



**LUND UNIVERSITY**  
School of Economics and Management

BUSM36 Degree Project in  
Corporate and Financial Management  
Department of Business Administration  
June 2009

# **Transparency of Executive Directors' Remuneration**

## **- The case of Sweden**

**Advisor**  
Lars Oxelheim

**Authors**  
Sara Hagelborn  
Ida-Karolina Lassesson

# Abstract

- Title:** Transparency of Executive Directors' Remuneration - The case of Sweden
- Seminar date:** 4 June 2009
- Course:** BUSM36 Degree project in Corporate and Financial Management, 15 ECTS
- Authors:** Sara Hagelborn, Ida-Karolina Lassesson
- Advisor:** Lars Oxelheim
- Key words:** Transparency, Remuneration, Compensation, Executive Director, Disclosure
- Purpose:** The purpose of this study is to analyze how transparent the reporting of executive directors' remuneration is in Swedish listed companies, by examining to what extent the demand for information is satisfied by the annual reports.
- Methodology:** The study is divided into two parts, performed with an abductive approach. The first part is qualitative with open semi-structured interviews, and results in the construction of a classification system. The second part is a quantitative documentary study with a descriptive purpose.
- Theoretical framework:** The theoretical framework is based on accounting theory, stakeholder theory, agency theory, managerialist theory and theories regarding transparency and confidence, as well as existing regulations and recommendations.
- Empirical foundation:** The empirical foundation consists of a media review and nine interviews with stakeholders. Moreover, the annual reports of 13 companies listed on OMX Stockholm Large Cap have been studied.
- Conclusions:** The market for information on directors' remuneration is in disequilibrium, caused by a supply deficit. Therefore the transparency of the disclosed directors' remuneration has been found to be mediocre, since no company fulfills a higher level than general disclosure.



# Abbreviations

<b>ABS</b>	Accounting Standards Board
<b>AGM</b>	Annual General Meeting
<b>CD&amp;A</b>	Compensation Discussion and Analysis
<b>CEO</b>	Chief Executive Officer
<b>ECGI</b>	European Corporate Governance Institute
<b>EU</b>	European Union
<b>EUCGF</b>	European Corporate Governance Forum
<b>IFRS</b>	International Financial Reporting Standards
<b>NBK</b>	Näringslivets Börskommitté - Confederation of Swedish Enterprise
<b>SOU</b>	Statliga Offentliga Utredningar
<b>ÅRL</b>	Årsredovisningslagen – The Annual Accounts Act



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# 1 Introduction

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*This chapter gives an introduction and background to the debate about executive remunerations. Following a problem discussion, the research question as well as the purpose of the study will be introduced to the reader. The intended target audience will be presented together with the delimitations of the study, and the chapter will end with definitions and an outline for the rest of the paper.*

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## 1.1 Background and earlier research

Much has been studied and written globally on the topic of executive remuneration and disclosure of compensation in particular. The United States with its Compensation Discussion and Analysis (CD&A) have for natural reasons been at the forefront of the discussion. Allan L. Beller from the Securities Exchange Commission established that all the new legal and regulatory features after Enron and Worldcom had improved the disclosure of executive compensation and resulted in more responsible corporate governance. But, he also saw a pattern of too opaque and unhelpful information; “disclosure that says as little as possible while seeking to avoid liability, rather than disclosure that seeks to inform”, “The keyword in the policy regarding disclosure is transparency.” (Beller 2004, p.21)

There have been plenty of evaluations of the new SEC CD&A regulations, for example Cheryl de Mesa Graziano’s (2006) account of its potential impact, Sean M. Donahue’s (2008) article about the insufficiency of the new rules, and Gerry Grant’s (2008) examination of the compliance with the new requirements. Grant found that most companies have improved disclosures on executive compensation, but still the SEC staff issues comment letters to companies with demands for additional information (2008, p.30). Stephen Miller (2008) observed that most large US companies did not intend to disclose the performance goals for their incentive programs, like the new rules require unless it results in competitive harm. The quality of disclosures was also found to vary much.

Following rising remuneration levels, significant owner reactions to excessive executive pay, and a request for more executive accountability, there has been increased focus on disclosure of more complete information on the pay levels, program structure and performance criteria for key executives also in most European markets. (Mercer Perspective 2007, p.1, 3)

The topic has recently been discussed at a transnational level at the European Corporate Governance Forum on Director Remuneration. The main recommendations emerging from the Forum in March state that disclosure of the remuneration policy of listed companies and of the individual remuneration of directors and any material change to it should be mandatory for all listed companies in the EU, to allow shareholders the appropriate control over compensation and the inherent risks. "The disclosure should contain sufficient detail to enable shareholders fully to understand the components of directors' remuneration as well as progress towards the achievement of previously granted awards and should include details on pension entitlements and increases thereof and perquisites and other benefits in kind." (EUCGF 2009)

In preparation for the Roundtable Discussion, Prof. Guido Ferrarini and Dr. Maria Christina Ungureanu (2009) from the University of Genoa measured the extent to which companies in 16 European countries followed the 2004 EU Commission Recommendations for the presentation and disclosure of their directors' remuneration policy. Disclosure practices were found to vary significantly across Europe but the recommendations were generally insufficiently applied, with Continental Europe at only 48 percent conformity. Furthermore, elements of the remuneration policy are scattered throughout the annual report in Continental Europe, impeding the assessment of the remuneration systems. Catherine Albert-Roulhac and Peter Breen (2005) also studied corporate governance in Europe, with the conclusion that the overall level of disclosure remains insufficient, especially the disclosure of individual compensation and compensation criteria.

Several reports and studies have also been made by Human Resource consulting firms, such as Hallvarsson & Halvarsson (2008a, 2008b) and Mercer (2007). Hallvarsson & Halvarsson *inter alia* investigated how the incentive programs were described in the notice to the annual general meeting, and found that the public information about the performance requirements and risk taking could be significantly improved, especially the transparency of incentive programs for executive directors (Hallvarsson & Halvarsson 2008a, p.3). Mercer investigated the key EU Commission Recommendations for compensation disclosures, the current disclosure practices across Europe, and expected changes in practice over the coming years. Among the countries with medium conformance they found Germany, Italy, Norway, Sweden and Switzerland. In these countries, executive remuneration is provided only as an aggregate amount apart from the CEO which is specified separately. For countries at a higher level of transparency such as the UK, Ireland and the Netherlands, more information is required on the linkage between pay and performance, and more transparency about benchmarking peer groups. (Mercer Perspective 2007, p.1-5)

## 1.2 Swedish perspective and particularities in the corporate governance system

Sweden has a hybrid corporate governance system, mixing Anglo-American characteristics with the governance system of Continental Europe, and is known for its rather high corporate transparency. (Oxelheim & Wihlborg 2008, p.14, 184) The Anglo-American system of governance with dispersed ownership, liquid financial markets, active markets for corporate control, and board control, is more shareholder-oriented and said to have better investor protection and information transparency. Still, excessive executive remuneration used to be less problematic in Continental Europe in the past with its large controlling owners, but today Europe's top paid CEOs reside all over Europe and not only in the UK. (Oxelheim & Wihlborg 2008, p.20)

The Swedish Code of Corporate Governance (*Sw. Bolagsstyrningskoden*) is much the same as its counterparts in other industrialized countries, but with a few particular features originating from the norm of concentrated ownership. There is a clear division of responsibilities between shareholders, the board, management and auditors, and shareholders are encouraged to take an active role by voting at annual general meetings (AGM) and working through nomination committees; the "ultimate power should rest with the shareholders". (Unger 2006, p.3) This matters e.g. for the CEO's ability to override the board's decisions (see the managerialist theory in section 3.4).

Sweden's hybrid system between the one-tier and the two-tier board system contains a board similar to the supervisory board, elected by the annual general meeting. The OMX Nordic Exchange Stockholm has listing rules that together with the Swedish Code of Corporate Governance require a majority of board members to be independent from the company, and two members to also be independent from the largest owners. Moreover, only one executive, normally the CEO, can sit on the board. (ECGI 2008, p.2) Another special feature is the presence of two or three employee representatives on the board of directors, in companies with at least 25 employees. A nomination committee should represent the shareholders and be made up of a majority of non-executive directors, often four or five representatives of the major shareholders. The board is to decide on the CEO's remuneration after a proposal by the remuneration committee. Proposed guidelines and principles for executive remuneration should however be presented to the owners in the AGM for its approval. (Unger 2006, p.11, 17-18) The Code stipulates that a remuneration committee consisting of independent members may be set up within the board of a listed company to prepare remuneration matters, but the entire board apart from the CEO can also handle this and ultimately decide on the proposals. The board must set CEO remuneration in line

with the binding principles, but bonuses, profit sharing and benefits in kind can be decided by the board. The AGM however has to approve any share based incentive scheme. Hence, shareholders have to be fully informed before the meeting. (ECGI 2008, p.3-5)

These rather special features, together with the claim above that Sweden supposedly has a fairly high degree of transparency, makes the case of Sweden particularly interesting. Moreover, the debate has really blazed with several recent stories about excessive bonuses, overly complex incomprehensible incentive programs and managers with greed beyond compare.

Earlier this year, one of Sweden's largest banks SEB experienced a minor scandal after having changed its incentive program. Likely because of a complex system and poor transparency, it appeared as the fixed salaries for the management had been raised significantly and the public outcry was massive. It harmed the customers' and owners' confidence for the bank to the extent that SEB was forced to withdraw and reformulate the program (*SEB-direktörerna avstår löneökning 2009*). Even more recent, AMF Pension came under fire when it was discovered that the former CEO Christer Elmehagen had received an extraordinary pension sum. The interesting aspect of this whole scandal was that important decision-makers claimed that they had not received adequate information about the pension agreement. The board chairman Göran Tunhammar indeed described the contract as complex, but simultaneously argued that the annual report had been clear regarding the total cost to the company. (*AMF:s ordförande: Årsredovisningarna har varit tydliga 2009*)

### 1.3 Problem discussion and research question

Variable pay has become more frequent and in increasing amounts during the last decades. Therefore, incentive programs have become more and more complex, which may result in excessive remuneration and even manipulation. (EUCGF 2009) The debate hitherto has mostly been whether variable pay is a good way of motivating executives by aligning their interest with that of shareholders, and how to balance the long-term incentives with short-term greed. But at the time of writing, the focus has somewhat shifted from the contents and appropriateness of the incentive programs to the disclosure and transparency of the information. "Increased transparency is a prerequisite for owners and the market to know about the existing compensation programs, and thereby form an opinion about their fairness." (Jan Persson in Svidén 2009) Thus, it is not the remuneration *level* that is of concern here, but the extent of disclosure and transparency of the director remuneration information has become the focal point. How much relevant information about executive remuneration is actually communicated, and is the infor-

mation provided by companies enough to satisfy different stakeholders' demand for information?

With inadequate transparency of the incentive programs no long-term investors would be able to evaluate and thereby ratify the programs in the annual general meeting. Hence, only short-term investors would be willing to invest, reinforcing the problematic short-termism all too prevalent in the financial markets. Therefore it is of critical importance that all details of the program are known and clearly connected to other parts of the remuneration, and general accounts should be avoided as far as possible. (Nachemson-Ekwall, 2009) Corporate self-interest is fulfilled with more executive pay transparency, because it keeps shareholders activism at bay (Miller 2008, p.1). Thus, companies' should be eager to provide the information that is demanded by stakeholders and shareholders in particular.

In general, the academic research in the area has been about the conformance of disclosure with different regulations and recommendations. Several comparative studies have been made (e.g. Ferrarini & Ungureanu 2009; Albert-Roulhac & Breen 2005). But after thorough investigation, nothing has been found on the demand. Most researchers probably assume that the legal frameworks capture all variables that are of interest to stakeholders, but this study intends to compile the demand for information of different stakeholders, and then compare it with the information provided in the annual reports.

The above problem discussion brings us to the following research question:

*How transparent is the reporting of executive directors' remuneration in Swedish listed companies?*

However, to measure transparency in an objective manner, the study starts by examining what information different stakeholders demand and require for the accounts to qualify as adequately transparent.

## 1.4 Purpose

This study intends to analyze how transparent the reporting of executive directors' remuneration is in Swedish listed companies, by examining to what extent the demand for information is satisfied by the annual reports.

## 1.5 Delimitations and target audience

The following study will not venture into a discussion about the reasonableness of the actual amounts and contents of the incentive programs, but is concerned only with the disclosure and transparency of information to enable well-founded

decision making and appraisal by stakeholders. It does neither intend to measure the actual amount of disclosed information, but only how supply conforms to demand. Lastly, only the annual reports have been examined as the source of remuneration information.

The main target audience is the academic community. However, the results of the study could benefit not only existing shareholders and future investors, but also be of interest to the entire society through public confidence and trust. Not only will investors and creditors want to know about any misappropriation of their funds, but there are high indirect costs involved in insufficient reporting and transparency of remuneration. The difficulty for shareholders to judge and assess incentive programs could give executives unreasonable benefits at shareholders expense resulting in a loss of investor confidence, especially if directors are awarded significant bonuses and perquisites when they are perceived of having influenced the decision-making process (AMN 2002:1). It is therefore in everyone's interest that remuneration information is properly communicated in the annual reports.

## 1.6 Definitions

*Transparency* – there is no generally accepted definition of the concept of transparency but in this study it will be defined as the disclosure of relevant, reliable, comparable and understandable information that fully meets the demand of stakeholders.

*Executive directors* – includes board members, the chairman of the board, the CEO and other persons in the top management. Also referred to as executives in short.

