CORPORATE GOVERNANCE IN NORDIC BANKS

Addressing Governance from a Behavioural Perspective Following the Financial Crisis

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Submitted by

Lucia Morris

Supervised by

Aleksandra Gregorič

Associate Professor and Ph.D.

Department of International Economics and Management

Copenhagen Business School

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Abstract

This thesis investigates the applicability of behavioural theories as a complement to agency theory in order to understand changes in banking governance following the global financial crisis. I consider systemically important Nordic banks at three time nodes in order to study both the level and development of corporate governance policies. The analysis and discussion build on agency and behavioural theories, using methods inspired by the clinical research methodology in finance, which combines quantitative and qualitative data. My results indicate that agency theory is insufficient to explain the many developments witnessed over the period, and I argue that behavioural theory has the capacity to lend deeper understanding to observed trends in corporate governance policies. I discuss how the prevailing narrow view of banking governance neglects pressures related both to industry-specific and social factors, which detrimentally affects the efficacy of agency prescriptions for good governance.

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1. Introduction

This thesis examines corporate governance at Nordic banks during and after the global financial crisis, and presents an approach that draws on behavioural governance theories to explain the developments observed. My research is motivated by a desire to understand how different factors and constraints interact in order to uncover insights that traditional governance literature and prescriptive policies often overlook. While the causes of the global financial crisis are still being debated, the financial sector is perceived to be at the epicentre of the events that unfolded in 2008, and has received widespread criticism for its role. The main criticism being levelled at banks, centres on their alleged excessive risk-taking, weak corporate governance, and lacking oversight by actors within and outside the firms. The banks in this paper have been classified as systemically important by the European Banking Authority (2015), meaning that their performance has widespread effects for the long-term prosperity of their sector and of European society as a whole. The systemic importance of Nordic banks has, logically, had an effect on how they are governed and what considerations are taken into account in decision-making and strategy formulation. The social environment in which stakeholders operate has an ambiguous impact on the actions they take.

This paper will combine traditional perspectives within corporate governance theory such as agency theory, with more socialised behavioural theories in order to give a more nuanced perspective on the developments observed. Agency theory relates to the pursuit of economic interests by rational actors and the inherent difficulties in the relationship between principals and agents with regards to incentives (Jensen and Meckling, 1976). Behavioural governance theories broaden this perspective by taking into account the social embeddedness of actors i.e. the fact that all relationships are coloured by the norms and values of individuals and the social environment in which they interact. These social aspects limit the ability of actors to act according to the traditional economic view of rational profit seekers, and can cause them to pursue a range of other goals (Westphal and Zajac, 2013). In bringing together these traditional and more developmental strands within corporate governance, I will attempt to analyse developments in the banks' governance from a holistic perspective that takes into account the myriad pressures and incentives affecting individuals.

The methodology in this thesis will focus on quantitative data, however qualitative data will be introduced through case studies. I have collected data on corporate governance indicators, and tracked their development over time in order to examine how they developed during and after the crisis, looking at the period of 2007-2014. In order to gain a deeper understanding, I will present selected interesting cases that highlight important aspects within corporate governance at the banks in the sample. This approach has been influenced by the clinical research methodology within finance, which uses small samples of data combined with case studies, in order to reach meaningful results (Jensen et al., 1989).

The aim of this paper is therefore to elucidate whether behavioural corporate governance theories, in combination with traditional agency theory, can be used to understand the considerable developments observed in Nordic bank governance over the observation period. I will assess the various factors and incentives working on the actors, and analyse their effects on the development in corporate governance indicators. My research question is:

> *To what extent does a holistic perspective on corporate governance, that takes into account both agency and socialised behavioural theories, explain observed developments in the Nordic banking sector following the global financial crisis?*

This study has numerous limitations; one of the most pertinent being that the sample consists of only six Nordic banks. These banks are however regional giants, and together represent the majority of Nordic banking customers.[1] Secondly the study is performed at just three time nodes, 2007, 2010 and 2014. These limitations clearly mean that the findings of this study apply only to these specific banks during this period; the results are not generalizable. In order to achieve generalizability the sample group would have had to be considerably larger and the observations more frequent and over a longer period of time. However, the aim of this paper is not to make normative recommendations as to corporate governance policies.

[1] The banks collectively hold 50%, 45%, 52% and 67% of the Danish, Finnish, Norwegian and Swedish markets for household deposits. The OP group holds a strong position in Finland, but as it is a conglomerate with widespread activities I have chosen not to include it in this thesis.

The remainder of this thesis will be organised as follows: after an introductory section that explains the financial crisis context, I will delve into the theoretical basis and research methodology underlying this paper. After presenting the data and results, a discussion section will constitute a rigorous analysis that lays the foundation for a final concluding section that aims to answer the research question.

1.1 Financial Crisis – the Nordic Experience

The financial crisis ostensibly originated from the US real estate bubble triggered by sub-prime lending and the subsequent mass default of these borrowers. The securitisation of pooled mortgages came hand in hand with a transformation of the traditional banking model, and move toward a "originate and distribute" model whereby banks issued loans and then repackaged and resold them. The attractiveness of this model was greatly increased due to lenient monetary policy and booming property prices. The securitisation of mortgages, subprime and otherwise, supposedly redistributed risk to those most able to bear it. As a result of this innovation of the banking system, mass defaults sparked contagion and ultimately illiquidity and a credit crunch when financial institutions became unsure about their exposure and were therefore reluctant to extend credit. (Blundell-Wignall et al., 2008; Brunnermeier, 2009; Taylor, 2009)

The nature of the Nordic countries' small open economies exposes them to the global economy, both through monetary mechanisms and through their reliance on exports; most of the region's cyclical variation is a result of external shocks. The highly concentrated and regionally interdependent banking sector became vulnerable when global markets faltered in 2008; Sweden was the first Nordic economy to waver. This export-dependent nation saw exports drop 12% in 2009, doubts about the euro-area economy led to the Swedish currency gaining safe-haven status damaging its competitiveness and contributing to negative inflation rates. Linkages to the euro-area, as well as the simultaneous housing price correction that depressed consumer spending, detrimentally affected Denmark: the most continental of the Nordic countries. Danish banks suffered greatly from the drying up of interbank credit and the consequent rise in insolvencies. Finland was the hardest hit by the crisis, suffering the largest reduction in growth due to a dramatic reduction in export demand of over 20% in 2009, due to reliance on telecommunications and capital goods: both heavily affected by the global recession. Norway was partly insulated from the crisis due to strong oil prices, limited exposure to the global manufacturing industry and substantial macroeconomic stimuli. (International Monetary Fund, 2013)

In Sweden, both Nordea and Swedbank received support from the national government. The former raised money from the government, its largest owner, through a rights emission and the latter participated in a guarantee program enabling it to raise funds through government-backed obligations for a fee. The other large banks chose not to participate in this program that would have limited salaries, bonuses and board remuneration in participating institutions (Bergström, 2009; Öhrn, 2008). Nordea also participated in the Danish equivalent of the guarantee program, as did Danske Bank that received hybrid loans from the state in 2008 (Bergström, 2009; Berlinske Business, 2009). The range of Danish rescue packages implemented over the period was instigated as a consequence of a spate of local banks' insolvencies; the government thus extended its AAA rating to domestically-based banks in return for substantial fees and a moratorium on dividends, share buy-backs or share option schemes (Anderson, 2008). The Finnish state offered its banks a similar guarantee program, both with regards to requirements and restrictions (European Commission, 2008). In Norway, Kredittilsynet encouraged banks to participate in government programs in order to assure capital adequacy and the ability to meet firms' and households' credit needs. In common with the other Nordic countries, an extended guarantee program was rolled out as well a preferential bond-buying program and fixed rate loans for smaller banks (Kredittilsynet, 2009). DNB was an active participant in this program and transferred 80% of its mortgage loans to its covered bond companies (International Monetary Fund, 2015).

The banking sectors in the three Baltic countries, Estonia, Latvia and Lithuania are closely linked to Swedish banks. SEB and Swedbank together dominate and in 2010, held 80%, 60% and 55% of the markets respectively, corresponding to loans of 400 BSEK, more than 10% of their total loan portfolios. The influx of loans from foreign banks in combination with loose fiscal policies contributed to unsustainable overheating of the economies; the global financial crisis was the catalyst for the inevitable bust. In 2008, both the Swedish and Danish central banks entered loan agreements with the Latvian national bank in order to support their currency reserves. The following year Estonia was extended a loan offer from the Swedish national bank, however it was not used. (Bergström, 2009; Ingves, 2010)

Following the financial crisis there were calls for increased financial regulation in order to prevent similar events in future. Finland, Norway and Sweden had suffered the consequences of insufficient financial regulation during their Nordic financial crisis in the early 1990s: specifically the ills of a rapid extension of credit (Jonung, 2010). This experience led to measures that increased central bank flexibility and made banks more conservative both with regard to risk appetite and capital adequacy. Hence the recession in the Nordic countries was largely a result of reduced exports and illiquidity for banks due the drying up of international financial markets, as opposed to domestic financial activities (Magnusson, 2013). International financial policies and regulations adapted in response to the crisis; several reforms occurred in the US, the EU and through international forums for cooperation like the Basel Committee on Banking Supervision. The Basel III regulatory standard has become a vital benchmark for banks aiming to increase resilience and improve their risk management, governance and transparency.

