# Corporate Governance and Short-Termism: An in-depth Analysis of Swedish data

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## Abstract:

In the *Study on directors' duties and sustainable corporate governance* prepared by EY Italy for the European Commission, dividend policies are used as a key indicator for financial short-termism. The study claims to identify short-termism among European companies and is set to be used as an empirical foundation for the Commission's work towards a new regulation that is claimed to support long-term investments and greater sustainability.

In this report, we scrutinize the claims of the study by examining potential signs of financial short-termism related to excessive dividend policies. Studying companies listed on the Swedish stock market, which has one of the largest market capitalizations within the EU as well as a vibrant IPO market, our dataset includes 786 unique firms and 7,389 firm-years during the years 2000-2019.

Our empirical findings demonstrate that (1) 44 % of companies do not pay out a dividend, (2) the payout ratio of the firms depends on their life cycle, and (3) the firms with the highest dividend payout are also the firms with the highest profitability while at the same time performing well in terms of sustainability reporting and sustainability ratings. Thus, we see no material indications of financial short-termism in Sweden, and also caution against changing a well-functioning system (both in sustainability and financial terms).



**Keywords:** Payout ratio, dividend payouts, Nordic corporate governance, Swedish case.

# 1 Introduction

The motivation for this study is the EY report "Study on directors' duties and sustainable corporate governance" prepared for the European Commission DG Justice and Consumers in 2020. While the report has been highly criticized in relation to research methodology (Bassen et al., 2020; Edmans, 2020; Fried & Wang, 2020; Roe et al., 2020) and from judicial standpoints (Andersen et al., 2020; Hansen & Lilja, 2020), we take an empirical stance. We believe such an approach can contribute with valuable insights and complement the ongoing debate[1]. Conducting an analysis of Swedish listed companies between the years 2000-2019, our dataset includes 786 unique firms and 7,389 firm-years. **Our main conclusion is that we see no material indications of financial short-termism in Sweden[2].**

From an EU policy perspective, the Swedish setting is interesting because Sweden has one of the largest capital markets within the EU as well as one of the most vibrant IPO markets in the world (De La Cruz et al., 2019), and the Nordic Corporate Governance model has been known for its holistic approach to combine both shareholder value and long-term sustainability (e.g., Lekvall, 2014; Thomsen, 2016a,b; Sjöstrand et al., 2016; Lekvall, 2018). In fact, the four largest dividend payers in Sweden (which make up 31.4 % of total dividends) are a family-owned global retail company (H&M), a telecom operator where the state is the largest owner (Telia), a bank with strong cooperative roots (Swedbank) and a bank-owned to a high degree by its staff (Svenska Handelsbanken).

This report makes three contributions to the current debate regarding new EU regulation in the area of sustainability and corporate governance. *First*, we show that there is no material evidence of short-termism among listed firms in Sweden. Addressing many of the methodological

[1] The importance of more empirical studies is acknowledged in the EY (2020) report. They describe how the lack of empirical studies impacted their report negatively and that existing empirical studies often do not focus on Europe. "The limited availability of empirical studies on the (long-term) effects of corporate short-termism impacted the investigation of this phenomenon in Europe from an empirical standpoint... Moreover, most of the available studies either have a wider geographical scope or do not focus on Europe." (p. 5)

[2] In the EY (2020) report, Sweden is described as one of countries with limited signs of financial short-termism (see section "3.1.1.6 Analysis by country" on p. 19-20).

weaknesses of the EY report, we find that 44 % of the Swedish firms do not pay out any dividend, and out of the remaining firms, a large portion of dividends come from a few large firms which are highly profitable and have strong sustainability performance.

*Secondly*, we contribute with a methodological approach to study short-termism. The EY (2020) report has received massive critique, and as such, it is important to address these methodological weaknesses and suggest new ways for studying short-termism. In our case, by acknowledging the importance of an organization's life cycle and clearly showing the impact of a small number of large dividend-paying firms, we provide a more nuanced and detailed way of studying short-termism.

*Thirdly*, our study points to the importance of analyzing the relationship between individual firms, the surrounding ecosystem, and the type of corporate governance model. In Sweden, the ecosystem consists of both small growth firms and large multinational companies. As our findings demonstrate, many of the growth firms do not pay any dividends, and among the top 20 dividend payers, these companies perform well both financially and from a sustainability perspective (the top dividend payer H&M being a good example). Consequently, it seems that the Nordic Corporate Governance model (Lekvall, 2014; Thomsen, 2016a; Sjöstrand et al., 2016) with its focus on active and long-term ownership addresses many of the key problem drivers that the EY (2020) report identifies.

The report is organized as follows: Section 2 discusses our research design and presents descriptive statistics. Section 3 reports empirical results. Section 4 concludes. We have also added five appendices. In Appendix 1, we develop our critique of the EY report, in Appendix 2, we describe central characteristics of the Nordic Corporate Governance model, in Appendix 3, we discuss the theoretical aspects of growth, investments, and dividends, and in Appendix 4, we describe the sustainability performance of the top 20 dividend-paying firms. Finally, in Appendix 5, we give detail information about the yearly distribution in our sample.

## 2 Research design

We obtained the data from Compustat Worldwide for our empirical analyses, which is commonly used in academic research. We require that the firm has the headquarter in Sweden and that the firm has a listing at the NASDAQ Stockholm Stock Exchange (Main Market), which is the largest stock exchange in the Nordics. We investigate the period 2000-2019[3] and obtain 7,389 firm-years and have 786 unique firms in our sample. Table 1 provides an overview of the industries and the firms in our sample.

**Table 1. Industry classification of firm-year observations**

| Industry | Freq | in % |
|---|---|---|
| Manufacturing | 3,254 | 44.0 |
| Services | 1,681 | 22.8 |
| Finance, Insurance and Real Estate | 971 | 13.1 |
| Transportation, Communications, Electric, Gas and Sanitary service | 414 | 5.6 |
| Retail Trade | 349 | 4.7 |
| Mining | 243 | 3.3 |
| Wholesale Trade | 233 | 3.1 |
| Construction | 130 | 1.8 |
| Non-classifiable | 98 | 1.3 |
| Agriculture, Forestry, and Fishing | 16 | 0.2 |

We follow the methodology suggested by Fried and Wang (2019, 2020) and Boudoukh et al. (2007) and calculate the dividend payments and the net issuance of the Swedish firms.[4] Empirical corporate finance research, such as for example, DeAngelo and DeAngelo (2006), suggest that the optimal dividend payout policy is driven by the need to distribute the firm's free cash flow and depends on the life cycle theory. In other words, firms optimally adjust dividends overtime to their investment opportunities. This means that, in their early years, companies pay no or minimal dividends because their funding needs for investment opportunities exceed their

[3] In Appendix 5, we show the yearly distribution of our sample. We acknowledge that the Compustat coverage in the beginning of the sample is thinner than compared to the later time period.
[4] In terms of dividend payment, we take the larger value of the value provided in the Compustat annual file (item *dvt*) and the calculated yearly dividend payment from the Compustat daily file. This procedure address missing values in the Compustat annual file.

internally generated capital. Hence, firms have too little funds to invest and therefore refrain from distributing any cash back to the investors. Our analyses add to the debate by including a life cycle analysis to understand the dividend-paying behavior better. To classify the company into the right life cycle phase, we follow the cash flow pattern classification approach of Dickinson (2011). Precisely, we classify the firms into one of the five following phases: (1) introduction, (2) growth, (3) mature, (4) shake-out[5], (5) decline. This is done by evaluating the cash flow characteristics from the cash flow statement and the relative importance of the three sources of cash flows according to the statement of cash flows: 1) cash flow from operating activities; 2) cash flow from investing activities; and 3) cash flow from financing activities. The cash flow composition for the different phases is described in Figure 1.

**Figure 1: Characteristics of cash flows for different life cycle phases**

| | 1<br>Introduction | 2<br>Growth | 3<br>Mature | 4<br>Shake-Out | 5<br>Shake-Out | 6<br>Shake-Out | 7<br>Decline | 8<br>Decline |
|---|---|---|---|---|---|---|---|---|
| Predicted Sign | | | | | | | | |
| Cash flows from operating activities | − | + | + | − | + | + | − | − |
| Cash flows from investing activities | − | − | − | − | + | + | + | + |
| Cash flows from financing activities | + | + | − | − | + | − | + | − |

*Figure 1:* Signs for cash flows from different parts of the cash flow statement to identify the five life cycle phases (Dickinson 2011, p. 1974). The (+) sign in the table indicates positive cash flows from that sector, and the (-) sign indicates negative cash flows. The columns show the combination of signs for the three statements of cash flow sectors that represent a specific phase in the life cycle. Note that the Shake-out and the Decline phases have multiple combinations of cash flows that characterize them.