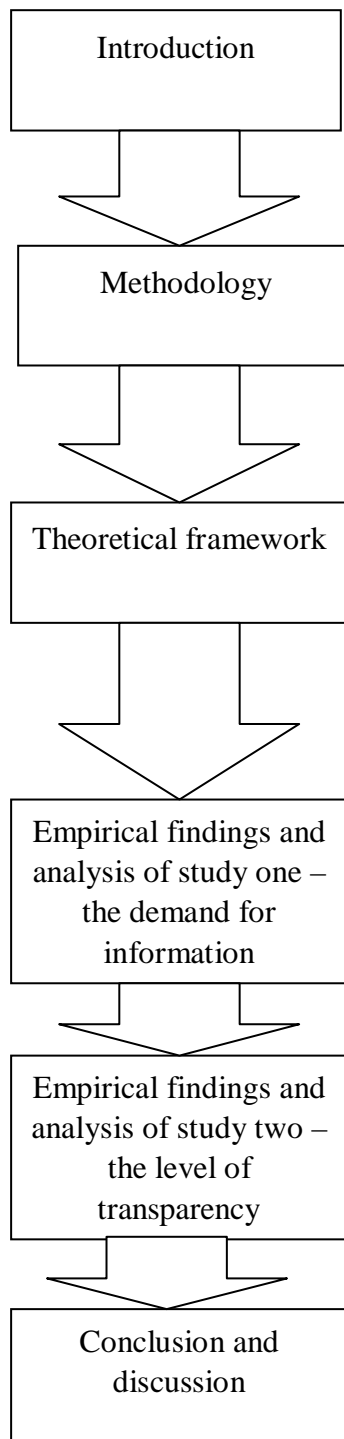
*Remuneration* – pay or salary for services rendered. Often consisting of fixed salary, short-term incentives, long-term incentives, pensions, non-cash benefits and severance payments.

*Bonus* – this concept is widely used as all variable remuneration. However, according to the Confederation of Swedish Enterprise “bonus” should not be used in this sense, but should only denote gratuities awarded with no prior agreement (Svenskt Näringsliv 2006, p.13). In this study it is therefore defined as the part of short-term variable remuneration that is not connected to any individual performance agreed in advance.

*Non-cash benefits* – includes all benefits regarded as remuneration such as company car, health insurance and accommodation. Also commonly referred to as perquisites.

*Incentive program* – programs designed to motivate employees with variable remuneration. Could include both long-term and short-term remuneration as well as bonuses.

## 1.7 Disposition



### **Chapter 1**

This chapter will give the reader an introduction to the subject and present the problem discussion, which leads to the research question and purpose of the study.

### **Chapter 2**

This is where the choice of scientific approach will be presented as well as the method of collecting data. The chapter ends with a discussion of the validity and reliability of the study, and some criticism of the sources.

### **Chapter 3**

The theoretical framework of the study will be presented in this chapter including accounting theory, stakeholder theory, agency theory, managerialist theory, theories regarding transparency and confidence, as well as regulations and recommendations.

### **Chapter 4**

This chapter will present the empirical findings from the study of demand for information, followed by an analysis which includes the creation of a classification system.

### **Chapter 5**

In this chapter the empirical findings from the examination of annual reports will be presented and analyzed.

### **Chapter 6**

This final chapter will present the conclusion and answer the research question. A further discussion will be held, and suggestions for future research will conclude the thesis.





## 2 Methodology

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*To give the reader an understanding of how the study has been conducted and the possibility to critically assess any possible research effect, this chapter will give an explanation of the methods of investigation. A discussion of the quality of the study will also be held.*

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### 2.1 Scientific perspective and approach

The study can be divided into two part studies. The first one is a qualitative study which, by studying regulations and recommendations and by interviewing different stakeholders, aims to define what actual information is demanded. The second study is a quantitative documentary study, where the supply of information in the annual reports is analyzed, with the demand found in the first study used as a basis. However, the aim is not to measure *how much* the companies disclose about remuneration, but to create an understanding of how well they live up to the demand of information. The study therefore has a descriptive purpose. (Bryman & Bell 2005, p.322)

The study is conducted with an abductive approach. Since it is based on the ongoing debate about the disclosure of remuneration and uses a theoretical framework as a basis for what kind of information is demanded, the method cannot be said to be inductive. Critics to the inductive method state that it is in fact impossible to use a completely inductive method since the researcher in question will almost always have an expectation of the result (Jacobsen 2002, p.43). However, the method used here is neither totally deductive because it does not start with a predetermined theoretical framework before collecting the empirical data, and the aim of the study is not to confirm or reject a hypothesis (Bryman & Bell 2005, p.23-25). Instead the study tries to be as inductive as possible when examining what information is needed for a good transparency of remuneration. Some of this information is found in the theoretical frameworks and some in the empirical findings. This information is then used to create different levels of transparency, in an original theoretical framework on how to classify transparency. The study then collects empirical data which is analyzed with the new theoretical framework. Thus, an abductive method is used (Alvesson & Svenningsson 1994 p.42).

## 2.2 Collection of data

In the beginning of the study research of secondary data was made to gain a deeper understanding of the topic and to see what areas had already been studied. Two different databases on the Internet were primarily used to find scientific articles; elin@lund<sup>1</sup> and ABI Inform<sup>2</sup>, with search words such as compensation, remuneration, disclosure, transparency and bonus. Furthermore, a review of the debate in the media has been made, mainly through the two search engines Artikelsök<sup>3</sup> and Affärsdata<sup>4</sup>. The sources were limited to the most well-known and reliable newspapers, business journals and websites; Dagens Industri, Svenska Dagbladet, Dagens Nyheter, Sydsvenska Dagbladet, Veckans Affärer, Affärsvärlden, Aktiespararna and Balans. Besides creating a deeper understanding of the subject, some of the articles found in the media have been used as inputs for defining the demand for information.

### 2.2.1 Defining demand of information

As a first step in defining demand of information, a compilation of the Swedish regulatory frameworks has been made, which includes the Annual Accounts Act (*Sw. Årsredovisningslagen*), the Companies Act (*Sw. Aktiebolagslagen*) and the Swedish Code of Corporate Governance. As the Annual Accounts Act only gives basic mandatory requirements for information and the Swedish Code of Corporate Governance does not give enough specific instructions of what information to disclose, three other guidelines and recommendations can be found to complement these regulations. They are issued by three Swedish organizations; the Securities Council (*Sw. Aktiemarknadsnämnden, AMN*), the Confederation of Swedish Enterprise (*Sw. Svenskt Näringsliv*), and the Swedish Industry and Commerce Stock Exchange Committee (*Sw. Näringslivets Börskommitté, NBK*). Besides the Swedish regulations and guidelines, the EU Commission Recommendations have also been observed and included in the study of demand for information.

Since there could be demand for information that is not captured by the regulations and guidelines, the public debate in the media has been reviewed and interviews with different stakeholders have been performed.

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<sup>1</sup>Electronic Library Information Navigator, a database that integrates data from several publishers, databases and e-print open archives.

<sup>2</sup> ABI Inform is a database with international working papers, periodicals and news papers within business and economics

<sup>3</sup> Artikelsök is a database with references to articles and reviews in Swedish periodicals, available for students at Lund University through Elin@Lund.

<sup>4</sup> Affärsdata is a database with reference to five Swedish newspapers; Dagens Nyheter, Göteborgs-Posten, Svenska Dagbladet och Sydsvenska Dagbladet, Upsala Nya Tidning, 32 business journals and telegram from news agencies.

Because of the geographical distance to the respondents, the interviews have been made by telephone, except for two respondents that only agreed to answer the questions by e-mail due to a busy time schedule. The interviews have been semi-structured, to fully allow the respondents to explain their views and thoughts, and open with only a few number of predetermined questions. (Bryman & Bell 2005, p.363) The interviewer frequently asked attendant questions to get further explanations on the information demanded.

### 2.2.2 Selection of interview respondents

The interview respondents have been selected to represent the different stakeholders interested in the reporting of remunerations. According to the stakeholder theory, there are several parties interested in the financial information given in the annual reports, e.g. customers, suppliers, employees, management, owners, creditors, the society, and interest groups (Clarke 2007, p.27-29). Current owners, as well as potential owners, are interested in the information for their decision of whether to sell, keep or buy shares. The employees want to know whether the company is profitable and stable, and the creditors can be assumed to use the information to decide if the company will be able to repay debts, interest and amortization. Customers want to know if the company will stay in business to provide them with replacement parts or additional services. The government and municipality use the information to regulate and determine taxes, and the society and interest groups want to be able to follow the company's economic state and business position. (Artsberg 2003, p.167) Since the levels of remuneration can affect the company's profitability and economic state in both a positive or negative manner, it should be a matter of concern for all these stakeholders.

According to the Companies Act as well as the Code of Corporate Governance, it is the owners that finally decide on the remuneration principles in the annual general meeting. Thus, it could be argued that the disclosure of remunerations is of special interest to this stakeholder group, wherefore there has been a particular focus on representatives of this group in the search for interview respondents. The chiefs of corporate governance at several institutional investment funds, such as Folksam, AMF Pension, Första AP-fonden, Öresund, Aktiespararna and Investor, have been contacted by e-mail directly. Most of them declined an interview with the argument that they did not have time to participate. Only two of these agreed to do an interview; Ossian Ekdahl at Första AP-fonden and one that wishes to stay anonymous.

As the ownership structure has become more and more diversified, with a large part of institutional investors, financial analysts have taken a more important role in the communication between current owners, potential investors and companies

(Blom et al. in Alvesson & Svenningsson 2007). Therefore, 23 analysts and chief analysts at 11 different banks have been contacted. Three of them replied that they do not look into the information about remunerations at all. Only two agreed to do a telephone interview and two agreed to answer the questions by mail.

Because of the inherent difficulty in finding interview respondents for customers, suppliers and employees that use the information given about the remuneration in the annual reports, interviews have instead been conducted with consultants representing the total group of stakeholders. More information about the respondents and the organizations can be found in the empirical findings. An interview has also been made with Carl-Gustaf Burén, the accounting expert at the Confederation of Swedish Enterprise. However, Burén did not give any specific details on what information is demanded, but simply referred to different regulations and recommendations on the area as well as the propositions and reports behind their regulations. All the regulations and recommendations that Burén referred to, can be found in 3.6 Regulations and recommendations.

Regarding the creditors, a number of credit analysts have been contacted. The three analysts that replied explained that they either do not use the annual report at all or they focus only on the balance sheet and income statement. None of them look at the information on remunerations at all. The demand from the society is covered by the regulations and recommendations and through a media review, which also incorporates the different public interest groups.

### 2.2.3 Defining levels of transparency

The annual report, which incorporates the annual account and the corporate governance report, is the main tool for communicating information regarding remunerations. (Hallvarsson & Halvarsson 2008b, p.22) Therefore, the second study will examine a number of annual reports to define how well the companies live up to the compiled information demanded.

Since the different information that is requested, from now on called variables, does not weigh equally it would not be accurate to measure transparency only by calculating how many variables the companies fulfill. Two companies that disclose just as many variables may not be equally transparent because of the different nature of the variables they disclose. Therefore a classification system will be created based on the demanded variables.

The classification system will consist of four levels, where the first level includes the variables that are regulated by the Annual Accounts Act. This is information that all companies should disclose according to legislation. To reach a higher level of transparency, the companies have to disclose several other variables demanded

by the different stakeholders. The variables given by the first study will be divided between level two and three depending on how firm-specific the information is. This is because more firm-specific information is assumed to give a higher level of transparency. The fourth and highest level of transparency does not require any additional variables but includes all the variables required on the previous levels.

The four different levels are:

- 1) *Basic disclosure*; the company only discloses the mandatory information given by the Annual Accounts Act,
- 2) *General disclosure*; the company discloses some additional information, but the nature of the information is very general and many of the more specific variables demanded by the stakeholders are omitted,
- 3) *Extended disclosure*; the company discloses more firm-specific information, but does not fully live up to all the demanded variables,
- 4) *Full disclosure*; the company fully meets the demand of information from shareholders as well as regulations and recommendations.

For a company to reach a certain level, half of the variables at that level need to be disclosed at the minimum. I.e. to reach level two, the companies need to fulfill half of the variables at level one and level two, and to reach level three half of the variables at level three needs to be fulfilled as well. This means that a company can reach level three by fulfilling half of the variables at level two and three, while a company that fulfills all variables at level two but none at level three will still be classified at level two. The motivation behind this is that the variables at level three give more transparency than the ones at level two. To reach the fourth level which implies full transparency, the companies need to disclose all demanded variables.

#### 2.2.4 Selection of companies

Because of the time limit of this study it was not feasible to include all Swedish listed companies in the empirical research. Incentive programs and variable pay is more common among the largest companies (AMN 2002:1), wherefore the study will focus only on the largest public corporations listed at the OMX Stockholm Large Cap. This selection is also motivated by the fact that the blazing debate about too high and complex remunerations has generally concerned executive directors in the very largest listed companies (Svenskt Näringsliv 2006, p.5). To delimit the study further, and to facilitate an industry comparison, three different industries have been selected; Financials, Industrials and Health Care. These are all prominent industries in the Swedish society, and they have different characteristics that can make a comparison interesting. Financial companies have been

particularly under fire in the debate about bonuses, and can be expected to be more secretive given the competitive environment. At the same time however, their whole business idea depends on confidence wherefore the matter of transparency should be especially relevant. The industrial sector in Sweden has always been a large part of the economy, and the cyclicity of the industry makes it interesting for comparisons. The health care industry is on the contrary not very cyclical, and likely attracts more long-term investors.

On April 18<sup>th</sup> 2009 there were 57 companies on OMX Stockholm Large Cap whereof 13 companies have been selected by using the random selection tool in excel; five companies, out of a total population of 16 companies in the industrial sector, and five out of 12 companies in the financial sector. The health care sector only has four companies on the large cap list and one of them, AstraZeneca, is a foreign company that follows the much more detailed regulation for disclosure of remuneration in the United Kingdom. AstraZeneca is therefore not part of the study to avoid a misrepresentation of the health care sector. Also, companies that do not have variable remuneration have been excluded from the study, since it is mostly the disclosure of variable remuneration that is of concern in the discussion of transparency.

Hence, the following companies were chosen:

Table 3.1 List of companies

Financials	Industrials	Health Care
Hufvudstaden (HUFV)	NCC	Elekta (ELE)
Investor (INV)	Atlas Copco (AC)	Getinge(GET)
SEB	SCANIA (SCA)	Meda (MED)
Nordea (NOR)	SKF	
Swedbank (SWE)	Volvo (VOL)	

The latest annual report for each company has been studied, i.e. the annual report from 2008, except for Elekta who does not have the calendar year as their fiscal year. To avoid reducing the number of companies in the health care sector further, Elekta's annual report for 2007/2008 has been studied.

## 2.3 Validity and reliability

The choice and number of interview subjects could affect the reliability of this study. Since only nine persons have been interviewed about the demand for information, it is possible that their answers do not represent the majority of the stakeholders. Therefore a study with different respondents could give a different

result of the demand for information. However, as will be shown in the empirical findings, several of the respondents' answers overlap with each other as well as with the media and recommendations, wherefore much different answers would not be expected. In the same way the studied companies represent a greater population, and even though they have been selected randomly there is a risk that they are not representative for all companies on OMX Stockholm Large Cap.