The financial crisis engendered a global recession that had a profound impact on people all around the world, and unsurprisingly the reputation of the financial sector suffered in its wake. The Occupy Wall Street movement is a prime example of a public backlash toward excessive gains in the sector (Kuchler and Jones, 2012; Goff and Boxell, 2011). The negative sentiments were particularly fierce in those countries that bailed out banks with taxpayers' money, and were lesser in nations like Sweden where governments received equity stakes in the banks that received public funding (Berlingske Business, 2009). Acceptance for high-risk investments, irresponsible mortgage lending and a low savings culture has generally suffered a harsh blow, and has been deeply criticised and regulated against (Riaz, 2009).

2. Theory

Corporate governance has been a vital topic within economics since the evolution of the corporate form; itself a nexus of incomplete contracts that pave the way for potential conflicts between investors, managers and other stakeholders (Wells, 2010). The central premise for corporate governance is the separation of ownership and control, an issue that has been addressed through several theoretical fields. These include agency theory (Jensen and Meckling, 1976), stakeholder theory (Freeman, 1984), new institutional theory (Meyer and Rowan, 1977), resource dependency theory (Pfeffer and Salancik, 1978), transaction cost theory (Williamson, 1981), stewardship theory (Donaldson and Davis, 1991) and a growing body of behavioural corporate governance theory drawing strongly on psychology and sociology (Hambrick et al., 2008). In order to answer my research question in a thorough and yet succinct way, I have chosen the two areas of theory that I believe are most relevant for understanding the observed developments in corporate governance in the Nordic banking sector following the global financial crisis. The chosen theories, agency theory and behavioural theory, will be presented in the following sections *2.1* and *2.2*, followed by a short explanation of how I believe that they are interconnected though the illustrative model that I have developed.

2.1 Agency Theory

2.1.1 Origins, Developments and Fundamental Principles

It was Adam Smith (1776), who first cast light on the seemingly inevitable conflict of interest that would occur through separation of ownership and management in his magnum opus, *The Wealth of Nations*. He propounded that when managers are "*managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own*", and that the consequences would be "*negligence and profusion*" as a result of incentive misalignment (Smith, 1776). Agency theory as we know it today, was born with Berle and Mean's seminal work which addressed the issue of separation of ownership and control in the modern corporation. Their primary thesis was that through dispersed shareholding, shareholders have replaced their role as active owners, for that of recipients of the so-called wages of capital. The authors argue that owners' lack of active involvement in the operations of the firm enables managers to engage in opportunistic behaviour. In order to mitigate these issues, the authors recommended embedded voting rights for all shareholders, along with greater managerial transparency, and accountability both to shareholders and society in general. (Berle and Means, 1932)

The contractual view of the firm was central to the subsequent wave of agency theory as laid forth by Alchian and Demsetz (1972). They highlighted that intra-firm[2] exchanges could be likened to those occurring through voluntary exchange in the marketplace; there is no superior authority to solve intra-firm issues, as the firm cannot own all inputs. Instead the authors propound that the firm, through contracting with all input holders, reaches optimum efficiency in usage of said inputs in order to maximise joint output. Crucially there is one party that is common to all contracts with the joint inputs, and that is the residual claimant i.e. the owner. The owner reserves the right to renegotiate or terminate contracts as a means to enhance efficiency in organisation of team production. Moral hazard and collective action issues are solved through monitoring and metering, which through contracting become more efficient and less costly, making it more economical to discipline input owners. The authors suggest that firms will reach maximum efficiency when they are able to mitigate intra-firm information asymmetries allowing the firm to take the role of an efficient marketplace for productive inputs. (Alchian and Demsetz, 1972)

Jensen and Meckling (1976), building on Alchian and Demsetz's research, expanded their view beyond the firm in order to include other important stakeholders like creditors, suppliers and customers. Through an integrative approach to theories within agency theory, property rights theory and finance, the authors develop a theory of the optimal ownership structure of the firm. They formalise conflicts of interest and highlight how each constituent (equity holder, debt holder, employee) will act to maximise its own utility; this is useful to determine how costs and rewards are allocated within the firm. Given the inevitable incompleteness of any contractual bond, residual loss is inescapable and different types of claims to the firm's cash flows and assets have residual control holders. Consequently, owners engage in

[2] In Alchian and Demsetz's framework the firm is to be understood a joint output unit consisting of owners, managers and employees.

monitoring and bonding, in order to increase effort and reduce shirking and expropriation, such that agency costs are minimised. Jensen and Meckling stress that the aggregate agency costs of monitoring, bonding (i.e. contracting) and residual loss, are as real as any other cost. However as these costs, and rewards, are asymmetrically distributed among constituents, the authors develop a theoretical overview of the optimal behaviour of each actor. (Jensen and Meckling, 1976)

Fama (1980), and Fama and Jensen (1983), direct their attention to the issue of separation of ownership and control in the modern corporation, where important decision agents have low equity participation, if any. In this way they diverge from the framework of Jensen and Meckling (1976), which centres on a central manager and residual risk bearer[3], despite sharing the contractual view of the firm. The two papers instead disaggregate the two functions of the entrepreneur into management and risk bearing. Fama and Meckling (1983) separate decision processes into decision management, including initiation and implementation, and decision control, comprising of ratification and monitoring. They theorise that this separation is valuable in organisations where specific information for decision-making is diffused among agents and when residual claims are dispersed. It further helps reduce agency issues by limiting the power of individual agents. Fama (1980) points to the external forces that can mitigate agency issues, namely the discipline of competition with other firms, and the managerial labour market both within and outside the firm. Interestingly, Fama and Meckling (1983) point to the role of the board of directors as agents at the apex of decision control systems, who do not bear significant wealth effects of their actions. The novelty of Fama's (1980) work is the outlining of an internal and external incentive structure whereby almost absolute separation of ownership and control is an efficient form of economic organisation.

[3] This actor is referred to primarily as the entrepreneur (Jensen and Meckling, 1976) or the employer (Alchian and Demsetz, 1972) in the property rights literature.

In a modern setting, corporations rely on suppliers of capital in order to survive and yet must provide a credible commitment that they will use funds in a profitable way, in order to generate profit and return dividends to investors. Schleifer and Vishny (1997) discuss the different ways in which corporate governance systems have been designed in order to ensure adequate capital supply for firms, and sufficient legal protection from expropriation and concentrated ownership, for investors. Concentrated ownership has implications: both for equity and debt claims. For small owners, the voting rights of common stock are typically impotent unless concerted action is taken: which is both difficult and costly. Debt holders do not have voting rights, however debt covenants enable them to impact the operations of the central firm and can entail an event-specific transfer of control. Despite the extraordinary powers granted to debt holders in the case of covenant breaches, enforcement of this right and subsequent control is prohibitively costly for small individual creditors (Schleifer and Vishny, 1997). Protection for minority owners is of particular interest in the Nordic setting; in Sweden, the voting premium of blockholding is among the lowest measured globally, and expropriation of minority owners is low. Despite the seemingly low incentives for concentrated ownership, the prevalence of controlling owners is very high (Schleifer and Vishny, 1997, p. 754-759).

2.1.2 Structure – the Categories and Mechanisms

Agency theory primarily deals with conflicts of interest, and ways in which incentives can be aligned in order to mitigate these conflicts. As opposed to presenting the typical stylised agency conflicts between: (1) owners and managers, (2) majority and minority owners and (3) owners and non-firm stakeholders, I choose to present only those relationships that are relevant for this thesis.[4] In what follows, I elaborate on the inherent conflicts and means for resolving them through corporate governance mechanisms in the interactions between: (1) owners and directors, (2) directors and managers, and (3) majority and minority owners.

[4] I have chosen to exclude debt-holders or any other constituents from the broader stakeholder society from this thesis.

2.1.2.1 Owners versus Directors

Within the boundaries and vocabulary of agency theory, the board of directors acts a representative for owners in their relationship with managers, but are themselves the agents to the owners' principals. The dynamics of this relationship are mired in similar conflicts of interest as other principal-agent interactions. Banks are however, fundamentally different from other firms in their financing and their balance sheets; high leverage impacts banking governance through the exacerbated incentive misalignment between shareholders, and depositors and other creditors. Though regulation acts on behalf of creditors and aims to mitigate shareholder opportunism, depositors have few rights and are highly dispersed. Shareholders are at the centre of corporate governance in non-banking firms due to their status as residual claimant, however in banks, creditors and indeed broader society stand to lose a great deal in the event of poor performance; including potential for financial contagion. Strong checks that limit risk-taking benefit creditors, though mechanisms like government deposit insurance and bailouts also limit shareholders' downside risk (Armour et al., 2016).