When applying the life cycle classification of Dickinson (2011), we find that most firm-years are classified as "mature" firms, 35.0 % percent of the sample. This is illustrated in Figure

[5] The Shake-out group captures firms that have entered a stage where they try to collect the final possible business opportunities in their development phase. This phase in the life cycle can be characterized by a number of different cash flow patterns. In Figure 1, this is shown in columns 4 through 6. Column 4 represents a situation where the company still invests in order to turnaround, but the underlying cash flows are weak. Column 5 and 6 represents a restructuring behavior with negative investments.

2. The second-highest group are shake-out firms (1 650). Together with the firms from the Decline phase (328), they are 1 978 firm-years or 26.8 % of the sample. These are the firms in the later stages of the life cycle. Early-stage firms are made up of the Introduction and Growth phases. They are 1 635 and 1 191 respectively and total 2 826 firm-years or 38.2 % of the sample.

**Figure 2: Firms in the sample according to the life cycle**

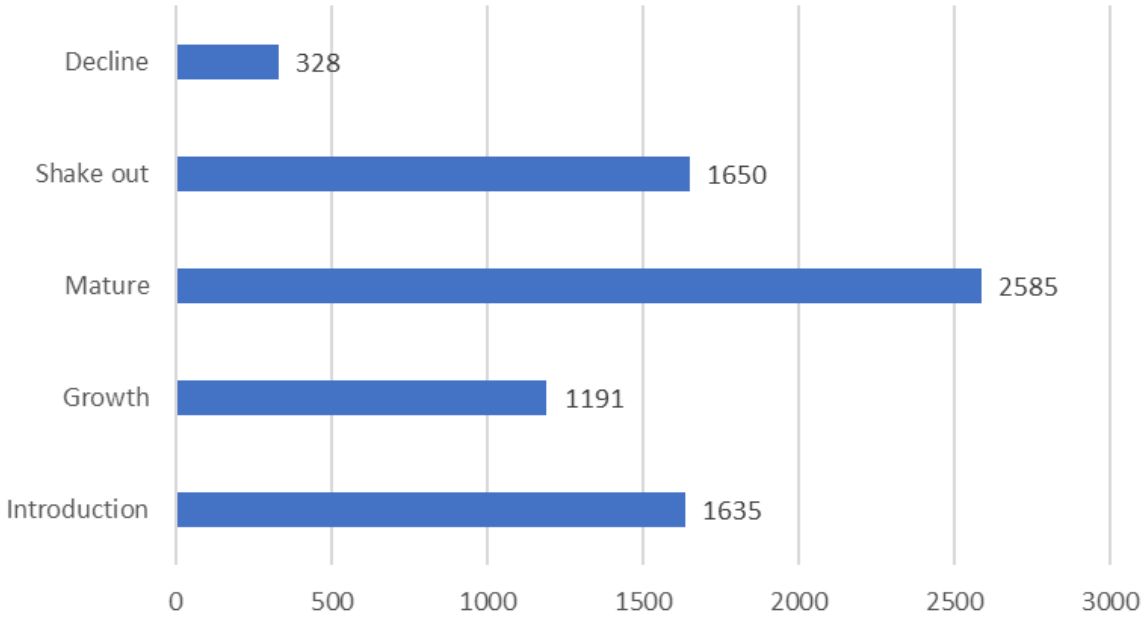


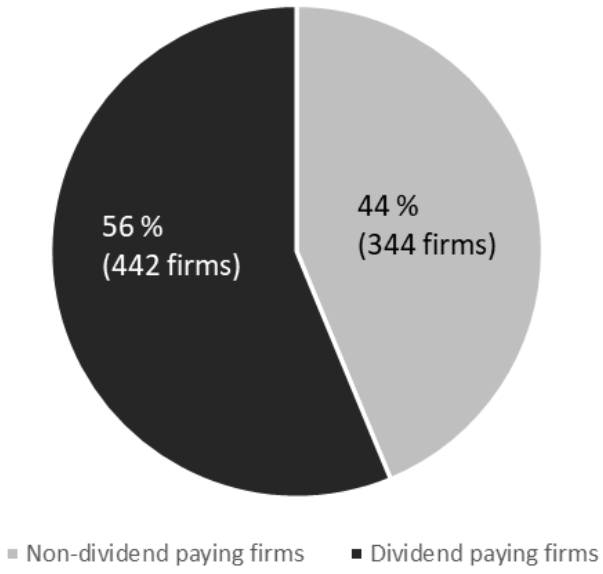

*Figure 2:* Firms and their life cycle in the sample. We use the five life cycle phases proposed by Dickinson (2011).

## 3. Empirical findings

### 3.1 44 % of the firms do not pay a dividend at all

First, we classify firms into dividend payers vs. non-dividend payers. We conclude that 344 of all 786 firms, corresponding to 44 % of the sample, are non-dividend payers, i.e., they have never distributed any dividends to their shareholders during our sample period. In addition to this set of firms that never paid any dividends, it is also likely that other firms have refrained from paying dividends in specific years. When analyzing this, we find that 51 % of the sample (firm-years) are non-dividend-paying firm-years. **In other words, this means that only 49 % of the observations include firms that in a particular year have paid any dividends to their shareholders.**

**Figure 3: Number of dividends paying firms (over a lifetime in period 2000-2019)**




A critical reader might argue that firms instead defer to other means by transferring the value to the shareholder through share buy-backs[6]. Our analysis shows that only 7.23 % of the

[6] A number of studies have criticized the American corporate governance system for focusing too much on share buy-backs (see for example Lazonick & O´Sullivan, 2000; Lazonick & Mazzucato, 2013; Lazonick, 2014).

firms in the sample make use of share buy-backs. Reasons for the low popularity of share buy-backs in Sweden can be found in the taxation system, where institutional investors do not pay taxes on dividends, and retail investors can circumvent direct taxes on dividends when they hold the dividends in an investment savings account. Moreover, the tax rates are the same for dividends and gains on sales. Interestingly, foundations are interested in receiving dividends to reinvest into new business opportunities and research projects. Interestingly, the proportion of dividend-paying firms has been fluctuating between 40 and 50 % of the sample over time. For the business year 2019, with the dividend paid out in 2020, the proportion of dividend-paying firms decreased to 19 % due to the Covid-19 crisis.

### 3.2 On average less than 50 % of profits are paid out as dividends

First, we examine all companies in our sample. Here we include companies with disproportionally low profits, which spike the payout ratio and similar situations. The average and median payout ratio for the full sample is 43.3 % and 0 %, respectively. Note that these figures are affected by some firm-years with exceptionally high payout ratios where the particular firm has had a very small net profit but has chosen to keep its dividends at constant levels.

If we disregard companies with a payout ratio above 1, since these usually are affected by temporary irregularities, including very small profits, the corresponding average is 20.5 %, with a median of 0 %. Focusing on the dividend-paying firms, we find a broad variation in Swedish firms' payout ratio, which is shown in Figure 4 below. However, most of the firms distribute less than half of their net profit as dividends. To be more precise, the average (median) payout ratio is 48.4 % (46.3 %) when we exclude outliers with a payout ratio above 1.

