

CORPORATE GOVERNANCE IN FINANCIAL CAPITALISM. OLD MUTUAL'S HOSTILE TAKEOVER OF SKANDIA

**SOPHIE NACHEMSON-EKWALL
HANKEN SCHOOL OF ECONOMICS 20100901
MASTERS PROGRAMME IN CORPORATE
GOVERNANCE**

DISPOSITION

- I Introduction of Myself
- II. Skandia – the Old Case
- III. The World in 2005?
- IV. Skandia – The New Case
- V. Skandia – Actors and Forces
- VI. Lessons of Corporate Governance in
Financial Capitalism

I Introduction of Myself

- Degree from Stockholm School of Economics, focus finance
- Over 20 years of financial journalism, lately Dagens Industri
- Award Winner
- Doctoral student in Corporate Governance at departement of Management and Organization at SSE
- Board of Swedish Shareholders Association and HQ Funds

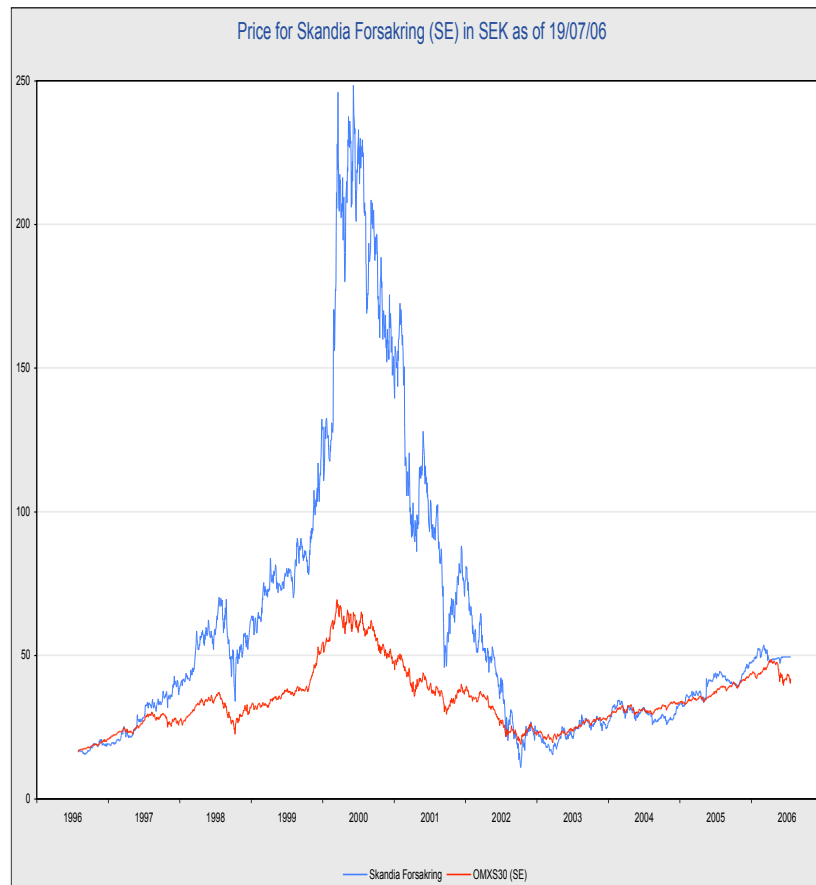
Co-Author of Three Books

- *Livsfarlig Ledning – Historien om kraschen ABB*, (Dangerous Management - the History of the Crasch of ABB), Ekerlids 2003.
- *Guldregn - Sagan om Skandia* (Golden Rain - the Skandia Saga), Albert Bonnier, 2005
- *Corporate Governance in Modern Financial Capitalism – Old Mutual's Hostile Takeover of Skandia'*, E-Elgar 2010

II Skandia The Old Case

- The largest private and listed insurance company in Sweden with a long history, high standing in society and restricted votingpower for shareholders.
- CEO Björn Wolraths insurance conglomerate of the 1980:s, with Jan Carendi betting on United linked insurance with open architecture, was streamlined by CEO Lars Eric Petersson in the late 1990´s.
- Successful international expansion – in UK and US
- Global Organic Growth Model. The H&M or Ikea of the Service Sector. A Harward Business Case

Skandia and the IT-bubble



- Market Cap March 2000
SEK 250 Billion
- Market Cap Sept 2002
SEK 11 Billion

A Case of Governance

By year 2000 Skandia had moved from managerial control to shareholder control

- From stakeholder value governance to shareholder value governance.
- Managerial powerstruggle
- Need of revising the business model

What Went Wrong in Skandia?