The role of the board in the modern corporation is to represent the interests of the, often dispersed, shareholders. Adams et al.'s (2010) survey of the role of the board of directors, identifies several areas in which directors contribute to the central firm including: providing advice and counsel to management, setting the strategic direction of the company, monitoring management, hiring/firing of the CEO and more. Within the Fama and Meckling (1983) view of the disaggregation of management activities, directors are responsible for decision control i.e. the ratification and monitoring of management's decision initiation and implementation. Given these diverse perspectives on the role of the board and its function, how can directors be incentivised to perform their tasks in a satisfactory manner? Agency theory centres in two distinct mechanisms through which interest incompatibilities are mitigated, namely monitoring and bonding (Jensen and Meckling, 1976).

The dealings of boards are necessarily private, contributing greatly to information asymmetry between the principal and agent (Adams et al., 2010). Effective monitoring on the part of the owners is hence rendered difficult and costly; this is exacerbated in the face of dispersed shareholding when no owner has the incentive to perform such costly activities (Holderness, 2003).[5] Monitoring primarily serves to minimise expropriation and entrenchment, however it could be difficult for directors to engage in either type of activity without the cooperation of management. Fama and Meckling (1983) hypothesise that collusion between directors and management is rendered both difficult and unlikely, through the multi-member organisation of corporate boards.

Given the impracticality of monitoring, save for director replacement, as a disciplinary tool, owners must increasingly rely on bonding to mitigate interest misalignment issues. Bonding fundamentally aims to make agents act as though they were the principals, and is achieved through contracts that link compensation to outcomes that are beneficial for the principal. This implies that directors must receive performance-linked compensation in order to motivate them to exert greater effort. Adams et al.'s (2010) survey finds that stock options are a very common addition to director compensation packages. This equity-based form of compensation encourages directors to act like owners, as they in fact become owners, however the efficacy of this kind of scheme is dependent on the director's risk appetite, existing individual and familial wealth, time horizon etc. (Core et al., 2003). An interesting interpretation from Fama (1980) is that directors could have additional incentives to act in the interests of owners, namely the discipline imposed by the labour market for directors.

2.1.2.2 Directors versus Managers

As mentioned above, directors in their role as representatives of the owners, take on the position of the principal in their relationship with managers. The role of the board was discussed briefly above, and can be summarised in that directors should work to maximise shareholder value, which in the banking industry could motivate excessive risk-taking due to the limited liability of equity-holders. In order to achieve their goal, directors must mitigate incentive misalignments with managers through a combination of monitoring and bonding.

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[5] Futher discussion on the different incentives of large and small owners will follow in section *2.1.2.3 Majority versus minority owners.*

In contrast to the ability of owners, directors have much greater insight into the operations of the firm and can perform monitoring more successfully. One particularly effective way in which directors exercise this control is in their power to hire/fire the CEO and other top executives. There are however factors that reduce directors' monitoring capacity including information asymmetries, time and cognitive restraints on directors and manipulation on the part of the CEO (Adams et al., 2010). Grove et al. (2011) posit that a high degree of regulation in the banking industry could reduce the incentives for directors to monitor management due to overreliance on regulatory effectiveness in protecting debt-holders.

Bonding activities to incentivise managers work in much the same way, and have the same shortcomings, as with directors. One of the main differences is that managers have a greater ability to affect the short-term share price of the firm, and so act opportunistically to increase their pay packages in the short-term by taking excessive risk. This feature is commonly addressed with claw-back provisions, convex compensation contracts and vesting periods (Goergen and Renneboog, 2011). Managers do not only have financial incentives to promote shareholder value, they are also motivated by future income and the labour markets for both managers and directors (Fama, 1980).

2.1.2.3 Majority versus Minority Owners

In the terminology of agency theory, the majority owner is the agent to the principal of the minority owners. The classification of majority and minority owners in this section is stylised to illustrate that large and small owners may not pursue the same goals, and so a conflict of interest arises. Majority owners, or so-called blockholders, have the means to exert disproportionate control over the firm and expropriate resources at the expense of minority owners. In this sense, blockholders can pose a threat to minority owners; however on the other hand, large owners can be important source of discipline for directors and managers alike. Along with amplified means to expropriate funds, blockholders have considerable incentives to monitor how the firm is run and have sufficient clout to engender change, as discussed above. The consequences of these two opposing attributes are ambiguous.

Laeven and Levin (2007) discuss the effect of the presence of multiple blockholders, and find it to have a positive impact on firm value, implying that the incentive to monitor exceeds that to expropriate. They find that bank risk-taking is positively correlated with the proportion of cash flow rights held by large shareholders, and that that enhanced monitoring is less likely when cash flow rights are unequally distributed (Laeven and Levin, 2007; 2009). This is of interest in the Nordic setting where mechanisms that separate cash flow and control rights, like dual-class shares and pyramid structures, are relatively ubiquitous (Bennedsen and Nielsen, 2010).

2.2 Behavioural Perspectives on Corporate Governance

2.2.1 Departure From the Standard Economic Model

Tirole (2001) formalises the agency theory game presented by previous scholars; his sequential model illustrates that it is suboptimal for managers to exert high effort unless their compensation is aligned with that of owners. However, Tirole also discusses the stakeholder society perspective and how firms could internalise the externalities they impose on various stakeholders by aligning managerial incentives with stakeholder value creation (Tirole, 2001). In the banking industry, the issue of negative externalities for external parties is especially pertinent as banks are largely debt-financed by the life-savings deposits of individuals, and due to the systemic nature of the industry (Armour et al., 2016). Tirole expounds that the benefit of taking a stakeholder value approach to organisational design is that decision-making is rendered less biased in favour of one group of stakeholders –the shareholders. This however occurs at the cost of decision-making speed and managerial focus (Tirole, 2001).[6]

Tirole's (2001) model is purely mathematical, and though it addresses reputational capital as a method of reducing moral hazard, it does not touch on the social context or relationships of the entrepreneur or investor and their impact on incentives. The behavioural approach to corporate governance, though it does not address the philosophical discussion of the role of the firm, discusses how stakeholders within and outside the firm influence decision-making.

[6] Stakeholder theory is a body of corporate governance reasearch unto itself, and will not be discussed further in this paper, please see Freeman (1984) for further explanation.

In order to do so, scholars have viewed the traditional agency issues using the lenses of sociology and psychology gleaning new insights into how and why agents act as they do.

In order to understand behavioural theories one must deviate from the Standard Economic Model (SEM) that views economic agents as purely selfish, rational utility maximisers with consistent time preferences for entirely fungible income and assets. Though the SEM provides helpful underpinnings for understanding economics, a more realistic psychological foundation increases the explanatory power of economic theory. Behavioural theorists have uncovered several psychological factors that impact the effectiveness of the incentive structures that lay the foundation for economic theory (Kamenica, 2012). There are several cognitive constraints that impact the ability of agents to act as economic theory would predict: including misattribution of cause, use of reference points and overconfidence (Camerer and Malmendier, 2007).

Decision-making is impacted by individual-level biases, however group and peer effects on emotional and cognitive boundaries are equally pertinent. Social comparison is an important factor for how agents perceive issues from their salaries to their skills; group identification can further impose cognitive influences such as disproportionate positive affect and loyalty for in-group members (Camerer and Malmendier, 2007). Reference points and social comparison are important for perceptions of monetary incentives, however studies show that people also care about the process by which incentives were determined as well as deriving “psychic” intrinsic income from some tasks (Kamenica, 2012).

Hambrick et al. (2008) propose a new perspective on how behavioural theories can be integrated into corporate governance in order to broaden the dominant economic and legal structures for understanding these issues. They highlight the need to examine how factors within and outside the firm impact the effectiveness of corporate governance and firm strategy. Through introduction of elements of behavioural structure, they highlight the need to incorporate how power and social networks impact which stakeholders are most successful, thus allowing for heterogeneity within stakeholder categories. (Hambrick et al., 2008)

Similiarly to other behavioural scholars, Hambrick et al. (2008) question the rationality of decision-makers both on an individual level but also when in a social environment. Answering their call for greater research into the antecedents and consequences of this broader perspective on governance, Westphal and Zajac (2013) compiled a behavioural governance survey that explains the socially constructed and socially constituted pressures that influence actors. This enables greater understanding of the social relationships and networks that serve as a setting for individual behaviour, as well as the socialising agents that shape the identity and socio-cognitive ability of actors.

2.2.2 Structure – the Levels and Mechanisms

Behavioural governance theories stress that governance issues are of a larger scope than the monitoring and incentive alignment of individual actors in order to reach positive organisational outcomes, due to the social and environmental influences that impact perceptions and impose cognitive restraints. Theorists aim to make explicit the social pressures that influence the actions and perceptions of individual agents. "*Elite conduct [does not occur] in a social vacuum, but rather in a socially situated context and by individuals whose interpretation of the context is itself socially constructed or constituted*" (Westphal and Zajac, 2013, p. 608). I take departure in Westphal and Zajac's (2013) excellent behavioural governance survey that articulates mechanisms of (1) socially situated and (2) socially constituted agency in order to describe how they impact the actions of agents within the firm.