We should acknowledge that there are firms that pay out more than 100 % of net profit in an individual year, as discussed above. Such a behavior can be explained by dividend stickiness, i.e., companies do not want to reduce dividends unless necessary, or that the net profit has dropped

temporarily due to, for example, a massive impairment or provisions. If they are included, they will have a large and non-representative impact on the figures. In our sample, approximately 5 % of the firm-years have a payout ratio above 1.[7]

**Figure 4: Histogram dividend payout ratio**

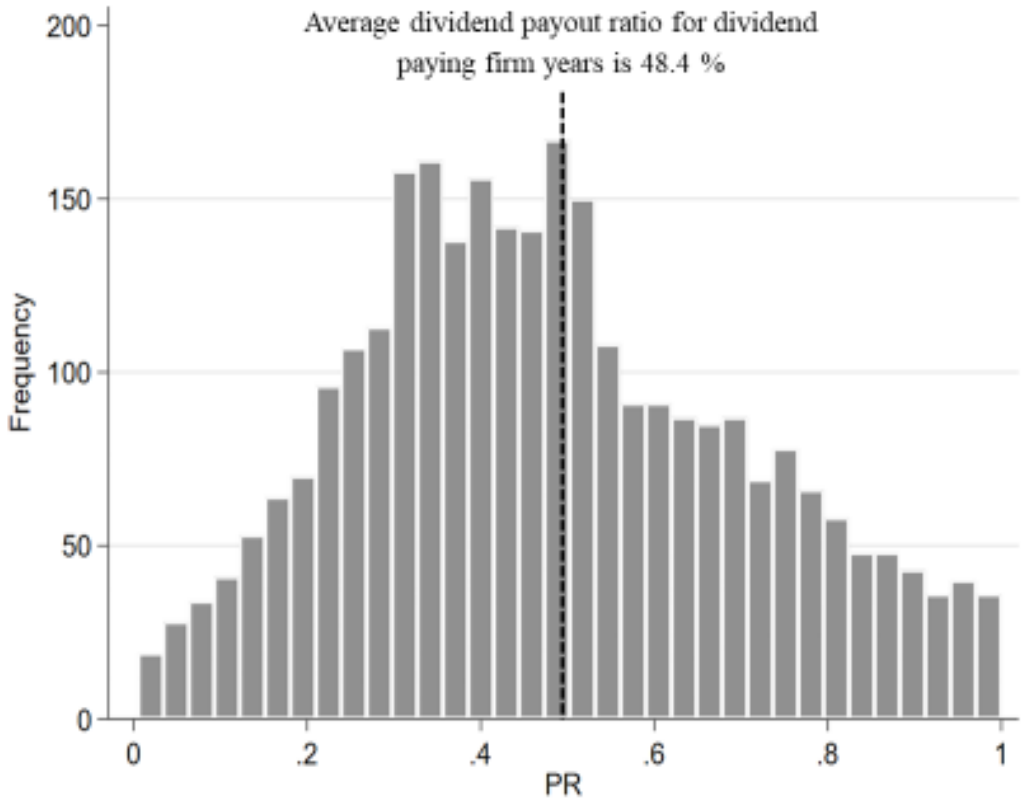



Figure 4: The figure shows the distribution of payout ratios (PR) for firm-years when dividends are paid.

### 3.3 A life cycle analysis of dividend payout

In this section, we apply the life cycle classification of Dickinson (2011). All companies are categorized into one of five life cycle groups, "Introduction", "Growth", "Mature", "Shake-out" and "Decline". For each of the five groups, we have studied the level of dividend payout ratios as well as how the five life cycle groups develop over time.

[7] The non-value weighted average is then 99.4 % for the payout ratio but the median stays at 50.3 % representing this unrevealing shift in averages.

We find and show in Figure 5 that the mature firms have the highest payout ratio consistent with the notion that those firms pay dividends to their shareholders, so they can recycle the money and reinvest their money into other/better investment opportunities in other firms. The internal growth opportunities in these mature firms are by construction smaller. From a capital market and societal point of view, this reallocation of capital is a sound behavior, since the opportunities for external capital allocation are larger than the opportunities for internal allocation. Over time, the mature group's average is about 38.4 %, with somewhat higher levels during 2013-2017. These years are characterized by high profitability in general.

**Figure 5: Dividend payout ratio categorized after life cycle group**

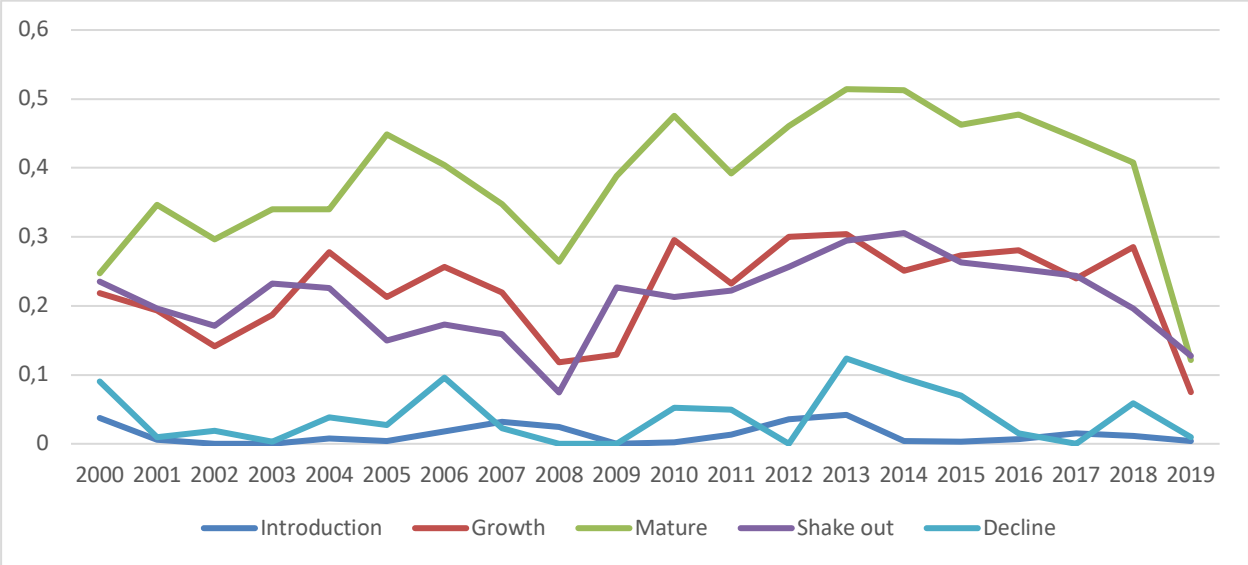



*Figure 5:* The figure shows the median within each life cycle group over the analyzed time period from 2000-2019. The life cycle definition follows Dickinson (2011).

The Shake-out firms is the category that experiences a somewhat higher level in the payout ratios during the latter part of the period. These firms have an average dividend payout ratio of 21.1 %. This is in contrast with the other groups. The general characteristics of the Shake-out firms are similar to the mature firms except that they have started to tip the point towards the end of the life cycle. Profitability tends to be lower as well as investments. The other three groups shown in

Figure 5 exhibits completely flat trends with some volatility during the 20 years of examination. The Growth group have averages of about 20 %, and for the Introduction and Decline groups, the averages are in the low single-digit level. There is a general drop in 2002, explained by the IT-crisis, another in 2008 related to the global financial crisis, and a final one in 2019 related to the Covid-19 pandemic. **The data presented above provides no distinct support for an increasing general level of dividend payouts during the past 20 years in Sweden, at least not if we take general economic development into consideration.**[8]

### 3.4 The relationship between dividends, profitability, and investments

Before we discuss the empirical observations on this matter, we will focus on a small numerical example. Say that a firm needs to grow by 100 in equity to satisfy its needs for investments in new sustainable opportunities. If the firm makes 500 in net profit, then 400 can be distributed to the shareholders. This corresponds to a payout ratio of 400/500 or 80 %. If the firm makes 150 in net profit, then only 50 can be distributed to the shareholders, corresponding to 50/150 or 33.3 %. Stated differently, we need to examine the relationship between dividend payout ratios, profitability, investments (tangible and intangible), and financing.

Table 2 focuses on the relationship between dividend payout ratios, profitability, investments, R&D, and financing. To create comparability between the different measures, all variables have been divided by opening balance equity, i.e., the level of equity at the beginning of each time period. The only exception in the columns is the dividend payout ratio, which is the same dividend payout ratio as we have studied before. The groups in the rows are constructed using dividends in relation to equity with five groups of dividend-paying firms (1-5) and a single

[8] When conducting statistical tests (available upon request) on the difference in payout ratios between the early phase leading up to 2010 and thereafter, it is only the Shake-out group that shows a statistically significant increase in payout ratios. All other groups show statistical significance levels for differences above 15 % when comparing the yearly averages between the early and late years in the sample (the lower the better for establishing a difference).

group of non-dividend paying firms (group 0). Table 2 shows a clear relationship between profitability and dividend payouts. Both variables increase systematically over the payout groups. We can conclude that not only do dividends in absolute terms increase when profitability increases (which would have been the case if the payout ratio in column 2 would have been constant), but it also increases as a percentage of profits. This means that all groups increase the equity with 6-8 percentage points yearly as a result of profits less distributed dividends (Appendix 3 includes a more thorough discussion of the relationship between profitability, dividends, financial position, and investments). **Stated differently, there is substantial room for investments above and beyond fundamental reinvestments as replacements for existing production capacity.**

**Table 2: Dividend payout ratios, ROE, investments, R&D, and financing**

| (1) | (2) | (3) | (4) | (5) | (6) | (7) |
|---|---|---|---|---|---|---|
| Group | Payout Ratio of Net Profit | ROE - Median | Investment | R&D | Cash | Debt/ Equity |
| 0 | 0.00 | -0.09 | 0.02 | 0.07 | 0.24 | 0.76 |
| 1 | 0.21 | 0.08 | 0.01 | 0.02 | 0.05 | 1.08 |
| 2 | 0.36 | 0.12 | 0.03 | 0.03 | 0.09 | 1.32 |
| 3 | 0.44 | 0.15 | 0.03 | 0.03 | 0.12 | 1.24 |
| 4 | 0.54 | 0.18 | 0.04 | 0.03 | 0.18 | 1.34 |
| 5 | 0.72 | 0.22 | 0.03 | 0.03 | 0.34 | 1.03 |

*Table 2:* The data has been divided into six groups based on dividends paid as a percentage of opening equity. Group 0 consists of the non-dividend paying firms, and groups 1-5 are evenly distributed quintiles of the dividend-paying firms. The columns show the payout ratio in relation to net profit, return on equity (ROE) defined as net profit divided by opening balance equity, Investments divided by equity, R&D divided by equity, and cash and cash equivalents divided by equity.