- Pervertive Incentive Systems
- Flawed Accountingsystem - the embedded value method
- Unclear US Accounting with GMDB
- Governance Skandia Life and Skandia AB
- Governance CEO and subsidiaries
- Governance CEO and Board and Shareholders

Led to Distrust and Stopped a Needed Capital Injection

Accounting in American Skandia

- The costs of the Death benefits were hidden in accounts, led to distrust and downgraded creditrating and resulted in the fire-sale to Prudential with huge loss.

Managerial Conflicts

Lars Ramqvist Chair of
Skandia, Volvo,
Ericsson

*"When I visit Volvo in
Bangalore they guide
me around the factory.
...but Why should I visit
Shelton? That's only a
site for computerwork.."*

UK Alan Wilson

Vs

COO Jan Carendi,

Vs

CEO L E Peterson
(and CFO Ulf Spång)

Vs

US Vade Dokken

After the Skandia Crasch

- Swedish Code of Corporate Governance (2005)
- Improved works of Nomination Committes
- A handful of Court Cases (one in prison, settlement between Skandia Life and AB)
- New Management and Board

III The World in 2005

Defining the Context

- 1. Financial Capitalism
- 2. Institutional Investors

- 3. Corporate Governance
- 4. Market for Corporate Control

- 5. Swedish Governance and the Market for Corporate Control

1. Financial Capitalism

- A belief in efficient markets. Economic –and rational man. Finance rules
- Free movement of capital.
- Corporate Governance based on (US-UK) Shareholder value, not (continental) Stakeholder value.
- Institutional Investors

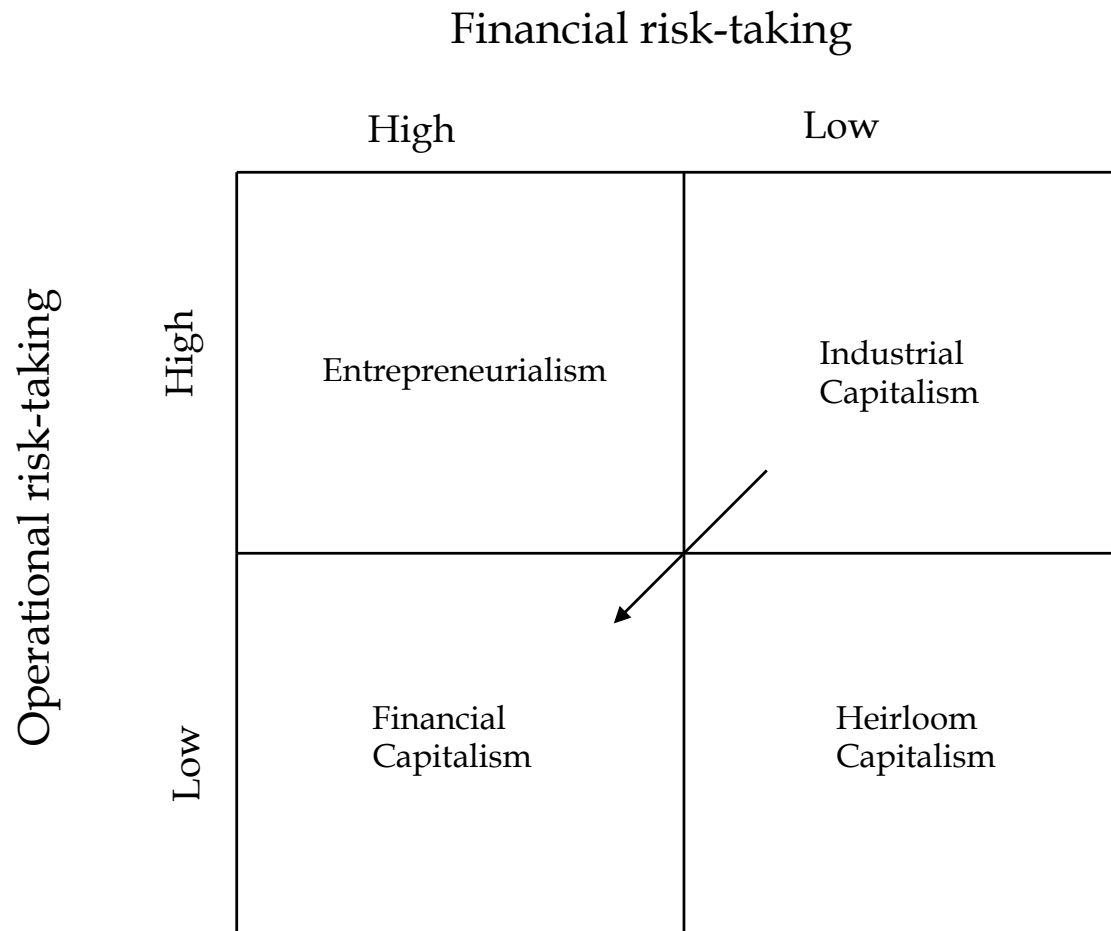
2. Institutional Investors

- They are Pension, - retail- , hedgefunds, activists, P-E-funds, SWF
- Compete for capital, follow index, incentivesystems
- wish to participate in corporate governance
- like principal-agent ideas which aligne management with the owners.
- Promotes short-termism rather than long term value creation.