2.2.2.1 Socially Situated Agency

Socially situated agency refers to the relevance of social surroundings for understanding the actions of agents. Traditionally, governance research focuses on the interactions between actors solely through the framework for agency theory classification: as either a principal or an agent. This neglects the social processes that influence the behaviour of corporate leaders as they relate to one another.

A particularly prevalent and significant type of social influence among corporate leaders is ingratiation. This type of behaviour is a form of social exchange that triggers identification and attachment through illuminating opinion conformity (Gordon, 1996; Jones, 1964;

Tedeschi and Melburg, 1984). Top managers frequently initiate ingratiation by referencing shared group memberships or social affiliations, therefore making opinion conformity look less obviously like flattery and reducing negative interpretations of this behaviour. The consequence of ingratiation is the trigger of similarity-attraction bias, thus inducing more positive regard for the ingratiator and his/her performance (Westphal and Zajac, 2013).

Westphal and Stern's research indicates that corporate leaders are more likely to receive recommendations for directorships from colleagues with whom they engage in ingratiatory behaviour (Westphal and Stern, 2006; 2007). One important corollary of this insight is that, as those that engage in ingratiation are socially deferential individuals, this type of person will be overrepresented on corporate boards (Westphal and Zajac, 2013). This not only weakens directors' ability to perform critical monitoring, flattery can compromise the quality of the firm's strategy as CEO overconfidence is exacerbated, thus lowering the likelihood of strategic changes in the face of poor performance (Park et al., 2011).

Helping behaviour is not limited to the relationship between directors and CEOs; senior board colleagues frequently mentor first-time directors. This advice typically initiates novice directors into norms for directorial conduct, including e.g. the custom that CEO's strategic plans should not be challenged in board meetings, except under extraordinary circumstances. Novice directors that receive such mentoring are more likely to conform to norms, and are increasingly likely to be recommended for further board positions by their colleagues as a consequence. Thus this is another factor that makes socially deferential and conforming individuals more successful in securing additional board positions. (Westphal and Zajac, 2013)

There is a large body of research that indicates that norms of reciprocity play a key role in corporate governance, including both positive and negative forms of reciprocal behaviour. Westphal and Zajac (2013) document that directors who were perceived as engaging in "elite threatening" behaviour were less likely to be invited to informal meetings, their colleagues did not support their comments in formal meetings and their inputs were solicited less often. Furthermore, this engenders social learning for directors, who after having experienced social distancing were less likely to support elite-threatening changes on other boards. Board interlocks, and the small world effect of corporate elites, imply that directors can be punished beyond the board of the focal firm, thus further contributing to the deterrence effect of negative reciprocity.

The prevalence of board interlock ties also enables the diffusion of social learning of decision-making processes, both through monitoring management and through active participation (Westphal and Zajac, 2013). Westphal et al. (2001) found evidence that firms with extensive board interlocks to other firms engaged in mimetic decision processes. They further found that the imitation of policy content was an artefact of imitation at the level of decision making processes, indicating that prevailing best practice assumptions are shared across firms. These findings lend a social learning interpretation to isomorphism, and the diffusion of identical policies across firms, which was arguably a strong contributing factor to the development of the financial crisis.

Ong and Wan (2008) discuss that the effectiveness of the board's provision of strategic advice, is dependent on the compatibility of the human capital of board members and the strategic needs of the firm. Contrary to the agency perspective that advocates board independence from management, studies indicate that low levels of CEO-director social ties are likely to compromise the efficacy with which the board performs its advisory role and thereby serves shareholder interests (Hoitash, 2010; Westphal 1999). Further research has found that relevant experience from other board appointments contributes strongly to the likelihood with which directors provide advice to management. These interactions were positively linked to subsequent firm performance. (Carpenter and Westphal, 2001; McDonald et al., 2008; Westphal, 1999)

2.2.2.2 Socially Constituted Agency

Socially constituted agency refutes the agency theory perspective that the only relevant attribute for understanding the actions of a corporate leader is that he/she is an agent. In contrast, this branch of behavioural governance "*emphasises that what an individual senses, considers, and acts upon all stem from a process of interpretation that is fundamentally social* *and fundamentally based on the multiplex roles and identities of that individual, which themselves are based on prior socialisation and other personal experiences or characteristics*" (Westphal and Zajac, 2013, p. 624).

Westphal and Zajac (1995) theorised that CEO compensation would be decided by the interaction between CEO power and similarity-attraction bias. This bias refers to the tendency to evaluate individuals who demonstrate similar characteristics more positively, as similarities form a basis for in-group categorisation and so elevate trust, affect and sympathy. Furthermore, this body of research suggested that directors would tend to attribute positive performance of "in-group" CEOs to internal factors, such as sound decision-making, and attribute negative performance to external factors, such as macro-economic conditions. The similarity-attraction bias is thus a form of social identification, which can affect directors' propensity to engage in monitoring depending on whether they identify with shareholders, management or other stakeholders (Westphal and Zajac, 2013).

Westphal and Zajac (2013) stress the self-regulated pattern of cognition that enables actors to emphasise personal and social characteristics they share with colleagues, in order to capitalise on mechanisms for social influence and acquire prestigious positions. This effective interpersonal behaviour is highly prevalent among corporate leaders, especially those from demographic minorities, for whom, exerting interpersonal influence is vital. Studies have found that a director's similarity to other board members is a predictor of his/her influence over decision-making, thus likeness is a source of social capital (Kim and Cannella, 2008). Westphal and Milton (2000) posit that minorities can be effective if they succeed in highlighting their similarities, and if they have prior experience as minority board members. This has consequences for which type of minority directors are able to be effective: woman are used to being minority directors on corporate boards, whereas nationality minorities could be unused to the situation.

Westphal and Bednar (2005) researched the causes and effects of pluralistic ignorance on corporate boards, and found it particularly common in those cases when the board was relatively diverse with few social ties between directors. This was a result of less communication, and biases that created a perceived divergence in opinions with demographically or socially distant peers. The consequence was a systematic tendency for directors to underestimate the extent to which their colleagues shared their concerns about firm strategy in the face of poor performance, and so made them less likely to challenge management.

Prevailing norms equate good governance with agency theoretic assumptions of mitigation of agency costs through compensation packages that advance incentive alignment between owners and managers. Symbolic management refers to the adoption of organisational initiatives that enhance the legitimacy of the firm through alignment with normative values, beliefs and objectives (Westphal and Zajac, 2013). One example of symbolic conformity with agency prescriptions includes increasing formal board independence by appointing directors with social instead of formal ties to management (Bednar, 2012). Negative financial market appraisals make firms more likely to engage in symbolic management, and tend to make nominations committees assign greater weight to whether directorial candidates seems likely to support the CEO's leadership as opposed to engage in extensive monitoring, indicating that boards also engage in this practice (Westphal and Graebner, 2010; Westphal and Zajac, 2013).

Studies have shown that firms do not necessarily have to apply legitimacy-enhancing policies in order to benefit from their positive effects; institutional decoupling refers to the formal adoption of structures and policies that conform to governance norms without fully implementing them in the organisation. Financial markets tend to react positively to initiatives that are framed in agency theoretic logic whether or not they are subsequently implemented; and theory indicates that pluralistic ignorance in the analyst community is a contributing factor to positive stock market reactions to policies that were subsequently decoupled (Westphal and Zajac, 2013). Furthermore, firms are considerably more likely to engage in decoupling when the CEO exercises influence over board members, and the firm has board ties with firms that have decoupled the policy in question, or other policies in the past. The corollary of this is that social learning contributes to the propagation of symbolic management through board members' previous experience and interlock ties. (Westphal and Zajac, 2001)

The work of Meyer and Rowan (1977) on institutionalised organisations, inferred that decoupling was an effective way to impose a buffer between standardised legitimating formal structures, and the inevitable variation in firm activities due to practical considerations. This innocuous perspective on decoupling is challenged by some corporate governance scholars who see decoupling as "*a mechanism by which powerful social actors protect or advance their political interests*" (Westphal and Zajac, 2013, p. 637). Literature suggests that symbolic management is a form of socio-political process, as the ability of executives to engage in the practice is dependent on their social influence in the focal firm. The degree of decoupling in a firm is a function of the monitoring of its implementation by powerful constituents, and therefore also to the extent to which monitoring is symbolic or substantive. (Westphal and Zajac, 2013)

2.3 An Integrative Perspective on Agency and Behavioural Theories

The preceding two sections expounded the two bodies of corporate governance theory that represent the foundation for this paper. In this section, I wish to summarise the theory section and present my understanding of the compatibility of these fields in order to develop an integrative perspective on corporate governance to be used in this paper.

