governance research, however, legal transplants are considered unproblematic. Hence, La Porta et al., write: ‘Our starting point is the recognition that laws in different countries are typically not written from scratch, but rather transplanted – voluntarily or otherwise – from a few legal families or traditions (Watson 1974)’, (1998, p. 1115). Further Djankov, Glaeser, La Porta, Lopez-De-Silanes and Shleifer, commenting on La Porta et al.’s (1998) results notes that:

transplantation, rather than local conditions, exerts a profound influence on national modes of social control of business, including both state ownership and regulation. This evidence poses a challenge to standard theories of regulation, which emphasize local industry conditions and the power of interest groups to explain regulatory practice (2003, p. 610).

Similarly, Coffee in discussing the development of transit economies notes that:

this transition seems to have largely involved the outright transplantation of common law legal rules for civil law rules, with the total package of legal reforms being usually designed by foreign legal advisors (often supplied by the United States). Still, because these reforms have been legislatively adopted, this wholesale transplantation seems to indicate that, at least under the pressures faced by transition economies, law makers have not felt obliged to maintain continuity with their historical legal system. Radical legal change is sometimes possible (2001, p. 13).

Thus, besides describing legal transplants as unproblematic, Coffee cites the importance of changing corporate governance regulations for converging corporate governance systems. Coffee’s view is shared by La Porta et al., (1999; 2000), Hansmann and Kraakman (2004) and Pistor (2004). And it is this focus on

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3 Coffee uses the concept of ‘common law rules’, which he contrasts with ‘civil law rules’. This basically referring to an old tradition in comparative law and economics (see Djankov et al., 2003, for discussion), leaning on the difference of Continental European written law (Civil or Roman law) and British/American case law (common law) to explain differences in economic development. Without getting into the normative controversies of comparative law and economics, one may clarify Coffee’s remarks by pointing out that common law has produced the corporate governance regulation regarded as superior in the convergence of corporate governance system debate above.
transplantation processes which is the starting point for this study of changes in the Swedish corporate governance system.


In legal studies, especially in sociology of law, there has been extensive discussion of which metaphor can truly capture the phenomenon of rules and regulations exported from one country to another. This question will be discussed in detail below; however, the main argument for using the transplant metaphor is that the ‘transplant’ concept is used in the dominant comparative corporate governance research and as such, makes it possible for this dissertation to contribute to this tradition. Only by taking the terminology of the dominant comparative corporate governance research tradition at face value this dissertation could engage in a dialog with the very same tradition. Hence, the contribution is completed by using and taking the terminology of the dominant comparative corporate governance research tradition seriously, but also by analysing earlier use of the transplant metaphor as well as specifying its possible application in an empirical setting as Swedish corporate governance. Not only is the transplant metaphor used in the dominant comparative corporate governance research, it is also used in a more generalized manner, that disregards much research effort in legal studies (see below). Thus, a more extensive discussion of the transplant metaphor as it applies to comparative corporate governance research is necessary. Watson (1974; 2000; 2001), a legal historian, claims that transplantations of rules and regulations is the leading method of legal development and at the same time a ‘socially easy’ one (1974). By socially easy, Watson means that ‘whatever opposition there might be from the bar or legislature, it remains true that legal rules move easily and are accepted into the systems without too great difficulty’ (1974, pp. 95-96). That is, the migration of a rule developed in one country to another country is comparable to developing the rule from scratch. Moreover, it is assumed that the transplanted rule will generate the same outcomes in the receiving country as in its country of origin. Obviously, this ‘easy transplant hypothesis’ gained a stronghold with those modern comparative law and economics scholars who argued for stronger (Anglo-American) minority shareholder protection so as to disperse ownership of the listed firms (e.g. La Porta et al., 1998; Coffee, 2001; Djankov et al., 2003).

As an empirical inquiry, what actually happens when rules and regulations are transplanted from one system to another? Were we to follow Watson or the dominant comparative corporate governance paradigm, this question would not be very interesting, as regulation is perceived to be easily transferred from one context to another, and as such, would fit and produce outcomes in the receiving system that were similar to its source. From a comparative corporate governance perspective, therefore, implementing Anglo-American corporate governance regulations to protect minority shareholders is not only necessary.
(normative convergence, Hansmann and Kraakman, 2004, above); it also produces outcomes such as larger ownership dispersion and economic development (La Porta et al., 2000; 2001).

The effects of legal transplants, is a topic that has been heavily debated in legal studies (e.g. Watson, 1974; 2000 vs. Legrand, 1997; or Teubner, 1998; or Nelken, 2001). Both Legrand and Teubner criticized Watson’s benign view of legal transplants. In Legrand’s (1997) case, drawing on a culture theory in sociology of law, a transplant of regulation in Watson’s sense is impossible, as a transplant cannot occur without the simultaneous transplant of all the people from the giving country. For Teubner (1998), drawing on systems theory, transplant is a misleading metaphor, as it does not capture the problems created by the transplanted regulations in the receiving system (Teubner’s concepts are discussed below in section 1.3.1). In this study, legal transplants are viewed as a viable metaphor for what occurs in the wake of globalisation of the world’s capital markets, as the same rules and regulations now appear in many countries and these are not the result of any independent invention. However, the transplant process is not at all unproblematic or socially easy. It generates unintended consequences. Hence, the study takes into account the critique of Legrand and Teubner. The goal of the dissertation is to produce more theoretically robust claims regarding the processes whereby corporate governance regulation moves from one context to another, contributing to comparative corporate governance understanding of such a phenomenon.

The ‘transplant is not socially easy’ position follows from Kahn-Freund (1974), who holds a more moderate position when questioning Watson’s ‘easy transplant hypothesis’ than Legrand or Teubner. Kahn-Freund continued Watson’s metaphorical discussion by comparing a kidney from a human to a carburettor of a car. Kahn-Freund’s basic argument is that a legal transplant should be considered somewhere between the kidney and the carburettor, that is to say, there are ‘degrees of transferability’ (1974, p. 299). Kahn-Freund acknowledges that sometimes transplanted regulations are rejected, as a kidney can be or that they can be accepted as the carburettor almost always is. The reason for this, Kahn-Freund claims, is due to the differences in how capitalist democratic societies actually function (e.g., constitution, interest groups) and the role played by the legal system in upholding these differences. To describe what makes legal transplants socially complicated, Kahn-Freund claims that:

the question is in many cases no longer how deeply it [the legal transplant] is embedded, how deep are its roots in the soil of its country, but who has planted the roots and who cultivates the garden. Or in a non-metaphorical language: how closely it is linked with the foreign power structure, whether that be expressed in the distribution of formal constitutional functions or in the influence of those social groups which in each democratic country play a decisive role in the law-making and decision making process (Kahn-Freund, 1974, p. 305).

Thus, following Kahn-Freund’s line of thinking, transplants of legal rules do not necessary lead to convergence, as the transplanted rules are the result of a foreign power structure, i.e., the consequences produced by the situation in the source country. If this power structure does not resemble the power structure of the receiving country, complications might arise. As shown in a number of empirical studies
written in the spirit of Kahn-Freund (e.g. Nottage, 2001; Dezalay and Garth, 2001; Gillespie, 2002; 2008a; 2008b; Daniel, 2003; Kanda and Millhaupt, 2003; Kingsley, 2004; Jordan, 2005; Varottil, 2009), the structure of the receiving context is decisive for understanding how the transplanted regulations will operate. For instance, existing alternative regulation might cause the transplanted regulation to be ignored (Kanda and Millhaupt, 2003). Different understandings among different social groups might cause the regulation to be used by only a few key actors (Gillespie, 2002). The legal transplant literature and its consequences will be further discussed below. The most important implication of this research is that any understanding of corporate governance regulatory transplantation is dependent on the context in the receiving country. Hence, to understand regulatory transplants to the Swedish corporate governance system, it is necessary to understand the Swedish corporate governance system. Previous research on the Swedish corporate governance system and the implications for legal transplants to such a system is discussed further in section 1.3 below.

Before this discussion of our prior understanding of corporate governance transplants and the specific context under study here, the purpose of this thesis will be outlined.

1.2 Purpose
Following the above stated background, regulators – as a result of financial globalisation – have transplanted corporate governance regulatory frameworks in order to achieve a convergent pattern of regulations. An understanding of these transplants from a comparative corporate governance perspective is essential because of the dominant viewpoint in which legal transplantation is seen to be ‘socially easy’.

The purpose of this thesis is to elucidate the phenomenon of legal transfers from the perspective of the dominant comparative corporate governance research paradigm. Drawing on legal studies and empirical observations, the thesis will develop the terminology for understanding the legal transplant metaphor in comparative corporate governance and to problematize the debate on convergence or divergence of corporate governance systems.

To address this purpose, firstly, the transplant literature and the previous empirical studies will be discussed and presented. This will be done in sections 1.3.1 and 1.3.2. Secondly, as claimed above, to understand the specific situation of transplanting to the Swedish corporate governance system, we need to discuss the specificities of the Swedish corporate governance model. This will be done in section 1.3.3.
1.3 Legal Transplant and the Swedish Case

The following sections concern legal transplants in general and provide further background on the Swedish corporate governance system as an object of the legal transplant process.

1.3.1 The transplant metaphor and its background

The use of the transplant metaphor to describe the process whereby regulations are transferred from one country to another could be traced back to the scholarly topics of legal history (e.g. Watson, 1974) and comparative law (e.g. Kahn-Freund, 1974). Watson, after extensive empirical research on legal development in ancient times, realised that similar rules (on the books) tended to find their way from the ancient high civilisations to newly established legal systems. For decades Watson has echoed his thesis in an extensive research effort underlining how legal transplants are the most common source of legal change and development (e.g. Watson, 1974; 1978; 1982; 2000; 2001). In comparative law – the scholarly topic concerned with comparisons of regulations between different the legal systems of different countries – research on legal transplants has been described as an important tool for legal reform (Kahn-Freund, 1974) as it tends to produce research results with policy implications (Sacco, 1991). That is, by comparing the rules on the books in model country A with problematic or transitional country B, the legal expert can recommend that regulators of country B change their regulations to resemble the ostensibly better legal standards those of country A (see below for a discussion of success of legal transplants).

Both the idea of policy relevant research and the transfer of law on the books from one country to another is also a basic assumption of contemporary comparative corporate governance thinking (see above, La Porta, Lopez-De-Silanes, Shleifer and Vishny 1997; La Porta et al., 1998; 1999; Djankov et al., 2003; Hansmann and Kraakman, 2004), leading to more or less normative research that pursue legal improvement in developing or transition countries by transplanting Anglo-American regulations (Coffee, 2001; Berkowitz, Pistor and Richard, 2003; Pistor, 2004). By all means, the comparative corporate governance research pioneered by La Porta et al. (e.g. 1998; 1999) has been highly contested within the corporate governance field. Braendle (2005), for example, claims that it is too U.S.-oriented, while Armour, Deakin, Lele and Siems (2009) and Armour, Deakin, Sarkar, Siems and Singh (2009) point out the reductionism regarding a complex social phenomena such as corporate governance regulation (see Siems and Deakin, 2010 for review of the proposed alternative approach). However, very little attention has been paid to the use of the legal transplant metaphor as such. Indeed, when a metaphor becomes as closely related to a policy oriented research tradition as has the transplant metaphor, it will become contested. However, this discussion has been limited to legal studies, while comparative corporate governance research has either ignored it or focused its critique on other topics. In the following sections the focus is on the legal scholarly discussion on transplants in order to gain a deeper understanding of the benefits and limitations of the transplant metaphor for comparative corporate governance research.
The critical discussion of legal transplants has been dominated by approaches based on systems theories (e.g. Teubner, 1983; Cankar, Deakin and Simoneti, 2008) and Sociology of law (e.g. Legrand, 1997; Nelken, 2001 Cotterrell, 2001). Alternative metaphors to transplant have been proposed, among them ‘irritant’ (Teubner, 1998), ‘reception’ (Wiegand, 1991), ‘formants’ (Sacco, 1991) and ‘circulation’ (Wise, 1990). In order to understand this metaphor discussion, one need to consider the different views on the relation between law as a human creation on one hand and the society that man inhabit on the other. This discussion dates back to the Enlightenment, when writers such as Montesquieu and von Savigny considered law as a result of the spirit of the people (see Watson, 2001). If law emanates from the ways and traditions of the people, to represent their unique interpretation of culture and power relations, then their legal practices will be a mirror of this particular society, and thus of its people (e.g. Wise, 1990; Watson, 2001). Viewed from this perspective, the use of the transplant metaphor is very problematic. Criticising Watson’s approach, Legrand (1997) observes:

The ‘legal transplant’ argument is precariously based on analogies, on mechanical analogies. The problem, therefore, is that in the way the reasoning promotes a most exacerbated positivism, it fails to grasp and express the multi-layered nature of the interaction between the constituents of a social totality. The refusal or inability to see that law acts as a site of ideological refraction of deeply embedded cultural dispositions does not, however, make reality go away (Legrand, 1997, p. 122).

To Legrand, the transplantation of legal rules is impossible because it involves the interpretation of the rule, and as such a process within the interpreting society.

Legrand’s position in the debate is certainly extreme. However, it draws our attention to the very obvious distinction between ‘law on the books’ and the ‘living law’ or law in society. In this study, this distinction is addressed by empirically focusing on the transplantation of Anglo-American corporate governance regulation to the Swedish corporate governance system, and from the perspective of what happens in the receiving system. Thus, for research on legal transplants to be productive, it must acknowledge that the human society and the human body are two very different things (see below for a discussion on the metaphor itself).

Teubner (1998) also criticizes the use of the transplant metaphor, although on different grounds than Legrand. Teubner claims:

To be sure, transplant makes sense insofar as it describes legal import/export in organismic, not in mechanistic, terms. Legal institutions cannot be easily moved from one context to the other, like the ‘transfer’ of a part from one

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4 It should be noted that Watson does not side with Montesquieu and von Savigny in this debate, although this point is owed to Watson.

5 The scholarly area of legal sociology is based on Ehrlich’s classical distinction between ‘living law’ and the ‘law of the courts’ (e.g. Nelken, 1984; Cotterrell, 1992). It is not the purpose of this study to contribute to the sociology of law.
machine to another. They need careful implementation and cultivation in the environment. But ‘transplant’ creates the wrong impression that after a difficult surgical operation the transferred material will remain identical with itself playing the same role in the new organism (1998, p. 12).

To Teubner, the transplanted rules will take a different form in its new context. The transplanted institution ‘irritates’ the receiving system and creates unknown reactions when interacting with other elements of that system. Thus, for Teubner, drawing on Luhmann’s systems theory, society is an interacting system made up of different parts, where law is but one part, itself formed as an interacting system of different parts. This is comparable to a view of society as an ecological system. Teubner’s critique draws our attention to the fact that we need to consider the receiving system: the new environment of the transplanted rule, the role it plays in shaping the imported rule and what happens to the rule once transplanted. In this study, the context is addressed below in 1.3.3, and the empirical studies in the book concern the consequences in the receiving context.

Watson, on the other hand, reacting to the critique of Legrand, argues that if society and law relate to each other as a mirrored picture, it is hard to explain why most laws are out of date, without any obvious interest group benefiting from them and why they appear to say more about history than present day society. Further, Watson claims that the history explaining a certain law is a: ‘history which is not woven into the general fabric of society, [rather] random events that affect a powerful individual or produce a more general “gut reaction”’ (Watson, 2001, p. 132). Thus, as the law does not seem to relate to societies’ needs, the easiest way to develop regulation would be to look at advanced countries and their solution. From this position, Watson argues that most legal development – historic and modern – is the result of transplantation. The implication of Watson’s work is that legal transplants are considered to be ‘socially easy’ (1974). ‘Socially easy’ makes for good use by comparative corporate governance scholars, as the proposed policy implications could be expected to have immediate results in receiving societies. A further discussion of these results is found below when discussing the success of legal transplants.

Thus informed by legal scholarship, the use of the legal transplant metaphor in this dissertation is not unproblematic. Still, the metaphor is used in much of the comparative corporate governance scholarship, and the use is considered either unproblematic (e.g. La Porta et al., 1998; Coffee, 2001; Djankov et al., 2003; Spamann, 2009) or necessary (i.e. Hansmann and Kraakman, 2004). To draw on the discussion of the transplant metaphor by legal scholars may thereby deepen our understanding of how the metaphor could be specified and used in comparative corporate governance research.

1.3.2 Legal transplant: how useful a metaphor?

In the following sections, the consequence of using the transplant metaphor will be discussed. First, like transplants in surgery, a legal transplant could also be rejected or accepted. Second, a number relevant empirical studies of legal transplants will be discussed, including examples of rejection and acceptance. Third, the reject/accept contrast will be discussed from the perspective what constitutes success in
transplant processes. Finally, the discussion will conclude by presenting a general plea for more empirical research on legal transplants.

In 1954, the first successful human organ transplant was performed, in which a kidney was transferred between identical twins; this solved the longstanding problem of rejection, identified by Alexis Carrel (Nobel Prize in medicine as early as 1912). Today, we know that the problem of rejection in medicine is due to the receiving body’s immune system attacking the transplanted organ, which has led to a number of solutions for enhancing the likelihood of a successful transplantation. In social science as well and in daily conversation, metaphorical descriptions of the human society as a human body are rather common, e.g. the ‘backbone of society’, ‘head of state’, ‘society as ill’ and so on. Thus, the idea of a legal transplant, transferring a law from one society to another is not farfetched, especially if one considers the receiving society as ill or deficient in some sense. For the regulator performing the legal transplant, the metaphor implies that the transplant can only result in acceptance or rejection, thus holding the perspective of the legal reformer as a surgeon performing an operation on the society. As will be seen below, research on legal transplantation has examples of both rejection and acceptance. The empirical cases of legal transplants would thus suggest the need to find the institutional complex that would parallel the immune system of the social body.

Examining the research on legal transplants, the situation is not that simple. The transplant metaphor is merely a metaphor. For instance, a traditional Watsonian approach would consider the existence of a specific rule entering the receiving country’s legal code as acceptance; in the works of Daniels (2003) the existence of an Anglo-American corporate governance code is observed in Indonesia, with all the relevant rules, although a vast majority of the listed firms do not follow the code. Should the Indonesian corporate governance code be considered as being rejected or accepted? Another example cited by Miller (2003) is when the transplanted norm is observed in the receiving society. In Kanda and Milhaupt’s study of fiduciary duties in Japan, it took almost 30 years for the transplanted rule to be used in court. In this case the conclusion must be that there was a period of 30 years’ rejection followed by acceptance. Also, this pattern of legal development could be considered very ‘Japanese’, as Nottage (2001) finds a similar pattern that he labels the ‘still-birth and re-birth’ of a Japanese legal transplant in the consumer protection area. This allows specific characteristics of the society’s ‘immune system’ to affect the transplantation process. A third example, described by Mattei (1994), claims that a successful transplant is when the transplanted rule produces the same social outcomes as in the source country; for La Porta et al. (1998; 1999), ownership dispersion in listed firms in common law countries is explained by the existence of strong minority shareholder protection; thus, stronger minority shareholder protection would lead to the social outcome of ownership dispersion; in Cankar et al. (2008), the introduction of stronger minority shareholder protection in Slovenia was followed by a re-concentration of ownership of listed firms. La Porta et al.’s (1999) main

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6 See linguist George Lakoff’s project: http://cogsci.berkeley.edu/lakoff/metaphors/Society_Is_A_Body.html.
finding is that 'law matters', but is it plausible to consider law to be so extremely important that society always changes immediately following a change in the legal regime? Watson himself (2001) would certainly not think so. For Watson, most laws are outdated and without obvious interest groups benefiting from them. This leaves us with the question of what constitutes a successful legal transplant? This study will return to this question following a survey of empirical studies of legal transplants. For now, however, it must be concluded that assessing whether a legal transplant has been accepted or rejected is in the eyes of the beholder.

Examples of accepted transplants
There are scholars who find the transplant metaphor appropriate and whose empirical research tends to support Watson’s observations also in a modern setting. These empirical accounts of legal transplant acceptance could basically be further divided as i) time lagged and partial; and ii) acceptance by 'law on the books'.

Examples of the first group, time lagged and partial, is found in Gillespie (2002) and Kanda and Milhaupt (2003). Kanda and Milhaupt (2003) studied fiduciary duties introduced into Japan during the American occupation following the Second World War. They observe, after 30 years, a well-functioning legal transplant. The specific transplant is considered accepted, as it is utilized by the actors of the system. In Gillespie’s (2002) study of Western corporate governance regulation transplanted to Vietnam, the transplant took hold among certain segments of the society, notably among politicians and regulators. In the second category, Harding (2001) follows legal transplants in Southeast Asia, documenting successful transplants in constitutional law and environmental law. It should be noted that Harding observes parallel legal systems, where transplanted law operates side by side with local law. As a general conclusion, however, Harding affirms Watson’s thesis in a Southeast Asian setting. Spamann (2009) also documents the Southeast Asian experience, focusing on corporate governance regulation, and he claims that there is a clear tendency for peripheral countries (Singapore and Malaysia) to transplant regulations emanating from the centre (UK through Australia) and that these transplants take hold. Fleischer (2005) studies the establishment of the UK concept of fiduciary duty in the United States, France and Germany, and he finds a successful transplant, as a similar concept of fiduciary duties now exists in all studied countries, although admitting that there is ‘no reception in complexi’ (p. 394).

Examples of rejected transplants
The empirical literature on legal transplants contains a number of examples of rejections. As one might expect from the above discussion, it is rare for two scholars to operate with the exact same definition of ‘rejection’. An attempt to systemise rejections in empirical research would be to classify them as cases of either i) non-use or ii) same label, different practice.

In the first case, a new rule could be introduced formally and placed on the books, but the rule would not have impact on social practice. For instance, in Kanda and Milhaupt (2003), the introduced rules on
fiduciary duties in Japan are not used by the courts or by the general business community for 30 years following their introduction. In Gillespie’s (2002) study of Western corporate law introduced into Vietnam, local entrepreneurs and businessmen ignored the new corporate law. For these actors, the old business practices prevailed regardless of the new transplanted regulations. A third example is Daniel (2003), who studied the introduction of a corporate governance code in Indonesia. Although the proper rules were transplanted, such as different committees and independent directors, most listed firms did not follow the rules.

In the second type of rejection, a transplanted rule on the books could be a mere label attached to quite different practices than those found in the source system. Wise (1990) remarks that ‘what is borrowed may be terminology rather than substance’ (p. 6). Examples are found in DC Clarke’s (2006) study of China. In DC Clarke’s material totally different practices (from those in the source country) were attached to the transplanted label: the only thing resembling the German ‘supervisory board’ (Aufsichtsrat) and the US ‘independent directors’ in China were their names.

Explaining acceptance and rejection: symbolism and localizing
Regardless of empirical observations of rejection and acceptance of legal transplants, there is a need to explain these empirical findings.

For Fleischer (2005), explaining a successful legal transplant in corporate governance is rather easy. Due to the relative instrumental needs of company law (as opposed to family law) and due to general needs for more efficiency as a result of globalisation, countries need to accept superior regulation. As Kanda and Milhaupt (2003) had a more complex empirical case – they need to explain the 30-year time lag – they introduce the concepts of ‘available substitutes’ and ‘institutional fit’ to explain their findings. ‘Available substitutes’ could either be similar legal rules or something outside the legal system such as societal norms (Kanda and Milhaupt, 2003, p. 891). According to Kanda and Milhaupt, ‘institutional fit’ is divided into micro-fit and macro-fit:

*Micro-fit is how well the imported rule complements the pre-existing legal infrastructure in the host country. Macro-fit is how well the imported rule complements the pre-existing institutions of the political economy in the host country (2003, p. 891).*

In Japan at the time of the transplant of the fiduciary duties, there existed other legal rules that protected the beneficiaries of fiduciary care. For the first 30 years, the Japanese preferred to use these rules for remedy. During three decades that followed the end of the Second World War, Japanese society changed, and other institutions developed that were more similar to the U.S. situation. As the transplanted fiduciary duties rules had a better fit with the new institutions, these rules came into use.
In the same manner as acceptance could be explained by the concept of fit, so could rejection be explained by a lack of fit between the legal transplant and other institutions in the receiving system. One example is Varottil (2009), who observes problems with legal transplants from the United States and the UK to India. Varottil concludes that Anglo-American corporate governance exports do not fit the concentrated ownership structures of India.

In explaining cases of rejection, the concept of symbolic transplants is used. Hence, rejection of transplanted rules is about ‘talking the talk’ while not ‘walking the walk’ (as in DC Clarke, 2006). Kanda and Milhaupt (2003) argue that when foreign capital is sought, the transplant is directed towards legitimacy rather than efficiency (also see Miller, 2003). The need to be a part of the international community – for trade or to qualify for international loans or aid – raises the need for certain rules. If these rules do not seem fit or are not accepted by the population, transplants could exist only on paper, or even only as labels. They would be mere symbols. However, it has been suggested that symbolic actions by regulators are becoming increasingly difficult. Dezalay and Garth (2001) point out that

once the transplant is defined in those terms and takes sufficient root, there are many pressures to shape it into the institution or approach after which it was named. [...] International communication and travel make it more difficult than in the past to continue the pretence that very different institutions can be given the same name (2001, p. 250).

Finally, and in close relation to the symbolism Gillespie (2008a) coins the concept of ‘localizing transplanted rules’. Localizing for Gillespie is the attempt by local lawmakers to ‘satisfy both international legal standards and diverse domestic interests’ (p. 674). Thus, the concept of localizing is an attempt to understand the actors in the transplant process. These actors ‘bridge global legal knowledge and local understanding’ (p. 676). How this could be done, according to Gillespie, is a matter of power and the ability of those being regulated to engage in dialog with the regulator; it is thus a specific attribute of the system.

How, then, do we distinguish a successful from a failed legal transplant? The answer, probably, is that we cannot, especially if one tries to avoid the pitfalls of normative research. As claimed by Nelken (2001), ‘the term “success” has strong evaluative overtones, it gives the impression of endorsing one outcome rather than another, and easily ends up mixing together normative and explanatory enquiries’ (p. 37). The same problem exist in the research that tries to move away from the transplant metaphor, as Nelken (2001) argues regarding those scholars who propose new metaphors or claim transplant impossible without empirical research: ‘We may be left wondering whether these authors really do believe that it is impossible to achieve greater harmonization and convergence or whether they fear that it is all too possible – but undesirable’ (p. 38).

Further complicating the use of the transplant metaphor for analytical purposes, there seems to be rather big differences in what to call a successful legal transplant. Drawing on Watson (1974), Miller (2003) and
Mattei (1994), we could analytically describe the relationship between legal transplants and success as a staircase model, see figure 1.1

Figure 1.1 The transplant staircase

For Watson (1974), a legal transplant is deemed successful if the law is on the books in different countries at the appropriate time and logically causal. That is, law A is observed in a legally advanced country in the year X and appears in another, less advanced, country a year or more later. Further on in this dissertation, this type of successful legal transplant will be referred to as transplant as text. As argued by Miller (2003), it is not enough that a law exists on the books to call it a successful transplant. There is a need for evidence that the transplanted regulation or law is actually respected in practice by the actors in the receiving system. This will be referred to as the transplant as practice criterion for successful legal transplant. To meet Miller’s criterion empirically, we first need to determine if Watson’s law as text criterion has been fulfilled, but we then need to determine whether any actors in the receiving system actually observe this rule. It would be difficult for a legal historian studying ancient Rome (as Watson did) to demonstrate that the transplant as practice requirement had been fulfilled. Finally, Mattei (1994) argues that a legal transplant is successful when a transplanted regulation produces the same social outcome as in the source country. This success criterion will be referred to as transplant as outcome. In the empirical accounts of legal transplants discussed above, we find accounts of transplant as text and transplant as practice, but no instances of transplant as outcome. Obviously, the determination of success using the transplant as outcome criterion place almost impossible demands on the research. To observe a transplant as outcome requires the demonstration of a causal relationship between regulator intention and social outcome. Furthermore, it requires the following data: i) regulator intentions emanating from the source country; ii) social outcome in the source country; iii) regulator intentions in the receiving country; and finally, iv) social outcome in the receiving country. Arguable, the requirements needed to determine a successful transplant using the transplant as outcome criterion points towards Legrand’s (1997) position regarding the impossibility of legal transplants.

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From the research in legal studies, it follows that it would be very hard to actually claim that a transplant is successful or not. This further underscores the need for further study of the actual process of transplantation. Perhaps the acceptance/rejection dichotomy is not the most useful approach to studying legal developments that follow from the globalization of financial markets. Perhaps we should focus more on the process of legal borrowing. Hence, Wise (1990) concludes:

*What should be of interest is the process by which such a high degree of cohesion has been achieved. [...] What is wanted in the study of the diffusion of legal ideas is not simply a catalogue of borrowed 'traits', but an examination of the devices for cultural sharing and selection through which legal 'unity' is constructed and sustained* (1990, p. 12).

The area of legal transplant is conceptually contested, and there is a need for empirical research and conceptual clarification on the notion of ‘successful legal transplant’. Fleischer observes:

*In trying to understand the phenomenon of legal transplants in European company law, it [the paper] sees many advantages in beginning with details of specific case studies (“bottom up”) rather than with general concepts and categories (“top down”)* (2005, p. 380).

Summing up the discussion, we can conclude that current state of knowledge on legal transplant is problematic. The empirical research and theoretical discussion has had a tendency to mix up the normative with the positive implications of the concept legal transplant. What is known is that the context of the legal transplant is important. In this vein, the study move on to the Swedish corporate governance system in order to show what could be expected in a situation of transplanting corporate governance regulation to this system.

### 1.3.3 The transplant metaphor and its context

As evident from much of the discussion on legal transplants above, most of the empirical work concerns problems of transplants to the developing world (e.g., Vietnam, India, and Indonesia) or to transition economies (e.g., Slovenia). Notable exceptions are Fleischer’s study of fiduciary duties in the U.S. and the core economies of the European Union and Kanda and Milhaupt’s study of U.S. corporate governance regulation in Japan. The empirical focus of this book is Sweden, a small open economy in many ways different from the other examples: it is a mature and developed economy in comparison with the developing and transition economies; it does not have the size to set the agenda as USA, Germany or France; and the changes studied is not the result of military conquest as in Japan. In the following sections, the comparative corporate governance research concerning Sweden is outlined.
The ownership structure of the Swedish listed firms is characterised by the existence of controlling shareholders. The annual publication ‘The Owners and the Power in Sweden’s listed companies’ (Fristedt and Sundqvist, 2005) provides the data. Approximately one-third of the Swedish listed firms have a dispersed ownership, with no single owner in control of more than 20% of the votes. The firms with dispersed ownership are generally smaller in size, with high technology and/or service content in their business model. Almost half of the firms have a single owner in control of more than 20% of the votes (although less than 50%). This group contains the largest, most well-known and most internationalised firms, and they are often controlled by business groups with interests in more than one listed firm (Collin, 1998; A Jansson and Larsson-Olaison, 2010, Chapter Three). Finally, about 20% of the firms have a single owner in control of more than 50% of the votes. In this group, we find older firms controlled by families who have often concentrated their ownership in only one listed firm (e.g., the Persson family who own the clothing retailer Hennes and Mauritz) or the main holding company in a business group.

The controlling owners of Swedish listed firms are often said to use an extremely disproportionately small amount of capital for the votes held (e.g., Henrekson and Jacobsson, 2003). This is the result of extensive use of strong voting stock (A- and B-shares) and/or pyramid ownership structures (Agnblad, Berglöf, Högfeldt and Svençar, 2001; Henrekson and Jacobsson, 2003). This structure creates a control dynamic in the Swedish firms where it is not uncommon that foreign ownership of the capital exceeds 30% and large local institutional investors hold about 20%, while the controlling shareholder, by use of e.g., voting strong shares and sheer active agency, controls all the important corporate governance decisions, such as board nomination, pay-out strategy, auditor nomination and so on (Bergström and Samuelsson, 2001). This dynamic appears to result in some rather unorthodox conceptions among the owners, where institutional investors view themselves as having purchased a control function provided by the controlling shareholder, while the controlling shareholders view themselves as the entrepreneur rather than the controller of management (Jonnergård and Larsson-Olaison, 2010b; A Jansson, 2013). The academic view of the Swedish controlling shareholders is generally positive. They are viewed as a well-functioning control structure of the firms’ management, based on tightly knit social networks (Sinani, Stafsudd, Thomsen, Edling and Randøy, 2008; Stafsudd, 2009) and they are described in the literature as socially controlled controllers (Agnblad et al., 2001; A Jansson, 2007) who efficiently reduce more agency cost in the firms than they create (Gilson, 2006).

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7 Data from 2005 is used because 2005 was the year when the Swedish corporate governance code was implemented. It should be noted, however, that very little has changed in the ownership and control of Swedish listed firms since then (see Henrekson and Jacobsson, 2012)

8 Using 20% of the votes as a cut-off requires further comment. La Porta et al.’s influential study ‘Corporate ownership around the world’ (1999) uses 10% as cut-off when distinguishing between dispersed and concentrated ownership. In Sweden, most firms have a single owner with 10% of the votes. However, the main reason for using 20% rather than 10% in this dissertation is that 10% in Sweden is associated with minority protection possibilities mandated by law (e.g., to demand minority shareholder auditor, to demand dividends and to avoid being squeezed out). Therefore, it could be claimed that to hold 10% of a listed firm in Sweden is a precautionary act rather than an attempt to control the firm. As claimed by Qui-Gon Jinn in Star Wars Episode I: ‘There is always a bigger fish’.

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The ownership structure in Sweden generates two effects. Firstly, many of the market-based corporate governance control structures are circumvented: hostile take-overs are rare (Agnblad et al., 2001); the managerial labour market is small (Lubatkin, Lane, Collin and Very, 2005) and often connected to a specific business groups (Collin, 1998); and large remuneration programs to management are both politically and socially problematic (Roe, 2002). Secondly, ownership concentration could increase the risk of minority shareholder expropriation (La Porta et al., 1999; Bebchuck, Kraakman and Triantis, 2000), that is, the agency costs associated with controlling shareholders. The actual existence of minority shareholder expropriation in Swedish firms is a subject of debate (Cronqvist and Nilsson, 2003 vs. Nenova, 2003), and various methodological assumptions dominate the controversies when, in this case, a theoretical concept (expropriation) in a very abstract sense is connected to a self-serving behaviour prohibited by law and seldom tested in court. At the same time, regarding minority shareholder expropriations, the corporate governance system functions as a control system (following the Shleifer and Vishny definition in the introduction). Because something is prohibited does not necessarily mean that it would occur without the ban. Conversely, because something is banned does not necessarily imply that it does not occur.

Economic analysis of the Swedish corporate governance system suggests that controlling shareholders come at a price. This price must be compared, however, with the benefits of reduced managerial agency costs provided for all owners by the controlling owner. This price is hard to estimate, although the mere existences of controlling shareholders indicates a social acceptance for the controlling owners. This is what Gilson (2006) labels the ‘controlling shareholder trade-off’.

The ownership structure of the Swedish corporate governance system is an important precondition that makes the Swedish system different from the Anglo-American corporate governance system (from where most transplanted regulations originate). Further, the Swedish system is structured around regulation on three different levels: law, i.e., societal level; business level self-regulation; and individual level self-regulation. The first level, the law, – in this case the Companies Act – prescribes a number of corporate bodies that are formed to protect the firms’ owners in a situation of ownership and control separation. Furthermore, the Companies Act stipulates the firms’ purpose to be ‘enhancing the shareholders interest’ (profit maximisation) and also formulates the basic principle of equal treatment of shareholders (the basis for Swedish minority shareholder protection) (Bergström and Samuelsson, 2001). Corporate governance self-regulation exists on two different levels: i) in the Swedish corporate governance code; and ii) the firms’ stock exchange listing contract. This self-regulation within the Swedish corporate governance system has resulted in firm level corporate governance structures resembling international corporate governance codes, such as the OECD code or the British combined code. The Swedish solutions, however, tend to differ on important aspects. The creation of this structure is very closely connected to the whole regulatory transplant process studied in this book, and it is summarised in figure 1.2 below.
Following figure 1.2, the firms’ owners (the AGM) appoint the firm’s board of directors. This is done by the use of an ‘election committee’ (Swedish: valberedning) or ‘nomination committee’ (Swedish: nomineringskommitté). This committee is comprised by the firms’ largest owners, regardless of whether they are currently on the board or not. The AGM also appoints the auditor. The board consist of at least two labour representatives; sometimes the CEO (this used to be more common, however, the independence discussion have led towards a zero inside directors policy in some firms); representatives of the large owner or owners; and independent directors (the Swedish definition of independence stipulates that a majority of the members of a board should be independent from management, that is, the owner representatives are excluded from this count; however, the Swedish definition also requires two directors who are independent of the major owners). The board should be divided into two committees: remuneration committee and audit committee. None of these committees allows for management-dependent directors, and in the audit committee at least one director must be independent of major owners. The main responsibility of the board is to hire and dismiss the CEO.

Figure 1.2 The basic corporate governance structure in Sweden

The Swedish corporate governance system is thus based on the large controlling shareholder as foundation. This is rather different from the Anglo-American situation, with dispersed ownership, from where the regulation framework discussed in this study has been transplanted. Next, after a short note on methodology in Chapter Two the articles follow in Chapter Three to Seven.
2. DESIGN OF CASE STUDY AND METHOD

Transplantation, according to Watson (1974), has been the most common process by which regulatory frameworks evolve. This claim is certainly true for the area of corporate governance. Starting from the point that international financial capital demands certain protection as well as familiarity with rules, both the EU and most of its member states have begun enormous projects to reform their respective corporate governance systems. Likewise, individual firms have felt the pressure from investors, from the international capital markets and from the stock exchanges where they are listed. Pressure on states and pressure on firms have resulted in massive transplants of Anglo-American corporate governance rules. There are a number of examples of transplant processes, such as audit committees and mandatory bidding. Audit committees were introduced by a number of individual Swedish firms during the 1990s and 2000s. Audit committee legislation found its way into the Swedish corporate governance code in the mid-2000s, presumably due to the EU audit directive and the American Sarbanes-Oxley Act. Shortly thereafter, the audit committee became a part of the Swedish Companies Act, and thus mandatory for listed firms. The Swedish rules on mandatory bids, then, draw heavily on the well-known London City code of take-overs and mergers. This is the case both when the rules were first introduced in 1971 as well as when they were updated with informal regulation (2006) and in self-regulation (2008). Thus, as an empirical phenomenon, the transplantation of Anglo-American corporate governance rules to the Swedish corporate governance system is not only common but has also been influential in directing the development of Swedish financial regulation.

In this thesis, the five papers describe four cases of transplanted corporate governance regulations: The first case is that of stock repurchase, which became permitted for Swedish listed firms through a change in the Companies Act in 2000. The prime inspiration for this change came from the American corporate governance system, where stock repurchases have played an important role for a long time. The second case is that of nomination committees, introduced in 2005 into the Swedish corporate governance code under the label ‘election committee’ (valberedning in the Swedish version) and ‘nomination committee’ (in the official translation into English). Prior to this regulation, nomination committees where used in a vast number of Swedish firms, but most commonly in the largest and most influential firms. Nomination committees have a fairly long history in both the UK and the United States, although they are most well-known from the influential Cadbury report from 1991. The Cadbury report as such popularised the concept of a corporate governance code, both as a collection of rules and as a method of regulation (a more
or less state-forced self-regulation upheld by the principle of comply or explain). This development leads to the third and fourth examples described in the articles: the introduction of a Swedish corporate governance code, which is studied in the process of referrals; and the introduction of the Swedish corporate governance code as regulatory process. ‘The code’, as concept, is most important for the entire process of corporate governance development in Sweden described here. The code concept signals a connection with a British regulatory tradition corresponding with the regulatory workings of the City and of the London Stock Exchange, where we find the above discussed takeover code, as well as the Cadbury report and other well-known regulatory initiatives (e.g., the Combined Code, a collection of different reports and codes, where Cadbury is one, formed into a code). The introduction of a corporate governance code in the Swedish corporate governance system was also motivated by the European Union’s effort toward the single market, basically implying harmonisation on Anglo-American foundations. Finally, the last example is the introduction of independent directors. The focus on independent directors is mainly a result of the British Higgs Commission’s work to restore the British corporate governance system after a series of setbacks attributed to a lack of monitoring by the independent directors. From the British scandals, the idea of independent directors travelled fast around the world. The Swedish corporate governance system’s rules on independent directors have long been a part of the registration contract signed by firms listing on the Stockholm stock exchange, before it became a part of the Swedish corporate governance code in 2005. It is important to recall here that the Swedish definition of independence differs from the British, as it differentiates between independence from owners and independence from management.

As already discussed in the introductory chapter, the understanding of transplanted corporate governance rules has mostly focused on developing or transition countries. In addition, the number of empirical studies is relatively few, especially compared to the extensive theoretical controversies involved. This makes the need for empirical studies, as has been done in this dissertation, highly relevant. As the empirical studies are closely related, although conducted using different methodologies, a number of methodological issues arise. These methodological issues will be addressed in the sections that follow. The basic methodological idea is to view regulatory transplants and their effect on the corporate governance system through the prism of a single, Swedish, case. The individual studies are empirical examples for understanding this process. Change in the corporate governance system takes place against the backdrop of a transfer of regulation towards a convergent corporate governance system.

In terms of case design and methods, certain questions need to be addressed. First, how do the five articles that comprise this dissertation correspond to each other and to the case as a whole? How could these articles be used as a general analysis of the case of ‘the changing Swedish corporate governance system in

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9 Certainly, there exist vast numbers of empirical studies of organisational and national change in terms of dispersions, bandwagons, institutionalizations and so on. These studies produced great insights on the general theme of change, and although they are related to the transplant concept, they not been included in this discussion in order to achieve the necessary depth regarding the transplant concept.
face of financial globalisation'. This question is discussed in section 2.1. Second, the individual articles all contain sections on methods; however, some issues of how the data collection corresponds to the case as a whole still need to be addressed. This is done in section 2.2.

2.1 The Interrelationship and Selection of Empirical Examples in the Study

2.1.1 Interrelationships of empirical examples

This dissertation contains separate articles, all previously published. Each article, from Chapters Three through Seven, consists of an empirical study of transplanted corporate governance rules. The overall context of the research in terms of concepts, data, method, conclusions and implications is discussed in Chapters One, Two, Eight, Nine and Ten. The doctorate project could be described as a multistep rocket launch, where each article represents the author’s steps in the process of studying transplanted corporate governance regulations.

Chapter Three, the first article-based chapter, (co-written with Andreas Jansson, published in Corporate Governance: An international Review, 2010), concerns the motives behind Swedish firms that are repurchasing stock. The question addressed is whether results gained from American theories and applied to American data could also apply to Swedish data. An earlier version of this article was completed in 2002. In contrast to what we expected then, the results from the Swedish case differed from the American case. This is not that surprising today, but it was in 2002. The assumption that firms from different countries with similar possibilities, on average, would choose similar methods for cash distribution to its owners was not validated in the study. This led to new research interests that have come to play a crucial role for this study. First, there is the issue of how much the context of the firm affects corporate decision-making. Second, a set of questions were raised, which in the end came to be my doctorate project. The first question was:

What roles do firms and regulators play in the change of transplanted rules?

This line of questioning is predominantly pursued in Chapter Four (the second article). The article concerns the introduction of nomination committees in the Swedish corporate governance system (published in Interpretation of law in the global world: From particularism to a universal approach, edited by J. Jemielniak and P. Miklaszewicz, 2010). The article sheds light on the role of history in changing the transplants that the regulators sought to do, or felt forced to do. In this article, it becomes clear that the practices of the firms limit regulators’ options. Thus, the normative content of the transplanted rule is not strong enough to alter the perceptions of the regulated firms. This leaves the regulators with no other solution than to standardize the current practice as the rule, though with a new – transplanted – name or
label. The practice is the same; it just has a more modern name. This article also highlights the roles played by different interest groups in changing corporate governance regulation, leading to the question:

What interest groups are active in the process of changing the transplanted rules, and how are their interests voiced?

This is the main question in the third article, Chapter Five, which analyses the process of referrals preceding the issuing of the Swedish corporate governance code (co-written with Karin Jonnergård, published in Law & Policy, 2007). The introduction of the Swedish code has a different focus than the two prior studies, as it concerns the introduction of a whole complex of rules. Thus, it is not only one rule but many, and at the same time, the individual rules in the code are in line with the selection criteria to be transplanted Anglo-American corporate governance rule, as is the entire regulatory approach. The article shows that the main distinction among the different interest groups is between the traditional Swedish controlling shareholders and the rest. ‘The rest’ in this case comprise the Swedish institutional investors, the Swedish small private shareholders and the international (Anglo-American) institutional investors. Here we should point out that regardless of this main distinction among varying interests, the Swedish controlling shareholders were in many cases supported by the Swedish institutional investors, making this divide less significant. Further, this chapter shows the interest of the Swedish state in the process of transplanting Anglo-American corporate governance regulation, including in this situation where the introduction of a Swedish code is based on self-regulation.

Taken altogether, the first three articles demonstrate how the introduction of international corporate governance regulations into the Swedish corporate governance system, while certainly affecting the Swedish corporate governance, does not necessarily cause it to resemble the Anglo-American original. This is regardless of whether the regulation has been transplanted as a law (stock repurchases), as collective self-regulation (the code) or in the form of individual self-regulation (nomination committees). The consequence of this conclusion for comparative corporate governance research is discussed in Chapter Eight. The phenomenon of changes in transplanted corporate governance regulation seems to be of some generality, and this leads back to the question of context:

How can the changes in the transplanted rules discussed in Chapters Three, Four and Five be understood? In what way does the context matter?

Chapters Six and Seven, the two last articles, concern the theoretical concepts convergence/divergence (published in the Corporate Ownership and Control, 2011) and institutional thinking (published in Från barkbröd till chiabatta, edited by K. Jonnergård and R. Larsson, 2009). Both articles are attempts to move beyond the simple ‘how’ to the more demanding ‘why,’ i.e., from ‘How does a transplanted rule change?’ to ‘Why do transplanted rules, in a more specific Swedish stance, change?’ In both articles, the answer is...
pursued among the identified actors that affect and are affected by the changing rules: the regulators, the self-regulators, firms and interest groups, but also the general context of the actors (the Swedish corporate governance system). In these two articles, the twin concepts of convergence and divergence are discussed in more depth. The key to understanding lies in how the actors identified in Chapters Three, Four and Five tie different levels together (i.e., macro/micro; national/international) in order to achieve coherence with their own reality. Hence, the convergence process, understood as the joining together of national and international levels, will be carried out by local actors. These local actors are often limited by their own way of thinking, and the international models they feel forced to apply are often vague and open to interpretation and redefinitions. Further, in these two articles, an alternative view of corporate governance regulation concerning transplants is proposed that is more multifaceted than the traditional logic of 1) regulation in place = convergence or 2) regulation not in place = divergence. The proposed view is based on the fact that there exist material differences among the world’s corporate governance systems (e.g., in ownership structure and models of finance) as well as immaterial differences (e.g., silent actors and traditions).

2.1.2 Selection of empirical examples
The chapters in this dissertation describe four empirical examples of corporate governance rules, transplanted from the Anglo-American to the Swedish corporate governance system. All the cases reflect the profound changes in the Swedish corporate governance system as a result of the internationalisation of the world’s financial markets. As stated above, the transplants are 1) change in the Companies Act that now allows firms to repurchase stock; 2) the first individual, and later on collective, self-regulation introducing the nomination committees; 3) and 4) the collective self-regulation which introduced a corporate governance code; and 5) the collective self-regulation leading up to the definition of independent directors. As also pointed out above, a series of other empirical examples could have been chosen. Thus, one relevant question to ask concerns the possibility to generalise from these five cases in relation to the greater problem of transplanted corporate governance rules from the Anglo-American corporate governance system to the Swedish and to the problem of transplantation of corporate governance regulation generally.

The five examples described in this dissertation are not easily comparable. Different actors are interested in different regulations at different times. Different regulatory methods are used at different times and different interests seem to be operating at different times. However, the examples are also very similar. It is usually the same actors who are involved, regardless of the specific transplant issue and the data employed to study it. Further, these actors seem to have the same basic attitude, in that they appear to be more or less rational. Every transplanted rule appears to evolve through a similar pattern, from the same initial resistance, to a final phase of consensual change in the rule. All in all, it is suggested here that there is something unique about the receiving context (the Swedish corporate governance system) in relation to the transplanted Anglo-American rules, resulting in similar alterations in all four empirical examples. Finally, it
would be reasonable to assume that a new corporate governance rule transplanted to the Swedish corporate governance system would go through a process similar to the rules studied in this project, and thus be affected by the same interest groups and the same reappearing pattern. Thus, it is argued here that the four empirical examples studied in the five different articles contain findings that can contribute to understanding the theoretical problem of transplantation to the Swedish corporate governance system generally.

2.2 Case Study and Case Material

The cases described in this dissertation concern the overall change of the Swedish corporate governance system following the internationalisation of the world’s financial markets (globalisation), where Anglo-American regulation is transplanted to Sweden. In the different articles, a range of empirical and methodological questions are addressed. However, there is some data that is general to all the articles, although not thoroughly presented and discussed in the individual articles. The following sections will address this.

2.2.1 Interviews

In the articles from Chapters Four, Six and Seven, interviews have been an important source of information. Twelve interviews were conducted during the period 16 October 2006 to the 18 of December 2007. These interviews lasted from 30 minutes to over two hours and were conducted with persons deeply involved in the development of the Swedish corporate governance code. The purpose of the interviews was to study the development of the Swedish corporate governance code and secondly as a follow-up study to Chapter Five/article Three, to study the code development as a part of the process of referrals. The persons interviewed were members of the governmental Commission of Trust (CT), and the commission’s Reference Group and/or the body the commission formed, together with the self-regulators, the Code Group (CG). For a more thorough discussion of the Swedish code development process, see Chapters Four and Five.

The selection of interviewees was made on the basis of recommendations (Arbnor and Bjerke, 1994), where the starting point was four interviews with representatives from four different interest groups (political, financial market, controlling shareholder and minority shareholder). These four persons made recommendations of other persons to interview, who in turn made new recommendations, until the new list of names was exhausted. Of the fourteen persons approached, all but two suggested representatives were actually interviewed. One representative declined to participate citing time considerations, and the second had left the country and the corporate world entirely. The first representative who declined to participate was regarded as a spokesperson of foreign owners, and as no other person with this role exists in the study, this could be regarded as problematic. However, other documentation from this point of view can be found,
such as written comments regarding regulation and articles in media which could be assumed to represent the representatives’ standpoint in many of the important questions. The second potential participant represented one of the larger spheres of controlling owners in Sweden, and as those interests were represented by three other interviewees, his lack of participation was not viewed as problematic.

Table 2.1 Interviews

<table>
<thead>
<tr>
<th>Interview</th>
<th>Position</th>
<th>Duration</th>
<th>Remark</th>
</tr>
</thead>
<tbody>
<tr>
<td>1: 16 October, 2006</td>
<td>Politically appointed regulator. Member of both CT and CG.</td>
<td>81 min.</td>
<td></td>
</tr>
<tr>
<td>2: 18 October, 2006</td>
<td>Representative of the Stock Exchange in the CG.</td>
<td>101 min.</td>
<td></td>
</tr>
<tr>
<td>3: 10 November, 2006</td>
<td>Representative of the smaller shareholders in the CG.</td>
<td>90 min.</td>
<td></td>
</tr>
<tr>
<td>4: 20 December, 2006</td>
<td>Representative of the controlling shareholders in larger firms in the CG.</td>
<td>52 min.</td>
<td>Interview by phone.</td>
</tr>
<tr>
<td>5: 5 June, 2007</td>
<td>Representative of the controlling shareholders in smaller firms in the CG.</td>
<td>66 min.</td>
<td></td>
</tr>
<tr>
<td>6: 11 July, 2007</td>
<td>Representative of controlling shareholders in both small and large firms in the CT’s Reference Group.</td>
<td>30 min.</td>
<td></td>
</tr>
<tr>
<td>7: 20 July, 2007</td>
<td>Representative of the institutional owners in the CG.</td>
<td>55 min.</td>
<td></td>
</tr>
<tr>
<td>8: 8 October, 2007</td>
<td>Representative of the institutional owners in the CG.</td>
<td>81 min.</td>
<td></td>
</tr>
<tr>
<td>9: 24 October, 2007</td>
<td>Secretary to the CT and CG.</td>
<td>139 min.</td>
<td></td>
</tr>
<tr>
<td>10: 7 November, 2007</td>
<td>Expert in both the CT and CG.</td>
<td>114 min.</td>
<td></td>
</tr>
<tr>
<td>11: 6 December, 2007</td>
<td>Secretary to both CT and CG.</td>
<td>92 min.</td>
<td></td>
</tr>
<tr>
<td>12: 18 December, 2007</td>
<td>Expert in both CT and CG.</td>
<td>89 min.</td>
<td></td>
</tr>
</tbody>
</table>

The series of interviews were conducted as semi-structured interviews (Merriam, 1994), with the following structure: 1) chronology of the code process; 2) discussion of individual rules; 3) recommendations for new persons to interview; and 4) individual questions. The semi-structured interviews force the interviewer to have a certain discipline on the subject, so that all planned areas could be covered, while it allows for brief excursions into areas the interviewer or interviewee find relevant, thus enhancing the internal validity and
the awareness of the context (e.g. Huberman and Miles, 1998). The series of interviews were performed during two separate stages separated by almost a year in time (four interviews, followed by the remaining eight). The reason for the relatively long time-lag separating the two stages is that after the first four interviews, a pre-analysis was performed, and that resulted in an updated interview guide. The updated interview guide resulted in more focus on individual questions and that chronology more or less was performed for validating the first four interviews.

All interviews were recorded and personally transcribed. The transcripts were sent to the interviewees to give them the possibility to review the interview and clear up any misunderstandings. Practically, very few changes were made. This process, however, is often expected to increase the inter-subjectivity in the material (e.g. Silverman, 2005).

All persons interviewed were promised anonymity. Questions concerning regulation of corporate governance are closely connected to issues concerning wealth distribution in society and power, which is obviously a sensitive area. Very few, if anyone, like to be connected to power concentration or self-interest in these regulatory issues. To make participation possible and to some extent increase the likelihood of confidence, the interviewed persons are kept anonymous. This certainly comes at the expense of reliability. However, the interviews are not the only empirical data used. Most of the data is freely obtained and could be used to evaluate the reliability of the published material.

The most important topics in the interviews concerned the transplanted rules and the influence and interests of different actors involved in the process in developing the Swedish corporate governance code. Many of the interviewed persons have been involved in Swedish corporate governance regulation for several years, and this allowed for many fruitful discussions and different perspectives on corporate governance regulation in general and transplant processes in particular. Many of these questions are not only connected to the code developing process, but are part of a larger change process that has occurred over a long period, and for this reason, many of the interviews are also important for the project presented here (concerning the overall change rather than the specific introduction of the code).

