I Introduction

While corporate boards, audit committees and remuneration committees have been subject to extensive analysis and research, one of the most important elements of corporate governance has been largely disregarded. It is the nomination committee.

The reason why it has been neglected is that it is perceived as falling between stools. In the widely dispersed ownership systems of the UK and US, the nomination committee is an organ of the board, and shareholders for the most part rubber-stamp the recommendations of the committee. In contrast, in the concentrated ownership systems of Continental Europe and the Far East, the dominant shareholders are able to exert so much control that a nomination committee is largely irrelevant – the large shareholders appoint at will. The nomination committee is therefore decisive or irrelevant. Either way it is not very interesting.

This paper suggests that, on the contrary, the nomination committee should be a primary focus of attention in corporate governance debates. The reason is that it plays a fundamental role in the appointment and removal of board members and is a key determinant of the composition of boards and corporate performance. If companies make the right initial appointments then much else follows; if they do not then no other aspect of corporate governance - monitoring, measurement or incentives – can fully rectify the damage.

This paper contrasts the way in which nomination committees operate in two countries: Sweden and the UK. Sweden and the UK are particularly interesting because Nasdaq Stockholm and London Stock Exchange (LSE) both pride themselves in being at the forefront of Europe’s most liberalized and active market economies based predominantly on self-regulation as against legal statute. In addition, both countries embody what is termed “shareholder primacy”, namely legal, regulatory and institutional structures that privilege
shareholders over the interests of other parties. They therefore stand in contrast to several other Continental European countries and many other parts of the rest of the world. They are in this respect similar to other common law countries, such as the US, and the analysis reported here has relevance to them too.

The two countries are also of interest because they contrast the different types of nomination committees that exist, namely internal committees where independent board members nominate their successors and external committees where large shareholders play an important role in the selection process. Swedish companies usually have a large controlling shareholder who can and has the incentive to exert significant influence over the nomination process. However, this might exacerbate the information asymmetry between large, well-informed and small, uninformed, shareholders. The problem in the UK system is less between dominant and minority shareholders than it is between shareholders and management. However, the internal NC might not solve that agency problem if shareholders remain effectively excluded from the nomination process. As we will see, differences in the nature of ownership in the two countries explain much of the contrasting nature of nomination committees but conversely nomination committees may contribute to some of the differences in ownership.

Understanding the way in which NCs operate in Sweden and the US is therefore fundamental to an appreciation of the merits and deficiencies of different forms of capitalism as reflected in the ownership and governance of firms. Would the UK system benefit from having more engagement by institutional investors in the nomination process and an external rather an internal nomination committee? Would Sweden be advised to reduce the power of dominant shareholders on the nomination process and to create a greater deal of independence of nominations from large shareholders?

To provide answers to these questions, we consider how the institutional corporate governance settings of Sweden and the UK work to empower the institutional investors through the NC. The paper draws on a mixture of academic research, legal documents and official as well as semiofficial reports. These sources show how ownership has evolved since the 1980s until now and the relevance of company law in defining the role of independent directors.

The paper draws on novel research showing how Swedish institutional investors have begun to take larger stakes in investee companies that are evaluated over longer time horizons than was previously the case (Nachemson-Ekwall, 2016). In the process, institutional investors engage on a more long-term basis in the NC collaborating both with controlling
shareholders and other long-term institutional investors. There are advantages in this in addressing agency problems but at the expense of the independence of the nomination process from particular shareholders. We discuss the possibility of achieving superior outcomes by combining features of the Swedish and UK nomination process.

The rest of the article is structured as follows. First, we describe the legal and regulatory background to NCs in Sweden and the UK. We then discuss the theoretical underpinning of NCs before analysing Sweden and the UK’s NCs in detail. Finally, we draw conclusions and policy recommendations.

2. The Swedish and UK governance systems

The UK choice of an internal NC and the Swedish choice of an external NC is a reflection of the respective countries’ companies acts, corporate governance codes, takeover codes, listing rules and stewardship codes. A list of relevant soft and hard laws and regulations is provided in the Appendix.

Both countries have companies acts that state that the board of directors owe fiduciary duties to their company but are accountable to the shareholders as a group in discharging those duties. In both systems, shareholders vote on director nominees at the annual general meeting (AGM) and can propose their own directors. In both countries, the NC is part of a self-regulatory system, based on the principle of comply or explain, set out in their respective corporate governance codes - the Swedish CGC and UK CGC. Both countries observe a high degree of compliance with their governance codes (Lekvall, 2013; Davies, 2015).

However, the countries differ in regard to shareholder influence on board composition and enrolment, the composition of the NCs, how votes are exercised by the shareholders at the AGM, and their attitudes towards shareholder collaboration. The countries also differ in their approach to reflecting the interests of minority shareholders in the nomination process. Figure 1 illustrates the differences between the two countries’ approaches to the composition of NCs.

Figure 1: Two different models of the NC
We turn to a description of the two countries’ nomination committees.