Agency theory rests on the fundamental assumption that all actors rationally and self-interestedly pursue individual goals in order to maximise their utility. As such, firm activity is simply an aggregate of individuals' activity, in response to pressures and incentives from shareholders, who equally self-interestedly pursue wealth maximisation. Though I agree with the agency perspective of actors as inherently self-serving individuals who aim to maximise their utilities, I find the implicit assumption that economic agents are capable of complete rationality, and the presumption that macro-level phenomena are simply the aggregate of individual action, overly simplistic.

Behavioural governance research has made inroads to understanding both micro- and macro-levels of analysis, perhaps most helpfully by avoiding a theoretical divide between the individual and the social. Little asserts that "*the molecule of all social life is the socially constructed and socially situated individual, who lives, acts, and develops within a set of* *proximate social relationships, institutions, norms, and rules*" (Little, 2012, p. 143). As such, the pursuit of agency is shaped by social context and the individual's perspective on what is deemed situationally possible.

Figure 1: Perspectives on Corporate Governance

	Formal structure	**Behavioural structure**	**Behavioural process**
Internal organisation	**Economics** Designing optimal incentive and monitoring structures	**Power** Showing how positions affect power/politics within organisations	**Social psychology** Revealing how decision-making processes may be biased

Adapted from Hambrick et al. (2008).

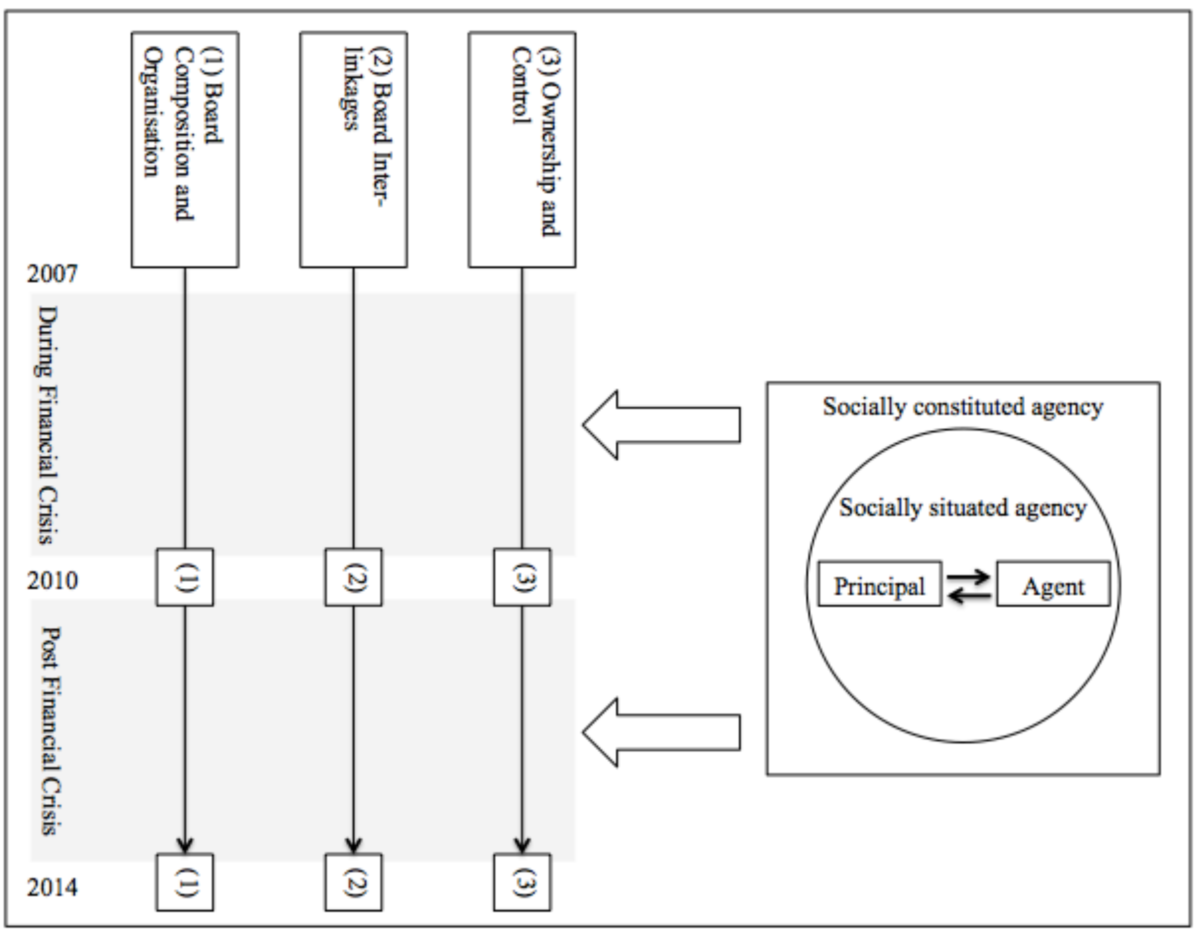
Hambrick et al. (2008) present an explicatory structure (see *Figure 1*) that highlights how research strains in corporate governance address different perspectives to the same underlying issues. Their paper, like this thesis, therefore illuminates the complementary quality of agency, behavioural and other theories for a deeper understanding of corporate governance.

2.3.1 Illustrative Model

Based on review of extant corporate governance literature, I propose that the pursuit of individual agency occurs within the social world, and as such is shaped by social context and the individual's perspective on what is deemed situationally possible as a result of prior socialisation. It is therefore necessary to use a model that explains how these factors interact. This model will provide additional structure that will be helpful in the discussion section: it will facilitate a comparison between which changes are explained and predicted by agency theory, and where an expanded perspective on corporate governance is able to impart greater understanding.

I develop my own illustrative model, see *Figure 2* below, based on the relationship between agency theory, and socially situated and constituted agency pressures as laid forth by Westphal and Zajac (2013). I suggest that this model be likened to a washing machine: agency interactions between principals and agents can only occur within the confines of their social context including existing relationships, networks and institutions, illustrated by the drum of the washing machine. A deeper level of influence however also works on individual agency; prior socialisation and cumulative personal experiences define what is deemed situationally possible. Using the washing machine metaphor, socially constituted pressures act as the frame that enforces constraints on the movement of the drum: i.e. the agency interactions occurring within the social context. One important corollary of this model is that corporate governance policies, as prescribed by agency theory, are influenced by multi-level social factors and thus discrepancies between expected and actual outcomes are foreseeable. Thus, agency and behavioural governance theories act as complements that together bring about a deeper understanding of corporate governance.

Figure 2: Illustrative Model



3. Methodology

Corporate governance is born of the inherent existence of the conflicts of interest that arise when ownership and control are separated. Within the functionalist paradigm of corporate governance, mechanisms are outlined which contribute to mitigating these conflicts through: legal and regulatory mechanisms, internal and external control mechanisms, and product market competition. This is the commonly held view within corporate finance, and closely corresponds to the agency theoretic framework for understanding these issues. (Ardalan, 2007)

Though I view agency theory as a helpful tool for understanding part of individual agency, the lack of contextual consideration renders this body of research lacking for understanding real world phenomena. Therefore, the interpretative paradigm is useful for examining aggregate behaviour within its social context, through its emphasis on the complementary nature of economic logic and social realities for understanding the shapers and influencers of corporate governance. This process-oriented paradigm recognises that social factors like power, social relationships and institutional contexts all impact the evolution of corporate governance (Ardalan, 2007). Moving away from a static view on corporate governance, I will use a complementary interpretive perspective within this traditionally functionalist field, in order to answer what is a fundamentally context based research question.

3.1 Research Design

In this paper I aim to analyse how corporate governance has developed in the Nordic banking sector following the global financial crisis. This task could have been performed using both quantitative and qualitative methods, both having their respective merits. However, given the conscious choice to leave room for interpretation in the research question, traditional quantitative hypothesis testing and statistical falsification methods are deemed to be too rigid to perform the level of analysis I wish to pursue. Therefore, I prefer a qualitative method whereby I compare the developments predicted based on agency theory (see section *6. Framework for Governance Pressures*) with the data collected, in order to examine the applicability of agency and behavioural theories for explaining the observed developments in governance indicators. Over the following sections, the choice of methodology will be explained both with regards to form and to motivation.

3.1.1 Determinants of Methodological Choice

Methodological choice must be in line with the both the researcher's preferences and the specific research question to be investigated. This second consideration is linked to the necessity of understanding both the nature of the question, and the insights sought, so as to choose the "correct" research methodology (Wruck in Ardalan, 2003, p. 1046). In order to gain deeper insight into what is a very open-ended research question, the functionalist field that dominates financial economics is lacking. Embracing a more interpretative world-view, in which social setting is paramount to understanding phenomena, is deemed preferable in addressing this context-related research question (Ardalan, 2003). In my conscious departure from the purely functionalist field, I choose to pursue clinical research methods within finance, a concept I will elaborate on below.