Some of the regulations and recommendations leave room for different interpretations, as will be discussed in the theoretical framework. This might affect both the validity and the reliability of the study, if the variables given in the first study are misinterpreted by the researchers. However, the regulations and recommendations have been examined together with any existing preparatory work as well as other revisions, to establish the most accurate interpretation.

To guarantee the reliability of the examination of the annual reports and minimize the risk of human error, all reports have been studied twice. Also, the first three annual reports were examined by both authors together to stipulate the exact interpretation of each variable as well as the information in the annual reports. The rest of the examinations were carried out by the same researcher.

## 2.4 Criticism of sources

When collecting information and data for this study mostly scientific articles, student literature and books have been used, but also articles from journals, magazines and daily newspapers. Because the scientific evidence of such articles can be questioned, they have mostly been used to create an understanding of the subject and the ongoing debate. Still, for the review of demand expressed in the media mostly daily newspapers and business magazines were used, but to maintain high reliability only statements from named and reliable stakeholders have been used.

Since the annual reports is not the only way for the companies to inform its stakeholders about their development but also a way to market itself, there is a possibility that the information they disclose does not correspond to the actual remunerations. This study will then measure a transparency that is not true. However, this problem is impossible to overcome in the study without doing thorough case studies on each company, comparing their remunerations with the information disclosed in the annual reports.

Regarding the interviews, there is a possibility that the respondents have replied according to what they believe is a correct answer. They might not truly request the information they proclaim themselves, but only be biased by the media debate. Even so, since it is assumed that what is discussed in media is a true indication of



demand, the possibility of influenced respondents does not cause any great problem to the investigation. Similarly, the respondents may however be biased by their working role and personal interests, giving rise to potential interview bias.

## 3 Theoretical framework

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*The theoretical framework of the study will be presented in this chapter, including accounting theory, stakeholder theory, agency theory, managerialist theory as well as theories regarding transparency and confidence. This will be followed by the relevant regulations and recommendations.*

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### 3.1 Accounting theory

The annual reports constitute the primary means of communicating with stakeholders, and shareholders in particular. They require regular information demonstrating that managers are accounting properly for the funds under their control. However, information to shareholders is normally restricted to that specified by statute, e.g. the Companies Act, professional regulation such as Financial Reporting Standards, or by market regulations such as listing requirements. Thus, there may be a tension between what information shareholders would like to have and what managers are prepared to provide of concern for business secrets or criticism, both in terms of quantity and quality of the information. (Elliott & Elliott 2006, p.3-4)

The confidence is very much dependent not only on the actual contents of the information disclosed, but also on the manner in which directors' remuneration is communicated. It is not necessarily only the quantity of information that causes troubles for investors, but also the way in which the information is portrayed and presented. According to accounting theory, information in the financial statements should have the following qualitative characteristics; relevant, reliable, understandable and comparable. However, improving the quality of information is far from simple. "In deciding which information to include in financial statements, when to include it and how to present it, the aim is to ensure that financial statements yield information that is useful." (ABS 1999, p.32)

Relevance is prioritized in case the other attributes are mutually exclusive, and implies that the information has the ability to influence the economic decisions of users, either because of its confirmatory or predictive value. Reliable information should faithfully represent the substance of transactions, be free from deliberate bias and material errors, and be complete and prudent in case of inevitable judgments. Furthermore, the information should be comparable and consistent, enabling users to evaluate events and numbers over time and across different

reporting entities. Lastly the information should be understandable, in the sense that its significance can be perceived by users that have a reasonable knowledge of business, economic activities and accounting, as well as willingness to study it with reasonable diligence. The threshold quality criterion is materiality; information which if misstated or omitted may influence the economic decisions of users should be disclosed. (ASB 1999, p.32-33, 37, 42)

There may arise conflicts between the different qualitative characteristics, forcing a trade-off. The most relevant information is not necessarily the most reliable, e.g. if there is a delay in the collection of information, making it irrelevant, but reporting it too early could impair the reliability whereas leaving it out would affect the completeness, and thus the reliability. There is also a potential conflict between prudence and neutrality within reliability. While neutrality implies freedom of bias, prudence is a potentially biased concept. Similarly, if information is relevant, reliable and comparable, this may result in so complex information that it is not understandable by all the users, even if they are assumed to have adequate knowledge of economic and accounting issues. Relevant and reliable information should nevertheless not be excluded from the annual report only because it is too difficult for some users to comprehend. (ABS 1999, p.43-44)

Regarding relevance of information, the statements are used by a variety of different stakeholders such as lenders, trade creditors, customers, employees, the government and the public which turn them into very general-purpose reports with a compromise between different information. It is virtually impossible to satisfy everyone's needs, and all information can hardly be relevant to everyone. At least in the Anglo-American corporate governance system, shareholders are considered of primary concern since they provide the companies with funding. (Elliott & Elliott 2006, p.4) Countries in Continental Europe take more of a stakeholder approach however, trying to balance the interests of all different parties.

## 3.2 Stakeholder theory

Stakeholder theory defines organizations as multilateral agreements between the enterprise and its multiple internal and external stakeholders. Employees, managers and owners are examples of the first-mentioned, whereas customers, competitors, suppliers, interest groups and the society are all external stakeholders. (Clarke 2007, p.27-29) In the preparatory work for SOU 2004:47, the Government established that remuneration matters are of relevance not only for shareholders, but also for other stakeholders. They all want executives' remuneration to be reasonable given the development of the company and the performance of each individual. (SOU 2009:34, p.311)

The relationships between the company and different stakeholders are governed by formal and informal rules, and can both constrain and create possibilities to the company. Management gets funding from shareholders, but long-term employees, suppliers and customers also contribute firm-specific assets to the company in different ways. Hence, management must consider the effect of corporate decisions on all the firm's stakeholders, which may result in severe difficulties to prioritize between different interests. The stakeholder theory is said to have intellectual appeal, but it is also argued that the multiple stakeholder responsibilities may leave management with too much freedom of manoeuvre. (Clarke 2007, p.27-29)

### 3.3 Agency theory

“To reduce the conflict of interest between absent owners and insightful CEOs, the linkage between pay and performance is the number one suggested remedy.” (Oxelheim & Wihlborg 2008, p.185)

The essence of the agency problem arises from the separation of ownership and management. With dispersed shareholdings the owners can no longer exercise direct monitoring and controlling but have to appoint managers or agents, to generate returns on their funds. (Jensen & Meckling 1976 in Clarke 2007, p.23) Contracts have to be written and enforced, and agency costs arise from the structuring, monitoring, and bonding contracts among parties with conflicting interests. (Jensen & Meckling 1976 in Fama & Jensen 1983, p.304) The theory assumes that individuals are self-interested and act to maximize their own utility. Provided that managers are given a considerable amount of control rights and discretionary power, the investors or principals will want to put constraints on managers to reduce the misallocation of their funds. To mitigate the agency problem, efficient markets in corporate control, management and information are important. (Clarke 2007, p.24) Thus, transparent accounting of remunerations and the link between pay and performance works as a control mechanism. The principals want to receive adequate information in order to monitor the reasonableness of agents' remuneration.

Agency theory has been criticized for its simplicity and crudeness. Even though the main agency relation is said to exist between shareholders and the management, in reality there is a double agency dilemma since owners first appoint a board of directors, who in turn select the management to lead the company. The board is supposed to act as a control mechanism, mitigating any diverging interests between the end-principal and agent, as elaborated on below. (Clarke 2007, p.24)

### 3.4 Managerialist theory and board responsibility

This theory is what commonly is referred to as the “emperor CEO”; when the managers get too much power relative to the board and can control the composition and decisions of the board. For example, if the CEO manages to determine the remuneration for senior executives including himself because of a distorted power balance. (Clarke 2007, p.29) A CEO that is awarding himself excessive amounts of remuneration would likely try and conceal this in the annual report. Therefore, to create confidence and understanding for the remuneration systems, it is necessary to openly provide clear information to the shareholders and the market (Svenskt Näringsliv 2006, p.16).

Furthermore, managerial accountability should be enforced by a critical and questioning board of directors. The board should act in the best interest of shareholders, but corporate governance critics argue that boards are unable or unwilling to monitor and control management and instead grant automatic pay increases to CEOs regardless of performance (Townsend 1984; Geneen 1984, in Mallette, Middlemist & Hopkins 1995, abstract). Thus, it is highly important to assure that executives do not abuse shareholders funds or confidence, by promoting an active role of the owners. One way is to provide shareholders with a better insight and understanding of the remuneration, and allow them the opportunity to discuss the matters. (SOU 2009:34, p.311)

Even though the board is responsible for designing the incentive programs for management, they have to present the remuneration policies and principles and put it up for voting in the annual general meeting. The fact that incentive programs are nowadays ultimately ratified or rejected by the owners in the annual general meeting allow the company board and management to shift the responsibility on to the shareholders and in so doing avoid criticism and a public outcry. It is thus of critical importance to provide the owners with adequate information or else they will vote blindly. Some argue that the AGM is nothing more than empty procedures, but the risk of misappropriation of assets is certainly greater the more ambiguous and unclear information that is reported to investors.

### 3.5 Transparency and Confidence

The Swedish Commission on Business Confidence (*Sw. Förtroendekommissionen*) was established in 2002 to examine the public confidence in the Swedish business sector and suggest remedies to a declining level of confidence. At that same moment a “Code Group” was founded, to work on a Swedish Code of Corporate Governance. There arose a realization that a lack of confidence could result in significantly increased transaction costs and therefore should be of

concern to the entire society, given the importance of public confidence to growth and prosperity. The study showed that deficiencies in salary and benefits systems, especially the high remuneration levels for senior executives with benefits insufficiently linked to performance, had particularly impaired the public's confidence in business.

Moreover, the lack of transparency and openness regarding directors' remuneration and incentive programs resulted in difficulties of assessment and correct decision-making for investors. The Commission considered openness to be a highly suppressive factor against abnormally high remuneration, especially if disclosure were to be made on an individual basis as well. One of the suggested strategies to manage the declining confidence was thus more openness and transparency, with the provision of clear, intelligible, correct and relevant information. The information provided should not be so complex that only an expert could understand and evaluate it. There was a reservation however, that companies may need to keep information confidential because of business secrets or integrity reasons. (SOU 2004:47, p.43-45, 47, 51, 137, 156, 226)

Corporate scandals and economic crises have put the spotlight on deficiencies in the corporate governance systems, conflicts of interest, agency problems and moral hazard, and the importance of corporate financial transparency. But the concept of transparency is still not precisely defined, apart from that it has to do with openness and access to unambiguous information. (Oxelheim 2006, p.1-2) Transparency has in this thesis been thought of as the disclosure of relevant, reliable, comparable and understandable information that fully meets the demand of stakeholders.

A suboptimal transparency can have far-reaching consequences, as agents demand a risk premium to compensate for the uncertainty. This increases the cost of capital, which results in fewer investments and ultimately a slow-down in economic growth. (Oxelheim 2006, Outline) Moreover, the overall propensity to save in e.g. corporate bonds is affected by savers' confidence, which also relates to transparency. Thus, the capital allocation efficiency is at risk here as the system may no longer efficiently direct the financial resources to the best investments. The sharing of information that ideally should take place to alleviate problems of moral hazard and adverse selection, and allow for proper evaluation of investments, may be obstructed. (Oxelheim 2006, p.9-10) Incomplete disclosure and poor transparency can possibly cause two other problems. If shareholders do not get complete, relevant and understandable information, they will not be able to influence the board's decisions on executive compensation by placing own proposals or voting no in the annual general meeting. Further, if the true and full picture is not known by shareholders, media and the public, "outrage costs" i.e.

negative reactions to high levels of compensation may harm the company (Bebchuk & Fried in Donahue 2008, p.66-67, 69).

In the case of transparent remuneration systems, it is sometimes argued that too much disclosed information could result in the loss of key competence, when competing firms know exactly what to offer executives to outbid their current employer. There is also a risk that more openness results in higher remuneration (Jan Persson in Svidén 2009), since the CEO and other executives can see what the competitors are offering and play the companies off against each other. When remuneration to executive directors is based on peer group comparison and especially when the company aims to be at the upper quartile of the benchmarked companies, there might be a “ratchet effect” – upward pressure on remuneration, without any connection to performance. (EUCGF 2009, p.3)

The Confederation of Swedish Enterprise also state that disclosure of remuneration should not go to extremes when it comes to individuals, because of integrity and competitive reasons. In the United States, only about half of the companies were found to report the financial targets on which compensation was based (Watson Wyatt Worldwide 2007 in Dalton & Dalton 2008, p.90), because too much detail is proprietary and could result in a competitive disadvantage. Most countries allow exemptions from such information disclosure that could be problematic in this sense, but who draws the line? Several companies use the competitive environment as a justification for all kinds of perquisites granted to executives. (Dalton & Dalton 2008, p.90-91)

However, companies apparently often make voluntary disclosure beyond minimum requirements, in response to market demand. This suggests that they understand the benefits arising from transparent information, when it comes to attracting capital and maintaining confidence in the capital markets. The OECD Principles of Corporate Governance highlight the importance of disclosure and real transparency to facilitate market-based monitoring of companies and owners’ ability to influence the company policies. Owners and potential investors need regular, reliable, detailed and comparable information to assess the management and make informed decisions. Poor transparency however, may result in unethical behavior and a loss of market integrity, impacting the whole economy negatively. The cost of capital will rise and resource allocation is impaired. (OECD Principles 2004, p.49-50)

Thus, there seems to be a concept as “optimal transparency” from the companies’ perspective. Whereas improved transparency lowers uncertainty and information asymmetries for investors resulting in reduced cost of capital, from a business perspective too much transparency could put the company at a competitive disadvantage. It may also be excessively expensive for companies to prepare the

information. (Oxelheim 2006, p.18, 39 & 303) Therefore, a trade-off between cost advantages and the competitive risks of a high transparency could be expected.