Regarding analysis, the interviews have been analysed in two different steps. The first step was a pre-analysis of the first four interviews. The transcripts of the interviews were organized in relation to themes, key concepts and stories. This process follows what Merriam (1994) refers to as clustering. The pre-analysis clustering was used as input for the following eight interviews, and thereby provided a good validation for further analysis.
2.2.2 Documents: regulation and preparatory works

As previously concluded, the development where corporate governance rules have been implemented as the result of foreign influence – here termed transplanted – is a process that has lasted a long time. It is not likely that any Swedish regulation in this area could ever be characterised as 'made in Sweden'. On the contrary, corporate governance regulation has always been accompanied by strong international influences. After 1995 and the Swedish entry into the EU, this tendency has escalated, with large de- and re-regulations of the Swedish financial markets. In this process, a great amount of texts have been produced, both political and judicial. For example, the regulatory works surrounding the Commission of Trust (SOU 2004:46; SOU 2004:130) and the New Companies Act Commission (SOU 2001:1) both had the explicit goal of adopting Swedish corporate governance to international practice (see Jonnergård and Larsson-Olaison, 2010a). Examples of documentation surrounding these commissions are the memorandum documentation at the National Archive (Riksarkivet) governmental directives; draft papers and commentaries. Also, in order to contextualise this regulation, the published interpretations are important, in this case for the Companies Act by Bergström and Samuelsson (2001) and for the Swedish code Svernlöv (2008).

A body of Swedish regulation without draft documents and well-established interpretations also exists for Swedish corporate governance regulation. This is the self-regulation stemming from The Swedish Industry and Commerce Stock Exchange Committee (SICSEC, Näringslivets börskommittée) and the Swedish Securities Council (SSC, Aktieräkningsnämnden). For comments and contextualisation on their work, P-O Jansson (1995) and Munck (2007) have been used. The historical regulation from SICSEC is usually not represented in the form of a coherent set of rules. Rather their work takes the form of long reasoned texts on a single topic (such as mandatory bids or board nomination). Together with the briefs and judgements from SSC, they bring a great deal of context for understanding Swedish corporate governance regulation.

Looking beyond the Swedish regulation, a number of foreign regulations exist which are relevant to this study. These regulations constitute the blueprints from which the Swedish regulation has been constructed. The foreign regulations are important for the further contextualisation. The transplanted regulations studied in this project are from the United States and the UK. The U.S. regulation derives mainly from the Sarbanes-Oxley Act, supplemented by regulation from the New York Stock Exchange (e.g., the code-like evaluation from CALS committee, 2002). Other key U.S. data have been obtained through the massive databases of Securities and Exchange Commission (SEC), containing both company filing and regulation. In the UK, the Companies Act from 2006 provides important information. Contrary to the popular belief about Common Law, the UK Companies Act has 761 pages (a crude comparison with the Swedish equivalent [ABL]: 162 pages). For this dissertation, however, the most important foreign regulation is related to the London City and the supervisory authorities at the Financial Service Authority (FSA), e.g., the Combined Code (derived from the Cadbury report, the Higgs review and the Hampel Committee

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10 SICSEC was closed down 2010 and the existing regulation was transferred to the Swedish Corporate Governance Board.

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report) and the City Code on Takeovers and Mergers. As a complement and contextualisation, the original regulations are needed for understanding their implementation in the Swedish corporate governance system.

### 2.2.3 Documents: annual reports

Primarily for Chapters Three and Four, the individual firms’ annual reports have been very important. Annual reports are viewed as the best information source on the individual firms’ operations and control. Viewed from a strictly corporate governance perspective, it was only after the issuing of the Swedish code in 2005 that the annual reports were standardised in their corporate governance reporting. In many cases, however, the firms disclosed a large amount of valuable corporate governance information, both on voluntary data such as director independence and use of committees and on the prescribed reporting such as the board, the auditors and the ownership structure.

For Chapter Three, much of the data was collected from the annual reports; see the method section.

For Chapter Four, on nomination committees, annual reports were used as a historical source of the firms’ nomination procedures. This entailed a considerable amount of detective work, such as locating old annual reports for firms no longer in existence. Important sources for these data were the library of annual reports of the Lund University School of Economics and Management, the un-categorised printed collections at the Lund University Library, the database Retriever, the database Affärsdata and the web portal [www.rapporten.nu](http://www.rapporten.nu) (now unfortunately closed).

Annual reports have had an important role in understanding the regulation processes described here. The regulators do not exist in a vacuum. Their relationship with, or pressure from, international organisations is mediated by the firms, who are the first to come into contact with foreign investors and foreign practice. Depending on the way the firms act, the influences will disperse in the Swedish corporate governance system, leading finally to the regulators. Therefore, the annual reports are an invaluable source for understanding the relationships studied in this dissertation.

As a caveat, it is not claimed here that annual reports offer the ‘true’ view of corporate practice. It is well known that corporate reporting practices – even more so in the case of voluntary information, as was the situation with most corporate governance reporting prior to 2005 – is the result of processes associated with legitimating and isomorphism. However, as one source of information among others, the annual reports are useful.
The analysis of annual reports in Chapter Three is described in the ‘Methods’ section of that paper. The categorisation of annual reports data for Chapter Four is likewise found in the ‘Methods’ section of that article.

2.2.4 Mass media

Corporate governance is often discussed in the mass media. The subject of corporate governance is entangled with important political aspects in general and particularly regarding the wealth distribution in Swedish society. Therefore, public debates tend to occur every once in a while, with an debating article or spontaneous comment to a journalist reporting from a company AGM. These small events enable us to see who are involved in certain discussions and what issues are important. As discussed elsewhere, e.g. Jonnergård and Larsson-Olaison (2010b), the media do not always provide the most objective picture of the Swedish corporate governance system, but for the purpose of this study, it provides a degree of contextualisation in relation to the formal regulation and the interviews. Furthermore, there is a tendency that actors who are not allowed in other parts of the debate are given a voice in the media.

Primary media sources for this book are four influential Swedish newspapers Dagens Industri, Dagens Nyheter, Svenska Dagbladet and Affärsvärden. On-going reading of newspapers combined with reoccurring media queries in the databases Mediaarkivet and Affärsdata provide for a full picture.

Following the introduction in Chapter One and this brief note on methodology, the empirical part of this thesis follows in Chapters Three, Four, Five, Six and Seven concerning transplanted corporate governance reforms to Sweden.
3. THE EFFECT OF CORPORATE GOVERNANCE ON STOCK REPURCHASES: EVIDENCE FROM SWEDEN

Jansson, A. and Larsson-Olaison, U.


3.1 Abstract

**Manuscript type:** Empirical  

**Research Question/Issue:** The paper examines whether corporate governance differences affect firms’ stock repurchasing behaviour. Previous hypotheses on stock repurchases, well-supported by US data, are based on assumptions of managerial autonomy that might not be descriptive in corporate governance systems characterised by influential controlling shareholders such as the Swedish.  

**Research Findings/Insights:** Stock-repurchasing patterns among Swedish firms differ from those previously observed among US firms. The findings indicate that Swedish firms do not repurchase stock to distribute excess cash, signal undervaluation or fend off takeovers. Stock repurchases are made in addition to dividends and thus do not substitute for them. Firm-level corporate governance arrangements directly affect stock repurchasing behaviour. Firms without a dominant controlling owner seem to use stock repurchases to increase leverage. The existence of a dominant controlling shareholder diminishes the propensity for stock repurchases, while cross listing on a US or UK stock market increases that propensity.  

**Theoretical/Academic Implications:** The findings suggest that corporate governance differences affect stock repurchasing behaviour. The agency-theoretical view of the firm, on which the leading hypotheses on stock repurchases are based, accurately predicts stock repurchases only in certain institutional and governance settings.  

**Practitioner/Policy Implications:** The study suggests that differences in national and firm-level corporate governance must be taken into account in order to accurately assess outcomes of regulatory reforms and/or harmonisation attempts.  

**Keywords:** Corporate Governance; Stock Repurchases; Sweden; Dividends.
3.2 Introduction

This paper examines the issue of whether corporate governance differences affect firms’ stock repurchasing behaviour. The paper tests whether five well-established hypotheses can explain stock repurchases among Swedish firms. These hypotheses are grounded in agency-theoretical reasoning and have often been found to explain stock repurchases in the US context. The issue at stake here is whether they can be generalised to a context with substantially different corporate governance arrangements: the Swedish. The paper also explores the impact of a set of firm-level corporate governance variables on stock repurchases. The results suggest that the hypotheses grounded in agency theory are unfit for explaining stock repurchases among Swedish firms, which is likely to be an effect of differences in corporate governance arrangements between Swedish and US firms. The paper identifies controlling shareholder salience and heightened exposure to Anglo-Saxon capital markets as important factors shaping stock-repurchasing behaviour among Swedish firms.

Previous research has hypothesised that stock repurchases constitute a way of distributing temporary excess cash (Guay and Harford 2000; Jagannathan, Stephens, and Weisbach, 2000; Fenn and Liang, 2001). It has also been suggested that stock repurchases are a substitute for dividends (Dittmar, 2000; Gruillon and Michaela, 2002; Skinner, 2008). Moreover, various forms of the signalling hypothesis suggest that the motivation behind stock repurchases may be that management wishes to signal perceived unfair low valuation of the firm’s stock (Vermaelen, 1981; Lakonishok and Vermaelen, 1990; Ikenberry, Lakonishok and Vermaelen, 1995; Dittmar, 2000; Sanders and Carpenter, 2003; Chang and Sullivan, 2007; Louis and White, 2007; Jun, Jung and Walkling, 2009). Furthermore, it has been hypothesised that the underlying motive behind stock repurchases may sometimes lie in an attempt by management to fend off take-overs (Vermaelen, 1984; Denis, 1990; Dittmar, 2000; Billett and Xue, 2007; Chang and Sullivan, 2007). Yet another hypothesis on the motives behind stock repurchases is that firms may repurchase stock to increase leverage (by decreasing outstanding equity) towards an optimal level that minimises agency and financing costs (Opher and Thakor, 1987; Wansley, Lane and Sarkar, 1989; Dittmar, 2000).

These hypotheses are not necessarily mutually exclusive, and have all gained substantial empirical support when tested with US data. They have, however, been developed to explain the behaviour of US firms, operating in a corporate governance system characterised by a comparatively high degree of ownership dispersion, managerial autonomy, and fraction of compensation that is performance-based (Gedajlovic and Shapiro, 1998; Weimer and Pape, 1999). These assumptions of managerial autonomy and motivations can be associated more generally with an agency-theoretical view of the firm. This view has received criticism for being US-centric, failing to take into account the effects that embeddedness of corporations in varying institutional contexts have on corporate actions (Fligstein and Freeland, 1995; O’Sullivan, 2002; Aguilera and Jackson, 2003; Gospel and Pendleton, 2005; Lubatkin et al., 2005). The pertinent agency problem in a corporate governance system, for example, is likely to vary with the relative strength of internal and external governance mechanisms (Dharwadkar, George and Brandes, 2000).
Swedish corporate governance, like most corporate governance systems throughout the world (La Porta et al., 1999), is characterised by powerful controlling shareholders who are actively involved in firms’ governance (Agnblad, 2001; Stafsudd, 2009). Swedish controlling shareholders are, for example, typically involved in board work (Dzialo, Jonnergård, Kärreman, Svensson and Urbanek, 1998; Jonnergård and Kärreman, 2004; Jonnergård and Larsson, 2007, Chapter Five). Moreover, managerial compensation in Sweden is, compared to US conditions, to a lesser degree performance-based (Oxelheim, Wihlborg and Zhang, 2008; Weimer and Pape, 1999). All this suggests that Swedish firms in general are characterised by substantially greater influence of powerful and active owners on board-level decisions such as stock repurchases, and less capital-market pressures on top managers, than US firms, although there may of course be firm-level variation on these dimensions in the Swedish context. To the extent that large owners and managers less incentivised by financial performance face different incentives from the more autonomous US managers regarding stock repurchases, these institutional differences may cause hypotheses on stock repurchases developed with US firms in mind to hold less explanatory power in the Swedish context.

This paper tests whether the hypotheses derived from an agency-theoretical view of the firm, which have received previous empirical support when tested on US data, can explain stock repurchases among Swedish firms, to explore whether the institutional differences in corporate governance between these two countries may produce dissimilar patterns of stock repurchases. We furthermore test whether variation in firm-level corporate governance arrangements affects stock repurchases, to explore whether Swedish firms governed more or less similarly to US firms exhibit dissimilar repurchasing patterns. Understanding how variation in corporate governance affect stock repurchases will arguably constitute one contribution towards a better understanding how institutional embeddedness of corporations impacts the behaviour of these corporations.

We find evidence that partially supports the leverage hypothesis, but not the other hypotheses. A sub-sample analysis reveals that the leverage hypothesis predicts stock repurchases for firms without a large shareholder (>25% of the votes), but not for other firms. Dividends are, contrary to expectations, positively related to stock repurchases, suggesting that stock repurchases are generally made in addition to dividends rather than as a substitute for them. Firms cross-listed in the US or UK are more prone to stock repurchases, whereas the presence of a large shareholder is negatively related to stock repurchases. Overall, this indicates that since board-level decisions such stock repurchases are likely to be under the control of large shareholders, and large shareholders are likely to have interests that are different from those of an autonomous management, hypotheses formulated within the agency-theoretical framework are generally unfit for explaining stock repurchases among Swedish firms.
The next section describes the historical development and characteristics of Swedish corporate governance. The section that follows reviews the literature on stock repurchases and develops the hypotheses to be tested, followed by a section detailing the sample and variables used. The paper continues by presenting the test results, followed by a discussion and conclusion.

### 3.3 The Swedish Corporate Governance System

As described by Agnblad et al. (2001), corporate governance in Sweden is characterised by highly concentrated ownership of listed firms. In fact, Swedish listed firms exhibit among the highest ownership concentrations in the world when measured as concentration of votes, which is facilitated by legal provisions that can be used simultaneously, such as dual-class shares and pyramid and cross ownership. These allow concentration of votes without corresponding ownership of cash flow rights. Sweden is also often argued to have only moderate formal minority protection in international comparisons (La Porta et al., 1999; Nenova, 2003), leading to a situation in which minority expropriation and a small and inactive stock market might be expected. Yet Sweden has liquid financial markets (Agnblad et al., 2001; Stafsudd, 2009) and very little minority shareholder expropriation from an international perspective (Nenova, 2003; Gilson, 2006).

These rather paradoxical facts are often said to be the effect of controlling owners that monitor management while refraining from exploiting minority shareholders for reasons of social prestige and reputational considerations (Agnblad et al., 2001; Jansson, 2007; Stafsudd, 2009). The large controlling shareholders are typically represented on the board of directors, where they are considered hierarchically superior by other board members (Kärreman, 1999), and can control the annual general meetings and thus hire and fire management at will (Collin, 1998; Jonnergård and Kärreman, 2004). At the same time, Swedish controlling owners are themselves monitored. The Swedish corporate governance system exhibits tightly knit personal networks among owners of firms (Sinani, et al., 2008; Stafsudd, 2009). This creates a situation in which owners operate in small worlds where information travels quickly and reputations for honesty are likely to become valuable, thus creating an environment in which minority expropriation is curbed (Stafsudd, 2009).

Assuming that the Swedish corporate governance situation is path-dependent (Bebchuck and Roe, 1999), clues to these features of the Swedish corporate governance system could be found in its history. According to Högfeldt (2005) the Swedish corporate governance situation should be viewed in light of historical compromises reached by the large business owners, the trade unions and the Social Democratic Party. When the Social Democrats came into power in the 1930s, Swedish economic policy was geared towards supporting very large firms in which discernible capitalists, available for negotiations, were in control. As Aguilera and Jackson (2003) predicts, the result was firms in the hands of the highly committed large owners, partly pursuing strategic goals such as prestige and social esteem (Agnblad et al., 2001; Stafsudd,
2009). This also facilitated a corporatist model of negotiations and compromises, in which private ownership by large owners was respected as long as they participated in achieving full employment and social reforms (Högfeldt, 2005).

As a consequence of the corporatist model employed, a number of very powerful business groups, often centred on families, could control multiple firms on the Stockholm Stock Exchange (SSE) (Collin, 1998). However, the concentration of power by controlling owners is also a general feature in firms independent from these business groups, which could also take advantage of the legal provisions used by large business groups to concentrate voting power. Moreover, economic success for Swedish firms is often said to be the effect of directing the business society’s resources to a few export-oriented industries, often with government support (e.g. Glete, 1994; Högfeldt, 2005). This resulted in a highly internationalised business society.

However, just as the present situation in Swedish corporate governance system is rooted in the past, recent changes have certainly sprung from globalisation; at least from a perceived pressure for change due to globalisation among business leaders and the government. The 1980s saw the start of massive deregulation of what had been a highly regulated capital market, making the Swedish markets de jure more akin to US and UK markets. This resulted, among other things, in a massive influx of foreign ownership to go with what were already very internationalised firms; foreign ownership on the SSE is now about 30 - 35% (Statistics Sweden). Another reform that emerged from this was that stock repurchases were allowed in 2000; this met hardly any resistance from the business community, suggesting that the reform was perceived as beneficial, or at least not harmful. After this reform the Swedish Companies Act stipulated that a decision to repurchase stock or to pay a dividend is a decision to be taken by the shareholders at a general assembly, which in practice almost invariably mandates the board of directors to take this decision.11

Firms also changed in response to globalisation. For example, the use of option schemes to reward top managers in Swedish firms became popular in the late 1990s. However, variable pay, though by now

11 It could be argued that in Sweden, well-known for its high tax environment, tax considerations and repurchases should be related. Although we do not focus specifically on tax-related explanations in this study, this warrants a few comments. Capital gains are taxed at an equal rate as dividends (30%) for physical persons, which is similar to the situation in the United States (cf. Dittmar, 2000). It could be argued that stock repurchases are beneficial for physical persons on the grounds that they are able to choose whether to realise capital gains or not, which is not possible with a dividend. However, many of the business groups use closed-end investment funds in pyramid-holding structures, and for these, dividends are, if they consist of dividends from portfolio companies passed on, tax-deductible. Controlling shareholder families also often exert control by foundations (due, among other things, to past inheritance-tax laws), which are taxed in other ways. Moreover, a third of the ownership on SSE is foreign, which faces the tax situations in their home contexts. Swedish institutions are taxed in yet other ways. Altogether, it is difficult to say whether shareholders as a group would prefer stock repurchases to dividends, even if only focusing on controlling shareholders. To the extent that taxes affect preferences, we capture some of that when we test the substitution hypothesis, and whether the presence of controlling shareholders or cross listing (implying more foreign ownership) affect stock repurchases.
common, still constitutes a much smaller part of total remuneration for Swedish managers than for managers in most other countries. Around a third of a Swedish CEO’s remuneration comes from variable pay systems (Oxelheim et al., 2008); the comparable number for US managers is over 80% (Murphy, 1999). This may be an effect of more active owner monitoring, making performance-based pay less necessary for aligning managers’ and owners’ incentives (cf. Eisenhardt, 1989). Despite globalisation, the Swedish model of powerful controlling shareholders still prevails and has proved itself very flexible throughout the course of history, adapting to, for example, the internationalisation of corporate ownership and the regulations that followed this development (Jonnergård and Larsson-Olaison, 2010a).

We thus have good reason to suspect that, in general, controlling owners constrained by a willingness to uphold a reputation for honesty, play a dominant role in board-level decision making in Swedish firms, such as in the decision to repurchase stock. The use of owner monitoring rather than performance-based pay to align managerial incentives with that of the (large) owners may also create a situation in which managers are shielded from capital market pressures to a higher extent than, for example, managers in the United States or the UK. Finally, although there may be a typical Swedish model of corporate governance, many Swedish firms are highly internationalised, both in terms of ownership (in some cases due to cross listings) and product market orientation, although foreign owners as minority shareholders will tend to have little direct influence compared to the dominant controlling shareholders (cf. Agnblad et al., 2001).

3.4 Literature Review and Hypotheses Development

In recent times, the dominant theoretical perspective in the analysis of corporate governance issues has been agency theory (Turnbull, 1997), a theory that has been accused of ‘made-in-the-US’ bias and of a failure to account for how embeddedness of corporations in varying institutional contexts affects, for instance, corporate organisation and decision making (Fligstein and Freeland, 1995; O’Sullivan, 2002; Aguilera and Jackson, 2003; Gospel and Pendleton, 2005; Lubatkin et al., 2005). Specifically, agency theoretical understandings of corporate governance issues typically presume absent owners and autonomous managers whose utility is highly dependent on stock performance (Aguilera and Jackson, 2003), which are features that may not necessary be descriptive of the Swedish corporate governance system, or many other corporate governance systems around the world. Agency theory and the accompanying assumptions of autonomous managers who are sensitive to capital market pressures can also be seen as the overarching framework for the dominant hypotheses on stock repurchases.

In this study we explore the impact of differences in corporate governance on stock repurchases. This is done, first, by empirically testing the extent to which leading hypotheses on stock repurchases, which have received widespread support when tested on US data, can explain stock repurchases among Swedish firms. Second, we do this by testing whether firm-level corporate governance arrangements that cause firms to be governed more or less as their US counterparts, impact firms’ stock-repurchasing behaviour. In this section,
we outline the five leading hypotheses on stock repurchases under test, and consider how the characteristics of Swedish corporate governance might impact their applicability to stock repurchases among Swedish firms, and then formulate a sixth hypothesis suggesting how firm-level corporate governance arrangements may affect stock repurchases. We begin, however, by outlining the basic agency-theoretical understanding of stock repurchases that frame the leading hypotheses.

3.4.1 Stock repurchases in agency theory

In agency theory, the firm is a nexus of contracts among various principals and agents (Alchian and Demsetz, 1972; Jensen and Meckling, 1976; Fama, 1980). As stated in the seminal work of Jensen and Meckling (1976), the agency theoretical model rests on a number of assumptions, for example, choices by economic agents are motivated by their self-interest and information asymmetry between management (agents) and shareholders (principals). It is typically presumed that management are separate from owners and that there is a conflict of interest between shareholders and managers (Fama, 1980; Fama and Jensen, 1983; Jensen 1986) and between shareholders and debt holders (Jensen and Meckling 1976). These conflicts of interest lead to agency costs (e.g., costs for monitoring, ex ante bonding and residual losses).

Stock repurchasing is a method of cash distribution from the firm to shareholders that, over the years, has grown in popularity in the United States, especially open market share repurchasing (e.g. Dittmar, 2000; Jagannathan et al., 2000; Fenn and Liang, 2001). It is often seen as an alternative to cash dividends, but differs from it in some significant aspects. A share repurchase, in contrast to a cash dividend, is not an irrevocable distribution of cash from the firm to shareholders. If not annulled, the repurchased shares may be sold back to investors, or be used as payment in acquisitions. However, the shares, in accordance with the logic that a firm cannot own itself, have no real value when owned by the firm. Hence, share repurchases do have a real effect on the firm’s capital structure by increasing leverage.

According to Jensen (1986), optimal capital structure occurs when the sum of the agency costs of equity and the agency costs of debt is minimised, and thus the market value of the firm is maximised. However, as pointed out by Stulz (1990), a management separate from owners is unwilling to achieve optimal capital structure. Management are likely to prefer a lower leverage, since this leaves them in control of more cash flow that can be used to pursue their own ends, untouched by contractually specified, scheduled interest payments and repayment of debt. Cash flow over and above what can be profitably invested is referred to as free cash flow (Jensen, 1986) and is thus an effect of lower than optimal leverage, which may lead to agency costs as management has incentives to invest the cash flow rather than distribute it to shareholders. Presuming an autonomous management that has incentives to achieve a lower leverage than optimal, a transaction that intentionally increases leverage (as a stock repurchase) should, according to agency theory, be interpreted by a rational investor as a transaction that will decrease future agency costs, as it implies less free cash flow under management’s control (cf. Harris and Raviv, 1991).
If an autonomous management were given total freedom to pursue its own interests, the firm’s leverage would thus presumably be lower than optimal. Nevertheless, several control mechanisms constrain managerial discretion. As suggested by Walsh and Seward (1990), these constraints may be classified as external and internal. External constraints are market-based mechanisms such as the market for corporate control and hostile take-overs (Jensen, 1986; Gedajlovic and Shapiro, 1998), the managerial labour market (Fama, 1980), and not least, pay made contingent on stock performance, which can exert considerable influence on managerial decision making (Lazonick, 2007). Internal constraints are organisationally based mechanisms, such as monitoring by the board of directors (Fama and Jensen, 1983) or the internal market for promotions (Fama, 1980). It is often assumed that the US and UK corporate governance systems depend on external constraints, whereas continental European systems depend more on internal constraints (Gedajlovic and Shapiro, 1998).

The Swedish corporate governance system relies mainly on internal control mechanisms for controlling management; in particular active owners who exert control through representation on boards of directors. The agency-theoretical understanding of stock repurchases presumes that management controls firms’ decision to repurchase stock, but, as argued above, we doubt that this may be true in the Swedish context, where controlling shareholders are likely to exert considerable influence over this decision. Controlling shareholders, however, may, similar to management, have reasons to prefer a lower-than-optimal leverage, since they typically have invested a large part of their portfolio in one firm and therefore may have an interest in decreasing the default risk of that firm.

3.4.2 Hypotheses on stock repurchases based on agency theory

What motivates firms to repurchase stock? In this section, we will describe the five hypotheses that are tested in this study and link them to the agency-theoretical framework outlined above. These are a selection of what has been discussed in the literature and were appraised as the most persistent explanations of the rationale behind stock repurchases. We have, to some degree, synthesised ideas expressed by other researchers about stock repurchases in order to form the five hypotheses. The rationale for repurchasing stock typically presupposes an autonomous management whose wealth is highly linked to stock price performance. After stating each hypothesis, we consider how the specifics of Swedish corporate governance, especially the likely dominance of controlling owners over the decision to repurchase stock and managers less sensitised to capital market pressures, might affect their ability to predict stock repurchases among Swedish firms.

Management-controlled firms may be motivated to repurchase stock to alter their capital structure towards optimum, which according to agency theory is likely to increase the value of the firm. This assertion gained empirical support when tested with US data by, for example, Wansley et al. (1989) and Dittmar (2000), although the results of Chan, Ikenberry, and Lee (2004) seem to contradict this finding. For an
autonomous manager subject to the discipline of the stock market, increasing the value of the firm is attractive, especially if the manager’s remuneration is tied to the performance of the firm’s stock. Moreover, according to agency theory, a higher value of the firm generally increases the management team’s market value on the managerial labour market (Fama, 1980), and makes the firm less attractive as a take-over target (Jensen, 1986) or a target for shareholder activism (Strickland, Wiles, and Zenner, 1996). Hence, the more a firm’s leverage negatively differs from the optimal level (i.e., the more free cash flow the firm generates), the greater the volume of stock repurchases that may be expected according to this rationale, \textit{ceteris paribus}. Thus, the following hypothesis, referred to as the leverage hypothesis, may be formulated:

\textit{H1: There is a negative relationship between firm leverage and extent of stock repurchases.}

It is straightforward to see why a manager whose wealth is tied to the market value of the firm may want to repurchase stock to leverage the managed firm if this increases its value. If this hypothesis can predict stock repurchases in the Swedish context with managers less exposed to the discipline of the market and large shareholders likely to largely be in control of stock repurchasing decisions is, however, less obvious. On the one hand, a major shareholder, whose wealth often is largely synonymous with the value of the firm, may have an interest in increasing firm value. However, some differences between the situation faced by an autonomous manager and a large owner may be raised. Many controlling shareholders may be reluctant to sell the firm, making them care less about its immediate market value and more about default risk, while managers’ rewards may depend more immediately on firm value (cf. Fama, 1980). Moreover, controlling shareholders are less likely to be disciplined by mechanisms such as hostile takeovers. To the extent that controlling shareholders influence Swedish firms’ stock repurchases, leverage is thus likely to be a less important driver than for firms in contexts where ownership is more dispersed. Bohman’s (2006) study of what affects the probability that a firm adopt a stock repurchasing program based on Swedish data consistently indicates that leverage has no effect.

While the leverage hypothesis focuses on recurring streams of free cash flow, liquid assets over and above profitable investment opportunities do not always have to come in a steady stream. It has been suggested, and empirically supported by, for example, Dittmar (2000), Guay and Harford (2000), and Jagannathan et al. (2000), Fenn and Liang (2001), that stock repurchases may be used to distribute temporary shocks of liquidity. Management-controlled firms may have an incentive to distribute cash over and above profitable investment opportunities to the shareholders to maximise firm value. If management decides to distribute temporary excess cash, it may prefer a stock repurchase as the method of distribution, in favour of a dividend. Jensen (1986) and Jagannathan et al. (2000) argue that stock repurchases are perceived as a weaker promise of future pay-outs; a decreased rate of dividends is typically punished by the capital market with large stock price reductions and may also be harmful to the reputation of managers (Gwilym, Morgan, and Thomas, 2000). The more excess cash a firm possesses that cannot be invested in profitable investment opportunities, the greater the volume of stock repurchases that may be expected according to this rationale,
ceteris paribus. Thus, the following hypothesis, referred to as the excess cash hypothesis, may be formulated:

**H2: There is a positive relationship between firm excess cash holdings and extent of stock repurchases.**

If board-level decisions, such as that of repurchasing stock, is controlled by large shareholders, as it is likely to typically be in the Swedish context, and if managers are to a less extent sensitised to stock market reactions, it is however less obvious why a stock repurchase would be preferred to a dividend. On the one hand, if the controlling shareholder has no intention to sell the firm, market reactions to temporary dividends may not play such a big role. On the other hand, using stock repurchases to distribute excess cash is a lower-risk transaction than an extraordinary dividend, as there is the possibility of selling the stock should the cash be needed after all. Moreover, if controlling shareholders, and Swedish managers alike, are less sensitive to negative market reactions to firms possessing excess cash, there may be weak incentives to distribute the cash in the first place. It is, thus, difficult to predict the extent to which contextual factors may affect the applicability of the excess cash hypothesis.

Stock repurchases may also be used as a substitute for dividends. This hypothesis has received empirical support in Grullon and Michaely (2002) and Skinner (2008), but is contradicted by Dittmar’s (2000) and Jiraporn’s (2006) results. Because of the weaker commitment to future payouts (Jensen, 1986; Jagannathan et al., 2000), a management-controlled firm may prefer a cash distribution policy, implying that a larger fraction of the corporate cash distribution is carried out by stock repurchases at the expense of dividends. Managers are more risk-averse than stockholders in widely held firms (Harris and Raviv, 1991) and such a policy will allow for sudden cuts in corporate cash distribution without depressing the stock price, thus inducing less risk for a future depreciation of the management team’s value on the managerial labour market (Fama, 1980) and slumps in performance-related pay. Grullon and Michaely (2002) also show that market reaction to decreasing dividends is not negative if the firm simultaneously engages in repurchasing stock. This suggests that when stock repurchases become an available alternative, a propensity for paying dividends might gradually decrease in favour of stock repurchases, ceteris paribus. Thus, the following hypothesis, referred to as the substitution hypothesis, may be formulated:

**H3: There is a negative relationship between firm dividends and extent of stock repurchases.**

Controlling shareholders may, like management, be more risk-averse than dispersed shareholders with diversified portfolios, but are also likely to be less driven by immediate market reactions. Therefore, they face less strong incentives to substitute stock repurchases for dividends, as the negative market reactions from lowering dividends as a response to poor performance is not as costly as for an autonomous manager. This suggests that the incentives for letting stock repurchases replace dividends in the Swedish context, in which controlling shareholders are likely to largely control the decision to repurchase stock, are weaker than in the US context.
These hypotheses are premised on the notion that managers have an incentive to ensure that the firm's market value increases, or at least does not decrease. Moreover, they assume that the firm is being valued fairly by the market. However, the point of departure for one of the most widely discussed explanations for stock repurchases is that the firm is not being valued fairly, or, more specifically, that managers of management-controlled firms perceive the firm to be undervalued. Management is assumed to have superior information than investors do about the firm. Vermaelen (1981), Asquith and Mullins (1986), Opher and Thakor (1987), Netter and Mitchell (1989), Ikenberry et al. (1995), Dittmar, (2000), Sanders and Carpenters (2003), Chang and Sullivan (2007), Louis and White (2007) and Jun et al. (2009), among others, have argued that stock repurchases are under most circumstances interpreted by investors as a signal that management perceives the firm to be undervalued. In fact, firms need not even necessarily repurchase share for the signal to work, which has given rise to what is, among US firms, the common practice of announcing a stock repurchase program without necessarily repurchasing many shares. Stephens and Weisbach (1998) show, however, that given three years, firms tend to repurchase around 80% of what they promised. This hypothesis has been widely discussed and elaborated on and has also been empirically supported. Lakonishok and Vermaelen (1990), moreover, argue that the signalling effect increases with the volume of stock repurchased. Management-controlled firms are therefore likely to repurchase stock to signal perceived undervaluation of the firm if such exist. The greater the perceived under-valuation, the greater the probability and volume of stock repurchases that may be expected according to this rationale, ceteris paribus. Thus, the following hypothesis, referred to as the signalling hypothesis, may be formulated:

**H4: There is a negative relationship between firm valuation and extent of stock repurchases.**

It is easy to see why a manager whose rewards and career prospects are tied to the market value of the firm would want to signal that the firm is undervalued if that is the case. It is, however, less obvious why a controlling shareholder would extend resources for such signalling to fix a problem that in the longer run is likely to fix itself anyway. Unless a controlling shareholder plans to exit the firm, a more or less temporary undervaluation should be of less concern. Signalling under those circumstances could be interpreted more as a favour to the minority shareholders, which nonetheless may be a plausible outcome of pressures among Swedish controlling owners to improve their reputations (Stafsudd, 2009). Another caveat regarding signalling in the Swedish context is that the market may not necessarily understand what the signal means. Zajac and Westphal (2004) show that it took a long time for the US stock market to begin interpreting stock repurchases as a signal that the repurchasing firm is undervalued. Altogether, this suggests that the incentives to repurchase stock to signal undervaluation may be weaker in the Swedish than in the US context.

In the hypotheses outlined thus far, the market for corporate control, especially the threat of hostile takeovers, is a disciplining mechanism for managements in management-controlled firms. Management is
motivated to keep the value of the firm high, so that it will not be an attractive target for take-over attempts. However, it has been suggested by, for instance, Vermaelen (1984), Denis (1990), Ikenberry et al. (1995), Dittmar (2000) and Chang and Sullivan (2007) that stock repurchases are used in order to fend off take-over attempts already in progress, or very closely imminent (Billett and Xue, 2007) in some cases (i.e., as an instrument in ongoing corporate power struggles). A stock repurchase fills, at the very least, two desirable purposes for a management team whose jobs are potentially endangered by a take-over: (i) A stock repurchase is likely to increase firm value due to decreased future agency costs from increased leverage or signalling effects and thus decrease the potential gains from an acquisition. (ii) The owners who are willing to sell their shares at the lowest price will sell them to the firm; thus these shareholders will be removed (Bagwell, 1991). According to this rationale, the more obvious and severe the threat of a hostile take-over, the more likely a firm would be to repurchase stock, *ceteris paribus*. We may therefore formulate the following hypothesis, referred to as the control hypothesis:

**H5: There is a positive relationship between take-over threats and stock repurchases.**

Obviously, firms with a controlling owner who holds a large fraction of the shares are less attractive takeover targets unless large shareholders are willing to sell. For that reason, hostile takeovers have been very rare in Sweden (Agnblad et al., 2001), and accordingly we do not expect the control hypothesis to be as important for explaining stock repurchases in the Swedish as in the US context. However, for those few firms that have dispersed ownership, takeover threats can still induce stock repurchases, which is why we test this hypothesis empirically on a Swedish data set.

### 3.4.3 The impact of firm-level corporate governance differences on stock repurchases

We have considered how the general characteristics of the Swedish corporate governance system might limit the applicability of leading hypotheses on stock repurchases developed with US firms in mind. Overall, this discussion suggests that corporate governance factors may be important for firms’ stock repurchasing behaviour. The literature can also give further clues as to what type of corporate governance factors may impact stock repurchases. Of particular interest is the literature focusing on stock repurchases outside an Anglo-Saxon context, which however is small, perhaps because stock repurchases have not been allowed for very long.

On a system-wide scale, the legal environment seems to matter. Gonzáles and Gonzáles (2004) show that a Spanish cap on the number of shares that companies can repurchase (similar caps exist in Sweden and other EU countries) induces firms to repurchase shares on the open market. In addition, the degree to which minority shareholders are protected may be of consequence. Jiraporn’s (2006) study, conducted in the US, shows that stronger shareholder rights expressed in, for example, state law and corporate charters, assumed to force managers to act more in the interests of shareholders, prompt more repurchases of stock. Bohman (2006) uses survival analysis to show that the probability that a Swedish firm will engage in a stock repurchase program increases with board interlocks with other firms that repurchase stock, although the
small worlds character of Swedish ownership and board networks (Sinani et al., 2008; Stafsudd, 2009) suggest that most boards are not many steps away from each other.

Ownership structure appears also to be linked to stock repurchases. Liljebloom and Pasternack (2006) show that foreign ownership increases stock repurchases among Finnish firms, and Ginglinger and l’Her (2006) show that the market reaction to announcements of stock repurchase programs vary with ownership structure in France, such that the market reacts more positively when the firm has large foreign ownership and when no single shareholder can dominate decision making and thus use repurchases for minority expropriation purposes. The latter is consistent with Jiraporn’s (2006) findings on the positive link between shareholder protection and repurchases; however, Swedish firms, though certainly often dominated by controlling owners, exhibit very limited minority expropriation (Nenova, 2003; Stafsudd, 2009), so this effect may not be as strong in the Swedish context. Nevertheless, these studies indicate that beyond system-wide effects, ownership concentration and heightened exposure to the pressures of international investors might be linked to stock repurchases. International investors are predominantly situated in Anglo-Saxon contexts and might both expect and be more positive to stock repurchases (cf. Zajac and Westphal, 2004) than other investors.

With the specifics and historical development of the Swedish corporate governance system in mind, this suggests that firms governed in more traditional Swedish ways (i.e., firms that are characterised by controlling shareholder dominance and limited influence of foreign investors), may be less induced to repurchase stock, ceteris paribus. This also appears consistent with our discussion about the applicability of hypotheses derived from agency theory in a context of controlling owner dominance. We may therefore formulate the following hypothesis, referred to as the governance hypothesis:

**H6: There is a negative relationship between traditional Swedish corporate governance arrangements and stock repurchases.**

### 3.5 Sample and Variables

Swedish firms were allowed to repurchases stock for the first time in 2000. The sample consists of yearly observations of all firms listed on the SSE 2000–2004 on which full information could be obtained. This includes all Swedish firms that were allowed to repurchase stock, with the exception of a few smaller ones listed on alternative market places. The sample excludes firms quoted on SSE that were not incorporated in Sweden, as they operate in different legal regimes regarding stock repurchases. In total, the sample consists of 1304 observations of which 233 were from 2000, 263 from 2001, 279 from 2002, 275 from 2003, and 259 from 2004.
The dependent variable, ‘Stock repurchases’, is defined as actually incurred stock repurchases in terms of millions of Swedish crowns (MSEK) over a year. The independent variables of the study are summarised in Table 3.1.

Table 3.1 Independent Variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>Definition</th>
<th>Expected relation to stock repurchases</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The leverage hypothesis</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leverage</td>
<td>Debt / Equity</td>
<td>Negative</td>
</tr>
<tr>
<td><strong>The excess cash hypothesis</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current assets-to-total assets</td>
<td>Cash and equivalents / Total assets</td>
<td>Positive</td>
</tr>
<tr>
<td>Cash flow-to-total assets</td>
<td>Cash flow / Total assets</td>
<td>Positive</td>
</tr>
<tr>
<td><strong>The substitution hypothesis</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends</td>
<td>Dividends paid</td>
<td>Negative</td>
</tr>
<tr>
<td><strong>The signalling hypothesis</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market-to-book</td>
<td>Market value of equity + book value of debt / Book value of equity and debt</td>
<td>Negative</td>
</tr>
<tr>
<td>Earnings-to-price</td>
<td>Earnings before tax / market value of equity</td>
<td>Negative</td>
</tr>
<tr>
<td><strong>The control hypothesis</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rumour</td>
<td>1 if a takeover rumour is identified in press searches</td>
<td>Positive</td>
</tr>
<tr>
<td><strong>The governance hypothesis</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Differential voting rights</td>
<td>1 if the firm uses dual-class shares</td>
<td>Negative</td>
</tr>
<tr>
<td>Crosslisting</td>
<td>1 if the firm is cross-listed on NYSE, NASDAQ and/or LSE</td>
<td>Positive</td>
</tr>
<tr>
<td>Owner &gt; 25%</td>
<td>1 if any one owner holds &gt; 25% of votes</td>
<td>Negative</td>
</tr>
</tbody>
</table>

Firms’ degree of leverage is captured by the variable ‘Leverage’, which is, similar to Sanders and Carpenter (2003) and others, defined as firms’ debt-to-equity ratio. Consistent with, e.g. Dittmar (2000) two measures are used to capture excess cash, one capturing the stock and the other the flow of overliquidity: ‘Current assets-to-total assets’ and ‘Cash flow-to-total assets’, measured as the ratios of current assets and
yearly cash flow to total assets, respectively. For banks and closed-end investment funds that do not account for current assets, total cash possessions were used instead.

The valuation of firms is captured by two variables: ‘Market-to-book’ and ‘Earnings-to-price’. Market-to-book is defined as firms’ market-to-book ratio, an established measure of potential undervaluation of firms (e.g. Dittmar, 2000; Bohman, 2006), and Earnings-to-price is measured as the ratio of earnings before tax to market capitalisation. The more traditional P/E ratio could not be used as many firms had negative earnings during the period. Dividends are, as in Sanders and Carpenter (2003), measured as cash dividend payouts in terms of MSEK, captured by the variable ‘Dividends’. Rumours of potential takeovers of firms are measured by a dummy variable, ‘Rumour’, that equals 1 if rumours of a potential takeover of the firm existed in the business press during year; if not it equals 0, similar to Dittmar (2000).

As in Dittmar (2000), all measures of independent variables are from the financial year preceding the year of stock repurchases (the end of this year for balance sheet and market value measures). This approach was chosen because of the hypothesised causal relationship that the nature of these fundamentals precede a stock repurchase. Moreover, in Sweden a stock-repurchasing scheme has to be authorised by the general assembly where the main source of information for the shareholders is the annual financial statement. Two exceptions exist, however: Dividends and Rumour. Dividends are measured at the year of stock repurchases to see whether stock repurchases substituted dividends. Dividends, too, have to be authorised by the general assembly. When measuring Rumours, take-over rumours for both the year of stock repurchases and the preceding year were recorded, as both imminent and ongoing take-over attempts may motivate stock repurchases (Billett and Xue, 2007; Chang and Sullivan, 2007).

We use three variables to capture the in-sample variation of firms’ corporate governance arrangements, indicating whether firms are governed in ways more representative of traditional Swedish corporate governance or in ways more similar to US firms. One of the most prominent features of Swedish listed firms, as opposed to US ones, is the prevalence of major block holders that actively control corporations, often by means of dual-class shares (Agnblad et al., 2001). We therefore include dummy variables indicating whether a firm has dual-class shares and whether any one owner holds more than 25% of the votes at the beginning of the year.12 Firms with these characteristics may be regarded as more representative of traditional Swedish corporate governance, whereas other firms thus have governance characteristics more similar to US firms, even though they still exhibit high ownership concentration from a US perspective (cf. La Porta et al., 1999). We also include a dummy variable, ‘Crosslisting’, which indicates whether a firm is listed on the London Stock Exchange (LSE), NASDAQ and/or the New York Stock Exchange (NYSE);

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12 We also collected data on whether firms had an owner in control of more than 10% of the votes. However, since over 91% of the firms in the sample did, the variable was not very useful for analysis due to limited variation.
this variable proxy for heightened exposure to the pressures of international investors, which traditionally has been low for most Swedish firms.

We furthermore control for size, industry and year. The natural logarithm of total assets measured in MSEK, ‘Log total assets’, and dummy variables indicating year and which industrial sector firms belong to according to GICS, the classificatory standard used by SSE, are used for this purpose.

All accounting data were collected from the EcoWin and Datastream databases or directly from the firms’ annual reports. Data on ownership structure, the presence of dual-class shares and market values were collected from the annual ‘Owners and power’ series, comprising highly reliable data on the ownership structures of listed Swedish firms. Data on stock repurchases and cross listing were collected from SSE’s records. Data on take-over rumours were collected from Affärsdata’s database that contains an archive of articles from the most important Swedish business press. A query with the search string containing the Swedish equivalent of ‘take-over’ was performed, and those firms mentioned as potential take-over targets were coded 1 and all others were coded 0. The data collected on takeover rumours are, in contrast to all other data, obviously not as reliable. In order to test for this, we attempted to recode rumours of the year 2001, and the results differed very little from our first attempt, indicating that the reliability problem is not particularly serious. All multivariate tests have also been performed with the variable excluded, and the results presented in the remainder of this paper are robust to the inclusion of the Rumour.

3.6 Results

Table 3.2 present descriptive statistics, VIF values and bivariate correlations (Pearson) among the variables and Table 3.3 compares the means for firms that did or did not repurchase stock, respectively (industry and year dummies are not reported). Table 3.3 also reports results from independent samples t-tests (t statistic) and Wilcoxon/Mann-Whitney U-tests (z statistic) to test for equality between the two groups.
The average firm of our sample repurchased stock worth MSEK 66.07, although the standard deviation is very large. The average dividend of MSEK 218.20, also with a high standard deviation, is about triple the size of the average stock repurchase. Considering that our sample encompasses the first five years in which stock repurchases were allowed for Swedish publicly traded firms, thus making dividends the only way for firms to distribute cash to investors prior to the sample period, the reform was at least not coldly received.

The governance variables show that 56% of the firms in the sample had shares with differential voting rights, and that 59% of the firms had a shareholder controlling 25% of the votes or more. Cross-listing, in this variable proxy for heightened exposure to the pressures of international investors, which traditionally has been low for most Swedish firms.

We furthermore control for size, industry and year. The natural logarithm of total assets measured in MSEK, 'Log total assets', and dummy variables indicating year and which industrial sector firms belong to according to GICS, the classificatory standard used by SSE, are used for this purpose.

All accounting data were collected from the EcoWin and Datastream databases or directly from the firms' annual reports. Data on ownership structure, the presence of dual-class shares and market values were collected from the annual 'Owners and power' series, comprising highly reliable data on the ownership structures of listed Swedish firms. Data on stock repurchases and cross listing were collected from SSE's records. Data on take-over rumours were collected from Affärsdata's database that contains an archive of articles from the most important Swedish business press. A query with the search string containing the Swedish equivalent of 'take-over' was performed, and those firms mentioned as potential take-over targets were coded 1 and all others were coded 0. The data collected on takeover rumours are, in contrast to all other data, obviously not as reliable. In order to test for this, we attempted to recode rumours of the year 2001, and the results differed very little from our first attempt, indicating that the reliability problem is not particularly serious. All multivariate tests have also been performed with the variable excluded, and the results presented in the remainder of this paper are robust to the inclusion of the Rumor.

The results are presented in Table 3.2 and Table 3.3.

Table 3.2 Statistics and correlations

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>S.D.</th>
<th>VIF</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
<th>11</th>
<th>12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock repurchases, MSEK</td>
<td>66.07</td>
<td>519.23</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Log total assets</td>
<td>7.08</td>
<td>2.15</td>
<td>2.62</td>
<td>0.29</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leverage</td>
<td>1.81</td>
<td>7.46</td>
<td>1.09</td>
<td>0.10</td>
<td>0.23</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current assets-to-total assets</td>
<td>0.51</td>
<td>0.28</td>
<td>1.58</td>
<td>-0.08</td>
<td>-0.44</td>
<td>-0.12</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash flow-to-total assets</td>
<td>-0.01</td>
<td>0.25</td>
<td>1.08</td>
<td>0.01</td>
<td>0.15</td>
<td>0.00</td>
<td>0.04</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market-to-book</td>
<td>-4.07</td>
<td>21.87</td>
<td>1.05</td>
<td>-0.01</td>
<td>-0.07</td>
<td>0.04</td>
<td>0.08</td>
<td>0.02</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Earnings-to-price</td>
<td>-0.32</td>
<td>5.08</td>
<td>1.03</td>
<td>0.01</td>
<td>0.05</td>
<td>0.03</td>
<td>-0.01</td>
<td>0.07</td>
<td>0.01</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends, MSEK</td>
<td>218.20</td>
<td>710.28</td>
<td>1.70</td>
<td>0.44</td>
<td>0.62</td>
<td>0.21</td>
<td>-0.22</td>
<td>0.09</td>
<td>-0.02</td>
<td>0.03</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rumour</td>
<td>0.20</td>
<td>0.40</td>
<td>1.11</td>
<td>0.07</td>
<td>0.18</td>
<td>0.06</td>
<td>-0.06</td>
<td>0.00</td>
<td>-0.04</td>
<td>0.01</td>
<td>0.06</td>
<td>-0.14</td>
<td>1.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Differential voting rights</td>
<td>0.56</td>
<td>0.50</td>
<td>1.28</td>
<td>0.04</td>
<td>0.09</td>
<td>-0.05</td>
<td>0.00</td>
<td>-0.01</td>
<td>-0.07</td>
<td>-0.01</td>
<td>0.06</td>
<td>-0.14</td>
<td>1.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cross-listing</td>
<td>0.05</td>
<td>0.23</td>
<td>1.26</td>
<td>0.21</td>
<td>0.37</td>
<td>0.05</td>
<td>-0.05</td>
<td>0.01</td>
<td>-0.01</td>
<td>0.02</td>
<td>0.27</td>
<td>0.07</td>
<td>0.07</td>
<td>1.0</td>
<td></td>
</tr>
<tr>
<td>Owner &gt; 25%</td>
<td>0.59</td>
<td>0.49</td>
<td>1.25</td>
<td>-0.09</td>
<td>0.07</td>
<td>-0.03</td>
<td>-0.07</td>
<td>0.01</td>
<td>-0.07</td>
<td>0.06</td>
<td>-0.01</td>
<td>-0.11</td>
<td>0.36</td>
<td>-0.02</td>
<td>1.0</td>
</tr>
</tbody>
</table>

Note: VIF values from estimation of Model 2 (Table 4)

Table 3.3 Tests for Equality

<table>
<thead>
<tr>
<th></th>
<th>Non-Repurchasepurchaser:</th>
<th>t</th>
<th>z</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(n=1145)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Log total assets</td>
<td>6.83</td>
<td>8.84</td>
<td>-11.75**</td>
</tr>
<tr>
<td>Leverage</td>
<td>1.60</td>
<td>3.26</td>
<td>-2.68**</td>
</tr>
<tr>
<td>Current assets-to-total assets</td>
<td>0.53</td>
<td>0.41</td>
<td>5.11**</td>
</tr>
<tr>
<td>Cash flow-to-total assets</td>
<td>-0.02</td>
<td>0.01</td>
<td>-1.33</td>
</tr>
<tr>
<td>Market-to-book</td>
<td>4.37</td>
<td>1.96</td>
<td>1.32</td>
</tr>
<tr>
<td>Earnings-to-price</td>
<td>-0.39</td>
<td>0.13</td>
<td>-1.22</td>
</tr>
<tr>
<td>Dividends, MSEK</td>
<td>159.94</td>
<td>624.94</td>
<td>-8.03**</td>
</tr>
<tr>
<td>Rumor</td>
<td>0.18</td>
<td>0.34</td>
<td>-4.70**</td>
</tr>
<tr>
<td>Differential voting rights</td>
<td>0.55</td>
<td>0.60</td>
<td>-1.14</td>
</tr>
<tr>
<td>Cross-listing</td>
<td>0.05</td>
<td>0.10</td>
<td>-2.62**</td>
</tr>
<tr>
<td>Owner &gt; 25%</td>
<td>0.60</td>
<td>0.57</td>
<td>0.59</td>
</tr>
</tbody>
</table>

Note: * p < .10, ** p < .05, *** p < .01
contrast, is much less common: 5% of the firms in the sample were cross-listed on LSE, NASDAQ, and/or NYSE.

As indicated by the VIF values accounted for in Table 3.2, the inclusion of the variable Log total assets in multivariate analysis creates hazards of multicollinearity. We have, however, performed all multivariate tests with this variable excluded to determine whether this is a problem. The results remained the same with this variable excluded, which indicates that it is not.

The sample contains 164 observations of stock repurchases, which means that in an average year, around 13% of our sampled firms repurchased stock. This is slightly less than US firms; in Dittmar’s (2000) sample of listed non-financial US firms, for example, 16% of firms repurchased shares in 1995 and 20% of firms repurchased stock in 1996. The tests for equality (Table 3.3) show that stock-repurchasing Swedish firms tend to be larger than those that are not repurchasing shares (t = -11.75; p < .01). Surprisingly, they also appear to be significantly higher leveraged (t = -2.68; p < .01), have less current assets relative to total assets (t = 5.11; p < .01), and pay larger dividends (t = -8.03; p < .01). The Wilcoxon/Mann-Whitney test, but not the t-test, also indicates that repurchasing firms have significantly higher earnings-to-price ratio (z = -12.39; p < .01) and lower market-to-book ratio (z = -3.65; p < .01). Repurchasing firms are also more often the subjects of take-over rumours (t = -4.7; p < .01). Thus far, the data appear to be outright contradictory to the leverage hypothesis, the excess cash hypothesis, and the substitution hypothesis, while being ambiguous regarding the signalling hypothesis and supportive of the control hypothesis. Yet the important qualification that the tests for equality do not take the volume of stock repurchases into account should be stressed. The tests for equality also show that repurchasing firms tend to be cross-listed more often than non-repurchasing firms (t = -2.62; p < .01), thus suggesting that they are more exposed to pressures stemming from US and UK investors.