3. Corporate Governance

- The **Corporation** is a product of law. The aim is to increase risk-taking in society, which is supposedly value-creative.
- Shareholders are residual claimants.
- Value-creation in the firm can be illustrated with two flows – operational flow and the financial flow. During industrial capitalism, the operational flow dominated. During financial capitalism, the governing-power moved to the financial flow.
- Operational flow means low(er) financial risk and vs.

3b Risk and type of Capitalism



4. Market for Corporate Control

- a. Neoclassic economic theory argues that the creation of an efficient market for corporate control is beneficial for society at large.
- b. In this context the hostile takeover can be seen as a viable governance mechanism in line with Principal-Agent focus on boards and contractual theory.
- c. Appeals to EU's aim to create a level playing field and enabling cross border hostile takeovers. UK Takeover regulation and EU Takeover directive

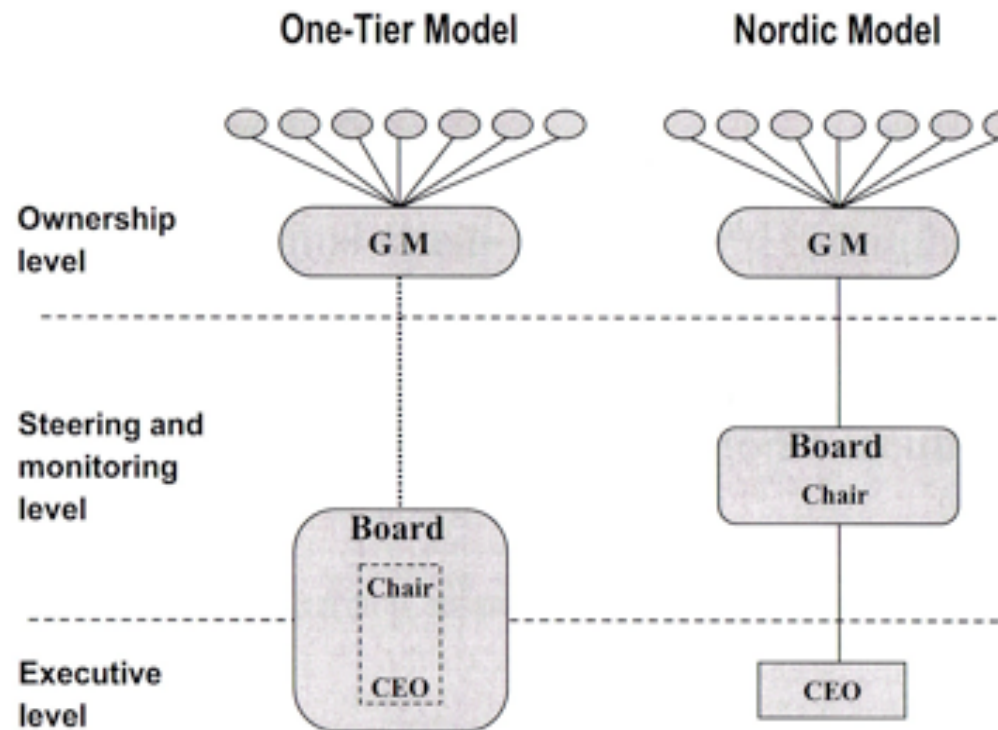
5. Swedish Takeover-Market

- The Swedish market for corporate control since the 1990s has been second only to UK.
- Due to differential voting-rights and block holder structure, that seem to have facilitated sell-outs.
- Also, the Swedish tax system disfavoured private wealth creation, and facilitated sell-outs
- as well as promoted the collectivisation of domestic savings that increased the precens of institutional investors.

And special features in the governance model

Swedish Governance Model

A different governance model



- Shareholders in Control (Unions on board)
- Nomination committee run by current shareholders can be controlled by short-term investors.
- In a takeover this opens for Arbitrage between different governance-regimes

5b. Swedish Governance

Governance I:

Kreuger (1880-1932)

Governance II:

Wallenberg (1864-1943)

Father of differentiation of
voting rights between A-
and B-shares

Father of separation of control
between management and
shareholders in the Board

5c. Swedish Governance

Summing up

- Global financial capitalism conflicts with industrial capitalism when it comes to control and governance of large listed corporations....at least in the Swedish market.
- The case-study Old Mutuals hostile takeover of Skandia tries to answer the following three questions.
 1. Which are the actors that drive restructuring of corporations today?
 2. What are their intentions?
 3. How do rules and regulations work in this areas? In Sweden? Globally?