The Swedish nomination committee

Swedish, and Nordic, corporate governance is based on a two-tier board with clear separation between the organs of the corporation: (i) the shareholders at the AGM: (ii) the board of directors, and (iii) the chief executive officer (CEO) and management. The Swedish Companies Act, Aktiebolagslagen, only allows one executive to be elected to the board, usually the CEO and approximately half of the boards of listed companies do not include the CEO (Lekvall, 2008). The Companies Act grants a single shareholder or group of shareholders controlling 50 per cent of the votes at the AGM the right to nominate all the directors of the board. The strength of a large shareholders may be further enhanced by multiple voting shares (Series A shares assigned 10 votes and B shares assigned 1 vote) and over half of listed companies have multiple voting stocks (Lekvall, 2014), despite a trend to IPOs with only one class of shares.

The Swedish Corporate Governance Code reflects the dual role of directors enshrined in the Companies Act. The Code describes the view of dominant shareholders as beneficial, and then applies a distinction between directors being independent of the company and directors being independent of major shareholders with the express purpose to promote their control over management. It is recommended that at least two directors be independent of both the company and large shareholders, defined as owners of more than 10 per cent of capital or votes. No more than half the directors are permitted to have had a relationship with the company (e.g. as a recent employee, customer or financial institution). In addition,
Swedish co-determination allows two directors to be nominated by the workers’ unions, usually one from each of blue and white-collar unions. The NC is appointed by shareholders at the general meeting or during the course of the year. About four of five listed companies use the latter approach (Carlsson 2007; Lekvall, 2008) with companies appointing the NC in the third quarter of the year.

In order to avoid the NC being entirely dominated by a controlling shareholder, at least one member of the committee has to be independent of the largest shareholder. A typical NC will comprise one or two representatives of the controlling shareholder, the Chair (who is often associated with the controlling shareholder) and two or three institutional investors. These are likely to be Swedish. Large foreign institutions generally decline offers to participate in the NC (Ehne, 2014). A representative of small investors is sometimes invited to join the NC but that is unusual.

It is common for the NC to comprise members representing 15 to 20 per cent of shares, which often is enough to control a majority of the votes at the AGM, particularly if the shares have multiple voting rights.

The UK nomination committee
Nomination committees (NCs) became commonplace after the British Cadbury-report on corporate governance was published in 1992.1 UK corporate governance is based on a one-tier board structure. The UK Companies Act allows boards to be made up of a mixture of inside (the CEO and other executives) and outside non-executive directors, NEDs. At least half the board, excluding the chairman, should comprise NEDs who are regarded by the board as independent. Exceptions are made for smaller companies, which should have at least two independent NEDs.2 British governance does not believe that large shareholders can be trusted to act in the interests of the shareholder community as a whole. The Companies Act defines a significant owner as one with more than 25 per cent of the votes and the CGC defines an independent director as one who represents a shareholder with less than 10 per cent of the votes.3

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1 The UK Corporate Governance Code (the Code) has its origins the Cadbury Committee in 1992 and paragraph 2.5 defines corporate governance as “the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies.”

2 A smaller company is one that is outside of the FTSE 350 during the year immediately prior to the reporting year.

3 The UK Companies act talks about “significant” owners and not large owners (which is the common wording in other jurisdictions). A significant owner is presumed to own more than 25 per cent

http://www.step.org/sites/default/files/Policy/PSC-register-Draft-Statutory-Guidance-3-December-2015.pdf The small business act defines a significant owner as someone controlling 25 per cent of the company’s shares or
The view that large shareholders cannot be trusted to act in the interest of the shareholder community as a whole is reflected in the composition of the nomination committee. As an internal organ within the board of the firm, the NC is required to comprise a majority of NEDs, usually at least three directors. The NC is expected to pursue a dialogue with shareholders. Shareholders vote at the AGM and in principle can propose their own candidates but this is seldom done in practice. There is no co-determination in the UK.

The NC is an important component of corporate governance in both the UK and Sweden and we turn now to its theoretical underpinnings to understand why it has not fully mitigated the agency conflict and information asymmetry between minority shareholders and management in the UK or between large and small shareholders in Sweden.

3. Theoretical underpinning of the NC

The legitimacy of the NC relates to three areas of research. These are: (i) the purpose of the board; (ii) the choice of NC model; and (iii) the legitimacy of independent directors.

The purpose of the board

Adam Smith (1776) discussed the board’s role in mitigating information asymmetries between shareholders and management. Ronald Coase (1937) identified the value of empowering the corporate form with a central decision-making body, substituting entrepreneurial fiat for the price mechanism of the market.

Success is expected to lead to a board that both contributes to corporate value creation and lower capital costs. Since the beginning of the 1980s the conventional view has been that value creation is evaluated in terms of shareholder wealth, and the board exists to monitor, advise and contribute to strategy formation to enhance shareholder value. For minority shareholders, it is both cheaper and rational to transfer decision-making to a smaller and informed body with authority (Banbridge, 2015).

The “agency-problem” is then defined as aligning the interests of board and managers with those of their external shareholders, to avoid unprofitable growth or undue complacency.

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The definition of independence is however broader, excluding the possibility of acting for any stakeholder-interest (customers, profession or any shareholder with a large holding, which is usually set at 10 per cent). [http://www.step.org/sites/default/files/Policy/PSC-register-Draft-Statutory-Guidance-3-December-2015.pdf](http://www.step.org/sites/default/files/Policy/PSC-register-Draft-Statutory-Guidance-3-December-2015.pdf)

4 This reasoning is developed by Bainbridge in Research Handbook on Shareholder Power (2015) Bainbridge adheres to the separation thesis as it strengthens the boards’ accountability, giving it a strong efficiency justification.
(Berle and Means, 1932/1968; Jensen and Meckling, 1976). However, the agency-problem can also be related to conflicting interests between a large block holder, with active participation on the board, and minority shareholders with both less influence and information. This is the principal-principal conflict (Easterbrook and Fischel, 1981/1991; Burkart and Panunzi, 2008). Minority shareholders need to be protected to ensure that the board is accountable to all shareholders, i.e. that there are limits to the ability of large shareholders to divert wealth to themselves.