### 3.6 Regulations and recommendations

The Swedish Companies Act and the Annual Accounts Act constitute the primary binding regulation in Sweden on the matter of directors' regulation. Since the 1st of July 2006 the Companies Act contains special regulations about the decision-making process for remuneration to board directors and executive directors in public limited companies, and simultaneously the section on disclosure of remuneration to executive directors in the Annual Accounts Act has been extended. The changes were a result of the work of the Commission of Trust, aiming to restore the confidence in Swedish companies. During this same period, the need for a Code of Corporate Governance was established, and the first Code came into force in July 2005. (SOU 2009:34, p.293-294) The Swedish Corporate Governance Code is nowadays applicable to all Swedish listed companies, via the "comply or explain" principle, but only contains very limited rules on the matter of remuneration and information disclosure. (ECGI 2008, p.2)

In 1995 an association of four different Swedish self-regulation bodies was created, *Föreningen för god sed på värdepappersmarknaden*, to promote best practice on the stock exchange; The Securities Council, The Swedish Corporate Governance Board (*Sw. Kollegiet för Svensk Bolagsstyrning*), The Swedish Industry and Commerce Stock Exchange Committee and The Swedish Financial Reporting Board (*Sw. Rådet för finansiell rapportering*). Any violation of the regulation is handled by the OMX Nordic Exchange Stockholm. There is also the Swedish Financial Supervisory Authority (*Sw. Finansinspektionen*) that supervises companies and has regulations for disclosure of remuneration principals for credit institutions, securities companies and insurance companies. (SOU 2009:34, p.300) Listed companies thus have a variety of listing rules regarding remuneration information to follow, enforced by the stock exchange.

There are continuously transnational organizations that put increasing demands on Swedish governance practices. Apart from the Swedish national regulation and recommendations, there are the EU Commission Recommendations and OECD's Principles of Corporate Governance from 2004 that cover the matter of directors' remuneration and disclosure. The EU recommendations aim to promote sound corporate governance by providing shareholders with more information and increased influence over the decision process. (SOU 2009:34, p.305-306) The OECD Principles more generally discuss the importance of disclosure and transparent information, and give few guidelines as to what to disclose. As regards the board and executive remuneration, the link between remuneration and



company performance is however of particular interest. Companies are expected to provide enough information to enable shareholders to assess the costs and benefits of incentive programs and remuneration. Lastly, OECD considers individual disclosure of remuneration, pensions and severance agreements to be good practice. (OECD Principles 2004, p. 50, 52)

The most influential frameworks when it comes to information disclosure are presented next.

### 3.6.1 The Companies Act and the Annual Accounts Act

The Companies Act (SFS 2005:551) chapter 7 §61 says that the annual general meeting of a listed company should decide on the principles for remuneration to executive directors, after a proposal prepared by the board. The principals are to include the weighting between fixed and variable remuneration, as well as the relation between performance and remuneration, main terms for bonus and incentive schemes, non-cash benefits, pensions and severance pay. Thus, the principles should cover on what basis salary and other benefits are rewarded, but do not have to be expressed in absolute amounts. The main purpose should be to give shareholders a clear and easily grasped picture of the main components of the remuneration policy including the maximum cost to the company in different scenarios, and also give them some influence over the policy. The Companies Act chapter 8 §51 suggests that the principles include some information on estimated future outcomes, and explain any deviations from earlier decided principles. (SOU 2009:34, p.295-296, 304-305)

The Annual Accounts Act (ÅRL 1995:1554) contains directions for how to create and publicize the annual report, group reports and quarterly reports. The disclosure of remuneration is regulated in chapter five §19-25 and some of the paragraphs were updated in 2006. Since it does not give much detailed information, a quite thorough summary can be reproduced here;

§19 only states that salaries and other remuneration shall be disclosed as well as social costs with pension costs specified.

§20 states that the sum of salaries and other remuneration shall be specified for; board directors, the CEO and executive directors as a group, and all other employees as another group. Variable payments should be disclosed separated from fixed salary for directors, CEO and other executive directors. Further, information about both fixed and variable remuneration shall be specified individually for the CEO and each board director, excluding employee representative. When information is given per group, the number of persons in the group should be specified. If the company has employees abroad, all this information should also

be provided separately for each country, but an exemption in chapter 7 §14 allows companies to skip the individual figures in these cases.

§22 treat the disclosure of pensions and state that the total amount of pension costs and similar commitments shall be disclosed for board members, CEO and other executive directors, with information about the number of persons in each group. Also here, disclosure of the amounts to each board director, except employee representatives, and CEO shall be made.

§23 and 24 state that the information above shall also include former board directors and former CEO, as well as board deputies and vice-CEO.

§25 states that if any golden parachutes or severance payments have been agreed to board directors, CEO or others in the management, these should be disclosed with the most essential terms.

As can be noted, the regulation does not demand much more than certain figures that shall be disclosed for some important people. The amendment in chapter five in 2006 was intended to clarify and strengthen the owners' power in determining the remunerations, and to improve the disclosure and information given about the executive directors' remunerations (FAR SRS 2008). The main changes were the definition of executive directors which now also includes other directors than just the CEO and board directors, the remuneration report for the combined group now has to disclose the total sums of both the parent company and all subsidiaries, and the individual amounts now has to be disclosed not only for current but also former board directors, former CEO, as well as board deputies and vice CEO. (Janzon, Törning & Arnell 2008)

However, the new regulation has been criticized for not being clear enough. Who is included in "executive directors" exactly? Moreover, there is no clear definition of *former* and *vice* board directors and CEO in §23. Depending on if §20 and §22 are interpreted to have an individual perspective where those once part of the group always stay part of the group, or a function perspective, §23 could include all former employees that once have been subject to the disclosure. This might entail hundreds of people. It is more reasonable that *former* should be interpreted as only persons that have had a function during the current year. (FAR SRS 2008) Janzon, Törning & Arnell (2008) argue that it should be interpreted as people that have resigned during the current financial year only. What is more, the requirement to account for all executive directors in all subsidiaries around the world in §20, could potentially result in thousands of people, even if the disclosure obligation is not on an individual basis. The companies still have to do the cumbersome and costly work of collecting individual information and aggregating it for all CEOs, board directors and executive directors in the group, and Janzon, Törning & Arnell question the informational value to investors. They argue for a

clarification of the paragraph, and the interpretation that the total remuneration from all the group companies should be disclosed for the executive directors in the *parent* company only.

### 3.6.2 Swedish Code of Corporate Governance

The Swedish Corporate Governance Board issued a proposal for a Swedish Code of Corporate Governance (*The Code*) as late as 2004 and in 2008 a revised code came into force. (Swedish Code of Corporate Governance 2008, p.3) Most corporate governance practices were however already in use after the Kreuger crash 1932 even if no comprehensive code had been formulated. (Carlsson 2007, p.1047) Some issues covered by corporate governance codes in other markets are governed by statute and are therefore not reiterated in the Swedish Code of Corporate Governance. (Unger 2006, p.3) Whereas the first version was aimed only at large listed companies, the current revised code requires all Swedish companies whose shares are listed on a regulated market in Sweden, regardless of size, to apply the Code. (Swedish Code of Corporate Governance 2008, p. 5)

The Corporate Governance Board works to promote good governance practices in listed companies in Sweden, and has the main responsibility to administer the Code. The board has no supervisory mandate to enforce the application of the Code, but works together with the Securities Council and the stock exchange when it comes to interpretation, enforcement and sanctions. Ultimately, it is for the actors in the capital market to judge how well companies apply the Code, and act accordingly. (SOU 2009:34, p.301)

The Code is one part of the self-regulation system, and complements the Companies Act and other binding regulation by extending the minimum requirements of governance to a higher level of best practice. This improves the public confidence in companies, facilitates the raising of finance, and ultimately improves the efficiency and growth in the Swedish economy. (SOU 2009:34, p.303) Like most other governance codes, it works through the “comply or explain” principle; compliance is not mandatory but in case of deviation this has to be declared and explained. This is to allow some flexibility to the diverse range of companies, since ultimately the investors can form their own opinion about the appropriateness of the companies’ solutions and invest accordingly. (Swedish Code of Corporate Governance 2008, p. 5-7)

Even if the Code intends to go above the minimum levels of disclosure and it does contain some more requirements of what information should be available to shareholders before the AGM, the paragraphs actually do not mention the annual report at all but only requires the information to be available on the company website. (ECGI 2008, p.3). Furthermore, as discussed already it is not mandatory

to comply, as long as it is explained. But, there are no sanctions in cases when deviations from the Code have not been explained, and no guidelines to follow to judge whether an explanation is adequate or not. The system expects the market and investors to be the judges of this. (SOU 2009:34, p.304) Thus, the Code can be criticized for being rather weak, especially in its enforcement. The relevant guidelines on the reporting of executive management remuneration state:

*“§9 The board is to have formal and clearly stated processes for deciding on remunerations to members of the executive management,”<sup>5</sup>*

*“§9.2 The shareholders’ meeting is to decide on all share- and share-price-related incentive schemes for the executive management. Members of the board are not to participate in share and share-price related incentive schemes designed for executive management or other employees of the company. If such a scheme is designed solely for the board, it must be approved by the shareholders’ meeting. The decision of the shareholders’ meeting is to include all the principle terms of the scheme.*

*Background material and documentation pertaining to the proposed scheme is to be made available to shareholders in good time before the shareholders’ meeting. The material is to be clear and simple enough to allow shareholders to form an opinion on the reasons for the scheme, the principle terms of the scheme and any dilution of the share capital that may result from it, as well as the total cost to the company of different conceivable outcomes” (Swedish Code of Corporate Governance 2008, p.21-22).*

### 3.6.3 The Securities Council 2002:1

The Securities Council, a private self-regulation body, has issued statements about the decision-making, information and content of incentive programs. Even if the Council has no sanction possibilities, the statements can be enforced by the stock exchange’s listing agreements and therefore become binding as well. (ECGI 2008, p.2) The statement recommends public companies to disclose additional information about incentive schemes in the annual report, such as an explanation of the outcomes during the financial year from new and old programs. (SOU 2009:34, p.301) The Securities Council further demands that share based incentive schemes are reported in the annual report, that events during the recent fiscal year for all incentive schemes are reported, and that an overall view of current programs are provided. (ECGI 2008, p.3)

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<sup>5</sup> Including board members

### 3.6.4 The Swedish Industry and Commerce Stock Exchange Committee

The Swedish Industry and Commerce Stock Exchange Committee (NBK) works to improve best practice in the Swedish stock market by issuing recommendations on different matters. (SOU 2004:47 Appendix 10, p.297) The document on executive directors' remuneration from 2002 gives detailed rules for mandatory information about benefits in the annual report, and it has been incorporated as a binding appendix to the listing rules. (ECGI 2003, p.2-3) Since the 1<sup>st</sup> of July 2006, there is an updated version of the Annual Accounts Act regarding decision-making and disclosed information about directors' remuneration. Consequently, the NBK rules on the matter have been abolished. However, they continue to be enforced in the exchange listing agreements and have therefore been considered as legally binding still. (Svenskt Näringsliv 2006, p.6)

NBK require listed companies to disclose directors' remuneration and benefits in the annual report, and if the company is part of a group the remuneration from all companies, whether Swedish or foreign, should be included. (ECGI 2003, p.3) The principles for remuneration of executives, e.g. the proportion of fixed and variable remuneration, should be explained. For the board chairman, the non-executive board members, the group CEO and the managing director, NBK require disclosure of the total amount of all remuneration and other benefits, as well as each remuneration item of more than minor importance, the fixed and variable components including major assumptions for the calculation of variable remuneration, holdings of financial instruments and other options received during the year and during previous years, and the most important terms of pension agreements or severance payments.

The financial instruments received during the year should be disclosed with respect to holding, estimated market value at the allotment date and the acquisition price for the instruments. It should also be clear whether they are offered at a discount. For board directors who have received additional remuneration apart from the board fee, the amount and the nature of the duties should be reported. Regarding pensions, the pensionable age and the period during which pension is to be paid are some of the terms to disclose. Moreover, it should be clear if variable remuneration constitute pensionable income, whether pension is based on contributions or benefits, and the cost for the year. If benefits-based pension, the pension level in relation to pensionable remuneration should be reported. It is also required to state whether the pension is revocable or not, i.e. whether the pension is contingent on future employment. (ECGI 2003, p.4-5)

Regarding severance payments, the prerequisites for a benefit must be disclosed for each executive concerned, in particular if it can be personally requested.

Further, there should be information on the preparatory and decision-making process for directors' remuneration, whether a compensation committee has been appointed and its mandate and composition. Lastly, any significant changes in the remuneration during the current year or from earlier information should be reported in the next report and made public. (ECGI 2003, p.6)

### 3.6.5 The Confederation of Swedish Enterprise Recommendations

The Confederation of Swedish Enterprise issued guidelines regarding remuneration to the CEO and executive directors in 2004, revised in 2006, to help companies create understanding and confidence with the shareholders and the public. They point out that remuneration is a matter for the owners to decide on, but emphasize the importance of openness of information to enable assessment, clear and justified terms, along with independent decision-making. The guidelines treat the role of the board and the annual general meeting, the contents of incentive programs, pensions and severance agreements, board remuneration and finally the information disclosure. It states that the board should give adequate account for the remuneration policy and paid out benefits in the annual report. (Svenskt Näringsliv 2006, p.4, 6)

The benefits should be principally described and the total cost over time possible to value in full. Other interesting information to provide could be the purpose of the variable remuneration, whether the performance targets lie within the executives' area of responsibility, what persons that are part of different programs, what time perspective there is and when remuneration is to be paid out, the weighting between fixed salary and variable remuneration, how performance is measured and evaluated etc. There should be a clear connection between targets and the individual's performance, i.e. variables should lie within their area of responsibility. For pensions based on benefits the pension level, pensionable age and pensionable remuneration should be accounted, and whether the pension is revocable or not. For contributions based pensions, the size of the premium and an explanation of its calculation is demanded. The true costs related to pensions should be calculated and accounted for. (Svenskt Näringsliv 2006, p.12-14)

### 3.6.6 EU Commission Recommendations

The EU recommendations are not binding for member states, but they are intended to act as a guideline for national regulations, via legislation or self-regulation. Nevertheless, several member states have exceeded the recommendations and imposed binding rules about disclosure for all executive directors on an individual basis, and the openness is good in general. What is lacking however

is transparency when it comes to the principles of remuneration, and in only a few countries including Sweden, the AGM decide on the principles by voting. (SOU 2009:34, p.307) Several member states have however strengthened their legislation or self-regulation on remuneration issues, or plan to do it before long. The debate in EU has mostly concerned the increasing gap between the remuneration to normal employees and the top executives, the far too weak link between remuneration and performance and the company's long term development, as well as shareholders' ability to influence and control the remuneration levels. In March 2009 the EU Commission declared its intention to sharpen the 2004 recommendations shortly, as well as publish a separate recommendation for the financial industry. (SOU 2009:34, p.308)

Unlike the Annual Accounts Act and the Swedish Code of Corporate Governance, the EU commission recommendations include more specified details on what information should be disclosed. The recommendation itself stresses that "it is important that listed companies display appropriate transparency in dealings with investors, so as to enable them to express their views". "Shareholders should be provided with a clear and comprehensive overview of the company's remuneration policy. Such disclosure would enable shareholders to assess a company's approach to remuneration and strengthen a company's accountability to shareholders." (EC/913/2004, p.55) However, it also points out that it should not oblige them to disclose information that is of commercially sensitive nature which could damage the company's strategic position.