3.1.2 Clinical as Opposed to Scientific Research

When the *Journal of Financial Economics* first established its Clinical Papers section in 1989, the objective was to provide "*a high quality professional outlet for scholarly studies of specific cases, event, practices and specialised applications*" (Jensen et al, 1989, p. 3). Clinical research, though lacking a commonly held definition, is a form of empirical work that performs rigorous analysis on small samples in order to drive observation based insights. Data can be public, private or both; the common trait for clinical research is its conscious delimitation of the sample and therefore the ability to perform more intensive analysis in order to disaggregate information and interpret meaning from empirical irregularities. The field typically aims to address questions that are harder to answer in quantifiable terms and instead require more descriptive and normative answers, thus complementing established theory and empirical tests. This is in contrast to the traditional functionalist research method, which relies heavily on statistical analysis and hypothesis testing of large data samples based on mathematical theory and introspection. (Tufano, 2001)

Ardalan (2003), in his paradigmatic focus, suggests that clinical research belongs to a separate paradigm to that of the traditional functionalist view, however I believe that the two can be complements. For though I attempt to reach generalizable insights as opposed to generalizable facts, I find the clinical method to be an excellent supplement in order to augment functionalist scientific research and thereby address a wider range of topics. Tufano (2001) suggests several roles in which clinical research can make valuable contributions, these include, but are not limited to, the ability to develop and test theory. The adductive capacity of clinical research to motivate theories based on real world observation is based on the interplay between the analysis of phenomena in aggregate and rigorous investigation of the underlying mechanisms that give rise to them (Wruck in Ardalan 2003, p. 1046). Clinical research can thus act as a catalyst for the development of theory, especially in fields related to individual and firm decision-making, e.g. the large contributions it has made to behavioural finance (Tufano, 2001).

3.1.3 Motivation for Choice of Methodology

As discussed above, choice of methodology is inextricably linked to the type of insights pursued; my research aims to generate insights that reach deeper than traditional aggregate associations. The pure scientific method develops logical propositions through introspection or mathematical theory, and tests hypotheses through statistical testing (Tufano, 2001). In my research however, I have aimed to approach the data with few preconceptions and instead perform rigorous analysis to examine governance from a contextual perspective, thus motivating my choice of the clinical research method.

The core of this thesis centres on a belief that social context is important for understanding developments in corporate governance. For this reason, it becomes vital to disaggregate data in order to understand the micro events that give rise to observed trends. In this way I will be able to compare actual developments with prescriptive theory and comment on discrepancies (Tufano in Ardalan, 2003, p. 1045; Wruck in Ardalan, 2003, p. 1046). My work therefore relies on clinical research as a complement to traditional scientific research methods, using case-based analysis to uncover the pursued insights.

Furthermore, traditional theory may experience shortcomings in explanatory power in the face of extraordinary circumstances, such as the global financial crisis. My research has shown considerable developments in corporate governance over the crisis period; clinical methods have the ability to drill down into the micro events that underlie these trends adding insights that would have been beyond the reach of the traditional scientific method. As an example, Krigman, Shaw and Womack (2001) performed a survey in order to add pragmatic validity and interpretation to their aggregate findings; they found a combination of methodologies helpful in adding meaning and generating true insight. In summary, I believe that pursuing a scientific approach, that makes use of clinical methods in the explanatory discussion, is the most suitable method to generate valuable insights and answer my research question.

3.1.4 Use of Theory and Cases

The foundation for this thesis relies on corporate governance theory to determine which parameters should be the focus of this study, as well as providing an academic filter through which I am able to comprehend and interpret the data. Theory is furthermore helpful in structuring the forthcoming analysis and lending a framework through which observations can be better understood.

Using techniques from clinical research I hope to be able to give a more profound and nuanced understanding of the observed developments in corporate governance. In this manner, this thesis will be able to identify trends but also, using a case-based approach lend a much deeper understanding to how and why these came about. In disaggregating data I hope to shed light on the real-world applicability of corporate governance theory, and hence ascertain whether socialised corporate governance theories could mitigate the "*possibility theorem*" flaw that is attached to theories that have little probability of explaining real-world phenomena (Jensen et al., 1989, p. 4).

3.2 Variable Selection

As will be discussed in section *4.1 Time Period*, publicly available data was collected at three time nodes in order to map the aggregate developments in corporate governance in the sample over the period. The variables can be grouped into three categories: (1) board composition and organisation, (2) board inter-linkages and (3) ownership and control. I have chosen these three areas as they are integral parts of corporate governance, and because they are likely to be impacted by behavioural as well as agency considerations. This paper aims to address governance at Nordic banks over the financial crisis period, as such it differs from other corporate governance literature that is not industry specific by considering the idiosyncrasies of banking governance, and placing extra focus on variables like: directors' banking experience, the prevalence of risk committees and CEO change. I am not aware of any other papers that have addressed the interplay between agency and behavioural issues within the banking industry, thus I aim to make inroads to this new perspective on the field. Other areas such as executive compensation, internal agency structures and external stakeholders, though important, have been omitted due to the limited scope of this paper.

		(1) Board Composition and Organisation	**(2) Board Inter-linkages**	**(3) Ownership and Control**
Agency mechanisms	**(1) Owners vs. Directors**	Board size Director turnover Diversity Director independence Banking experience Meeting frequency Audit committee Compensation committee Risk committee	Other assignments Interlinks Industry concentration	Number of blockholders Share held by blockholders Government stake CEO change
	(2) Directors vs. Managers	Board size Director turnover Diversity Director independence Banking experience Meeting frequency Audit committee Compensation committee Risk committee	Other assignments Interlinks	CEO change
	(3) Majority vs. Minority Owners	Board size Director turnover Director independence	Interlinks Industry concentration	Number of blockholders Share held by blockholders Government stake

Table 1: Variables

3.2.1 Board Composition and Organisation

The first group of variables relates to the subject of corporate boards, long discussed in corporate governance literature due to their centrality. Initially I consider *board size* and *director turnover* on the boards of the banks in the sample. Board size has an ambiguous effect on firm performance both in theory and in empirical studies. Larger boards enable broader stakeholder representation, supply a wider range of competences and resources for the firm and could reduce agency issues through more intensive monitoring. However, larger boards facilitate free riding. Empirical research into the relationship between board size and firm performance (measured by Tobin's Q) including Conyon and Peck (1998) and Guest (2009) find a negative relationship, whereas studies that focus on financial firms by Adams and Mehran (2008) and Belkhir (2009) both find positive relationships.

High director turnover could limit the monitoring ability of directors as a consequence of less firm-specific knowledge, however I conjecture that the positive effects of reduced entrenchment and ability for board members to influence and socialise each other are greater. Director turnover is a prime example of an area where disaggregation can generate important insights into the causes of director replacement and if those replaced have common characteristics. This parameter is especially interesting to study in periods of economic turmoil such as the financial crisis, as director turnover is indicative of owners' monitoring role.

Director nationality has been used as a proxy for board *diversity* by counting the number of nationalities represented on each board at each time node. Though this is an imperfect proxy it does give indication as to the diversity in background, experience and network represented on each board. All else equal, a more diverse board is likely to ensure a broader supply of competences and perspectives for the firm. Diversity, or lack thereof, will be very important when discussing the social embeddedness affecting board members' decision-making behaviour.

The share of independent directors is expected to improve the monitoring function of the board, which in conjunction with allegations of lacking oversight makes this an interesting variable to track. *Director independence* can be defined in multiple ways, however most agree that the director should neither have executive responsibilities in the company nor have a material interest in the firm. This makes the classification of directors somewhat diffuse, as the definition of "material interest" is highly subjective. Banks are required to classify if directors are independent or not in their annual reports, therefore I have chosen to use the banks' own classifications throughout. The entire sample group is domiciled in countries where national law requires employee representatives on boards (dependent on firm size); therefore some non-independent directors are to be expected.

Banks have become increasing complex as a result of the bevvy of modern financial instruments, this taken together with the interconnectedness of the banking system and systemic importance of the banks in the sample group, sets high standards for the competence of bank directors. The *banking experience of directors* has been included in order to give an indication of the directors' ability to understand and monitor the complex dealings of a modern bank. This is especially important with regards to monitoring opportunistic behaviour on the CEO's part, for example measures that manipulate the stock price in the short-term ahead of bonus payouts.

The *frequency of board meetings* has also been mapped for each bank. All else equal, more meetings should mean that directors have a greater opportunity to monitor the CEO and thus improve the management of the firm. However, greater meeting frequency also engenders greater opportunities for directors to socialise each other, exacerbating groupthink and reducing the occurrence of diverging perspectives.

Finally, I have mapped the prevalence and turnover over of three different *board committees*: (1) audit committee, (2) compensation committee, and (3) risk committee, as I believe that these are highly indicative of the self-perceived purpose of the board. The *audit committee* performs vital monitoring functions that reduce agency problems, and is therefore arguably the most important committee. Reliable audit is a pre-requisite for the firm to be able to raise capital and engage in long-term relationships with suppliers and customers. The *compensation committee* is responsible for reducing the inherent agency issues that arise in the contract between the principals and the agents by designing executive compensation schemes. Members of the compensation committee must motivate executives to expend effort but not take excessive risk. Lastly, the *risk committee* is responsible for monitoring the risks the bank is exposed to, as well as ensuring that the bank is engaging in adequate risk management activities. This committee has risen in importance following post financial crisis regulation in both Europe and the US.