Examining the investment figure for the groups shows a stable level across the groups. The combined level of traditional investments and R&D is about 6-7 percentage points of equity for all groups (this is the combination of columns 4 and 5). **It is slightly higher for non-dividend payers, particularly focusing on R&D. However, we have previously concluded that these**

**firms are predominantly in the early stages of the company life cycle.** Thus, the results are not surprising. The level of investments is in line with the growth in equity. One could expect that it should be higher given that investments include reinvestments, but we have to remember that fixed assets are only parts of the balance sheet and increases in working capital also absorb capital.

We can also see that there is a substantial amount of cash in the companies and particularly for the high dividend payers. This is an indication that even these companies keep a considerable amount of cash internally in order to handle unexpected risks or opportunities. We can further see that the debt financing seems to be highly negatively correlated with the cash position. Financing does not appear to be a problem for the investment strategies of any firm, and the sources of financing to support investments and growth are not related to dividend policy. **We conclude that there seems to be enough capital to support both growth in equity (reinvestments) and dividend payments at the observed level. This further ensures the ability to make investments and to grow in assets. The core of the issue appears to be which investments the capital is allocated to within the firm, i.e., sustainable ones or non-sustainable ones, but that is a different issue than using dividend payout ratios as an indication of unhealthy short-termism.**

### 3.5 The largest dividend payers and their sustainability work

An important dimension of the payout issue concerns the magnitude of dividends paid out by firms in different payout ratio groups. If all companies were of equal size and generated equal profit, the companies with the highest payout ratios would also be the highest dividend payers. This observation can then be tilted in either direction. Table 3 shows an analysis of the dividend-paying firms based on payout ratio groups (using the same approach as EY, 2020).

**Table 3. Aggregated dividends by payout group (MSEK)**

| Payout Group | Aggregated Dividends Per Group | In Percentage |
|---|---|---|
| Dividend payers with negative income | 80 555 | 3.6 |
| Payout ratios between 0 and 0.25 | 153 125 | 6.8 |
| Payout ratios between 0.25 and 0.5 | 540 781 | 24.0 |
| Payout ratios between 0.5 and 0.75 | 599 672 | 26.6 |
| Payout ratios above 0.75 | 880 642 | 39.1 |
| Total | 2 254 776 | 100 |

*Table 3:* The table shows the aggregated dividends divided by the level of payout ratios for individual firm-years. The payout groups have an equal size of payout ratios.

We observe that almost 40 % of all dividends have been paid by the companies having the highest payout ratio, i.e., above 0.75. This result is somewhat disproportionate since that group only comprises 12.1 % of all dividend-paying firm-years. This indicates that not only do these firms pay much of their profits in dividends, but they are also large in relation to other companies included in the sample of Swedish companies.

**Table 4. Top 20 dividend payers**

| Rank | Name | Total Dividend |
|---|---|---|
| 1 | HENNES & MAURITZ | 216 816.0 |
| 2 | TELIA COMPANY | 205 631.5 |
| 3 | SWEDBANK | 142 923.7 |
| 4 | SVENSKA HANDELSBANKEN | 142 747.8 |
| 5 | VOLVO | 127 849.4 |
| 6 | ERICSSON | 116 952.0 |
| 7 | SEB | 111 216.1 |
| 8 | ATLAS COPCO | 101 564.6 |
| 9 | INVESTOR | 90 970.5 |
| 10 | TELE2 | 73 506.1 |
| 11 | SANDVIK | 62 057.5 |
| 12 | SKANSKA | 48 921.8 |
| 13 | SCA | 46 880.4 |
| 14 | SKF | 37 937.3 |
| 15 | SCANIA | 35 988.9 |
| 16 | ELECTROLUX | 35 367.4 |
| 17 | ASSA ABLOY | 34 700.0 |
| 18 | INDUSTRIVÄRDEN | 34 671.1 |
| 19 | SWEDISH MATCH | 30 164.3 |
| 20 | HOLMEN | 24 536.8 |
| **Sum** | | **1 721 403.3** |

*Table 4:* This table reports the top 20 dividend payers in Sweden over the sample period 2000-2019. The dividends are the accumulated dividends over the total period.

In Table 4, we chart the 20 firms that have paid out the highest dividend amount in million SEK. Not surprisingly, these are some of the largest firms on the NASDAQ Stockholm Stock Exchange. **These firms have distributed 73.1 % of all dividends paid during the analyzed period.** However, an interesting aspect of this is how these top dividend payers perform in terms of sustainability. Appendix 4 describes in more detail our investigation, but we have focused on two aspects; sustainability reporting and sustainability performance. Within sustainability reporting, we study whether the top 20 dividend-paying firms use the GRI standard, the TCFD framework[9] , and have external assurance. The category of sustainability performance is divided into two parts, one part focusing on whether the firm has qualified for sustainability indexes (Dow Jones Sustainability Index and the FTSE4Good Index) and one part focusing on scores in sustainability ratings (ASSET4 and CSRHUB). **Our overall assessment is that the top 20 dividend-paying firms in Sweden perform well in both sustainability reporting and sustainability performance. Thus, our Swedish data shows that the firms that make up 73.1 % of the dividends paid between 2000-2019 also performed well in terms of sustainability.**

### 3.6 A Critical review and comparison to the EY Report

As a final issue, we want to compare our Swedish sample with the EY report. We follow the same classification as in the EY report, shown in Figure 6, and apply it to our data as shown in Figure 7. Comparing the two graphs, we can see the following two differences: First, comparing the first three years (2000-2003) with the last three years (2017-2019), we see that the fraction of firms with a payout ratio higher than 75 % has increased slightly from 5 % to 8.6 %. Even under the wrong assumption that this an appropriate way of measuring short-termism, this would not provide enough evidence of short-term behavior.

[9] TCFD stands for Task force for Climate Related Financial Disclosure. This is a new framework with the aim of supporting companies in identifying climate related risks and opportunities.