The recommendation further states that, to be able to appreciate the remunerations in the light of the overall performance of the company, the shareholders should be provided with information on the individual directors of the company as well as executive and non-executive or supervisory directors. Adequate transparency about the policies regarding directors' remuneration should also be given, which includes information about notice periods and termination payments. A definition of director is given as "any member of the administrative, managerial or supervisory bodies of a listed company". (EC/913/2004, p.56)

All information should be disclosed in an independent remuneration report and/or be included in the annual accounts, as well as on the company's website. It should mainly focus on the company's policy on directors' remuneration for the following year but if appropriate, even the previous years, and any significant changes in the policy as compared to previous financial year should be disclosed. The list of what information should be included in the remuneration report is four pages long and all items will not be enumerated here, but an extraction is given to give an understanding of what kind of information is required.

At least the following information should be set out: “(a) explanation of the relative importance of the variable and non-variable components of directors' remuneration; (b) sufficient information on the performance criteria on which any entitlement to share options, shares or variable components of remuneration is based; (c) sufficient information on the linkage between remuneration and performance; (d) the main parameters and rationale for any annual bonus scheme and any other non-cash benefits; (e) a description of the main characteristics of supplementary pension or early retirement schemes for directors”. (EC/913/2004, p.57)

“The remuneration statement should also summarize and explain the listed company's policy with regard to the terms of the contracts of executive directors”. “Information concerning the preparatory and decision-making process used for determining the listed company's remuneration policy for directors should also be disclosed”. (EC/913/2004, p.57)

The recommendation also states that the total remuneration and other benefits given to each individual director, who has served as a director during the relevant financial year, should be disclosed in detail in the annual accounts or in the notes to the annual accounts. The reasons for why any remuneration is paid in the form of profit sharing or bonus payments shall be explained. The total estimated value of *all* non-cash benefits considered as remuneration shall be disclosed as well as compensation paid to or receivable by former executive director in connection with the termination of his activities during that financial year.

There is also more detailed information regarding shares, option programs and other share-incentive schemes saying that following information should be disclosed: “(a) the number of share options offered or shares granted by the company during the relevant financial year and their conditions of application; (b) the number of share options exercised during the relevant financial year and, for each of them, the number of shares involved and the exercise price or the value of the interest in the share incentive scheme at the end of the financial year; (c) the number of share options unexercised at the end of the financial year; their exercise price, the exercise date and the main conditions for the exercise of the rights; (d) any change in the terms and conditions of existing share options occurring during the financial year”. (EC/913/2004, p.58)

As can be seen, the EU Commission Recommendations is focusing more on the policies and motives behind the remunerations and information that is needed to evaluate the costs and effects of the share incentive schemes.





## 4 Empirical findings and analysis of study one - the demand for information

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*In this chapter the empirical findings from the study of demand for information will be presented. It will start with the review of demand expressed in the media. Subsequently, the answers from the interview respondents will be presented one by one. The chapter will end with an analysis of the empirical findings which includes the creation of the classification system.*

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### 4.1 Discussion in media

After several scandals and increasingly indignant investors, institutional funds and pension funds have raised their demands on the structure and disclosure of incentive programs. Several of the people responsible for corporate governance in these funds have expressed their views on the matter in media recently.

The recent debate about remuneration programs have caused embarrassed executive directors, as well as angry and disappointed customers. The confidence for banks and fund trustees has fallen. But Carina Lundberg-Markow, chief of corporate governance at Folksam – one of Sweden’s largest insurance and pension companies, argues that if the public debate results in more openness it is worth the hassle. The bonus and incentive systems, including the targets connected to payouts, are extremely complex. Lundberg-Markow is missing a clear connection between the remuneration outcomes, and a positive company result as well as individual performance. Folksam urge all banks and pension funds to openly disclose all existing remuneration systems and what purpose they serve to customers, owners and the public. There are plenty of benefits from increased openness; customers and investors can choose the company whose remuneration values and policies they support, and the companies can avoid embarrassing unmasking and scandals. (Lundberg-Markow 2009)

Helena Levander, CEO of Nordic Investor Services, claims that the remuneration accounts of Swedish listed companies are often insufficient, vague and full of empty phrases. The purpose of the remuneration policy is frequently lacking or the description is ambiguous, according to a study made by Nordic Investor Services. The companies moreover often fail to account for how many of the existing contracts that diverge from the declared remuneration policy. There is almost always a reservation allowing the board to deviate from the guiding

principles, which is debatable. Levander further would like to see more clarity about what exact achievement that is required for variable remuneration, and where the ceiling kicks in. The formulation of achievements is often only given in very general terms, such as “related to the company’s result” or “measurable within the individuals’ area of responsibility”. In addition, it should be clear whether variable pay work as pensionable income, how many employees that still have a defined-benefit pension, and some indication of what it may come to cost the company. Frequently, the description about pension systems is limited to “pensions can be based on contribution, benefits or a combination”. (Palutko Macéus 2009)

Första AP-fonden, one of Sweden’s main pension administrators, just recently released new owner policies with higher demands on the disclosure of remuneration information. They request a clear and measurable achievement for individuals in order to be awarded a payment, which further should be related to the company’s profitability i.e. considering also the costs of producing the profit, and clearly communicated to shareholders. Moreover, the cost of the program including potential share dilution should be clearly accounted for. (Första AP-fonden) Not to forget, the purpose of the incentive program should be declared, as well as the means of evaluating it (Sidea 2009).

The Swedish Shareholders' Association (*Sw. Aktiespararna*) also requests clear performance criteria and explicit follow-up and thorough evaluation of the remuneration programs, as well as a ceiling for the maximum outcome on the variable parts. There should be a clear connection to the company’s development, and a plain account of the purpose and motive of the incentive program. (Olsson 2009a; Sidea 2009; *Aktiespararna tar ton mot bonusar* 2009) In an article in *Dagens Industri* Carl Rosén, head of corporate governance at Andra AP-fonden, Elisabeth Tandan at Aktiespararna and Annika Andersson, head of corporate governance at Fjärde AP-fonden, also point out the importance of separate disclosure of fixed and variable remuneration. (Svensson 2008).

All details of the programs should be known and clearly connected to other parts of the remuneration. According to the Code, the programs should be presented in a way so shareholders can estimate the costs for the company in different scenarios. It would be ideal if companies disclosed exactly how much the CEO and executive management may come to earn if the programs vest under the period, but at this time no listed company does this. (Nachemson-Ekwall, 2009)

The demand expressed in the media can be summarized as in table 4.1 below.

Table 4.1 Information demanded in the media

* More company-specific explanations
* The connection between bonus payouts and the company's development
* Clearly disclosed performance criteria
* The exact achievement required
* A thorough evaluation of the effectiveness of the program
* The purpose of the incentive program
* If there is a ceiling on the variable remuneration
* Whether variable pay work as pensionable income
* How many employees that still have a defined-benefit pension, and some indication of what it may come to cost the company
* The reason for why remuneration is paid in the form of variable remuneration
* Any dilution of share capital

## 4.2 Demand derived from interviews

### 4.2.1 Respondent A – Anonymous

This respondent requested to stay anonymous. He/she has more than 20 years of experience as an analyst, responsible for several analyst teams in large banks with a focus on Health Care companies. The respondent has also worked as a columnist in a well reputed newspaper and at a website for investors.

First of all, the respondent points out that the information needs to be more specific. Since the remuneration systems have become very complex and hard to understand, it is essential that they are explained step by step. It is not only the total sum that is of interest but the different parts of the remuneration system as well. If the variable remuneration is based on performance criteria, these should be specified together with the specific targets required. The respondent says that this kind of information currently is not always disclosed. Moreover, even if some companies do specify the specific targets for their long-term remuneration, often share-based, they rarely do it for the short-term remuneration. In addition, in cases where targets are relative to peer groups, the benchmark companies or indices should be specified.

Furthermore, the respondent argues that information on an individual basis should not only be disclosed for the CEO but also for other executive directors. It should be possible to assess the cost of the remuneration to different executive directors, and what different remuneration programs they take part in.

The respondent also says that it can be a bit confusing where to find the information, since you have to search for it in different places. It would therefore be

more convenient if all the information were gathered in one place in the annual report.

#### 4.2.2 Respondent B – Ossian Ekdahl

Ossian Ekdahl is chief of corporate governance at Första AP-fonden, one of Sweden's largest pension funds that is assigned to manage the pension capital of the Swedish people. Their primary task is to maximize the long-term return on investment with a low level of risk<sup>6</sup>. Ekdahl has also been head of portfolio strategy at Första AP-fonden, head of the analysis group at the central bank of Sweden (*Sw. Sveriges Riksbank*) and head of Section at the Ministry of Finance. One of his assignments at Första AP-fonden is to pursue the matter of remuneration in the portfolio companies, and he has publicly commented on remuneration programs several times (Sidea 2009; Blomberg 2008).

Ekdahl says that the most interesting information regarding remunerations is an explanation of the long-term incentive programs. First and foremost, he wants to know the total costs and outcomes of the programs, which includes not only the costs for the company but also for the shareholders in terms of share dilution. This information is often given, perhaps not in much detail but sufficient for stakeholders to make an adequate judgment of the remunerations, Ekdahl says. Furthermore, he is particularly interested in the performance criteria; the specific variables that are used to measure performance. It is not sufficient to write that the remuneration is linked to different key performance indicators without specifying which these are. If, for example, the measured variables are return on investment (ROI), earnings per share (EPS), economic value added (EVA), maximum waiting time for customers or other similar measures, these should be disclosed. Also, the target levels of the variables should be clearly disclosed. E.g. if the variable is ROI, the actual percentage required for the remuneration to be paid out should be stated. Ekdahl however explains that this could be sensitive information to disclose, as it gives the competitors information about the company's targets for development.

Overall, Ekdahl and Första AP-fonden request more company-specific information and less standard wording. The company should motivate why the remuneration systems would benefit the shareholders. Ekdahl argues that it is not enough to say that incentive programs are utilized in order to attract and retain the executives in the management group. A proper explanation should contain why the specific company use complex incentive programs instead of motivating and remunerating executives and employees in other ways, e.g. by offering a higher fixed salary. Further, the companies should make evaluations of the effectiveness

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<sup>6</sup> Första AP-fonden website; <http://www.ap1.se/en/Our-mission/>

of the programs annually, to analyze if and how the remuneration systems really make the company perform better. The conclusion of this evaluation should then be disclosed.

Even though Ekdahl says that investors need more specific information to be able to evaluate the remunerations, he understands why the companies do not reveal everything given the competitive environment. Första AP-fonden holds the opinion that there should be a clear distinction between the responsibilities of the board and the shareholders. It is the duty of the board to decide on directors' remuneration and then the shareholders essentially only have to decide whether the board has done a satisfactory job or not. According to Första AP-fonden this relationship should be maintained, and it affects what information the owners demand.

Therefore, Ekdahl considers the information to be sufficient in general, even though a few pieces are missing. He agrees that it is sometimes hard to find the relevant information since it is placed in different parts of the annual reports, but as an experienced reader one learns where to look and how to interpret the explanations, he concludes.

#### 4.2.3 Respondent C – Gabriel Thulin

Gabriel Thulin is a senior partner at Hallvarsson & Halvarsson (H&H), a consulting firm that helps companies create value by improving their communication and thereby create a better understanding and confidence with the stakeholders.<sup>7</sup> They have also conducted numerous surveys for national and international companies and organizations, several on the subject of remuneration. H&H often help companies put together their annual report and pursue a greater disclosure on remuneration. However, Thulin says that most companies are unwilling to disclose more information and no one wants to take the lead in giving out more, possibly sensitive, information. Thulin also believes that some companies purposely withhold information about the remunerations and therefore end up in media. Apart from his work on the matter of remuneration in H&H, Thulin has also worked as a journalist at the financial magazine *Veckans Affärer*. With this background, he says that he knows a lot about what information the shareholders and other stakeholders demand.

First of all, Thulin thinks that all the information about remuneration should be found in one place, preferably in a separate remuneration report, and the information should be presented in tables as far as possible. It should be easy to find and not concealed in an obscure note, nor repeated in several places. It would also

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<sup>7</sup> Hallvarsson & Halvarsson website; <http://www.halvarsson.se/>

be useful to get information about earlier years' remuneration for comparison. When it comes to desirable information, he says that there is much more information to be requested about how the remuneration systems are designed, especially about variable remuneration to the CEO and executive directors. There should be a clear connection between the performance and the remuneration, with disclosure of the specific measures used to decide the payment as well as the actual targets. In addition, this information should be given for all kinds of remuneration. Thulin further would like to know if there is a ceiling to the payments.

For self-evident reasons, he wants to know the total payments but also how these are connected to the company's development and the business cycle. This is often raised in the media, and Thulin says that the reason is that sometimes the time perspective of the remunerations is not properly explained. It is not always clear during what financial year the performance was achieved. As an example, he says that the payments we read about in 2009, disclosed in the annual report for 2008, are often payments related to performance in 2007. Therefore he requests an explanation about which period the performance was achieved.

It is also important to get information on the decision process behind the remunerations. Who decides the remuneration for the CEO and the board? Is there a remuneration committee or have any external consultants been used?

When it comes to the disclosure of pensions, Thulin says that there is often a lack of information especially for people that receive defined-benefit pensions. If the company has not made enough contributions to future pension payments during the employees' service, the additional cost for the company could be very high when these employees retire. Therefore, it would be desirable to know how many employees that still have a defined-benefits based pension, and some indication of what it may come to cost the company.