The shareholder primary model has been questioned in many contexts (e.g. Stout, 2012 and Colin Mayer, 2015). According to these critiques, corporate governance is about “ensuring that the corporation abides by its stated purpose, values and principles”. Consequently the board’s role should focus on creating value in the interest of the corporation itself, its employees, stakeholders, including shareholders and society. This focus of the board’s function moves away from the agency view to team production theory (Blair and Stout, 1999; Huse, 2007).

Research shows that long-term committed owners have great influence on corporate governance. Almost all Nordic companies have a strong owner (Lekvall, 2013). Studying Danish foundations, Hansmann and Thomsen (2012) find a correlation between value creation and support of long-term committed industrial foundations. However, strong ownership is by no means always successful and it is not clear how much of the success of the Nordic corporate model is attributable to the high trust nature of Nordic societies, i.e. small country effects (Sinani et al. 2008). In the case of Sweden, it might just be that respect for large owners, passive support from minority institutional investors, and a healthy relationship with both the state and labor unions have allowed Sweden to develop profitable, well-run companies (Henrekson and Bergh, 2013).

**Empowering directors through the NC**

Most jurisdictions formulate the director’s fiduciary duty as being accountable to the company and/or shareholders as a whole. This puts the long-term owner-perspective centre stage rather than the interests of either current short-term shareholder or management. However, the role of the NC differs appreciably between Nordic countries and the UK and US.

The Nordic model embraces shareholder nominated directors on the board, including

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representatives of large shareholders. All Nordic jurisdictions allow owners controlling 50 per cent of the votes at the AGM to enroll all shareholder-nominated board members. Nordic countries have chosen different versions of the NC. The Norwegian NC is specified in the corporate charter, and different stakeholders are elected to the NC at the AGM – shareholders, employee-representatives and board members. Finish companies can choose between an internal or external NC model. There are no employee representatives on the Finish board. The NC in Denmark is internal and has a mixture of executives and shareholder supported directors and there is Danish codetermination.

The Swedish external NC with shareholder representatives as part of the code is an extreme version of the Nordic corporate governance model. It offers all owners a forum to discuss governance issues and to enter a dialogue with the company. Collaboration and concerted activities among shareholders, including institutional investors, are encouraged. A number of studies of the Swedish capital market suggest that conflicts between large and small shareholders have overall been kept at a low level, trust between majority and minority shareholders in general being high (Gilson, 2006; Sinani et al. 2008; Lekvall, 2014).

In contrast the UK and US have stock markets dominated by dispersed ownership and companies acts that empower management-led boards. In the US case the board comprises a mixture of internal and external directors empowered to interpret their fiduciary duty to protect long-term interest of the company. Board enrolment is an internal matter, with the NC part of the board and in the control of the chair, the vice chair and the CEO. In the post-financial crisis era, a number of companies have been pressed by their shareholders to change their byelaws to facilitate enrolment of shareholder nominated directors.6

The UK Companies Act empowers the General assembly to suggest directors (just as in Sweden) but shareholders seldom do. British governance views large shareholders as stakeholders with specific interests rather than those of shareholders as a whole. At the same time, a board composed by only independent NEDs would turn into a pure monitoring board, in the UK eyes (Davies, 2015). To balance the different role of the directors, the Companies Act requires a mixture of internal and external (independent) directors. This is reflected in the UK corporate governance code’s requirement that a NC be composed of a majority of independent directors and recommends that only one representative for a large owner be

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6 In 2010 the Obama administration plan to force companies to include directors’ nominees from certain large shareholders in the corporation’s proxy under specific conditions (US 2010, Rule 14a-11) was voted down. Shareholders have since acted to change byelaws instead. For a description see: IGOPP, institute of governance. Who should pick board members? Proxy Access by Shareholders to the Director Nomination Process. Policy paper no. 8 2015. Canada. www.igopp.org
Legitimacy of independent directors

Legal scholars highlight that corporate governance codes, including the original British Cadbury rules, are unclear about the definition of “independent directors” (i.e. Hansen, 2013; Andersson, 2013; Kershaw, 2015).

Hansen (2013) draws on the Nordic governance experience to argue that independent directors all too often fail to monitor and discipline management. Independent directors that are independent of both the company and owners do not solve the governance problem; instead Hansen claims that governance should recognize the importance of active owners.

There is no evidence of significant performance effects from the presence of independent directors on company boards (Bhagat and Black, 1999, 2002; Hermalin and Weisbach, 2003; Adams et al. 2010). Examining the rise of independent directors as a legal transplant from jurisdictions with dispersed ownership to other systems in which controlled corporations are dominant, Ferrarini and Filippelli (2015) show that countries use different definitions of, and assign different powers to independent directors of dispersed ownership and controlled companies. Independent directors of controlled companies have a narrower and weaker role than their counterparts in companies with dispersed ownership. Thus, independence requirements in the block-holder context need to be sufficiently broad to encapsulate the relationship between independent directors and controlling shareholders.

