

# EXECUTIVE SUMMARY

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

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

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

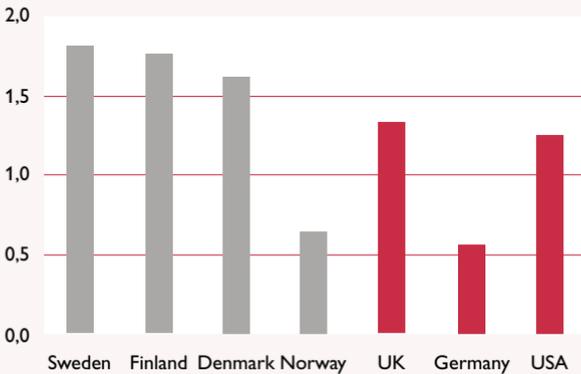
## The Nordic supermodel

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

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

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

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



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

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

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

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

## What is a ‘governance model’?

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

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

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

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

## Why a book about Nordic corporate governance?

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

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

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

## Incentives and tools for shareholders to act as real owners

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

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

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

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

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

## Effective minority protection

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

The most important of these minority-protection measures are:

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

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

# R I G H T S

## *of minority shareholders to take action*

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

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

## **Effectiveness of the model – research evidence**

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

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

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

## **A tradition of self-regulation**

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

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

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

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

## Well-functioning code enforcement

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

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

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

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

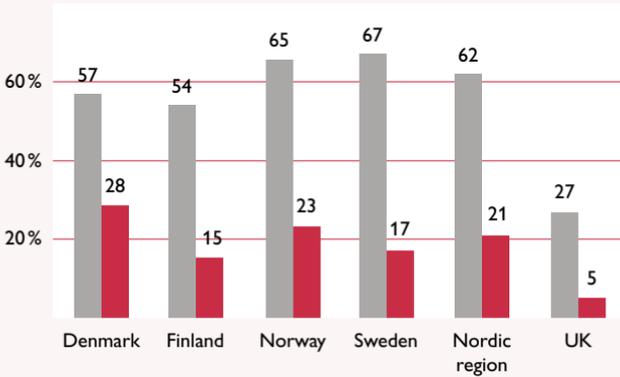
### A model flexible to different ownership structures

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

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

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

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