**Figure 6: Fraction of dividend payout ratio over time (EY 2020, p. 16)**

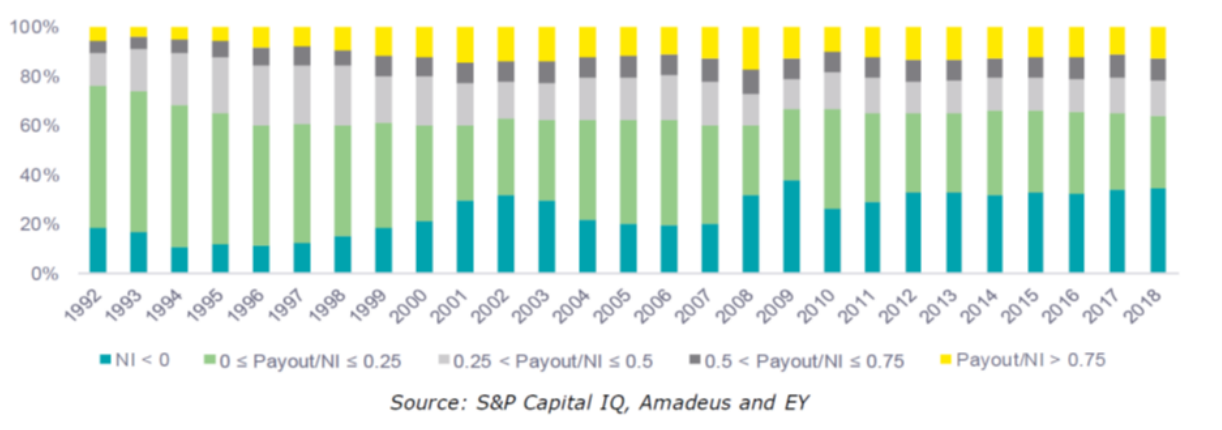
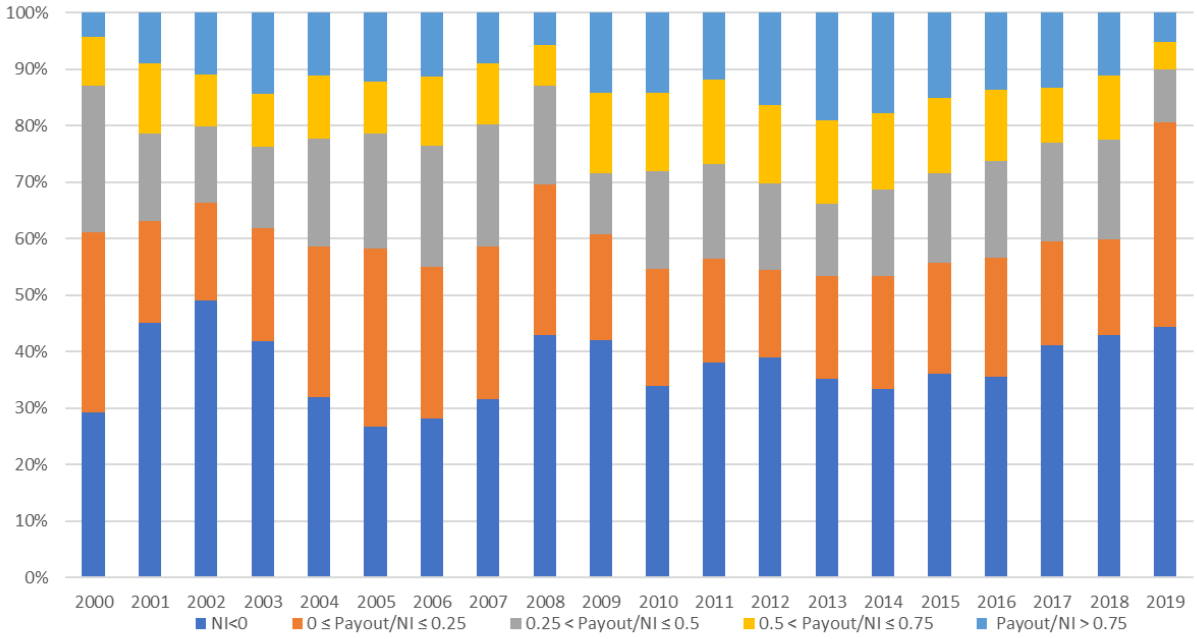



Figure 6 is a copy of Figure 4 in EY (2020).

**Figure 7: Distribution of listed companies by payout ratio (own calculations)**




The figure shows the proportion of companies with payout ratios in different quartiles. The payout ratios range from 0 to 1. An additional group is formed based on the firm-years with negative net income. The figures is constructed in accordance with figure 6 above (Figure 4 in EY (2020)).

Second, the construction of the sample matters. Our sample contains **all firms** that have ever been listed on the NASDAQ Stockholm Stock Exchange (Main Market), whereas the EY

report starts with only the ones that have **survived** in their long sample period (1992-2018). This has serious consequences since it induces a severe survivorship bias. **Therefore, the results in the EY (2020) report about the increase of dividend-paying firms are severely biased, and one cannot rely on their results and their claim of increased short-termism, even if accepting the faulty assumptions underlying the study.** To have a well-rounded picture, one needs to include the growth firms in the analysis, given that they are an essential part of the capital ecosystem.

Lastly, the EY (2020) report makes some questionable research choices. For example, it combines non-dividend paying but profit-making firms with the ones that are paying out less than 25 %. We suggest that one should be able to disentangle these two groups. Another example is that they start their sample period in the year 1992, which was a year of a worldwide recession, and therefore it is not a surprise that firms pay higher dividends in times with a better business climate, as it was the case before the Covid-19 crisis. Finally, looking at a chart showing the evolution of the payout ratio over time is not rigorous enough. This type of analysis does not include any control variables whatsoever.[10] For example, it could be that the higher profitability in the latter part of the sample drives the higher payout ratios instead of some short-termism. As we have shown in the analysis before, many factors determine the optimal payout ratio from a firm's perspective, for example, the firm's life cycle and its investment opportunities.

[10] Alex Edmans from the London Business School puts it like this: "The bespoke analysis in Section 3.1.1 is also of very poor quality and would not pass the requirement for even a first year PhD student paper. It contains charts showing the evolution of total payout vs. net income, without any control variables whatsoever. There are very many factors that determine a company's optimal payout ratio, but these are ignored in the quest to claim "short-termism" (Edmans, 2020).

# 4 Conclusions

The debate about sustainable corporate governance regulations within the EU has resulted in fierce battles among various stakeholders. Even though most actors seem to agree on the general notion that increased sustainability is positive, *how* this should be done is less clear. This report has focused on conducting an in-depth analysis of Swedish companies. Investigating the years 2000-2019, our dataset includes 786 unique firms and 7,389 firm-years. **Our empirical findings demonstrate that (1) 44 % of companies do not pay out a dividend, (2) the payout ratio of the firms depends on their life cycle, and (3) the firms with the highest dividend payout are also the firms with the highest profitability while at the same time performing well in terms of sustainability reporting and sustainability ratings. Thus, we see no material indications of the financial short-termism in Sweden.**

Given the potential risks of new regulation, a natural next step for policymakers is to conduct more empirical research. As the EY (2020) report states, the project team encountered several difficulties during data collection (p. 5), and the fact that the cross-country comparison only contains three years (2016-2018, see p. 19-20) makes us believe that further studies could be valuable.

## APPENDIX 1: Our view of the EY report

The EY report calls for regulatory action based on the claim that short-termism has increased in the EU[11]. Empirically, the report investigates how the net corporate funds are being used for payouts to shareholders in dividends and share buy-backs. Interestingly, even in their own report, EY (2020, p. 11) acknowledged that *"there is not any defined threshold above which one can state that the focus on short term is excessive"*. That is why the report focuses on the development of the payout over time and argues that an upward trend of payouts demonstrates short-termism.

**We argue that EY's approach is questionable for four reasons**. First, as explained in Roe, Spamann, Fried, and Wang (2020), the more precise measure to demonstrate whether short-termism has increased would be "net" payouts (i.e., gross payouts minus equity issuances). Second, given that there is no real "threshold" where one can classify a dividend payout as myopic, it makes little sense to look at how this measure changes over time. Third, the sample in the EY study is based on *currently* listed companies.[12] This induces the problem of a potential survivorship bias. Fourth, investigating a firm's dividend policy is not as straight-forward as the authors argue.[13] Since the seminal paper of Miller and Modigliani (1961), the notion of dividends has puzzled finance and accounting scholars worldwide. One potential explanation for paying out dividends is based on the desire to communicate and signal information to shareholders or satisfy the demand for payouts from heterogeneous dividend clienteles (see Baker and Wurgler (2004a,

[11] On p. VI, the core problem is described as "Evidence collected over the 1992-2018 period shows that there is a trend for publicly listed companies within the EU to focus on short-term benefits of shareholders rather than on the long-term interests of the company. Data indicate an upward trend in shareholder pay-outs, which increased fourfold, from less than 1 % of revenues in 1992 to almost 4 % in 2018. Moreover, the ratio of CAPEX and R&D investment to revenues has been declining since the beginning of the 21st century. **The study shows that, to some extent, corporate "short-termism" finds its root causes in regulatory frameworks and market practices**. These trends work together to promote a focus on short-term financial return rather on long-term sustainable value creation."

[12] In robustness tests they only include the 800 companies listed throughout the entire period and the largest 350 European firms. Whereas we like the idea of this robustness tests, this test biases the results towards large mature firms.