Table 3.4 reports results from OLS regressions with Stock repurchases as a dependent variable, hence taking into account the variability in the volume of stock repurchases the tests for equality fail to acknowledge. Information technology and 2002 are consistently used as reference categories in the estimated models. Since the sample to a large extent consists of data from the same firms over consecutive years, there is a risk of serial correlation. We control for year to preserve the independence of the observations, but also report Durbin-Watson statistics, all of which suggest that serial correlation is not at hand in the estimated models.
Table 3.4 Results of OLS Regressions with Stock Repurchases as Dependent Variable

<table>
<thead>
<tr>
<th></th>
<th>Model 1 (all firms)</th>
<th>Model 2 (all firms)</th>
<th>Model 3 (firms with owner&gt;25%)</th>
<th>Model 4 (firms with no owner&gt;25%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Coefficient</td>
<td>Std. Error</td>
<td>Coefficient</td>
<td>Std. Error</td>
</tr>
<tr>
<td>(Constant)</td>
<td>-480.96**</td>
<td>56.58</td>
<td>-42.77</td>
<td>83.77</td>
</tr>
<tr>
<td>Log total assets</td>
<td>77.17**</td>
<td>7.45</td>
<td>-1.07</td>
<td>9.65</td>
</tr>
<tr>
<td>Leverage</td>
<td>0.45</td>
<td>1.00</td>
<td>1.00</td>
<td>0.86</td>
</tr>
<tr>
<td>Current assets-to-total assets</td>
<td>47.63</td>
<td>58.38</td>
<td>50.16</td>
<td>36.55</td>
</tr>
<tr>
<td>Cash flow-to-total assets</td>
<td>-26.45</td>
<td>53.21</td>
<td>-16.00</td>
<td>33.26</td>
</tr>
<tr>
<td>Market-to-book</td>
<td>-0.41</td>
<td>0.60</td>
<td>-0.97</td>
<td>1.23</td>
</tr>
<tr>
<td>Earnings-to-price</td>
<td>-0.04</td>
<td>2.55</td>
<td>-10.35</td>
<td>11.17</td>
</tr>
<tr>
<td>Dividends, MSEK</td>
<td>0.30**</td>
<td>0.02</td>
<td>0.04**</td>
<td>0.01</td>
</tr>
<tr>
<td>Rumour</td>
<td>37.99</td>
<td>33.69</td>
<td>1.13</td>
<td>20.40</td>
</tr>
<tr>
<td>Differential voting rights</td>
<td>36.24</td>
<td>29.16</td>
<td>12.80</td>
<td>17.17</td>
</tr>
<tr>
<td>Cross-listing</td>
<td>213.01**</td>
<td>63.34</td>
<td>-95.50**</td>
<td>36.18</td>
</tr>
<tr>
<td>Owner &gt; 25%</td>
<td>-108.52**</td>
<td>29.15</td>
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<tr>
<td>Energy</td>
<td>141.46</td>
<td>224.30</td>
<td>6.03</td>
<td>210.40</td>
</tr>
<tr>
<td>Industrials</td>
<td>-42.83</td>
<td>40.05</td>
<td>36.69</td>
<td>38.81</td>
</tr>
<tr>
<td>Consumer discretionary</td>
<td>-39.17</td>
<td>50.69</td>
<td>44.20</td>
<td>48.57</td>
</tr>
<tr>
<td>Consumer staples</td>
<td>-16.96</td>
<td>104.37</td>
<td>130.15</td>
<td>98.81</td>
</tr>
<tr>
<td>Health care</td>
<td>-34.86</td>
<td>53.20</td>
<td>-7.94</td>
<td>49.89</td>
</tr>
<tr>
<td>Financials</td>
<td>-74.80</td>
<td>48.24</td>
<td>31.06</td>
<td>50.52</td>
</tr>
<tr>
<td>Telecommunication services</td>
<td>-200.20*</td>
<td>101.21</td>
<td>-77.70</td>
<td>95.71</td>
</tr>
<tr>
<td>Utilities</td>
<td>-270.83</td>
<td>251.37</td>
<td>34.08</td>
<td>237.41</td>
</tr>
<tr>
<td>2000</td>
<td>99.88*</td>
<td>44.17</td>
<td>98.38*</td>
<td>42.33</td>
</tr>
<tr>
<td>2001</td>
<td>42.17</td>
<td>42.74</td>
<td>37.76</td>
<td>40.30</td>
</tr>
<tr>
<td>2002</td>
<td>15.49</td>
<td>42.26</td>
<td>2.76</td>
<td>39.62</td>
</tr>
<tr>
<td>2004</td>
<td>58.94</td>
<td>42.02</td>
<td>38.88</td>
<td>40.22</td>
</tr>
</tbody>
</table>

Note: *p < .1, **p < .05, ***p < .01

Models 1-2 are estimates based on the full sample. Entering the experimental variables (Model 2) greatly increases the explanatory power compared to Model 1 consisting only of control variables (Adj-R²=.083 and .223 respectively). The regression analysis indicates that stock repurchases are positively related to dividends (t=12.93; p<.01). This contradicts the substitution hypothesis, suggesting instead that stock repurchases are made on top of dividends; firms that pay large dividends are more likely to repurchase large volumes of stock. Beyond that, all hypotheses based on agency theory fail this test, suggesting that patterns of stock repurchases among Swedish firms differ substantially from that among US firms.

Two governance variables are significant at the 1% level, indicating that corporate governance indeed affects stock-repurchasing behaviour. Our results suggest that firms with a shareholder in control of more than 25% of the votes tend to repurchase less stock (t=-3.72; p<.01). Being cross-listed on LSE, NASDAQ, and/or NYSE is positively related to stock repurchases (t=3.36; p<.01). We thus find evidence to support the governance hypothesis, that firms with more traditional Swedish governance arrangements repurchase less stock. The presence of dual-class shares does, however, not predict stock repurchases in our sample, so...
the support is not unambiguous. Ownership concentration and heightened exposure to pressures of US or UK investors seem, however, to be of significance for Swedish firms’ stock repurchasing behaviour.

The presence of a shareholder in control of more than 25% of the votes appears to be of major importance for stock repurchases among Swedish firms. We therefore estimated two additional models: one based on the subset of firms with a large owner (Model 3) and one based on the subset of firms without a large owner (Model 4). A number of industries were only represented in one subset and the respective dummy variables were thus excluded from the estimation based on the subset in which they were not represented.

The significant positive relationship between dividends and stock repurchases (t=3.18; p<.01; and t=12.93; p<.01, for Model 3 and 4, respectively), and cross listing and stock repurchases (t=-2.64; p<.01; and t=2.56; p<.05, for Model 3 and 4, respectively) is consistent across specifications. However, there is a significant negative relationship between leverage and stock repurchases for the subset of firms without a large owner (t=-3.46; p<.01), suggesting that the leverage hypothesis can predict the behaviour of this group. Interestingly, the R² differs substantially between the two models. The estimated model based on the subset of firms with a large owner have an Adjusted R² of only 0.075, whereas the model based on the subset of firms without a large owner have an Adjusted R² of 0.367. This suggests that the model is a substantially better fit for firms with an ownership structure more similar to US firms, which indicates that the independent variables, largely selected based on agency theoretical explanations of stock repurchases, does a far better job at predicting stock repurchases among firms with corporate governance arrangements more similar to US firms than those with more traditional Swedish arrangements, supporting the governance hypothesis.

Overall, the only hypothesis derived from agency theory to which our results are partly supportive is the leverage hypothesis, but it only appears to predict stock repurchases among the subset of firms that do not have a large controlling shareholder. Another caveat is that the bivariate tests show that the group of stock-repurchasing firms on average is more highly leveraged than the non-repurchasing group, but this effect thus disappears when volume of stock repurchases are taken into account. Variables derived from the other leading hypotheses fail to predict stock repurchases, or are related to stock repurchases in the opposite direction than expected. The results differ somewhat from Bohman’s (2006) study of stock repurchases in Sweden that indicates that a high return on assets and a low market-to-book may increase the probability for a firm to engage in a stock repurchase program, whereas leverage appears to be indifferent. These differences are likely attributable to the fact that Bohman studies the probability to engage in a stock repurchase program, whereas this study uses the volume of stock repurchases as dependent variable.

Some of the governance variables, in contrast, are interestingly enough significantly related to stock repurchases, indicating that stock repurchasing behaviour is affected by corporate governance arrangements. More specifically, firms with concentrated ownership seem to behave differently from those with less concentrated ownership in the sense that they repurchase less stock. Firms with less concentrated ownership
ownership seem also to behave more similarly to what has been observed among US firms. Those firms that are more exposed to the pressures of US or UK stock markets, seem also to behave differently from other firms in the sense that they repurchase more stock; this supports the governance hypothesis.

3.7 Discussion and Conclusions

Table 3.5 Results of the study

<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>Studies suggesting the hypothesis’ explanatory power for US firms</th>
<th>Results of this study</th>
</tr>
</thead>
<tbody>
<tr>
<td>The leverage hypothesis</td>
<td>Ofer and Thakor (1987); Wansley et al. (1989); and Dittmar (2000)</td>
<td>Supportive only for firms without owner &gt; 25%</td>
</tr>
<tr>
<td>The excess cash hypothesis</td>
<td>Stephens and Weisbach (1998); Dittmar (2000); Jagannathan et al. (2000); Guay and Harford (2000); and Fenn and Liang (2001)</td>
<td>Unsupportive</td>
</tr>
<tr>
<td>The substitution hypothesis</td>
<td>Grullon and Michaely (2002); and Skinner (2008)</td>
<td>Unsupportive</td>
</tr>
<tr>
<td>The signalling hypothesis</td>
<td>Vermaelen (1981); Netter and Mitchell (1989); Lakonishok and Vermaelen (1990); Ikenberry et al. (1995); Louis and White (2007); Chang and Sullivan (2007); and Jun et al. (2009)</td>
<td>Unsupportive</td>
</tr>
<tr>
<td>The control hypothesis</td>
<td>Vermaelen (1984); Denis (1990); Dittmar (2000); Chang and Sullivan (2007); and Billett and Xue (2007)</td>
<td>Unsupportive</td>
</tr>
<tr>
<td>The governance hypothesis</td>
<td></td>
<td>Supportive</td>
</tr>
</tbody>
</table>

Table 3.5 summarises our empirical results on stock repurchases among Swedish firms with regards to the five leading hypotheses on share repurchases, which are compared with earlier US research, and the governance hypothesis. We find evidence to support the governance hypothesis, that firms with more traditional Swedish corporate governance arrangements are less prone to stock repurchases. We also find evidence that partially supports the leverage hypothesis, that firms with repurchase stock alter their leverage closer to an optimal level – although only firms with relatively dispersed ownership do this. However, we find little evidence to support the other hypotheses based on an agency theory view of the firm, (i.e., that share repurchases are used as a mean to distribute excess cash, signal undervaluation, or fend off takeover attempts). Neither are repurchases a substitute for dividends. In fact, dividends are positively related to
stock repurchases in our sample, indicating that they are made in addition to cash dividends, rather than substituting for them.

Overall, the results support the view that variation in corporate governance arrangements impact stock repurchasing behaviour. We find direct evidence to suggest that firm-level governance affect stock repurchases. The pattern of stock repurchases among Swedish firms also appears to differ substantially from that of US firms. Although this is not conclusive evidence that differences in corporate governance institutions drive these differences, our results on how firm-level corporate governance arrangements affect the volume of stock repurchases in such a way that firms whose corporate governance arrangements are more similar to those of US firms (relatively less ownership concentration) and with heightened exposure to US or UK stock markets (through cross listing) repurchase more stock, support this interpretation. This is in line with Liljeblom and Pasternack (2006), who show that foreign ownership increases stock repurchases among Finnish firms, and with Ginglinger and l’Her (2006), who show that stock-price reactions to share buybacks by French firms are more positive if foreign ownership is high and there is no dominating controlling shareholder. Another finding that is consistent with the view that national corporate governance institutions partially drive these changes is that the model, consisting mostly of variables linked to hypotheses that had received previous support by US data, fits firms with more dispersed ownership a lot better (in terms of R²) than firms with a dominant controlling owner, which are common in the Swedish (Agnblad et al., 2001), but not in the US (Weimer and Pape, 1999) context.

Hence, our results are consistent with the institutional literature arguing that agency theory suffers from US-centricity and fails to account for the effects of important institutional differences (Fligstein and Freeland, 1995; O’Sullivan, 2002; Aguilera and Jackson, 2003; Gospel and Pendleton, 2005; Lubatkin et al., 2005), which seem to matter also for stock repurchases. The study contributes to this literature by identifying institutional factors that may be important drivers of cross-national differences in stock repurchases: controlling shareholder salience and exposure to Anglo-Saxon capital markets. Controlling shareholders are likely to have interests regarding stock repurchases that differ from autonomous managers. While approximately a third of the stock traded on SSE is owned by foreigners and Swedish firms generally have highly international sales, the existence of dominant controlling owners is also likely to shield many firms from pressures stemming from foreign investors that often seem to have a preference for stock repurchases (Ginglinger and l’Her, 2006; Liljeblom and Pasternack, 2006). Cross listing may, however, indicate heightened exposure to such pressures that firms, whether they have a dominant controlling owner or not, cannot resist.

What our study largely fails to do, however, is to provide a convincing explanation as to why Swedish firms repurchase stock in general. It is obvious that the leading hypotheses on stock repurchases have limited explanatory power in the Swedish context. Even though the leading hypotheses have better explanatory power for Swedish firms with relatively dispersed ownership (in terms of R²), they still do not have strong explanatory power even for those firms; only the leverage hypothesis seems to significantly explain stock
repurchases among this subset of firms. What does seem clear, however, is that any explanation of stock repurchases among Swedish firms should consider that stock repurchases are likely to largely reflect the interests of controlling shareholders, rather than those of an autonomous management sensitive to capital-market pressures.

Our findings have clear implications for the literature on stock repurchases. The leading hypotheses seem to accurately predict stock repurchases only in certain (Anglo-American) institutional and governance settings that, from a global perspective, are special cases. We also show that firm-level corporate governance can have a significant influence on incentives for stock repurchases. This highlights the need to integrate the impact of corporate governance in the rising on stock repurchases and our study contributes by indicating some factors that may influence the decision to repurchase stock.

The findings also have implications for policy makers. Specifically, the finding that differences in national and firm-specific corporate governance institutions seem to affect stock repurchases has implications for reform work. This finding essentially suggests that attempts to harmonise legislation on stock repurchases around the world (as has been done in the EU) is likely to yield stock-repurchasing behaviour that differ between countries in ways that reflect these countries' unique institutional settings. While this study certainly cannot fully substantiate such a claim, it does suggest that de jure harmonisation will not automatically lead to de facto harmonisation when it comes to stock repurchases. Policy makers need to consider the impact of their respective institutional context on the incentives to repurchase stock in order to more accurately assess the effects of reforms in this area.

The study has a number of limitations. Since we only have data from Sweden, we were unable to make direct comparisons between stock repurchases among Swedish firms and among firms in other countries. The results of this study suggest that such direct comparisons may be a promising avenue for future research, which should be able to, with more precision, identify those differences in national institutional arrangements that affect stock repurchases. One such difference between Swedish and US firms that potentially could be an important driver behind our results, is the differences in CEO compensation between the two countries (cf. Murphy, 1999; Oxelheim et al., 2008). Another potentially important factor that has not been regarded in this study is cross-national variation in board composition. Swedish firms have, for example, labour representatives on the board, who may be more interested in reinvesting excess cash than distributing them to shareholders by stock repurchases.

Another interesting avenue for future research is to develop and test hypotheses on stock repurchases in corporate governance systems characterised by concentrated ownership. One potential reason for why controlling shareholders may want to repurchase stock is to consolidate their ownership stake (cf. Ginglinger and l'Her, 2006). By letting the firm repurchase stock and not selling privately held stock, the relative stake of the controlling owner increases. Controlling shareholders are often argued to derive private
benefits from being in control (Rydqvist, 1996; Nenova, 2003; Dyck and Zingales, 2004), so such company-financed consolidation of the ownership stake should be especially valuable to controlling shareholders that plausibly could face a control contest. In our sample, the absence of an owner holding more than 25% of the votes increases the volume of repurchased stock. At the same time, over 90% of all firms in the sample have a block holder controlling over 10% of the votes. Hence, most firms that repurchase stock are likely to have a controlling shareholder that could conceivably lose control over the firm. Also consistent with this conjecture is the fact that our sample contains only 11 observations of repurchases of shares with higher voting power, typically held by controlling owners, even though 60% of the repurchasing firms had dual-class shares in operation. Though these observations are in line, we do not have the data to directly capture whether this motivation drives stock repurchases in Sweden, but future research might wish to examine this hypothesis more closely.

We thus conclude that differences in corporate governance seem to impact stock repurchases. More specifically, we conclude that controlling shareholder salience seems to be negatively related to stock repurchases and exposure to Anglo-Saxon capital markets appears to be positively related to stock repurchases. As Swedish firms typically have a much higher ownership concentration than US firms, hypotheses developed to explain stock repurchases among US firm fail to predict the behaviour of Swedish firms. Among five hypotheses, all of which are well-supported when tested with US data, only the leverage hypothesis partially predicts stock repurchasing behaviour among Swedish firms, although only among those firms that do not have a dominant controlling owner (>25% of votes). The excess cash hypothesis, the signalling hypothesis, the substitution hypothesis and the control hypothesis seem not to describe the stock-repurchasing behaviour among Swedish firms.
4. THE TRANSLATION OF TRANSPLANTED RULES: THE CASE OF THE SWEDISH NOMINATION COMMITTEE

Larsson-Olaison, U.


4.1 Abstract
This chapter concerns how the Swedish national corporate governance system is reformed by regulatory means. The regulation in focus is the implementation of nomination committees, an idea from the UK Cadbury Code, imported to Sweden as part of the Swedish Corporate Governance Code. The main objective is to understand the intersections between international best practice regulation and local practices on the one hand, and between actions by the regulator and those regulated on the other hand. The first intersection is captured by the use of the concepts of transplantation and convergence derived from the sciences of law and economics, and the second intersection is captured by the concept of translation from organizational theory. The main findings of the chapter concerning the Swedish nomination committee implementation are that the imported regulations result in local rather than international convergence and that the impact of regulators in transplanting transnational rules is limited by translations made by those regulated.

4.2 Background
In December 1992, in the UK, the Committee on the Financial Aspects of Corporate Governance issued a report, later known as the Cadbury Code. Its rule no. 4.30 deals with director nomination by a nomination committee. This committee should be formed as a subcommittee of the board, have a majority of non-
executive directors and be chaired by either the chairman of the board or a non-executive director. In December 2004 the Swedish Code Group issued a formally binding Swedish corporate governance code for the largest firms listed on the Stockholm stock exchange. Section 2.1 deals with nomination committees. A Swedish nomination committee is appointed by the Annual General Meeting (AGM), has a majority of non-board members, no members from management, and no board member is allowed to chair. Thus, the typical Cadbury nomination committee is a subcommittee of the board, formed by one executive director and two non-executive directors, with one of the non-executives as chairman. On the other hand, following the Swedish code, a typical nomination committee should be formed as a subcommittee of the AGM and have one director (not an executive director, rather someone representing a major owner on the board) joined by two non-directors (probably representing major owners outside the board).

Often when the globalization of the world’s capital markets is discussed the focus is on convergence (e.g. Coffee, 2001). Convergence implies the reform of inferior corporate governance systems (like the Swedish one) to better assemble a superior corporate governance system (like the British). Reforming local regulation in line with international regulation can achieve convergence, the most efficient way to converge the regulatory structure being to transplant the regulation (Watson, 1974; La Porta et al., 2000). An example of a transplant leading towards convergence is the introduction of nomination committees in Sweden as described above.

However, it would be problematic to account for the differences in a Swedish nomination committee in relation to the Cadbury nomination committee only by means of the concepts of convergence and transplantation. In this paper, drawing on organization theory, the use of the general model of translation (Latour, 1986; Czarniawska and Jorges, 1996) is proposed to enrich the transplant concept. The translation model stresses the importance of the actors involved in the process and the way they handle different concepts and practices (Latour, 1986). In the specific process studied here the actors are found on two different levels: the firm level and the regulatory level. On the firm level several Swedish firms have introduced nomination committees prior to regulatory demands. On the regulatory level there has been an ongoing debate dating back to when the Cadbury report was first published.

In this paper both the transplantation process and the translation process are followed with the purpose of providing a rich empirical account of the transplantation of the nomination committee from the UK to Sweden. The contribution is twofold. First, empirical studies of transplanted corporate governance regulation are rare. Second, drawing on the empirical study, some theoretical implications for corporate

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13 We will return to the label used in the Swedish code below. For now it is enough, however, to state that the formal Swedish translation used in the code is ‘nomination committee’.

14 In this paper corporate governance is defined according to Schleifer and Wishney (1997) as the national system of rules and norms safeguarding the investment of the suppliers of finance.

15 In this paper the introduction of the Swedish code is used as a demarcation of this debate, even though it has continued.

governance system reforms through regulatory change are proposed. This is important as transnational regulation will be used continuously in developing local corporate governance.

Next, a frame of reference is built on the concepts of translation, transplantation and convergence. Thereafter the research design is displayed, followed by the case of the Swedish nomination committee. After a discussion the paper is concluded.

4.3 International Corporate Governance in Local Practice: Transplants and Translations

This frame of reference is structured to enable a discussion of the main theoretical differences in the view of how international best practice rules function in local practice. First, the concept of transplantation of legal rules is introduced in the convergence discussion. This is contrasted with the influence of local context and actors. Second, the influence of local actors is conceptualized by the use of the notion of translations.

4.3.1 Transplants and those transplanting

In order to survive, according to the convergence thesis, local corporate governance systems must adapt to international best practice or they will perish in competition (La Porta et al., 1999; Hansmann and Kraakman, 2004). This position and its consequence are summarized in this quote:

*Despite a continuing bias in favor of home-country investing, the internationalization of capital markets has led to more cross-border investing. New stockholders enter, and they aren't always part of any local corporate governance consensus. They prefer a corporate governance regime they understand (Gordon and Roe, 2004, p. 2).*

One of the most viable methods to achieve an understandable corporate governance regime is held to be by a reform of the regulation (Coffee, 2001; Hansmann and Kraakman, 2004). This concept of convergence treats regulation as an answering machine, where international competition automatically leads to better rules, thus simultaneously treating regulation as the standardization and enhancement of effectiveness. Standardization is important, as international investors recognize local practice in common rules. This is a gain for the investors. This gain is also an enhancement of the effectiveness, as local firms thereby grow more competitive in the struggle for global equity capital. The international investors, and their taste in regulation, are often described as Anglo-American (e.g. Oixelheim and Randøy, 2003). Thus, to compete for international capital standardization is needed and that is achieved by the transplant of Anglo-American rules. Watson, the legal historian that most comprehensively treated the concept of legal transplants, summarizes:
First, the transplanting of individual rules or of a large part of a legal system is extremely common. [...] Secondly, transplanting is, in fact, the most fertile source of development (Watson, 1974, p. 95).

The transplant perspective is used in ‘The new comparative economics’ (Djankov et al., 2003). The interest of new comparative economics is to compare different economies in terms of corporate governance. However, as the results of the research tend to show that some corporate governance systems are better, there is a tendency towards the normative:

For most countries, the improvement of investor protection requires radical changes in the legal system. [...] Laws generally need to be amended. [...] The law’s general stance toward outside investors – suggests at least tentatively that many rules need to be changed simultaneously to bring a country with poor investor protection up to best practice (La Porta et al., 2000, p. 20).

The new comparative economics, drawing on Watson (1974), is based on the notion of legal origins (common law or civil law). The implication of this research is the need to transplant investor protection regulation from common law countries to civil law countries (La Porta et al., 1999; 2000). Real world examples are frequent, e.g. the introduction of corporate governance codes around the world (Aguilera and Cuervo-Cazurra, 2004) and company law harmonization efforts by the European Union.

However, scholars have questioned the use of the transplantation metaphor for understanding the transfer of rules from one society to another (e.g. Kahn-Freund, 1974; Teubner, 1998). Transplantations point to medical science (Kahn-Freund, 1974), and as the transplanted rules do not always achieve the desired ends, other metaphors have been proposed. Such metaphors include ‘degrees of transferability’ (Kahn-Freund, 1974), ‘the transplant effect’ (Berkowitz et al., 2003) and ‘legal irritants’ (Teubner, 1998). Obviously, both sides take the metaphors literally, as they tend to think of the transfer of the rule as a transfer of a physical artifact that could be disconnected from the users of the rule (see Legrand, 1997, for his criticism on Watson, 1974). This literal view is attributed to the ways by which Watson introduced the concept, but in this paper the use of the transplant metaphor is nonetheless proposed to be considered figuratively rather: the same rule is transplanted as the regulator uses the same phraseology (label). However, in contact with the users of the rule the meaning of the rule may, or may not, be altered. Thus, we need to highlight local elites and their use of rules, in order to seriously consider the criticism by both Kahn-Freund (1974) and Berkowitz et al. (2003) of the transplant concept.

To focus on local elites is controversial in the scholarly area of corporate governance, as local elites are often given negative connotations such as ‘tunneling’, ‘regulatory capture’ and ‘minority shareholder expropriations’ (e.g. La Porta et al., 1999; Gordon and Roe, 2004). In this paper the local elites are considered a precondition – a rule without a user is nothing (Berkowitz et al., 2003), and the transplanted rule must be meaningful for the local users, or else they will not use it (Kahn-Freund, 1974).
4.3.2 Those transplanting are also translators

Turning to local users to understand why international rules change in local use calls for a different approach. This paper draws on organization theory. In this theory a similar situation exists when following how organizational practices spread among organizations. A static perspective, comparable to the perspective of Watson (1974), labeled the diffusion model (e.g. Tolbert and Zucker, 1983), is often contrasted with a translation perspective (e.g. Latour, 1986; Czarniawska and Jorges, 1996). In a diffusion model the actors involved in the diffusion are not important, what is important being the diffusing practice. The contrast to this, the translation model, rather emphasizes that it is not the initial force or local resistance that decides the diffusion of an innovation:

_The spread in time and space of anything – claims, orders, artifacts, goods – is in the hands of people; each of these people may act in many different ways, letting the token drop, or modifying it, or deflecting it, or betraying it, or adding to it, or appropriating it (Latour, 1986, p. 267)._

With this starting-point it becomes obvious that the actors involved in the process and their relationship to the transplanted rule are of utmost importance to the result of the transfer. One example is found in the study by Buck, Shahrim and Winter (2004) of the introduction of ‘American’ stock-option programs in Germany:

[suggesting] that US-Style ESO schemes have been translated to meet the needs of interest groups in German firms, and to fit in with the wider governance environment in Germany. German ESOs do not seem to provide an example of convergence on US-style governance structures (Buck et al., 2004, p. 184).

From this perspective it is taken for granted that the rule traveling from one context to another will become something else (see Czarniawska and Sevón, 2005). Thus, what we must study is what happened, as pointed out by Sahlin-Andersson:

_we need to understand both how the 'diffusion' happens and how forms and practices are shaped and reshaped in various stages of this process: we need to follow how ideas travel (Sahlin-Andersson, 1996, p. 7)._  

Following Sahlin-Andersson, we need rich empirical accounts. Before we turn to that section, however, a short summary of the theoretical positions of the paper will be made. It is proposed that the actual diffusion of international best practice rules from one context to another is transplantation. This transplantation is a metaphor and should not be thought of as an actual transplantation in a medical sense – we need to think of it figuratively. There will be actors involved in this transplantation, and they will adopt the rule as they think appropriate. What is interesting is then how these local elites translate actual rules, and for this we need a rich empirical material.
4.4 Research Design

This paper is based on a longitudinal single-case study of the process where the nomination committee became the regulated solution for board nomination in Sweden. In this section the case data is presented and relevant methodological questions are addressed.

The case study is built on extensive empirical material: semi-structured interviews, annual reports, ownership data, board data, auditor data, ownership policies and regulatory documentation.

Following the implementation of the Swedish Corporate Governance Code, 12 regulators and self-regulators were interviewed. The interviewees are both from the governmental ‘Commission of Trust’, which initiated and participated in the code developing process, and from the ‘Code Group’, the group formed jointly by the commission and the business society responsible for the code. In this paper the interviews are treated anonymously and this trade-off of validity was made to increase the quality of the answers provided.

The interviews were conducted in relation to the development of the Swedish Corporate Governance Code, which is the final phase of the nomination committee implementation in Sweden. Thus, extensive verbal accounts of this part of the process are used to develop the case. However, the interviews have great bearing on the story presented earlier in the process. Several of the interviewees have a long history in the Swedish corporate governance system, e.g., as long-time leaders of central organizations and also long-time regulators. Thereby the semi-structured interviews covered and gave input to the case for the entire period studied.

The nomination practices of the listed Swedish firms were captured by annual reports. They represent the best available source for covering actual firm behavior. The annual reports were surveyed for the years 1998, 2000, 2002 and 2004. The population consists of all firms listed on the Stockholm Stock Exchange, the former A-list and O-list. To be included in the sample the firms have to be listed for the full year and to produce an annual report. For 1998 this amounts to 223 firms; however, for 14 firms it has been impossible to find the annual report, which leaves us with 209 firms. In 2000 was 252 (14 non-responses), for 2002 273 (0 non-responses) and for 2004 253 (0 non-responses).

The data from the annual reports are categorized into seven categories: 1) No disclosure of board nomination practice; 2) Nomination committee with a majority of board members; 3) Nomination committee with a majority of non-board owners; 4) Nomination committee non-specified; 5) The director nomination is coordinated by the chairman; 6) The annual report states that the firm does not have any

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17 In the rare cases where the financial year is not identical with the calendar year the first half was used, i.e., for 1998 annual reports from 1997/1998 were used rather than from 1998/1999.
committees; 7) The dominant owners coordinate the board nomination. The categories were the result of the categorization process and capture all the reported nomination practices.

Data on the firm level for ownership and votes are collected by the annual book *Owners and power in Sweden's listed companies* by Fristedt and Sundqvist (1998; 2000; 2002; 2004). These books are used to mine data for firm market value, identity of largest owner, share of capital and votes for largest owner, foreign ownership share of capital and votes (excluding the share of a foreign owner when also the largest owner) and the number of 'corners' (owners with at least 10% of the votes and/or capital).

Regarding the identity of the owner, many Swedish firms are controlled by so-called spheres (see Agnblad et al., 2001; Collin, 1990). These spheres are often tied to a family and will figure in the case. The leading spheres are Wallenberg and Handelsbanken, but other spheres such as Stenbeck, Lundberg, will also occur in the material.

Fristedt and Sundqvist publish *Directors and auditors in Sweden's listed companies* annually (1998; 2000; 2002; 2004). These publications are used to mine data on management presence on the board (the CEO18), the presence of foreign directors, the presence of Anglo-Saxon directors, and interlocking directorships. The data on foreigners is based on present residence.

The interlocking directorship is measured by two components. First, the number of directors unique to that board alone, expressed in percentage of total directors. Second, the average number of directorships within the sample.

Fristedt and Sundqvist’s *Directors and auditors in Sweden's listed companies* is also used to mine data on ‘big league’ auditors (an auditor active in more than 6 firms in the population), firms using more than one audit firm and the audit firm used.

In 1997 and 2003 Kristiansson collected all ownership policies in Sweden. These are mainly issued by institutional investors and provide information on their stand on different corporate governance issues. In this paper they are treated as part of the regulation development process, as these organizations can by no means directly force any firms to implement the solutions, but by repeating their positions they can affect regulators. As ownership policies are updated continuously, the Kristiansson’s books contain a unique source of the situation in 1997 and 2003.

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18 Please note that a Swedish board is composed differently with regard to management in comparison with, for instance, Anglo-Saxon boards, see below.
In Sweden self-regulation has traditionally held a strong position in corporate governance regulation. From the SICSEC to the ‘Code Group’ a great deal has been said on board nomination. Both the SICSEC and the ‘Code Group’ will be discussed at greater length below; here it is only necessary to note that these are the dominant self-regulatory institutions in the Swedish corporate governance system during the period studied.

In formal binding regulation the board nomination question has been discussed, for instance in the preparatory work for the latest Swedish Companies Act or the different corporate governance documents from the EC. These discussions have also been used to enrich the case.

Together this data is used to build two possible stories about how the nomination committee became the regulated solution for board nomination in Sweden. There could be and, since corporate governance is a self-interest driven area, there are other possible stories about this. However, with the extensive data collected the story presented is provided with some validity.

4.5 The Case: The Convergence of Swedish Board Nomination

The following section provides two separate accounts of the development of Swedish board nomination procedures. First, the proceedings on the Swedish regulatory level are displayed. Secondly, the disclosure of Swedish listed firms is presented. Before this a brief background is given to the Swedish corporate governance system.

4.5.1 The traditional Swedish corporate governance system and the board nomination issue

In 1992 the Cadbury Report started a wave of international corporate governance reform. This report was a response to current misbehavior in British listed firms and the focus was on the non-executive directors (NEDs) of the boards. Directors tied to the CEO acted with low integrity, were unable to exercise control and thus became scapegoats (Spira, 1999). The British corporate governance system is characterized by dispersed firm ownership and by the market forces rather than owners being supposed to control management. Therefore the focus on NEDs is natural. NEDs are to be independent of the firm with regard to both employment and ownership and thereby the independent experts control management. To increase the number of NEDs on the boards, and also the actual independence of each NED, nomination committees should be formed as subcommittees of the boards (Carson, 2002). The idea was simple: if the recruitment of new NEDs was handled by NEDs – separated from the rest of the board in a committee – new NEDs would improve board independence. Consequently, in the Cadbury UK nomination committees were formed as a response to the power of the CEOs, whereby the boards needed to be empowered to exercise the control function (Carson, 2002).
The Swedish corporate governance system is characterized by only mildly dispersed ownership, with active traditional owners (e.g. Agnblad et al., 2001; Jonnergård and Kärreman, 2004). The introduction of nomination committees was by many actors regarded as a solution to a non-existing problem. Ownership is exercised by board presence and board nomination (Sjöstrand and Petrelius, 2002; Jonnergård and Kärreman, 2004). It was, and still is today, not unusual that the CEO holds a position on the board but is prohibited to be chairman. Instead, the boards are comprised of representatives of the traditional owners, employee representatives and outsiders (Jonnergård and Kärreman, 2004). The nomination to new board members that took place among the largest owners was traditionally coordinated by the chairman (Sjöstrand and Petrelius, 2002). Thus, unlike the situation at Cadbury UK, managerial influence on board work is not the main problem in Sweden.

4.5.2 Swedish regulatory development for the nomination committee

The description of the regulation developing process by which Sweden implemented the nomination committee is summarized in Table 4.1 and thereby a timeline for the process is established.

Table 4.1 The Regulatory Developing Process

<table>
<thead>
<tr>
<th>Year</th>
<th>1991</th>
<th>1993</th>
<th>1995</th>
<th>1997</th>
<th>1999</th>
<th>2001</th>
<th>2003</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Voiced Support</td>
<td>SSA: All firms</td>
<td>Private institutions: Firms without control owner</td>
<td>Public institutions: All firms</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Voiced opposition</td>
<td>Controll owners: voluntary</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regulators and self-regulators: voluntary</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

A year after Cadbury, in 1993, the idea of the nomination committee first came up in the Swedish debate. It started through the issuing of a corporate governance policy, or as it is called an Ownership Policy, by the
Swedish Shareholders’ Association (SSA). The issuing of an ownership policy was an innovation; it is the document that many of the following policies and codes in Sweden are based on. The basic idea of an ownership policy is to influence firm and regulator action; SSA can by no means force firms or regulators to follow or implement their solutions and thus the policy is a statement of their positions on the topic at hand. The leading actors of the Shareholders’ Association came across the Cadbury Report at an early stage and were greatly influenced by it. The Shareholders’ Association did not specify how this nomination committee should be composed or how they should perform their duties, but they started lobbying intensively for the committee formation in media and at the annual general meetings. It would not be an exaggeration to say that the Shareholders’ Association put corporate governance reform on the Swedish agenda altogether. This was largely done by their publication of the policy, and one of their most loudly voiced reforms was the introduction of the nomination committees. Considering the scoop of the Shareholders’ Association, its relative size and the existence of stronger interest groups in the Swedish corporate governance system, it is easy to underestimate their influence on corporate governance reform. However, the direction for a Swedish corporate governance system that the association pointed out was clear: the board nomination practices needed reform by the introduction of nomination committees. Eleven years later this was the solution.

In 1994, as a direct response to the Shareholders’ Association, the ‘Swedish Industry and Commerce Stock Exchange Committee’ (SICSEC, Näringslivets börskommitte) issued a recommendation on board nomination. SICSEC was at the time the leading body for self-regulation in the Swedish financial markets and had the possibility of enforcement through the listing requirements at the Stockholm stock exchange. Among the founders almost all major stakeholders of the Swedish financial markets were represented, which implies that the organization was tightly knit together with the traditional owners and ownership spheres. Therefore it is not strange that the SICSEC took a negative position towards the formation of nomination committees, as they might create a problem for traditional owners in exercising their rights. SICSEC’s argument was that nomination was not a problem in most Swedish firms, since the ownership structure implied that the control problem was solved – nobody entered a Swedish board feeling gratitude towards the CEO. The SICSEC clearly took the position of the traditional owners, fuelling those who opposed the idea of nomination committees and legitimizing the then current practice of a great number of Swedish firms.

The SSA ownership policy was followed by number of policies from institutional investors, who also wanted to express their positions on different corporate governance issues. In Kristiansson (1998) all Swedish owner policies present in May 1997 are collected. There it is evident that board nomination has risen on the agenda of the institutional investors. In the 14 provided owner policies, most of them from private pension funds, demands for nomination committees were raised in all public firms (the SSA). Three policies do not mention nomination committees. The remaining ten point out that a nomination

---

19 Organization for small shareholders.
committee is appropriate for board nomination in firms lacking big owners. This implies that the institutional investors were willing to work with board nomination, and in most cases within the formalized process that they readily referred to as nomination committees. This was only, however, when there was no traditional owner present. This could be called one of the first steps of what Skog (2004) refers to as: ‘The awakening of the Swedish institutional investor’ associated with the debate about institutional investors acting as ‘real’ owners.

For quite a long period, from 1997 to 2004, the Swedish Shareholders’ Association and some of the institutional investors continued the struggle for nomination committees at the firms’ AGMs. Besides, few regulators or other major stakeholders in the Swedish corporate governance system gave their opinion publicly on the use of nomination committees. One notable exception occurred in 1998, when the Swedish government published the preparatory work for a new Companies Act. There the question of mandatory nomination committees is discussed with a direct reference to the SSA proposal. The preparatory work does not reject the proposal as vigorously as SICSEC did in 1994, but the rejection is supported by the same arguments as, and with reference to, SICSEC. Finally, the preparatory work concludes that the government would not hesitate in the future to impose mandatory regulation if problems with public firms’ board nomination should become evident. However, the then current practices seemed to be working in the eyes of the regulators drafting the new Companies Act.

The number of ownership policies increased as the public pension funds, insurance companies and the government also issued theirs. They were compiled again by Kristiansson in 2003, by which time they had risen to 19. This time the Shareholders’ Association was no longer alone in demanding nomination committees in all firms. The Swedish government and the public pension funds were generally positive towards nomination committees, and one of the pension funds demanded it. The insurance companies were also positive, but not to the same extent as the public pension funds. The private pension funds, which made up the bulk of the corporate governance policies in 1997, do not seem to have changed their minds: nomination committees are one possibility in firms without large owners.

The next time the nomination committees reached the public agenda was when the Government Commission for Trust, together with the Swedish Business Society, embarked on issuing a Swedish code of corporate governance. The Corporate Governance Code was issued by a formal process of referrals (see Jonnergård and Larsson, 2007, Chapter Five). This implies that the code would take the same path as a government act in Sweden – with a proposal, a process of referrals and a final proposal. In the first proposal, from 2004, all listed firms were to have an election committee20 (Swedish: valberedning) appointed by the annual general meeting, taking the majority of the committee from outside the board, the

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20 In the Swedish cooperative and voluntary sectors the concept of election committee (Swedish: valberedning) is a well-known method of dealing with board nomination issues in an attempt to avoid power concentration.
only board member allowed being the chairman. It is important to note that, although the official translation into English still used the term nomination committee, the term used was election committee (Swedish: valberedning). I will return to this change in vocabulary. In this first proposal, the election committee was left with far-reaching responsibilities, leaving many actors in the Swedish corporate governance system in fear of a fifth corporate body.\(^\text{21}\) Note that this is the first time that a regulator actually set about specifying how a board member should be nominated by the use of a committee. Up to this point the committee concept in Sweden was empty, leaving different actors to their own interpretations. By the issuing of the Code of Corporate Governance this vacuum was filled with meaning.

Therefore, it is not strange that the election committee issue was fiercely debated. Many of the traditional actors in the Swedish corporate governance system opposed the proposal for the composition of the committee. The proposed total abolishment of other directors than the chairman in the committee would have made a clear cut with all other current firm practices. More importantly, it would have created a rather obscure situation in firms with a major physical owner exercising his/her ownership through board presence. If the major owner did not chair the board s/he would not be able to nominate candidates for the board even though the same owner should control the annual general meeting where the actual decision was made. It is also clear that the proposal was written to empower institutional investors, as they never exercise ownership through board presence. However, many of the institutional investors disapproved of this solution, as the far-reaching responsibilities of the election committee would label them insiders. At this stage it was also decided which firms were going to be regulated by the Corporate Governance Code, namely, the largest firms with a market value above 3 billion Swedish kronor (SEK).

Another interesting aspect of the process of referrals for the Swedish Corporate Governance Code was that there was little discussion of the actual presence of election committees. No actor stepped forward arguing against the formation of nomination or election committees. Obviously, in 2004, the question was no longer problematic or else everybody realized that a corporate governance code could not be issued leaving out nomination committees.

In the final version of the Swedish Corporate Governance Code the AGM was to appoint an election committee with a majority of non-board members and with no members from management. At this point the Swedish election committee had become something very different from a Cadbury nomination committee. Instead of the NEDs of the board forming a committee, as in the Cadbury solution, the Swedish election committee was going to be composed by owners outside of the board. Instead of a committee connected to the board it had become a committee connected to the AGM. This implies that the Swedish solution now only shares its name with the British original and that only in the official translations.

\(^{21}\) The other being the AGM, the board, the managing director (CEO) and the auditor.
Finally, the question of the labels of this board nomination practice needs to be addressed. In corporate practice and in the English translated regulation the term is nomination committee, and thus the same as the internationally accepted terminology. In the Swedish version the usage of the term election committee (Swedish: valberedning) stands out as very interesting as i) it is an established term in the cooperative and voluntary sectors and ii) it clearly marks the difference from international praxis. In fact, in the writings of the Swedish code group it is argued that the usage of the term election committee signals that it is another practice than the usual Cadbury nomination committee. This practice is by some of the members of the code group considered as an innovation that could be transplanted to other corporate governance systems in need of empowered owners.

To summarize, the regulatory developing process could be divided into three distinct phases. The first phase is a challenger phase, where the Swedish Shareholders’ Association challenges the established Swedish corporate governance actors, who oppose or neglect the demands. The second phase is a mobilization phase, where the Shareholders’ Association mobilizes other stakeholders, like the institutional investors, while the establishment is still opposed to the idea. Finally, this ‘status quo’ is broken and the final phase of consensus takes place. This final phase arrives very fast and it is almost as if nobody ever opposed the nomination committee concept. However, it is in this phase that it is established that it should not be a nomination committee of the Cadbury model but a Swedish nomination committee, and this committee should only be labeled nomination committee for foreigners, whereas in Sweden the term should be election committee.

4.5.3 Firm actions in face of international capital market pressure
The development of the Swedish nomination committee was not only the result of regulatory developments. The pressures felt by regulators were also felt among the firms. In the following section the establishment of nomination committees among Swedish firms is followed. This process is summarized in the Table 4.2 timeline.
was composed of owner representatives without a board representation (institutional investors) and thereby none of them could be regarded as independent in the Cadbury sense. Skandia, similarly to Volvo, lacked traditional owners and was consequently controlled by management. Thus, at least two different forms of board nomination practices labeled nomination committees are found in the mid-1990s, one where board directors representing traditional owners also formed nomination committees as a board subcommittee and one where representatives of owners not present on the board formed a subcommittee of the AGM.

The 1998 firm survey A complete examination of all Swedish public firms' annual reports from 1998 on the disclosure of board nomination procedures is summarized in table 4.3:

Table 4.3 nomination procedures 1998

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>116</td>
<td></td>
<td>18</td>
<td>19</td>
<td>7</td>
<td>24</td>
</tr>
<tr>
<td>47</td>
<td></td>
<td>11</td>
<td>9</td>
<td>2</td>
<td>10</td>
</tr>
<tr>
<td>69</td>
<td></td>
<td>7</td>
<td>10</td>
<td>5</td>
<td>18</td>
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<td></td>
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<td></td>
<td></td>
<td>5</td>
</tr>
</tbody>
</table>

Firstly, the above table is divided between the A-list and the O-list, where the A-list is the top list consisting of the largest and most established firms, whereas the O-list is to a larger extent composed of smaller, less established firms. Secondly, the table is divided into seven categories for disclosed board nomination practice (see 4.3). The first category is 'no disclosure', which means that the annual report contains no disclosure of board nomination. The second category, 'nomination committee board', involves that a firm reports a nomination committee composed of a majority of board members (compare with Industrivärden above). The third category, 'nomination committee AGM', is a reported nomination committee but is staffed by a majority of non-board members (for a similar example, see Volvo/Skandia above). The fourth category consists of firms that report a nomination committee without any specification of the members. The fifth category, 'chairman coordination', is similar to the proceeding reported by Sjöstrand and Petrelius (2002) (section 4.1), whereby the firm reports a process coordinated by the chairman among the largest owners. Notably, this chairman coordination is similar to the workings proposed by SISEC (section 4.2). The praxis of the sixth category, firms that report that no board subcommittees exist, corresponds to the writings of SICSEC, as their recommendation deemed committees inappropriate. In the seventh category, 'dominant owner coordination', the reported procedure points out one or two owners that appoint all new board members with regard to a special treaty.

The same year as the Shareholders’ Association published its policy the first formally documented nomination committee was formed in Sweden by Volvo. Volvo is one of Sweden’s largest firms, but also an outsider firm, as it is not connected to an ownership sphere and thereby traditionally regarded as being under managerial control. The committee was composed of representatives of large institutional investors with no directors included. This was not a result of the SSA policy; it was a result of the failed Volvo-Renault merger (Skog, 2004). The merger was blocked by Volvo shareholders. After the failed merger every position on the Volvo board needed new appointees, and thereby the board influence on the decision was per definition impossible. The owners needed to step forward. In comparison with the original British idea, the Volvo nomination committee was not formed as a subcommittee to the board but as a subcommittee to the annual general meeting; nor was the nomination committee composed of NEDs but of larger institutional owners.

By 1995 nomination committees began to show up in more Swedish firms. One example is Skandia, the insurance company, which in the annual reports of later years describes the foresight of the annual general meeting which proposed the formation of a nomination committee. Another interesting example is Industrivärden, the investment company. A striking difference between the nomination committees in Skandia and Industrivärden is found in the relation to board members and owners. In Industrivärden the nomination committee is composed of board members, just as in the British original, but none of the members would have been classified as NEDs in the Cadbury terminology – they were all connected with the Handelsbanken interest sphere. In Skandia, on the other hand, like Volvo, the nomination committee
was composed of owner representatives without a board representation (institutional investors) and thereby none of them could be regarded as independent in the Cadbury sense. Skandia, similarly to Volvo, lacked traditional owners and was consequently controlled by management.

Thus, at least two different forms of board nomination practices labeled nomination committees are found in the mid-1990s, one where board directors representing traditional owners also formed nomination committees as a board subcommittee and one where representatives of owners not present on the board formed a subcommittee of the AGM.

The 1998 firm survey
A complete examination of all Swedish public firms’ annual reports from 1998 on the disclosure of board nomination procedures is summarized in table 4.3:

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A-list</td>
<td>47</td>
<td>11</td>
<td>9</td>
<td>2</td>
<td>10</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>O-list</td>
<td>69</td>
<td>7</td>
<td>10</td>
<td>5</td>
<td>5</td>
<td>18</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td>116</td>
<td>18</td>
<td>19</td>
<td>7</td>
<td>15</td>
<td>24</td>
<td>10</td>
</tr>
</tbody>
</table>

Firstly, the above table is divided between the A-list and the O-list, where the A-list is the top list consisting of the largest and most established firms, whereas the O-list is to a larger extent composed of smaller, less established firms. Secondly, the table is divided into seven categories for disclosed board nomination practice (see 4.3). The first category is ‘no disclosure’, which means that the annual report contains no disclosure of board nomination. The second category, ‘nomination committee board’, involves that a firm reports a nomination committee composed of a majority of board members (compare with Industrivärden above). The third category, ‘nomination committee AGM’, is a reported nomination committee but is staffed by a majority of non-board members (for a similar example, see Volvo/Skandia above). The fourth category, consists of firms that report a nomination committee without any specification of the members. The fifth category, ‘chairman coordination’, is similar to the proceeding reported by Sjöstrand and Petrelius (2002) (section 4.1), whereby the firm reports a process coordinated by the chairman among the largest owners. Notably, this chairman coordination is similar to the workings proposed by SISEC (section 4.2). The praxis of the sixth category, firms that report that no board subcommittees exist, corresponds to the writings of SICSEC, as their recommendation deemed committees inappropriate. In the seventh category, ‘dominant owner coordination’, the reported procedure points out one or two owners that appoint all new board members with regard to a special treaty.
In the annual reports of 1998 firms use different labels for the procedures. Three firms call it election committee (Swedish: valberedning) and one firm uses proposal committee (Swedish: förslagskommitté). In Table 4.3 these different committees are classified in accordance with the body which actually held the positions: the proposal committee in category 2; two election committees in category 3; and one election committee in category 4.

In Table 4.3 above only 86 out of 196 firms disclose anything about board nomination. There is no difference between the firms listed on the A-list and those on the O-list. Besides the vague notification that there exist no board sub-committees three procedures stand out as the most common disclosed procedures: nomination committees composed of board members, nomination committees composed of non-board owners, and chairman coordination. In Table 4.4 the characteristics of these firms on important corporate governance dimensions are contrasted with the non-disclosing ones.

### Table 4.4. Firm characteristics in 1998

<table>
<thead>
<tr>
<th></th>
<th>Nomination committee on board</th>
<th>Nomination committee on AGM</th>
<th>Chairman coordination</th>
<th>No Disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average largest voting stake</td>
<td>39 %</td>
<td>24 %</td>
<td>43 %</td>
<td>43 %</td>
</tr>
<tr>
<td>Average foreign ownership</td>
<td>14 %</td>
<td>19 %</td>
<td>19 %</td>
<td>16 %</td>
</tr>
<tr>
<td>Average number of Anglo-Saxon directors</td>
<td>0</td>
<td>0</td>
<td>0,06</td>
<td>0,13</td>
</tr>
<tr>
<td>Proportion CEO on board</td>
<td>90 %</td>
<td>100 %</td>
<td>90 %</td>
<td>90 %</td>
</tr>
<tr>
<td>Proportion audited by ‘big league auditors’</td>
<td>55 %</td>
<td>58 %</td>
<td>46 %</td>
<td>46 %</td>
</tr>
<tr>
<td>Average unique directors</td>
<td>41 %</td>
<td>55 %</td>
<td>43 %</td>
<td>55 %</td>
</tr>
<tr>
<td>Average number of interlocks</td>
<td>2.2</td>
<td>1.4</td>
<td>2</td>
<td>1.5</td>
</tr>
<tr>
<td>Comment</td>
<td>Handelsbanken sphere nomination.</td>
<td>13 out of 19 firms lack controlling owners.</td>
<td>Hagstömer &amp; Qyiberg sphere nomination.</td>
<td>Most traditional industrial families: Wallenberg, Stenbeck, Lundberg, Söderberg etc.</td>
</tr>
</tbody>
</table>

In Table 4.4 we find some interesting facts. In all four categories there are, on average, some remarkable similarities in firm size (market value, not disclosed here); foreign ownership; Anglo-Saxon directorships;
board structure; and firm relation to the density of the Swedish auditor network. Four things stand out. First, the importance of owner identity, one large Swedish interest sphere, the Handelsbanken sphere, having chosen a Cadbury-like structure, which is disclosed,\(^{22}\) while among other big interest spheres, the interest in disclosing the board nomination process is at the time low. Second, the ownership characteristics of firms disclosing a nomination committee formed as a subcommittee of the AGM show that the institutional investors are working in correspondence with their ownership policies (section 4.2), since firms with rather dispersed ownership form nomination committees of this sort. Third, the low foreign/Anglo-Saxon influence among these early nomination committees, which is similar to that of other firms. One would think that foreign ownership and Anglo-Saxon directors would have had some bearing on the adaptation or non-adaptation of a nomination committee. However, the foreign ownership stakes are similar among all the firms and none of the nomination committee firms had an Anglo-Saxon director. Fourth, looking at the average number of interlocks, the board nomination committee and the chairman coordination stands out; it is obvious at this point that firms more established in the Swedish system use these methods. All in all, a picture emerges of a variety of board nomination practices in accordance with firm needs.

The 2000 firm survey
The annual reports of the listed Swedish firms are surveyed for the year 2000. The result is summarized in Table 4.5:

Table 4.5 nomination procedures 2000

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A-list</td>
<td>30</td>
<td>7</td>
<td>15</td>
<td>1</td>
<td>8</td>
<td>3</td>
</tr>
<tr>
<td>O-list</td>
<td>96</td>
<td>13</td>
<td>14</td>
<td>4</td>
<td>11</td>
<td>24</td>
</tr>
<tr>
<td>Total</td>
<td>126</td>
<td>20</td>
<td>29</td>
<td>5</td>
<td>19</td>
<td>27</td>
</tr>
</tbody>
</table>

As in the 1998 survey, Table 4.5 is divided between the more established A-list and the less established O-list. The table is further divided between the different observed categories of board nomination practices found in Swedish firms’ annual reports. Again, labels different than nomination committee are used. Three election committees (Swedish: valberedning) are classified as belonging to category 3. One voting committee (Swedish: valkommitté) is classified in category 4, and one proposal committee (Swedish: förslagskommitté) in category 2. Finally, there is one committee (Swedish: kommitté) classified in category 2.

\(^{22}\) Note that Industrivärden discussed above is the leading investment company in the Handelsbanken sphere.
From Table 4.5 we can see that the interest in disclosing the board nomination procedure has not increased. One interesting thing to notice is that nomination committees at AGMs are growing; this is partly due to the emerging migration of the Handelsbanken sphere to this category (see below, 4.3.3). We still see three procedures that stand out: the board nomination committee, the AGM nomination committee, and chairman coordination. These are contrasted with the non-disclosing firms of important corporate governance dimensions in Table 4.6.