#### 4.2.4 Respondent D – Albin Rännar

Albin Rännar is the Operative Director at Nordic Investor Service, a company that offers information, analysis and services on corporate governance-related issues. Their goal is to help companies and institutional owners improve their corporate governance. Rännar has specialized in the area of incentive programs, where he has worked for seven years. Rännar is also a senior analyst and he was earlier employed as a financial analyst at Swedbank. He has also worked in the corporate finance department at Orkla Securities, and as the Vice President and co-founder of a Swiss venture capital firm called Catey<sup>8</sup>.

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<sup>8</sup> Nordic Investor Services website; <http://www.nordicinvestorservices.se/>

Overall, Rännar thinks that the disclosure of remuneration is extremely poor, especially the disclosure of long-term share option programs. He requests better disclosure of the connection between performance and remuneration. Sometimes only the proportion of variable remuneration to fixed remuneration is given, with no information about the underlying performance. These performance criteria should be disclosed, he says. Rännar adds however that it is understandable why the companies conceal some of this information, because either they want to protect private integrity e.g. if employees get an expensive private car, home care or paid education for their kids, or it could be sensitive information on company targets that affects their competitiveness. Further, even though some large owners hold the opinion that the question on remuneration is for the board to decide and no excessive information should be revealed because of its sensitivity, Rännar argues that other owners still have the right to be adequately informed.

According to Rännar, there is a demand for individual disclosure of each executive director's remuneration, at least the five highest paid. Regarding the different programs, one would like to know how many persons that take part and what year they derive from. In particular, it is interesting to see what programs the CEO and executive directors take part in. If the company uses option programs there is a lot of information to request, e.g. how many options are offered, what year they originate, the exercise price and exercise date, if there is a ceiling, and if there is any dilution of the share capital. The performance criteria for receiving options or any other remuneration should also be specified together with the targets, and how the options are distributed if only parts of the targets are reached (i.e. if linear distribution or another method is used). Investors would also want to know how the option valuation is made, e.g. the Black & Scholes option pricing model, and the assumed parameters such as the volatility.

Rännar points out the difficulty of understanding the time perspective; if the cost relates to paid-out remuneration or if it is remuneration earned during the year. Furthermore, he says that it would be better to find all information about the remunerations in one place, and the total costs of the board should be disclosed including attendant costs. He also mentions that when it comes to pensions, it would be interesting to know how much of the costs that belong to the current CEO and executives, and how much that are costs to former CEO and executives.

#### 4.2.5 Respondent E – Tomas Ullman

Tomas Ullman works as an equity analyst at Erik Penser Bankaktiebolag and he has been an analyst for seven years. Currently, he is focused on banks and he regularly follows SEB and Swedbank among others.



As an analyst, Ullman is more concerned about the total costs in the company. Thus, he does not focus much on the remunerations apart from the total cost for all employees. Since this information is often given in the income statement as well as in a note, Ullman says that he gets all the information he needs for his analysis.

Even though Ullman does not look into any specific information about the remunerations in general, he occasionally tries to understand the development of the remunerations in a company over time. He says that companies could be better at motivating the remunerations and the connection with the company development, but overall he thinks that the disclosed information is sufficient. Especially the large companies give a very transparent disclosure on remunerations, he declares.

#### 4.2.6 Respondent F – Magnus Dalhammar

Magnus Dalhammar is an equity analyst at Handelsbanken, focused on investment companies.

Dalhammar neither looks much into the information about remunerations. He follows the media to see if anything is highlighted about the companies and tries to follow the development to see if anything abnormal occurs. However, some of the international investors are more interested in the remunerations and ask for more information. Dalhammar himself looks primarily for the total amount of remunerations and how many in the top management and among other employees that take part of the variable remuneration systems. He would like to see presented any changes in the programs from year to year, e.g. if the terms of the programs have been changed or if new programs have been started, but also how the total cost has changed from year to year. Furthermore, he would like to know on what basis the remuneration is paid out. However, he is not requesting any specific parameters, but more a general account for how the performance is measured.

In sum, Dalhammar thinks that he gets all the information that he needs about remunerations in the annual report, and that the accounting is transparent. Today, he works exclusively with equity analysis but he has formerly worked as a credit analyst as well. There, he focused mainly on the balance sheet and income statement, and did not look into the information about remunerations at all.

#### 4.2.7 Respondent G and H – David Halldén and Anders Hansson

David Halldén has 12 years of professional experience and is today a chief financial analyst at HQ Bank. He focuses mainly on investment companies and companies within telecommunication services. Anders Hansson is an equity

analyst at Danske Bank with eight years of work experience. He focuses on retail and consumer goods.

Since Halldén and Hansson did not have time to take part in a telephone interview, they instead answered a couple of questions by e-mail. Without the possibility to elaborate or make attendant questions, the respondents did not give any specification about what information they need for their analysis, and their answers were pretty short.

Halldén however argues that the information he gets today is overall sufficient, even if it is still a little bit weak and not fully transparent. Apart from the total cost, he would like to know the specific performance criteria for variable remuneration to be paid out. He also says that he frequently finds factual errors and careless mistakes, and sometimes the companies seem to conceal information out of tactical reasons. Hansson on the other hand thinks that the information given today is fully sufficient for his analysis, and he argues that the current disclosure is fully transparent. He mostly uses the information about board remuneration and option programs.

#### 4.2.8 Summary of demand from interview respondents

As can be seen, a lot of the information requested by the different interview respondents overlap. For example, most of the respondents specifically ask for disclosure of the performance criteria and an explanation of the target achievement required. Four respondents say that it would be desirable to find the information in one place, and they wish to see the connection between paid out remuneration and the company's development. A few mention the time perspective and would like to see an explanation of what year the performance was achieved, as well as historical numbers for comparison. In addition, they request information about whether there is a ceiling on the variable remuneration, and how many people that takes part of the programs.

The interview respondents together point out 25 variables that they wish would be disclosed. These are compiled in table 4.2 below and have all been used in the study of the annual reports, except for the last three which are either too general or not possible to check for.

Table 4.2 Information demanded by the interview respondents

* Total cost of the program
* Number of persons that take part of the program
* Any changes in the program from previous year
* Specified performance criteria
* The target achievement required
* Thorough motivation for why the company needs to have variable remuneration
* Thorough evaluation of the effectiveness of the program
* Any benchmark companies or indexes
* Individual information for the CEO and each executive directors
* Historical numbers for comparison
* If there is a ceiling on the variable remuneration
* The connection between paid out remuneration and the company's development
* Explanation of what year the performance was achieved
* Information concerning the decision-making process
* How many employees that still have a defined-benefit based pension, and what it may come to cost the company
* Specification of what program the CEO and executive directors have
* How many options that are offered, what year they originate, the exercise price and exercise date
* Any dilution to the share capital
* How the valuation of options is made
* Total costs for the board, including attendant costs
* Separate disclosure of pension costs to former CEO and executive directors
* All information found in one place in the annual report
* Specification of the different programs
* More company specific information
* More tabular information

## 4.3 Analysis of study one

### 4.3.1 Demanded variables compared and contrasted

Comparing table 4.1 Information demanded in media and 4.2 Information demanded by the interview respondents, several variables are found to overlap. Almost all of the variables discussed in media were also given by one or more interview respondents.

Looking at the specific variables demanded, the different stakeholders do not request the same information. Credit analysts turned out not to use the remuneration information whatsoever, and the financial analysts at the different banks use

the information only to a limited extent. The information about remunerations is not of great importance for them when valuing companies. This could explain why most of the financial analysts express satisfaction with the information disclosed. Other groups are instead dissatisfied. For example, the consultants at Hallvarsson & Halvarsson, Nordic Investor Services and the large institutional owners are more concerned about the corporate governance, and consequently demand more detailed information.

It is also interesting to compare the variables from the media review and the interview respondents, with the existing regulations and recommendations. A first point to notice is that most of the variables cannot be found in the Annual Accounts Act, i.e. there is a demand for much more information than is regulated in Swedish legislation. The Code of Corporate Governance does neither cover all of the demanded variables, but only a few more. These include for example; information concerning the decision-making process, the reasons for why the company has variable remuneration and if there is any dilution of the share capital due to the remunerations.

Some of the variables are found in the Swedish Industry and Commerce Stock Exchange Committee's guidelines. These are mainly; how the valuation of the options is made, how many options that are offered, the exercise price and exercise date, any changes in the programs from last year, and historical information from previous years. The number of people that take part of the programs, the time perspective and an evaluation of the programs, are mentioned in the recommendations from the Confederation of Swedish Enterprise.

However, out of the examined rules, regulations and guidelines it is the EU Commission Recommendations that cover most of the variables mentioned in the media and the interviews. For example, a motivation of why the company needs to have variable remuneration, information concerning the decision-making process, any dilution to the share capital, information about the options that are offered, the exercise price and exercise date, individual remuneration for each executive director, and any changes in the program from previous year, can be found in the EU recommendations. It is even more interesting that it also covers the two variables that several of the interview respondents and the media debate requested in particular; specified performance criteria and the target achievement required.

The variables given in the interviews or media that could not be found in *any* of the regulations or recommendations are; the number of employees that still have a defined-benefits based pension and what it may come to cost the company, the total cost for the board including attendant costs, separate disclosure of pension

costs to former CEO and executive directors, and that all information should be found in one place.

### 4.3.2 Classification of the variables

Compiling all the information demanded from the regulation and recommendations and the demand expressed in media and from the interviews, results in a table of 41 variables. These have then been allocated into the four different levels in the classification system, where level four includes all variables in the previous levels. Level one only consists of variables binding by law, i.e. the Annual Accounts Act. These are as shown in table 4.3. The next level contains variables beyond the Annual Accounts Act but it is still very general in nature, as shown in table 4.4. The third level includes variables that give more firm-specific information and therefore could be argued to give a higher transparency. These are found in table 4.5. The last level, full disclosure, includes all variables found on previous levels.

An explanation of how the variables are interpreted can be found in appendix 1.

Table 4.3 Classification level one; basic disclosure

<b>Level 1: Basic disclosure</b>	
<b>1</b>	The total cost of the program
<b>2</b>	The total amount of salaries and other remuneration shall be specified for each of the following groups:
	1. The board directors, CEO and other executive directors
	2. Other employees not mentioned in 1
<b>3</b>	Variable payments to board directors, CEO and other executive directors specified separately
<b>4</b>	Salary and remuneration for the year specified separately for each board director (except employee representatives) and the CEO
<b>5</b>	If the company has employees abroad, the sum of remunerations to board directors, CEO and other executive directors specified for each country
<b>6</b>	The total amount of pension costs and commitments disclosed for board directors, CEO and other executive directors
<b>7</b>	Number of persons specified for each group
<b>8</b>	Information about pensions specified separately for each board director (except employee representatives) and the CEO
<b>9</b>	If any golden parachutes/severance payments or alike to board directors, CEO or others in the management have been agreed, these should be disclosed with the most essential terms
<b>10</b>	Remunerations as above, with pensions separately, disclosed for former board directors and former CEO

Table 4.4 Classification level two; general disclosure

<b>Level 2: General disclosure</b>	
11	The purpose of the incentive program
12	Information concerning the preparatory and decision-making process
13	Explanation of the relative importance of the variable and non-variable components
14	Whether there is a ceiling on the variable remuneration
15	Number of persons that take part of the programs
16	The total remuneration and other benefits granted to individual executive directors over the relevant financial year
17	Specify what program the CEO and other executive directors have
18	Significant changes in the policy as compared to previous financial year
19	Explanation of what year the performance was achieved
20	Provide historical numbers for comparison
21	Total estimated value of non-cash benefits considered as remuneration
22	The number of share options offered or shares granted
23	The number of share options exercised during the relevant financial year, the number of shares involved and the exercise price
24	The number of share options unexercised at the end of the financial year; their exercise price and exercise date
25	How the valuation of options is made
26	Any dilution of the share capital that may result from the program
27	How many employees that still have a defined-benefit based pension, and some indication of what it may come to cost the company
28	Whether variable pay work as pensionable income
29	The pensionable age for CEO and executive directors
30	Whether pensions are revocable
31	All information on remuneration found in one place

Table 4.5 Classification level three; extended disclosure

<b>Level 3: Extended disclosure</b>	
32	Sufficient information on the performance criteria for variable remuneration
33	Sufficient information on the link between remuneration and performance
34	The target achievement required
35	The main parameters and rationale for any annual bonus scheme and any other non-cash benefits
36	The reason for why remuneration is paid in the form of variable remuneration
37	How the executive directors can influence the achievement of targets
38	If targets are relative to other companies or indices, these companies and indices should be specified
39	Total cost to the company in different conceivable outcomes
40	Thorough evaluation of the effectiveness of the program
41	The connection between paid out remuneration and the company's development

Table 4.6 Classification level four; full disclosure

<b>Level 4: Full disclosure</b>	
<b>1-41</b>	All variables demanded



## 5 Empirical findings and analysis of study two - the level of transparency

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*In this chapter the empirical findings from the examination of annual reports will be presented and analyzed. The companies' different levels of transparency will be analyzed using the theoretical framework. Complementary material can be found in the appendix.*

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### 5.1 The fulfillment of variables demanded

The study shows that the financial sector in general is marginally better than the industrial companies at providing transparent, company-specific information. Out of the total 41 examined variables the industrial and health care sectors fulfill 53 percent each, whereas the financial sector reaches 58 percent (see table 5.1). However, one must be careful when interpreting these total numbers as it assumes that all the variables are equally weighted, something which obviously does not hold true. The details of the results can be found in appendix 2

Table 5.1 Fulfilled percentage per level

	Financials	Health Care	Industrials
<b>Basic disclosure</b>	88%	83%	82%
<b>General disclosure</b>	68%	62%	60%
<b>Extended disclosure</b>	10%	0%	7%
<b>Full disclosure</b>	0%	0%	0%
<b>Total</b>	58%	53%	53%

Looking instead at the conformity of different levels, the sectors are almost equally good at complying with the level of basic disclosure, even if the financial sector is a little bit ahead; 88, 83 and 82 percent respectively. The level of general disclosure however, is significantly harder to abide by. The industrial sector reaches an average of 60 percent, the health care industry 62 percent and the financials 68 percent. Thus, all companies are fulfilling the level of general disclosure, apart from NCC and Hufvudstaden which do not reach the threshold. There is a rather wide spread within this level, with Swedbank and Meda just qualifying and Nordea (86 percent), SEB (76 percent), Elekta and SKF (71



percent) being the high-performers. To advance further to the level of extended disclosure, another 50 percent of those variables should be fulfilled. Therefore, none of the companies manage to progress. Also at the level of extended disclosure, the financial industry has the best disclosure with 10 percent compliance, compared to 7 percent in the industrial sector and 0 percent in the health care industry. It is noteworthy that Investor still manages to comply with 40 percent of level three, while the health care industry has zero percent disclosure. The health care industry is slightly better than the industrial industry at complying with the variables in levels one and two, whereas the industrial companies outperform the health care industry in level three.