4. Contrasting NCs in Sweden and the UK

Inspired by the Cadbury Code in 1993, the Swedish external NC was developed by the Swedish Shareholders’ Association, with support of a group of the leading domestic institutional investors. It was put into practice for the first time in 1993, after the failed merger between Swedish vehicle conglomerate Volvo and French Renault, which left Volvo without a board of directors. However, as incumbent owners in general were negative towards adopting a corporate governance code, it took until 2005 before the NC became standard Swedish procedure.

7 Provision B.2.1 of the UK Code.
8 See, inter alia, the European Commission, Green Paper on Corporate governance in financial institutions and remuneration policies, COM (2010) 284, Brussels, 2 Jun. 2010, 8, where a reason for the failure of shareholders in the recent crisis is explained by ‘the lack of effective rights allowing shareholders to exercise control’, and in the title of its Action Plan, n. 3 supra, specific reference is made to engaging shareholders.
That Sweden settled for an external NC is partly explained by the Swedish popular movement tradition, with civil society democratically structured with non-profit organizations and cooperatives in all parts of life (föreningstradition). Thus the original proposal from the Shareholders Association was for the shareholders to join together to set up the NC at the AGM, to assure the NCs accountability to all shareholders. When the Code was revised in May 2008, a sentence (Chapter 2 §1) was added that the members of the NC are to promote the interest of all shareholders.\(^9\) To assure the NCs independence from large owners it was also stated that at least one member should be independent of any large shareholder or shareholders working in collaboration. (Chapter 2 §3). However, the notion of independent directors was removed from the Nasdaq Stockholm’s listing requirements in 2010, consequently limiting the efficacy of the NC.

When Cadbury 1992 first introduced the NED, it stated that a majority of directors should be independent of the company and that these should be at least a group of three. Independence was defined as free from any business or other relations that might materially interfere with their exercise of independent judgment. NEDs were to be selected through a formal process with the support of a nomination committee and both this process and their appointment was to be a matter for the board as a whole, thereby limiting risk of stakeholder influence (1992: 4.10–4.17). Re-election was stated to be at least every third year.

In the preparatory work of the Cadbury code consideration was given to the idea that shareholders should be more closely involved in the appointment of directors and auditors through the formation of “shareholders’ committees”. This was ruled out: “…as we have not seen evidence explaining how it would be possible to form shareholder committees in such a way that they would be both truly representative of all the company’s shareholders and able to keep in regular touch with their changing constituencies. Unless these tests of legitimacy are met, the Committee is unable to see how shareholder committees can become the accepted link between a board and its shareholders.” (Section Accountability to the Shareholders. 6.3)

A number of studies show that the Swedish version of an external NC has had a spiral effect as shareholders’ engagement in the nomination process has increased confidence in the board function and stimulated shareholders to become more engaged (Poulsen, Strand and Thomsen, 2010). Building on comparative material from institutional investor activities and proxy statements at the AGMs in Denmark and Sweden, Hannes and Strand (2013) show how

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\(^9\) the change is explained in the background
http://www.bolagsstyrning.se/UserFiles/Archive/404/kodjamforelse.pdf
the Swedish model has transferred power from the board to the shareholders across almost all listed companies at the SSE. Almost all companies listed on SSE have domestic institutional investors on the NC, often two,\(^\text{10}\) thereby reducing both the free-rider and collective action problems (Hannes and Strand, 2013). Also, the old boys network has clearly been broken (Björkmo, 2008).

Domestic institutional investors have enhanced the recruitment of female board members. There are more females among the independent directors than among the owner dependent directors (AP2, 2016). This indicates that engagement of institutional investors on the NC (as the institutions are only involved in the enrollment of independent directors), have had a clear impact on the Swedish gender-development (Table 3). Sweden lacks a gender quota. Other studies claim that institutional investors in NCs have been particularly contributive to director enrollment in small and medium sized companies, as the executives and owners often lack a relevant network of qualified people (Grönberg and Kallifatides, 2012).

**Table 3: Enrolment of female directors among owner dependent and independent directors. Statistics AGMs 2016.**

<table>
<thead>
<tr>
<th>Females, %</th>
<th>Total</th>
<th>Independent</th>
<th>Owner dependent</th>
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<tr>
<td>Large</td>
<td>32</td>
<td>44</td>
<td>18</td>
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<tr>
<td>Mid</td>
<td>29</td>
<td>42</td>
<td>8</td>
</tr>
<tr>
<td>Small</td>
<td>24</td>
<td>32</td>
<td>10</td>
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</table>

Source: with courtesy from Lannebo funds, Didner& Gerge, AMF and Swedbank (2016)

Here we draw special attention to novel research showing how Swedish institutional investors in the post financial crisis era have begun to take larger stakes in the investee companies and that this leads them to engage more, thus leveraging on the NC (Nachemson-Ekwall, 2016). This research includes in-depth interviews with fifty representatives of Swedish institutional investors conducted 2014–2016. Looking at the period 2000–2016 seventy per cent of them show to have committing more capital to larger stakes than previously and evaluate those investments with a longer time horizon (Table 4). The purpose has been to enhance performance.