IV Skandia. The New Case



- One of the largest cross-boarder hostile takeovers in during the 6th takeover-wave

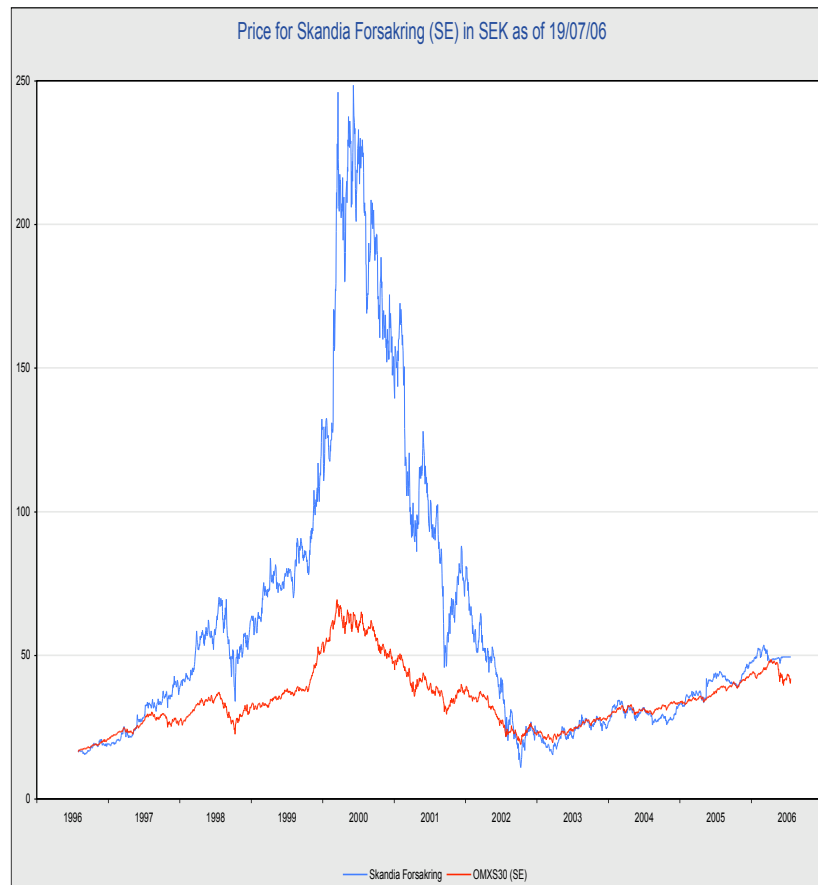
The Empirics

- 270 pages.
- Over 200 interviewees with around 75 people.
- Starts in the old story but refocuses on the changing shareholder-structure and the role of the British subsidiary, as this played a major role in Old Mutuals decision to bid for Skandia.
- Most interviewees done December 2006 - May 2008. First meeting with all actors were carried out before the global financial crisis.
- But the financial crisis has influenced our own interpretation of the material.

I Old Mutuals Fair Rationale

- The case is not to be read as a critique of the buying part, Old Mutual. CEO Jim Suthcliffe had legitimate reasons to wish to buy Skandia. Wanted to rebalancing products, markets, and currency exposure. Also sought to increase market cap and close valuation gap through being included in a global index.

II Skandia a Perfect Target



- In 2004, Skandia was performing badly,
- The UK management, did not cooperate.
- Sampo had just given up a merger attempt.
- Open shareholder-structure
- Reputational damage pressed the share.
- new board and management, all with short track-record.

III Skandia had Dispersed Shareholder Base

Shareholders 31 Mars 2004 (percent)

SEB	4.2
Swedbank Robur	3.9
AP2	2.5
SHB	2.4
Gov of Singapore	1.7
Alecta	1.4
Nordea	1.3
AP4	1.1
AP1	1.1
Fidelity	0.8