Even though disclosure rates are slightly down from 1998, things are beginning to change. This is indicated by the fact that half of the influential Wallenberg sphere’s firms are now disclosing ‘chairman coordination’ as a support for traditional methods and for SICSEC. AGM nomination committees are beginning to stand out; they are marked as larger than board nomination committees, especially on the more established A-list (Table 4.5.) The average market value for AGM nomination committees stands out; this indicates the method that should be used for large firms with larger ownership dispersion. In addition to owner identity, the larger market value and larger ownership dispersion for the AGM nomination committee, the firms in the four categories are remarkably similar. Thus, the disclosed nomination procedure, or the choice not to disclose, is dependent on who the owner is: if ownership is dispersed or the controlling owner is the Handelsbanken sphere, it is probable that the firm discloses that it has a nomination committee. If the firm is controlled by another traditional Swedish owner it is likely not to disclose, and if it does it will be ‘chairman coordination’.
Table 4.6 Firm characteristics in 2000

<table>
<thead>
<tr>
<th></th>
<th>Nomination committee on board</th>
<th>Nomination committee on AGM</th>
<th>Chairman coordination</th>
<th>No Disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average market value, MDR</td>
<td>7,2</td>
<td>20,2</td>
<td>9,6</td>
<td>14,3</td>
</tr>
<tr>
<td>Average largest voting stake</td>
<td>35 %</td>
<td>24 %</td>
<td>34 %</td>
<td>38 %</td>
</tr>
<tr>
<td>Average foreign ownership</td>
<td>13 %</td>
<td>21 %</td>
<td>19 %</td>
<td>20 %</td>
</tr>
<tr>
<td>Average number of Anglo-Saxon directors</td>
<td>0,05</td>
<td>0,03</td>
<td>0,15</td>
<td>0,18</td>
</tr>
<tr>
<td>Proportion CEO on board</td>
<td>90 %</td>
<td>90 %</td>
<td>84 %</td>
<td>81 %</td>
</tr>
<tr>
<td>Proportion audited by ‘big league auditors’</td>
<td>35 %</td>
<td>55 %</td>
<td>47 %</td>
<td>36 %</td>
</tr>
<tr>
<td>Average unique directors</td>
<td>60 %</td>
<td>53%</td>
<td>55 %</td>
<td>63 %</td>
</tr>
<tr>
<td>Average number of interlocks</td>
<td>1,22</td>
<td>1,55</td>
<td>1,45</td>
<td>1,08</td>
</tr>
<tr>
<td>Comment</td>
<td>Half of the Handelsbanken sphere firms.</td>
<td>Some of Sweden's absolutely largest and most widely held firms. Also half of the Handelsbanken firms.</td>
<td>Some large Swedish owners such as Hagströmer &amp; Qviberg. Half of the Wallenberg firms.</td>
<td>Most Swedish traditional owners: Stenbeck, Lundberg, Söderberg, Douglas. Also half of the Wallenberg firms.</td>
</tr>
</tbody>
</table>

The 2002 Survey
Disclosure in Swedish firms was surveyed in 2002. This is summarized in the following table:
Table 4.7 nomination procedures in 2002

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A-list</td>
<td>7</td>
<td>5</td>
<td>27</td>
<td>0</td>
<td>11</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>O-list</td>
<td>92</td>
<td>27</td>
<td>35</td>
<td>12</td>
<td>21</td>
<td>20</td>
<td>12</td>
</tr>
<tr>
<td>Total</td>
<td>99</td>
<td>32</td>
<td>62</td>
<td>12</td>
<td>33</td>
<td>23</td>
<td>13</td>
</tr>
</tbody>
</table>

Table 4.7 follows the same structure as the tables of the 1998 and 2000 processes. Different labels are still used: four firms use the label ‘election committee’ (three classified in category three and one in category two), one uses ‘committee’ (category three) and two ‘nomination groups’ (category two).

The disclosure of board nomination procedures has increased. Regarding the A-list, disclosure has become the norm, as only seven firms refrain from disclosure. On the O-list, on the other hand, 92 still avoid disclosure, but this is a marked improvement. However, the reported praxis still varies, and the three procedures – nomination committees composed of board members, nomination committees composed of non-board owners, and board nomination through chairman coordination – stand out. Following the pattern from the year 2000, the nomination committee composed of a majority of owners without board representation is clearly more frequent than the other two groups. This is even more striking on the A-list, where this procedure is clearly the dominant one. From Table 4.8 it becomes evident that things have changed.

To disclose the nomination process in the annual report has become standard among major firms – among the 99 non-disclosing firms only 19 have a market value over 1 billion SEK. The traditional spheres refraining from disclosure have become marginalized. The three largest categories have become very similar in almost every characteristic: market value, largest voting stake, foreign ownership, the number of Anglo-Saxon directors, proportion of CEOs on the board, the use of a ‘big league auditor’ and interlocking directorships. This implies that the characteristics of the firms are becoming less important in determining how board nomination should work. The Handelsbanken sphere completes the emigration from board nomination committee to AGM nomination committee, together with some of the Wallenberg sphere firms, which indicates a growing consensus among the most established Swedish corporate governance actors on board nomination. However, as the remainder of the Wallenberg sphere firms, together with the Bennet sphere firms, disclose chairman coordination, support for the traditional methods is consciously displayed.

Thus, for 2002 a move towards an internal convergent pattern of board nomination is observed. Regardless of opposition the pattern is: a listed Swedish firm, of a given size, should have a nomination committee and that committee should be linked to the AGM.
Table 4.8 Firm characteristics in 2002

<table>
<thead>
<tr>
<th></th>
<th>Nomination committee on board</th>
<th>Nomination committee on AGM</th>
<th>Chairman coordination</th>
<th>No Disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average market value, MDR</td>
<td>8</td>
<td>13</td>
<td>8</td>
<td>1,5</td>
</tr>
<tr>
<td>Average largest voting stake</td>
<td>32 %</td>
<td>27 %</td>
<td>32 %</td>
<td>41 %</td>
</tr>
<tr>
<td>Average foreign ownership</td>
<td>18 %</td>
<td>19 %</td>
<td>18 %</td>
<td>13 %</td>
</tr>
<tr>
<td>Average number of Anglo-Saxon directors</td>
<td>0,19</td>
<td>0,3</td>
<td>0,16</td>
<td>0,14</td>
</tr>
<tr>
<td>Proportion CEO on board</td>
<td>80 %</td>
<td>82 %</td>
<td>88 %</td>
<td>63 %</td>
</tr>
<tr>
<td>Proportion audited by ‘big league auditors’</td>
<td>38 %</td>
<td>58 %</td>
<td>47 %</td>
<td>38 %</td>
</tr>
<tr>
<td>Average unique directors</td>
<td>63 %</td>
<td>53 %</td>
<td>48 %</td>
<td>62 %</td>
</tr>
<tr>
<td>Average number of interlocks</td>
<td>1,25</td>
<td>1,5</td>
<td>1,8</td>
<td>1,1</td>
</tr>
<tr>
<td>Comment</td>
<td>No pattern since Handelsbanken sphere left this group.</td>
<td>The non-controlling owner firms are crowded out by the Handelbanken and some of the Wallenberg sphere firms.</td>
<td>Hagströmer &amp; Qviberg sphere only has one firm left in this category, the Wallenberg sphere has four. Preferred method for Bennet sphere.</td>
<td>The remaining traditional industrial families: Stenbeck, Lundberg, Stillström etc.</td>
</tr>
</tbody>
</table>

The 2004 firm survey
A survey of the annual reports from 2004 is summarized in Table 4.9
Table 4.9 nomination procedures in 2004

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A-list</td>
<td>2</td>
<td>7</td>
<td>32</td>
<td>0</td>
<td>6</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>O-list</td>
<td>25</td>
<td>59</td>
<td>81</td>
<td>11</td>
<td>16</td>
<td>4</td>
<td>9</td>
</tr>
<tr>
<td>Total</td>
<td>27</td>
<td>66</td>
<td>113</td>
<td>11</td>
<td>22</td>
<td>4</td>
<td>10</td>
</tr>
</tbody>
</table>

Table 4.9 is arranged the same way as tables 4.3, 4.5 and 4.7. The variation in labels is growing. There are now 21 election committees (Swedish: valberedning, six in category two, 14 in category three and one in category four); seven firms variably use nomination committee and election committee in their disclosure\(^{23}\) (six in category three and one category four); there is one informal nominations committee (category three) and there are three nomination groups (Swedish: nomineringsgrupp, all category three).

Table 4.9 shows that the disclosure of board nomination praxis has become institutionalized, even on the O-list, and thus less established firms closely follow the practice of the more established ones. It is also becoming clear that nomination committees formed by a majority of non-board members constitute the largest nomination practice, especially amongst the A-list firms, giving a hint of which practice a regulator might choose (see above). This corresponds to the figures presented in Table 4.10.

The divide between firms using nomination committees and those which do not is growing. Those firms that do not disclose their nomination practice are now rare and only owners in almost total control of the companies can refrain from doing so. The traditional method of ‘chairman coordination’ has decreased and the last three Wallenberg sphere firms are remaining in isolation. However, the two most important changes relate to the two different nomination committees. In slightly more closely held firms some traditional owners have moved to nomination committees with a majority of board members. This seems reasonable, since by now very few would doubt that the Swedish corporate governance code holds provisions on committees, but the stance on who should make up the committee was still open for discussion. The most remarkable development is of course the ‘victory’ of the AGM nomination committee: almost half of all firms and 90 % of the A-list firms disclose these proceedings.

\(^{23}\) The common way of using both labels used to be having one in the heading and another in the running text. A possible explanation for this is that by this time the work of the Swedish code group (see above) was beginning to be known among the firms, and in the final corrections of the annual report mistakes occurred.
Table 4.10 Firm characteristics in 2004

<table>
<thead>
<tr>
<th>Nomination committee on board</th>
<th>Nomination committee on AGM</th>
<th>Chairman coordination</th>
<th>No Disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average market value, MDR</td>
<td>6</td>
<td>17</td>
<td>9</td>
</tr>
<tr>
<td>Average largest voting stake</td>
<td>31 %</td>
<td>27 %</td>
<td>35 %</td>
</tr>
<tr>
<td>Average foreign ownership</td>
<td>15 %</td>
<td>21 %</td>
<td>17 %</td>
</tr>
<tr>
<td>Average number of Anglo-Saxon directors</td>
<td>0,12</td>
<td>0,38</td>
<td>0,22</td>
</tr>
<tr>
<td>Proportion CEO on board</td>
<td>58 %</td>
<td>67 %</td>
<td>63 %</td>
</tr>
<tr>
<td>Proportion audited by 'big league auditors'</td>
<td>30 %</td>
<td>33 %</td>
<td>18 %</td>
</tr>
<tr>
<td>Average unique directors</td>
<td>64 %</td>
<td>54 %</td>
<td>65 %</td>
</tr>
<tr>
<td>Average number of interlocks</td>
<td>1,1</td>
<td>1,5</td>
<td>1</td>
</tr>
<tr>
<td>Comment</td>
<td>The Handelsbanken sphere void is filled by some traditional owners such as Douglas/ Schörling, Stenbeck and Stena spheres. Notably, these owner’s firms occurs in other categories.</td>
<td>The Handelsbanken sphere is joined by a majority of the Wallenberg sphere firms, joined by firms from Stenbeck, Douglas, Stena, Hagströmér/Qyberg and Tigershiöld.</td>
<td>The three Wallenberg firms in this category are getting abounded as this traditional method has declined to only 22 disclosing firms.</td>
</tr>
</tbody>
</table>

4.6 Discussion: Divergences in a Convergent Process

In this paper’s empirical part we have witnessed a two-level change – on the firm level and on the regulatory level – of how the Swedish corporate governance system nominates its boards. A rather opaque
structure, where traditional owners were in single charge was left in favor of a more open structure where the traditional owners have to share their influence with other types of owners (i.e., local institutional investors). This took time and many pieces had to fall into place. Following the empirical material the process could be summarized as follows:

- Institutional entrepreneurship by the Swedish Shareholders’ Association – a demand for nomination committees.

- A pressure on the institutional investors for exercising owner responsibility – a demand for nomination committees.

- Corporate scandals, in Volvo leading up to the first ‘Swedish’ committee, and in Skandia, leading up to the Swedish code being issued. What is interesting to note, in this case, is that the firms involved in the scandals lacked large owners and that a nomination committee was part of the solution.

- There exist a number of firms with rather dispersive ownership, which causes problems in terms of board nomination. Their solution was the ‘Swedish’ nomination committee.

- The logics of isomorphism and legitimacy made the committee concept diffuse among firms until the vast majority among the biggest and most established ones established a ‘Swedish’ nomination committee.

- Regulatory fiat, with highly legitimate actors forced by fear of government intervention, finally settled for the ‘Swedish’ nomination committee.

The original concept has been translated in two different ways. First, an actual translation of the Swedish label, from nomination committee (Swedish: nomineringskommitté) to election committee (Swedish: valberedning). This has been done in the official Swedish documents and only in the final phase. Second, the function of the rule has been translated from a subcommittee of the board to a subcommittee of the AGM including a change of the personnel. Viewed from this perspective, one might say that the first translation (of the label) is driven by the second (of the form), and thus one might argue that there has been no attempt at transplantation. However, we must consider the fact that the second translation had already been made by the firms before the regulator changed the label. Since the translation of the label has only been made in Swedish, a Swedish investor is not likely to be ‘fooled’ by this play with words, but perhaps a foreign investor with limited resources to devote to assessing individual companies in a foreign country (‘ticking the boxes’) would feel comfortable with the Swedish firm also having a ‘nomination committee’ (see Gordon and Roe, 2004, on the home country effect).
This is highly congruent with translations found in Buck et al. (2004) and Buck and Shahrim (2005). For a long time a nomination committee in Sweden could be almost anything that the actor labeled so. These are simply good examples of the modifications, additions or appropriations – in short the translation – that Latour (1986) speaks of. Certainly, as pointed out by Buck et al. (2004), actors would define and translate the concept to fit their interests. After more than ten years of elaboration at the firm level the regulator finally settled for a solution and only after that one might say that the concept acquired a real meaning. What is interesting to note is that the regulator seemed to have no other choice than prescribing the solution used by the majority, the largest and the most established firms. Thus, when institutionalization leads to the cohesive phase (Scott, 1995), the translation perspective (e.g. Czarniawska and Jorges, 1996; Buck and Shahrim, 2005) is limited – no more translations are possible – at least not in a regulatory sense. We are then only left with the memory of the great translation of the transplanted rule. Thus, the regulator’s possible achievements are restricted by past translations of that which is being regulated. In this case, it would not be possible to introduce a nomination committee with a Cadbury stance, since the firm practice is likely to decouple and the legitimacy of the regulator would probably be questioned.

The firm-level development is not only compatible with the diffusion and more traditional neo-institutional perspective in its final phases. In the 1998 and 2000 surveys early adoption seemed to be driven by rational reasons (Tolbert and Zucker, 1983), e.g., the AGM nomination committees in the firms with dispersed ownership. The 2002 survey points at decoupling and confusion (Meyer and Rowan, 1977) – the nomination committee concept has by then become associated with legitimacy, but there is yet no consensus regarding the actual meaning of the concept. The final phase, the 2004 survey, is associated with the normative and cohesive forms of isomorphism (Scott, 1995), as all firms evidently now need nomination (election) committees, regardless of ownership situation and managerial discretion over board nomination.

Finally, we cannot deny the fact that we have witnessed a transplantation of an internationally recognized best practice rule into the Swedish corporate governance system, at least not if we accept the above statement that a foreign investor will see the Swedish concept of nomination committee and associate it with the international concept of such a committee. Nor can we deny that the regulator finally accomplished a formal convergence (Gilson, 2004). However, the regulatory structure does not converge on international best practice, as Gilson (2004) assumed, but it is converging internally. From the beginning, a great variety of nomination practices existed among the Swedish firms. In the surveys from 1998 and onwards it became clear that different owners choose different methods of director nominations, i.e., that identity mattered and one could thus claim that firm characteristics mattered. In a firm with dispersed ownership most established actors agreed that nomination committees connected to the AGM were a good solution. However, if the firm had one single owner in control of, for instance, 30 % of the votes on the AGM, the resources could probably be spent better. Finally, when the Swedish Corporate Governance Code is put to action there is no more room for variation; all firms are to have an election (nomination)
committee as a subcommittee to AGM. It is a different solution from the international one, but it has been implemented in all firms following Code.\textsuperscript{24} Notably, this could probably not have been accomplished without action by the regulator, since accomplishing a change in corporate governance without the regulator – as proposed by e.g. La Porta et al. (1999) – would have been complicated, and the reform would most certainly have been subject to various diverging translations.

Thus, this paper claims that in the case of the transplantation of the nomination committee concept into the Swedish corporate governance system the convergence thesis does not hold internationally, but nationally. This is a rather unexpected consequence. Certainly, one might speculate if this is only the first phase in a convergence process – first we need nomination committees and only after that can we get nomination committees of a ‘real’ international character. However, it seems more reasonable to discuss the empirical findings of this paper in terms of path dependencies (Roe, 2002; Bebchuck and Roe, 2004). The path dependency perspective implies that (regulatory) paths chosen in history rule out some, and suggest other, regulatory solutions. It is obvious that the Swedish history of a few large industrial owners in control of most firms (see Henrekson and Jacobsson, 2003; Högfeldt, 2005) has effected the implementation of the nomination committees. The independent directors were useless at nominating directors, as their loyalty lies with the traditional owners. Neither was it possible to propose a practice restricting the traditional owners’ influence, because it is protected by the Companies Act. What was possible was a practice where the traditional owners were forced to listen to minority owners before making a decision. There were also paths chosen in other areas, such as the cooperative and voluntary sector concept of election committee, which effected this corporate governance change. Therefore, predictions based on the path dependence perspective are meaningless, as it seems reasonable that paths in almost any area might, or might not, be involved in shaping the future.

In this paper we followed the process both on the firm level and the regulatory level. Otherwise we would not have been able to see the interaction and the consequences of this interaction: institutional entrepreneurship (from the Swedish Shareholders’ Association, DiMaggio, 1988), entrenched interest (from SICSEC and traditional owners, Kahn-Freund, 1974), and corporate scandals (in Volvo and Skandia, T. Clarke, 2004) were all important. However, all things considered, firm legitimacy in both investors’ and competitors’ eyes and the ability to adopt and innovate (i.e., translate) paired with the genuine uncertainty about what constitutes ‘good corporate governance’ are also reflected in the patterns of changing corporate governance systems. This highlights the complex workings of local actors in relation to international best practice regulation.

\textsuperscript{24} Mandatory in the Swedish code regulation means in a ‘comply or explain’ sense. However, the code has shown great normative influence and deviations have been very rare.

In this paper following both firm-level action and action on the regulatory level, the process – where international corporate governance regulation is implemented in local practice – seems to be iterative. Starting from the La Porta et al. (1999) perspective, the Swedish board nomination convergence on international best practice seems to be a question of labels rather than actual practices. Thus, from the perspective of an international investor, Swedish firms’ implementation of nomination committees seems largely driven by symbolism and legitimacy, rather than by the wish to curb agency costs, and we could say that we are experiencing a transplant effect (Berkowitz et al., 2003), as the transplantation of the UK nomination committee to Sweden resulted in another nomination committee. However, viewed from the perspective of local firms, at least initially, the development seems driven by efficiency motives (Tolbert and Zucker, 1983) rather than by an ambition to ’fool’ international investors. Firms in the Swedish corporate governance system lacking traditional owners, and thereby sensitive to agency costs associated with management, introduced nomination committees that were different from their UK counterpart but that nonetheless addressed a real problem in the Swedish corporate governance system (not the problem Cadbury intended to solve). As the process continues, more and more firms have to adopt and form nomination committees, even though their actual need is smaller than the early adopters (Tolbert and Zucker, 1983), thus bringing symbolism and legitimacy into the story again. Then, however, the institutionalization process and the regulators have ended up with an ‘innovation’ (at least in the corporate sector) working against concentrated power and thus filling a previously not identified need. Thereby we might conclude that the relationship between local practice and international developments follows a rather obscure logic, to quote Iron Maiden:

You’ll take my life but I’ll take yours too/You fire your musket but I run you through (Iron Maiden, The Trooper, 1983).

Thus, this paper’s conclusion is: in the case of nomination committees in Sweden, the international best practice corporate governance solutions kill traditional local corporate governance practice, but at the same time the local corporate governance practice kills the international best practice solution. Thereby the Swedish nomination committee constitutes a convergence but it is not on international best practice; the convergence is on local consensus. This convergence could not be achieved without the regulators, although the regulators’ solution could not be achieved without those regulated. Empirically, this phenomenon could not be observed without this paper’s focus on local actors.
5. DEVELOPING CODES OF CONDUCT: REGULATORY CONVERSATIONS AS MEANS FOR DETECTING INSTITUTIONAL CHANGE

Jonnergård, K. and Larsson, U.


5.1 Abstract

The introduction of a new corporate governance code in Sweden, modeled after prevailing Anglo-Saxon norms of corporate governance, offers the opportunity to investigate global regulatory convergence. Using the metaphor of regulatory space, this article analyzes the positions of the parties who submitted formal responses to the introduction of ‘The Swedish Code of Corporate Governance – A Proposal from the Code Group.’ While the globalization of financial markets might forecast unconditional acceptance of the proposed code by business and financial interests, the analysis of who made comments, and what was said, reveals three categorically distinct groups: Swedish business ‘insiders’ connected to the existing institutional framework who opposed changes that would erode traditional division of functions, including collective responsibility for the actions of company boards; ‘outsiders’ (e.g., foreign investors and more marginal Swedish investors) aligned with Anglo-Saxon internationalization of the markets who would change the system of corporate accountability; and the professions (i.e., auditors), who advocated for their professional interests. Of the three groups, Swedish business insiders were most successful in gaining support for their positions. Although international financial and political interests were key to the introduction of the Code in the first place, the article demonstrates how the dynamics of national (local) culture and power structures influence the transfer of regulatory law across jurisdictions.
5.2 Introduction

5.2.1 Translations of codes of corporate governance between contexts
The transfer of new types of regulation between different national contexts is likely to result in two things. First, the transferred regulation will be adjusted in accordance with local conditions; and second, the local traditional institutions will change in the face of the new regulation. This double-sided process may be difficult to describe and analyze, but one way of framing the process is to utilize the metaphor of regulatory space and to investigate the regulatory conversations that occur during the transfer and implementation of the new regulation. In this article we undertake such a project with reference to the development of the code of corporate governance in Sweden. We begin by introducing corporate governance codes and the case of Sweden.

Although in most countries, business laws have existed for approximately two hundred years, what we now refer to as corporate governance appeared only in the early 1990s (Corbett and Bottomley, 2004, p. 61). The first code of corporate governance was a British invention, closely linked with the British context and legal tradition. In 1991, in the aftermath of several financial scandals and collapses, the Financial Reporting Council, the London Stock Exchange, and the accounting profession established the Committee on the Financial Aspects of Corporate Governance. The Committee was chaired by Sir Adrian Cadbury, and their report, issued in December 1992, became widely known as ‘the Cadbury Report’. It recommended a Code of Best Practice for the boards of all companies listed at London Stock Exchange and included rules regarding the structure and composition of the board, the contract and remuneration of the executive directors, financial control, and transparency. In Britain, the Cadbury code has been succeeded by a number of new reports and codes covering new issues and parties in the corporate governance system. In general, corporate governance codes often include discussions regarding board composition, the transparency of the information provided by the company, the jurisdiction of the government, and the business community and/or professional associations within the business community.

Since their introduction in Britain, corporate governance codes have met with enormous international success. Interest groups, such as the European Association for Stock Dealers (EASD), Organization for Economic Cooperation and Development (OECD), individual countries, and other actors on the financial markets, have all issued corporate governance codes (Collins, 2004, p. 15; Black, 2004; Corbet and Bottomley, 2004). The European Corporate Governance Institute (ECGI) lists on its Web site (www.ecgi.org/codes/all_codes.php) over 140 different codes from all over the world and from different pan-national or international organizations. The initiators of the codes and the status of the codes vary substantially, as do the number of codes issued in different countries. Regulatory jurisdiction varies between
countries with a stronger emphasis on self-regulation in the Anglo-Saxon countries and a stronger emphasis on legislation and governmental control in, for example, the Scandinavian countries (Spamann, 2009). Many nations have multiple codes that are issued by different bodies and enforced in different ways. Most of these codes are issued by private organizations and do not involve formal sanction systems. The relatively rapid diffusion of codes for corporate governance may be viewed as a part of the global convergence of corporate governance systems, a situation one might expect to arise in the aftermath of the globalization of the financial markets (Oxelheim, 1997; Oxelheim and Randøy, 2003). Our view is that the convergence of corporate governance is not merely a matter of law. Convergence requires complementary institutional change, that is, changes in the behavior and ‘taken-for-granted’ assumptions of key actors affected by the code.

5.2.2 The case of Sweden
We investigate whether the tendency toward global convergence is observed during the referral process\(^{25}\) of a proposed corporate governance code, initiated in Sweden by the governmental commission, ‘Commission for Trust’. The commission was established in order to rebuild trust in the Swedish business community and the financial markets, trust that was eroded in the aftermath of several international and national business failures, such as Enron, Parmalat, and the insurance company Skandia, respectively. Because corporate governance codes regulate the relationships between, and the obligations of, different parties within the corporate governance system, the codes have implications for the interests, composition, and power of key interest groups. Such groups include, among others, majority owners, minority owners, management, and professional service firms.

The Swedish corporate governance system has been traditionally characterized by concentrated ownership, with salient active owners who work in close cooperation with the trade unions and the state (see Puxty, Willmott, Cooper and Lowe, 1987; Lubatkin et al., 2005; Collin, 1998). Recently, there have been indications that this system has changed due to the increasing share of foreign ownership on the Stockholm Stock Exchange and the importation of Anglo-Saxon norms regarding boards of directors and corporate governance (Agnblad et al., 2002; Henrekson and Jacobsson, 2003; Söderström, Berglöf, Holmström, Högfeldt and Meyersson-Millgrom, 2003), although the degree of change and the effects of these changes have not been well documented (for exceptions, see Oxelheim and Randøy, 2003; 2005; Jonnergård and Kårreman, 2004; Jonnergård, Kårreman and Svensson, 2004).

A study of the Commission of Trust’s import of a code of conduct presents an opportunity to evaluate the ways that efforts to globalize corporate governance influence and are influenced by the Swedish community. Importing an idea such as the corporate governance code provides structure and space for new regulation, and it may create an opportunity to interpret and reinterpret concepts, which, in turn, may lead

\(^{25}\) The process of referral is part of the Swedish legislative process in which different authorities, organizations, and other interested actors may voice their opinions on a proposed regulation; see Section 5.4.
to an opportunity to challenge old truths and power structures. Neither the contents nor implementations of an imported code of conduct may be determined beforehand. A single word or concept may be interpreted and applied in one country differently from how it is applied in the next. For example, corporate boards in Britain used to be composed mainly of corporate executive managers. In Britain, therefore, the rules for increasing the number of nonexecutive directors in order to support the board’s control function were highly relevant. The idea that nonexecutive directors are important presupposes a perceived need for them, as well as a relatively dispersed ownership. In contexts such as the Swedish one, where there is a tradition of active majority owners and few executive directors on the board, these preconditions are less relevant. Accordingly, when the code of conduct was developed, the concept of nonexecutive was reinterpreted and became ‘not connected with the major owners’. In this way the notion of nonexecutives in the Cadbury code took on new meaning in the Swedish governance system. In this article, we focus on the debate concerning the proposal of a corporate governance code in the processes of referral. This debate has been both lively and extensive, dealing with issues such as the rights of the owners, the composition of boards, and the transparency of financial accounting. In contrast to other countries, the discussion in Sweden has dealt with the possibility of restricting the power of the major owners rather than with the agency problems related to top management teams. We examine the interests expressed in the formal comments submitted during the code development process and the influence those comments have had on the final code. We also examine the communities of interest that form in response to the Code and their impact on the changing composition of the Swedish business community.

The objective is 1) to develop our knowledge of the process of convergence of corporate governance systems, taking the Swedish system as our case, and 2) to contribute to the literature on the relationship between regulation and institutional changes. We start by discussing convergence of corporate governance systems from an institutional perspective, after which we present the institutional context of Sweden and the issues raised in this context by the new code. Thereafter, the methodological device of regulatory space is presented together with the empirical material. The empirical results are discussed in relation to the importance of national culture and local elites, the influences of foreign investors and their norms of behavior, and the role of the state. We conclude with remarks regarding the ongoing institutional changes in the Swedish corporate governance system, and we discuss key insights for future research.

5.3 Convergence from an Institutional Perspective

While the advocates of a convergence between different corporate governance systems often propose that the globalization of the financial market and the Europeization project (e.g. Cuervo, 2002; Oxelheim and Randøy, 2003; Cernet, 2004, p. 148) will lead to a convergence, more skeptical analyses suggest that globalization of the markets may be met with other factors that moderate the tendency toward convergence (see Guillén, 2000; 2001). Inhibiting factors may include inert legal systems, vested interest in certain
political systems (e.g. Fligstein and Freeland, 1995; Branson, 2001; Reid, 2003, p. 235), culture (North, 1990), and power relationships within and between social groups in a society (Fligstein, 2001), and they may mediate the impact of the globalization of financial markets as a driver of regulatory convergence.

In our view, convergence requires institutional change, that is, a multifaceted transformation of rules, norms, and cognition – each of which may change at different rates (R. Scott, 2001; Townley, 2002; Zilber, 2002; Jonnergård et al., 2004). R Scott (2001) argues that the three necessary pillars of institutions: cognitive, regulative, and normative (ibid. p. 85) must be aligned for complete institutionalization to unfold. The cognitive pillar stands for the ‘taken-for-granted’ logic behind the phenomenon; the regulative pillar stands for the disciplinary aspect, that is, the rules and enforcement mechanisms of the institution, while the normative pillar includes the expediency, that is, the norms and values, inherent in the institution. Deinstitutionalization or institutionalization may begin in one of the pillars and may or may not travel to the other pillars of the institution at hand. The different pillars may be out of step with each other; for example, the people’s cognition may be aligned with a new institution, while their norms may remain steadfastly connected to an older institution (Jonnergård et al., 2004). Complete institutionalization demands consistency between cognition, norms, and practices, and is often measured through the actions it brings about (Zilber, 2002). The sequences of institutional change are, however, not pre-determined (Jonnergård et al., 2004).

Since cognition and norms may be difficult to study per se (Townley, 2002), one way of detecting whether an institutional change has occurred is to observe changes in the behavior of different actors (Zilber, 2002) and the actors’ conversations regarding the issue at hand. That is, changes in behavior and conversations become a proxy for institutional change. When studying corporate governance, for instance, changes in power, or more precisely, change (or the lack of change) in the composition and power of the local elite in a specific national context is one observable indicator of institutional change (Fligstein, 2001; Aguilera and Jackson, 2003; Reid 2003, p. 235). Fligstein and Freeland claim:

*Available evidence suggests that there will be no world market for corporate control. Property rights and governance structures are under the control of nation-states and local elites. As long as states claim sovereignty, they are unlikely to undermine their control over their economies in this way. Moreover, their local elites also have a great deal to lose from current arrangements, and they will oppose actions that would force conformity to someone else’s standards (1995, p. 39).*

The behavior of the local elite and the emergence of new elites may therefore be viewed as critical for the development of a corporate governance system and the content of the code of conduct. They may also provide cues for detecting institutional change.

In Sweden the growing prevalence and clout of institutional investors, and the need for the intergenerational transfer of resources (O’Sullivan, 2000a; 2000b) pose a challenge to the traditional
Swedish model, with its few dominating strongly industry-oriented owners of large companies (see Agnblad et al., 2002; Henrekson and Jacobsson, 2003; Söderström et al., 2003). Since 1990, the domestic institutional investors have largely kept their share of the Swedish stock market, whereas the foreign investors have substantially increased their ownership, and nonfinancial Swedish companies have substantially decreased their ownership. The relative decline of Swedish ownership, along with other changes, such as the adaptation of the EU legal system and a shifting toward a more ‘Anglo-Saxon’ style of board behavior (Oxelheim and Randöy, 2003; Jonnergård and Kärreman, 2004; Jonnergård et al., 2004), suggest that the institutional investors and foreign investors will gain in importance and power, whereas the traditional Swedish owners will lose power and position. Studying the development of the Swedish corporate governance code in light of these dynamics contributes to our knowledge of the relations between old and new elites and the processes of convergence and institutional change in Sweden.

Previous studies of the transformation of the Swedish corporate governance system have focused mainly on changes in cognition and modes of action (see Jonnergård et al., 2004; Bengtsson, 2005). In this article, we focus on the actors and changes in the position and power of different interest groups as both a part and a consequence of the institutional change process. We consider how emerging and traditional entities voice their arguments and the influence these groups have on the code. From our analysis, we draw conclusions about how various actors’ positions in the regulatory space have changed, where such change has occurred, and how it has affected the power and position of the local elite.

5.4 Regulation and Corporate Governance in Sweden

In the 1980s the Swedish regulatory style was characterized as corporatism (Puxty et al., 1987). The business conditions of companies were regulated in close cooperation between the state, the trade unions, and the large owners of the various industries. The main features of this dynamic remain and are today reflected in the structure of the formal rule-making process. Entities affected by proposed regulations may participate in the government’s rule making through involvement in an open referral process. That is, most often the government establishes a commission with representatives of different political parties and interest groups in order to investigate an issue of public interest. The assembled commission issues a proposal and then solicits comments from those who may be affected. The process is open in the sense that anyone, whether invited or not, may participate and voice an opinion. The opinions are collected and taken under advisement, and when the comment period ends, the proposed code is revised by the same commission and becomes formal enforceable regulations after parliament approval. The corporate

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26 Financial companies and banks have gone from owning 35.8% of the total stock value in 1990 to 31.9% in 2006. Investment companies and investment funds owned 19% of the total stock value in 1990 and 17.2% in 2006. Nonfinancial companies owned 25.3% of the total stock value in 1990 and 10.6% in 2006, and foreign owners possessed 7.7% in 1990 and 35.6% in 2006. All figures from http://www.SCB.se.
governance code in Sweden was developed in this way, although with one key distinction, which we will return to shortly.

The corporate governance code has emerged from within a complex of interlocking rules (Black, 2004, p. 55). The foundation and framework for regulating corporate governance is the Companies Act, which dates to 1975 and has been thoroughly updated to comply with the European Community (EC) directives and recommendations. The Companies Act contains rules stating what formal bodies the company should have (i.e. AGM, Board, Audit, CEO), the tasks each should perform, and how they should be appointed. In doing so, the Act serves to divide responsibility and accountability with the aim of reducing tension and conflicts of interest between owners, creditors, directors, and managers (Bergström and Samuelsson, 2001). The Companies Act applies to all companies; publicly traded companies are exposed to additional forms of regulation.

The first additional regulation for publicly traded companies is the registration contract between the company and the privately owned Stockholm Stock Exchange (SSE). The SSE registration contract regulates issues regarding the timeliness of information disclosure, as well as other issues related to corporate governance, such as board independence and ownership dispersion. The rules in the registration contract are tied to the SSE disciplinary board, and a company that breaches the contract may be expelled from the stock exchange.

The second form of additional regulation for publicly traded companies originates from ‘The Association for Stock Market Issues’ (Föreningen för Aktiemarknadsfrågor), which was formed to establish and promote proper practices on the Swedish stock markets. This association was founded by what could be referred to as the ‘crème de la crème’ of the Swedish stock market stakeholders. Association members include auditors, banks, associations for companies, insurance companies, stockbrokers, institutional investors, and the SSE. Given the composition of this regulatory body, some have suggested that the Swedish regulatory style is dominated by different interest groups (Elvander, 1974; Jordan and Richardson, 1983). The work of the Association for Stock Market Issues is done through two subassociations: ‘The Swedish Industry and Commerce Stock Exchange Committee’ (Näringslivets Börskommitté), whose main function is to issue rules for participation in the stock exchange; and ‘the Stock Market Board’ (Aktiemarknadsnämnden), whose function is partly disciplinary. The Stock Market Board issues statements that provide guidance about good practice on the Swedish Stock Market and that provide interpretations of the rules issued by ‘The Swedish Industry and Commerce Stock Exchange Committee’. Some of these rules are included in the registration contract, which renders them enforceable. The

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27 A new company act was implemented on January 1, 2006. The study reported here was performed under the reign of the former company act.

28 A new organization for the self-regulation was introduced in December 2005, with a new name and with inclusion some additional organization. In practice very few changes are supposed to occur as a result of this. The study was performed before the new organization was established.
remaining rules are advisory, but the rate of compliance of publicly listed companies is considered 'high' by the Committee itself (NBK 2003).

The corporate governance code initiated by the government’s Commission for Trust has emerged as a third form of additional regulation, and it is positioned between legislation and self-regulation. The Commission for Trust was led by a former financial minister of the ruling party and included a representative of the labor union, a former CEO of a state-dominated public firm (Telia), and a former CEO of the SSE. The commission formed the ‘Code group’ together with the same associations that make up the ‘Association for Stock Market Issues’ (‘the crème de la crème’, above) and representatives of the smaller shareholders. The Code group developed a proposal for a code of conduct. This proposal was very far reaching and modeled on internationally accepted corporate governance standards, and consequently, it was similar to the Cadbury code. The proposed code underwent the formal process of referrals that accompanies the introduction of governmental regulation. Instead of becoming formal law, however, the final code was removed from the legislative process and incorporated into the SSE registration contract. Thus, one can conceptualize the proposed code as a form of ‘enforced self-regulation’ (Braithwaite, 1982; Hood, Oliver and Scott, 2000; Fairman and Yapp, 2005), where the government together with the high-profile stakeholders of the Swedish financial markets set about to impose new regulations on the publicly listed companies.

5.4.1 Governance issues raised by the new code
In this section we highlight the rules that were most fiercely debated as the code proposal moved through the governmentally mandated referral process to its eventual integration into the SSE registration contract. These include proposed changes to the rules that defined the existing systems of accountability and the division of functions between different parties in the corporate governance system. In some cases, the rules opposed traditional norms about responsibility for the governance of Swedish companies. In other instances, the rules appeared to threaten institutionalized power structures. Sweden’s distinctive pattern of corporate ownership and regulatory traditions offered potentially significant roadblocks to the wholesale adoption of the code.

Two issues connected to the annual general meeting (AGM) were highlighted in this process. The first issue focused on who should chair the AGM. The proposal stated that neither the chairman of the board nor any of the other directors may chair the annual general meeting. This proposal was withdrawn and replaced by a system through which the election committee nominates the chairman for the annual meeting. The second issue involved the creation and function of an obligatory election committee. Election committee (Swedish: Valberedning), is a Swedish practice used in political and voluntary associations to

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28 See further Section 5.1 above on imported corporate governance reforms.
single out those candidates who will run for a democratic election. It is interesting to note here that the election committee in the code is merely another label for the type of nomination committee that most Swedish companies already have. In the proposed code, the election committee was given very far-reaching responsibilities, which included nominating both members of the board and the auditor; evaluating both the board and the auditor; setting compensation for the board and for the auditor; and finally, determining the compensation of the election committee. In the final version of the code, the election committee was exempted from four of these tasks: the evaluation of the board (which should be performed by the board), the proposal of principles for board members’ compensation (which no one should perform), the evaluation of the auditor (which should be performed by the audit committee), and finally, the proposal of the election committee’s compensation (which no one should perform). Taken as a whole, it appears that the election committees ended up with the same mandate as that of the nomination committee.

The code group proposed that a majority of the board members should be independent vis-à-vis the firm and its management; among these at least two board members were required to be independent of the major owners. As a proxy for ensuring independence, the code proposal required that directors with a tenure exceeding eight years and directors older than seventy years provide special reasons for reelection. In the final code, the independence provisions remained unchanged, but the restrictions regarding age and tenure limits were removed.

In the code proposal, the remuneration committee was to prepare and suggest principles for executive compensation (salary, bonus, stock options, etc.), which the board was to present to the annual meeting. According to the proposal, the shareholders at the annual meeting were expected to approve these principles, and the board was to make the final decision. In the final version, this decision-making process regarding ordinary compensation was left unchanged. However, the suggested change regarding the board decisions about stock based compensation was approved. Whereas, in the code proposal, the remunerations committee was to consist of directors independent of the management, in the final version, the remunerations committee was to consist of the whole board apart from the executive directors (i.e., the firm management on the board).
Table 5.1 The code proposal relatively the final version

<table>
<thead>
<tr>
<th>Issue</th>
<th>Proposed</th>
<th>Final version</th>
</tr>
</thead>
<tbody>
<tr>
<td>The chairman of AGM</td>
<td>The chairman of the board, or any other director, shall not chair the AGM.</td>
<td>The election committee proposes who should chair the AGM and the AGM decides.</td>
</tr>
<tr>
<td>The election committee</td>
<td>The election committee should evaluate the board and the auditor; should propose auditor and board to the AGM; should propose chairman of the board and principles for board member compensation; should propose election committee compensation.</td>
<td>The election committee should propose auditor and board after consulting the audit committee and board’s evaluations.</td>
</tr>
<tr>
<td>The independent director</td>
<td>A majority independent of management and at least two directors independent of dominant owners. Directors with tenure exceeding eight years and older than 70 needs special reasons upon re-election.</td>
<td>No age and tenure restrictions.</td>
</tr>
<tr>
<td>Management remuneration</td>
<td>Remuneration committee is required; the committee prepare and propose the principles on management remuneration, board present to AGM, AGM approves and board decides.</td>
<td>The whole board may function as remuneration committee. Regarding stock-based compensation the AGM, not the board, decides.</td>
</tr>
<tr>
<td>The independent auditor</td>
<td>Audit committee is required; the committee should evaluate and appoint the auditor.</td>
<td>The whole board may function as audit committee; the audit committee should not appoint the auditor.</td>
</tr>
<tr>
<td>Financial reporting</td>
<td>The CEO and the board should leave a written assurance in the annual report regarding the quality of the financial accounting. The board should demand an assurance from the CFO regarding the quality of the financial reports.</td>
<td>Only the board and CEO leave assurances.</td>
</tr>
</tbody>
</table>
Both the responsibility of the auditor and the responsibility for the financial accounts were debated in the referral process as well. The code proposal required the formation of an audit committee consisting of at least two members independent of the management and at least one member independent of the major owners. One function of the audit committee would be to assist the election committee in proposing an auditor. The proposal also named the audit committee as one of two responsible committees for evaluating the auditor (the other one was the election committee). The decision to make the audit committee responsible for appointing the auditor is in both the proposal and the final version. In the final version of the code, the whole board could function as an audit committee if directors from management are kept out. In addition, the final version of the code states that only the audit committee may evaluate the auditor. The results of this evaluation are to be submitted to the election committee to be used as a basis for selecting an auditor and deciding how this auditor should be compensated.

The code group also proposed that the board and the CEO should include a written assurance stating the following in the annual report:

\[
\text{[T]o the best of our knowledge, the annual accounts have been prepared in accordance with generally accepted accounting principles for a public listed company and that the information presented is consistent with the actual conditions and that nothing of material value has been omitted that would affect the picture of the company presented in the annual report (SOU 2004:46, p. 40).}
\]

Furthermore, the board should demand written assurance from the chief financial officer, an assurance stating that:

\[
\text{the company's financial reports meet the requirements of the existing regulation in all essential respects. The assurance is also to state other circumstances that are important to the board in its assessment of the quality of the financial reports (ibid.).}
\]

In the final version of the code, the demand for the chief financial officer’s assurance to the board was deleted, while the board and the CEO’s assurances were kept intact (see Table 5.1).

### 5.5 Creating Regulatory Space through Regulatory Conversation

The metaphorical device, 'regulatory space' (Hancher and Moran, 1989, p. 277; C. Scott, 2001, p. 330) provides a useful starting place for investigating the impact of the new corporate governance code on regulations governing the financial markets. Regulatory space is an abstract conceptual space constructed by people, organizations, and events acting in concert upon a set of specific regulatory issues subject to public decisions (see Young, 1995, p. 57).
The ‘regulatory’ space metaphor draws attention to the fact that regulatory authority and responsibility are frequently dispersed between a number of organizations, public and private, and that authority is not the only source of power within a regulated domain. The regulatory space approach is ‘holistic’ in the sense that it looks at the interactions of each of the players in the space, and can recognize plural systems of authority and of other resources and a complex of interests and actions (C. Scott, 2001, p. 331).

Exclusions as well as inclusions of actors and/or issues are thereby important for the development of the regulatory space.

The concept of space implies that ‘it is available for occupation’, and that it is unevenly divided between actors (Hancher and Moran, 1989, p. 277). Regulatory conversations – discursive activity between involved actors, organizations, and interest groups – define and redefine the space. First, they build an understanding of the definition of problems and their acceptable and appropriate solutions, as well as the function of the very regulations themselves (Black, 2002, p. 165). Second, conversations create interpretive communities (ibid., p. 174) in which interactions produce meaning, coordination, and action. The interpretive communities that develop out of regulatory conversation often display a degree of internal heterogeneity, as ‘actors deploy language and interpretations in a boundedly strategic manner’ (ibid., p. 178). Third, regulatory conversations create identities for the actors participating in the conversation. They ‘identity matters because it affects how individuals and organizations are viewed and thus responses to them, and because it affects action, for example, agenda setting or policy positioning’ (ibid., p. 183).

In sum, the metaphor of regulatory space helps to draw our attention to the positions of different actors and to detect which interests are taken into account in the regulatory process. Issues are interpreted and reinterpreted in this process, and the regulatory spaces are the scenes in which different issues and interests are voiced. It is in this space that the regulatory agenda and the destiny for different forms of regulation are set.

5.6 To Converse about the Code

In this section, we analyze the written debate concerning the referral process of a corporate governance code in Sweden to detect which positions were taken into account and what kinds of interpretive communities might have formed as a result. The referrals (i.e., written comments) are public and thereby accessible. They also offer a valid way of discerning the debate. Following Black (2002), we define three dimensions of regulatory conversation: when in the regulatory process the conversation occurs, what is discussed, and who is involved in the conversation. The ‘when dimension’ confines our subject as we are studying a limited period of the regulatory process: the referral process. The ‘what’ and ‘who’ are the main dimensions used to structure our descriptions and analyses. Our analysis is limited to the written debate
and, thus, clearly misses the spontaneous verbal discussions that may go on between different parties. However, the written referrals are likely to be built on inputs from such discussions and to reflect, at least in part, these discussions.

5.6.1 Data capturing the regulatory conversations
The conversation about governance codes began when, following a process of Swedish governmental investigation, a proposal for a code was issued. It ended when a final proposal of a code was presented to the general public and the financial markets. The entire process – from governmental directives to proposal and onwards to the final version – was transparent. Between the proposal and the final version, the stakeholders, the general public, and other public authorities had the opportunity to put forward their opinions of the proposal in writing.

The following items form the subject of our analysis:

Initial proposal. ‘The Swedish Code of Corporate Governance – A Proposal from the Code Group’, is a fifty-three page document, which consists of an introduction to corporate governance in general, proposed regulations, appendices, and the statement from member who opposed adoption of the code. The regulations take up twenty-five pages and cover central dimensions of corporate governance: the annual meeting, board and auditor appointments, the board, the top management team, the auditor, and information regarding corporate governance.

Written comments. The proposal received seventy statements from different stakeholders in the code. There is evidence of great diversity in the statements, ranging from two-line notices that the stakeholder will not respond to the proposal, to statements more extensive than the proposal itself. In Table 5.2 the actors who participated with written comments are listed.

Final code. The final and processed version of the code, ‘The Swedish Code of Corporate Governance’, is a concise twenty-two page document with chapters that follow the same pattern as the proposal, save for the ‘auditing’ chapter, which was deleted. Three reactions were gauged: total rejection of suggestions, acceptance pending changes in vital parts of the suggestions, and support for the suggestions (see Table 5.3).

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The statement emphasized that the code was too little in agreement with the international codes.
Table 5.2 Actors who had sent in referrals

<table>
<thead>
<tr>
<th>Category</th>
<th>Number referrals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Academia</td>
<td>2</td>
</tr>
<tr>
<td>Governmental agency, of which:</td>
<td>20</td>
</tr>
<tr>
<td>- supervisors of the business community</td>
<td>9</td>
</tr>
<tr>
<td>- agencies for industrial support</td>
<td>3</td>
</tr>
<tr>
<td>Regulatory bodies for self-regulation</td>
<td>2</td>
</tr>
<tr>
<td>Business and industrial associations</td>
<td>4</td>
</tr>
<tr>
<td>Banks and financial associations</td>
<td>2</td>
</tr>
<tr>
<td>Stock-markets and authorized marketplaces</td>
<td>3</td>
</tr>
<tr>
<td>Firms, of which:</td>
<td>7</td>
</tr>
<tr>
<td>- with concentrated ownership</td>
<td>4</td>
</tr>
<tr>
<td>- with dispersed ownership</td>
<td>2</td>
</tr>
<tr>
<td>- others</td>
<td>1</td>
</tr>
<tr>
<td>Institutional owners and their organizations, of which:</td>
<td>16</td>
</tr>
<tr>
<td>- Swedish</td>
<td>13</td>
</tr>
<tr>
<td>- international (all British)</td>
<td>3</td>
</tr>
<tr>
<td>Organization representing small owners</td>
<td>3</td>
</tr>
<tr>
<td>Professions and their associations, Whereof</td>
<td>6</td>
</tr>
<tr>
<td>- information officer</td>
<td>1</td>
</tr>
<tr>
<td>- legal profession</td>
<td>1</td>
</tr>
<tr>
<td>- auditors</td>
<td>3</td>
</tr>
<tr>
<td>- internal auditors</td>
<td>1</td>
</tr>
<tr>
<td>Consultants</td>
<td>3</td>
</tr>
<tr>
<td>Trade Unions</td>
<td>2</td>
</tr>
<tr>
<td>General public</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>73</td>
</tr>
</tbody>
</table>

The Swedish business society

The Outsiders

The Auditors
<table>
<thead>
<tr>
<th>Issue</th>
<th>Change between proposed and final code</th>
<th>Parties listened to</th>
<th>Argument(s) of parties listened to</th>
<th>Parties not listened to</th>
<th>Argument(s) of parties not listened to</th>
</tr>
</thead>
<tbody>
<tr>
<td>The chairman of AGM</td>
<td>A restriction in directors’ chair function of the AGM was removed in favor of the election committees’ appointment.</td>
<td>- Firms with concentrated ownership and business and industry associations.</td>
<td>- Self-evident, owner’s decision, resemble praxis and cost efficient.</td>
<td>None.</td>
<td>None.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- The legal profession.</td>
<td>- The topic is to complicated for a code.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Consultants.</td>
<td>- Do not agree with practice.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The election committee</td>
<td>The extensive tasks of the election committee were reduced to be more similar to the tasks of the former nomination committees.</td>
<td>- Local institutional investors, the business and industry associations, firms with concentrated ownership.</td>
<td>- Fear of a fifth corporate body besides the annual meeting, the board of directors, the CEO and the auditors, with no legal basis.</td>
<td>-Small owners and international institutional investors claimed the structure as inappropriate, as it was not independent of the owners.</td>
<td>- The election committee is not independent of owners.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Local institutional investors, part of the business and industry, part of the firms with concentrated ownership and parts of the banking and finance sector.</td>
<td>- The evaluation of the board would lead to a diffusion of roles and responsibilities.</td>
<td>- The audit profession was in favor of the committees’ evaluation of the auditor.</td>
<td>- The evaluation would increase the independency of the auditor.</td>
</tr>
<tr>
<td>The independent director</td>
<td>The proposal and the code remained the same, however, the restrictions on age and tenure were removed.</td>
<td>- The small shareholder association.</td>
<td>- Satisfied with the definition of independence</td>
<td>-British institutional investors, one bank and finance, and one governmental authority.</td>
<td>- Unsatisfied, too low demands on independency</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- The firms with concentrated ownership, the business and industry associations, the stock exchanges, the consultants, the legal profession and one representative of small owners</td>
<td>- Disagreed with the age and tenure restrictions as this is a restriction in the rights of the owners and could be against anti-discrimination regulations.</td>
<td>- One bank and finance, one firm with concentrated ownership and one small owner representative.</td>
<td>-Unsatisfied, too high demands on independency</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- The independent director</td>
<td>-One small owner representative.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>- In favor of the age and</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management remuneration</td>
<td>The AGM should decide upon stock based compensation and the whole board could function as a remuneration committee.</td>
<td>One British institutional investor.</td>
<td>In favor of all board work in committees</td>
<td>Swedish institutional investors, firms with concentrated ownership, firms with dispersed ownership, the consultants, and the stock exchange. - Swedish institutional investors, firms with concentrated ownership, some firms with dispersed ownership, part of banking and finance, and part of business and industry.</td>
<td>The remuneration committee is unnecessary as it is inefficient and conflicts with the provisions on small boards - remuneration should be the responsibility of the board.</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>The independent auditor</td>
<td>Only the audit committee should evaluate the auditor and the whole board could function as an audit committee.</td>
<td>One British institutional investor.</td>
<td>In favor of all board work in committees</td>
<td>Swedish institutional investors, some firms with concentrated ownership, firms with dispersed ownership, and the stock exchange. - The audit profession and the supervisory authorities handling auditing.</td>
<td>The audit committee is unnecessary as it is inefficient and conflicts with the provisions on small boards - The audit committee evaluation to be inappropriate as it was in conflict with the auditor independence.</td>
</tr>
<tr>
<td>Financial reporting</td>
<td>The board and the CEO declarations remained but the CFO declaration was removed.</td>
<td>Audit profession and their supervisory authorities. - Swedish institutional investor, one firm with dispersed ownership, business and industry, the stock exchanges and some representatives of the banking and finance.</td>
<td>Approved the board and CEO assurance as it clarifies the responsibilities. - Disapproved to the CFO assurance as it does not change the responsibilities of the CEO and the board and therefore only leads to uncertainties.</td>
<td>Swedish institutional investor, one firm with dispersed ownership, business and industry, the stock exchanges and some representatives of the banking and finance. - Audit profession and their supervisory authorities.</td>
<td>Disapproved the board and CEO assurance as it does not change the responsibilities only blurs them. - approved the CFO assurance as it clarifies the responsibilities.</td>
</tr>
</tbody>
</table>
5.6.2 Key actors and their opinions

As expected, most interest groups in the Swedish corporate governance system were involved in the referral process. We hypothesized that institutional changes within the Swedish corporate governance system would be reflected both in the parties who got involved and in the parties who shared similar opinions; therefore, they would be grouped together in the analysis. In order to classify the referral material, we first categorized the stakeholders based on presupposed similarities in the mission or function of the stakeholder and/or their membership in a specific interest group. For instance, there were sixteen written comments from different institutional investors and their organizations. Because these firms share a common purpose (to invest other people’s money) and have a common agent–principal relationships (agents of the savers, principals of the companies they invest in) – we expected them to have a common view of the code proposal. If traditional globalization arguments held true, we would expect to see actors with similar agency relationships, that is, the institutional investors and foreign investors, begin to form their own interpretive communities that would begin to dominate or greatly influence the regulatory conversation that took place. However, in some cases, the assumption of similar opinions within the category did not hold true and further subcategorization was needed. For example, in the case of institutional investors, thirteen of the written statements were from Swedish investors and three were from their British counterparts. There were marked differences between these two groups’ opinions, and thus, they were separated.

In the final categorization, which is found in Table 5.2, stakeholders with common interests and opinions were grouped together, and within the groups there were few conflicting opinions. However, stakeholders within a group at times focused on different questions, which suggest that not all stakeholders voiced their opinions on all issues. For example, only one of the British investors wrote that he was in favor of all board work being done in committees, while the other two British investors did not express any opinion concerning board committees (see Table 5.3).

From the written comments to the code proposal, three interpretive communities emerged, that is, actors could be divided into three main groups where the interpretation of problems and solutions, as well as appropriate regulation was similar. We have labeled these communities as the Swedish business community, the outsiders, and the profession (see Table 5.2, column 3).