\(^{10}\) [www.holdings.se](http://www.holdings.se) lists all nomination committees.
The changed investment style has been done within the current regulatory framework and without increasing exposure to the Swedish stock market. To further the discussion on changing the domestic institutional-investor rationale Nachemson-Ekwall (2016) re-conceptualizes their investment strategy using a three-phase framework. In the first phase, broadly consisting of the period 1980-2000, the collectivization of the Swedish capital market both took off and began to move abroad. There were institutional investments in larger stakes, but engagement remained more or less passive (Hellman, 2005). In the second phase, broadly consisting of the period just before the turn of the millennium and up to the beginning of the post-financial-crisis era, the globalization of capital markets was refined, with the industry focusing on low-cost benchmarking, index tracking and smaller stakes in each company. The third phase, can be said to have already begun during the final stage of the financial-bubble years, but the results – in the form of an increased focus on larger stakes in the active portfolio mandate on the Swedish stock market – began to show up a few years into the post-financial crisis era. This change in investment style hinges on a reconsideration of portfolio-allocation strategies and leveraging on the shareholder friendly Swedish governance model. In the process, the Swedish institutional investors claim to engage more long-term with the NC; collaborating both with controlling shareholders and other long-term institutions. Sweden lacks a Stewardship Code for institutional investors, though most of the domestic actors have developed one.

Table 4: The largest Swedish institutional investors and their stakes on the SSE
A head of stock equity at a life insurance company explains:

“We believe in home bias. Seventy percent of all our assets are invested in Sweden. We have 10% in Swedish stocks. We have been around for a long time; we know our companies, engage in corporate governance and can talk to the directors. It pays off, long-term. Outside Sweden, my network is weaker. In Asia, I am a nobody.”

Also, all institutional investors highlight the close interaction between domestic institutional investors in the Swedish corporate governance model. Large shareholders are expected to be engaged and to coordinate activities. Everyone knows each other. A chair can easily get in touch with the five largest domestic investors, whereas the foreign institutional investors are either disengaged or difficult to reach. The head of sustainability and governance of a bank-controlled mutual fund describes its role:

<table>
<thead>
<tr>
<th>2016 Owner</th>
<th>&gt; 3% 2007</th>
<th>&gt; 3% 2016</th>
<th>&gt; 5% 2007</th>
<th>&gt; 5% 2016</th>
<th>Focus?</th>
<th>No of stocks</th>
<th>Billion SEK</th>
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<tr>
<td>1 Swedbank Robur</td>
<td>57</td>
<td>97</td>
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<td>3 AMF pension &amp; funds</td>
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<td>5</td>
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<td>4 SHB funds</td>
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<td>5 SEB funds</td>
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<td>6 Nordea funds</td>
<td>25</td>
<td>48</td>
<td>8</td>
<td>31</td>
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<td>5</td>
<td>16</td>
<td>+</td>
<td>192</td>
<td>37</td>
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<td>12 Lannebo funds</td>
<td>15</td>
<td>43</td>
<td>8</td>
<td>36</td>
<td>+</td>
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<td>5</td>
<td>0</td>
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<td>14 SNPF1</td>
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<td>3</td>
<td>1</td>
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<td>17 Carnegie funds</td>
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<td>18 SPP funds</td>
<td>-</td>
<td>0</td>
<td>-</td>
<td>0</td>
<td>=</td>
<td>71</td>
<td>24</td>
</tr>
</tbody>
</table>

Source: Aktieservice, 2007; Holdings.se 2016; In Nachemson-Ekwall (2016)

*Bought Skandia AB for SEK 22.5 Billion in 2011, and sold off parts of the Swedish portfolio

**Bought 10 % in Swedbank for SEK 10 Billion in 2008
“We have been practicing governance for 20 years now. It is expected of us that we are engaged and responsible. When we make large investments, we engage (for the) long term. Sweden is in the forefront in this process.”

There are also studies revealing critique of the works of the Swedish external NC. A survey made by proxy-consultant Nordic Investor Services (2010) of 27 chairs of companies and 33 chairs of nomination committees from 25 large and 25 smaller companies in April-June 2010 reveal that there is a problem with relating to insider information and that institutional investor-representatives, like corporate governance specialists, often lacked company specific competence. This has largely been left un-addressed. A list of the institutional investors on the NC complied from the AGM season 2016 reveal an overwhelming number of investment professionals, and a number of them participate on 10 NC (Table 5).