10 largest Shareholders 20.4

Market Capitalization 30 Billion SEK

Focus on Bid Process, not OM

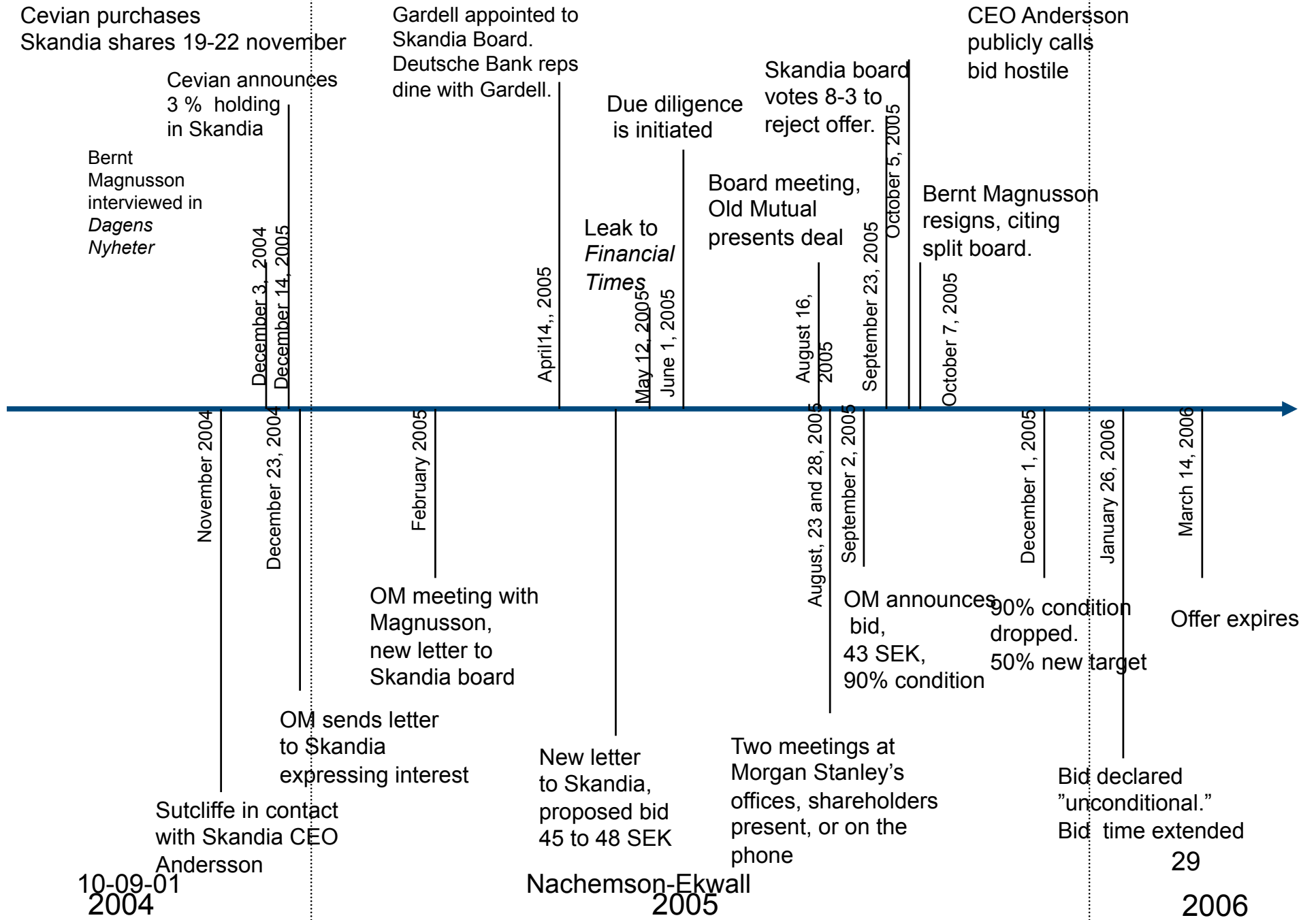
The book addresses the:

- Take-over process
- Underlying governance-process
- How different actors act to maximize the outcome of their own goals and agendas
- What this implies for the company addressed, in this case Skandia AB

