

# Finding the right balance

Long-term value creation is gaining ground, both among asset owners and regulators. However, finding the right balance between the short-term and long-term is key for maximising economic growth according to researcher Sophie Nachemson-Ekwall.

Text: **Peter Sullivan**

Corporate governance research is a hot topic with many different angles currently being covered. Sophie Nachemson-Ekwall, a researcher at the Stockholm School of Economics, has recently been looking into the need for long-term owners in small to medium-sized enterprises (SMEs). “There is a need among SMEs for long-term capital owners that don’t rock the boat too much. The corporate boards need to be given time to develop and implement on their long-term strategies,” Sophie Nachemson-Ekwall says.

However, after the financial crisis, the situation for many SMEs is less stable than before. “Small and mid-caps are in a sense more exposed than before the financial crisis,” she says. “The banking sector has been hit with a regulatory framework that inhibits them from lending as much as they have done in the past. At the same time, many institutional investors have from a cost and resource perspective not been willing to invest the time and money directly in too many small and mid-sized companies, which means that the SMEs are in a double whammy.”

She notes that it is in the interest of large international investors to help ensure that the global economy continues to grow. “A part of this is to safeguard that small and mid-sized companies grow up to become large companies. That’s why large institutional investors cannot disregard investing in SMEs,” Sophie Nachemson-Ekwall says.

She also stresses that long-term ownership in domestic companies by domestic asset owners provides a good environment for value creation over time. “If you chose 10 stocks that have good corporate governance, a strong business and so on and stick with them for the long-term, then

the chance is high that this group will outperform the index over the course of the next couple of years,” says Sophie Nachemson-Ekwall. “Investing more in domestic companies isn’t as risky as one may think since domestic investors have a competitive advantage from being better informed.”

In Sweden, the corporate governance model makes it easy for owners to get a say if a company runs into trouble. All directors are elected through shareholder votes on the AGM, which means that even with relatively small positions in a company, an investor can influence the board composition if there isn’t a majority owner in place. Even in situations with multiple voting stocks, the controlling shareholder often feels a need to gain legitimacy through support from minority shareholders.

The backside is that in companies that lack a strong owner, a short-term activist can get more leeway. “Today, the activist investor gets a rather large influence. In many Swedish companies, there is no ownership that counterbalances the short-term activism,” Sophie Nachemson-Ekwall says. “But if four institutional investors with long term capital would take 5 per cent each in a smaller company, then that board has support of enough long-term owners to withstand activists.”

Investing larger sums for more influence may work better in a domestic environment, such as in Sweden, than it would in markets further away, where institutional investors will need to team up with others. “AP4 has been doing this with GO for instance,” she says. “AP4 has part of their portfolio passively managed, they are engaged in their Swedish home market and then they have a few focused mandates outside Sweden. It will be quite interesting to follow.”



SOPHIE NACHEMSON-EKWALL

Sophie Nachemson-Ekwall notes that many countries are moving in the direction towards more long-term commitment and the UK is an example where long-term thinking is being integrated in a favourable manner. "Already back in 2006 the UK changed the Companies Act. After Kraft Food's acquisition of Cadbury in 2009, the acquisition rules in the UK were changed further. And now they are targeting the short-sightedness of institutional investors," says Sophie Nachemson-Ekwall. "Stewardship codes and the UK law commissioner says that pension funds not necessarily need to say yes to what appears to be a financially attractive bid but that they can take other considerations into account, like the long-term growth perspective of the firm, allocation of R&D and effects on employees - as long as the decision doesn't hurt the pension fund's performance."

This has hampered the activities of short-term deals and given corporate boards a better chance of working more long-term. "The changes from 2006 and forward were absolutely crucial for Astra Zeneca with chairman of the board Leif Johansson given time to fend off Pfizer's bid," she adds. "If Astra Zeneca had had their headquarters in Sweden, the board would have been all in the hands of the short-term investors and wouldn't have been able to offer any real resistance. Here we have things to work on."

This development of putting long-term interests at the forefront is not only happening in the UK but also in Europe in general, according to Sophie Nachemson-Ekwall. "The double voting right in France for long-term shareholders is interesting," she says. "Italians are also looking at this and the French want to take this up to the EU-level. We need many ideas to move ahead."

She adds that finding the right balance between the short and the long term is key. "Both short-term and long-term considerations can be driven too far," Sophie Nachemson-Ekwall notes. "An activist can actually be good for a company since their suggestions and actions can act as a catalyse for the corporate board to take some necessary steps. An activist can push for changes like changing the CEO or selling certain assets that are not crucial for the long-term survival of the company. But the key issue is striking the right balance between the two forces. When an independent board gets the time to listen to both sides it gets the best chance to make the right decision."

However, this is not an exclusive responsibility for private and public pension funds. Asset managers should also be more active and long-term, according to Sophie Nachemson-Ekwall. "A large portion of the retail clients that invest in domestic equities through investment funds usually stay with a fund for 20-30 years. In essence, they are long-term in their characteristics and part of these funds capital should reflect that time horizon too," she says. ◆

#### ABOUT SOPHIE NACHEMSON-EKWALL

She is affiliated researcher at the department of management and organisation at Stockholm School of Economics. Her past is somewhat unusual as she after getting her degree from Stockholm School of Economics worked as a financial journalist for a quarter of a century. Two years ago, she received her PhD and she was earlier this year named one of the most influential women in the Swedish business sector by the financial magazine *Veckans Affärer*, coming in at number nine.