Table 5: Institutional investors with the largest number of members on the NC

<table>
<thead>
<tr>
<th>Institutional Investor</th>
<th>AUM</th>
<th>Nomination committees</th>
</tr>
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<tbody>
<tr>
<td></td>
<td></td>
<td>No of individuals</td>
</tr>
<tr>
<td>Swedbank Robur</td>
<td>172</td>
<td>10</td>
</tr>
<tr>
<td>Vanguard</td>
<td>140</td>
<td>0</td>
</tr>
<tr>
<td>Black Rock</td>
<td>132</td>
<td>0</td>
</tr>
<tr>
<td>Alecta</td>
<td>120</td>
<td>7</td>
</tr>
<tr>
<td>AMF</td>
<td>115</td>
<td>7</td>
</tr>
<tr>
<td>SHB funds +Exact</td>
<td>95</td>
<td>7</td>
</tr>
<tr>
<td>SEB funds and life</td>
<td>87</td>
<td>5</td>
</tr>
<tr>
<td>Capital Group</td>
<td>63</td>
<td>0</td>
</tr>
<tr>
<td>Nordea funds</td>
<td>63</td>
<td>13</td>
</tr>
<tr>
<td>AP4</td>
<td>51</td>
<td>9</td>
</tr>
<tr>
<td>Fidelity</td>
<td>44</td>
<td>0</td>
</tr>
<tr>
<td>Skandia Life &amp; funds</td>
<td>42</td>
<td>5</td>
</tr>
<tr>
<td>Folksam</td>
<td>42</td>
<td>1</td>
</tr>
<tr>
<td>Didner &amp; Gerge</td>
<td>38</td>
<td>4</td>
</tr>
<tr>
<td>LF funds</td>
<td>37</td>
<td>4</td>
</tr>
<tr>
<td>Lannebo funds</td>
<td>35</td>
<td>12</td>
</tr>
<tr>
<td>Invesco</td>
<td>31</td>
<td>0</td>
</tr>
<tr>
<td>AP2</td>
<td>28</td>
<td>3</td>
</tr>
<tr>
<td>Catella funds</td>
<td>15</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: Holdings.se 2016. 10 individuals on 69 NC mean an average of 7 each.

Studies also highlight the concentration of power in the hands of the NC. When the NC only represents like 10–15 per cent of the total shareholdings it really lacks legitimacy in the eyes of other minority shareholders (Björkmo, 2008). The Swedish version of external NC has also
difficulty dealing with controlling shareholders that choose not to collaborate with minority shareholders, that could also be institutional investors (Nachemson-Ekwall, 2012/2017). In addition, there is no regulation enforcing independent directors, and no checking on the quality of the two independent directors that are enrolled in companies where a large owner controls a majority of the votes at the AGM (Nachemson-Ekwall, 2012). Discussing the activities taken buy hedge fund activist Cevian in relation to Old Mutual’s hostile takeover of Skandia 2006 Kallifatides et al (2010) shows how the Sweden’s external NC appears to be able to handle risks of short-termism or stakeholder-interest only in the case a shareholder responds to social control, i.e. legitimacy (Nachemson-Ekwall, 2012; Andersson, 2013).

In the revised Code 2015 two changes were introduced related to the NC. Rule 2 now states that any person on the NC shall upon acceptance consider possible conflicts of interest. It also demands that the NC considers diversity of directors and works to promote gender equality (Chapter 2 §1).

There appears also to be a dominance of independent directors educated at a few business schools. Among the independent female board members almost all have an exam from Stockholm School of Economics. These are all dependent on good relationships with the institutional investors. Integrity is not all that matters when there is a risk of “cold shouldering” gives less opportunities for further jobs, writes Andersson (2013). Studying Norwegian female board members, Huse et al (2014) points at the problematic with the growing group of female independent directors that has become professionals, aiming to get board positions rather than being loyal to the company. Consequently, the quality of independent (female) directors cannot be guaranteed in the shareholder led NC either.

Here we wish to add that foreign institutional investors, such as Vanguard, Blackrock and Capital group abstain from participation on the NC, thus limiting engagement from the international community to a few activist hedge funds. The general reason given is that they don’t understand the model; there is a language barrier and there are problems related to allocation of time (Ehne, 2014).

Also the model with shareholder led NCs enrolled through the ranking of size work against private investor participation, as these are difficult to reach during the year (i.e. the Q3-model) and usually lack financial resources to set off time to participate. This is especially troubling in SMEs that often lack enough institutional capital.

7. Analysis
The nomination process is a particularly important but largely ignored aspect of corporate
governance. It has been ignored in relation to the attention that has been paid to other corporate governance committees such as the remuneration and audit committees. Both of these appear to have greater relevance to the financial performance of firms and the correction of managerial failure.

In actual fact, the nomination process is particularly important because it is a primary determinant of the composition of corporate boards and therefore the functioning and performance of the firm. As custodians of the corporate purpose and firm values, the board plays a critical role in establishing the objectives of the firm and overseeing their implementation through the formulation of strategy, measurement of performance and setting of standards and incentives. The identification of the right members of the board is therefore a primary influence on operation of the firm.

The comparison of the nomination process in Sweden and the UK has been particularly insightful because of the superficial similarities between the two countries. Both countries place considerable significance on self-regulation and liberalized markets, and on shareholder rights and privileges. However, the differences are as pronounced as the similarities in particular in terms of the presence of block holders and significant concentrations of shares in Sweden but not in the UK.

This has given rise to pronounced variations in the way in which the nomination committees have been structured and operate in the two countries. In Sweden, an external nomination committee provides a forum in which the contrasting views of dominant shareholders about the composition of boards can be resolved. It is an effective way of encouraging shareholder engagement in the nomination process.

In the UK, the highly dispersed nature of share ownership makes the involvement of shareholders in the nomination process more difficult. There is a serious free rider problem that has given rise to the phenomenon of the “ownerless corporation” in which no investor plays an active governance role. As a result, instead of engaging shareholders in the nomination process, appointments are an internal process in which (independent) members of the board nominate board members themselves for ratification at shareholder meetings.

The advantage of the UK procedure is that it keeps the nomination process independent of any particular shareholding group and promotes the fair treatment of all shareholders. In the Swedish internal nomination process, while there is a requirement on members of the committee to represent the interests of all shareholders, there is an inevitable and unavoidable privileging of those present on the nomination committee. Indeed, some investors regard the fact that appointees inevitably feel a sense of gratitude to those who have
appointed them as a potential advantage of building a relation between investors and boards.