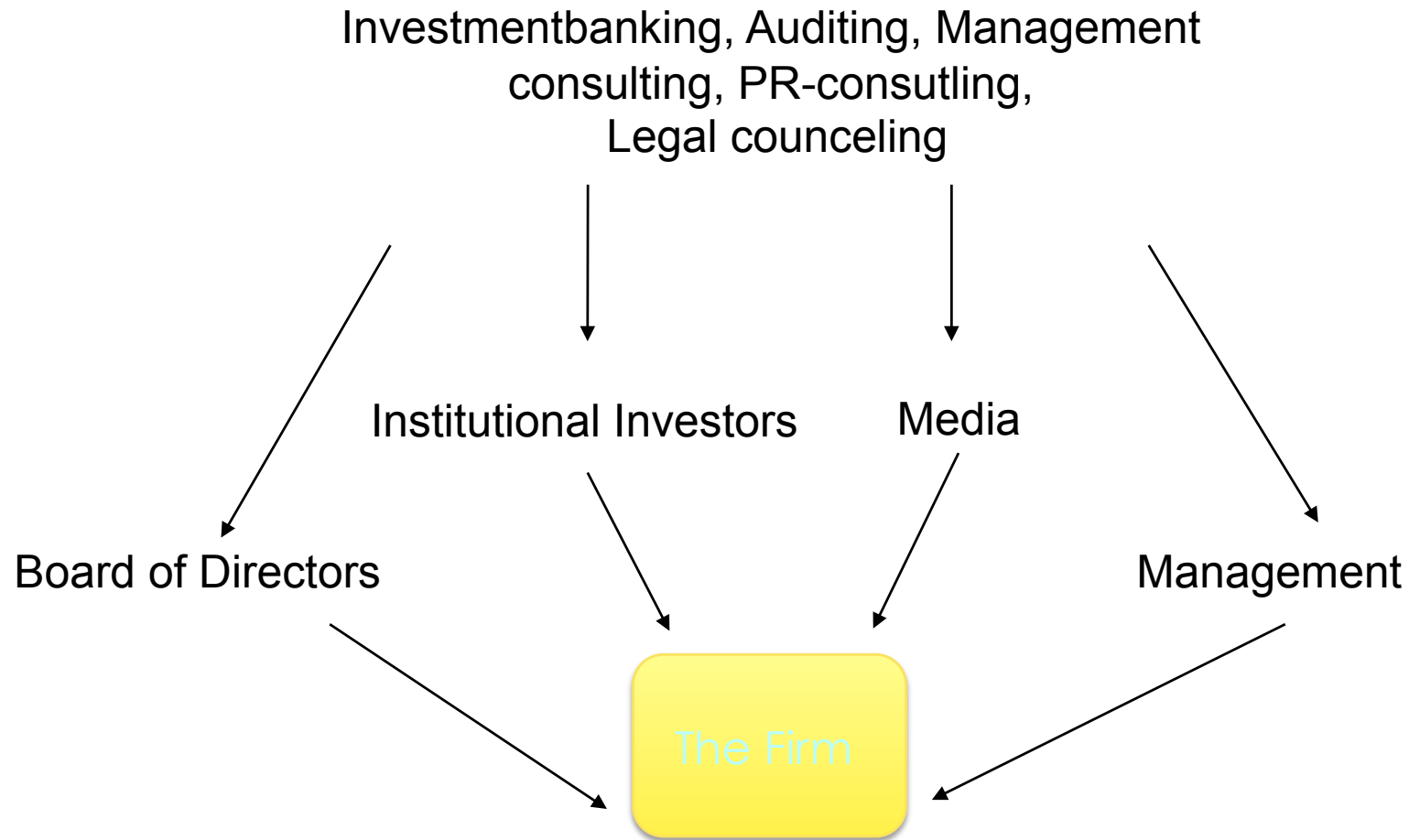
Overreaching goal to deepen understanding of the forces behind corporate governance and control.

Skandia and Old Mutual in European Perspective

<i>European insurers</i>	<i>Assets under management (2004) Bn pounds</i>	<i>Embedded value (2005) Bn pounds</i>
Allianz	770	20
AXA	630	14,5
ING	370	23
Aviva	300	9,5
Generali	240	15
AEGON	220	10,5
Prudential	200	7,5
Legal&General	180	6
Old Mutual	160	6,5
Friends Provident	120	2,5
AGF	90	6,5
Swiss Life	50	2,5
Skandia	50	2,5
AMB	50	2,3
RAS	20	5
Mediolanum	17	1
Alleanza	15	4
Storebrand	15	1



V Skandia Actors and Forces (the informal hierarchy of governance)



I Owners as Institutional Investors

Historical governance model with voting-restrictions put management in control. Took five years to change this – 1995-2000. Seven phases of (Institutional) owners with differing rationalities.

1. Historical: Bonniers, Ratos, Investor – STAKEHOLDER MODEL
2. Control-struggle of 1990 – SEB/ Storebrand – STAKEHOLDER ENVIRONMENT
3. 1995 - Pohjola, Industrivärden, Alecta – PASSIVE ACTORS
4. After the crash Spring 2003: Sampo FAILURE OF FRIENDLY MERGER
5. Winter 2004: AP2, SEB, Fidelity – SWEDISH MODERN GOVERNANCE
6. Winter 2005: + Cevian, + Icelandic banks – MISUSING “”
7. Fall 2005: Hedgefunds and Arbitragefunds – FINANCIAL GOVERNANCE

Implications for Composition of Nomination Committee and Board.

I The Last set of (Shortterm) Shareholders

Shareholder December 2005	Percent of capital/votes	Standing on Old Mutual's bid
Fidelity funds	9	Yes
Credit Suisse First Boston	5.4	Yes
Paulson & Co Inc	5.1	Yes
Noonday	4.9	Yes
Second National Pension Fund	3.5	No
Cevian Capital LP	3.4	Yes
Robur funds	2.4	No
SHB/SPP funds	2.1	No
Nordea fonder	2.0	No
Straumur-Burdarás	1.6	Yes
Swed. Sharehold. Assoc. + proxies	3.8	No
Third Avenue	0.9	No

II A Split Board

The new board 2004 was voted on by current shareholders to re-establish trust. It was split ideologically in three groups.

1. Shortterm Shareholder Value: Magnusson, Björnsson, Gardell
2. Longterm Value Creation: Jeansson, Ullberg, Lindståhl
3. Stakeholderinterest: Hedberg, Hammarkvist

As the struggle over corporate control moved on the ideological stance of long term value creation and stakeholder ideas coincided.