Volvo, SEB, Nordea and Investor have actually disclosed parts of the three first variables 32-34 relating to information about the performance criteria and the target levels, but only for their long-term incentive programs. However, they still overlook their short-term programs. They have therefore been regarded as not complying with the variables. Still, it is interesting to see the moderated result if their disclosure was accepted. Volvo would move from 11 to 44 percent compliance on the level, SEB from 0 to 30 percent, Nordea from 10 to 40 percent, and Investor from 40 to 70 percent. Had this been the standpoint, Investor would thus have qualified for the third level of transparency.

Thus, the companies have the following transparency levels:

Table 5.2 Transparency levels of the companies

Basic disclosure	General disclosure	Extended disclosure	Full disclosure
NCC	Scania	-	-
Hufvudstaden	Volvo		
	SKF		
	Atlas Copco		
	Nordea		
	Swedbank		
	Investor		
	SEB		
	Elekta		
	Getinge		
	Meda		

Looking at particular variables in detail, almost all variables on a basic disclosure are fully complied with. This is to be expected given that it is enforced by the binding Annual Accounts Act. Variables five and ten are the only odd ones out with merely 33 and 8 percent compliance. At the level of general disclosure the

most outstanding variables are 31) that all information on remuneration should be found in one place, and 16) that total remuneration granted during the relevant financial year should be disclosed on an individual basis for all executive directors. Neither of these variables has been fulfilled by any of the companies.

Other underachievers on this level are variables 19 and 27; what year the relevant performance was actually achieved (38 percent) as well as how many employees that still have a defined-benefit based pension and what it may come to cost the company (8 percent). According to one respondent, it is interesting to know about the number of employees with defined-benefit pensions in particular, to avoid any future surprises in case insufficient funds have been put aside. Regarding the timing of performance, it is often confusing and hard to understand to what year the performance and associated remuneration belong. Quite a few variables end up at 46 percent compliance; 11) the purpose of the incentive program, 15) the number of persons taking part of the programs, and 30) whether pensions are revocable.

The variables fulfilled either by all companies or all but one, are 12) information on the preparatory process, 14) disclosure of the ceiling, 17) specification of what programs the CEO and other executive directors have, 22-24) the number of share options granted/exercised/unexercised, and 29) the pensionable age for the CEO and other executive directors.

The majority of the companies do not fulfill any of the variables at the level of extended disclosure. The highest percentage score is for 38) disclosure of benchmarking companies or indices, but this is just because the variable is relevant only for three companies that make use of peer groups. It is still only one company that fulfills the variable. Most of the other variables are similarly only fulfilled by one or two of the companies. Investor is the only one to account for 40) an evaluation of the effectiveness of the programs and 36) the reason for why variable remuneration is used, whereas Volvo is the only one that presents 41) the connection between paid out remuneration and the company's development. Nordea and Investor give 35) the main parameters and rationale for any annual bonus scheme and any other non-cash benefits. Apart from 33-34) sufficient information on the link between remuneration and performance and the target achievement required, no company explain variable 37) how the executive directors can influence the achievement of targets, i.e. whether the criteria lies within their area of responsibility, nor 39) the total cost to the company in different conceivable outcomes.

## 5.2 Analysis of study two

### 5.2.1 Accounting and stakeholder theory

Accounting theory positions the annual report as the primary source of information for stakeholders. However, as shown in the empirical findings, the given information is often restricted to that specified by statute. Thus, there seem to be a tension between what information stakeholders would like to have and what companies are prepared to provide, both in terms of quantity and quality of the information.

The fact that the majority of the companies only comply with the minimum requirements from the Annual Accounts Act at the first level and a few variables at the second level could be analyzed from the perspective of the different qualitative characteristics of financial information. Transparency is much contingent on the manner in which executive directors' remuneration is communicated, and the presentation may cause as much trouble to investors as the actual quantity of information.

As found in the first study, not all stakeholders demand the same information, and there is further a difference in how much information they demand. As Elliott and Elliott (2006) argue, it is virtually impossible to satisfy everyone's demand for information and all information can hardly be relevant to everyone. The statements are used by a variety of different stakeholders which may force the companies to prioritize between the different interests and demand for information. This in turn implies that the management has much freedom of manoeuvre to decide what information demand to satisfy, according to Clarke (2007). Instead of disclosing all the information that every stakeholder group requires, they may choose a middle path where they satisfy enough stakeholders or their most important stakeholders. The consequence is that for some stakeholders the *relevance* criterion in accounting theory is fulfilled which explains why some of them think it is fully transparent, whereas the transparency is far from satisfying for others.

Even though there seem to be some differences in what information the stakeholders require, it is nonetheless in everyone's interest that the information is correctly reproduced, complete, prudent, and that it faithfully represents the substance of transactions, i.e. that it is *reliable* information. As the study shows, the information is nevertheless at least not complete to all stakeholders. Whether it is correctly reproduced and prudent cannot be confirmed by this study, but it is however worth mentioning that one of the interviewees, Halldén, said that he often encounters factual errors and careless mistakes when looking at the remuneration information in the annual reports.

For the sake of *comparability*, several variables are important to facilitate comparison of the remunerations both over time and between companies. However, the two variables 20) “provide historical numbers for comparison” and 18) “significant changes in the policy as compared to previous financial year” are of special importance for the comparability. Both these are fulfilled by the majority of the companies, but three and four companies respectively do not give this information. It can also be pointed out that historical numbers for only one year was demanded and few of the companies exceeded this, although it would be even better with several years in comparison.

The ASB Principles only require information to be *understandable* to users that have a reasonable knowledge of business, economic activities and accounting, as well as willingness to study it with reasonable diligence. However, the aim has got to be to improve the clarity so also the average investor has a chance at comprehending. The Commission of Trust did state that to deal with the declining confidence, clear, intelligible, correct and relevant information should be provided, but more importantly, the information should not be so complex that only an expert could understand and evaluate it. Even though there is no single variable in the empirical findings that check for the understandability of the information in particular, the authors can confirm that a lot of the information was hard to understand and evaluate even with a reasonable knowledge of business and accounting.

In addition, much of the information about executive remuneration is found in two places, both in the notes and in the corporate governance report, which may render a proper evaluation more difficult. At the first level in the classification system, the most outstanding variable is indeed that all information on remuneration should be found in one place, and the observed result is zero percent compliance. This is however to expect since some information is regulated to be disclosed in the notes to the annual report while other information is supposed to be given in the corporate governance report. This does impair the understandability and thereby the transparency of the remunerations.

The inherent conflict between the qualitative characteristics, causing a trade-off between the relevance and the understandability of the remuneration information, is potentially confirmed by the mediocre level of conformance and transparency. The remuneration information is already fairly complex and the decision to disclose more relevant information has to take into consideration the risk of impairing the understandability. According to the UK ASB however, the companies should disclose all relevant information even if it may cause problems of comprehension for some users. What is more, as Halldén expresses above, the completeness and correctness of the remuneration information, i.e. the reliability, also seems to have been disregarded in some cases.

### 5.2.2 Agency and managerialist theory

In the light of the agency theory and its assumption of self-interested, rational individuals, executives may avoid excessive transparency and prioritize form over substance of the information by concealing some information. Thereby, they would fulfill the minimum level but avoid the need for any further explanation. Since this study does not investigate the reason for the different levels of transparency it has not been possible to confirm this theory, but the results indicate that a majority does choose to fulfill only a little more than the minimum level. As argued by Clarke (2007), for legitimate companies and truthful managers it would be of interest to mitigate the agency problem and any adverse selection premium by facilitating efficient markets in corporate control and information. As could be seen, a few companies do indeed give out some further information.

To ensure shareholders' funds and to counteract any managerial hegemony, the board should act as a control mechanism and promote an active role of the owners. It is still debated whether the board or the owners should be responsible for the setting of directors' remuneration but regardless, investors need adequate information to base their evaluation on and to vote on the principals of the schemes. The first study also showed that the stakeholders are interested in information concerning the preparatory and decision-making process, and the second study shows that all the companies have provided information on this point. However, as can be seen in appendix 1, the requirement was merely for a general account of the process. It could therefore be questioned whether the owners really get enough information about the decision-making process to counteract any managerial hegemony.

### 5.2.3 Transparency and confidence

The level of transparency could be deliberately chosen by the companies as a result of a thorough cost-benefit analysis where a reduced cost of capital is evaluated against the risk of competitive disadvantage, some kind of "optimal transparency". The study shows that some of the companies such as Investor and Nordea disclose much more information than their peers, and in so doing almost reach the third level in the classification system. They may have chosen to disclose more to reduce the risk of "outrage costs" mentioned by Bebchuk and Fried. Companies that realize the benefits with transparent information often make voluntary disclosure beyond the minimum requirements in response to market demand.

On the contrary, Hufvudstaden and NCC choose a much lower level of transparency. Because of the potential loss of key competence or the cost of compiling the information, the companies may prefer a lower level of transparency. The

results also show that there is a tendency not to disclose excessive information at the level of extended disclosure in the classification system, especially information that could be of sensitive and proprietary nature which may cause a competitive disadvantage to the company. This is further confirmed by the interview respondents. The performance criteria and targets seem to be the most critical variable in this respect, as companies do not want to reveal what goals they strive towards and their strategic direction. None of the companies examined presents enough information on the link between remuneration and performance or the required target achievement, presumably because of the sensitiveness of the information.

Another example of arguably sensitive information is the individual disclosure of each executive's remuneration. None of the companies disclose this information, which could be to protect the integrity of the individuals or to avoid the "ratchet effect" mentioned in the EUCGF statement 2009. According to both the EU Commission Recommendation and the Confederation of Swedish Enterprise companies are not expected to disclose information of sensitive nature, but Dalton and Dalton (2008) argue that the competitive environment might also be used by the companies as a justification for perquisites and poor disclosure of them.

Thus, the observed level of disclosure and transparency may be a deliberate balance between the advantages of reduced information asymmetries and a lower cost of capital, and the disadvantages in terms of competitiveness and excessive administration costs - that is "optimal transparency" according to Oxelheim (2006). Companies may trade-off the cost of capital to avoid the exposure of too much sensitive information.

#### 5.2.4 Regulation and recommendations

In terms of variables, almost the entire level of basic disclosure is fulfilled by all companies which can be expected since the variables come from the binding Annual Accounts Act. There are two outliers however; the variable about disclosure for executive directors in all subsidiaries around the world (33 percent), and the requirement to disclose remuneration and pensions for *former* board directors and CEO (8 percent). Given the difficulties to interpret paragraphs §20 and 23-24 in the Annual Accounts Act argued by Janzon, Törning & Arnell (2008), the result is not very surprising and a clarification of the definitions is vital. With the current formulation, remuneration information for potentially hundreds of people in all subsidiaries would be necessary. Further, if *former* is interpreted as anyone who has ever had a particular position, similarly hundreds of people would have to be accounted for. Thus, the low level of compliance on these variables may either be because of misinterpretation or because companies consider the admin-

istrative burden to be too high. Moreover, the multitude of overlapping regulatory frameworks in Sweden can be expected to create confusion for both companies and investors, possibly causing the mediocre transparency.

The request for all information on remuneration to be in one place, and the requirement to disclose the total remuneration on an individual basis for all executive directors have scored zero on compliance. This is probably because neither of the variables is required by any of the Swedish binding regulations. Both points are however legitimately demanded, the first by interview respondents and the second by the EU Commission. Sweden is particularly bad at presenting the information assembled in one place in the annual report, which does impair the transparency. Regarding the latter variable, individual disclosure is currently only required for the CEO and board directors, but The Commission of Trust already in 2004 lobbied for an extension of the Annual Accounts Act and the Companies Act to include a requirement for individual disclosure of the terms of employment for *all* the executive directors and *all* board members in a listed company, following NBK's guidelines (SOU 2004:47, p.227).

As stated in the theoretical framework, and somewhat verified by the more specific information demanded by stakeholders in the first study, the existing rules and recommendations are in general rather unclear, ambiguous and unspecific. They leave much room for "creative compliance", and minimum requirements can be achieved without really revealing much useful information at all. As can be seen in this study the companies do avoid the more company specific explanations. For example, none of the companies disclose the specific performance criteria or target levels. An explanation such as the one given by Atlas Copco; "variable compensation is dependent upon how certain quantitative and qualitative goals set in advance are achieved" is a typical example of general rather than specific information disclosure. This highly affects the level of transparency.

## 6 Conclusion and Discussion

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*This final chapter will present the conclusion and answer the research question. A further discussion will be held and the chapter will conclude with suggestions for future research.*

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This study has examined several different sources in order to compile the demand for information on directors' remuneration, and thereby ascertain what information is needed for annual reports to qualify as adequately transparent. Moreover, the remuneration information provided in the annual reports of different companies has been examined. Thus, the study has analyzed the level of transparency in Swedish listed companies.

The first study shows that demand in general exceeds the information that is required by statute. Stakeholders require much more firm-specific information with motivations as well as evaluations of the remuneration programs. In particular, a clearer connection between payments and performance have been requested, both individual achievements and the company's overall development. However, there seems to be a difference in what information the different stakeholders require, where the financial analysts demand less detailed information than owner representatives at the pension and institutional funds.

The total demand for information was compiled into a list of 41 variables and subsequently divided into the four levels of transparency, where the variables that require more firm-specific information imply a higher level of transparency.

Analyzing the annual reports of Swedish large listed companies, an overall mediocre level of transparency was found. The majority of the companies comply only with a few variables at the second level, apart from the minimum requirements. Two companies merely qualify for the first level of transparency, basic disclosure, while all other companies at least fulfill the variables at level two, general disclosure. No company reaches the third level, extended disclosure, although one company comes very close. This shows that the companies are especially poor at disclosing the more firm-specific information that was requested by several of the stakeholders. In particular, the specific performance criteria and targets are desired by the majority, but none of the companies disclose sufficient information in this regard.