Given our original hypothesis, we grouped parties who got involved and those who shared like opinions together in the analysis. In short, we presumed that power had shifted from the owners of the owner-dominated companies to the institutional investors, that the institutional investors and dominant owners had different interests, and that the influence of foreign investors had increased. However, for most issue

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31 As noted earlier, the regulatory convergence associated with the globalization of financial markets has been framed traditionally by agency theory (see Oxelheim, 1997). According to this theory the actors may be identified through their self-interest and through their agency-principal relations (Fama, 1980).
discussed during the referral process, national culture trumped agency. An interpretive community seemed to emerge based among Swedish institutional investors, business and industrial associations, and owner-dominated companies. For certain issues, this interpretive community was complemented by Swedish actors from the banking and financial sectors, and on no issue did the Swedish actors have contradictory opinions. This suggests that a sense of identity and belonging to the traditional Swedish business community was important for an actor’s position in the regulatory conversation. In part, this contradicted our assumption that an actor’s functional membership (such as being an institutional investor), would have a greater bearing on the actor’s position in the discussion.

The interpretive community was manifested in the opinions of this group. The traditional Swedish business community did not react favorably to the suggestions in the code. They opposed most suggestions that would change the line of accountability. There was strong resistance to a fifth corporate body in the form of an election committee with extended duties. In addition, the formation of the audit committee as well as changes in the decision process regarding remuneration met resistance. In addition, the suggestion of a written assurance from the board regarding the true and fair view of the annual account met opposition. The arguments were based on the fear that the code would put demands on the corporate body outside the scope of the law and would change the responsibility and decision power of the board of directors.

The second interpretive community that emerged – the outsiders – is more readily explained by agency theory (Jensen and Meckling, 1976; Fama, 1980). This group consisted of the international institutional investors (here, the British) and smaller (minority) owners who aligned with foreign investors on issues of independence, which may be defined as being on the margin of traditional Swedish corporate governance system. Agency theory assumes that actors are maximizing their own welfare; for example, the top management team may act in its own interest instead of in the interest of the investors, which may lead to agency problems when ownership is dispersed and separated from control. Foreign investors, smaller shareholders, and most minority owners face similar agency problems (La Porta et al., 1999). This includes, in addition to the eventuality of shirking management, the possibility of private consumption by the dominant owners.

In general, the outsiders reacted most favorably to the suggestions in the code. They readily accepted the idea of committees that divide accountability and decision power between them. Their main arguments were that board committees ensure independence and ‘fair monitoring’ of the top management group and that transparency reduces information asymmetry. These arguments mirror the arguments that have been put forward in the Anglo-Saxon world (see, e.g. the Cadbury Report; Mallett and Fowler, 1992; Eng and Mak, 2003; Spira and Bender, 2004), as well as in research done from an agency perspective (see, e.g. Letza, Xiuping and Kirkbride, 2004). Given the common agency problems within the group and their marginal power position in the Swedish system, a common definition of problems and solutions was not surprising.
The third salient community was the professions, or more precisely, the auditors. For auditors, the agency problem is more indirect and is related to the possibility of protecting their independence as well as their discretion (see Fant, 1994). This gives them incentive to assume a position and an identity of their own in the regulatory space of corporate governance. It might, however, be an oversimplification to refer to the voice of the auditors as merely a vehicle for resolving agency problems. Another possible explanation for this grouping of actors may be found in their professional basis and the role of the auditors’ professional associations to protect both the private interest of the profession and the public’s interest that the profession fulfill its role (Parker, 1994; Greenwood, Suddaby and Hinings, 2002). Auditors raised their voice only on issues related to their professional function. Such issues concerned auditor independence and the competence of those evaluating the auditors’ work. Additionally, there had been reports of auditors receiving unjustified criticism for errors that are ultimately the responsibility of the board of directors and chief financial officer, so the auditors pushed to make these responsibilities clear and explicit. The arguments regarding auditors’ independence and their fear of receiving unprofessional evaluations have recently been voiced in several discussions regarding the professional role of auditors and the transparency of the audit processes (see, e.g. B. Larsson, 2005; Erlingsdottír and Jonnergård, 2006; Jonnergård, 2013).

In summary, the regulatory conversation studied here consisted of three kinds of discourses drawn from three different interpretive communities: one emerging from the discourse of (Anglo-Saxon) internationalization, one connected to the existing Swedish institutional framework, and one connected to the interest of a particular professional group. The arguments are closely connected to the position of the actors stating them. The regulatory conversation may thus be said to deal with how to adjust to international development, how to consider international development, and how to divide accountability and responsibility in a way that agrees with the institutional framework and power relations in Sweden. This is summarized in Table 5.3.

5.6.3 Who’s voice was heard?

By classifying the various actors and their lines of argument, we distinguish the actors who participated in the regulatory space and determine which issues were salient in the negotiation of the code. The effects of the conversation, on the other hand, give an indication of the actors’ positions in the regulatory space. Actors may very well have participated in a conversation, but did anyone listen to them? For example, considering the difference between the proposed code and the final version (see Table 5.1) we found that few, if any, arguments put forward by the auditors or foreign investors carried the day (see Table 5.3). By contrast, arguments advanced by the traditional Swedish business society resulted in substantial changes to the code. For example, in the final version, the functions of the election committee are restricted in a way that largely mirrors existing practice (Chapter Four). Also, the work of the remuneration committee was adjusted in a way that better agrees with the existing processes for rewarding the board and top management. In addition, the independence requirement was adjusted to better correspond to the owner
situation in Sweden. However, this does not imply a total surrender to the viewpoints of the business community. The written assurance regarding the annual report’s presentation of a fair and true view remains in the code, and the concept of an audit committee has been introduced. Some of the other minor issues remained unchanged or were implemented with minor changes. From this we may conclude that opinions of the Swedish business community have had the most impact on the final code, while the opinion of both the outsiders and the professionals have had substantially less, or no influence on the final code.

The auditors’ lack of influence on the process is somewhat surprising given that auditors have historically had a substantive impact on the governance of auditing practice (Wallerstedt, 1999; Jonnergård, 2013). One of the two professional associations\(^\text{32}\) for auditors that influences regulation in Sweden was founded in 1899 with the aim of influencing the audit regulation. And since the passage of a 1944 Swedish business law, authorized auditors have held a legal monopoly for auditing listed companies, and the auditors’ professional associations have been most salient as lobbying groups (Sjöström, 1994). They have been active in different governmental investigations and included in committees regarding the business law, the extension of auditing, etc. (B. Larsson, 2005). Often, they have succeeded in using different business scandals for introducing measures that enhance their own legal status through, for example, an extension of the kind of businesses for which the auditors must be authorized (Wallerstedt, 1999). The auditors have also been the initiators of importing new audit regulations into Sweden, which has given them advantages when dividing the regulatory space of auditing between the profession and the state. One example of this is the implementation of statutory quality control system for auditors in 2003. The statutory quality control system is based on an EC recommendation (2001/2565/EG).\(^\text{33}\) The EC recommendation implies that the quality system has to be supervised by a governmental organization. In Sweden, such an organization would be the Supervisory Board of Public Accountants, a governmental organization with the aim of controlling the auditing business. However, the Swedish auditors had already implemented a system of peer review supervised by the professional organizations. After extensive negotiations with the Supervisory Board the auditors succeeded in retaining control over their quality control, allowing the Supervisory Board only to make spot-checks of the quality controls performed by the auditors’ professional organizations (Jonnergård, 2013). In this way the auditors, through proactivity and lobbying, have had a large impact on the regulation of auditing and the business law in Sweden. However, regarding their wider capacity in the corporate governance system, auditors appear to have more trouble making their voices heard. To explain this would require speculation, but the absence of influence is interesting to note; it may be an indication that a new division of the regulatory space is emerging.

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\(^\text{32}\) Sweden has had two professional associations for auditors, the Association for Authorized Public Accountants, which is known by the Swedish acronym FAR and the Association for Approved Public Accountants, which is known by the Swedish acronym SRS. In 2007, the two organizations merged and is today known by the acronym FAR SRS.

In summary, the issues and norms in this regulatory space were initially established by the code group and were heavily influenced by the international development of codes, which has been itself heavily influenced by the Anglo-Saxon system. The code, at least indirectly, had its roots in the interests of the international investors. Many actors were invited to take part in the regulatory conversation, and the result of the conversation helped to redefine the playing field for corporate governance in Sweden. After the code was introduced, the members of the traditional business community were most successful in gaining support for their opinions. International investors could be silent because their interests were represented in the proposal itself. The party that did not seem to have a voice was the auditors. This is surprising, given that the code of conduct was partly initiated as a result of audit failures and the profession’s earlier success in lobbying activities. Perhaps auditors – however important they may be – were looked upon as mere assistants rather than as important participants in the corporate governance system.

5.7 Discussion

Above we have followed the referral processes and identified actors together with their opinions and their influences. In this section we discuss the empirical findings and the importance of national culture and local elites, the norms underlying the code, and the role of the state.

5.7.1 The importance of national culture and local elites

In accordance with the arguments put forward by Fligstein (2001; see also Aguilera and Jackson, 2003), we found an interpretative community amongst the Swedish business society in a general sense. Fligstein claims that local elites share a common interest and, therefore, have similar attitudes toward changes in the corporate governance system. He has convincingly shown (1990; 2001) both how the American business society built up interpretive communities around the concept of control and how the common definition of this concept has changed over time. Jönsson (1995) has done a similar study of the Swedish business society and concludes that common definitions of problems and solutions exist within different generations of the Swedish business elite. In line with this, Bengtsson (2005) has concluded that when Swedish institutional investors influenced the governance of the firms through different investors’ activities, they used both the same means and arguments as the traditional Swedish owners of owner-dominated companies. In other words, there seems to exist an institutionalized way of acting. Swedish owners and Swedish business elites are embedded in institutional and power structures, and thus, have a common identification.

The resistance to change voiced by the Swedish business society may be explained by the inherent inertia in the deinstitutionalization of traditional norms and regulation. Oliver (1992, p. 567) suggests that deinstitutionalization (i.e., change of the existing norms and regulation) may be triggered by political, functional, or social pressures. While political pressure comes from mounting performance crises and functional pressure from changing economic utility, social pressure comes from increasing social
fragmentation. When existing practices are perceived to be working, none of these pressures are salient. And, therefore, the preconditions for deinstitutionalization in such circumstances are lacking. In addition, one may claim that both the cognitive and regulative pillars (R. Scott, 2001) of the Swedish institutionalized corporate governance pattern are challenged by the suggested code: the cognitive pillar because the code implies a convergence with the logic of the Anglo-Saxon system, and the regulative pillar because it implies a new division of responsibility. When discussing accountability issues, one should keep in mind that the boards of directors in Sweden have a widespread collective legal responsibility for the actions of the board and the company (Bergström and Samuelsson, 2001). A division of functions into committees would not change this legal responsibility, and thus it implies that directors might be responsible for issues over which they have no control. This background may explain some of the arguments voiced against conditional participation in, for example, the remuneration committee and the audit committee.

5.7.2 The contextualization of norms and the agency theory

The code developed in Sweden is rooted in the Anglo-Saxon tradition. As such, it contains the relevant norms and theory, the most salient of which are neoclassic economics and agent theory. Agent (agency) theory has a prescriptive and a normative aspect. As a prescriptive device, it helps us to structure relations between actors and to define conflicts of interests, such as those noted above. However, since it emerges from the Anglo-American context, it also bears Anglo-American normative assumptions about human behavior and the proper solutions of agency problems. And agent theory may thereby be claimed to be contextual (Jönnergård and Kärreman, 2004; Letza et al., 2004; Lubatkin 2005; Lubatkin et al., 2005). This implies that investors originating from Great Britain may be more influenced by agency models than are Swedish investors. Lubatkin explains this from an American perspective:

Moreover, the model may bear the markings of 'made in the USA' in the sense that its assumptions about self-interest and economic rationality, if they apply at all, may more closely reflect the U.S. institutional context than they reflect that of anywhere else (2005, p. 215).

The common normative base for the code and the foreign investors may partly explain the positive attitude these investors had to certain parts of the suggested code. In addition (as mentioned in 5.4), the agency problems experienced by small shareowners and the foreign investors were similar: the two groups were minority owners and/or outside the Swedish business elite. This may have lead to information asymmetry and the problem of minority exploitation. That the two group's interests and rationality (cognitive pillar) coincided may explain why they formed an interpretive community during the referral process.

At the outset, we had assumed that the foreign investors would claim part of the regulatory space for itself, and that this group would have a greater say because the code was largely an adjustment to international
development. However, our analysis of foreign investors’ participation in the referral process appears to contradict that assumption. But to conclude that foreign investors are a less powerful group may be inaccurate. In the international arena, generally, the demands of investors have been an important starting points for corporate governance codes. One may say that the investor has set the agenda. The very introduction of the code itself may have been a way for the government to consider the demands of the foreign investors and may have been an expression of the convergence of the Swedish corporate governance system with the Anglo–Saxon system. Thus, it may well be that the foreign investors exerted their influence by setting the preconditions for regulatory conversations to take place rather than by participating in the regulatory conversation per se. Nonetheless, the opinions they voiced in the referral process were more or less ignored.

5.7.3 The state as the silent driver of convergence

One important party that did not appear in the conversation above is the state. This is particularly relevant to consider when describing a state-dominated country such as Sweden (Puxty et al., 1987; Henrekson and Jacobson, 2003; B. Larsson, 2005). We have earlier (see 5.4) defined the process of developing the code of conduct as enforced self-regulation (Braithwaite, 1982; Brien, 1998; Fairman and Yapp, 2005). This is a method of governmental control of the business community without restraining its creativity and efficiency. By allowing the business community to create or be involved in creating their own standards while the state controls and accepts the standards, a cost effective system (for all parties) is achieved (Braithwaite, 1982). In the case of the Swedish code of conduct, the government initiated the Commission for Trust and utilized traditional governmental referral processes in order to anchor the code in the corporate governance system. By utilizing the governmental referral processes, the government assured the code’s legitimacy in society. By using the code group and the label of self-regulation for the process, as well as for the enforcement of the code, the government assured acceptance by the business community. At the same time, the state had a decisive influence over the scope of the issues introduced into the regulatory space and it had the power to allow so called self-regulation to be enforced by law.24

The influence of the government is evident also in the code first proposed, when we consider that it consisted largely of ideas imported from various international codes. The government may be said to have been, indirectly, both the initiator of corporate governance reforms and a supporter of the internationalization of the Swedish corporate governance systems (see Cioffi, 2002, for a similar situation in Germany). This partly opposes the normative economic theory that capital markets and their actors (Oxelheim, 1997) – not the state – drive changes in the world’s corporate governance systems. Politics have an influence in other ways as well, such as, in the concepts that are employed in the process. For example, the concept ‘election committee’ rather than ‘nomination committee’ was used. Election committees are

24 One example of this is a suggestion from the government for the accounting of remuneration of the salaries of the CEO and boards of directors. This means a much greater transparency than suggested in the code. The traditional business society has opposed the suggested regulation with, among others, references to the code.
more readily associated with the vocabulary of politicians than they are with the vocabulary of the business community.

There are several possible reasons for this proactivity on the part of the state. Firstly, as described in the introduction, codes of conduct have been rapidly diffused throughout the world. Given this powerful diffusion of the code, it might even attain the status of a worldwide model, that is:

*Worldwide models define and legitimate agendas for local actions, shaping the structures and policies of national-states, and often local actors in virtually all of the domains of rationalized social life – business, politics, education, medicine, science, even the family and religion* (Meyer, Boli, Thomas and Ramirez, 1997, p. 44).

Secondly, the code may be seen as part of the effort to merge and standardize the different markets within the EC (Meyer, 2002). The common market is a political project in which the state has the role of enforcing basic rules for the function of the capital markets. In other words, both the Swedish state’s legitimacy as a well-developed nation and the political practice of the EC may be said to support the role the state has chosen when implementing the code.

### 5.8 Conclusions: Business as usual in the Kingdom of Sweden?

The regulatory conversation examined here dealt mostly with the possibilities of maintaining the old Swedish system, with its collective responsibility for the board and active owners. As shown by the various metaphors used, and the comparison between the proposed code, the public comments, and the final version of the corporate governance code, the Swedish business interests prevailed. International investors and auditors exerted no direct influence on the public debate. Given the salience of the Swedish business community and the state in these regulatory conversations, it would be a simple matter to conclude that nothing has happened, that is, that the system is characterized by institutional inertia rather than institutional change.

Does this suggest that no convergence has occurred? Well, yes and no. It does suggest that traditional power relations continue to dominate the public arena in Sweden. This finding is consistent with research that claims that there exists an inherent inertia against convergence, because local elites have at least partial control over the market institutions and may be unwilling to adopt changes that will reduce their power or their privileges (Fligstein and Freeland, 1995; Fligstein, 2001; Reid, 2003). Even so, a certain convergence has occurred. The content of the initial proposal and the final version of the code introduced several new elements, for example, the requirement for written assurances from the board. But, contrary to the assumption in most normative research regarding the convergence of corporate governance systems (e.g. Oxlheim, 1997), forces of convergence in the financial markets were indirect rather than direct. Anglo-
Saxon agency norms were built into the proposed code but were a less significant part of the ensuing debate. Most significantly, we find that convergence is not simply a functional response to the needs of the financial markets. In Sweden, convergence is driven forward by the regulator, that is, the state, rather than by the financial actors.

It is, therefore, important to study not only the events that occur within the regulatory space during the referral process but also the preconditions for the regulatory conversation itself. The referral process does not involve a ‘free’ conversation, but rather a conversation strictly limited to an exchange of written comments and suggestions. One conclusion from this is that it is not sufficient to investigate regulatory conversations per se in order to understand divisions of regulatory space or who influences the referral process. Both the initiator of the conversation and the participants are vital for such understanding. Enforced self-regulation may be a typical example of when a large-scale investigation is necessary. Enforced self-regulation, as both a concept and a phenomenon, implies that the state creates the playing field – and thus the conditions for – the regulation. At the same time, the government is supposed to stay out of the regulatory conversation and to allow different interests to divide the regulatory space.

From this perspective one may claim that the (re)institutionalization process in this case is characterized by coercive isomorphism (DiMaggio and Powell, 1983, p. 149), that is, convergence that *stems from political influence and the problem of legitimacy* and that the pressure of deinstitutionalization is related to political rather than functional or social pressures. Accordingly, a change in the regulatory pillar of the institutionalized corporate governance system is likely to occur, while the cognitive and normative pillars may persist. In this way the state and the new regulation stand for convergence and isomorphism, whereas the local elite stands for institutional inertia based on, for example, the old regulation such as the paragraph in the Company Act regarding division of responsibility and the collective responsibility of the boards of directors. This indicates that the strength of the established elite’s resistance is connected to how deeply institutionalized previous legislation is, as well as to the behavioral patterns and power relations this institutionalized legislation has caused.

In conclusion, we have not detected salient changes in the position of power or in the relations among actors involved in the corporate governance system in Sweden as a result of the formation of a new code. Yet our research suggests that the international financial market discourse exerts substantial influence on the referral process and development of the code and that international investors also play an indirect role in this process. This influence is especially powerful because it creates the preconditions for regulatory conversations to take place rather than being a part of the regulatory conversation per se. Through this, European countries can, both individually and cooperatively, play an important role in the convergence of European corporate governance systems. Whether such a convergence will occur remains to be seen.

Finally, it may be noted that the concepts of regulatory space and regulatory conversation as methodical devices have been shown to be useful when studying regulatory processes characterized by what appears to
be institutional change and convergence. These metaphors capture relevant dimensions of the processes and thereby help to account for regulatory changes in the background of internationalization.

Appendix 1
Responses in the referral process

Academia
Jaan Grunberg and Ingemund Hägg, Uppsala University.
Department of Business Studies Stockholm School of Economics.

Governmental Agencies
Bokföringsnämnden – Swedish Accounting Standards Board.
Bolagsverket – Swedish Companies Registration Office.
Datainspektionen – Swedish Data Inspection Board.
Ekonomistyrningsverket – The Swedish National Management Authority.
Finsinspektionen – The Swedish Financial Supervisory Authority.
ISA – Invest in Sweden Agency.
kammarrätten i Sundsvall – the administrative court of appeal in northern Sweden.
Kommerskollegium – National Board of Trade.
Länsstyrelsen i Stockholms län – Stockholm County administrative board.
NUTEK – Swedish Agency for Economic and Regional Growth.
Revisornämnden – Supervisory Board of Public Accountants.
Rikspolisstyrelsen – the police authority.
Riksåklagaren – public prosecutor.
Riksteveverket – Swedish National Tax Board.
Statskontoret – The Swedish Agency for Public Management.
Svea Hovrätt – the central court of appeal.
Sveriges Riksbank – The Riksbank (Swedish central bank).
Svenska kommunförbundet & Landstingsförbundet – The Swedish Association of Local Authorities and Regions.

Regulatory Bodies for Self-Regulation
Aktiemarknadsbolagens förening – the stock exchange firms association.
Aktiebranschnämnden – the stock market board.

Business and Industrial Associations
Svenska Handelskammarförbundet – The Swedish Chambers of Commerce.
Svenskt Näringsliv – Confederation of Swedish Enterprise.

**Banks and Financial Associations**

Finansbolagens förening – The Association of Swedish Finance Houses.
Försäkringsförbundet – The Swedish Insurance Federation.

**Stock Markets and Authorized Market Places**

AktieTorget – The Equities Market Place.
Nordic Growth Market.
Stockholmsbörsen – The Nordic exchange.

**Institutional Owners and Their Organizations**

Alecta.
AMF Pension.
1 AP-Fonden.
2 AP-Fonden.
3 AP-Fonden.
4 AP-Fonden.
6 AP-Fonden.
7 AP-Fonden.
Hermes.
Institutional Shareholder Services.
Institutionella Ägares Förening för Regleringsfrågor på Aktiemarknaden – the institutional owners association for stock market regulation.
The National Association of Pension Funds Limited.
Skandia.

**Organizations Representing Small Owners**

Lantbrukarnas Riksförbund – The Federation of Swedish Farmers.
Ägarfrämjandet – the ownership promoters.

**Firms**

Castellum.
Coop.
H&M.
LE Lundbergföretagen.
Nordstjernan.
Note.
TurnIT.

**Professions and Their Associations**

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FAR – the professional institute for authorized public accountants, approved public accountants and other highly qualified professionals in the accountancy sector.

Internrevisorerna – The Institute of Internal Auditors – Sweden.


Sveriges Redovisningskonsulters Förbund – The Association of Swedish Accounting Consultants.

Revisorsamfundet – Swedish Association of Auditors.

Consultants

Björn Forslöw and Gabriel Thulin representing Directus Executive Services and Hallvarsson&Halvarsson.

StyrelseAkademin Sverige – board recruitment.

Styrelsepoolen – board recruitment.

Trade Unions

SACO – The Swedish Confederation of Professional Associations.

TCO – white-collar trade union.

General Public

Lars-Göran Josefsson.

Torulf Jönsson.

Per-Olof Palmgren.
6. THE CONVERGENCE AND DIVERGENCE DEBATE: A REGULATORY CONVERSATIONS PERSPECTIVE

Larsson-Olaison, U.


6.1 Abstract
A frequent starting point when the developments of the world’s corporate governance systems are discussed is whether those systems will converge (see e.g. Hansmann and Kraakman, 2004) or continue on their path of divergence (e.g. Roe, 2000). The empirical evidence used in that discussion could be referred to as ‘anecdotic’ (Coffee, 2001). Given the weight of the theoretical arguments on convergence or divergence and the weaknesses in their empirical support, one could argue that these two concepts co-vary rather than mutually exclude and can thus help to account for the findings of simultaneous convergence and divergence in e.g. Collier and Zaman (2005) and Jonnergård and Larsson (2007, Chapter Five). In this paper the processes leading up to the Swedish corporate governance code being issued are used to shed some light on how divergence in convergence and convergence in divergence are produced in the regulatory discourse (Black, 2002).

6.2 Background
The aim of this paper is to deepen the debate about the convergence or divergence of corporate governance systems prevailing in the literature. This paper thus concerns the development of international corporate governance regulation and its pressure for the reform of local corporate governance practices. By utilizing the concept of regulatory conversation among local regulatory elites in the creation of the Swedish corporate governance code, a more thorough understanding of the concepts of convergence and divergence is proposed.
A simple search in Google Scholar for the words ‘convergence’ and ‘corporate governance’ results in approximately 28 300 hits. This may function as a proxy for how extensive the debate has been regarding the convergence or divergence of the world’s corporate governance systems. The two concepts are used in such disparate disciplines as mathematics, medicine and economics; the universal meaning of convergence is, however, ‘a movement directed toward or terminating in the same point’ and for divergence ‘moving off in different directions’. In the economic discipline it seems reasonable to add the efficiency aspect, that is, with a phenomenon of economic interest the inefficient will converge on the efficient, otherwise, in competition the efficient will triumph over the inefficient. Hence it might not be so strange that, for instance, Black and Coffee (1994) worried about why the USA did not seem to converge on corporate control with the then perceived more efficient (production) economies of Germany and Japan in the 1980s and early 1990s. Neither is it strange that convergence on Anglo-Saxon corporate governance principles is regarded as the only possible outcome by most scholars today.

Thus, the normative issue at hand – Which is the most efficient corporate governance system? – has supposedly been solved (see, for instance, O’Sullivan, 2000b; Oxelheim and Randøy, 2003). The consensus of this also becomes clear according to the academic debate, where the only topic discussed is whether the corporate governance systems of continental Europe will change to become more similar to the Anglo-Saxon corporate governance systems or not. What is also important for this paper is that there are two distinctly separate parties: one arguing that the world’s corporate governance systems will converge (e.g. Hansmann and Kraakman, 2004; Braendle and Noll, 2006) and one arguing for continued divergence (e.g. Guillén, 2000; Roe, 2000). In spite of the totally dichotomous opinions both parties are united by their strong theoretical argumentation and, as also argued by Coffee (2001), their weak empirical support. This implies that both supporters and opponents would have a hard time recognizing a convergence, or a divergence, if they saw one. This situation leaves us with the possibility to account for the rather strange occurrence of both convergence and divergence in different corporate governance reforms, reported in e.g. Collier and Zaman (2005) and Jonnergård and Larsson (2007, Chapter Five).

Regulation is one of the most important areas that would be affected by global trends of converging corporate governance (Coffee, 2001; Hansmann and Kraakman, 2004; Braendle and Noll, 2006). Nation states must reform their corporate governance systems by for instance dissolving ownership arrangements protecting management from the control markets (e.g., implementing one-share, one-vote, Bebchuck et al., 2001), increased outside minority investor protection (e.g. La Porta et al., 1999) and issuing a corporate governance code (e.g. Aguilera and Cuervo-Cazura, 2004). However, regulation is not drafted and implemented by international markets or global trends and, as argued by McCann (2007), this is not a

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35 Oxford English Dictionary.
36 Oxford English Dictionary.
37 For notable exceptions see Ponsard, Plihon and Zarłowski (2005) on the convergence on a hybrid form of the shareholder and stakeholder models.
process of automatic response, since the regulatory process is very much in the hands of local elites who are not interested in diluting their own influence (North, 1990; Fligstein, 2001). It is therefore reasonable to suspect that it is in these regulatory processes that convergence and divergence, as discussed above, are created simultaneously. Therefore, in this paper, the intention is to follow the regulatory conversations (Black, 2002) leading up to one such corporate governance change, namely the issuing of the Swedish corporate governance code. To follow a regulatory conversation, according to Black, is to follow the ‘discursive practices in a regulatory process’ (2002, p. 171). Thus, this paper will attempt an investigation into the interpretative communities amongst those local elites that create the local regulation that is the result of international corporate governance developments.

The purpose of this paper is to increase our understanding of the co-variance of convergence and divergence in corporate governance regulations, using the regulatory conversations of the local elites in the formation of the Swedish corporate governance code as a starting point. Thereby, our understanding is increased with regard to i) how corporate governance codes are created, and ii) how international regulation affects local regulation in a way corresponding to both the convergence and divergence theses. The remainder of this paper is structured as follows: First, the theoretical and empirical concepts of convergence and divergence are discussed; secondly, the research design is displayed; thirdly, a case study of the implementation of the Swedish corporate governance code with the focus on simultaneous convergence and divergence is presented and, finally, the results are discussed and the paper is concluded.

6.3 The Convergence and Divergence Debate

The following sections are devoted to the ongoing debate on the convergence and divergence of corporate governance systems. The first section searches for the background of the debate in the globalization discourse. Thereafter, the theoretical and empirical parts of the debate are examined, leading to a picture where strong theoretical argumentations paired with weak empirical operationalization leave the research in a vacuum. Finally, the consequences of this vacuum for our understanding of the development of corporate governance regulation are discussed. This is done by the introduction of the concept of regulatory conversation. Regulatory conversation is proposed as a tool to understand the workings of local regulation, the area where both convergence and divergence are evident.

6.3.1 Background: globalization and corporate governance

Following Giddens (2000), globalization is something discussed everywhere – in science, in media, in politics, in corporate communications and even in fiction – wherever we turn we will be faced with the establishment of the image of us living in a globalized world. For a person without prior understanding of the globalization discourse it seems to be something very fast, which moves across borders as if they did not exist and which reduces the supremacy of the nation states. According to Giddens, the effects of
globalization are also very far-reaching, electronic communications reducing the information monopoly of the local elites in power and traditional institutions transformed to mere shell institutions as national economic politics loses influence. Giddens 'Runaway World' was first issued 2000, but it has not lost its relevance, at least not if we look at the topics of today's international politics: the questioning of international institutions such as the World Bank or the IMF, the global effect of environmental problems and the streams of migration where millions of people try to leave poverty. Thus, political leaders and regulators of the world still today face the same problems and the same limitations of globalization as they did in 2000.

One area affected by globalization is corporate governance, even if this almost seems as a truism. Certainly, the governance of the world's largest corporations will be affected by globalization. Outsourcing, off-shoring, foreign subsidiaries and international growth are all natural aspects of their business. For the topic of this paper, however, the assumed global streams of financial capital is the most interesting aspect of globalization. At both ends of a global capital stream there is a local firm in need of corporate governance and thus a country's corporate governance system will be under pressure to handle issues such as cross-listings, foreign ownership of local firms or just the treatment of foreign owners. These global demands on the local corporate governance system must be traded off against the nationalistic and regionalist industrialism often seen in plant closings, mergers and acquisitions. It is also a well-known fact from the comparative branch of corporate governance studies that there will be a great many national characteristics distinguishing different corporate governance systems (e.g. Barca and Becht, 2001; Franks, Mayer and Renneboog, 2001). This relationship between national corporate governance systems and globalization is at the heart of this paper.

Thus, the topic of globalization raises a number of new interesting questions. One of the important ones is, according to Guillén (2001), does globalization produce convergence? In this paper this question is discussed with reference to corporate governance. The convergence and divergence discussion in corporate governance, as seen in the introduction, has been both extensive and lively. The concept of convergence has often been discussed solely on its own merit, with the possibility of moving toward a specific point without relating to the opposite. Divergence, on the other hand, is always discussed in polemic with convergence, and therefore it seems reasonable to start with convergence.

### 6.3.2 Convergence in theory

Within comparative corporate governance there is consensus on an overall division of the world's corporate governance systems into two large categories, which may be called shareholder vs. stakeholder (Letza et al., 2004), or network vs. market (Moerland, 1995), or something else. The basic point of these discussions is the attempt to capture the difference between, on one hand, the Anglo-Saxon corporate governance systems (basically the UK and the USA) and the rest (which often includes Germany, France, Japan, but
also smaller countries like Sweden), on the other. There is also consensus on the superiority of the Anglo-Saxon corporate governance model (O’Sullivan, 2000b; Oxelheim and Randøy, 2003). To sum up comparative corporate governance research, the Anglo-Saxon corporate governance model implies a strong focus on external control markets (managerial labor markets and markets for hostile takeovers), transactions at arm’s length and, finally, managerial focus on shareholder value; the others would, consequently, imply the opposite. In face of globalization the strong flows of capital will force a convergence on the most efficient corporate governance system; otherwise competition will force inefficient firms out of the market. Among the strongest proponents of convergence are Hansmann and Kraakman (2004), who proclaimed ‘the end of history for corporate law’, a tradition illustrated by the following quote:

[… the pressures for further convergence are now rapidly growing. Chief among these pressures is the recent dominance of a shareholder-centered ideology of corporate law among the business, government, and legal elites in key commercial jurisdictions. […] It is only a matter of time before its influence is felt in the reform of corporate law as well (2004, p. 33).

Thus, the logical argument in the convergence thesis is based on there being no alternative.

How would then convergence be recognized? Since regulation takes place in the driver’s seat (Coffee, 2001; Pistor, 2004) a converging corporate governance system must produce a set of rules (e.g., a corporate governance code, Aguilera and Cuervo-Cazurra, 2004), containing certain rules (e.g., an audit committee, Collier and Zaman, 2005) and common vocabulary (shareholder value, Lazonick and O’Sullivan, 2000). The argument of the convergence thesis is that if we can find these concepts at work in different corporate governance systems, what we witness is convergence.

6.3.3 Divergence in theory

However, there are many who in polemic with the convergence proponents have argued for the alternative, and that is the continued divergence of the world’s corporate governance systems. O’Sullivan (2000b) argues that the trends that could be called convergence are rather the result of the need to transfer pension resources through generations in industrialized societies characterized by an ageing population. That is, O’Sullivan argues, what seem to be the consequences of economic efficiency following globalization constitute a natural transfer of power to those who gave accumulated a pension capital. Anther common argument for continued divergence is based on the tendency of structures, such as corporate governance systems, to be path dependent (North, 1990; Bebchuck and Roe, 2004); that is, historically chosen paths limit future possibilities.

Finally, another common way to polemically argue against convergence and for divergence is to use local elites as the starting point (Kahn-Freund, 1974; North, 1990; Fligstein, 2001). Regarding the transfer of regulation, which is the topic of this paper, there are two local elites at hand: one from the giving and one
from the receiving country. This implies, first, that the solution at hand, that is the regulation, reflects the interests and composition of local elites in the giving country (Kahn-Freund, 1974). Secondly, this implies that the local elites in the receiving country, if their interest and composition are not similar to that of the first country, will work against all changes restricting their influence (North, 1990; Fligstein, 2001) or, if changes are made, de-couple the regulation label from its actual content (Gillespie, 2002; Kanda and Milhaupt, 2003; Larsson-Olaison, 2010, Chapter Four). Please keep in mind that none of the divergence explanations contradicts the other, but in this paper the focus will be on the receiving local elite’s involvement in the production of convergence and divergence when new regulation is issued.

6.3.4 Convergence and divergence in the empirics
How do we then really know when we have observed convergence or divergence? The great problem of operationalization certainly plays a role when testing the theories of convergence and divergence. Coffee (2001) states that there is evidence, even if it tends to be anecdotic, that the world’s corporate governance systems are converging. Coffee lists four areas where convergence is evident: i) formal legal reforms, ii) the dispersion of ownership in Europe and Japan, iii) the rise of an international market for corporate control, and iv) the growth of European stock markets. Obviously, legal reforms are taking place, most of which, for instance the corporate governance codes, bear the mark of Anglo-Saxon corporate governance. However, these reforms tend to be the result of EC initiatives rather than of strong market pressure. Besides, there is a trend of ownership dispersion and stock market development in Europe, although it is hard to separate the attempts to lower the capital cost from the cost of pensions for an ageing population (O’Sullivan, 2000b). Certainly, there is the development of an international market for corporate control, although it is obvious how sensitive one such market is to political intervention (Davies et al., 1994).

Branson (2001), on the other hand, claims that there is no evidence of convergence whatsoever. Branson’s argument is that convergence is a theoretical construct; however, he does not support his claim with empirical evidence. One advocate of divergence who actually makes empirical tests is Guillén (2000). He argues that there is a need for both quantitative and longitudinal data. Guillén, however, searches for convergence and divergence in somewhat different places than Coffee (2001). Guillén’s data contains the following dimensions: i) foreign direct investment, ii) institutional ownership of assets, in percent of GDP, iii) institutional ownership of stock, in percent of GDP, iv) the leverage of public firms, v) the existence of long-term incentive plans, and vi) the number of hostile takeovers. Guillén uses longitudinal data from the same 43 countries as those reported in La Porta et al. (e.g. 1998; 1999), and he concludes that no convergence is occurring and that globalization rather makes different countries specialize. However, Guillén’s claims also prove that convergence and divergence are sought for in many different places. In comparison with Coffee, as reported above, the only corresponding feature is the activity on the market for corporate control. Thus, one might question the value of the empirical evidence backing the divergence thesis as well.
This paper has no intention to solve the empirical problems associated with the convergence and divergence debate. The reason for the last couple of paragraphs has rather been to demonstrate the confusion with regard to what has been measured, the basic point being that we are looking at an irresolvable debate, since we lack empirical agreement.

6.3.5 Determining convergence and divergence in regulation: regulatory conversations

One area that is much easier to build on when trying to capture divergence and convergence is what Coffee (2001) refers to as formal legal reforms. That is also what Hansmann and Kraakman (2004) places at heart of their portrayal of convergence. One such common formal reform is the issuing of a corporate governance code, accounted for as a development of convergence by, for instance, Aguilera and Cuervo-Cazurra (2004). In other words, following the reasoning of convergence theorists, the mere existence of, for instance, a corporate governance code, with rules on, for instance, audit committees, would imply that a country is converging with the international/Anglo-American acceptance of corporate governance practices.

The basic premises of the idea of converging corporate governance systems takes its starting point well above the horizon of the nation state, that is, on an international level. The power of global financial capital will without doubt force, for instance, local rules to converge on the globally accepted regulation. However, that is really not the way regulation takes place in a democratic country. In most democratic countries there is an established process for how this is done. Or, as argued by McCann:

Irrespective of the power of those pressures, however, the pattern of regulatory reform across states can never wholly be a product of their operation. Fundamental changes in regulatory practice can only be effected through major political reform of legal provisions and related changes in the behaviour of agencies, financial actors and firms themselves (2007, p.73).

This implies that in the real world there will always be local actors carrying the changes triggered by the globalization and internationalization of capital. Thus, the change itself does not happen on the international level, but on a local level, and it is at that level the actors carrying the change must be sought.

This can help us to account for the contradicting results reported in, for instance, Collier and Zaman (2005) and Jonnergård and Larsson (2007, Chapter Five). Collier and Zaman found broad acceptance of the audit committee concept but only gradual convergence in recommended audit committee practices (p 763). This conclusion was further supported in Jonnergård and Larsson (2007, Chapter Five), where this pattern was found throughout the Swedish corporate governance code. Thus, in local corporate governance regulation we find that the same rules as the ones found in different countries, signaling convergence, with the exception that those rules actually differ in meaning, signaling divergence. Both Collier and Zaman and
Jonnergård and Larsson point in the direction of the local actors drafting the regulation. Therefore, we need a concept to capture the working of these local actors.

One such concept, introduced by Black (2002), is regulatory conversations. Following Black, regulatory conversation comprises the discursive practices amongst the interpretive community that actually creates the regulation and is thus well in line with the prior understanding of Kahn-Freund (1974), Fligstein (2001) and McCann (2007).

In this paper I try to follow the process and trace the discourse surrounding the regulation leading up to the issuing of the Swedish corporate governance code. The actors participating in this regulatory conversation should be the creators of both convergence and divergence.

To sum up this far, in this paper I argue that convergence and divergence are two concepts that may co-vary, rather than mutually exclude. This is due to the loose coupling between the concepts, the operationalization of the concepts and the equivalent of the concepts in empirical materials collected by different scholars. More importantly, however, this is also due to the process where international trends of, in this case, corporate governance regulations transform into local action, that is, when any change that could be understood as either convergence or divergence occurs in a corporate governance system, it is always performed by local actors. This process responds to the regulatory conversations that occur among those local elites that actually have to make the reforms at hand. It is their interpretations, their translations and their methods or, in short, their discourse which forms the actual change, and this change will thereby look as both convergence and divergence, simultaneously.

6.5 Methodology
This paper is based on a single-case study approach on the implementation of the Swedish corporate governance code. The empirical material is very rich, being both based on personal interviews, an extensive written material of formal regulation and referrals and the lively debate that followed the code development process in the media.

6.5.1 The material
The personal interviews have been performed with centrally placed actors that were involved in the code development process. The total number of interviews is twelve. There is an overlap between the participants of the governmental ‘commission of trust’ and the ‘code group’ (see below for a presentation of these groups). The interviewed regulators represent the legitimate spheres of the Swedish corporate governance system: the state, the controlling shareholders, the stock exchange and the minority.
shareholders. Interviews were also made with the regulators supporting the interested parties, e.g., experts in law and accounting.

The participants in the interviews were selected by snowball sampling and, as only two declined participation, the sample is regarded as representative. The focus of the interviews is on issues like: who is perceived as salient in the process, what kind of interests do the salient actors represent, and what roles do they occupy in the process, what kind of arguments are given for different rules during the emergence of the code, and what is the outcome of the process.

As the code was developed within the domain of Swedish public investigations, an extensive written material has also been used to further enrich the case. The written material consists of a proposed code, a final code, a large number of written referrals on the proposed code and also the written investigations including the underlying considerations.

Finally, there was a public debate in some of the Swedish newspapers, where different actors voiced their opinions. This material has also been taken into account to make this case richer.

**6.5.2 The story and the actors**

The case study resulted in an interesting storyline of how the Swedish corporate governance code was produced. This story will follow below in 6.6, but some comments are necessary by way of introduction. All the participants in the interviews were granted anonymity. Even though there will be several actual quotes in the text, it does not claim to represent someone else’s story. Thus, the following story should be viewed as the author’s representation of the interviewees’ stories.

For an easier understanding of the story some of the actors need presentation. They are presented in Table 6.1 in the order of appearance. This grouping of actors is of course a simplification and does by no means capture the total dynamic of the forces in the Swedish corporate governance system. Nonetheless, it serves a pedagogic purpose and it could be claimed that it captures the overall conflicts.
Table 6.1 Some actors in the Swedish corporate governance system

<table>
<thead>
<tr>
<th>Actor</th>
<th>Function</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institutional investors</td>
<td>Very heterogeneous group, sometimes well embedded in the Swedish corporate governance establishment and sometimes a loud voice for reform. A group politically pressed to take larger responsibility in corporate governance issues that today also seems to be more involved than previously. Also participates as a formalized interest group in the Swedish self-regulatory system.</td>
</tr>
<tr>
<td>Traditional owners</td>
<td>A rather homogeneous group of inherited and/or entrepreneurial controlling owners of Swedish listed firms. Their power is usually based on voting caps and is usually politically and popularly portrayed as the necessary owners of flesh and blood that outweigh short-sightedness and institutional ownership. At least historically in firm control of the Swedish corporate governance self-regulatory system and through corporatism influential in other regulatory issues.</td>
</tr>
<tr>
<td>Firms</td>
<td>The listed Swedish firms, approximately 300, are extremely heterogeneous, ranging from very small consultancy firms with dispersed ownership to international market leaders in manufacturing with controlling owners. Nonetheless, as they act as mediators or as an arena for different corporate governance interest groups’ agendas – most importantly in the big international firms – their role must be taken into account.</td>
</tr>
<tr>
<td>The commission of trust</td>
<td>A Swedish state commission formed as a response to perceived mistrust in Swedish business. Formed in a corporatist spirit. Initiated the Swedish corporate governance code and formed the code group, see below, together with the system of Swedish self-regulatory bodies (the traditional and the institutional owners, see above) and the SSA (see above).</td>
</tr>
<tr>
<td>The code group</td>
<td>Temporary formation of the regulators behind the corporate governance code studied here. Composed of all major interest groups surrounding the Swedish listed firms.</td>
</tr>
</tbody>
</table>
6.6 When Sweden Obtained a Corporate Governance Code like the Rest of the World

In the beginning there was no Swedish corporate governance code, and no single norm – outside the Companies Act – for how good corporate governance should be performed in public firms. Instead there were many different firms, supposedly adapted to their own demands and needs, who were differently controlled (e.g. Larsson-Olaison, 2010, Chapter Four). In some cases this implied close correspondence with Anglo-American practice, and in other cases it did not. The Swedish corporate governance system is often characterized as positioned somewhere in between the Anglo-Saxon and Germanic ones (e.g. Agnblad et al., 2001; Jonnergård et al., 2003). The financial markets are relatively well developed (Agnblad et al., 2001, Stafsudd, 2009), but formal ownership control is in many cases centered into the hands of the business groups rather than dispersed (Collin, 1998). Connected with these business groups there are managerial labor markets (Collin, 1998). However, due to the extensive use of e.g., dual-class shares with different voting caps, the market for control and hostile take-overs is very much circumvented (Agnblad et al., 2001). To add up to this, there was also, before the issuing of the code scrutinized here, a rather opaque structure of corporate governance regulation (Jonnergård and Larsson, 2007, Chapter Five), with overlapping self-regulation, laws and registration contracts. The following paragraphs describe how this very traditional European corporate governance system, being one of the last in the EC, developed a corporate governance code.

The first Swedish owner policy was issued in 1993; shortly after the Cadbury report was issued in the UK. The content of this policy very much resembled the Cadbury report – e.g., its demand for independent directors and board work in sub-committees – basically involving what would today characterize the usual corporate governance code. Since the issuer was the Swedish Shareholder Association (SSA), which organizes small private shareholders, it was not binding in any sense. The SSA was far from part of the established Swedish corporate governance elite, although they continued to travel from AGM to AGM demanding firm level corporate governance reform. Many of the SSA corporate governance demands were also part of the regulatory conversations regarding a new companies act, but the regulator turned them down, as they were considered to be too Anglo-Saxon and too much oriented towards large companies. However, as time went on and the SSA, sometimes allied with different institutional investors, continued to press for corporate governance reform, a momentum was built up.

On the self-regulation level, however, the Swedish business society subsequently refused all Cadbury-influenced governance reform in the years from 1993 until 2002 claiming that there was no need for nominations committees, audit committees or independent directors. This implies that the traditional Swedish owners and their organizations did not want any change, often using arguments implying that these Anglo-Saxon solutions do not suit the traditional Swedish corporate governance system as they not correspond with the Swedish regulatory cornerstone of facilitating active ownership by physical owners. This was contrary to the development on the firm level, where many corporate governance reforms were implemented (see, for instance, Larsson-Olaison, 2010, Chapter Four, on the situation of nomination
committees). Thus, the situation at hand was a strange kind of deadlock where, on one hand, the business society elite continuously refused any corporate governance reform and, on the other, the firms’ experiments showed a great diversity of corporate governance solutions and more fringe groups pressed for change.

Regardless of the growing momentum, the usual trigger for corporate governance reform was, as always, corporate scandals. In this case the international developments of Enron and WorldCom did not pass unnoticed. Meanwhile, in Sweden the maverick management of the Skandia insurance company, remuneration problems in ABB and, more importantly, the wipe-out of billions in firm value in the Swedish business crown jewel, telecom manufacturer Ericsson, made politicians react:

*And then the politicians went: someone has to pay for this!*

The Swedish political reaction was to initiate a governmental ‘Commission of Trust’. Although the scope of the commission was broadly defined from the beginning, the commission turned the issuing of a corporate governance code into the solution to most of their problems. At approximately the same time, the traditional Swedish business society realized that the pressure was too large, and that there was a need for a corporate governance code. For a short while, it looked as if Sweden was going to go from no formal codes whatsoever to two in a very short time. However, for many reasons – which would merit their own paper – the business society decided to cooperate with the governmental commission on the issuing of a corporate governance code, and thus the so-called ‘code group’ was formed.

Given that the general content of a corporate governance code is deemed to be very Anglo-American-inspired and that this could not be unknown to the business society, there must have been a very rapid shift amongst those who dominate the business society. Instead of the previous reaction of fighting this development, they made these corporate governance topics into their own and expressed their wish to participate in this development.

The members of the code group have many different interpretations of why there was suddenly such a large need for a corporate governance code. Among other things, there was a growing discontent with the workings, or perhaps non-workings, of the old rather opaque self-regulation system. The self-regulatory system was claimed to be controlled by the traditional owners, and the institutional investors wanted more influence. Since a corporate governance code needs future development, the formation of a new self-regulatory body was assumed from the beginning, and that was also what finally happened. Simultaneously, there was what could be referred to as a pedagogic demand to explain the workings of the Swedish corporate governance system to foreign institutional investors:

*Partly, this is also to increase the transparency, there are many who don’t understand the Companies Act, we still see that.*
Thus, the code group was not primarily driving for harmonization *per se*. They very often tended to emphasize the individual character of the Swedish corporate governance system and also the superior workings of this system. They claimed that Sweden had a companies act which was ‘better than most’ and which, among other things, permitted a large influence from owners, and therefore a strong focus on shareholder value. The problem then was how to get loud foreign investors to understand this.

However, after stating the usual rational reasons as seen above, in the end, when it comes to the development of a corporate governance code, it seems to reflect much of the ‘zeitgeist’:

[…] by then, such codes were under development in almost every western European country. […] Sweden was the last country out on the field; even Norway was before us […]

or formal legislative pressures:

*Meanwhile, we knew that the EC was about to demand that all countries should issue a corporate governance code and that certain rules should be included in that code.*

Consequently, we might say that by 2002 a situation has arisen that everybody assumed the existence of a corporate governance code in a European country. If this was not the case, such a code must be presented.

The code group was formed with a very traditional Swedish interest group representation, comprising governmental representatives (the chairman being a former Swedish minister of finance and including a former CEO from one of the state-dominated firms) and the rest representing different interests such as the Stockholm stock exchange, institutional investors, traditional private owners and small owners. Tied to the code group were also a number of experts, mostly from law and auditing. All of this was held together by the secretary of the code group, considered by some of the members as the ‘primus motor’, who fed the group with texts to discuss. The work of the group is characterized, by the members themselves, as a striving for the lowest common denominator and consensus.

*One can say that it was very ‘Swedish’; in this case however, that’s in a very good sense, as anchoring in different constituencies is necessary; it is good to consult and to spread the word and talk about things. Thereby, when everything is done nothing really happens, it becomes a non-event, because nobody sees the reason to complain anymore.*

What is also very important in this kind of process is the need to get support among other important constituencies, which was done by incorporating more people in the group and by arranging different consultations. The work could be described as follows:
Thus, this work included a couple of very different but yet important parts. First, there was the codification of practice, secondly, to somewhat press the Swedish corporate governance practice ahead and, finally, to fend off or prepare for new laws. The codification of practice was seen in many cases as a way to bring the deviant firms back into line but, of course, this implies at the same time the protection of status quo. The improvement could very much be seen as the introduction of many Anglo-Saxon solutions, such as the demand for remuneration committees and written assurances from some key staff. Another step ahead was the development and formalization of the Swedish form of nomination committee (or election committee, as the code group came to call it), which is seen by some of the group members as an invention that should be exported to other countries. The nomination committee was also one of the two major areas of disagreement in the group (the other one concerning the independence of directors, on similar grounds), the two positions being very much for or against an Anglo-Saxon solution, however:

We were a majority – including me – who said we cannot use the British method, where the owners don’t decide upon who should be a director of the board […] we followed the Swedish model […]

This conflict also came into the open when one of the proponents of the Anglo-Saxon solution made a special statement of disagreement along with the code proposal. The third dimension, the relationship with other regulations, basically concerned adaptations to what was considered as upcoming EC demands (an audit committee was considered as such) or fending off demands from the Swedish government (e.g., proposed gender quota system on the boards).

As the code group was initiated in cooperation with the governmental commission, the work of the group was treated as such. In Sweden this implies that the code had to go through a written formal process of referrals, implying an open process where every citizen or interest group has the possibility to speak their mind. This is of course another way to anchor the new regulation with important stakeholders; however, it also produced a massive number of different opinions that had to be taken into account. Therefore, the code group reappeared with some minor changes in personnel and set about to create the final code.

At this stage of the process it became obvious to the members of the code group that they had gone too far in many of their proposals. It was not only the private owners of what could be called the deviant firms that reacted strongly; so did also many institutional owners, stock-brokers and bankers, for instance. Of course, when such important constituencies of the Swedish corporate governance system opposed, the code group had to fall back. After the very ambitious proposed code a smoother code was handed over to the Swedish business community, which involved that the Swedish corporate governance code more or less came to
resemble standard practice among the largest firms instead. The final code also lost much of what was considered too detailed regulations and areas where the code came into conflict with the legislation in place.

The members of the code group saw their mission as creating the best, or the most efficient, code. This implies that they did not regard themselves as takers of regulations, the formation of the Swedish corporate governance code being a national Swedish issue:

 [...] every country has its own tradition, its own Companies Act, and that implies that one has to have an adopted corporate governance code [...] 

This is also mirrored in the rather inconsiderate treatment of the opinions voiced by large British pension funds in the process of referrals:

No, we were not that attentive to either American or English viewpoints in this case. This was because it was the Swedish model of ownership that should be represented in this code. Thereby most foreign ideas fell flat on the ground.

The final result of this development process could be said to be an internationally accepted corporate governance code, but with Swedish rules. This implies that the Swedish corporate governance code contains all the relevant and taken-for-granted words: audit committee, remuneration committee, nomination committee and independent director. On the other hand, actual rules bear the trademark of Swedish corporate governance practice: an audit committee and a remuneration committee can be composed of the whole board; such a committee should also perform different task than, for instance, a British counterpart; a Swedish nomination committee is not composed of independent directors but of direct owner representatives; a Swedish independent director is always independent of management, like the British counterpart, but only exceptionally independent of the firms’ owners, and that is very unlike the British.

In sum, from the perspective of a regulator we might say that this is a corporate governance code dilemma, as shown in the contrast between the following two citations:

Then of course, let's pretend that Sweden actually would not be bothered about independence directors, audit committees, and nomination committees and all the other ideas that constitute the core of the international development, then certainly, I can say that much, that we would not be credible on the international market, that's for sure.

In contrast to:
Why the hell should we have nomination committees then, and what should they do, because we don’t have that problem. The board of directors and management – the CEO – is separated here, so we don’t have that problem, typically, management is not part of the board.

Thus, in dealing with this code dilemma – international credibility and legitimization versus the decoupling felt to exist between national corporate governance problems and international solutions – the Swedish regulators were pragmatic. Thus, everything considered, we might say that Sweden by this process has got a corporate governance code with the structure and the rules that one might expect in an internationally accepted corporate governance code, and consequently it implies convergence. Meanwhile, the process and the regulatory conversation where the code was made part of the Swedish corporate governance regulation transformed the meaning of the rules, implying continued divergence.

6.7 Discussion and Conclusions

Convergence and divergence, two words that per definition are totally separate appear together as one, in the reformation of the Swedish corporate governance system. This is the result of the extremely complex workings of globalization; hereby action on the local level (that is in the jurisdiction of the nation state) is connected to actions on the international level. How financial capital is formed and moved on both global and local levels is important, just as how political ideas and ideologies are constructed and exchanged on both these levels. We might not have any models that can account for these complex processes, neither can we lean on easy answers like the efficiency of the market (see O’Sullivan, 2000b). What we do know is that globalization causes changes, or at least creates agendas for different actors to act. In these changes, or opportunities for changes, complex patterns are found in the relationship between internationally predestined solutions and effective local agency. The following paragraphs are some reflections on the relationship of convergence and divergence in corporate governance change.