[13] For the interested reader we can recommend the following literature reviews on dividend policy (e.g. Frankfurter and Wood, 2002; Allen and Michaely, 2003; DeAngelo et al., 2008; Al-Malkawi et al., 2010; Baker and Weigand 2015).

b). An alternative explanation has been proposed by DeAngelo and DeAngelo (2006), which is that the optimal payout policy is driven by the need to distribute the firm's free cash flow and depends on the life cycle theory.[14] According to this theory, companies optimally adjust dividends over time to their investment opportunities. Hence, this theory predicts that, in their early years, companies pay no or minimal dividends because their funding need for investment opportunities exceed their internally generated capital. In other words, they have too little money to invest and therefore refrain from distributing any funds back to the investors.[15] In later years, internally generated funds (by successfully selling products and/or services) exceed investment opportunities, so firms optimally pay back the excess funds to the investors. Simply said, the money is transferred back to the investors, which can reinvest the money into firms with better investment opportunities.[16] This "recycling and reallocating" of money is a crucial driver of a well-functioning capital market.[17] Previous literature such as DeAngelo, DeAngelo, and Stulz (2006) find that the propensity to pay dividends is positively related to their maturity proxy (the ratio of retained earnings to total equity). Finally, we want to clarify that we do not believe that excessive shareholder payouts are at the expense of society or stakeholders. As others have said (Edmans, 2020), "One of the most wasteful actions that an executive can undertake is overinvestment, which uses both shareholders' and society's resources… Responsible companies know when to invest and when to show restraint."

[14] This theory combines agency theory (e.g. Jensen, 1986) with the evolution of the company's investment opportunity sets (see Fama and French, 2001), Grullon, Michaely, and Swaminathan, 2002).
[15] Previous research such as Smith and Watts (1992) and Gaver and Gaver (1993) find that industries with high growth options pay less dividends.
[16] This is a large advantage given that otherwise management might be tempted to use the available free cash flow for empire building projects that do not add value to the firm (Jensen, 1986).
[17] See Chen (2018) who follows the money and finds that the cash paid out by larger companies is reinvested in smaller companies.

## APPENDIX 2: Characteristics of the Nordic Corporate Governance model

A central argument in the EY (2020) report is that shareholders lack a long-term focus at the expense of other stakeholders such as employees, tax-payers, suppliers, and customers. In this appendix, we therefore describe the central characteristics the Nordic Corporate Governance model (see Lekvall, 2014; Jakobsson & Korkeamäki, 2015; Jonnergård & Larsson-Olaison, 2016; Ringe, 2016; Sjöstrand et al., 2016; Thomsen, 2016a,b; Lekvall, 2018). Even though research have shown that there are differences between the Nordic countries (Sjöstrand et al., 2016), several studies have found that a number of characteristics unite corporate governance practices across the Nordic countries (Lekvall, 2014; Thomsen, 2016a,b). Examples of such characteristics are (1) a high degree of ownership concentration, (2) a well-developed system of minority protection, (3) self-regulation, (4) employee representatives on the board, and (5) modest executive incentive systems.

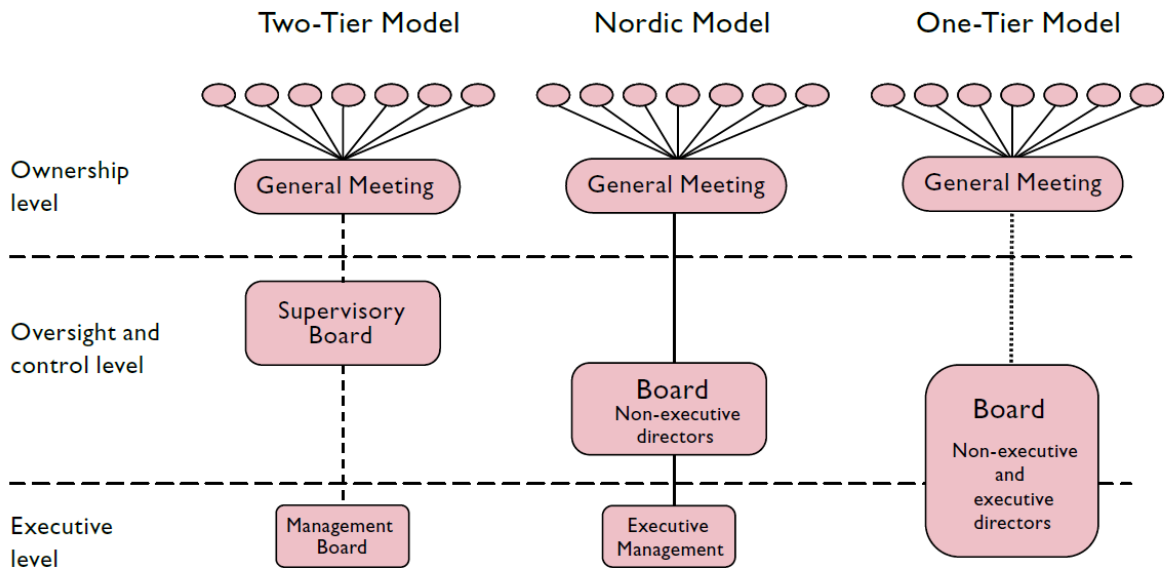



*Figure A2.1:* Comparing the Nordic corporate governance model with other governance models (adopted from Lekvall et al., 2014, p. 60).

Comparing the Nordic Corporate Governance model with the Anglo-Saxon and German models, Lekvall (2014) describes how the corporate governance models differ in critical aspects.

Starting with the two-tier model often found in German speaking countries, there is a clear division between the supervisory board and the management board (Lekvall, 2014; Ringe, 2016). As a consequence, individuals cannot sit on two boards at the same time since the role of the supervisory board is primarily to control and evaluate the management board. In this model, the management board often has a strong mandate in relation to the general assembly and the supervisory board (Lekvall, 2014). If the German two-tier model makes a clear distinction between the oversight and control level and the executive level, the Anglo-Saxon model is the opposite. As Figure A2.1 shows, the board consists of both non-executive and executive directors. In the best of worlds, this can create fast decision-making and adaptation to external events. However, as several articles have shown (Lazonick & O'Sullivan, 2000; Lazonick & Mazzucato, 2013; Lazonick, 2014), the American Corporate Governance model also has limitations. For example, if the non-executive and executive directors become too friendly, there is a risk that the board loses its controlling function, which can result in excessive executive pay (Lazonick, 2014) and which has even been linked to short-termism at the expense of long-term value creation according to Lazonick's works, on which the EY study (EY 2020) heavily draws (cf. Lazonick & O'Sullivan, 2000; Lazonick & Mazzucato, 2013).

In between the German and Anglo-Saxon models is the Nordic Corporate Governance model. In this model, there is a direct and hierarchical line between the General Meeting, the board, and the executive management team. The purpose of this set up is that majority owner(s) should have a long-term and active interest in the company should be able to appoint the non-executive board, which then controls (but also supports) the executive management (Lekvall, 2014). As the empirical evidence in our report demonstrated, many large dividend payers (such as H&M, Telia, Swedbank, and Svenska Handelsbanken) were able to combine both short and long-term issues. Thus, financial short-termism was not to be found. A key feature of the model is, however, the incentives and manoeuvrability allowed for majority shareholders for monitoring and engagement.

These structures seem to be vulnerable to over-regulation, and several scholars have cautioned against extensive EU harmonization in the area of corporate governance without proper analysis of the national consequences, with the risk that the remedy would otherwise be worse than the cure if the goal is long-term ownership and engagement (e.g. Hansen, 2007; Henrekson and Jakobsson 2011).

**APPENDIX 3: The theoretical aspects of growth, investments, and dividends – some examples**

This appendix is aimed at illustrating the relationship between growth, profitability, and investments. We use three numerical examples that illustrate different financial development that a firm might search for depending on the position in the life cycle the firm finds itself in. The examples are stylized and illustrate the theoretical and necessary practical developments given certain financial strategies and the construction of the financial system.

Growth and financial decisions of various kinds have been analyzed for a long time and are well-known. A comprehensive analysis is provided in "The Profitability, Financing and Growth of the Firm" by Sven-Erik Johansson and Mikael Runsten (2014). The focus in this type of analysis is on the development of the balance sheet of a company/group. A balance sheet is made up of two kinds of assets, current assets (CA) and non-current asset (NCA). The other side of the balance sheet concerns the financing of the firm in the form of interest-bearing liabilities/debt (D) (e.g., bank loans, issued bonds etc.), non-interest bearing liabilities (NIBL) (e.g., payables and accruals), and equity (E) (i.e., shareholder contributions). Changes on the asset must match change on the financing side.

$$\Delta CA + \Delta NCA = \Delta NIBL + \Delta D + \Delta E$$

Where $\Delta$ represents the change between two balance sheets at different dates.