“An independent Skandia is good for the Stockholm as a financial centre”

III Split Chair-CEO

1. The cooperation between Hans-Erik Andersson and Bernt Magnusson never worked out.
2. Industrial background Vs insurance-service sector
3. Chair wanted to sell Skandia now – CEO wished to restructure an lift profit first.

IV Middlemen Investmentbanks

- Morgan Stanley acted on a mandat from the Chair without full knowledge and understanding from other directors. Worked with the auction, due diligence, fairness-opinion, success-fee
- Merrill Lynch designed OM's bid with stocks and cash to facilitate incumbant investors to and arbitrage investors that would accept OM's bid.
- Deutsche Bank helped OM, as well as Lenner &Partner
- All in all, every single investmentbank was involved in one way or another.

V Middlemen Lawyers

- Linklaters – was brilliant in circumventing the Swedish Takeover rules.
- OM used ***the force merger rule***. At the time of the Skandia-bid a bidder following an acquisition of 66.7 per cent of the shares could reserve the right to take actions in order to initiate an implementation of a statutory merger between the bidder and the target. This was due to a change in the Company Law around the Millenium with unintended consequences. In the Skandia-bid it was clearly used to circumvent the 90 percent minority-protection rule in the Swedish Company's Act.

VI Media

- Media as an arena for leaks and lobbying.
- Chair-interview, DN 20041203
- Cevian-flagging,
- the leak 20050513 and insider-dealing,
- Morgan-Stanleys auction-process,
- the conflict between boardmembers,
- AP2's work to stop the deal.

"It is best to sell Skandia"

Fidelity International,
Trelawney Williams
major stockholder in Skandia

SEB Funds
Björn Lind
major stockholder in Skandia,
Chairman of nomination committee
during 2004/2005

Merrill Lynch
Advisors/brokers to/for Old Mutual

The Second National Pension Fund
Lars Idermark
Major stockholder in Skandia
Member of nomination committee 2004/2005

Lenner & Partner
Lars Lenner
Advisor to Old Mutual

Old Mutual
CEO Jim Sutcliffe
Offering to acquire Skandia

Cevian
Christer Gardell
Major stockholder in Skandia
Member of nomination committee 2004/2005,
Board member

Deutsche Bank
Advisors to Old Mutual

Morgan Stanley
Advisors to Skandia

Bernt Magnusson
Chairman of the Board, Skandia
Resigned in October 2005

Björn Björnsson
Vice chairman of the Board, Skandia



Birgitta Johansson-Hedberg
Board member, Skandia

Kajsa Lindståhl
Board member, Skandia

Lennart Jeansson
Board member, Skandia
New chairman after Magnusson's resignation

Hans-Erik Andersson
CEO, Skandia

Anders Ullberg
Board member, Skandia

Karl-Olov Hammarkvist
Board member, Skandia

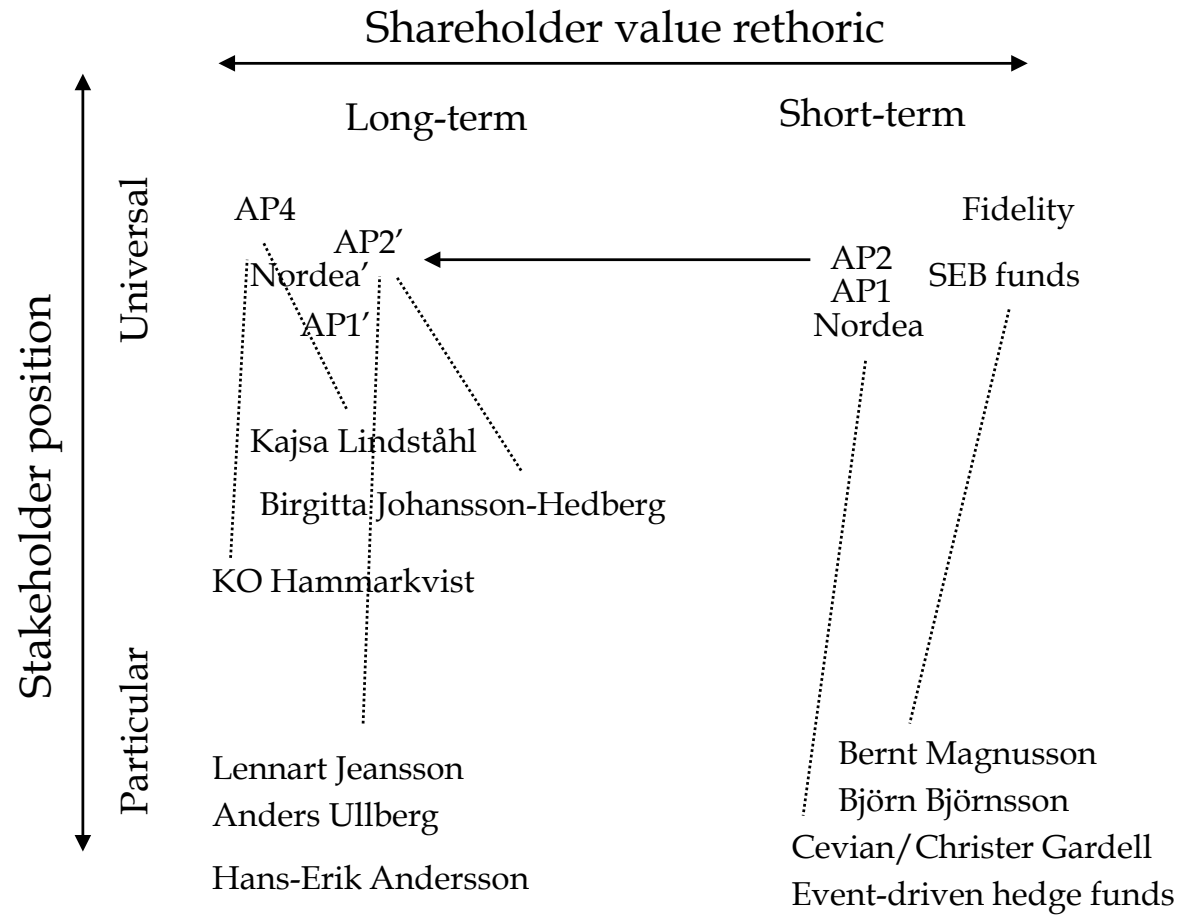
The Second National Pension Fund
Petter Odnhoff/Carl Rosén
Major stockholder in Skandia
Member of nomination committee
2005/2006