The drawback of the UK system is the lack of effective oversight of the nomination process by parties other than the board itself. The members of the board owe a fiduciary of care and loyalty to all shareholders and no doubt perform their functions to the best of their abilities but it is essentially an internal self-election process, albeit subject to ratification by shareholders.

The more serious consequence is that it does not create the feeling of loyalty and mutual respect between directors and dominant shareholders of the Swedish system. There are no dominant shareholders with whom to establish relations in the UK process and therefore relations are transactional in nature. That makes reliance on indirect mechanisms of corporate control through activism and takeovers particularly commonplace in the UK context. It exacerbates the impression in the UK of short-term attitudes and engagement by shareholders.

An external nomination committee is therefore part of the development of the longer-term relations between investors and firms that are emerging in Sweden and have been noticeably absent from the UK. Indeed, in addition to being a consequence of the presence of share blocks, Swedish external nomination committees may contribute to the formation of blocks by providing an inducement to shareholders to acquire sufficiently large and long-term shareholdings to gain representation on the committees. It is in essence a reward for sacrificing some of the benefits of portfolio diversification.

While the Swedish and UK systems may be regarded as contrasting in terms of their structure and operation, there is no reason why elements of the two cannot be combined. In fact, one can regard a pure external and a pure internal nomination committee as lying at two ends of a spectrum in which the nomination process can vary between an external shareholder and internal board determined process. For example, some of the board positions could be nominated by external and other by internal committees. Alternatively, all appointments could be by internal committee as in the UK but with some external shareholder representation.

This has significant implications for the exercise of corporate governance because it provides for both long-term engaged shareholder participation and independent self-appointments by the board. It allows, for example, for lead shareholders to take it in turn to initiate board positions on behalf of other shareholders and benefit themselves from the lead role played by their co-investors in other companies. In other words a flexible application of internal and external nomination committees may help to address many of the issues
associated with free-riding and conflicts of interests in corporate governance.
## Appendix A

### UK

<table>
<thead>
<tr>
<th>DEVELOPMENT OF HARD LAW</th>
<th>COMMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>UK COMPANIES ACT</strong></td>
<td>The duty of loyalty is &quot;to promote the success of the company for the benefit of its members as a whole&quot; and have regards to employees, environment, customers and suppliers, society, reputation and fairness among different stakeholders</td>
</tr>
<tr>
<td><strong>Companies Act 2006</strong></td>
<td>The board is to be made up of a mixture of inside and outside (non-executive) directors</td>
</tr>
<tr>
<td></td>
<td>A shareholder may submit a proposal for the nomination of a director candidate if he holds 5% of the shares of the company.</td>
</tr>
<tr>
<td></td>
<td>Incumbent management and board do not have to treat these candidacies on equal footing with those proposed by the NC</td>
</tr>
<tr>
<td></td>
<td>Exceptions are made for smaller companies; these should have at least two independent non-executive directors</td>
</tr>
<tr>
<td><strong>Co-determination</strong></td>
<td>UK lacks employee representatives on the board; government plans for introducing an advisory board</td>
</tr>
<tr>
<td><strong>TAKEOVER RULES</strong></td>
<td>Directors can consider other issues besides price when making a recommendation to the shareholders</td>
</tr>
</tbody>
</table>

### DEVELOPMENT OF SOFT LAW

<table>
<thead>
<tr>
<th>GOVERNANCE CODE</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cadbury Code 1992</strong></td>
<td>The board must constitute not more than 50% executives and at least 50% independent NEDs.</td>
</tr>
<tr>
<td></td>
<td>A large shareholder, (with more than 10% of votes), may only nominate one director</td>
</tr>
<tr>
<td></td>
<td>Separation between the CEO and chair</td>
</tr>
<tr>
<td></td>
<td>Directors of the 350 largest listed companies shall stand for annual re-election</td>
</tr>
<tr>
<td></td>
<td>Nomination Committee to include three independent NEDs</td>
</tr>
<tr>
<td><strong>Myners Report 2001</strong></td>
<td>Encourage investor engagement in corporate governance</td>
</tr>
<tr>
<td><strong>Higgs Report 2003</strong></td>
<td>Cleared the independence of a large shareholder, set at 10%, introduced a 10 year limit for independence</td>
</tr>
<tr>
<td></td>
<td>The NC to be made up of a majority of independent directors, clearer role for senior independent director</td>
</tr>
<tr>
<td><strong>Walker Review 2009</strong></td>
<td>Yearly re-election of all directors</td>
</tr>
<tr>
<td></td>
<td>Relaxation of definition of independence, to enable enrollment of industry-competence</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ROLE OF NON EXECUTIVE DIRECTORS NEDs</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>NEDs</strong></td>
<td>Defined as independent of the company and an owner that might influence behaviour</td>
</tr>
<tr>
<td></td>
<td>A senior independent NED is assigned the role to have contact with large shareholders</td>
</tr>
<tr>
<td><strong>Controlling Shareholders</strong></td>
<td>An owner &gt;30% of votes must sign a &quot;relationship agreement&quot; codifying the relationship to minority shareholders</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ROLE OF INSTITUTIONAL INVESTORS</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Stewardship Code</strong></td>
<td>Subject to Stewardship Code since 2010</td>
</tr>
<tr>
<td></td>
<td>Encourage formation of &quot;investor forum&quot;, supported by asset owners in 2013</td>
</tr>
<tr>
<td></td>
<td>Companies are obliged to state how they interact with their shareholders</td>
</tr>
<tr>
<td></td>
<td>Targeting institutional investors on the LSE to enhance engagement and monitoring long-term</td>
</tr>
<tr>
<td><strong>Shareholder collaboration</strong></td>
<td>Owners &quot;Acting in Concert&quot;, i.e. in control over 30% of stocks must present a mandatory bid</td>
</tr>
<tr>
<td></td>
<td>Owners may &quot;collaborate&quot; on director nomination, given that they not aiming for control seeking activities</td>
</tr>
</tbody>
</table>
## DEVELOPMENT OF HARD LAW