In likeness with director turnover on the board as a whole, I have chosen to state the *director turnover of each committee*. The interpretation of this is not clear-cut as some boards frequently reshuffle committee members, whereas in other cases directors could potentially be changed due to poor performance or lacking knowledge. I find it especially interesting to view committees as an additional forum for directors to meet and influence each other on more intimate terms. This could provide directors the opportunity to develop closer ties with one another and so potentially reduce their likelihood of being replaced.

3.2.2 Board Inter-linkages

Agency theory relates to the ability to design contracts that align the interests of principals and agents. One major criticism that has been levelled at this body of theory is that the individual contract is not seen in the context of the agent's existing wealth, relationships or personality: including risk-appetite.

Board members have several constraints on their time and cognitive abilities, I therefore find it relevant to chart the *number of other assignments* held by each director. By serving on other boards, directors could bring valuable knowledge and resources to the firm, but this also logically limits the time they have available for any one company to perform vital monitoring and advisory roles.

I map the *inter-links between board members* in order to highlight the fact that, in so far as the board members are agents to the shareholders' principals, there are multiple factors acting on their ability/desire to act in line with their "optimal" contracts. The percentage of inter-links on a board could potentially be negatively related to the degree of director turnover as a result of cronyism in the face of poor performance. I further hypothesize that disaggregation might show interesting relationships between the number of inter-links of individual directors, and their participation in committees and propensity to be replaced. We must remember that committee participation indicates an increased level of trust in the individual and can imply additional financial compensation.

After mapping the degree of inter-links, I find it relevant to investigate if there is an *industry concentration* of board member experience. Though concentration is to be expected in the presence of a high degree of inter-links, cross-referencing this with the characteristics of the largest owners generates some interesting insights. More information about the owners and their characteristics follows below.

3.2.3 Ownership and Control

Ownership is at the centre of the field of corporate governance, as it is the separation of ownership and management that gave rise to the fundaments of this branch of economics (Smith, 1776). Within this area I choose to investigate the prevalence and ownership stake of so-called blockholders, the presence of significant government ownership stakes and the incidence of CEO change.

The field of corporate governance has allocated a great deal of time to the issue of blockholders, which I define as shareholders with an ownership stake of over 5%. The reason for the fascination with this subject is that blockholders differ from normal shareholders as they have both the additional incentives to perform monitoring, and the increased ability to expropriate firm resources (Holderness, 2003). I therefore investigate both the *number of blockholders*, and their *ownership share*. Laeven and Levin (2007) find that firms with multiple blockholders have significantly higher valuations than firms with only one blockholder. However, the presence of multiple blockholders is more likely to be detrimental to firm valuation when cash flow rights are closely held (Bennedsen and Wolfenzon, 2000). This could be particularly relevant in the Nordic context, where dual class shares are unusually common (Bennedsen and Nielsen, 2010). In this thesis, the presence of blockholders is relevant in so far as it could impact the behaviour of board members that directly or indirectly represent the owners.

Looking more closely into the characteristics of the owners, I investigate whether there is a significant *government ownership stake*. Some banks in the sample have had national governments as significant owners historically, however none of the banks were nationalised as a consequence the financial crisis though this was a common occurrence internationally. Government ownership, whether following a passive or active role in the bank, must logically have some effect on the behaviour of individuals within and outside the firm, e.g. closer journalistic review or reputational effects.

Finally I examine the occurrence of *CEO change* in the sample group. During the financial crisis, over a two-year period of 2007-2008, the banks lost on average 63%[7] of their stock market value, and did not recover to 2006 levels until 2013. In the face of this dramatically poor performance, itself a consequence of a credit crunch in international financial markets but also the overheating of Nordic and Baltic markets through contended irresponsible banking activity, I inspect if CEOs were held responsible for these failures and replaced. Theories abound as to the ability of executives to retain positions of power despite poor performance, a few examples are the ability of the CEO to "capture" the board, the limited information and insight of board members, norms of social reciprocity and behavioural biases (e.g. Hermalin and Weisbach, 1998; Westphal and Zajac, 2013; Camerer and Malmendier, 2007). Clinical research methods, such as interviews, have the potential to shed light on these issues.

[7] On 2006-12-31 the average market capitalisation of the sample group was rebased to 100, by 2008-12-31 the figure was 36.87.

3.3 Research Methodology – Statistical Testing and Case Studies

In my ensuing attempt to explain the developments in corporate governance in the Nordic banking sector after the financial crisis, I will take the following steps: (1) statistical testing, (2) a framework for the expected developments predicted by agency theoretic prescriptions, and (3) my discussion where I compare expected developments with actual outcomes, and augment the data with case based evidence. Below I present how I have carried out my study, thus concluding this section on methodology.

3.3.1 Data-driven Tests

The data collected takes various forms, some being discrete like the existence of certain board committees (nominal) or the number of board members (count), whereas the share of directors that are independent is a continuous variable. Depending on the type of data, I have chosen to present it in slightly different ways. Both count data and continuous data are presented as an average value for each time node. Nominal data, to which the answer is simply yes/no, is presented as the number of affirmative data points and the sample size per group (e.g. three yes and four no is presented as "3/7"). Though the sample group did not change over time I find that this manner of presenting binary data makes for clearer understanding.

As the sample group is small and data only collected at three time nodes, standard reporting of standard errors and significance levels would not be appropriate. Instead I report the minimum, maximum, standard deviation and outliers, for those variables that I believe it adds to the understanding, and whose interpretation contributes toward answering the research question. I test no null hypotheses, as this would not be supported by the limited data set, instead I am highly conscious of the fact that I am not drawing generalizable conclusions. The case method, which I will describe in further detail below, will enable disaggregation of the data and hence illuminate the underlying causes of the observed findings in the individual situations.

3.3.2 Framework for Governance Pressures

In order to lend structure to the discussion section, I map the expected developments in corporate governance indicators as predicted by agency prescriptions. This will be subject to my interpretation of what agency theoretic rhetoric suggests for each parameter, and as such will be a representation of reality, as opposed to a comprehensive account of all agency prescriptions. The primary aim of this section is to provide a starting point for the subsequent discussion.

3.3.3 Case-based Tests

Introducing cases to the analysis will enable me to dig deeper into interesting developments or outliers, in order to find the drivers of the developments observed. This is very much in line with the clinical research methodology that "*augments insights from statistical analysis with more in-depth examination of individual firms*" (Tufano 2001, p. 181). My hope is that this kind of analysis will provide answers as to how socialised governance theories can be made concrete by real-world examples. It is important to note that I have chosen not to conduct interviews; the events underlying this paper took place many years ago, therefore is unlikely that accounts of those events would be accurate today, especially taking into account hindsight biases.

When presenting the cases I will give some context surrounding the external and internal environment of the specific bank, as well as some information about the most important actors if deemed relevant. Thereafter I will explain which variables caused this particular bank to be selected as a subject of more intense scrutiny. Finally I will discuss if the observed developments, though surprising viewed with basis in traditional corporate governance theory, can be understood using behavioural governance theories.

In conclusion, I have chosen to go about my research in way that is highly consistent with the clinical research approach. Complementing my dataset with case-based research will glean a more profound understanding of the underlying mechanisms behind the observed developments. In this way I hope to move toward a more holistic perspective on corporate governance, understanding that it is "*a social process, which is not isolated from (…) factors such as power, legislation, social relationships and institutional contexts*" (Ardalan, 2007, p. 511).

4. Data

4.1 Time Period

The analysis in this paper will be based on observations at three points in time. These have been chosen to reflect the pre-crisis (2007) state of affairs, the situation in the midst of the crisis (2010) and how the situation is today, using the most recent data available (2014). This method will enable analysis of the *state* of corporate governance indicators as well as give an indication of the *development* they have undergone during the crisis stage and in its wake. Corporate governance practices and structures are expected to change gradually toward a desired state, therefore it is beneficial to analyse their development over a time period of a few years. The specific dates chosen are linked to their significance for the chain of events related to the financial crisis, and the wish to include the most recent data available.

4.2 Selection of Observation Group

The sample is limited to the Nordic financial institutions that have banking as their primary activity, and have thus excluded insurance providers and asset management firms. This will make comparison across firms easier as it increases homogeneity within the sample. Due to considerations of this kind I have excluded Icelandic banks from the sample group as I consider the Icelandic chapter of the financial crisis to be a situation unto itself, characterised by the unique national environment. The other Nordic countries: Denmark, Finland, Norway and Sweden are the focus of this paper, as I believe that they share many common attributes especially a distinct Nordic approach to corporate governance.