Two other important relationships for the analysis is related to the development of non-current assets and equity, respectively. First, non-current assets are affected to depreciations/amortizations/impairments (DEPR) and new investments (INV). The relationship then looks like follows.

$$NCA_t = NCA_{t-1} + INV_t - DEPR_t$$

$$\Delta NCA_t = INV_t - DEPR_t$$

Where the time indexes show the point in time for the balance sheet items and the period between the two points in time for investments and depreciation. The other relationship is the development of equity. Equity is affected by net profit (NP) and transactions with owners (NDIV). The owner transactions include dividend payments from the firm and new contributions from the shareholders, normally in form of new issues of shares or share buy backs if these are negative. We call these net dividends. Following the structure from non-current assets this gives

$E_t = E_{t-1} + NP_t - NDIV_t$

$\Delta E_t = NP_t - NDIV_t$

Finally, we need to define the reporting return to the shareholders, more commonly known as return on equity (ROE), being calculated as net profit divided by beginning of period equity.

$ROE_t = NP_t / E_{t-1}$

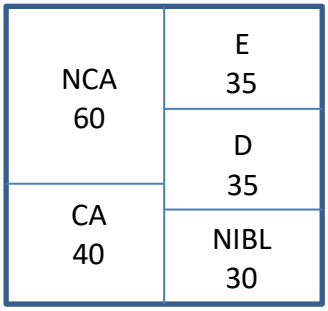



*Figure A3.1:* Starting balance sheet for the analysis growth, investments and dividends.

Let us now study a couple of numerical examples. First, we examine a situation with **3 % growth** of the balance sheet, and an unchanged financing structure, i.e., the relationship between NIBL, D, and E is unchanged, and ROE is 12 %. Second, we move to a situation where the **growth is 10 %,** an unchanged financing structure and ROE of 12 %. Finally, we analyze a **5 % growth**, where equity grows by twice the percentage point as the other liabilities and a

ROE of 12 %. In all situations, we start with 30 % NIBL, 35 % D, and 35 % E on the financing side, and 40 % CA and 60 % NCA on the asset side, as shown in the figure below. In all cases, we assume 20 % depreciation of the initial balance sheet. This corresponds to approximately 10-12 years of useful life/depreciation period for non-current assets.

***Example 1: the mature firm with a balance sheet growth of 3 %***

The first example illustrates a firm which is in a mature state or alternatively a long-term stable situation for all firms. The growth is 3 %, which is at the top-end of a long-term GDP growth. The ROE is 12 %, and the financial position is unchanged. The investments in the firm amount to 13.8, which is 23 % of the value of the non-current assets on the balance sheet. The growth is modest but total investments are still considerable and open up for considerable changes in the production capacity. ***Such a firm can still afford a 75 % dividend payout of reported net profit, which is a very high number and well-beyond figures that we see in most companies today.***

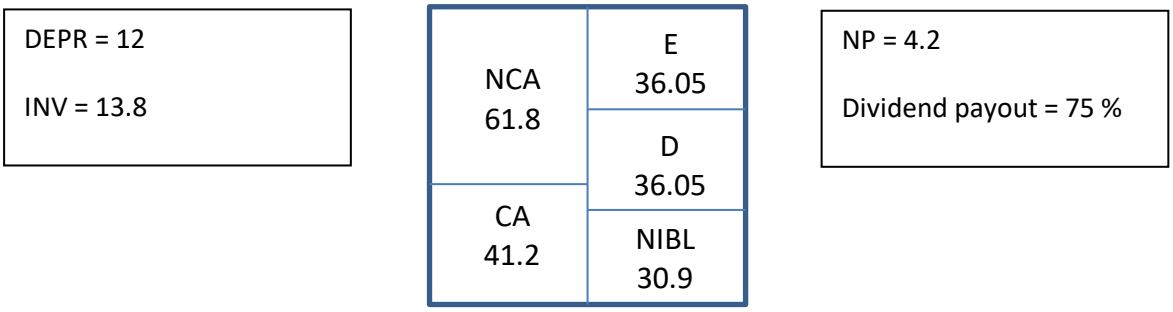



*Figure A3.2:* Balance sheet, investments, depreciation, net profit, and dividend payout when the firm grows by 3 % and generates 12 % ROE with an unchanged financial position.

***Example 2: a fast-growing firm with a balance sheet growth of 10 %***

In the second case we illustrate ***a fast-growing firm*** where the balance sheet grows with 10 % per year, with a modest return on equity of 12 %. The financial position is unchanged. In this case the investments are in total 18, which corresponds to 30 % of the carrying value of the

assets on the balance sheet in the beginning of the period. The strong investment pattern can still be matched with a dividend payout ratio of 17 % of net profit, which is well beyond what the companies in the lower end of the distribution pays to their shareholders. This is not a long-term sustainable level of growth for a firm, but for a limited period of time it is definitely a reasonable number.

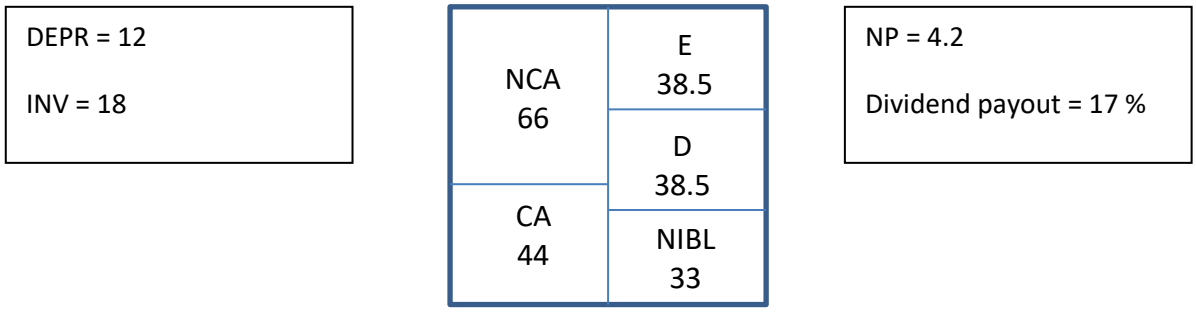



*Figure A3.3:* Balance sheet, investments, depreciation, net profit, and dividend payout when the firm grows by 10 % and generates 12 % ROE with unchanged financial position.

***Example 3: a medium-growing firm with a balance sheet growth of 5 %***

The final example illustrates ***a medium-growing firm which improves its financial position***, i.e., the proportion of equity increases. In this case we can observe two things first the investments correspond to 25 % of the value of the non-current assets at the beginning of the period. This is a substantial amount, which means that not only do we exchange past production capacity, but we also have the opportunity to increase the capacity with better characteristics. The firm is generating a modest return of 12 %, and it has a payout ratio of 38 % of net profit. This means that the generated profits of the firm are sufficient to ensure substantial new investments, improved financial position, and a close to average payout ratio. This is a financially strong achievement.

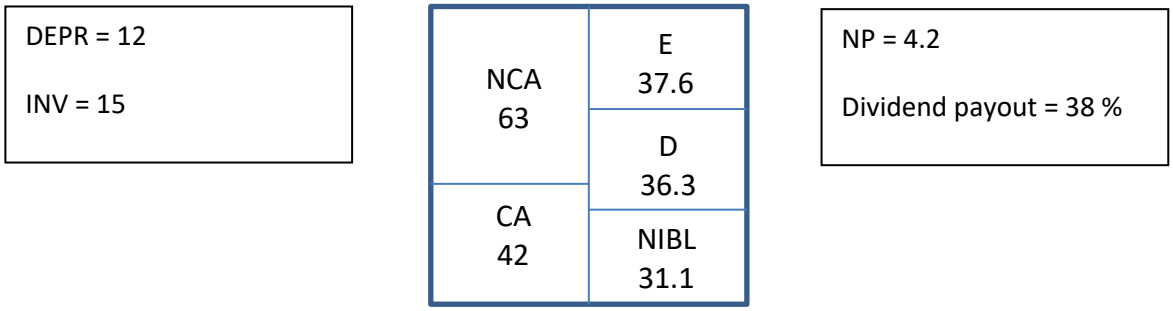



*Figure A3.4:* Balance sheet, investments, depreciation, net profit, and dividend payout when the firm grows by 5 % and generates 12 % ROE with an improved financial position.

**The above examples illustrate that dividends in themselves are not contradictory to investments and growth of firms in a normal capitalistic society**. Dividends that we have illustrated above are in many situations in line or above what we empirically observe today. Two issues regarding the examples can be highlighted. First, the major question is what kind of investments are being made in companies today and in the future. If these investments are directed towards society improving activities, there is a substantial amount of money on the table. Second, the money that is distributed to owners may in turn be reinvested into other firms to ensure growth and positive transitions. This is generally the dynamics we see in society and the general role of the financial markets. A key element appears to be the incentives and direction of the investments rather than the magnitude and disposition of currently available funds.