One first point to make regards the uncertainty that we face when looking for the empirical equivalent of the theoretical concepts of divergence and convergence. In this case we have seen the implementation of the Swedish corporate governance code. This would constitute a pattern of converging corporate governance systems following Coffee (2001) and Aguilera and Cuervo-Cazurra (2004). Also, we see the actual rules such as independent directors, audit committee and so on, which would definitely fit our prior understanding of a ‘shareholder-centered ideology of corporate law’, in Hansmann and Kraakman’s (2004, p. 33) terms, as the labels of the rules bring our thoughts to regulation connected with influential Anglo-American regulation such as the Combined Code and Sarbanes Oxley Act. However, these labels are put on other rules, or on rules that gain new meaning in use, making it plausible to also speak of divergence as Roe (2000) or Fligstein (2001) do. As we will see below, this connects to the regulatory conversations (Black, 2002) occurring in the formal rule-making process (McCann, 2007). These observations of divergence and simultaneous convergence are also consistent with prior research results where the same
corporate governance rules contains different meanings (Collier and Zaman, 2005) or are adapted to local practice (Jonnergård and Larsson, 2007, Chapter Five). What is observed is the local actors answer to the code paradox of international legitimacy traded off against local efficiency.

To understand this complex connection between convergence and divergence, it becomes extremely important to consider the workings of local democratic regulatory processes (McCann, 2007). Although the Swedish corporate governance code was a result of enforced self-regulation only (Braithwaite, 1982; Jonnergård and Larsson, 2007, Chapter Five), and thus not subject to formal legal regulation, the process shows great signs of corporatism and local anchoring among different constituencies, which explains many of the adaptations of the rules. It is obvious that many of the Anglo-American rule ideas failed to address issues important to the local actors. However, as certain rules were deemed necessary, something had to happen. Further, in the different interest groupings where the rules needed to be anchored certain causes where needed to remedy the concerns regarding the rules. This also implies that we need, following McCann (2007), to understand the local workings of the regulatory process to grasp the reform of local corporate governance. When doing this, we will observe the actions taken by the local elites. However, in this paper, these local elites tend to pose in a different way than in many other accounts, as they are far beyond the simple dichotomies of the state capturer or some entrenched focus on status quo, on one hand, or as simple takers of regulation on the other hand. The local elites in this paper are the true agents of change, maybe because they are the only possible agents. However, without them there would be no convergence and, to put it the other way around, no divergence.

Furthermore, the basis for observing this convergence and divergence is following the regulatory conversations (Black, 2002), because only by doing that can we understand how and why this will happen. The local elite’s regulatory conversation forms an important part of how we can understand the local regulatory process. In this case the discourse is focused on the sense-making and understanding of foreign rules whose meaning is not well understood.

A second set of observations concerns the workings of the reform agenda for local corporate governance systems in face of globalization in general and of the EC specifically.

Giddens’ (2000) formulation of the nation states problems in face of globalization is that the problems will be simultaneously too big and too small to actually handle. In this paper we can see how a nation state is mobilizing, from government to business society, to face the global trend of issuing corporate governance codes. The participants more or less circumvented the pressure from globalization by adopting the rules and redefining central concepts of international corporate governance. This occurs due to the extensive demand for new regulation that seems to stem from the globalization discourse, keeping in mind that business has been global for a long time, while accountability by international regulation is something more or less new. Then, it may also explain the strong state influence reported in Cioffi (2002) and Jonnergård and Larsson (2007, Chapter Five) in the reformation of continental European corporate governance systems – when
everybody issues similar regulation nobody will lose in the ‘race to the bottom’ (see Wouster, 2000). However, this raises questions on how market pressure – the basic assumption behind the convergence thesis – is actually exercised. This could be a topic for future research in this area.

Beyond this strong state influence it is obvious that one must consider the EC pressure on local corporate governance reform (e.g. Ferrarini, 2004). From the so-called Winter report to a vast number of communications from the Commission it is evident that the EC, leaving harmonization behind, is demanding key corporate governance code elements as the existence of at least one national code, with audit committees and remuneration committees based on a comply or explain model. This brings yet another dimension to the concept of enforced self-regulation (Braithwaite, 1982), as local self-regulators are not only pressured by local government but also by supranational governmental organizations, making elements of the international corporate governance development, such as a code, nearly impossible to reject. The workings of supra-national regulators, such as the EC, are largely unknown, but open yet another area for interesting regulatory research.
7. THE VALUE OF GOOD CONNOTATIONS: THE INSTITUTIONAL THINKING OF INDEPENDENT DIRECTORS AND ‘INDEPENDENT’ DIRECTORS

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This is a translated and developed version of: De svenska oberoendereglerna: Motsättningen mellan internationella regler och lokal användning. In Jonnergård, K. and Larsson, R. (eds), (2009) Från barkbröd till chiabatta: Kreativitet och kontroll inom ekonomistyrningen. Växjö University Press, Växjö.

7.1 Introduction

An answer is only seen to be the right one if it sustains the institutional thinking that is already in the minds of individuals as they try to decide (Douglas, 1986, p. 4).

One of the more important aspects of what is currently understood as globalization is the free movement of financial capital between different financial markets (e.g. Stiglitz, 2003). Historically, investors’ activity was often geographic restricted, while today, a high level of foreign direct investment (FDI) is permitted in most countries and is even considered as a measure of a country’s economic success (e.g. OECD, 2013). The effects of financial capital globalization are important for how listed corporations should be run and controlled, i.e., for corporate governance. Following Gordon and Roe (2004) and Rasheed and Yoshikawa (2012), the globalization of financial capital has triggered a standardization of corporate governance regulation in line with international benchmarks.

In a scholarly sense, understanding corporate governance change and development is in the interest of comparative corporate governance. By comparing different systems at different times, we can reach conclusions about the individual systems and their development. As pointed out by Aguilera and Jackson (2010), the comparative study of corporate governance systems has focused on dichotomies: arm’s length/control (Berglöf, 1997), insider/outsider (Franks and Mayer, 1997), coordinated/liberal (Hall and Soskice, 2001) or stakeholder/shareholder (e.g. Gordon, 2007). The upshot of this contrastive pairing activity is the creation of ideal types that highlight the difference between the Anglo-American corporate
governance system and other systems. Certainly, such ideal type reasoning helps in focusing scientific enquiry and guiding analysis. However, in studying real world corporate governance systems the strategy of focusing on dichotomous pairs is problematic, as it implies an analysis where an entity must be defined as either one or the other. For example, a corporate governance system may be defined as stakeholder-oriented until, through a series of changes, it turns into a shareholder-oriented system. A dichotomy of convergence and divergence is thereby built into this way of reasoning. More recently, a growing body of empirical research has shown that when pressured to change, different systems do not either converge or diverge: they change according to their own incremental logic (e.g. Buck et al., 2004; Lutz, 2004; Collier and Zaman, 2005; Jonnergård and Larsson, 2007, Chapter Five) and form ‘hybrids’ (Yoshikawa, Tsui-Auch and McGuire 2007; Aguilera and Jackson, 2010). Yoshikawa et al., (2007) define ‘hybridization’ as a process where changes in a national governance system will result in a model placed somewhere on a continuum between the national/traditional/original system and the Anglo-American system. Hence, the hybrid perspective posits that a traditional corporate governance system that is forced to change in an Anglo-American direction does not necessarily imply a convergence. The end result could also be a hybrid between the new and the old, between the traditional system and the Anglo-American system.

This paper focuses on the change of corporate governance system through the change of regulation. More specifically, this paper takes the regulators’ perspective on changing corporate governance systems rather than the perspective of the regulated. Compared to Yoshikawa et al. (2007), who discuss complying firms’ implementation of convergent regulation and find hybrid use, this paper focuses on regulations that in themselves are hybrid, i.e., partly traditional and partly Anglo-American. The aim of the paper is to investigate how different actors involved in a process of regulating director independence use and interpret the concept of ‘independent directors’ through applying Douglas’ notion of institutional thinking (1986). This is carried out in order to better understand how corporate governance evolves as a result of increasing financial globalization. In this paper, we utilize a case study of the Swedish regulation on independent directors. Independent directors are considered a core component of international standardization of corporate governance, and the introduction of such directors would be a sign of alignment of a traditionally based corporate governance system to the Anglo-American (convergence). However, it is also clear that the Swedish regulation on independent directors reflects some form of hybrid model, implying that something happens when the concept is implemented into Swedish practice. The outline of the paper is as follows: first the concept of institutional thinking (Douglas, 1986) is introduced and applied to a regulatory setting focusing on regulators. We then describe the regulators’ perspective on corporate governance; it is argued that the regulators’ perspective must deal with the problem of separating ownership from control. In an ideal type mode of reasoning, this perspective implies two possible solutions: one based on the market (the Anglo-American) and one based on controlling shareholders (the traditional Swedish). How the corporate governance problem of separating ownership from control is solved, we argue, takes the form of an institution and thereby strongly influences how it is possible to think of different solutions. Our empirical case is based on interviews with Swedish regulators and other case material. Following this presentation of
the data, the implications are discussed. The contribution of the paper is threefold: 1) a further understanding of regulatory change of corporate governance systems operating under conditions of financial globalization; 2) introducing the regulator as an important actor in this change process; and 3) a further understanding of the role played by institutional thinking in relation to the regulators and their possibility to shape future corporate governance.

7.2 Institutional Thinking and Regulation

As stated above, financial globalization has led to standardisation of regulation on an international benchmark. In other words, a need for changing corporate governance regulations is created. In the different corporate governance systems, this change is handled by regulators. As a point of departure for this paper, regulators – like all actors – are considered to be operating within an institutional structure, where ‘institution’ is understood in the sense applied by the anthropologist Douglas (1986).

Following Douglas (1986), the creation of institutions emerges in the establishment of social order. Douglas takes a position against the conception of social order in economics, where social order is the result of collective action (i.e. Olsen, 1965), and thus very complicated to achieve in large (latent) groups without cohesion. To Douglas, social order could arise regardless, as an unintended ‘thought style’ within the latent group, which could then sustain the current social order. Drawing on Durkheim, Douglas claims that ‘individuals entrench in their mind a model of the social order’ (1986, p. 45) which in turn results in stable institutions. The concept of institution is defined by Douglas as ‘legitimized social grouping’ (1986, p. 46), where grouping could be social (e.g., the family) or practice (e.g., a ceremony). However, according to Douglas, an institution is not any given practical arrangement, as institutions ‘rest their claims to legitimacy on their fit with nature of the universe’ (1986, p. 46).

Following the last point, Douglas’ view of institutions implies a stricter definition of institutions than usually applied in corporate governance research. In corporate governance research, there is a tendency to regard certain practical mechanisms of corporate governance as institutions, e.g., the board of directors or independent directors. While the board and its directors are certainly integral to solving the problem of separating ownership from control, the claim to legitimacy rests on an institutional foundation which in turn rests it claim to legitimacy on nature. Certainly, if a legitimate interest group in society were to demand the abolishment of the board of directors, justifying their demand with good reasoning, such a demand would invoke protest from entrenched groups (e.g., directors and those who appoint directors); however, the defence of the board mechanism would be successful only if the defence is linked to the overall institution of how the corporate governance problem should be solved. Thus, the entrenched solution to a social order problem being the institution – in this case the solution to the problems created by separation of ownership and control – needs to draw its legitimacy from a natural order (see further Douglas, 1986). In this paper, following Douglas, it is claimed that both the market (e.g., the invisible
hand) and controlling shareholders (e.g., the natural order of ownership) are two possible institutions. In Douglas’ writing, both the market (1986, p. 42) and structure of ownership rights (1986, p. 114-115) are described as institutions. We shall return to these institutions in the next section.

What then, is the consequence of Douglas’ view of institutions? The title of her book is ‘How institutions think’. Nonetheless, Douglas does not posit that institutions are endowed with human properties of thinking and acting. It is the way that institutions govern the thinking of humans that is important: the institutional thinking. Douglas refrains from an explicit definition of institutional thinking, although she points to a number of traits of institutions that could guide our understanding of institutional thinking: 1) institutional thinking governs thought by means of classification; 2) institutional thinking provides answers; 3) primary institutions govern important decisions; 4) most parts of the institution are invisible to those governed by it.

The first of these traits concerns how institutions and institutional thinking commit our thinking by structuring what could be said, thought and done. Douglas claims that: ‘Our minds are running on the old treadmill already. How can we possibly think of ourselves in society except by using the classifications established in our institutions?’ (1986, p. 99). Thus, the institutional arrangements are conceived as stable. Over time, they establish the classifications by which we understand our world. As such, they are at work in times of change; the old classifications will guide the understanding of the new, and thereby a sense of stability is achieved. Hence, institutional thinking also could guide our understanding of what happens when new regulatory initiatives – linked to other versions of institutional thinking – reach local regulators. The local regulators will lean on their prior institutional thinking to make sense of the new, thus applying old classifications to understand the new.

Secondly, according to Douglas (1986), institutional thinking functions as an answering machine:

If the institution is one that depends on participation, it will reply to our frantic question: ‘More participation!’ If it is one that depends on authority it will only reply: ‘More authority!’ Institutions have the pathetic megalomania of the computer whose whole vision of the world is its own program (1986, p. 92).

Thereby, the institutions that we are governed by are very helpful in decision-making. A decision is right and rational if it fits within the institutional thinking. In a regulatory setting, a transferred rule is linked to answers prevailing in its original setting. The local regulator would search to fit the new rule with the answers provided by their institutions. Regardless of analysis, those governed by a specific version of institutional thinking already know the answer.

Third, Douglas asserts that it is a common misunderstanding that we create our institutions in order to avoid routine-like decisions. On the contrary, ‘the individual tend to leave the important decision to his
institutions while busyng himself with tactics and detail (p. 111). Douglas exemplifies this point by drawing on empirical studies on what happens in a primitive society in the case of famine (Torry, 1984, in Douglas, 1986) and in a modern society when a new medical advance for treatment is not readily available to all those who might need it (the first kidney dialysis, Barry, 1978, in Douglas, 1986). In both cases — those who get to eat and those who receive treatment — the very institutions that governed ordinary life were applied to select who should survive. As the institutions form a very strong sense of control, both the fortunate and the unfortunate accepted the institutional solution. The more important the decision, the more likely it is that it is based on institutional thinking and its rationality, rather than on strategic considerations. In this paper, this notion will be applied in the not so life-threatening situation of regulation aimed to enhance foreign capital supply following financial globalization. In this case, the existing institutions benefitted some actors, while the transferred regulation might have benefited new groups at the expense of the old groups.

The fourth trait identified by Douglas is that we generally do not think of ourselves as governed by our institutions. Institutions are largely invisible, except one small part of the institution that she labels the ‘sacred’. The sacred part of the institution is the ‘symbol’ that the people guided by the institution protect fiercely. The sacred could be a totem or a sign (e.g., the cross) or, as we will discuss in the final part of this paper, the controlling shareholder.

In summary, Douglas shows how institutions guide actors as they try to make decisions. Actors enrench a notion of social order that is sustained by their minds so that the solution, or answer, is contained in the question. In this paper, the notion of institutional thinking will be applied to regulators facing a situation where they have to make sense of international regulation and its institutional baggage in relation to a local reality already reflecting other institutions. The next section concerns the regulator’s perspective on corporate governance. It is argued that in a situation where a regulation is transferred from one regulatory setting to another, two versions of institutional thinking may be operating: one from where the regulation’s source (with its roots in an ideal type Anglo-American corporate governance model) and one from the local setting which either adopts the regulation or on which the regulation is imposed (in this case, the Swedish corporate governance model).

7.3 The Regulator’s Perspective: Corporate Governance as a Problem

In this paper, ‘corporate governance’ is understood as a regulatory construct designed to manage the separation of ownership from control in listed firms. Corporate governance is needed from a societal perspective, as the financial capital and the skills needed to form capital by running a firm are rarely found within one and the same person (e.g. Jensen and Meckling, 1976). In governance terminology, the wealth is held by the investors and the skills by managers and would-be managers. Only in exceptional cases — e.g., when the wealthy and the skilled belong to the same family or within some small religious society (North,
1991) – will capital and skill be combined and corporate governance unnecessary. From society’s standpoint, this combination is essential for economic development; hence, regulators are commissioned to design corporate governance so as to manage the separation of ownership from control (Coffee, 2001).

In this paper, the solution to the corporate governance problem is understood to be similar to Douglas’ problem of social order as described above. Thus, the basic solution is formed into an institution. This paper takes the perspective of the commissioned regulators who are assigned by society to oversee and manage the separation of ownership and control. From the regulators’ perspective, corporate governance is a problem looking for a solution. The regulators’ solutions for addressing the corporate governance problem will institutionalize over time, thereby forming strong conceptions of how corporate governance should be carried out, and this varies between different countries (e.g. Hall and Soskice, 2001).

The practical solution to the corporate governance problem is dynamic and change over time. There are a number of reasons for this. First, how the regulators understand the problem, as well as the assumptions they make regarding the regulated, will have consequences for the regulatory outcome. For the regulator, the issue is whether capital or skills should be given priority; how to handle free-riding by wealthy; or shirking by skilled; and incentives for both; as well as the long-term development of the economy; and so on. These are basically political issues, where what appears to be proper today may well be considered flawed tomorrow. Second, the dynamics of the solutions are enhanced by the cat-and-mouse-game between the regulators and the regulated in the wake of reoccuring corporate scandals (T Clarke, 2004). Third, historical solutions are subject to path dependency, where a previous solution will guide the present one (e.g. Bebchuck and Roe, 2004). Finally, and importantly today, the strong degree of internationalization makes global models for good corporate governance fashionable (e.g. Collier and Zaman, 2005; Jonnergård and Larsson, 2007, Chapter Five).

In this paper, we describe two ideal-type solutions, based on two different versions of institutional thinking. The two solutions are theoretical and empirical constructs that attempt to solve the problems of the Anglo-American and Swedish corporate governance systems. There are other solutions available, e.g. involving unions or banks (as in Germany) or the state (as in Russia or China). The solutions described below, however, are those seen as relevant for the empirical case of this paper, as it involves the entry of Anglo-American regulation into the Swedish corporate governance system.

7.3.1 The market as the solution
In the United States in the late 1970s, Berle and Means’ (1932) classic study of the separation of ownership and control in publicly traded companies was again highlighted by the introduction of agency theory (i.e. Jensen and Meckling, 1976). The ownership of the large American corporations was found to be dispersed among small investors, pension funds and other institutional investors. The ownership dispersion created a
situation where decision-making in companies fell in the hands of the hired managers, who were considered to have somewhat different incentives than what would be socially optimal (e.g., over-investment in firm growth; see Jensen, 1986). Thus, in the U.S. in the 1970s, as in the 1930s, the agents had seized power over the principals’ assets; a problem that had to be handled by society, as capital shortage otherwise threatens to cripple the economy (Jensen and Meckling, 1976; and La Porta et al., 1999; 2000, for more modern examples). However, when the oil crises and economic decline of the 1970s turned to the 1980s economic boom, the agency theory-oriented researchers’ focus on explaining the efficiency behind the separation of ownership and control had to be revised. The answer to the puzzle was found in the market. Hence, in what could be called the agency theoretical approach to the corporate governance problem, we see a shift of focus from the by ‘agent costs plagued principals’ idea (e.g. Jensen and Meckling, 1976) to ‘by the market enriched society’ (e.g. Fama, 1980). The initial view of the separation of ownership from control as a problem was now converted into an ideal to be achieved. As Fama puts it:

*The main thesis of this paper is that separation of security ownership and control can be explained as an efficient form of economic organization within the 'set of' contracts' perspective. We first set aside the typical presumption that a corporation has owners in any meaningful sense. The attractive concept of the entrepreneur is also laid to rest, at least for the purposes of the large modern corporation. Instead, the two functions usually attributed to the entrepreneur, management and risk bearing, are treated as naturally separate factors within the set of contracts called a firm. The firm is disciplined by competition from other firms, which forces the evolution of devices for efficiently monitoring the performance of the entire team and of its individual members (1980, p. 289).*

Thus, following Fama, the hired management is not controlled directly by capitalists, entrepreneurs or owners; rather, management is controlled by the ‘market’. Fama (1980) identifies the product market and the external labour market for managers. Manne (1965) identified the market for hostile takeovers, where the theoretical understanding later was developed by agency theory (e.g. Fama and Jensen, 1983; Jensen, 1986). Beside these external control markets, agency theory also highlights a number of control functions within the firm that are based directly on the market or that support the market. Watts and Zimmerman (1978; 1983) explain the use of accounting and independent auditors to verify the managers’ accountability; in Fama (1980), it is the internal labour market that controls managers; and in Fama and Jensen (1983), the use of boards of directors in controlling management is explained. The internal functions do not need direct input from an owner or other actor; they only need information that could be inferred from the market through the company’s share price. By introducing this neoclassical view of the market, a solid and comprehensive solution to the corporate governance problem could be deduced from agency theory.

Yet somewhere along the way, agency theory turned normative. As such, agency theory has had important implications for corporate governance practice, especially in the Anglo-American world (e.g. Turnbull, 1997). One of the most common manifestations of the normative consequences emerging from agency theory is the emphasis on shareholder value. According to Lazonick and O’Sullivan:
Agency theorists argued that there was a need for a takeover market that, functioning as a market for corporate control, could discipline managers whose companies performed poorly. The rate of return on corporate stock was their measure of superior performance, and the maximization of shareholder value became their creed (2000, p. 16).

Lazonick and O’Sullivan claim that the emergence of agency theory – in addition to the awakening of the institutional investors – is the primary driver of shareholder value as a dominant form of ideology for the market-based solution to the corporate governance problem. The shareholder value perspective provides that a role be played by the owners: to buy and sell shares, and thereby efficiently provide input for management decisions. Regarded in this way, the market became the most important factor. The market provided not only a role to the owners; it also provided a mechanism to improve corporate governance: better functioning markets would lead to better corporate governance.

Following normative agency theory’s (shareholder value) view on the corporate governance problem places specific demands on the regulator. Many of these issues resolve themselves naturally through the market, while others require the regulator’s intervention (La Porta et al., 1999; Coffee, 2001). The main issue for the regulator is to allow the market to evaluate management teams. This requires some kind of independent evaluations institutions from management, such as transparent accounting (Watts and Zimmerman, 1978), independent auditors (Watts and Zimmermann, 1978, Van Lent, 1999) or independent directors (Gordon, 2007). These independent evaluation mechanisms supply the market with reliable information and thereby make the firm’s operations transparent (Coffee, 2001). According to some scholars, the regulator also needs to intervene to protect the dispersed ownership from re-concentrating, that is, strong minority protection is needed so that no easy money from exploiting minority shareholders is ‘left on the table’ to an actor using the market for corporate control (La Porta et al., 1999; Coffee, 2001).

An example of the market solution

A good example of a corporate governance mechanism, that draws its legitimacy from the market as the solution to the corporate governance problem, is the role of the independent director. In order to promote unbiased decision-making at arm’s length, it is the outside independent experts who should control management. Today, the Anglo-American market solution independence is understood with regard to both employment (managerial) and ownership; thus, the independent a director could neither come from the ranks of management (present or prior) nor hold a large ownership stake in the firm.

The move towards independent directors in the Anglo-American setting should be understood as a response to the traditional situation where management dependence was the primary solution. Problems associated with free-riding in firms, where ownership was dispersed, created a situation where management monitored itself through the board. Following corporate scandals, UK regulators (e.g. Cadbury and Higgs reports) recognized that the dependent board was part of the problem and saw the solution as having
independent directors. Following the Enron/Worldcom scandals, this approach was picked up in the United States.

The reason why the owners themselves should not sit on the board is partly due to the problems associated with minority shareholder expropriation (e.g. La Porta et al., 1999) and partly due to the prominent role that institutional investors play in the Anglo-American corporate governance systems (Lazonick and O'Sullivan, 2000). It is suggested by La Porta et al., (1999) that a shareholder who sits on the firm’s board will use the situation to expropriate wealth from other shareholders not on the board. Therefore, no owners should serve on the board. In addition, in any system for preventing insider trading, the institutional investor will prefer not to sit on the board, as the insider situation created by board work tends to undermine their entire mission (buying and selling shares). This is not only important for the institutional investors but to anyone interested in the efficient operation of the firms, as the institutional investor’s buying and selling of shares is necessary in the transfer of information to the market through the pricing mechanism. Institutional investors’ operating independently of the firm is important for the market that ultimately controls management (Fama, 1980).

Furthermore, Gordon claims that the independent director is the key to market-based control model:

*The overriding effect is to commit the firm to a shareholder wealth maximizing strategy as best measured by stock price performance. In this environment, independent directors are more valuable than insiders [...] Instead, they [the independent directors] look to outside performance signals and are less captured by the internal perspective, which, as stock prices become more informative, becomes less valuable [...] In the United States, independent directors have become a complementary institution to an economy of firms directed to maximize shareholder value (2007, p. 1465).*

Following Gordon (2007), independent directors are critical if the market is to serve as an institution that solves the corporate governance problem. The independent directors do not have the same ties to the company, its operations or its employees. The independent director will function as the link between the anonymous dispersed owners and the firm’s management team. These directors will be the physical manifestation of the volatile stock market, as they filter out noise surrounding decision-making. Thereby, the independent directors strengthen the Anglo-American market solution to the corporate governance problem. As such, independent directors are an important innovation. It is not surprising, therefore, that investors from the United States and UK who invest in firms abroad favour and demand independent directors.

### 7.3.2 The controlling shareholder as the solution

Another possible solution to the agency problems created by the separation of ownership and control takes its starting point from the involved actors. Managing this problem could be placed in the hands of those
with the greatest interest in a solution, in this case the owners. After all, while the owners may have small stakes, it is still their wealth that is being affected. In Demsetz words:

_The allegation of effective separation between ownership and control, if true, would pose a genuine puzzle. The alleged vacuum of control surely should not exist, for the self-interest of owners calls for avoiding the surrender of the control of valuable assets except to others who have similar interests. Not every owner of shares can or wishes to control management, but those who purchase shares do presume that in the typical case there will be some owners with enough at stake to oversee management_ (1983, p. 387).

Demsetz thus asserts that despite the perceived separation of ownership from control, there is often an owner who holds a greater share than the other shareholders and that this shareholder typically also oversees management. Demsetz represents a theoretical tradition called ‘Property Rights’ (see Alchian and Demsetz, 1972 and Demsetz, 1983). The property rights theory shares the same premise as agency theory (the firm as a nexus of contracts). However, property rights theory is not based upon a complex structure for the market to control management. Instead, property rights theory takes what can be considered a ‘common sense’ approach to the problems created by the separation of ownership and control. Its main principle is summarized by Demsetz: _‘All private owners have strong incentives to use their property rights in the most valuable way’_ (1983, p. 22).

Therefore, one might claim that the regulators’ challenge is to find a structure that offers the possibility for the modern corporation to achieve the same community of interests as the classical firm, that is, where the residual claimants are considered a ‘centralized contractual agent’ who receives their return after all other stakeholders are paid (Alchian and Demsetz, 1972, p. 778). Thus, following the property rights perspective, a controlling shareholder is needed who can oversee management and ensure that they act in the interest of all shareholders, and they will do so because it is their wealth that is affected.

In this paper, it is argued that the property rights approach closely corresponds to what could be called ‘the Swedish solution’ to the corporate governance problem.\(^{38}\) To develop our understanding of this alternative solution to the corporate governance problem, we turn to the research available on the Swedish corporate governance system. This section will also function as a contextualisation of the following case. It should be noted that the agency theoretical approach described above has had a very strong position in the scholarly field of corporate governance (e.g. Turnbull, 1997). As such, much of the research presented below consists of attempts to apply agency theory to a Swedish situation, or attempts to show and explain why the Swedish situation differs from the Anglo-American case.

\(^{38}\) Certainly, this is not only the Swedish solution. It is also the most frequently employed solution all over continental Europe. Also, drawing on Demsetz (1983) one could assume that this is not an uncommon solution even in the United States.
The historical background of the Swedish solution to the corporate governance problem can be traced to the Swedish post war policy and development of the general welfare model (Henrekson and Jacobsson, 2003; Högfelt, 2005). The controlling shareholders, the trade unions and the Social Democratic government all had strong motives to concentrate control over large enterprises in a few hands: the controlling shareholder because it was in their hands, the trade unions had easy identifiable negotiating parties for issues of wages and benefits, and the Social Democrats because fewer capitalists would facilitate their goal of creating socialist firms without owners (Henrekson and Jacobsson, 2003). This meant, according to Agnblad et al. (2001) that the Swedish corporate governance model came to rely on internal control mechanisms, while external mechanisms (such as the takeover market and managerial labour market) were circumvented by the existence of controlling shareholders. As the external control markets are circumvented, the internal control could not be based on the market. The internal control needs the controlling shareholder in order to function. Jonnergård and Kärreman (2004) describe how these features of the Swedish model are manifested in the operation of the Swedish boards, where active involvement from owners is the main rule. Bergström and Samuelsson (2001) explain how this system is built into the Companies Act, where the law would be constructed to empower the owners at the expense of management. How these large owners act as a control mechanism is adequately developed elsewhere, in board work (Kärreman, 1999), as internal labour markets and in internal capital markets (Collin, 1990) and in as socially controlled controllers (A Jansson, 2007; 2013; Sinani et al., 2008 and Stafsudd, 2009).

This ‘Swedish’ solution to the corporate governance problem also creates a special situation for the corporate governance regulators. The regulator must consider the trade-off between the rights and obligations of different owners, discriminating for their size. Primarily, this means dealing with issues concerning minority shareholder expropriation, preventing the controlling shareholder from using its privileged status to obtain advantages at the expense of the minority shareholders (e.g. Coffee, 2001; Nenova, 2003). When handling the issue of minority shareholder protection, the regulator is required to take measures to ensure the workings of the solution regardless of the investment horizon of the controlling owner; that is, the corporate governance solutions must be stable regardless of the controlling owner’s identity (e.g., a traditionally family-based controlling shareholder vs. a so-called ‘activist’ fund financed by foreign pension funds). The problem with the investment horizon requires that controlling ownership of a listed firm is viewed not only as a right but as an obligation with long-term responsibilities (Jonnergård and Larsson-Olaison, 2010b; A Jansson, 2013). Furthermore, the regulator’s situation is complicated by the international discourse that exists around corporate governance rules (Jonnergård and Larsson-Olaison, 2010a; 2010b), a discourse that basically demand the introduction of Anglo-American corporate governance rules. The international discourse also forms the basis for the empirical focus of this paper: the imposed introduction of an internationally accepted corporate governance code and rules on independent directors. The general trend is that corporate governance systems such as those in Sweden import rules from the system assumed to be the best, that is, the Anglo-American (e.g. La Porta et al., 1999; 2000; Coffee, 2001; Oxelheim and Randøy, 2003).
An example of the controlling shareholder as a solution

Given the differences between Sweden's approach to the corporate governance problem and the Anglo-American approach, what, then, is an independent director in the Swedish context? First it should be noted that the Stockholm Stock Exchange has had rules on independent directors since the 1990s. However, the empirical focus of this paper is on the introduction of the Swedish corporate governance code in 2005 and the rules on independent directors therein. The rules on independent directors that appeared in the final code are almost identical to the former Stockholm Stock Exchange rules. However, it is instructive to follow the introduction of the rules in the code as: 1) the enactment of the code implied a larger appropriation than the stock exchange rules regarding involved stakeholders' ability to influence content of code, 2) the code was introduced via a more transparent process and thus better suited for reliable empirical research, and 3) the code was introduced with the stated goal of enhancing Swedish corporate governance in order to attract foreign investments.

The Swedish rules on independent directors deviate from the international definition, as the Swedish rules define independence in two levels. Firstly, there must be a majority of directors who are independent of management, and secondly, there must be at least two directors who are also independent of the firms' major shareholders. As a complement to the requirement of a majority independent of management, the code also contains a rule allowing only one director from the current management team. Thus, while the international independence regulation is more strictly delineated, the independence of a Swedish director is graded into: 1) international independence (i.e., the two directors are independent of both management and owners); 2) the exception given to the physical controlling owner (the majority owner dependent and management independent); and 3) the business group exception (the minority owner dependent, present management independent while dependent on past management).

This is an interesting solution in light of the institutional environment in which rule is placed. Ownership and control of listed Swedish firms are traditionally divided into two business groups: the Wallenberg family business group and the Handelsbanken management business group (see Collin, 1998). Traditionally, the typical board of a Swedish listed firm has only one director from the present top management team and that is the CEO (Jonnergård and Kärreman, 2004). Although, more recently, it has become common that not even the CEO will hold a position on the board, the limit of only one director from the current management team is in line with practice. However, management dependence applies not only to the present day management team; previous managers are also allowed to form a minority of the board. In other words, the Swedish regulation is in line with international requirements for independence of directors from previous management. This requirement is also in line with the practices of the Handelsbanken business group, where former CEOs tend to be on key boards of the business group’s firms. Hence, from the regulators' view, there was no inconsistency between Swedish practice and international demands. The second part of the international independence rule, that a director also must be independent of the firm’s major shareholders, poses a challenge to the regulators. The Swedish Companies
Act stipulates that directors shall be appointed by the owners of the company, and it would be difficult to restrict this practice in a corporate governance code. Also, the internationally accepted requirements on independent directors collide with actual practice of publicly traded firms with controlling shareholders. In short, to introduce a regulation that limits the major shareholders to being a minority of the board would provoke major conflict with controlling shareholders and would challenge the overall solution to the corporate governance problem. This solution is well-established institutionally and should be evident below, supported by the institutional thinking amongst almost all regulators involved in the process.

Before moving on to the case, table 7.1 summarizes and contrasts the two ideal type basic solutions to the corporate governance problem described above: the Swedish concept, based on the controlling shareholders and the Anglo-American, based on the market. In this paper, the basic solution is considered to be different versions of institutional thinking that concretely manifest themselves in the contrasts shown in the table.
### Table 7.1 Market control vs. ownership control

<table>
<thead>
<tr>
<th>Theoretical basis/Institutional thinking</th>
<th>The Anglo-American solution: Market Control</th>
<th>The Swedish solution: Controlling Owners</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central party</td>
<td>The dispersed shareholders.</td>
<td>The controlling shareholder.</td>
</tr>
<tr>
<td>Coordination</td>
<td>Market.</td>
<td>Direct supervision (hierarchy).</td>
</tr>
<tr>
<td>Role of Owners</td>
<td>Buy and sell shares.</td>
<td>Serves on the board, appoint the board, oversee management and to be ‘accountable’.</td>
</tr>
<tr>
<td>Implication for the regulator</td>
<td>Primarily to be able to demand accountability of the management team. This is done by supporting independent institutions for oversight, and by facilitating the function of the market (creating transparency and disclosure). Also, certain minority shareholder protection is needed in order to maintain the separation of ownership and control.</td>
<td>Creating conditions for the controlling owner to act. This involves balancing economic incentives with the protection of minorities and thus possible capital inflow (international competitiveness). Typically, this requires some type of regulatory imports.</td>
</tr>
<tr>
<td>The role of the independent director</td>
<td>A director is either dependent or independent. An independent director is independent of both management team and owners. The independent director is the outsider who interprets the feedback from the financial market. For power reasons, the independent directors should form a majority of the board.</td>
<td>Independence, and thus dependence, is graded according to whom the director is dependent on. Dependent on present management team: one person (the CEO) – a supra majority independent board. Independent from historical management team: a minority (the Handelsbanken exception) – a majority independent board. Independent from controlling shareholder: two persons (the Wallenberg exception) – a minority independent board.</td>
</tr>
</tbody>
</table>
7.4 The Case of the Swedish Independent Director: Value of Good Connotations

In this section, the case of regulating independent directors in the Swedish corporate governance code is presented. In the case, the two versions of institutional thinking are shown to be linked to different actors involved in the regulatory process; mediated by different actors, the different versions are competing versions of reality. The case will also show how the institutional thinking (in Douglas’ terms) defines the possible solutions to a regulatory dilemma. It should be noted that the case is not concerned with the regulatory process as such but with how institutional thinking is displayed in the discussion of different regulatory solutions.

7.4.1 Case background and case study design

In September 2004, the Code Group presented a Swedish code for corporate governance. This code was intended to apply to the largest segment of firms from June 2005 (market capitalization above 3 billion Swedish krona). The rules were developed through a ‘forced self-regulation’ process in which the Swedish state played an active role. The Code Group was formed as a cooperative effort between the governmental commission of Trust and the Group formed by the Swedish business society as a response to the governmental aspirations for developing corporate governance ‘self-regulation’. As the Code Group was linked to a governmental commission, the code developing process closely resembled the Swedish legislative development process. This entailed that a first code draft was published in April 2004, and it was then edited by the Code Group following an extensive process of referrals before its final publication in September 2004. For a more detailed description of the code development process in Sweden, see Jonnergård and Larsson (2007, Chapter Five) and Larsson-Olaison (2011, Chapter Six).

In this process, a number of actors tried to influence the regulatory outcome. Some of these actors were commissioned regulators, while others represented different interest groups who tried to influence regulation from the outside. In this paper, the commissioned regulators are understood to be the regulators and the others as actors. In the following case, a clear distinction will be made between the two.

The code developing process initiated a rather substantial corporate governance debate in Swedish society. Parts of this discussion have been documented and used in this case study, see next section.

Case study materials

To form the basis for an understanding of the code development process in general and the Swedish independence regulation in particular, our data was drawn from several sources: the presented codes, other legal documents, the given referrals, archives and personal interviews with regulators.

The codes: As mentioned above, both a draft and a final version of the code were published in Sweden during the period under study. The draft was subject to a process of referrals. The draft was in many
respects heavily influenced by well-known Anglo-American codes, while the final code could be said to better mirror Swedish best practice. In this case, it should be noted that the definition of 'independent directors' was almost the same in both codes: a majority of the directors should be independent of managers and two of these should also be independent of controlling shareholders. The only important difference concerned the presence of the CEO. In the final version, it was stated that only one director from current management was allowed to be director.

Legal documents: As the code development came as a result of a governmental commission, extensive documentary material was published containing legal briefs and other statements (i.e., written statements of disagreement from individual regulators).

Referrals: As stated above, a process of referrals was conducted. This was open to a vast number of stakeholders in the Swedish corporate governance system. Some of the referrals concerned independence, and they could basically be divided into two categories: 1) Swedish controlling shareholders arguing for reduced independence regulation; and 2) Anglo-American institutional investors arguing for more independence regulation.

Archival data: The commission of trust left a rather large amount of documentation at the National Archives (Riksarkivet). These materials have been used to validate other sources used in the case study.

Personal interviews: Twelve interviews was conducted between 2006 and 2007 with Swedish corporate governance regulators participating in the code development process. Regulators from all interest groups participating in the code developing process were interviewed as well as the participating experts. The interviewed regulators were selected using a snowball sample technique; all but two targeted interviewees choose to participate. When used in the case study described below, all the interviewees are anonymous. This was a basic demand for their participation in the study.

7.4.2 The Swedish regulatory process for independent directors

This paper is written as an attempt to follow in the footsteps of the Swedish regulators issuing a corporate governance code. Most quotations in this section are from interviews made with these regulators. The regulators are in one sense trapped between international regulatory developments and the demands for effective corporate governance and their own institutionalised understanding of how corporate governance should be practiced. Two interview quotations from the same interview illustrate this:

[...] of course, it is the same issues [as in the UK codes]. But it’s not because it is mandatory, it’s because you are voluntarily required. These are the issues that are important. Then one might say that we in Sweden should – just play with the idea – ignore the issues of independent directors, audit committees and nominating committees and
other ideas that belong to the core of the international developments; obviously, we would not be particularly credible in the eyes of the international market (Regulator Interview 12, Expert).

But:

Meanwhile, it's not that we don't understand that there are fundamental differences in, if I might say so, Anglo-Saxon corporate governance and Swedish corporate governance. Obviously, these differences had to be addressed (Regulator, Interview 12, Expert).

Hence, a dilemma exists, and the regulators are very well aware of this. They understand the demands for harmonization with Anglo-American practice, while they also see differences that need to be ‘addressed’. The rest of this section will describe their reasons for doing so. This will be supplemented by the views of outside actors who have tried to influence the regulators.

How should the Swedish code group regulators respond to the international trend toward more independent directors? Their mission was to create a code. This code was intended to reflect Swedish corporate governance practice and to enhance Swedish corporate governance so as to further attract foreign investment (e.g., the proposal from the Code Group, SOU 2004:46). The popular sentiment for code development was positive (Larsson-Olaison, 2011, Chapter Six): Sweden could not be alone in Europe (together with Albania) in not having a code. In addition, developing a code provided an opportunity for a number of stakeholders in Swedish corporate governance to make their voices heard, as manifested in public hearings, reference groups and public processes of referrals. Certainly, there were also public views opposing the code development and the direction it had taken: ‘Sweden has a well-functioning corporate governance model, and this does not need to be changed’, was a common argument made by certain controlling shareholders (especially those with low risk operations, for an example see the quotation below from Lundbergsföretagens). It was especially issues of board structure and board appointment that led to heated public debate. Much of the debate among the regulators concerned how Anglo-American rules should be introduced, without actually being introduced. As one regulator, appointed by the Swedish government, puts it:

Of course, the Swedish rules do not follow the Anglo-Saxons, where the majority should be independent from both the firm and the controlling shareholders. However, we were all in agreement about this – except her [see below]. Directors who are independent of controlling shareholders do not fit with the Swedish model, where we emphasize the importance of strong owners. Therefore, the controlling shareholders must have strong influence. We had strong consensus regarding this, and thus, we still deviate from the Anglo-Saxon model, but it is important to understand that this is a deliberate statement. We think that their solution is bad and does not fit Sweden (Regulator, interview 1 appointed by government).
In this quote the ‘her’ referred to is Karin Forseke, who participated in the code group and eventually publicly stated that she disagreed with the Swedish code provisions concerning among other things directors’ independence. Forseke argued that the Swedish definition could not both differ from the international practice and at the same time be taken seriously (see below and footnote 40).

Thus, following the quote above from interview 1, a corporate governance code must contain rules on independent directors, although it is possible for the regulators to alter the actual meaning of the rules. These changes are carried out with reference to the context: The Swedish model should persist, as it is considered superior to what is found internationally; there should be independent directors, however, they should not be independent as it is understood internationally. In the interviews, the regulators often returned to the distinctiveness and superiority of the Swedish corporate governance model, i.e., the existence of controlling shareholders:

*A Swedish independence! We have a very special situation in Sweden, where we have strong owners, and the influence of the owners is important in corporate governance practice. This is regardless of whether it is small owners or large owners. This you will not find in the Anglo-Saxon rule, for instance, where the director should be independent of the owners, as you might have understood, there are two concepts of independence: that of the firm and that of the owners. That you should be independent from the owners is a rather strange conception, as the firm is owned by the owners, and the owners shall have the right to appoint the board. I find this a very odd discussion (Regulator, Interview 4, representing controlling shareholders in large firms).

Or

*where we have not only another form of acceptance, but also a positive attitude towards strong owners who participate in the governance of the firm. This is not the view over there, and this is due to the fact that the normal listed firm in the United States and England is what we call a firm ‘without master’ with dispersed ownership, while the normal thing here is a firm with one or maybe two controlling shareholders. We actually think that these controlling shareholders have a responsibility to serve as directors and so forth, while the Anglo-Saxon view is that they should keep out and decide only if they should invest or divest (Regulator, Interview 12, expert).

To the Swedish regulators, independence is still a word with very positive connotations: certainly the regulation must demand independent directors. However, the idea that independence could also be defined as independence from owners is somewhat hard to understand. The regulators tried to rationalize that the concept of independence could be flawed if it was understood as independence from owners. This was done by invoking the differences between the Swedish and Anglo-American corporate governance (or ‘Anglo-Saxon’ as the regulators often termed it). One of the regulators even used the term ‘without master’ to describe the situation of US and UK firms, where s/he felt that directors independent from owners could be useful; ‘without master’ is ‘herrelöst’ in Swedish, a word often connoting dogs, people or organizations
without obvious goals (supposedly ‘a chicken with its head cut off’ is the equivalent concept in English). The US/UK situation is contrasted with the uniqueness of Sweden, where the owners actually ‘own’ the firms. It is also worth noting how the regulator in interview 12 describes the function of the investor (owner) in the Anglo-American setting: they invest and they divest, implying that the Swedish regulator has a good understanding of the theoretical model behind the independent directors. The problem, however, is that the models do not apply to Sweden and the controlling shareholders. The problem is viewed by the regulators as a pedagogical one: why doesn’t everyone else understands what we see as self-evident? Hence:

*First, it is important to understand that the board should be dependent on the owners. To only talk about the board being independent of the owners as some – Karin Forseke and such people do – I think it is foolishness. I believe that the more owner-dependent the board, the better. Then, of course, it is not good if the board is only dependent on one owner. The board should be there for all stockholders. But how a board could be described as bad if it is dependent on the owners, I cannot understand* (Regulator, Interview 5, representing controlling shareholders in small listed firms).

Among the Swedish regulators, there was a different interpretation of the risk associated with minority shareholder expropriation compared to the view of Anglo-American institutional investors who tried to influence the Swedish corporate governance code by direct involvement in the code development process. The Anglo-American investors demanded majority ‘truly’ independent (of both management and owner) board of directors for their protection. However, the Swedish regulator pointed the finger back at the Anglo-Americans:

*We would like to point out that some of the scandals we have witnessed in the USA are caused by this, there are no opposing forces, and the management team could do as they please. Our statement [on independent directors] is deliberate. We oppose their model, there is a big value in strong owners and they must have real influence* (Regulator, Interview 1, appointed by government).

The strong owners are thus viewed as functioning as direct supervisors of the management team. Therefore, the controlling owners protect not only the individual firm but also the whole society from arbitrary expropriations by management. This influence is strongly associated with serving as director:

*In this case [the independent director debate], we saluted the Swedish model, that is – and I fully support this – that the owners should decide, and it is the owners who should sit on the boards* (Regulator, Interview 3, representing minority shareholders.)

And in that situation, having a majority of independent directors simply does not work:

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39 See above and footnote 40.
I'm damn sceptical towards that way of working, this 'good people', it is dangerous, only middle hands. To have a lot of people on semi-mandates without accountability, without personal authority, no personal accountability, it is very dangerous, to make a lot of decisions, it is only the general public's money, I did my best (Regulator, Interview 6, representing controlling shareholders).

Thus, the independent director could be described as a person without real accountability. They could be dangerous for the wealth of the shareholders rather providing guarantees for it. A majority of owner-dependent directors are needed on a Swedish board; otherwise, the firm might end up in a situation where management finds allies on the board rather than the board acting as the much needed watchdogs that the regulators were looking for.

One regulator, Karin Forseke, in the Swedish code development process had a different opinion regarding the independent directors. When the code was published, it was accompanied by a ‘written statement of disagreement’ (Swedish: särskilt yttrande):

_In my opinion, it is very dissatisfactory that the Swedish deviant definition of independence is set down in formal regulation, as different definitions will create uncertainty regarding the corporate governance of Swedish firms and thus imply a competitive disadvantage in comparison with regulation for investment in different regions (Written statement of disagreement to the Swedish corporate governance code, by Karin Forseke, SOU 2004:47)._

Karin Forseke is the dissenting voice among the Swedish corporate governance regulators in the process of developing a code. Forseke spent a number of years working in the UK, in the City, serving for a time as a non-executive of the FSA. Her argument is based on the view that the Swedish code must not deviate from international 'best practice', that is, she does not base her argument on emotions or good or bad, it is only the goal – securing international financing for Swedish firms – that matters. In the general process of developing the corporate governance code, her views received support from Anglo-American institutional investors who tried to influence the process of referrals. For instance, Institutional Shareholder Services (ISS), a US-based, corporate governance consultancy, stated that regarding independent directors

_ISS would like to propose a further extension of attention on the issue, especially considering that it is the first and foremost element through which good corporate governance practices may be implemented within a company structures. [...] We do not believe that a founder, co-founder, or a member of a founding family can be considered independent. Neither do we believe that a former executive of the company can be considered independent, even if he/she has not been employed within the company for the past three years. With respect to the number of independent_

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40 Karin Forseke declined to be interviewed for this study. Her opinions and arguments are based on public sources; therefore, we see no reason to make them anonymous.
Thus, arguing from a resource-based perspective (e.g. Hillman and Dalziel, 2003) and after stressing the extreme importance of the independent directors, the ISS believes that what we might call key aspects of Swedish corporate governance should be changed. It is very clear to the ISS that controlling shareholders is part of the corporate governance problem and not the solution.

The Swedish code group solved its practical problems with the international regulations’ comprehensive definition of ‘independent directors’ by introducing a graded definition in the Swedish code. As a first step, a majority of the board should be independent of previous management; as a second step, two of the previous management-independent directors should also be independent of controlling shareholders; and third, only one director from the present management team is permitted to sit on the board. The Swedish version of independence introduced into the code coincides with the previous regulation formed by the registration contract that the firms sign with the Stockholm Stock Exchange.

It should be noted here that during the regulatory process, there was little discussion of the first step of the solution regarding the part of the international regulation requiring a majority independent of management. In Swedish listed firms prior to the issuing of the code, the CEO was the only director who was part of the present management team (Jonnergård and Kärreman, 2004). This was also codified and thus exceeded the international blue-print. However, the code also included a rule whereby a majority of the board should be independent of management (also past), familiar to international regulation. This could be understood as an attempt to copy international praxis, although, it should be noted that the use of past CEOs as directors is the key to understanding the firm level corporate governance of the Handelsbanken business group (Sweden’s second largest business group). In this case, a measure that seems to be in line with international demands is also a continuity of local tradition.

Regarding the second step towards the solution, independence in relation to the firm’s owners, the Swedish regulators found it difficult to make sense of the provision. They simply could not see what problem the international definition of independence was aiming to solve, only that it would be in conflict with well-established practice as well as disturb the important work performed by the ‘flesh and blood’ owners (Jonnergård and Larsson-Olaison, 2010b; A. Jansson, 2013). Finally, they solved the problem after reaching two conclusions: 1) the situation in the Anglo-American context is different from Sweden; 2) the situation in Sweden is much better than in the Anglo-American context. Following this, of course, all opposition could be dismissed as coming from people with less knowledge than themselves. The only logical course of action is then not to implement a rule on independent directors in the Swedish corporate governance code at all. The quote in the beginning of this section concerning credibility in the international eyes, indicates that the Swedish code group probably never even considered this an option, thus confirming
the likelihood of the concept of independent directors as well as the strength of the international regulation. The trade-off between efficiency and legitimacy is captured in this quote:

*It is not only that most big firms in Sweden are controlled by families – or at least controlled by a few owners – but they also have been dependent on international capital for a long time, and they are, so to speak, well educated in how to get this funding (Regulator, Interview 10, Expert).*

If the firms want access to international finance, they need to listen to the international investors. If the international investors want independent directors, you give them independent directors; however the best way to achieve this is to call some of the dependent directors independent. This was the general consensus among the Swedish actors dominating the regulatory process. Only in one instance in the case study was there any outside opposition towards independent directors; in the process of referrals, one of the traditional controlling shareholders with little or no need to raise equity soon claimed:

*The code concerns the owner’s governance of the corporations. It is therefore hard to see the reason for why the code prescribes that two directors should be independent of the owners. This is an introduction of a form of minority shareholder protection. Minority shareholder protection should be governed by the Companies Act, not the code (LE Lundbergsföretagens, referral).*

To summarize the empirical data, all regulators and most outside actors agreed that a corporate governance code needs to include provisions demanding independent directors. One regulator and the Anglo-American institutional investors involved thought that independence in Sweden should be defined exactly as is done internationally (the Anglo-American way). The vast majority, and especially those who are influential, among both Swedish regulators and Swedish interest groups supported a different definition of independence. This Swedish definition of independence was to be graduated, where first one director could come from present management team, second, a majority of the directors should be independent of previous management, and third, where two directors should be independent from controlling shareholders.

7.5 Discussion and Concluding Remarks

This final section discusses the case of independent directors in Sweden in relation to the previously identified basic solution to the corporate governance problem and Douglas’ (1986) notion of institutional thinking.
7.5.1 Two competing versions of institutional thinking

Following Douglas (1986) institutions exist to solve problems of social order. In this paper, this social order is linked to solving the problem of ownership separated from control. According to Douglas, institutions govern the thinking of those who act within the institutions boundaries. The empirical material described above reveals two competing versions of institutional thinking in the materialization of a corporate governance mechanism in the Swedish regulatory setting: the Anglo-American market-based thinking and the Swedish-oriented idea based on controlling shareholders. In order to understand the relationship between the different types of institutional thinking, certain aspects of the Anglo-American version of institutional thinking should be highlighted.

The Anglo-American market-based institutional thinking is riding on a wave of financial globalization which makes itself evident by the need for regulatory transfer in the first place (e.g. Gordon and Roe, 2004 and Rasheed and Yoshikawa, 2012). The Anglo-American institutional thinking is embodied in the transferred regulation. The Anglo-American, market-based version of institutional thinking is directly supported by one regulator and the Anglo-American institutional investors, and indirectly by the Swedish state who commissioned the regulators to introduce regulation that was internationally acceptable. In the empirical part of the paper, the materialization of the market-based institutional thinking is most visible when it confronts those actors who do not fully support this way of thinking. Hence, the Swedish regulators argue against the very solution they themselves were introducing, claiming that ‘most US companies are without masters’, and that ‘in the UK the only function of the owners is to invest or divest’ and so on. The Swedish regulators show that they are intimately familiar with the Anglo-American model, that they disapprove of it, but that they are also participating in introducing regulations associated with it.

On the other hand, the adherents of the Anglo-American approach supporting their view of independence, in so far as they would be subject to this version of institutional thinking, never seemed to perceive a need to justify the Anglo-American model. They are rational (i.e., the Forseke reply) and respond to resistance with ridiculing statements rather than arguments (e.g., ISS claiming that everybody understands that the founder and his family can never be independent). For the discussion on independent directors in Sweden, this implies a claim: everybody knows that in the Anglo-American sense, independent directors are good regardless of whether these directors have the capability to interpret market signals or are competent in some other way (compare the ISS reply above, drawing on resource base theory rather than agency theory for support). Therefore, in the ‘export situation’ created by financial globalization, and put in the terms of Douglas (1986), independence becomes the sacred, a visible aspect of the Anglo-American corporate governance institution.