In conclusion, the market for information on directors' remuneration is in disequilibrium, caused by a supply deficit. Therefore, the transparency of the



disclosed directors' remuneration has been found to be mediocre, since no company fulfills a higher level than general disclosure.

Of the investigated sectors, the financial industry appears to be somewhat more transparent than the industrial or health care sector. The higher transparency in the financial companies can possibly be explained by the fact that they earn their living through confidence and have to build trust with their customers and investors. Moreover, a possible explanation can be that the financial companies have been particularly under scrutiny in the recent debate about bonuses, and special guidelines exist for companies in this sector.

The overall mediocre transparency can have several underlying causes and even if this thesis does not primarily intend to explain the level of transparency but merely establish it, a few possible explanations exist. The current regulations appear rather limited and prone to misinterpretations, which may constitute one reason for the low level of disclosure. In terms of the qualitative characteristics of information, the result may also be caused by a trade-off between relevance, reliability and understandability. The different demand for information of different stakeholders makes it impossible to provide everyone with relevant information. This explains why some are satisfied with the current disclosure, while others desire much more company-specific information. Apparently, the information is neither entirely reliable. Although the variables concerning comparability were fulfilled by most companies, it would be even better if more historical information was disclosed. The study has not been able to conclude anything regarding understandability, apart from the authors' opinion that the information is complex and exceptionally hard to understand. Moreover, had the remuneration information been assembled in one place in the annual report a proper evaluation would have been facilitated, as supported by the interviews.

A pure speculation is that executives may avoid excessive transparency to serve their own purposes, such as unjustified perquisites and bonuses. Ambiguous and slack regulations, as well as diversified stakeholders, arguably leave management with a lot of freedom of manoeuvre when it comes to disclosures. Finally, the level of transparency may be a deliberate choice, having weighted the advantages of reduced cost of capital against the disadvantages of revealing sensitive information. Several of the respondents and the regulatory bodies are sympathetic when it comes to disclosing potentially sensitive information, and there are exemptions for information of this nature. However, it is debatable whether the owners get sufficient information to evaluate the programs and counteract any managerial hegemony.

## 6.1 Suggestions for future research

An extension of this study is possible in several ways. It would be interesting to elaborate on the differences in transparency between different sectors, and therefore investigate several other industries as well. Moreover, this study only looked at “large cap” companies, but a further study of companies of different sizes could reveal differences in transparency. One could go one step further and investigate the reasons behind the transparency levels, either by interviewing the companies and in a qualitative study derive the explanation, or by running a regression with different explanatory factors such as e.g. size, ownership structure and degree of foreign ownership. It would be of interest to investigate the impact of transparency on the actual levels of remuneration, as well as reviewing all manners of communication including the information on websites and the notice to annual general meetings. Lastly, instead of the classification system a transparency index could be constructed. This would however require consideration of the different weights, to get a reasonable result.



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## Websites

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Hallvarsson & Halvarsson: [www.hallvarsson.se](http://www.hallvarsson.se)

Första AP-fonden: <http://www.ap1.se/>

## Annual reports

Atlas Copco (2008)	Nordea (2008)
Elekta (2007/2008)	SEB (2008)
Getinge (2008)	SKF (2008)
Hufvudstaden (2008)	Swedbank (2008)
Investor (2008)	Volvo (2008)
Meda (2008)	Scania (2008)
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## Interviews

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Ekdahl Ossian, Första AP-Fonden, telephone interview 2008-04-23

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Thulin Gabriel, Hallvarsson & Halvarsson, telephone interview 2008-05-04

Ullman Tomas, Erik Penser Bankaktiebolag, telephone interview 2005-05-08





# Appendix 1

	Variables	Description
1	The total cost of the program	
2	The total amount of salaries and other remuneration shall be specified for each of the following groups:	
	1. The board directors, CEO and executive directors	
	2. Other employees not mentioned in 1	
3	Variable payments to board directors, CEO and executives specified separately	
4	Salary and remuneration for the year specified separately for each board director (except employee representatives) and the CEO	
5	If the company has employees abroad, the sum of remunerations to board directors, CEO and executive directors specified for each country	The information should be provided for all executive directors in subsidiaries worldwide. Aggregated disclosure is allowed but the variable remuneration shall be separated for each country.
6	The total amount of pension costs and commitments disclosed for board directors, CEO and executive directors	Aggregate.
7	Number of persons specified for each group	For groups 1 & 2 as in Annual Accounts Act
8	Information about pensions specified separately for each board director (except employee representatives) and the CEO	
9	If any golden parachutes/severance payments or alike to board directors, CEO or others in the management have been agreed, these should be disclosed with the most essential terms	Since it is impossible to know if all essential terms are disclosed a very general explanation is required, but at least the maximum severance pay must be disclosed.
10	Remunerations as above, with pensions separately, disclosed for former board directors and former CEO	Also former CEOs and board directors have to be accounted for.
11	The purpose of the incentive program	A very general explanation is sufficient. An example from SKF is; "The purpose of the program is to motivate and compensate value-creating achievements in order to support operational and financial targets."
12	Information concerning the preparatory and decision-making process	Specify what people that take part in the preparation and decision-making process, and if there is a remuneration committee.
13	Explanation of the relative importance of the variable and non-variable components	An explanation of the variable remuneration as a percentage of the total remuneration or of fixed remuneration is enough.
14	Whether there is a ceiling on the variable remuneration	Disclose also if there is no ceiling.

15	Number of persons that take part of the programs	The total number of participants in the different programs shall be disclosed.
16	The total remuneration and other benefits granted to individual executives over the relevant financial year	The information should be provided on an individual basis for all executive directors, not only board directors and the CEO.
17	Specify what program the CEO and executive directors have	
18	Significant changes in the policy as compared to previous financial year	Approval is given if the changes are explained or if it is stated that no changes are made.
19	Explanation of what year the performance was achieved	
20	Provide historical numbers for comparison	Comparable numbers for at least the year before have to be given, not only for the total cost but for the groups (1&2) as well.
21	Total estimated value of non-cash benefits considered as remuneration	Monetary value.
22	The number of share options offered or shares granted	
23	The number of share options exercised during the relevant financial year, the number of shares involved and the exercise price	
24	The number of share options unexercised at the end of the financial year; their exercise price and exercise date	
25	How the valuation of options is made	It is not enough to say that it is calculated with the Black & Sholes valuation model, but the main parameters used for the valuation has to be disclosed as well.
26	Any dilution of the share capital that may result from the program	
27	How many employees that still have a defined-benefit based pension, and some indication of what it may come to cost the company	
28	Whether variable pay work as pensionable income	
29	The pensionable age for CEO and executives	
30	Whether pensions are revocable	Whether pensions are contingent on future employment or not.
31	All information on remuneration found in one place	
32	Sufficient information on the performance criteria for variable remuneration	The specific criteria shall be disclosed, e.g. if the measures are EPS, ROI, TVA or others. It is not enough to only state that the performance criteria are different key performance indicators.
33	Sufficient information on the link between remuneration and performance	State how much that will be paid out in remuneration if the targets are reached. If only the maximum remuneration is disclosed, it has to be explained if the remuneration is allotted proportionately or with another method of distribution.

<b>34</b>	The target achievement required	Disclose the exact target levels required for remuneration to be allotted.
<b>35</b>	The main parameters and rationale for any annual bonus scheme and any other non-cash benefits	An explanation of why the company uses bonuses i.e. variable remuneration that is not related to individual performance and non-cash benefits, and how they are distributed.
<b>36</b>	The reason for why remuneration is paid in the form of variable remuneration	A very firm-specific explanation of why the company needs variable remuneration and how it benefits the owners.
<b>37</b>	How the executives can influence the achievement of targets	If the achievement of the targets are really within the executive's area of responsibility or what other factors that may influence the achievement.
<b>38</b>	If targets are relative to other companies or indices, these companies and indices should be specified	
<b>39</b>	Total cost to the company in different conceivable outcomes	Presentation of different scenarios.
<b>40</b>	Thorough evaluation of the effectiveness of the program	An evaluation should be made and the main results should be disclosed in the annual report.
<b>41</b>	The connection between paid out remuneration and the company's development	For example the remunerations' connection to the financial result the year the performance was achieved or how it relates to the company's business cycle.



Level 2: General disclosure		SWE	INV	NOR	SEB	HUFV	MEDA	GET	ELE	NCC	AC	SCA	SKF	VOL	
11	The purpose of the incentive program	0	1	1	1	0	0	0	1	0	0	1	1	0	46%
12	Information concerning the preparatory and decision-making process	1	1	1	1	1	1	1	1	1	1	1	1	1	100%
13	Explanation of the relative importance of the variable and non-variable components	1	1	1	0	0	1	0	1	1	1	1	1	1	77%
14	Whether there is a ceiling on the variable remuneration	1	1	1	1	1	1	1	1	0	1	1	1	1	92%
15	Number of persons that take part of the programs	0	0	1	1	0	0	0	0	1	1	1	1	0	46%
16	The total remuneration and other benefits granted to individual executive directors over the relevant financial year	0	0	0	0	0	0	0	0	0	0	0	0	0	0%
17	Specify what program the CEO and other executive directors have	*	1	1	1	1	1	1	1	0	1	1	1	1	92%
18	Significant changes in the policy as compared to previous financial year	0	1	1	1	1	0	1	1	0	1	1	1	0	69%
19	Explanation of what year the performance was achieved	0	0	1	1	0	0	0	1	0	0	0	1	1	38%
20	Provide historical numbers for comparison	1	1	1	1	1	1	1	0	1	0	1	0	1	77%
21	Total estimated value of non-cash benefits considered as remuneration	1	1	1	0	*	1	1	1	0	0	1	0	1	67%
22	The number of share options offered or shares granted	*	1	1	1	*	1	1	1	*	1	*	1	1	100%
23	The number of share options exercised during the relevant financial year, the number of shares involved and the exercise price	*	1	1	1	*	1	1	1	*	1	*	1	1	100%
24	The number of share options unexercised at the end of the financial year; their exercise price and exercise date	*	1	1	1	*	1	1	1	*	1	*	1	1	100%
25	How the valuation of options is made	*	1	1	1	*	1	0	1	*	1	*	0	0	67%
26	Any dilution of the share capital that may result from the program	*	1	1	1	*	0	1	1	*	1	0	1	1	80%
27	How many employees that still have a defined-benefit based pension, and some indication of what it may come to cost the company	0	0	1	0	0	0	0	0	0	*	0	0	0	8%
28	Whether variable pay work as pensionable income	1	0	1	1	1	1	1	0	0	1	0	1	1	69%
29	The pensionable age for CEO and other executive directors	1	1	1	1	1	0	1	1	1	1	1	1	1	92%
30	Whether pensions are revocable	1	0	0	1	0	0	1	1	0	0	0	1	1	46%
31	All information on remuneration found in one place	0	0	0	0	0	0	0	0	0	0	0	0	0	0%
	<b>Fulfilled variables</b>	<b>8</b>	<b>14</b>	<b>18</b>	<b>16</b>	<b>7</b>	<b>11</b>	<b>13</b>	<b>15</b>	<b>5</b>	<b>13</b>	<b>10</b>	<b>15</b>	<b>14</b>	
	<b>Fulfilled percentage</b>	<b>53%</b>	<b>67%</b>	<b>86%</b>	<b>76%</b>	<b>47%</b>	<b>52%</b>	<b>62%</b>	<b>71%</b>	<b>31%</b>	<b>65%</b>	<b>59%</b>	<b>71%</b>	<b>67%</b>	

Level 3: Extended disclosure		SWE	INV	NOR	SEB	HUFV	MEDA	GET	ELE	NCC	AC	SCA	SKF	VOL	
32	Sufficient information on the performance criteria for variable remuneration*	0	0/1	0/1	0/1	0	0	0	0	0	0	1	1	0/1	15%
33	Sufficient information on the link between remuneration and performance*	0	0/1	0/1	0/1	0	0	0	0	0	0	0	0	0/1	0%
34	The target achievement required*	0	0/1	0/1	0/1	0	0	0	0	0	0	0	0	0/1	0%
35	The main parameters and rationale for any annual bonus scheme and any other non-cash benefits	0	1	1	0	0	0	0	0	0	0	0	0	0	15%
36	The reason for why remuneration is paid in the form of variable remuneration	0	1	0	0	0	0	0	0	0	0	0	0	0	8%
37	How the executives can influence the achievement of targets	0	0	0	0	0	0	0	0	0	0	0	0	0	0%
38	If targets are relative to other companies or indices, these companies and indices should be specified	*	1	0	0	*	*	*	*	*	*	*	*	*	33%
39	Total cost to the company in different conceivable outcomes	0	0	0	0	0	0	0	0	0	0	0	0	0	0%
40	Thorough evaluation of the effectiveness of the program	0	1	0	0	0	0	0	0	0	0	0	0	0	8%
41	The connection between paid out remuneration and the company's development	0	0	0	0	0	0	0	0	0	0	0	0	1	8%
	<b>Fulfilled variables</b>	<b>0</b>	<b>4</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>	<b>1</b>	
	<b>Fulfilled percentage</b>	0%	40%	10%	0%	0%	0%	0%	0%	0%	0%	11%	11%	11%	

\* 0/1 means that they fulfill the variable for their long-term incentive programs but not for the short-term incentive programs

<b>Level 4: Full disclosure</b>	SWE	INV	NOR	SEB	HUFV	MEDA	GET	ELE	NCC	AC	SCA	SKF	VOL
All demanded variables													
<b>Fulfilled variables</b>	<b>17</b>	<b>27</b>	<b>28</b>	<b>24</b>	<b>15</b>	<b>19</b>	<b>22</b>	<b>23</b>	<b>13</b>	<b>21</b>	<b>19</b>	<b>24</b>	<b>24</b>
<b>Fulfilled percentage</b>	<b>50%</b>	<b>66%</b>	<b>68%</b>	<b>59%</b>	<b>45%</b>	<b>48%</b>	<b>55%</b>	<b>58%</b>	<b>37%</b>	<b>54%</b>	<b>53%</b>	<b>60%</b>	<b>60%</b>