The Fourth National Pension Fund
Thomas Halvorssen
Major stockholder in Skandia

Sven-Erik Österberg
Minister in Social Democratic Government

"It is best to keep Skandia"

Shifting Argumentative Positions of the Board



VI Lessons of Corporate Governance in Financial Capitalism

Three parallel processes governs a hostile cross-boarder takeover in financial capitalism.

- 1. The (Swedish) model of corporate governance,
- 2. Short-termism amongst institutional investors
- 3. Rule/Culture/Moral arbitrage.

1. Swedish Model of Corporate Governance.

- Extrem Shareholder Power, compared from the rest of Europe, US and UK.
- Designed for a system with controlling long term shareholder but malfunctioning in an environment with dispersed ownership on a modern financial market.
- Nomination Committe in the hands of activist investors (AP2, SEB, Cevian, Paulson)
- Short-term- or long term shareholder value or stakeholder value

2. Short-termism among Institutional Investors

- There does not exist rational investors acting on an efficient market
- Most institutional investors follow index rather than govern companies longterm
- When the board said no the shareholder base had already changed

Question: Is it better with short-term institutions than managerial power?

3. Regulatory Arbitrage

- Different actors make use of national rules and regulations to enable arbitrage between different systems of corporate governance. Knowledge, attitudes and moral governs to what extent these mechanism are used.
- Skandia was squeezed between a bid driven by US-inspired investmentbanks, reliance on UK-takeover rules, in a company with Swedish corporate governance tradition.
- Due diligence process, the role of the board, bid-time-limits, forced merger rule, fairness opinion

Post OM-Skandia

- New Takeover Regulation (2009)
- Revised Code of Corporate Governance (2009)
- Revised Insurance Companies Act (2006)
- New Forced Merger Rule (2007)

Post Financial Crisis

- Finish/French government has a SWF
- EU caps bonus-cash payments
- Tax-incentives to stimulate a 5%-stake-ownership in any particular stock?
- Better information to long term investors?
- Staggering boards?

Where do we stand now?

- time to question if the hostile takeover is an efficient method for long-term value creation in the public corporation. There might be others – like customers and competitors - that are just as efficient governance mechanism.
- **Focusing on Governance it seems that the stakeholder-perspective is winning followers in financial capitalistic countries like UK and US.**

UK-US stakeholder debate

In UK FSA's CEO Hector Saints talks June 2010 about moral and ethical responsibility in supervision, and a move away from the strict shareholder focus.

"In my view the outcomes that firms are seeking should be redesigned to better align them with values supported by society as a whole..I would thus strongly advocate intervention in the UK through changing the Companies Act framework for directors, for example.

The Key Agreed Principles for the Business Community as stated by the US Round Table and the National Associates of Corporate Directors has been rewritten(2008) as:

"..The board's fiduciary objective is long-term value creation for the corporation; governance form and process should follow.."

Last

Lesson from the Old Mutual Skandia case still gives that much remains to be done to assure that hostile cross-border takeovers involve well-managed buyers and badly managed targets, i.e. not only events orchestrated by investment banks, legal advisors and short-term investors.