The second version of institutional thinking revealed by the case is based on the myth of the controlling shareholders. This thinking appears in all the interviews. When describing the foreign solutions (i.e., independence) that they need to adopt, the regulators emphasize the need for the regulation to fit the Swedish model, a model which they perceive as heavily dependent on the owners. It is while following the
reasoning of the Swedish regulators that the conflict between the different versions of institutional thinking becomes evident. On one hand, it is necessary to introduce regulation on independent directors – how should they otherwise be credible internationally? On the other hand, the role of independent directors should remain a ‘Swedish independence’ as one regulator expressed it. The Swedish regulators are close to make ridicule of those who oppose them rather than presenting arguments to support their own view, e.g., ‘the owners own the firm’ or ‘it is foolishness’. The Swedish regulators exhibit a thinking that appears to adopt change, but in fact only perpetuates the previous solution to the overall corporate governance problem. They have, in the words of Douglas (1986), a distinctive thought style that sustains their Swedish ‘tradition’. Sustaining social order when it comes to corporate governance is an institutionalized practice that, in Sweden, rests on the importance of the controlling shareholder. This solution demands independent directors, but their independence should be limited. The Swedish adaptation to the imposition of international regulation is, at best, reluctant, and at worst, a façade.

Similar to how the independence amongst directors appears as the answer to corporate problems in the Anglo-American thinking, the more active owners appears as the answer in the Swedish thinking. Present in both versions of institutional thinking, is the answer-machine approach identified by Douglas, an approach characteristic of an institution that is ultimately resistant to outside imposition or internal innovation and that keeps repeating: ‘more active owner involvement’ from Swedish actors and ‘more independence’ from actors connected with the Anglo-American institutional thinking.

7.5.2 The controlling shareholder as sacred

Returning to the Swedish corporate governance system and the institutional thinking present there, Douglas (1986) argues that actors entrench social order by forming institutions. In our case, the controlling shareholder is a central part of the institutional solution for separating ownership from control. Does the case support Douglas’ argument?

Douglas (1986) asserts that most parts of the control exerted by the institution are invisible to those actors within it. In our case study, the problem of separation of ownership from control is not very visible. The issue of whether the managers could seize power is present only when the regulators discuss the situation elsewhere (in the ‘Anglo-Saxon’ countries). Instead, they emphasize how they and the whole country view the controlling shareholder: with great respect. The regulators tend to return to the controlling shareholders, as a ‘frantic’ answer, as Douglas describes this.

In Douglas terminology, the explicit part of the institution is referred to as the ‘sacred’ (drawing on Durkheim). According to Douglas, the sacred could be recognized by three characteristics: 1) dangerous to challenge; 2) attack generates emotions in defense; 3) it is invoked explicitly by sacred symbols, (1986, p. 113). These features certainly coincide with the way the concept of controlling shareholder is articulated by
the Swedish regulators interviewed in this study. The controlling shareholder is ‘sacred’ among the Swedish regulators in their view of the Swedish corporate governance system. The controlling shareholders are the sacred symbols of the institution, where separation of ownership and control is made possible, although they have no special sign or totem that could be invoked. To challenge this order is dangerous: the Anglo-American institutional investors should take care of their own backyard, and the Swedish regulators see themselves as trying to protect the country from a situation where firms lose their masters. The interviews also show emotional defense: the regulators are cursing and calling actors with other opinions ‘stupid’ or ‘foolish’. For the regulators, it is impossible to see any other solution to the problem of separation of ownership and control. To quote Douglas: ‘The sacred makes a fulcrum on which nature and society comes into equilibrium, each reflecting the other and each sustaining the known’ (ibid.). Thus, an attack on the controlling shareholders is an attack on everything good.

7.5.3 Independence connects with all thinking: good connotations
Regardless if independence is considered as sacred (the Anglo-American institutional investors) or whether it is seen as a practical necessity in order to achieve legitimacy (the Swedish regulators), it is obvious that both versions of institutional thinking are compatible with the concept of independence. This is in spite of the fact that they define ‘independence’ in very different ways. The concept of the ‘independent director’ seems to have positive connotations for all actors, regardless of which versions of institutional thinking is operating. Thus, independence is perceived as desirable, even if independence may stand for very different things. Therefore, a discussion between two people committed to different versions of institutional thinking could end up being very confusing. Such confusion is seen in our case material. Basically, the only thing that Swedish regulators and Anglo-American institutional investors agree upon is that independence among directors is one of the most pressing corporate governance issues internationally and that it signifies ‘good’ corporate governance. In mediating between different versions of institutional thinking, Douglas (1986) uses the metaphor of ‘diplomacy’, and we will return to the prospects of diplomacy below.

The fact that different versions of institutional thinking all have positive, desirable connotations has implications for how we might think about the consequences of internationalization of corporate governance. The concept of independent directors is a key issue for regulators (e.g., the Higgs commission and the interview quotes) as well as scholars (e.g. Gordon, 2007). However, when local regulators are assigned to implement international regulations, it might be the case – as in this case – that they have the institutions to do their thinking for them. As shown in the case, the attachment of independent director to different versions of institutional thinking may imply that different meanings and cognitive schemas define the concept in different ways, leading to differences in practice. As noted in the introduction, a growing body of research focuses on how the globalization of financial capital does not necessary foster convergence (Buck et al., 2004; Lutz, 2004; Collier and Zaman, 2005; Jonnergård and Larsson, 2007, Chapter Five; Yoshikawa et al., 2007; Aguilera and Jackson, 2010). In this paper, the role of institutional thinking that regulators are committed to is proposed as one possible explanation for this divergence.
It appears that the internationalization of financial capital partly occurred through the creation of labels with unarguably positive connotations, such as the label ‘independent directors’. These labels are then affixed to corporate governance mechanisms (practical solutions following from the institution, [Douglas, 1986]), in this case, to some of the firm’s directors. However, the cognitive content of the mechanisms varies according to which institution that does the thinking (in this case, the market-based or the controlling shareholder-based). This results in a situation where the same mechanism is infused by the competing versions’ institutional thinking (in this case the Swedish notion of the independent director vis-à-vis the international notion). Both versions of institutional thinking consider the mechanism of independent directors to be important; however, there is a big difference in the relative importance each version ascribes to the independent directors. That is, the role of the independent director varies depending on what institution does the thinking and on how they solve the corporate governance problem. In this paper, two version of institutional thinking have been discussed, the empirically investigated Swedish and the theoretically constructed Anglo-American, and in these two solutions to the corporate governance problem, the role of independent directors is not equal. In the market-based solution to the corporate governance problem, the independent director is a visible part of the institution, one of the defining elements of ‘good’ corporate governance. The demand that independent directors be put together with other regulations that express this institutional thinking gives the Anglo-American model of corporate governance its reputation as the ‘superior’ or ‘most demanding’ type (e.g. La Porta et al., 1997 or Oxelheim and Randøy, 2003). It creates the basis for the uncontested desirability of the independent director. In the institutional thinking where the controlling shareholders are the key to solving the corporate governance problem, the independent directors are merely a support mechanism that assists the firms in procuring international financing (compare interview quote by regulator 10, who describes firms as being dependent on international finance for a time, and that the firms are well educated to get it). As such independent directors could not interfere with the overall solution to the problem (the controlling shareholder). The regulators adjust to what independence is, and in the words of one of the regulators quoted above, creates ‘a Swedish independence’.

7.5.4 ‘Diplomacy’ between institutional thinking and the political economy
Scholarship from the dominant perspective on corporate governance, e.g. La Porta et al., 1998; Bebchuk and Roe (1999) or Morck and Steier (2005), provides vivid accounts of how entrenched groups, such as the controlling shareholders, have ‘captured’ the regulator, or even whole nation-states in order to pursue their own interests at the expense of other stakeholders. If this research had been used as a starting point, the analysis would probably point out that many of the regulators were in fact controlling shareholders themselves or appointed by controlling shareholders. Such an analysis would see the case presented above as a result of the material situation at hand, rather than some ‘sacred’ institutional practice. However, although
these two approaches probably do not exclude each other, there are indications that the material situation does not explain all the data in our case.

First, while many of the regulators were indeed connected to controlling shareholders, and thus had an economic interest in the present solution, other regulators representing stock exchanges, minority shareholders, the state, as well as academic experts all exhibited the same institutional thinking and faith in the controlling shareholders as the solution. For instance, the regulators who represented minority shareholders, from an organization that has been very vocal on minority shareholder protection in Sweden, spoke positively of the Swedish independent directors: ‘we saluted the Swedish model, that is – and I fully support this’. Also, if we look to the outside actors who tried to influence the process, there were a number of controlling shareholders who opposed the very idea of introducing the code (represented in the case above by the referral from the Lundberg group). Thus, if the controlling shareholder were in total control, there would not even be a discussion and no introduced regulation on independent directors. The only regulator in opposition had worked for a long period abroad; and among those who responded in the process of referrals, only those actors outside the geographical context of Sweden provided answers that were not in line with the regulators. Thus, in explaining the regulatory outcome of ‘a Swedish independence for a Swedish company’, the most viable explanation is that we are witnessing thinking among actors who jointly are committed to a certain institution – that of the controlling shareholders.

If we accept that different versions of institutional thinking come into play in the transfer of regulation following financial globalization, we need to understand how these versions are mediated in practice. Douglas (1986) proposes the metaphor of ‘diplomacy’. Following Douglas, to introduce independent directors into a corporate governance system as the Swedish is not a routine decision. It is indeed a question of (institutional) life and death. Applying the international definition of independent directors would pose a major threat to the Swedish corporate governance model, as it would effectively eliminate the controlling owners from the boards and remove their ability to function as physical controllers of management. The controlling shareholders would indeed lose relevance.

It is in the interface of introducing independent directors or introducing ‘Swedish’ independent directors that Douglas and modern political economy research meet. Following Douglas, it is easy to see why there is conflict between Swedish regulators and UK/US institutional investors: they do not share a common world view. Hence, in conflicts

between institutions of the same kind, based on the same analogies from nature, and sealed with the same ideas of justice, diplomacy has a chance. But diplomacy between different kinds of institutions will generally fail. Warnings will be misread. Appeals to nature and reason compelling to one party, will seem childish or fraudulent to the other (Douglas, 1986, p. 126).
Indeed, each side in this conflict ridicules the other, and they certainly show no understanding of the other’s position. In this paper, it is argued that this is because their institutional thinking is not based on the same analogy: the UK/US institutional investors think ‘market first’, and the Swedish regulators think ‘controlling shareholder first’. Following Douglas, there would be no room for diplomacy between them, and the most powerful actor must ‘win’. Certainly this would be the observation made by political economy scholars in the first place (e.g. La Porta et al., 1998; Bebchuk and Roe, 1999; and Morck and Steier, 2005), although it would oppose the popular belief in the strength of international financial markets as a strong driver for change (e.g. Gordon and Roe, 2004; Hansmann and Kraakman, 2004). This conclusion indicates a complex relationship between financial capital globalization and corporate governance change. One part of how this relationship could be understood lies in understanding the different versions of institutional thinking at play.

Finally, table 7.2 summarizes the discussion regarding the basic solution to the corporate governance problem and its relation to Douglas’ (1986) notion of institutional thinking.
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<table>
<thead>
<tr>
<th>Table 7.2 Concluding the case</th>
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<tr>
<td><strong>The market solution</strong></td>
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<td><strong>Institutional classification</strong></td>
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<td><strong>Answer-machine institution</strong></td>
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<td><strong>Important decision guided by institution</strong></td>
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<td><strong>The invisible and sacred</strong></td>
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8. DISCUSSION: COMPARATIVE CORPORATE GOVERNANCE AND THE LEGAL TRANSPLANTS

The articles presented in Chapters Three through Seven are empirical examples of the change in the Swedish corporate governance system through the transplant of regulation that originated in an Anglo-American context. In this chapter, the five articles are discussed in light of the transplant literature and other relevant sources. This is followed by a further discussion of the implications of the new insights for the dominant comparative corporate governance research paradigm and its view of legal transplants.

Let's begin with a brief recapitulation of the transplant concept and how it has been used. In Chapter One figure 1.1 was introduced describing legal transplant as a staircase. The main point of the proposed figure 1.1 was to capture the differences in existing literature on the ‘success’ of legal transplants. Watson (1974) argues that a successful legal transplant has occurred when law from one country is observed on the books in the receiving country; this is referred to here as the transplant as text criterion. A stronger requirement for success, as proposed by Miller (2003) is when the transplanted rule is actually observed in the receiving country (transplant as practice criterion). The final step in the staircase resembles Mattei’s (1994) more or less extreme demand that a successful legal transplant must generate the same social outcome in the receiving country as in the source country, a criterion called ‘transplant as outcome’.

8.1 Example 1: Stock Repurchases (Chapter Three)

During the 105 years between 1895 and 2000, the repurchase of the firm’s own stock was prohibited in Sweden. The ban was justified by the regulators as a means of protecting both creditors and minority shareholders from being abused by controlling shareholders. The ban as such was motivated by previous abuse. In 1997, however, (SOU 1997:22) the Swedish regulator states:

*The Swedish rules regarding corporations repurchases of their own stock is more restrictive than corresponding rules in other countries. The committee’s review of the legal situation in other countries shows that all EC countries today allow for stock repurchases following the European Union’s second company directive. […] Only Liechtenstein

Further:

The Swedish business community is very eager to achieve the same possibilities as in the other countries with which we usually compare ourselves. [...] The committee understands their demand. [...] It appears as a disadvantage that Swedish firms do not have the same possibility (SOU 1997:22, p. 250, author's translation).

The regulators of the Swedish corporate governance system thus argue for harmonisation of regulation so that the Swedish corporate governance system would not fall behind. In the documents of the regulatory committee written prior to proposing the legalisation on stock repurchases for Swedish firms, much space was devoted to the discussion of the importance of stock repurchases in the American corporate governance system. Regarding the Swedish regulators’ discussion of stock repurchases in the American corporate governance system, the regulators use references to American research regarding motives for the repurchasing firms. Furthermore, this body of research basically tests the same hypothesis as in the article presented in Chapter Three. However, the Swedish regulator uses the American hypothesis as an argument for allowing stock repurchases in Sweden, i.e., stock repurchases should be allowed in Sweden so that the firms could adjust their capital structure towards an optimum and so on. The arguments thereby reveal an intention from the regulators to reach a similar situation (same social outcome, Mattei, 1994, transplant as outcome criterion in figure 1.1) in the Swedish corporate governance system as in the U.S. However, what was thought of as empirically testable theoretical hypothesis in the American setting (albeit confirmed in much research) was for Swedish regulators a normatively desired result of the transplanted regulation. In the regulatory committee’s report, no space was devoted to any real discussion of differences between the situation in Sweden vis-à-vis America, and how that might influence the actual stock repurchasing behaviour of Swedish firms. It is only in a stated objection by one of the participants of the committee is this questioned:

The need for international harmonisation is, and should be, a guiding star for the design of such rules. However, it is not possible to uncritically accept foreign rules without taking in account the design of the regulatory system in general (Stated objection, Lars Millberg, SOU 1997:22, p. 426).

To accept or not to accept was never an issue to the regulator. Sweden, as an EU member, must work for harmonisation in the single market and, in the year 2000, Swedish firms were again allowed to repurchase their own stock. Drawing on the dominant comparative corporate governance research tradition (e.g. La

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41 In a Swedish public investigation, the members are thought to represent the mission of the investigation, but it should be noted that in many other circumstances, Lars Millberg represents the Swedish Shareholder Association, an organization representing minority shareholders.
Porta et al., 1997; 1998; Hansmann and Kraakman, 2004), one could thereby argue that the Swedish corporate governance system converged on the best model regarding corporate financial distributions. This was achieved by the transplantation of international (Anglo-American) regulation. Finally, this was done with a direct reference to the competitiveness of the Swedish corporate governance system.

Thus far, the study of the re-introduction of stock repurchases in the Swedish corporate governance system follows Hansmann and Kraakman’s (2004) ‘end of history’ and their ‘strong convergence’ thesis. It further aligns with the argument that the most important tool in this process is the introduction of rules and regulations (see La Porta et al., 1999; 2000; Coffee, 2001 and Pistor, 2004), rather than more market-based spontaneous change. Therefore, it is concluded, that the new Swedish regulation on stock repurchases is a successful legal transplant ‘on the books’ (Watson, 1974; 2000; 2001, successful following the transplant as text criterion). This would imply that a piece of regulation from a source country (USA) found its way to a receiving country in the same manner as Watson empirically found Roman law to be travelling to the outer reaches of the empire. Also, as the empirical evidence in Chapter Three suggests, a number of stock repurchasing programs were initiated by Swedish firms; thus, the transplanted regulation came into use, thereby meeting the transplant as practice criterion of successful legal transplants (Miller, 2003, compare Kanda and Milhaupt, 2003).

Turning to the actual use of the new rules by the Swedish firms, however, as seen in Chapter Three, the story of this transplant becomes more complicated in relation to the transplant as outcome criterion, which requires the same social outcome as in the source country (Mattei, 1994). The chapter, drawing on agency theory and American data, puts forward the following hypothesis to be tested on Swedish data:

1. Firms repurchase their own stock in order to adjust their capital structure towards an optimum.
2. Firms repurchase their own stock in order to distribute temporary shocks of cash.
3. Firms repurchase their own stock instead of distributing cash through dividends.
4. Firms repurchase their own stock to protect the firm from hostile takeovers.

Furthermore, a number of corporate governance variables are used to test if they could explain stock repurchases: i) typical Swedish corporate governance, measured by existence of controlling shareholders and different voting rights, and ii) large influence of Anglo-American corporate governance, measured as parallel listing on a stock exchange in either the UK or the United States.

The empirical study of stock repurchases reported in this chapter analysed the five first years in which repurchases were permitted, from 2000 to 2004, for all Swedish firms with the possibility to repurchase stock. Technically, both pair-wise tests comparing repurchasing and non-repurchasing firms (Wilcoxon/Mann-Whintney U-tests), and regressions (OLS) were calculated. The main results of this analysis could be summarised as:
1. Swedish firms with more dispersed ownership repurchase stock to adjust their capital structure towards optimum.
2. Swedish firms do not use stock repurchases to distribute temporal excessive cash.
3. For Swedish firms, stock repurchases do not replace dividends. Rather, stock repurchases complement dividends.
4. Swedish firms do not repurchase stock to fend off threats from the take-over market.
5. Swedish firms with parallel stock exchange listing in the United States or UK are overrepresented in the group of repurchasing firms.
6. Swedish firms with differentiated voting rights are underrepresented in the group of repurchasing firms.

The main question of this chapter was: Do Swedish firms repurchase stock for the same reasons as American firms do? This does not appear to be the case according to the results of the study. Instead, the findings suggest that the regulator would like to adopt the system to be more similar to what is internationally accepted. This is done by the introduction of a new regulation. When the regulation is used, and not-used, by the different actors of the new system, it rather seems to strengthen the distinctive character of this system, as more ‘Anglo-Americanised’ firms (those with more dispersed ownership and parallel listings) prove to differ less from what is expected from research in an Anglo-American setting, in terms of repurchasing behaviour than the more traditional Swedish firms (with more concentrated ownership and with dual class shares) that tend to stand out by not meeting the hypothesised behaviours.

Therefore, the difference between the few ‘Anglo-Americanised’ firms and the majority traditional ‘Swedish’ firms grow as the new regulation is introduced, making the already ‘Anglo-Americanized’ firms more ‘Anglo-American’ and the ‘Swedish’ firms more ‘Swedish’.

That the firms with parallel listing in the UK and the U.S. are overrepresented in the group of repurchasing firms could be expected. These firms have already shown an openness towards Anglo-American corporate governance practices, and they need to conform to the norms that are important in this system (compare Oxelheim and Randøy, 2003). The large chunk of repurchasing Swedish firms are not, however, parallel listed, and their repurchasing pattern is distinctly different from the American hypotheses. If the firms do not use stock repurchases for reasons tested in this chapter, they must use stock repurchases for other purposes, thus not fulfilling the regulators’ intentions of a more ‘Anglo-American’ firm behaviour. This means that somewhere along the implementation process, the new regulation – introduced with the intent to alter the system – has instead been altered by the system. This is in line with the general lesson from legal studies, where the contextual setting matters (Legrand, 1997; Nelken, 2001), even though the same rules exist on the books and are used by the actors. In this study, therefore, it is probable that the basic cause behind the alteration of the newly introduced regulation can be found among certain elements of the corporate governance system receiving the transplant.
Certainly, compared to other corporate governance transplants, the regulation that allows share buybacks in Sweden came into use (successful transplant following the transplant as practice criterion, Miller, 2003). Nor did it disappear, as occurred with the fiduciary duty in Japan (Kanda and Milhaupt, 2003), or as occurred with the corporate law in Vietnam (Gillespie, 2002). On the contrary, several Swedish firms instantly introduced stock repurchasing programs. One could conclude that the firms found use for the new regulation. Thus, in this Swedish case, it was not necessary for other institutions in the system to ‘catch up’ (Kanda and Milhaupt, 2003), as the rules could be used instantly. According to the model proposed by Kanda and Milhaupt, this rapid adoption could be explained by lack of alternatives; that is, the new regulation helped the firms achieve what had previously been prohibited. Stock repurchases are in many ways equivalent to dividends; it is a method to distribute cash to stock owners, though with an important difference that it has the ability to change the ownership structure of the firm. Thus, following Kanda and Milhaupt, the reason why firms chose to repurchase shares in Sweden is not among those expected from the American hypothesis. In Sweden, stock repurchases provided new possibilities for the owners/board of directors of Swedish firms (e.g., to strengthen/preserve a concentrated ownership structure of the firm while distributing cash in good times in traditional ‘Swedish’ firms; and e.g., to signal conformism with Anglo-American practices in more ‘Anglo-Americanized’ firms). This is certainly plausible, as no opposition was voiced to adopting the new stock repurchases regulation by the ‘entrenched interests’ (Coffee, 2001; Hansmann and Kraakman, 2004) of the Swedish corporate governance system (being the controlling owners). As pointed out by DC Clarke (2006), the structure of interest group power in the United States, which early on demanded the possibility for share repurchases, is probably centred around powerful business leaders (that is management in a system of dispersed ownership). As such, it is not similar to the Swedish interest group in power, which is probably centred around powerful business leaders with controlling stakes in the firms (see section 1.3.4). Therefore, important underlying circumstances such as ownership concentration affect the use of the transplanted rule (also see Varotttil, 2009, for a similar situation in India, producing different social outcomes – a failure to meet the success criterion for transplant as outcome, although meeting the criteria for both transplant as text as well as transplant as practice).

The argument here is that the regulated actors of the system are making the rule adapt to their needs and interests. That is, the actors are fitting (a verb) the rule rather than the rule is fit (a noun) to the system, as in the Kanda and Milhaupt’s (2003) case. For Kanda and Milhaupt, the receiving society needed to develop in other areas in order to fit the transplanted rule. In the Swedish case described here, it is the rule that is fitted and the metaphor to use would be an Italian tailored suit, rather than a much too large sweater that the (social) body has to grow into, as proposed by Kanda and Milhaupt. This draws the attention to some sort of localization process (Gillespie, 2008a) of the transplanted regulation. However, Gillespie’s localizing concept requires a regulator who in some manner adopts the transplanted regulation to fit both international demands and local reality. In this case, the regulation looks the same as it is on the books.

42 Also, it could be claimed that a halted repurchase program is not received as badly among investors as a cutback in dividends.
However, regulated firms and owners of these firms use the transplanted regulation in a manner quite different from the Anglo-American regulation. In the further analysis of the Swedish transplants performed in this study, the central analytical distinction will be between localizing – as an act carried out by regulators – and fitting – as an act by those who are being regulated.

Meanwhile, the special circumstances that lifting a ban implies need to be acknowledged. Compared to the other transplants described in this book, where the regulators command firms to carry out certain measures (like introducing a nomination committee or complying with a code, see the following sections), the existence of a ban would signal a propensity for firms to actually repurchase stock if they were not stopped. That is, allowing stock repurchases gives the firms’ new possibilities, while the other examples limit the firms’ options. It is reasonable that this could explain the differences compared to Kanda and Milhaupt’s (2003) case described above, where Japanese society needed to develop before anyone had use for fiduciary duties. Similarly, in Gillespie’s (2008b) case, the transplanted corporate law was not used by those who needed it most, while many Swedish firms immediately initiated repurchase programs. Thus, it is claimed in this book that different outcomes of legal transplant processes could occur depending on different types of regulation, i.e., the lifting of a ban is different than a command-like attempt to force the regulated to comply with international norms. Following this observation, it could be claimed that a new typology of different sorts of transplanted regulations could be needed to further understand different transplant outcomes. Such a typology could be a complement to Miller’s (2003) typology based on the factors that motivate legal transplants (i.e., cost-saving or legitimacy generating), and a promising area for further research in legal studies.

Finally, we must also point out that allowing stock repurchases in a Swedish context – once banned as a threat to both creditors and minority shareholders – is probably still a threat. This is due to the existence of large shareholders in most Swedish firms, who by controlling the firm’s stock repurchases could influence the capital structure and the ownership structure of the firm in a manner that is harmful to other, smaller, owners. Although the regulator claims (SOU 1997:22) that these problems would be remedied by the demand for the firms to manage stock repurchases as dividends, this question is nonetheless still open for debate among different owner categories in Sweden. This conflict is demonstrated in Jonnergård and Larsson-Olaison (2010b), where a proposed repurchase program in the listed firm SSAB, supported by the controlling shareholder, was cancelled after substantial critique from minority shareholders. To the minority shareholders in SSAB, it was very important which class of stocks were repurchased, as SSAB has a traditional Swedish structure of voting-strong A-shares and voting-weak B-shares, and if the free floating A-shares (that is, the A-shares not owned by the controlling shareholder) where repurchased and annulled, the controlling shareholder would gain votes without paying. Viewed in this way, the comparative corporate governance research ‘convergence by regulatory transplant story’ (Coffee, 2001; La Porta et al., 1999; Hansmann and Kraakman, 2004) does not describe the Swedish situation, as allowing stock repurchases does not provide enhanced protection for minority shareholders (see La Porta et al., 1997; 1998; 1999) or protecting the dispersed ownership from re-concentration (Coffee, 2001). Arguably, among
some Swedish minority shareholders stock repurchases is viewed as potentially having the opposite effect – an increase in minority shareholder expropriation and simultaneously higher ownership concentration (Jonnergård and Larsson-Olaison, 2010b). This implies, that the introduction of a rule transplanted from a foreign context could function in a different way when implemented just due to variation in the ownership structure of firms in the system (also see Varottil, 2009). However, such an observation might better correspond to the transferred rule as an ‘irritant’ causing unforeseen consequences in the receiving corporate governance system rather than a simple transplant (Teubner, 1998; Cankar et al., 2008).

8.2 Example 2: Nomination Committees (Chapter Four)

Depending on early interest from the Swedish Shareholder Association (organising small shareholders) and some of the institutional investors, the nomination committee has been one of the most contentious corporate governance topics in the 1990s and 2000s in Sweden. Nomination committees, as well as other board committees such as the audit committee and remuneration committee have been at the centre of international corporate governance reform debate since the early 1990s and the Cadbury report. In practice, this implies that in every case, nationally or internationally, where there has been a corporate governance code issued, the code included a demand for these committees. In short, one might say that the standard solution for improved corporate governance has been better, or more fair, monitoring of management through the introduction of British-style board committees.

If one were to ask, using a questionnaire or perhaps an index variable like the La Porta et al. (1998) ‘anti-director index’: ‘Has Sweden converged on the internationally accepted best practice regarding board nomination?’, the answer most likely would be: ‘Yes, in Sweden the regulation demands nomination committees, and the firms tend to follow these rules’. Arguably, there is a correspondence with the law on the books (transplant as text, cf. Watson, 1974; 2001), as well as the fact that the regulation is used in the receiving society (transplant as practice, following Miller, 2003). Compare this with the Indonesian case (Daniel, 2003), where Indonesian firms simply ignored the corporate governance code. In Chapter Four on Swedish nomination committees, however, the question of convergence and successful transplants becomes a little less straightforward. The chapter describes the 11 years following the establishment of the first documented Swedish nomination committee, at Volvo in 1993, until the regulators (the Code group) made the nomination (election) committees mandatory for the largest firms in 2004. The first Swedish nomination committee was something completely different than the British Cadbury nomination committee and this prevailed during the years. In this sense, we might speak of a uniquely ‘Swedish nomination committee’, in as much as it had a different design, member composition and formation. For sake of argument, these differences are summarised in table 8.1:
Table 8.1. Nomination committees.

<table>
<thead>
<tr>
<th>Connected to the following corporate body</th>
<th>Annual General Meeting (AGM).</th>
<th>The Board.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Members</td>
<td>Owner representatives on and off the board, the chairman of the board.</td>
<td>A majority of board members independent from management and owners, a minority of management-dependent directors.</td>
</tr>
<tr>
<td>Duties</td>
<td>Prepare board elections for the AGM.</td>
<td>Make a recommendation for new directors to the board (the Combined Code) for the AGM to decide (UK Companies Act).</td>
</tr>
<tr>
<td>Function</td>
<td>From the beginning a practical solution to the director nomination problem in firms that do not have controlling shareholders. Later on, a transparent solution where the largest owners meet and where institutional investors were forced to take 'owner responsibility'.</td>
<td>The purpose is to decrease the management-dependent directors’ influence on the board’s work, that is, hinder self-control in a setting where the board is self-sustaining.</td>
</tr>
</tbody>
</table>

From table 8.1, it becomes clear that the common denominator, besides director nomination, between the British original nomination committee and Swedish transplanted one is the name, and even the name corresponded only to the official translations. Transplanting the nomination committee to the Swedish corporate governance system was characterised by a complete de-coupling between name and form. This is similar to the findings of DC Clarke (2006), where corporate governance transplants to China, revealed a complete changed in practice, except for the name (also see Wise, 1990). We need to focus, however, on the lens used in the different transplants studies. If we compare the account given in Chapter Four of the nomination committee process in Sweden with DC Clarke’s (2006) account of the ‘Aufsichtsrat’ and the ‘independent directors’ in China, we will see that DC Clarke does not take into account the importance of the local actors (compare Gillespie, 2008a; 2008b). In the Swedish case, nomination committees were introduced by a large number of firms before they became mandatory. These firms were supported, or
perhaps influenced, by different interest groups (such as small, international and institutional investors). In fitting the rule’s format to their own needs, the structure of the Swedish interest groups is demonstrated, and most probably also the changing power relations therein (see Jonnergård and Larsson-Olaison, 2010b and 2013, as well as Nachemson-Ekwall, 2012, for accounts of the power struggle between different owners in the Swedish corporate governance system). There is nothing in the data that indicates that these changes in the rules for nomination committees were based on some kind of misunderstanding by the Swedish regulators (as was DC Clarke’s, 2006, interpretation of the Chinese case). Rather, it occurs to be the other way around. The Swedish regulators fully understood the ownership structure and power relations of the Swedish corporate governance system, and in order to apply the rule, they adapted it to Swedish conditions, and thus localized it (compare Gillespie, 2008a). Certainly, the local actors’ ability to localize the incoming regulation to local conditions limits the usefulness of regulatory transplants in the political ambition to achieve convergence. Nevertheless, the empirical study of such transplantations increase our understanding of the receiving corporate governance system and the role played by regulation in changing such systems.

This rather strange occurrence creates a need to adopt the previous literature’s idea of criteria for accepted legal transplants. A rule, in the form of a label, could be placed on the books (transplant as text) and used (transplant as practice). However, if the wording of the rule – its legal content – is different (as marked above in table 8.1), then it can be concluded that the transplant has been rejected as transplant as text, and thus logically, rejected following the transplant as practice criterion. That a rule could be transplanted as a mere label is certainly known in previous literature (e.g. Wise, 1990; Dezalay and Garth, 2001; DC Clarke, 2006). However, this phenomenon has not been conceptualized in the general discussion on legal transplantation and criteria for successful transplantation (see Nelken, 2001). Instead, referring to previous literature, when only a label is transplanted, it is viewed as yet another example of a rejected transplanted rule. In this study, to transplant a label is also a successful transplant; it is a signal of conformity to an influential corporate governance model, albeit not as strong as a transplant of the content of the rule. Below (8.6.1), this phenomenon will be conceptualized by sub-dividing successful transplant as text (on the books, Watson, 2001) into transplant as label and transplant as content.

In relation to comparative corporate governance research, a key result of the analysis in Chapter Four concerns the great variety of practices that the firms could concede under the umbrella of the term ‘nomination committee’ prior to regulatory intervention. A nomination committee could be formed within the board, outside the board or with half the members within and half the members outside. The positions could further be held by large owners, smaller owners, CEOs and even suppliers in rare cases. In fact, almost anyone could hold this position as long as they were not independent directors (as they should be in the UK blueprint). This great variety existed until the regulator forced coherence through a single solution. One should not forget, though, that the direction pointed out by the regulator was already followed by the most influential firms (the largest, with the largest ownership dispersion and with the greatest public interest). Logically, this follows from the concept of code regulation and its dependence on ‘best practice’
In a Swedish setting, best practice is most likely to exist among the most influential firms, comparable to the use of the concept of ‘good practice’ (Swedish: *god sed*) in financial market regulation in general although most well-known within accounting, where ‘good practice’ is defined as ‘actual practice among a qualitatively representative group of accountable firms’ (Swedish: *en faktiskt förekommande praxis hos en kvalitativt representativ krets bokföringskyldiga*). This fact suggests two things: i) the regulators’ possibility to create solutions outside the system might be limited, that is, the regulator might look to the outside although the actual solution will come from the inside; and ii) the Swedish system contains mechanisms to create internally convergent, although externally divergent, corporate governance practices; that is, practices within different local firms come to resemble each other without necessarily becoming more similar to international practices.

In the case of the Swedish nomination committees, this means that the analytical distinction between fitting and localizing becomes important. As pointed out above, ‘localizing’ refers to actions of the regulator when mediating between local and international demands (Gillespie, 2008a), while ‘fitting’ refers to the actions by the regulated party when adopting international regulation to their own need (an adaptation of Kanda and Milhaupt’s, 2003, concept of fit). It is obvious that finally, when the nomination committees became mandatory, the regulator localized the regulation (Gillespie, 2008a), as the international label was intact but attached to other practices. These practices however, were not random or constructed by the regulator. They were the result of the regulated firms fitting prior to regulation. Thus, the concepts of localizing and fitting overlap. In the intersection of the concepts, fitting predefines and limits the possibilities of localizing. The consequence of this distinction will be further developed below in 8.6.2.

To summarise, the study in Chapter Four showed that for convergence to occur, not only does the rule have to exist in the receiving corporate governance system on the books under the *transplant as label* criterion, it must exist in formal text as *transplant as content* (Watson, 1974; 2000; La Porta et al., 1999). Moreover, both these levels have to be achieved before it is logically relevant to speak about whether or not the regulation is being utilised by central actors in the system, i.e., the *transplant as practice* criterion (Miller, 2003, compare Kanda and Milhaupt, 2003 and Daniel, 2003). However, if the regulators leave to the actors to anchor the introduction of the new, one could expect great variety in what the firms introduce (perhaps because ‘one size does not necessary fit all’ in corporate governance, Larcker, Richardson and Tuna, 2004; Romano, 2005). Furthermore, when the regulator feels pressured to create some order and standardisation in the system, the regulator is forced to follow the paths chosen by the key actors. Certainly, this has implications for the dominant comparative corporate governance research tradition (e.g. La Porta et al., 1997; 1998; Djankov et al., 2001): if the regulator only codifies the practices that occur, even among its most influential practitioners, the only result would be label convergence. This last point is central, as the localizing and fitting of the legal transplants very much strengthens the distinctiveness of the Swedish corporate governance system compared to the Anglo-American source blueprint. Dezalay and Garth (2001), claim that intentional regulatory action, where the name and function of an institution are separated, would be increasingly harder in present times of travel and communication. However, in this
Swedish corporate governance case, this is an intentional process from the regulator and the regulated firms. The Swedish regulator is aware of the differences between the label and the international rule. They consider the differences merited (due to ownership situation), and when parts of the international community contest these somewhat fraudulent and symbolic transplants, the Swedish regulator, instead of changing, tries to make the international investors understand; see for instance Unger (2006) ‘Special features of Swedish corporate governance’ published by the Swedish self-regulatory body ‘The Swedish Corporate Governance Board’ that tries to explain Swedish corporate governance to international investors. Fitting and localizing are definitely intentional in the Swedish transplant process studied here, raising serious doubts as to the merits of the ‘convergence by legal transplants’ approach of contemporary comparative corporate governance writings.

8.3 Example 3: The Code seen as a Process of Referrals (Chapter Five)

A corporate governance code is not a specific rule. It is a whole set of rules and a particular way of regulating. The code concept as such is originally connected to a British regulatory tradition and has no real legal meaning in the Swedish system. Central aspects of this code tradition are i) self-regulation for the actors involved in the process; and ii) the enforcement system of ‘comply or explain’. Codes and self-regulation are connected by the way codes have come to function as a supplement to laws (filling in the grey areas left by ordinary or ‘hard’ regulation). Laws and hard regulation that take years to create need not be outdated before they are published; they must be kept at a more general level. If the rules governing the actual practices of different actors on the market are kept at a general level, there is a need for relevant and swift practical regulation (Seidl, 2006). As such, self-regulatory codes could be expected to be well-functioning, as they use the knowledge of those who know practice best (Gunningham and Rees, 1997; Braithwaite and Drahos, 2000; Seidl, 2006). Regarding enforcement of these codes, the principle of ‘comply or explain’ is an important innovation. The basic idea is that a firm should follow the rules and state that it does so. However, if the firm does not wish to follow the rule, it states that it does not together with an explanation for why it does not. Besides using knowledge of those close to the process, there are at least three good reasons why ‘comply or explain’ dominates code enforcement. First, the self-regulators lack the possibility of the state to use coercive measures and thus, the ultimate legitimacy of forcing compliance with the law. Second, ‘comply or explain’ makes it possible for regulators to set higher standards than otherwise, making it ideal for those who want change. Third, ‘comply or explain’ has a high coherence with the neo-liberal logic of the market, with transparency and the right to choose as central themes in construction of perfect exchange. Corporate governance codes have had an extreme impact also outside the British financial markets and are created by everybody; from international organisations like the OECD and EU to individual interest groups such as small shareholders in Sweden, and, most importantly, to individual nations. Codes have become the universal model for ‘internationally accepted best practice corporate governance’ (Aguilera and Cuervo-Cazurra, 2004; 2009; Zattoni and Cuomo, 2008), and as such,
are characterised by a large degree of international standardisation (for example, the rules that should exist in a code are clearly defined, such as board committees; as well as the rules that should be excluded from the code, such as recommendations on insider trading). Thus, most codes around the world look fairly alike, and on one level, therefore, it is possible to say that as regulatory methods and as a regulatory system, codes are part of the international convergence of corporate governance system (see further Aguilera and Cuervo-Cazurra, 2004, for the development of this standpoint).

In Chapter Five, the process of referrals of the introduction of the Swedish corporate governance code is followed. The introduction of the code is a part of the process where Sweden converged with the rest of the world regarding the existence of a formally binding corporate governance code (one argument for developing a Swedish code was that all European states, except Lichtenstein and Albania, had such a code or were about to receive one, thus a legitimacy-generating transplant, Miller, 2003). In this chapter, a number of assumptions surrounding the theoretical concept of convergence are called into question. For instance, the convergence development seems to be driven by the Swedish state rather than by the market, where strong market actors opposed the issuing of a code. The actions by the Swedish state for driving convergence, in turn, are connected to the EU role in the European corporate governance reform agenda following the Lisbon strategy. When the EU stipulates that every country must have a corporate governance code, the Swedish state realises the lack of such a code in Sweden, and looks for a solution. When it is also understood that a code is expected to be part of the self-regulation, the state finds itself without regulators. Meanwhile, threatened by facing the state as a code developer, business society regulators appear (hence the term ‘enforced self-regulation’ used in the paper, expanding Braithwaite’s, 1982, concept43). Yet these demands stem from state interventions rather than the threat of the market. This is somewhat problematic in relation to the strong convergence thesis (Hansmann and Kraakman, 2004), i.e., that the market does not exert pressure for anything. Certainly, the state is important in constructing and preserving markets (see Rapaczynski, 1996 for a discussion) and as such, the state will function as the intermediary, or interpreter, of the market. In short, if no state, there is no market, and hence, no corporate governance. Sweden is traditionally claimed to be organized in accordance with the principles of corporatism (Puxty et al., 1987), where an alliance of state, business and trade unions organise society. This implies that when a change is being pushed by the state, local interest groups will be involved. Thus, changes that appears to be the result of pressure from the markets, through state intervention, become part of the local interest groups’ responsibilities. As seen in the other empirical examples of this dissertation, the local interest groups and regulators have abilities to adapt to transplanted rules by fitting and localizing the transplanted rules.

In addition, in Chapter five, the influence by local interest groups again can be identified through the seemingly basic mechanism where the names (remuneration committees, independent directors and so on)

43 Braithwaite (1982) proposed state enforcement to regulation by self-regulators to remedy the weakness of both state regulation and self-regulation: combine the knowledgeable regulation by self-regulators with the legitimacy of state regulators.
are intact, but attached to practices better known in the Swedish corporate governance system. This follows more or less the exact same path as in the case of the nomination committees in the previous Chapter Four. Hence, one might be able to generalize regarding the Swedish corporate governance system and the localizing by regulators in relation to the fitting by the regulated, and also thereby in relation to the distinction made below (8.6.1) in this book regarding the criteria for successful transplants as transplant as label versus a more profound transplant as content.

In Chapter Five, this development is in an obvious way driven by the different interest groups in Swedish society. At an early stage of the process, the state-supported self-regulators proposed far reaching changes in Swedish corporate governance regulation – changes that would more appropriately align with the letter and spirit of the Anglo-American regulation. It was closer to an ‘on the books’ transplant. However, this Anglo-Americanisation of Swedish corporate governance practices was rejected by strong interest groups (almost everyone except the international investors and the interests representing small Swedish investors). The views of the business community and their supplier of finance were certainly taken into account by the regulator. Many members of the self-regulatory body also belonged to the very same interest groups that rejected the proposal. It is reasonable to assume that the regulators appointed by local interest groups needed strong public support from their home constituencies in order to make the final adaptations of the transplanted regulation. They ended up attaching a new label to current local ‘best practices’ (see also Chapter Four). This may be compared with the Chinese experience described by DC Clarke (2006) – where only the label was transplanted. DC Clarke could not connect the practices with the new labels. In the Swedish case, we see that the transplanted label is attached to better known practices in the Swedish system. Further, these practices are not only well known but also known as best local practice. That is, while not used by all firms, the users are those Swedish firms recognised as having superior forms of corporate governance. Thus, the internationally recognised best practice (the UK Cadbury report rules), are transplanted as mere labels attached to the practices used by Swedish firms that are considered as local best practice by the local stakeholders. It should be noted that the basic idea of self-regulation is to use knowledge from those most proximate (e.g. Gunningham and Rees, 1997) and as such the Swedish case is a good example. However, it is doubtful whether these consequences were those intended by the EU commission, where harmonisation is considered a mechanism for creating a more competitive European financial market.

Meanwhile, there is a need to point out that Chapter Five does not portray the international investors and the international corporate governance discourse as powerless and incapable of affecting the Swedish corporate governance system. To do so would disregard the basic fact of the actual transplant taking place, as well as the convergence idea, which is the basic theme of this dissertation. Even though the international investors did not manage to place their imprint on the process of referrals, they had set the agenda for the whole codification idea (see also Thomsen, 2007) and as a speculative note, for the institutional investors perhaps this is only a first step where the firms become accustomed to the new regulatory labels, before the
push for real change follows. That would be similar to an indirect strategy of achieving convergence (compare Cankar et al., 2008) and real change might thus follow in the Swedish corporate governance system in due time (Dezalay and Garth, 2001). Viewed this way, the inevitability of the strong convergence thesis (Coffee, 2001; Hansmann and Kraakman, 2004) becomes a step by step mechanism, where the label is the first step and the practice the second step. However, this distinction between criteria for identifying a successful transplant using *transplant as label* and *transplant as content* must be an empirical enquiry rather than a theoretical discussion.

Finally, in the code developing process, there was one transplanted concept that was readily accepted: the ‘comply or explain’ principle. On the one hand, this is fairly strange, as this concept definitely does not fit a judicial system based on Roman law, as is the Swedish. However, on the other hand, ‘comply or explain’ allows for change to happen in a partly entrenched system – and who could argue against a reformer who said: ‘You do not have to follow this, but state your reasons’. This could be seen as the perfect compromise, well fit for a corporate governance system characterised by great variety among firms (large, internationalised firms with relatively dispersed ownership would probably be in better use of corporate governance reforms than the opposite) and by loud supporters on both sides. In Sweden, rule-following has certainly been regarded as high (according to the self-regulatory body), even if there are examples of firms explaining more than they comply (most often these are firms that are strictly controlled by large owners who have openly opposed the changes in the Swedish corporate governance system). The ‘comply or explain’ approach, then, is a successful legal transplant in the forms of *transplant as label* and *transplant as content* (on the books as both label and wording, Watson, 1974) as well as *transplant as practice* (used by the actors, Miller, 2003). Admittedly, however, that there are no empirical accounts of Swedish firms explaining behaviour in comparison to UK firms (for the UK experiences see MacNeil and Li, 2006). Therefore, there could be no conclusion regarding the Swedish ‘comply or explain’ transplant following the criteria for *transplant as outcome* (same social outcome, Mattei, 1994), indicating an area where future empirical research is needed.

### 8.4 Example 4: Convergences and Divergences in the Code (Chapter Six)

The introduction of the Swedish corporate governance code is in many ways the peak of a ten-year-long debate regarding Swedish corporate governance. As is evident from the earlier articles in this book (Chapters Four and Five), the traditional controlling shareholders tried to stall the on-going ‘Anglo-Americanization’ of the Swedish corporate governance system. However, when the European Union came to the conclusion that all member states should have a corporate governance code, and when the Swedish state realised that they did not have one, the time for a Swedish code had come, regardless of opposition. Chapter Six takes the regulators’ perspective on developing a corporate governance code, as will the sections 8.4 and the following 8.5. It should be noted that this regulator perspective is a deviation from the corporate perspective discussed in the previous sections.
From the dominant comparative corporate governance research perspective (e.g. La Porta et al., 1998; 1999), the regulators silently accept the legal transplant. Thus, they are portrayed as mere objects of regulatory interventions, without any possibility for human agency. This notion follows from the legal transplant perspective held by Watson that legal transplants are socially easy and any opposition is easy to overcome (Watson, 1974). As we have seen in the empirical examples from the corporate governance transplant experience described here, the situation tends to be different in Sweden. Regulators take local practices into account (in Chapter Four), and the regulators are mandated to distinguish between labels and practices contained in the same regulation (above 8.1, 8.2 and 8.3). Thus, to understand the local regulators is to understand the transplant process studied here.

First of all, it needs to be pointed out that the regulators engage in a conscious process in the transplants studied in this book. In comparison, DC Clarke (2006) observes regarding Chinese corporate governance transplants, that drafting regulation:

is the responsibility of those who not know very much about law. It may be initiated by officials who have little more than a surface of understanding of the institution being borrowed, to say nothing of the environment in which it functions in its home jurisdiction (2006, p. 17).

This is very different from the Swedish case. The regulators developing the code had a good understanding of the situation at hand: they often claim that certain regulation only make sense in a UK setting with dispersed ownership; that changing certain local regulations will affect other important aspects of Swedish corporate governance and politics; and that they understand the international corporate governance discourse where transplants are needed for international credibility. It is the understanding of the situation at hand that places the Swedish regulators in a great dilemma: on one hand, they consider the Swedish corporate governance system to be well-functioning and the transplants might endanger this. On the other hand, they are sensitive to international pressure, especially when mediated by the EU and the Swedish state. The regulatory actions they take, the solutions they put forward, are their way of solving this dilemma.

Secondly, the way for the regulators to overcome the dilemma is to localize. Localizing, according to Gillespie (2008a), concerns the process whereby local regulators try to satsisfice both local and international demands. In most cases studied here, the concern showed for the international demands came as the transplant of labels, and the concern for the local interests was displayed in the content of the regulation placed under the international labels. Viewed this way, the local interest groups were given the upper hand in the localizing process. In comparison to Thomsen (2007), who view code development processes as a form of rent-seeking from international investors, the Swedish controlling shareholder managed to reclaim their ‘rents’ by gaining regulatory support for their current practices, albeit under new labels. On a
speculative note, perhaps the Swedish regulators consider the international institutional investors, their advisors, and indeed academia in comparative corporate governance as 'box tickers' who construct indexes for easy comparison between countries. As such, the international investors will be satisfied once they find the right words, e.g., the firms have a nomination committee, the directors are independent and so on. This interpretation is supported by the recurring claim by the regulators that the international investors do not understand Swedish corporate governance.

Third, it needs to be acknowledged who these regulators are. The Swedish corporate governance code was implemented – as expected in the case of corporate governance codes – through self-regulation. Thus, most regulators represented a local organised interest. Following what we now about Swedish corporate governance (see 1.3) and its history (e.g. Henrekson and Jacobsson, 2003; Högfeldt, 2005), the most important actor is the controlling shareholder. Therefore, it is not that strange that the controlling shareholder proved influential in the localizing process. This point is further reflected upon below in Chapter Ten.

Fourth, viewing the local regulators as conscious actors with the ability to localize transplants, rather than as recipients of regulation, has important implications for the comparative corporate governance debate on convergence and divergence. When the Swedish regulators transplant and simultaneously localize the rules, they also make permanent, and through formal regulation institutionalise the very differences they are assumed to eliminate by transplanting Anglo-American rules. The regulators, pressed between the state and their home constituents in different interest groups, are tricksters, holding the pen when, as is the main point of the chapter, convergence and divergence become contained in the same regulation: for some as an international label and for others as local practice. Thus, in the chapter, one of the more extensive scientific corporate governance debates is made more understandable. In the Swedish case, the convergence proponents (e.g. Coffee, 2001; Hansmann and Kraakman, 2004) and the divergence proponents (e.g. Guillén, 2000; Branson, 2001) might be describing the same phenomenon. Depending on the perspective from which we view the transplanted regulation, we see convergence or divergence. That is, a transplanted rule viewed from above (international regulatory macro perspective) looks like convergence, although the same rule viewed from below (national regulated micro perspective) looks like divergence. Viewed from an international perspective, we see law on the books, which meets the criterion for successful legal transplant as transplant as label. Viewed from a local perspective, practices and codified practices actually differ from law on the books and from the labels (which fails to fulfil the criterion of transplant as content). This will be further discussed below in Chapter Nine. Regarding the Swedish divergence and simulations convergence, it should be noted that these differences are not facilitated by a situation where the firms do not follow the rules (as in Daniels, 2003) or some other problem with enforcement (La Porta et al., 1998; 1999). Simply, the international labels have become a way to institutionalise local best practice and then actually create an internally convergent pattern in the Swedish system where previously, a multitude of practices prevailed.
Finally, thus far, to understand what happens when Anglo-American rules are transplanted into the Swedish corporate governance system, an extensive understanding of how the Swedish interest groups function is needed. It is concluded that the Swedish self-regulatory community is more open to legitimate interests than what could be expected following e.g. La Porta et al. (1998; 1999), Coffee (2001) or Bebchuck and Roe (2004), were the term entrenched is used to describe the situation. The traditional controlling shareholders had a lot to lose by allowing the institutions and smaller shareholder into the room. Nonetheless, they did not seem to have much choice. Obviously, with the introduction of a Swedish code, the Swedish self-regulation was revitalised. To handle the new regulation, new regulatory bodies were created and old ones eliminated. In this process, new interests entered the community. This also changed the actual regulation, however, not necessarily towards a more Anglo-American approach but towards an internally convergent pattern.

8.5 Example 5: Independent Directors and Institutional Thinking (Chapter Seven)

Chapter Seven can be viewed as an empirical culmination for this dissertation. The chapter begins with the observation that the Swedish rules on independent directors, in important areas differ from the Anglo-American original. Thus, Chapter Seven take as its starting-point the main findings of the first three empirical chapters (Three, Four and Five), especially the distinctions previously made between localizing and fitting, but also the distinction between transplants that are accepted as, respectively, label, content and practice. Regulations on independent directors, from an international or Anglo-American perspective, require that a majority of the boards of directors should be independent from both management and owners. The Swedish transplanted regulation on independent directors instead demands that a majority of the directors should be independent in relation to management, while only two need to be independent in relation to controlling shareholders. Also, Swedish regulation on independent directors states that only one director could be appointed from the current management team.

The fact that the Swedish corporate governance code – similar to the listing agreement succeeding the code – makes such a clear distinction between independence from management and independence from owners reflects the low demands on independence from owners and the high demands on independence from current management.

That two of the independent directors should be independent from larger owners is a compromise between international demands for minority protection and local Swedish practice. In a traditional Swedish listed firm, larger owners could typically control all corporate bodies (Bergström and Samulesson, 2001), thus making all actors owner-dependent. The minority shareholders might thus find some consolation in the fact that the board of directors have two checks on the power balance. Regarding the demands for directors independent of owners, the difference between transplant as label and transplant as content is demonstrated
again (see also 8.2 and 8.3). In the empirical cases presented in this dissertation, this seems to be the standard solution for handling regulatory transplants when the conflict between local interest group and international interest group is too acute: transplant the label and attach it to local best practice.

That a majority of the board should be independent of the firm’s management might occur to be a rule blindly copied from Anglo-American corporate governance. However, it is not all that easy. On one hand, to only allow one director from current management team correspond to Swedish practice and could arguably be interpreted as much stricter demand than Anglo-American regulation. Thereby, Swedish regulation outcompete the blueprint. On the other hand, why then not impose that this supra majority demand in relation to management all together? The answer to this is probably found in the fact that the practice of the second largest Swedish ownership sphere, the Handelsbanken sphere, that typically places former CEOs in the boards of the sphere firms. Their practice simply happens to meet the demands of Anglo-American regulation. Meanwhile, the international rules are the result of the situation in UK and the United States, where prior to regulation, demanding boards with independent directors and a majority of directors from management was common (the inside board). Considering what we have learned from the transplants studied thus far, one would expect that this rule in the Swedish corporate governance system would be introduced in a way localized to practice. This was done regarding the independence of directors in relation to current management, that is the rule is accepted as transplant as label and rejected as a transplant as content, although not in relation to the second part, independent of previous management, where the rule is accepted as transplant as label and transplant as content but rejected as transplant as practice (Kanda and Milhaupt, 2003; Miller, 2003).

In Chapter Seven, the localization of corporate governance regulations when transplanted into the Swedish corporate governance system, was assumed as a starting point. This allowed us to focus on why these changes occur and gave us the tools to understand the role of firm ownership (which has been the prime factor in explaining the differences) within a larger system of different institutions governing the listed Swedish firms. The starting point of Chapter Seven is that the ownership of the firms as such (that is, the level of concentration), is related to a specific version of institutional thinking (Douglas, 1986), making the solution for how the separation of ownership from control should be handled seem obvious for the regulators. The institutional thinking characterising the Swedish corporate governance system has resulted in certain rules in the Swedish corporate governance system, but it is also the key to understanding the localizing (Gillespie, 2008a) of new transplanted rules. That is, in facing the introduction of ‘foreign’ regulation, the regulator mediates the institutional thinking in order to comprehend which adaptations are necessary in order for the new regulation to be useful. Similarly, the rules on independent directors are the result of another institutional thinking of how the separation of ownership and control should be handled, namely the one existing in the Anglo-American corporate governance system. As the regulations that sprung out of that institutional thinking were internationalised together with financial capital, the regulations ended up in new places. From the conclusions in Chapter Seven, one could start to see a more systematic pattern of how certain transplanted rules are localized, others fitted while being transplanted
into the Swedish corporate governance system, while others are ignored or resisted. This will be further elaborated below.