<table>
<thead>
<tr>
<th>Act</th>
<th>Description</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>COMPANIES ACT 1944/75/95</strong></td>
<td>Separation between the CEO and chairman. Directors are voted in by simple majority at AGM. Only one executive on the board.</td>
<td></td>
</tr>
<tr>
<td><strong>Voting rights</strong></td>
<td>A shareholder/shareholders controlling 50 per cent of the votes at the AGM can vote in all nominated directors. Companies can have multiple voting stocks, no more than 1:10.</td>
<td>Since 1995, before 1:1000, removed over a number of years, the last 2001.</td>
</tr>
<tr>
<td><strong>Companies Act 1944</strong></td>
<td>Until the millennium there existed different types of caps on voting i.e. 20 %, 5 %, number of shares (20). To enhance trust between different groups of shareholders – i.e. large dominating shareholders and minority shareholders – it was possible to include in the company’s charter that no single shareholder should be able to vote for more than 20 per cent of the votes present at the AGM.</td>
<td></td>
</tr>
<tr>
<td><strong>Companies Act 1975</strong></td>
<td>The chief rule of the stating that no shareholder may vote for more than one-fifth of the shares represented at the meeting, unless otherwise stipulated in the articles of association.</td>
<td>Swedish Government SOU 1995:44 p. 20.</td>
</tr>
<tr>
<td><strong>Companies Act 2005</strong></td>
<td>All directors are to act in the interest of all shareholders.</td>
<td>The General Clause in the Swedish Companies act 8 Ch. 41 § (ABL 2005:551)</td>
</tr>
</tbody>
</table>

## DEVELOPMENT OF SOFT LAW

<table>
<thead>
<tr>
<th>NC</th>
<th>Description</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The Swedish external NC</strong></td>
<td>Swedish Shareholders Association suggested a Governance Code 1993, with an NC. Smaller shareholders can invite a participant. To provide continuity a member can be asked to stay, even of stocks have been sold.</td>
<td>Sweden introduced a CGC 2005. The CGC offers different alternatives (CGC Rule 2:2). The AGM structure was suggested by the Swedish SI. 4/5 of the companies apply the Q3 model.</td>
</tr>
<tr>
<td><strong>Member on NC</strong></td>
<td>Usually the word &quot;representative&quot; has been used, which the CGC corrected in 2008, instead writing &quot;appointed by&quot;,</td>
<td>CGC 2008 § 1 but &quot;representative is still used, partly as a result of the presence of large owners.</td>
</tr>
<tr>
<td><strong>Setup off external NC</strong></td>
<td>Usually the 3 or 4 shareholders are invited at the time of the Q3. A majority of its members must be independent of the company. At least one member must be independent of the company's largest shareholder or groups of shareholders acting in concert. Chair of the board cannot be the chair of the NC, no executives on the NC, Directors can participate but only one may be dependent on a major owner. A representative of smaller shareholders can be invited to participate. To provide continuity a member can be asked to stay, even of stocks have been sold down.</td>
<td>CGC Rule 2:3. 4/5 of the companies apply the Q3 model.</td>
</tr>
</tbody>
</table>

## ROLE OF INDEPENDENT DIRECTORS

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Description</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Listing requirements</strong></td>
<td>2005–2010 the Nasdaq Stockholm listing requirement of two from large owners independent directors: Two independent in the Code.</td>
<td>All listed companies need to follow the code, including the Swedish CGC.</td>
</tr>
<tr>
<td><strong>Swedish CGC</strong></td>
<td>The majority of the members of the board must be independent of the company. At least 2 directors must also be independent of majority owner (defined as owner with +10 % of shares and votes).</td>
<td></td>
</tr>
<tr>
<td><strong>Swedish Shareholders Association</strong></td>
<td>Wants to se 3 directors independent of large owners written in the Nasdaq Stockholm listing rules.</td>
<td>Suggested in the Owner Policy 2017.</td>
</tr>
</tbody>
</table>

## ROLE OF INSTITUTIONAL INVESTORS

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Description</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Stewardship Code</strong></td>
<td>Sweden lacks a Stewardship Code. Many have compiled their own code.</td>
<td>Swedish Investment Fund Association has a code.</td>
</tr>
<tr>
<td><strong>Limits on voting</strong></td>
<td>The national pensionfunds (SNPF) have a voting cap at 10%. The retail funds have limits, generally viewed to be 10 % too.</td>
<td>Regulated in law.</td>
</tr>
</tbody>
</table>
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