## APPENDIX 4: Sustainability reporting and performance among top 20 dividend payers

To investigate whether major dividend payers lag behind in terms of their sustainability efforts, we collected information on their reporting practices and overall performance from three different sources; (1) Financial and Sustainability Reports, (2) ASSET4 performance ratings, and (3) CSRHUB performance ratings. Nowadays, companies worldwide are paying more attention to reporting on their sustainability performance in terms of Environmental, Social, and Governance (ESG) activities. In addition, seeking external assurance is an essential step for companies that want to increase trust in their reporting process, as it provides an independent, third-party view of the thoroughness and relevance of the sustainability work. Adding external assurance can add both internal and external value to the sustainability report through improved quality of the internal reporting and control process and help management focus on business implications and material issues. Based on EU directive 2014/95/EU, the Swedish Annual Accounts Act requires larger companies to report on their sustainability performance. In addition, the law stipulates that an external auditor has to verify that the company has prepared a statutory sustainability report. However, the current legislation does not specify any specific reporting framework. Neither does the law require that the report is assured by a third-party. According to a recent study on sustainability reporting in large companies around the world by KPMG, about 77 percent of the 100 largest companies in each EU member state report on sustainability performance, and 67 percent of the reporting companies disclose their information following the GRI standards (KPMG, 2020). According to the report, the GRI standards are the most widely used and trusted frameworks to disclose sustainability performance information.

Table 4 shows that 90 percent of the top 20 dividend payers in Sweden applied the GRI standards in 2019. Out of these firms, 80 percent have been seeking voluntarily limited external assurance on specified sustainability information in their sustainability reports. The equivalent

figure for larger listed companies worldwide is 51 percent (KPMG, 2020). The appendix also shows that one in five of the highest dividend-paying companies in Sweden reports climate risk in line with TCFD recommendations. This is in line with the findings in the study by KPMG (KPMG, 2020). **Thus, the Swedish top 20 dividend payers seem to perform well with respect to disclosing trustworthy sustainability information to the market.**

Firms also get evaluated on their sustainability performance by external analysts and receive ratings on different dimensions of their sustainability work. High-performing companies are typically included in a renowned sustainability index such as the Dow Jones Sustainability Index (DJSI) and the FTSE4Good. These indices are designed to gauge the financial performance of companies demonstrating strong environmental, social, and governance practices. Transparent measurement and clear criteria for performance evaluation make them suitable tools for managing or evaluating sustainable investment strategies. Our analysis shows that nine out of the twenty top dividend payers in Sweden belongs to one of the two indices. Taken by itself, this is quite an impressive figure considering that none of the banks (SEB and Handelsbanken) or investment companies (Industrivärden and Investor) are included in any of the two indexes. Nonetheless, these two investment companies can be classified as engaged long-term owners who actively support building and developing sustainable best-in-class companies.

Our final analysis examines the sustainability performance scores for our top dividend payers from two prominent rating agencies, ASSET4 and CSRHUB[18]. If we exclude the two investment companies, the average ASSET4 environmental Pilar score (A4_Env_Pilar) equals 72.74. The corresponding figures for social performance (A4_Soc_Pilar) and combined ESG

[18] ASSET4 is a leading provider of ESG performance data that was acquired by Thomson Reuters (currently known as Refinitiv) in year 2009. CSRHub is a web service that offers consensus ESG ratings to benchmark performance, study supply chains, improve reporting, and build portfolios. They provide transparent ratings and rankings of 17,660 companies from 145 countries, driven by 724 industry-leading CSR/ESG data sources including ESG analyst, crowd, government, publication, & and not-for-profit data.

performance (A4_Combined_Score) are 76.20 and 57.98, respectively. These figures can be compared with the results from the study by Iamandi et al. (2019), which includes 1165 large European listed companies. Their sample reported an average environmental performance of 64,89, a social performance of 62,44, and a combined ESG performance equal to 59,53. Hence, a comparison of these figures does not show any indication of sustainability underperformance among the largest dividend distributing firms in Sweden. Also, the Corporate Social Responsibility (CSR) performance measure from CSRHUB supports this conclusion. This measure provides perspective by rank ordering a Companies composite sustainability rating against all other firms' ratings in the same industry. Column (9) in Table 4 shows that many of the highest dividend payers are also top performers in sustainability according to this metric.

**Taken together, our results show that companies with high dividend payouts are also performing well in terms of different aspects of sustainability.** This is in line with the large body of research that documents a positive association between financial performance and sustainability performance (see Brooks and Oikonomou, 2018 and Malik, 2015 for excellent reviews on this topic). However, whether sustainability drives financial performance, or if it is the other way around is a question yet to be answered.

| | Reporting | | | Inclusion in sustainability index | | Sustainability performance | | | |
|---|---|---|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) |
| | GRI Standards | TCFD | Ext. assurance | DJSI | FTSE4Good | A4_Env_Pilar | A4_Soc_Pilar | A4_ESG_Score | CSRHUB_Rating |
| **H&M** | Y | Y | Y | Y | Y | 92.44 | 83.94 | 44.37 | 96% |
| **TELIA** | N | N | Y | N | Y | 59.67 | 79.03 | 58.38 | 92% |
| **SWEDBANK AB** | Y | Y | Y | Y | Y | 81.36 | 70.39 | 40.28 | 90% |
| **HANDELSBANKEN** | Y | Y | Y | N | Y | 86.28 | 77.58 | 65.82 | N/A |
| **VOLVO AB** | Y | N | Y | N | N | 88.98 | 88.32 | 66.29 | 92% |
| **ERICSSON** | Y | N | Y | Y | N | 84.58 | 88.74 | 61.18 | 91% |
| **SEB** | Y | Y | Y | N | N | 91.75 | 79.84 | 53.10 | N/A |
| **ATLAS COPCO** | Y | N | Y | N | Y | 79.92 | 88.98 | 79.45 | 95% |
| **INVESTOR AB** | Y | N | Y | N | N | 26.55 | 65.19 | 52.67 | 74% |
| **TELE2 AB** | Y | N | Y | N | N | 53.60 | 80.23 | 45.79 | 86% |
| **SANDVIK AB** | Y | N | Y | Y | Y | 70.66 | 78.96 | 79.22 | 95% |
| **SKANSKA AB** | Y | N | Y | N | Y | 58.14 | 73.48 | 68.81 | 96% |
| **SCA** | Y | N | Y | N | N | 80.63 | 88.60 | 73.95 | 95% |
| **SKF** | Y | N | Y | N | Y | 91.44 | 83.99 | 50.11 | 95% |
| **SCANIA** | Y | N | N | N | N | N/A | N/A | N/A | N/A |
| **ELECTROLUX** | Y | N | Y | Y | Y | 81.66 | 85.13 | 60.03 | 97% |
| **ASSA ABLOY** | Y | N | N | N | Y | 80.49 | 73.22 | 68.61 | 97% |
| **INDUSTRIVÄRDEN** | Y | N | N | N | N | 19.78 | 50.27 | 34.68 | 70% |
| **SWEDISH MATCH** | N | N | N | N | N | 70.44 | 81.60 | 76.91 | 84% |
| **HOLMEN** | Y | N | Y | N | N | 57.27 | 69.64 | 51.28 | 98% |

*Table A4.1:* Top 20 dividend payers and their sustainability reporting and sustainability performance.

**Appendix 5: Yearly Distribution in our Sample**

| Year | Number of Firms | in % |
|---|---|---|
| 2000 | 208 | 2.8 |
| 2001 | 244 | 3.3 |
| 2002 | 292 | 3.9 |
| 2003 | 299 | 4.0 |
| 2004 | 323 | 4.4 |
| 2005 | 337 | 4.6 |
| 2006 | 344 | 4.7 |
| 2007 | 365 | 5.0 |
| 2008 | 372 | 5.0 |
| 2009 | 367 | 5.0 |
| 2010 | 359 | 4.9 |
| 2011 | 347 | 4.7 |
| 2012 | 341 | 4.6 |
| 2013 | 352 | 4.8 |
| 2014 | 377 | 5.1 |
| 2015 | 425 | 5.7 |
| 2016 | 462 | 6.3 |
| 2017 | 516 | 7.0 |
| 2018 | 528 | 7.1 |
| 2019 | 531 | 7.1 |

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