The distinction between the institutional thinking underlying a rule and the rule as such is discussed by Stout (2002). Stout argues that what needs to be transplanted to achieve convergence in the area of minority shareholder protection is not only the American law on fiduciary duties but also the cognitive culture of ‘altruistic compliance’ found among the American actors. The case of the Swedish independent directors, as described in Chapter Seven, however, differs in one important sense: there already exists a cognitive culture among the actors in the receiving system, and this culture is used to interpret the transplanted rules in the first place; thus, real change must involve collective cognitive change, which supposedly would be somewhat more complex than simply transplanting a rule on the books. This is certainly a complex problem that needs further research, and a reasonable starting point for that is Legrand’s (1997) argument concerning the impossibility of legal transplantation in relation to transplant as outcome, the issue being how to measure this outcome (Mattei, 1994).

The developments described in Chapter Seven certainly relate to the concept of path dependence (e.g. North, 1991; Bebchuk and Roe, 2004). Path dependence means that history matters. To Bebchuk and Roe (2004), this implies that historical regulation influences current ownership structure. This is expanded in Chapter Seven, as it is demonstrated that institutional thinking – manifested in ownership structure – affects current regulations by stipulating localization of the transplanted regulation. Also, when introducing the notion of successful transplants as label, content and practice, to the concept of path dependency, speculations regarding possible explanations become possible. Causality is always tempting, although research in this area is having problems finding it. However, there seems to be a correlation between historical solutions and present solutions, regardless of present time focus on globalisation and convergence.

Finally, Chapter Seven focuses on the regulators’ understanding of the transplanted regulations. It again becomes clear that they do not blindly transplant (compare DC Clarke, 2006). The regulators realize that they are forced by the state and by the EU to implement, for example, regulations on independent directors. The regulators understand the local reality in the receiving country, as well as in the country from which the regulations originate. They then try to make the best possible result out of the situation. In this case, this means localizing the rules in accordance with how they see the Swedish corporate governance system (that is, the institutional system) in some cases (e.g., the demand for independence from owners and current management) and when they consider that such localization was not necessary (e.g., the independence from previous management), they choose the path of least resistance. Therefore, the localization of transplanted rules is viewed here as a conscious process where real world politics and conflicts of interest (Gourevitch and Shinn, 2005) shape the transplantation process rather than straight line market considerations (Hansmann and Kraakman, 2004) or a push for dispersed ownership among regulators (La Porta et al., 2000; Coffee, 2001). This will be further elaborated below.
8.6 Legal Transplantation and the Dominant Comparative Corporate Governance Research Paradigm

The dominant paradigm of comparative corporate governance research would suggest that insurmountable market forces lead to convergence of national corporate governance systems on the best available model (Alchian, 1950; Hansmann and Kraakman, 2004); among the most influential scholars, the consensus is that the best corporate governance model is the Anglo-American (e.g. La Porta et al., 2000; Coffee, 2001; Oxelheim and Randøy, 2003; Hansmann and Kraakman, 2004); and that convergence on a practical level will be achieved through transplanting these regulation into countries that lack these (La Porta et al., 1999; 2000; Coffee, 2001; Djankov et al., 2003; Pistor, 2004). Therefore, it is argued in this thesis that one implicit assumption of the dominant comparative corporate governance research tradition is that legal transplants are socially easy (Watson, 1974); that is, new rules appear on the books, are used and observed by the actors of the receiving system, and the transplanted rules produce the same social outcomes as in the country from where the regulation originated (Watson, 1974; Mattei, 1994; Miller, 2003).

It is possible to confirm the predictions from comparative corporate governance research based on the empirical observations made in this study on the Swedish corporate governance system: i) the American practice of stock repurchase has been re-introduced for Swedish firms; ii) The UK invention\textsuperscript{44} of nomination committees for director nomination is used by the Swedish firms; and iii) The UK invention of a corporate governance code, based on ‘comply or explain’ and with all the relevant rules, has been introduced to govern the Swedish firms. Viewed this way, the most viable conclusion for this thesis would be that we are witnessing the end of history for corporate governance regulation in Sweden and a number of successful steps towards convergence on the Anglo-American model (Hansmann and Kraakman, 2004). However, by including a more refined theoretical lens on transplants from legal studies, this thesis is open for a different interpretation of the i) empirical results presented in chapters Three through Seven; and ii) discussion above in sections 8.1–8.5.

Drawing on insights from legal studies, the implicit assumptions behind the view of legal transplants in the dominant comparative corporate governance research tradition is called into question (e.g. Kahn-Freund, 1974; Nelken, 2001; Gillespie, 2008a): legal transplants are not necessarily socially easy. Indeed, the empirical studies described in chapters Three through Seven provide ample demonstration that legal transplantation of Anglo-American rules to the Swedish corporate governance system can be incredibly complicated and contradictory, rather than socially easy. The empirical studies point to the need for a more theoretical robust view of legal transplants for comparative corporate governance research. Specifically there are two main contributions to comparative corporate governance research from this discussion: i) a clearer...

\textsuperscript{44} Indeed, nomination committees have existed among U.S. firms since the 1970s. The Swedish transplant, however, was based on the UK experience.
understanding of the levels of acceptance of legal transplants; and ii) a further understanding of the fit(ting) and localizing concepts in relation to legal transplants into the Swedish corporate governance system. In the following sections, these two implications will be further elaborated.

8.6.1 Different levels of acceptance of legal transplants
In the first chapter of this book, a staircase model of criteria for acceptance of legal transplants was developed from previous research in legal studies, see figure 1.1. (in section 1.2.3). In this model, a transplanted regulation, understood as transplant as text, needs to be transplanted into the new country, that is, the rule needs to exist on the books (Watson, 1974; 2001). On the second step of this model, the new rule needs to be observed by relevant actors in the receiving system, meeting the transplant as practice criterion (Miller, 2003; Kunda and Milhaupt, 2003). On the third step, the transplanted rule needs to produce the same social outcome in both the source and receiving countries, i.e., transplant as outcome (Mattei, 1994; Legrand, 1997). The basic idea of the model is to view the transplanted rules as moving upwards in the staircase in an analytical determination of what is considered a successful legal transplant (compare the discussion of Nelken, 2001). Following the discussion above in 8.2 and 8.3, this staircase model needs to be refined to align with the empirically observed transplant processes in the Swedish corporate governance setting. The refinement is completed by the division of the transplant as text criterion into transplant as label and transplant as content, where transplant as label implies that the legal transplant exist on the books as a label, and transplant as content that the legal transplant exists on the books with the same wording. This further division of the ‘law on the books’ concept is necessary in order to account for the propensity of Swedish corporate governance regulatory actors to transplant relevant labels – such as nomination committees or independent directors – to locally well-known corporate governance practices which often differ from the Anglo-American blue-prints. The empirical evidence supporting this distinction described in this thesis is based only on the Swedish situation; however, similar accounts are available for China (DC Clarke, 2006). The refined version of figure 1.1 is displayed below in figure 8.1, in what could be termed the ‘refined staircase’ model.

45 It should be noted that the third step, regulation as outcome, would be very complicated to observe by empirical research. What is the intention of the regulator in the source country? What is the social outcome? What is the intention of the regulator in the receiving country? What is the social outcome? In answering these questions, society and history needs to be held constant, perhaps in a manner possible only in a laboratory setting, thus beyond the scope of social science. These problems could explain the heated debate in legal studies between Watson (1974) and Legrand (1997) on the possibility or impossibility of legal transplants.
The image of legal transplants portrayed in figure 8.1 shows that theoretical clarity is needed to guide empirical research in comparative corporate governance. There is a need to determine what step of the model is reached in order to determine that a transplant has reached the stage of convergence. In the theoretical discussion on corporate governance convergence (see Yoshikawa and Rasheed, 2009, for review), much of the debate has scholarly positions that seem impossible to reconcile. However, with this framework, these positions could be brought together by simply deciding on what is adequate in terms of accepted step (transplant as label, transplant as content, transplant as practice or transplant as outcome) for declaring that corporate governance systems have undergone convergence or divergence. As argued in this thesis, the implicit assumptions of the dominant tradition in comparative corporate governance research are based on Watson’s notion of unproblematic (‘socially easy’) transplants (1974), basically implying that if the right regulatory labels are observed in a country, we can conclude that convergence has occurred. This approach could be illustrated by La Porta et al.’s (1999; 2000) use of index variables such as the anti-director index or in Aguilera and Cuervo-Cazzura (2004), where the notion of corporate governance code diffusion implies convergence. This study of the Swedish transplant experience contradicts this view. Diverse local practices converge on the local level under well-known international corporate governance labels. Hence, by moving one step further up, we move from socially easy convergence to socially complex divergence. Certainly, further empirical research is needed in this area: does this occur only in Sweden? Is this relevant only for transplant processes taking place by self-regulation? Most of the examples in this book are limited to the development of the Swedish corporate governance code in the mid-2000s. But we might ask whether it is also relevant to other Swedish transplant processes? Can we, indeed, formulate a theory of transplantation within corporate governance?
Comparative corporate governance research needs to be more explicit in its future handling of regulations that travel and its relation to convergence of corporate governance systems. The dominant research paradigm needs to acknowledge that legal transplants are not always unproblematic. They can be complex social phenomenon, and what you see is not necessary what you get. In legal studies, this is hardly a new insight. Kahn-Freund (1974), in discussing ‘degrees of transferability’, pointed out that some types of regulation should be harder to transplant than others (e.g., regulation regarding family and religion). In this spirit, Fleischer (2005) claims that corporate governance regulation should be relatively easy to transplant, as it concerns economic reality in a setting characterised by rationality. This notion is also supported by Fleischer’s empirical findings in convergence between U.S., British, German and French regulation on fiduciary duties. This is contrasted with the empirical studies presented in this dissertation, which show that corporate governance regulation in Sweden is not always a smooth, socially easy, process.

8.6.2 Fitting and localizing regulatory transplants

A second contribution to comparative corporate governance research of this thesis is an increased understanding of what happens with transplanted regulation once it is placed in its new environment. That is, if legal transplant is not viewed as socially easy (8.6.1), how can this complex phenomenon be conceptualised, analysed and thus understood? In previous literature in legal studies, two concepts applicable to the Swedish empirical situation studied here proved relevant: Localizing (Gillespie, 2008a) and Fit (Kanda and Milhaupt, 2003). Localizing refers to changes that regulators carry out on transplanted regulation to meet the demands of both local users and the international community. Fit, in Kanda and Milhaupt’s terminology, refers to how well transplanted regulation fits with other local institutions, implying that it might be the case that local society (those being regulated) need to change in order for the transplanted rule to become effective. In the discussions above, it becomes evident that it might be the situation that the regulated, rather than changing other institutions to fit the transplanted rule, carries out a fitting of the transplanted rule so it could fit with local institutions directly. Thus, this thesis makes a distinction of two possible different explanations for the rejection of legal transplants within the criteria of transplant as content: the regulator that is localizing and the regulated that is fitting.

This thesis also brings clarity to how these two concepts could relate to each other (the arrow between fitting and localizing in figure 8.2 below). In previous literature, the concepts of fit and localizing have been used to explain the social complexity inherent in the legal transplant processes. In the empirical examples provided in this thesis, there is a tendency for the fitting done prior to regulation (by the regulated) to drive the paths of the localizing possible for the regulator; this is the case with the Swedish nomination committee, which existed for many years before it was implemented in the code. That is, the possibilities for localizing, by the regulator, could be very limited by previous fitting carried out by the regulated. Obviously, a situation where the regulated, by historical practice, limit the regulators’ reform possibilities
will pose problems for the normative side of comparative corporate governance and its project of reform towards international practice through legal change.

Figure 8.2 Localizing and Fitting

Using central concepts from legal studies – such as localizing and fit – would be the natural path to follow for comparative corporate governance research after acknowledging that legal transplants are complicated and not socially easy (8.6.1). By adding some clarity to these concepts from legal studies, this thesis has contributed to developing comparative corporate governance research.
9. CONCLUSIONS

At a first glance, the Swedish corporate governance system seems to have developed in a convergent manner with the best regarded corporate governance system in the world, i.e. the Anglo-American. Firms are allowed to repurchase stock. Firms have nomination committees. There exists a corporate governance code. The boards have a majority of independent directors. Hence, from a law on the books perspective, one could conclude that the ‘strong convergence thesis’ (Coffee, 2001; Hansmann and Kraakman, 2004) holds true and that the main catalyst of this development is the transplant (Watson, 1974; 2000) of internationally best regarded corporate governance regulation (Coffee, 2001; Oxelheim and Randøy, 2003; Pistor, 2004; Fleischer, 2005). This conclusion would thus be in line with the dominant comparative corporate governance paradigm.

If we look beyond this checklist, however, using a lens borrowed from legal studies, the Swedish corporate governance system also seems to be developing in a different direction. It is in some sense comparable to the findings from Japan (reported in Kanda and Milhaupt, 2003) or Vietnam (reported in Gillespie, 2002) or India (reported by Varottil, 2009): that is, as proposed by Kahn-Freund (1974), the transplant processes and its consequence is indeed contextually specific. As follows from the analysis in Chapter Eight, convergence by transplanting rules is somewhat more complicated than expected, as legal transplants not always are ‘socially easy’ (Watson, 1974). This conclusion is relevant for comparative corporate governance, both the normative and the positive branches.

This study has two main conclusions. The first relates to the dominant comparative corporate governance research paradigm (see 9.1). The second relates to the discussion on converging corporate governance systems (see 9.2).

9.1 Comparative Corporate Governance Research and the Legal Transplant

In this dissertation, a number of corporate governance transplants from the Anglo-American corporate governance system to the Swedish have been studied empirically, and the conclusion drawn from this is
that legal corporate governance transplants are not always ‘socially easy’ to use Watson’s terminology. Some transplants are implemented without too much resistance, other transplants are not likely to influence corporate practice at all, and still others are implemented as mere labels attached to local practice. Thus, a multitude of different outcomes are observed. This notion is important for developing further research in comparative corporate governance. The outcomes of how the transplants to Sweden moved up in the staircase model (see above 8.6.1) are summarised in table 9.1:

Table 9.1. Summary of empirical examples

<table>
<thead>
<tr>
<th>Legal transplant</th>
<th>Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock repurchases</td>
<td>- Accepted transplant as text (both regulation as label and regulation</td>
</tr>
<tr>
<td></td>
<td>as content) transplant.</td>
</tr>
<tr>
<td></td>
<td>- Accepted transplant as practice transplant.</td>
</tr>
<tr>
<td></td>
<td>- Rejected transplant as outcome, the transplanted rule is fitted in use.</td>
</tr>
<tr>
<td>Nomination committees</td>
<td>- Accepted transplant as label.</td>
</tr>
<tr>
<td></td>
<td>- Rejected transplant as content.</td>
</tr>
<tr>
<td></td>
<td>- Fitted and then localized.</td>
</tr>
<tr>
<td>Code</td>
<td>- Transplant as label, transplant as content, transplant as practice and</td>
</tr>
<tr>
<td></td>
<td>possible transplant as outcome acceptance of the ‘comply or explain’</td>
</tr>
<tr>
<td></td>
<td>principle.</td>
</tr>
<tr>
<td></td>
<td>- Rest of code: accepted as transplant as label.</td>
</tr>
<tr>
<td></td>
<td>- Rejected as transplant as content transplant.</td>
</tr>
<tr>
<td></td>
<td>- Fitted and then localized.</td>
</tr>
<tr>
<td>Independent directors</td>
<td>- Independence from previous management: transplant as label and</td>
</tr>
<tr>
<td></td>
<td>transplant as content acceptance and transplant as practice rejection.</td>
</tr>
<tr>
<td></td>
<td>- Independence form owners and independence from current management:</td>
</tr>
<tr>
<td></td>
<td>transplant as label acceptance and transplant as content rejection.</td>
</tr>
<tr>
<td></td>
<td>- Localized (probably fitted, although not studied here).</td>
</tr>
</tbody>
</table>

In table 9.1, it was concluded from the empirical studies that legal corporate governance transplants from the Anglo-American corporate governance system to the Swedish proved to take a multitude of paths. All transplants studied here reached the step of transplant as label, which is certainly not surprising in view of the minimal criteria, described in Chapter Two for an actual transplantation. A number of transplants were rejected at the step of transplant as content. These regulations tended to be those considered to be the core of international corporate governance regulations (i.e., different sub-committees of the board and owner-independent directors). These regulations are necessary in a legitimacy sense; however, they tend to interfere with local practice. There is one example that is rejected at the step of transplant as practice: the directors being independent of previous management. As discussed above, the international rule does not
relate to the problem in the Swedish setting; thus, it is not problematic for the regulator to comply, as there is no local constituency that is likely to complain. Finally, there is one example that reaches the top of our transplant staircase: the ‘comply or explain’ regulation which meets all the criteria for a successful transplant.

Thus, in table 9.1, we see a number of possible outcomes of a legal transplant process. The diversity of the empirical results illustrates the problems associated with making predictions: why does it, to some, seem that legal transplants are socially easy (Watson, 1974), while to other appear to be impossible (Legrand, 1997)? Certainly, much more empirical research is needed to answer this question, but to the dominant stride of comparative corporate governance research, the default answer cannot be that the regulatory transplants are the solution, as this is clearly not always a socially easy process.

From legal studies, two key concepts are utilised to describe the Swedish corporate governance transplant experience: ‘localizing’ (Gillespie, 2008a) and ‘fit’ (Kanda and Milhaupt, 2003). Localizing refers to the actions by the regulator to meet the demands of both the international community and the local actors. The concept of fit is here developed into the concept ‘fitting’, referring to the actions taken by the regulated where the transplants are made ready to use in the new setting. In this dissertation, it is found that the fitting made by the regulated sometimes limit the possible localizing by the regulators. A further discussion of the concepts of localizing and fitting is found in 8.6.1.

Corporate governance regulatory transplants into the Swedish system occur in an intentional process designed by regulators with a good understanding of local reality and different group interests and attitudes. The regulators create acceptable regulatory compromises starting from the agenda set by the international institutional investors (Thomsen, 2007), facilitated and supported by the Swedish state and the European Union, while often ending up in a regulatory solution known as ‘local best practice’, although this sometimes deviates from international best practice. The metamorphosis is completed at the hands of the controlling shareholders acting directly in the firms (fitting) and indirectly in the regulatory process (localizing).

Finally, the international institutional investors are always present in the empirical studies, seldom physically but always in the minds of the regulators, the state and the controlling shareholders. The international institutional investors in corporate governance regulation act as a guiding star for actions by other actors. All other actors try to interpret what the international institutional investors really want. At the end of the day, the transplant of Anglo-American regulation is carried out in order to attract foreign capital.
9.2 Convergence and Divergence

This dissertation takes its point of departure in Alchian (1950) and Hansmann and Kraakman (2004)’s Darwinist view of how corporate governance system develops towards convergence in the context of financial globalisation. As a final conclusion, the thesis will return to this question. The convergence/divergence debate has been one of the most hotly debated issues in international corporate governance research during the last two decades (e.g. Gordon and Roe, 2004; Rasheed and Yoshikawa, 2012). Obviously, the idea that the future development of a complex social system could be predicted is very tempting. This is certainly true in a scholarly sense, as prediction of future development might be viewed as part of the job description, but it is also true for regulators, where a complex reality of economy and different interest groups could be reduced to a game of ‘following the leader’ with the best model.

As discussed above, the empirical results presented in this book could be interpreted as strong support for the convergence claim. However, the discussion in 8.6.1 shows that corporate governance transplant from the Anglo-American system to the Swedish is not always socially easy. Local regulators are prone to localizing the rules, often in accordance with the fitting previously done by the regulated (8.6.2), leaving the convergent rule as labels attached to local practice. Therefore, the empirical results of this book could also be interpreted as divergence. That is, convergence and divergence are occurring at the same time, which is similar to the findings of Buck et al. (2004); Lutz (2004), and Collier and Zaman (2005). Simultaneous convergence and divergence needs to be understood from the perspective of comparative corporate governance. The developments studied in this book correspond neither to the strong convergence thesis (e.g. Hansmann and Kraakman, 2004) nor to the divergence thesis (e.g. Branson, 2001). On the other hand, some of the developments studied in this book correspond to the strong convergence thesis (e.g. Hansmann and Kraakman, 2004) and others to the divergence thesis (e.g. Branson, 2001). At the end, it all depends on how the empirical material is interpreted and ultimately, how the cases are selected.

As an illustration of the selection problem, if the cases chosen for the studies in this dissertation had been confined only to the regulatory transplant of stock repurchases, the ‘comply or explain’ approaches and the rules on directors independent from previous management (see above 8.6.3), the conclusion would have been that corporate governance regulations are easily transplanted to Sweden. The conclusion would have been that we were witnessing a trend of convergence between the Swedish corporate governance model and the Anglo-American (compare Fleischer, 2005 on fiduciary duties between UK, USA, Germany and France). If instead, the only cases chosen were the Swedish corporate governance code, the nomination committee and the directors independent of owners, the valid conclusion would have been that local corporate governance practice prevailed, simply hiding under international labels; thus, no convergence would be occurring. Certainly, this selection problem cannot be ignored, and all empirical research on convergence and divergence needs to be aware of the consequences of choosing one case above another.
In one sense, the comparative corporate governance debate on convergence/divergence is rather similar to the legal studies debate on transplants. In legal studies, the transplant debate gravitates along an axis ranging from socially easy (Watson, 1974); to degrees of transferability and socially complex (Kahn-Freund, 1974); to impossible (Legrand, 1997). Certainly, in legal research it is common that the extreme positions of Watson and Legrand are supported, although as Nelken (2001) points out regarding the socially easy position ‘the term “success” has strong evaluative overtones, it gives the impression of endorsing one outcome rather than another, and easily ends up mixing together normative and explanatory enquiries’ (p. 37).

For their opponents: ‘We may be left wondering whether these authors really do believe that it is impossible to achieve greater harmonization and convergence or whether they fear that it is all too possible – but undesirable’ (ibid, p. 38). The consequence of Nelken’s claim, of course, is that more explanatory research is needed regarding when a transplant can be termed successful and when is it rejected; that is, we need more knowledge of the ‘degrees of transferability’ (Kahn-Freund, 1974), and thus a ‘third way’ between two different extremes.

In comparative corporate governance, Hansmann and Kraakman (2004, p. 68) have claimed that ‘as European equity markets develop, the ideological and competitive attractions of the standard model will become indisputable, even among legal academics […], convergence in most aspects of the law and practice of corporate governance is sure to follow.’ Compare this with Branson (2001, p. 85), who observes:

*Seldom in lifetime will one see scholarship and advocacy that is as culturally and economically insensitive, and condescending, as is the ‘global’ convergence advocacy scholarship that the elites in United States academy have been throwing over the transom. Those elites have oversold an idea that has little grounding in reality, or in true ‘global’ reality.*

Thus, extreme positions are not uncommon in corporate governance research.

For sure, there are examples of a ‘third way’, or a Kahn-Freund like position in comparative corporate governance. Lutz (2004) presents ‘convergence within divergence’ model, and Yoshikawa and Rasheed, (2009) invoke a ‘hybridisation model’. However, most ‘third way’ solutions suffer from what Nelken called ‘mixing together normative and explanatory enquiries’ (2001, p. 37). Even a hybrid model needs to acknowledge that one aspect (rather than one system) is superior to another and then the trap door of normativity easily closes.

Perhaps we can better understand the convergence/divergence debate using a rather simple image of the measurement problems associated with convergence and divergence. It is an airplane model:
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Depending on which perspective a researcher views a transplanted regulation, one can see either convergence or divergence. A transplanted rule viewed from above (international regulatory macro-perspective) looks like convergence. The same rule viewed from below (national regulated micro-perspective) appears to be divergence. This relates to the distinction made above regarding the criteria for an accepted transplant: whether we are talking about transplant as label or transplant as content; from a macro perspective; whether it is only the label that needs to be changed, or from the micro-perspective, whether it is change in actual practices that must be confirmed. In the Swedish case, the label and the practice tend to differ, leading to confusion. In a more metaphorical description: transplanted Anglo-American regulation is like an aircraft with the wings painted black on the topside and white on the plane’s belly; thus, depending on the viewing angle, scholars can see a black and/or a white aircraft. As a description, neither black nor white is wrong, and certainly, neither black nor white are fully accurate correct. The airplane, like most social phenomena, is black and white. Corporate governance is not developing in a convergent manner, nor a divergent manner; it is simultaneously developing in vectors that are both convergent and divergent.

What, then, is the contribution of this claim for the divergence and convergence debate? Alchian (1950) did not view the idea of convergence in terms of being desirable or undesirable. It was the logical consequence of applying standard economic thinking to a real life situation, thus an attempt to explain rather than to prescribe, and thus to simplify a complex reality into a testable theory. The evaluation of socially complex phenomena such as the transfer of corporate governance regulation should be made on a value-free basis and viewed from the side rather than from top or below.
10. REFLECTIONS ON THE SWEDISH CASE: REGULATORY CHANGE IN SWEDISH CORPORATE GOVERNANCE

From the conclusions reached in this dissertation, Chapter Nine, it is evident that the corporate governance transplants studied here are not always ‘socially easy’. Some are rejected and some prevail and others prevail but in unexpected ways. The transplants are often localized and fitted. Attempts have been made, throughout the individual articles as well as the discussion above (Chapter Eight), to explain these observations. Common to all these explanations is the role played by the concentrated ownership of the Swedish firms. This is not strange, given the weight placed on the concentrated ownership in much previous corporate governance research in a Swedish setting (see section 1.2.4). However, all explanations based on ownership boil down to the roles played by different interest groups in the regulatory processes, and especially their roles when corporate governance regulation is transplanted into the Swedish system. Following the articles and the discussion in Chapter Eight, a final reflection from this thesis is offered as a synthesised description of the role of interest groups in Sweden. This discussion is aimed mainly as a further understanding of the Swedish corporate governance system, although, comparative corporate governance research might benefit from an example from outside a non-Anglo-American setting. As such, it should be noted that this Chapter is beyond the scope of the stated purpose of the thesis. It is a reflection on the implications found in the discussion of legal transplants in a Swedish setting. From this reflection, some further implications for future research are drawn.

In the comparative corporate governance research tradition that currently dominates, local interest groups are basically described as ‘entrenched’, with a tendency to simply expropriate other actors. For instance La Porta et al. (2000) describe minority shareholder protection thusly:

*Marginal reform may not successfully achieve the reformer’s goals. In part, the existing corporate governance arrangements benefit both the politicians and the entrenched economic interests, including the families that manage the largest firms in most countries in the world. Corporate governance reform must circumvent the opposition by these interests* (2000, p. 24).
More bluntly Morck and Steier (2005) contrast Anglo-American corporate governance with the rest of the world:

*In much of the rest of the world, capitalism is a system where a handful of immensely wealthy families control almost all of a country’s great corporations, and often its government to boot. […] Professional managers are hired help, subservient to oligarchic family dynasties that jealously safeguard their power, sometimes at great cost to their host economies (2005, p. 2).*

It is safe to say that the dominant comparative corporate governance research is somewhat biased towards the Anglo-American standard, with a tendency to view the rest of the world as rather backward. Nonetheless, more nuanced descriptions and a deeper understanding of different types of actors in a non-Anglo-American corporate governance system can benefit comparative corporate governance research. In this area, too, theoretically more nuanced alternative approaches exist, such as Hall and Soskice (2001) ‘Varieties of Capitalism’ approach and Gourevitch and Shinn’s (2005) social science approach to corporate governance. In order for the dominant comparative corporate governance research tradition not to lose relevance, it is necessary to reach out to these research traditions and expand the analysis to include national policy and interest group involvement in local regulatory reform processes (also see McCann, 2007).

From the empirical studies presented in Chapters Three, Four, Five, Six and Seven, a number of actors and interest groups emerge that are involved in the reform process of Swedish corporate governance: i) the Swedish state (backed by the EU); ii) the controlling owners; iii) institutional owners; iv) small owners; v) foreign owners. In so far as the Swedish state is one of the largest shareholders on the Stockholm stock exchange, it is safe to say that ownership is the most important factor explaining involvement in the regulatory process. However, to claim that it is only a matter for the immensely rich oligarch families – as argued by Morck and Steier (2005) above – is obviously an exaggeration. In the following sections, the different actors’ involvement is discussed.

### 10.1 The Swedish State and the EU

Certainly, it is not all that strange that the Swedish state emerges as an important actor in the analysis of regulatory transplant. After all, this dissertation deals with regulatory changes, whereas regulation is commonly understood as the role of nation states in governing. This being said, only Chapter Three deals with change of actual ‘hard’ law; drawing on a traditional division of ‘hard’ law (issued by state and upheld by courts, police and the general monopoly of violence) and ‘soft law’ (basically various forms of self-regulation upheld by different regulatory regimes and ultimately the threat of ‘hard’ law) as described in the regulatory scholarship (e.g. Gunningham and Rees, 1997; Braithwaite and Drahos, 2000). The Swedish state’s involvement was more direct in the ‘soft law’ self-regulatory processes covered in chapters Four and Five than in the ‘hard law’ change portrayed in Chapter Three. This could probably be explained by the fact
that the issuing of a code that stipulated e.g., nomination committees or independent directors faced local opposition, whereas allowing stock repurchases was also a demand made by key business interest groups.

In the empirical studies, it does not appear that the Swedish states acts in its capacity as one of the largest shareholders on the Stockholm stock exchange. It seems to be as a member of the European Union: stock repurchases were considered necessary under the existing EU directives, and it is the EU that considers a national corporate governance code to be necessary in the first place. The Swedish state could have acted as an owner, demanding specific corporate governance arrangements in the firms in which they held controlling interests. Instead, the state went for a broader approach, facilitating change in all listed firms in Sweden through the traditional Swedish regulatory model based on appointing a commission (the commission of trust) and supporting the commission’s work by not only providing resources but also the infrastructure of a legitimate process of referrals. Thus, creating a new form of enforced self-regulation, where Braithwaite’s (1982) original concept concerned self-regulation backed by state enforcement, the Swedish state forced through the actual self-regulation. The Swedish state also directly intervened in the self-regulatory process by demanding specific rules, threatening the self-regulator with ‘hard law’ if they failed to include it in the code (see Chapter Seven). In the popular media debate, the Swedish state is often accused of trying to be the ‘best pupil in class’ when it comes to introducing unpopular EU decisions. In the case of corporate governance reform discussed in this thesis, it could be claimed that the Swedish state crossed some (theoretical) thresholds in order to lend its support to the idea of the common European market, that is, in order to harmonise corporate governance, the Swedish state blurred the boundaries between self-regulation and law (Gunningham and Rees, 1997; Braithwaite and Drahos, 2000).

Both when stock repurchases were allowed and when the code was introduced, it occurred under a Social Democratic government in Sweden. In comparative corporate governance research, the existence of Social Democracy in Europe is sometimes used as an explanation for things different in Continental Europe in relation to the Anglo-American setting. A well-known example is Roe’s (2000) political explanation for why ownership of listed firms in continental Europe is concentrated, based on Social Democratic (labour oriented) pressure on management to forego some profit maximisation while reducing managerial agency costs by the use of controlling shareholders (for Swedish accounts, see e.g. Collin, 1998; Henrekson and Jacobsson, 2003; and Högfeldt, 2005). However, drawing on a ‘Varieties of Capitalism’ approach (Hall and Soskice, 2001) and challenging Roe’s theories, Cioffi and Höpner (2006) show that center-left (Social Democratic) parties have been the key political group forwarding current shareholder-oriented corporate governance reform in continental Europe. Cioffi and Höpner explain this development as a need for centre-left politics ‘to attack the legitimacy of existing political economic elites, present themselves pro-growth and pro-modernization, [to] strike political alliances with segments of the financial sector, and appeal to middle-class voters’ (2006, p. 463). Obviously, the political colour of parties spearheading corporate governance reform is one possible explanation of the developments described here, and the existence of a Social Democratic government during the period of stock repurchase reform and the introduction of a corporate governance
code in Sweden, supports Cioffi and Höpner’s claim.\footnote{It should be noted that this is a contested area. Schnyder (2008a; 2008b) specifically use the Swedish case to argue against Cioffi and Höpner’s (2006) center-left paradox in corporate governance reform. Schnyder argues that there is strong political support for the controlling shareholders in Sweden from both left and right. However, even if this position is still valid (see the next section on controlling shareholders), minority shareholder protection has been strengthened in the periods following Schnyders empirical study.} Thus, the traditional role ascribed to Swedish Social Democracy (e.g. Collin 1998; Henrekson and Jacobsson 2003 and Högfeldt 2005) as the strong protector of statuesque and the controlling shareholders might have changed during the first decade of the 2000s.

Also, in Roe (2000) generally, and in Henrekson and Jacobsson (2003) and Högfeldt (2005), it is specific to Sweden that Social Democracy is the facilitator of compromise between labour and capital. This is also the basic model proposed by Gourevitch and Shinn (2005) to explain variation in corporate governance arrangements in different countries. In the case material presented in this thesis, the labour unions, both blue collar and white collar, where invited to participate in the regulatory processes (see Chapter Five on the process of referrals) but they declined for undisclosed reasons. Gourevitch and Shinn point out the obvious problems of representing the interest of labour in corporate governance issues today, as the pension funds of the labour unions increased their ownership of the listed firms, and thus in some sense turn labour into residual claimants. This topic will be further discussed below regarding the institutional investors. However, the role played by Social Democratic governments portrayed in Cioffi and Höpner (2006) and the empirical material presented in this thesis marks a cut between historical accounts of labour involvement and the role played by Social Democracy (also see Jonnergård and Larsson-Olaison, 2013, for a discussion of the changed role played by the Swedish unions in corporate governance issues between the 1980s and the 2000s).

In Cioffi and Höpner (2006), however, the role played by the European Union is downplayed.\footnote{In Cioffi and Höpner (2006), the European Union is present only in the Italian case study, where it was used as further pressure for reform.} In the empirical examples provided here, the Swedish government almost seems most urgent to appear as governing a modern, and thus legitimate, European state in the eyes of the EU. This includes corporate governance built on strong minority shareholder protection and dispersed ownership (also see Jonnergård and Larsson-Olaison, 2010a, for a discussion of the regulatory discourse describing the ownership of listed Swedish firms as international and institutional regardless of the empirical evidence at hand). For future comparative corporate governance research – at least when European countries are studied – it is necessary to address the role, the agenda and the power of the European Union in order to grasp the full picture of regulatory changes following the globalisation of the financial markets. Obviously, the Union’s drive for a more competitive European economy is a strong explanation for changes, which in comparative corporate governance habitually would ascribe to strong market pressure (e.g. Hansmann and Kraakman, 2004).

Finally, as a basic and often implicit assumption in comparative corporate governance research, it is often claimed that the ‘market’ plays the key role in the international convergence process (i.e., from Alchian, 1950, to Hansmann and Kraakman, 2004). In modern and democratic European nations, this pressure
needs to be intermediated by local government and local interest groups (McCann, 2007), and the dominant stride of comparative corporate governance research needs to acknowledge this fact rather than describing the situation as oligarch families crippling the host economy.

10.2 Controlling Shareholders
In 1962, the leader of the Swedish communist party, C.H. Hermansson, published a book on the 15 families controlling Swedish business. While Hermansson’s book must be seen in the light of his political ambition to make the public aware of power concentration and perceived inequalities in Swedish society, it also marks the beginning a Swedish tradition of documenting ownership concentration with governmental commissions (e.g., the Ownership Commission reporting in 1988) as well as later volumes (Owners and Power in Sweden’s Listed Companies, Sundqvist, 1985-2010, together with Sundin and Fristedt). Their efforts have probably turned Sweden into the country with the world’s most detailed data on ownership in listed firms48 (also compare La Porta et al., 1998). We therefore know plenty about the Swedish controlling owners’ position in the Swedish corporate governance system.

Concerning the regulatory situation in the Swedish corporate governance system, the controlling shareholders historically held a very strong position. As described in Chapter Four, the self-regulatory bodies involved prior to the development of the corporate governance code (i.e., SICSEC) were dominated by the controlling shareholders (also see P-O Jansson, 1995); the regulatory role played by the Swedish controlling shareholders has balanced on the very thin line between ‘regulator capture’ and ‘regulation by those with knowledge’.

Glete (1994), in a historical account of Swedish controlling owners, documented a large decline in the influence of the original 15 families during the 1970s and the 1980s. This has left the Swedish corporate governance system in a situation where only the famous Wallenberg family and the Handelsbanken network49 were significant controlling owners of business groups controlling more than one listed firm. This development has been associated with a political ambition (Social Democratic) of listed firms without owners (Henrekson and Jacobsson, 2003) and where these two groups were tolerated for their ability to mitigate agency costs and facilitate political negotiation (Collin, 1998).

48 Certainly, the Governmental Statistics Sweden (SCB) has statistics on ownership of the listed firms starting in 1983. However, Statistics Sweden reports broad categories rather than individualized data, making the data confusing, as many controlling shareholders own listed firms through other firms or trusts and the controlling shareholder appears as a form of institutional ownership.
49 The Handelsbanken network is a special case. The bank (listed on SSE), the investment company (Industrivärden, also listed on SSE) and the listed operative firms in which they hold controlling blocks (during the years, famous examples as SCA; Skanska; SSAB; Sandvik and Volvo) are not being controlled by a specific family and thus not even listed by Hermansson. The Handelsbanken network seems to be a less formalized heavily interlocked network of business leaders, controlling the group through trusts, cross-ownership and voting restrictions. It is also worth noting that after the period empirically studied in this thesis, a family-based business group has started to build a power position in the Handelsbanken network.
As pointed out by Henrekson and Jacobsson (2012), however, the financial crises of the 1990s and the subsequent reforms of the Swedish economy gave rise to a new set of Swedish controlling shareholders. The new controlling shareholders were also private capitalists who built up business groups in the same pattern as the 15 families documented by Hermansson. Thus, rather than a development where ownership of listed Swedish firms was dispersed in an Anglo-American manner, the controlling owner persisted. Although Sweden has experienced massive changes in the composition of controlling owners on the Stockholm stock exchange since the 1960s, the controlling shareholders still dominate two-thirds of the listed companies (cut-off point: 20% of the votes). This occurred during a period when regulation became more oriented towards facilitating hostile takeover, starting with the Ownership Commission (1988) and throughout the period until today (e.g. Nachemson-Ekwall, 2012) when minority shareholder protection was strengthened (Schnyder, 2008a; von Koch, Nilsson and Eriksson, 2014). Obviously, the developments in Sweden do not fit very well with the axioms of most comparative corporate governance research, that strong (Anglo-American) minority shareholder protection and hostile takeovers should disperse ownership in listed firms (e.g. La Porta et al., 1997; 1998; 1999).

The controlling owners, although often seen as having tenuous control using a very small capital base (i.e. Agnblad et al., 2001; Henrekson and Jacobsson, 2003; 2011), survived through strong political support and strong support from the general public. It has been argued that controlling shareholders persist as long as they are perceived to add more value than they extract. This is Gilson’s (2006) controlling shareholder trade-off, where managerial agency costs reduction is larger than minority shareholder expropriation. This trade-off is relevant in the Swedish case, as the controlling shareholders have strong political support (cf. Reitner, 2003; Schnyder, 2008b), the ears (and sometimes the pen) of the corporate governance regulator (see Chapters Three, Four and Five) and portrayed in the general public discourse as the ‘real owners’, saving the firms from managers who might create problems (A. Jansson, 2013). As such, the controlling shareholders definitely still have a large influence over corporate governance regulations in Sweden, although they are no longer in single control.

In the case studies presented in the foregoing chapters, the controlling shareholders demanded change (Chapter Three) and opposed change (Chapters Four and Five). The easy explanation for this contrast is that stock repurchase was to the benefit of the controlling owners, or at least did not hurt them; the code regulation, on the other hand, was perceived as costly (Henrekson and Jacobsson, 2012, documents a ‘going dark’ tendency, where large Swedish firms tend to become owned outside the stock market) and invasive (no one should tell me how to run my business). It is doubtful whether the controlling shareholders would ever have helped introduce a corporate governance code in Sweden without state intervention. Meanwhile, it is worth noting that many code provisions – e.g., nomination committees (see Chapter Four) – had already been introduced in many of the firms with controlling owners. Thus, one could view the opposition of the controlling shareholders as more of an emotional response rather than a rational strategy. At the same time, the controlling shareholders, as documented in Chapters Four and Five, are not a homogenous
group; one group of controlling shareholders are insiders to the regulatory situation with a history of bargaining and self-regulation (e.g., the Wallenberg family), while another group of controlling shareholders continue to be outsiders and loudly oppose all change (e.g., the Lundberg family). Therefore, when it comes to understanding controlling shareholder involvement in the regulatory process, it is not one economic interest that has to be accounted for but many. An increased understanding of controlling shareholders’ perception of changing corporate governance regulation would be a promising area for future research.

From the perspective of dominant comparative corporate governance research, the situation in Sweden would be interpreted as oligarch families trying to protect their own possibilities of rent-seeking, and this is to some extent done under political protection (e.g. La Porta et al., 2000; Morck and Steier, 2005). However, other interpretations are possible. The controlling shareholders’ main argument for the opposition against the corporate governance code was a legalistic one: minority shareholder protection is a matter for the company law, and Swedish company law is already better than most (see Chapter Five). If we assume that minority shareholder expropriation is comparably low in Sweden (which is commonly done in research on the Swedish system, see 1.3.4 and Nenova, 2003), there could be other, more plausible explanations for the controlling shareholders opposition than a reduced possibility for rent seeking. For instance, corporate governance implies costs; increased control and harsher listing arrangements imply transaction costs as well as monitoring costs. Although these costs are borne by all owners, the controlling owners, who also invest their time in control activities (e.g., serving as directors) might view the increased costs as unnecessary. There is evidence (e.g. Henrekson and Jacobsson, 2012), that the stock market in Sweden is becoming less important. Firms are going private, which would be preferable in terms of competition, as an increased role is played by private equity at the expense of the stock exchange. In an established firm, however, it would be very expensive for a controlling shareholder with a small capital base to buy out the other shareholders and delist the firm, especially as minority shareholders have rather strong protection in such situations (e.g., flagging requirements, mandatory bid, and squeeze out rules). In this sense, the opposition of controlling shareholders could be understood as a method of protecting the almost irreversible – or at least very costly – investment in a stock listing from the competition from non-regulated financing. This hypothesis needs confirmation; however, the re-concentration of ownership in listed Swedish firms while strong minority shareholder protections are strengthened is a challenge to comparative corporate governance.

In developing the analysis of the cases presented in this thesis in order to understand the role played by the controlling shareholders, we need to analytically separate the actions of the controlling shareholders on a corporate governance system level and on a firm level. At a system level, the controlling shareholders try to block change in the Swedish corporate governance system as long as possible. However, when an idea has its time, like the code in 2004, some of the controlling shareholders pragmatically realise that ‘if you can’t beat them, join them’, and they become part of the regulatory process. Certainly, with a history of self-
regulatory participation, the controlling shareholders have no problem obtaining a position of influence in a developing regulatory structure (see Chapters Four and Five). Being on the inside, the controlling shareholders are very much involved in the processes identified above in fitting and localizing the transplanted regulation. How this fitting and localizing should be carried out is directed by the same controlling shareholders on the firm level, that is, the regulation should be the practice that they have already introduced in the firms they control. In view of the variation between the corporate governance practices between different controlling shareholders (see Chapters Four and Seven), a promising avenue of research would be to focus on the regulatory process outcome in creating internally Swedish convergent practices under international convergent labels. The process could be viewed as a regulatory capture, with the underlying strategy of imposing costly changes on rival business groups that do not participate in the regulatory process. In a less conspiratorial view, supported by the interviews reported in Chapter Seven, the process could be viewed as an attempt to find the best practice among the different existing practices. This is congruent with Seidl’s (2006) key feature of corporate governance codes development (using central practical knowledge to establish best practice).

10.3 Local Institutional Investors

Understanding the role played by local institutional investors in the regulatory processes described in this dissertation poses a puzzling problem. On one hand, Thomsen (2007) links institutional investors to the code development process as rent-seekers imposing costs on other stakeholders for their own benefit. As codes tend to lead to a convergence of corporate governance practices around the world, it makes evaluation work easier for institutional investors. This view is supported by Lazonick and O’Sullivan (2000), who link institutional investors to the spread of the shareholder value conception of the firm and thus to the Anglo-Americanisation of corporate governance. On the other hand, in Chapter Five, geography trumps economic interest; that is, facing an Anglo-Americanization of Swedish corporate governance practice represented by the proposed code provisions, the Swedish institutional investors sided with the controlling shareholders in opposing change. These actions at the systems level must also be compared with the demands for corporate governance reform in individual firms reported in Chapter Four, where the institutional investors continuously demand nomination committees in the listed firms. However, regarding the Swedish institutional investors’ demands for nomination committees, it should be noted that their demands were for Swedish nomination committees where institutional investors could participate in director nomination without being insiders, not Cadbury-style nomination committees where owners are excluded. Therefore, the Swedish institutional investors had played an important role in the fitting process of transplanted regulation discussed above.

Swedish institutional investors’ actions at the firm level could be explained by the ‘fifteen minutes of fame hypothesis’ suggested by Nordén and Strand (2011). At annual general meetings, the institutional investors gain an opportunity to stand out in the competition on the savings market. However, demanding
nomination committees also changed the role played by Swedish institutional investors in Swedish corporate governance. In the public discourse, there are a number of pledges demanding that institutional investors act as ‘real owners’ (e.g. Chapter Four; Jonnergård and Larsson-Olaison, 2010b; and A Jansson, 2013). The Swedish nomination committee provided an opportunity for the institutional investors to do so. In this area, then, the Swedish institutional investors are motivated to protect the Swedish nomination committee in the regulatory process.

As pointed out by Gourevitch and Shinn (2005), institutional investors are not a homogenous group, although they all have fiduciary duties under Swedish law. The finding in Chapter Five could in many cases be plausibly explained by the fact that most Swedish institutional investors are connected to the large banks, which in turn are connected to the largest business groups. In other cases, the Swedish institutional investors are jointly formed by employer and labour organisations on the Swedish labour market. It is plausible that the employer organisations have strong ties to the large controlling shareholders and that the labour unions have a strong commitment to a corporate governance model based on controlling shareholders (see above, concerning the Swedish state’s role); thus, such institutional investors could oppose change based purely on economic rationality of their key stakeholders.

Swedish institutional investors may sometimes promote change and may on other occasions act to preserve the status quo. Further research on local institutional investors’ interest in corporate governance regulatory processes, informed by Gourevitch and Shinn’s (2005) notion of a heterogeneous group with heterogeneous interests, is much needed for comparative corporate governance research. Finally, to add to the confusion regarding the Swedish institutional investors’ role, they might have changed their perception of their mandate in the years following the development of the code, as demands connected to economic interest trumped geography in a number of empirical studies (Jonnergård and Larsson-Olaison, 2010b; 2013 and Nachemson-Ekwall, 2012).

10.4 Other Local Minority Shareholders

In Sweden, where controlling shareholders have dominated the economic and political scene, it might seem strange that the small shareholders appear to be very active and indeed influential in the corporate governance reform process. From the perspective of comparative corporate governance research, small shareholders are expected to be helpless victims of corporate insiders; this is the basic premise behind all theories concerning ownership dispersion/concentration, from original agency theory (Jensen and Meckling, 1976), to more modern applications, e.g. La Porta et al. (1998; 1999) and Coffee (2001). However, Swedish society is also characterised by a high degree of organised civic movements – beginning with the various religious, sobriety and labour movements in the late 18th and early 19th centuries. Beginning in the 1980s, one of the largest civic movements today are private savings in the stock market.
Although constantly declining, more than two million Swedes (out of a total population of nine million) own a listed share directly, that is, not counting people with savings invested in various funds, insurance and pension schemes. In the public discussions, the interest of the small shareholders are organised by Aktiespararna (The Shareholders Association, 2012 about 64,000 members, 142,000 members in 2000). With strong and often charismatic leadership, the Shareholders Association is seen throughout Chapter Four and Five as demanding change. It could be claimed, at least concerning the introduction of codes, that the Shareholders Association invented corporate governance in Sweden: they issued their first corporate governance code\textsuperscript{10} in 1993 (The Cadbury code was issued in 1992, and more than a decade before the Swedish code); at annual general meetings and in different regulatory processes, they have publicly demanded change in line with their code; and in 2004, the CEO of the Shareholders Association became a member of the regulatory group developing the code.

In this dissertation, the small shareholders have constantly been on the opposite side of the table from the controlling shareholders. In the discussion above (6.1) on stock repurchase, there was a stated objection to the change in the preparatory works written by a well-known member of the Shareholders Association; in Chapter Four, they demanded nomination committees so many times that the controlling shareholders, through the SICSEC, needed to issue a recommendation on board nomination (basically stating that nomination committees are not necessary) and finally in Chapter Five, they supported all the proposed changes that subsequently were fitted and localized. On the one hand, and in relation to the dominant comparative corporate governance research tradition, the conflict between the controlling shareholders and the minority shareholders could have been expected; after all, the controlling shareholders were probably intending to expropriate the minority shareholders. On the other hand, the Shareholders Association in Chapter Seven as well as publicly supported a Swedish corporate governance model based on controlling shareholder. In their program from 2006:

\textit{Efficiently governed listed firms require competent and strong owners who are willing to be active, with a long term investment horizon performing as accountable owners. History shows that personal interest and responsibility for their own capital investments makes individual persons the most sufficient owners (Idea program, p. 7, author's translation).}

Thus, the Shareholders Association acknowledges that controlling owners are important for the minority shareholders. Perhaps the controlling shareholders sometimes need a push in the right direction. This notion is supported in Jonnergård and Larsson-Olaison (2013), where a discussion of a proposed change of

\textsuperscript{10}The Shareholder Association translated corporate governance into \textit{'ägarstyram' or 'owner control'}, a term replaced in the public setting by the regulatory body that developed the Swedish code (2004/2005), translating corporate governance into \textit{'bolagsstyrning'} retranslated as \textit{‘company control’}.  

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the Swedish LEO-law\textsuperscript{51} saw the Shareholders Association siding with the controlling shareholder, demanding less minority shareholder protection to prevent certain behaviours by foreign minority shareholders at Swedish AGMs.

\textbf{10.5 International Institutional Investors}

The transplant processes studied here was not only a local affair. The influence of the global capital markets is recognised throughout the case studies, beginning in the stock repurchase case (Chapter Three) and the nomination committee case (Chapter Four). The theme of the necessity to adopt Swedish corporate governance to the international situation is pervasive. Finally, in Chapters Five and Seven, the global capital markets materialised in the form of the international institutional investors. In the process of referrals for the Swedish corporate governance code, a number of organisations representing Anglo-American pension funds participated. The position in the regulatory process held by the international institutional investors is easy to understand: the international institutional investors demand Anglo-American corporate governance practices, as they are familiar with these, and global standardisation allows them to more quickly and easily assess investment possibilities (e.g. Thomsen, 2007).

In one sense, the international institutional investors must be described as the winners in this process. Indeed, Sweden introduced a corporate governance code, and in many cases the regulation follows Anglo-American practice. The international institutional investors, after setting the agenda internationally and in the EU, needed to devote very small resources to the specific Swedish case. In another sense, the international institutional investors were on the losing side, as they were kept outside the process (Chapters Five and Six) and watched from the side-lines when local actors fitted and localized the transplanted regulation, sometimes beyond recognition.

The international institutional investors are comparable to the Swedish folklore character of the House-Elf: if the House-Elf is pleased with the people, he was of great help, however, very little was need to make the House-Elf angry with the people, and a disgruntled House-Elf is gruesome, slaying the cows or worse. Thus, if the Swedish state and the controlling shareholders continue to transplant Anglo-American corporate governance regulation, the international institutional investors will remain happy and continue to provide necessary investments. If not pleased, the international institutional investors might opt for investing in other markets, with devastating effects on a stock market where more than a third of the shares are owned by foreigners.

\textsuperscript{51}The Swedish LEO law was introduced in the 1980s after a corporate scandal involving directors in firms without controlling shareholders who reaped benefits in an unlisted subsidiary that could be claimed to belong to the owners. On one hand, the LEO law lacks international comparability, as it exists only in Sweden. On the other hand, the law accords very strong protection to minority shareholders.
In a conceptual sense, the international institutional investors always seek to change the Swedish corporate governance system.

### 10.6 Conceptualizing Economic Interest in the Swedish Regulatory Process

We have seen that a number of different actors are involved in the process where international (Anglo-American) regulation is transformed into a ‘Swedish’ regulation that is not convergent with the international although internally convergent in relation to the Swedish system. Below in figure 10.1, we present a synthesised model how this transformation has occurred in the empirical examples studied here:

Figure 10.1 Corporate governance transplants in Sweden

Figure 10.1 summarizes the finding and discussions on the involvement of different interest groups in the Swedish regulatory process where Anglo-American regulation is transplanted into Sweden. As such, the figure also extends the scope of figure 8.2, as the localizing and fitting by the regulator and the regulated is connected to the economic interests that support the different events. Figure 10.1 should be read from left to right, following the path of a transplanted regulation from an international regulation throughout a transformation and finally into a Swedish regulation. This is described in red, and the conclusion is that the Swedish regulation deviates significantly from the international blue-print. Returning to the left of the figure, the agenda of the international regulation is set by international institutional investors (Thomsen, 2007). Their agenda is brought to life by the Swedish state (and the European Union), and the process of transplantation is initiated. The initiative of the state is supported by the minority shareholders. Once the transplant process enters the Swedish corporate governance system (marked in the figure), the international regulation is transformed into local regulation. Following the discussions above, this transformation occurs through fitting (adoption of Kunda and Milhaupt’s, 2003, concept of fit) and localizing (Gillespie, 2008a). The fitting is performed under the influence of the controlling shareholders in the listed firms, and the
localizing is supported by the controlling shareholders participating in the regulatory process, leaving the transplanted regulation with a distinct tone of ‘made in Sweden’.
REFERENCES


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**Regulation sited**


CALS Corporate Accountability and Listing Standards Committee (2002).

Hampel Committee on Corporate Governance (1998).


London City code of Takeovers and Mergers (1968).

Sarbanes-Oxley Act (2002).

SOU 1997:22 Aktiebolagets kapital, Delbetänkande av Aktiebolagskommittén [The corporation and its capital].


SOU 2001:1 Ny aktiebolagsslag, Slutbetänkande från Aktiebolagslagskommittén [The new companies act].

Turner Commission 2009.

UK Companies Act 2006.


Regulations
CALS Corporate Accountability and Listing Standards Committee (2002).
Hampel Committee on Corporate Governance (1998).
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