In creating the group I have sought to include those financial institutions that are important actors in the Nordic countries with respect to being important to broad society and subject to public scrutiny, in order to be able to identify the effect of stakeholder pressures from a range of sources. I have chosen to use the six Nordic banks included in the European Banking Authority's (EBA) 2014 list of globally systemically important institutions for my sample, as I believe that these banks are likely to face the myriad corporate governance issues that arose as a result of the financial crisis. Furthermore I believe that this approach constitutes an objective criterion for sample selection, as the EBA has classified European banks in this way in order to highlight the financial institutions that contribute to systemic riskiness in the global financial system. This classification has been done since 2013, thus the inability to consider the systemic importance of the sample group at the other time nodes (2007 and 2010) has the potential to bias the sample. However, the chosen six have historically been the leading financial institutions in this geography and I therefore deem the problem to be minimal.

Though this paper aims to address Nordic corporate governance there is no Finnish bank in the sample, the reason for this is that the largest Finnish bank OP-Pohjola engages in considerable other activities that would harm the homogeneity of the sample; there are no other sizeable listed Finnish banks. However, over 45% of the Finnish banking market (whether classified by public loans or deposits) is controlled by other Nordic banks in the sample group. A further weakness is related to having a small sample group, which is partly inevitable given the consolidated Nordic banking market, and is of lesser relevance in this study, as I will not attempt to draw generalisable results. This paper will therefore include the following banks (domicile): Danske Bank (DK), DNB (NO), Handelsbanken (SE), Nordea (SE), SEB (SE) and Swedbank (SE). Despite the overrepresentation of Swedish banks, all six banks have the Nordics as their home market, as well as several of them having a large focus on the Baltics.

4.3 Collection of Data

In order to reduce errors connected with using databases I have chosen to extract most data from company filings, primarily annual reports but also corporate governance reports as available on company websites. In some cases the prior experience of board members is not stated in company annual reports and in those instances I have used sources like the Orbis database, LinkedIn and newspaper articles. For data related to capital markets I have used the S&P Capital IQ database.

4.4 Description of Observation Group

As described above, the sample group includes four banks domiciled in Sweden, and one bank domiciled in Denmark and Norway respectively. As well as national differences in corporate governance regulation and macroeconomics, the individual banks were affected differently by the global financial crisis due to different geographical and asset class exposures, business mixes and capital structures. The table below indicates the markets that account for more than 10% of the banks' operating income. Both SEB and Swedbank have a great focus on the Baltic region, something that will be discussed further later.

Country	**Danske Bank**	**DNB**	**Handelsbanken**	**Nordea**	**SEB**	**Swedbank**
Denmark	X			X		
Finland	X			X		
Norway	X	X	X	X		
Sweden			X	X	X	X

Table 2: Share of Operating Income >10% per Market, Source: Company Annual Reports

In order to give an overview of how the banks fared during the financial crisis and thereby give an indication of the reason for the observed changes in corporate governance indicators, I will consider performance data for each bank. I will use four key metrics in order to analyse the performance of each bank and the average of the sample group: (1) y-o-y market capitalisation changes, (2) price to book ratio, (3) return on assets and (4) non-performing loan ratio.

Date	**Danske Bank**	**DNB**	**Handelsbanken**	**Nordea**	**SEB**	**Swedbank**	***Average***
31-Dec-06	100.00	100.00	100.00	100.00	100.00	100.00	*100.00*
31-Dec-07	91.29	101.37	96.56	102.33	76.81	73.64	*90.33*
31-Dec-08	27.72	30.75	57.77	51.99	28.38	24.63	*36.87*
31-Dec-09	59.12	97.45	93.64	107.09	67.44	64.20	*81.49*
31-Dec-10	62.77	118.03	98.51	107.66	84.35	85.18	*92.75*
31-Dec-11	42.77	94.27	82.92	78.41	60.30	76.42	*72.52*
31-Dec-12	58.35	103.14	107.91	91.33	83.03	108.83	*92.10*
31-Dec-13	78.02	144.25	147.39	127.38	127.41	155.09	*129.92*
31-Dec-14	111.78	145.24	171.03	133.87	148.80	168.26	*146.50*

Table 3: Rebased Market Capitalisation, Source: S&P Capital IQ

The first two measures of bank performance are important as they indicate how capital markets value the firms; market capitalisation is used as opposed to share price as several banks had rights issues over the period. As the table above shows, banks' market capitalisation (rebased at 100, 2006-12-31) was drastically affected by the financial crisis, on average declining from an average of 90.33 at year-end 2007 to 36.87 by year-end 2008. On average the banks' stock did not recover to pre-crisis levels until 2012. Along with the stark drop in the banks' market capitalisations, the price-to-book ratio experienced a dramatic reduction from an average of 1.62 to a range of 0.60-1.27 over the crisis period. Even at the end of 2014, six years after the outbreak of the crisis, this ratio has on average not exceeded its pre-crisis level.

Date	**Danske Bank**	**DNB**	**Handelsbanken**	**Nordea**	**SEB**	**Swedbank**	***Average***
31-Dec-07	1.35	1.62	1.88	1.87	1.53	1.47	*1.62*
31-Dec-08	0.34	0.48	1.10	0.82	0.55	0.31	*0.60*
31-Dec-09	0.81	1.01	1.60	1.31	0.99	0.72	*1.07*
31-Dec-10	0.96	1.27	1.58	1.36	1.27	1.17	*1.27*
31-Dec-11	0.54	0.84	1.23	0.93	0.82	1.01	*0.90*
31-Dec-12	0.68	0.92	1.45	1.08	1.07	1.38	*1.10*
31-Dec-13	0.87	1.29	1.89	1.40	1.61	1.88	*1.49*
31-Dec-14	1.05	1.18	1.94	1.35	1.70	1.93	*1.52*

Table 4: Price to Book Ratio, Source: S&P Capital IQ

Grove et al (2011), assert that earnings are the underlying drivers of performance and therefore recommend the use of the return on asset (ROA) ratio in order to measure banks' efficiency in value creation (Grove et al., 2011). We can read from table 4 below: banks' efficiency in using assets to generate revenue declined from an average of 0.7% pre-crisis to just 0.1% in 2009. Similarly to the price to book ratio, the return on asset ratio has on average yet to exceed its pre-crisis level. Loan quality is a great operational concern in financial institutions as rating agencies use this to assess banks; I therefore use the non-performing loan ratio to demonstrate loan quality. This ratio is defined as non-performing loans (non-accrual loans, restructured loans and loans 90 days past due) to total assets, and is shown as n/a when S&P Capital IQ is unable to retrieve data due to limited financial reporting. The data shows that this ratio on average increased nine-fold in the years between 2007 and 2010, indicating that the banks' loan quality was dramatically reduced as a consequence of the crisis.

Date	Danske Bank	DNB	Handelsbanken	Nordea	SEB	Swedbank	*Average*
31-Dec-07	0.5%	1.1%	0.6%	0.9%	0.6%	0.8%	*0.7%*
31-Dec-08	0.0%	0.5%	0.6%	0.6%	0.4%	0.6%	*0.5%*
31-Dec-09	0.1%	0.4%	0.5%	0.5%	0.1%	(0.6%)	*0.1%*
31-Dec-10	0.1%	0.8%	0.5%	0.5%	0.4%	0.4%	*0.4%*
31-Dec-11	0.1%	0.7%	0.5%	0.4%	0.5%	0.7%	*0.5%*
31-Dec-12	0.3%	0.6%	0.6%	0.4%	0.5%	0.8%	*0.5%*
31-Dec-13	0.3%	0.7%	0.6%	0.5%	0.6%	0.8%	*0.6%*
31-Dec-14	0.2%	0.8%	0.6%	0.5%	0.7%	0.8%	*0.6%*

Table 5: Return on Assets, Defined as Operating Income / Total Assets, Source: S&P Capital IQ

Date	Danske Bank	DNB	Handelsbanken	Nordea	SEB	Swedbank	*Average*
31-Dec-07	0.3%	0.4%	0.1%	0.2%	0.3%	0.1%	*0.2%*
31-Dec-08	0.9%	0.9%	0.2%	0.2%	0.6%	0.6%	*0.6%*
31-Dec-09	1.8%	1.5%	0.2%	0.4%	n/a	2.2%	*1.2%*
31-Dec-10	n/a	1.5%	n/a	n/a	n/a	2.0%	*1.8%*
31-Dec-11	n/a	1.4%	0.2%	n/a	n/a	1.3%	*1.0%*
31-Dec-12	n/a	1.3%	0.2%	n/a	0.6%	0.8%	*0.7%*
31-Dec-13	1.8%	1.3%	0.2%	n/a	0.4%	0.4%	*0.8%*
31-Dec-14	1.7%	1.0%	0.2%	n/a	0.4%	0.3%	*0.7%*

Table 6: Non-performing Loan Ratio, Defined as Non-performing Loans / Total Assets, Source: S&P Capital IQ

The performance of the various banks over the crisis period is mixed, and the different performance indicators give somewhat contradictory information. DNB, Handelsbanken and Nordea consistently performed above average with regards to market capitalisation, however the Norwegian bank had the highest ratio of non-performing loans in the group in 6/8 time periods. Danske Bank and Swedbank were relatively persistently among the worst performers in the sample, on all parameters. SEB suffered in the capital markets with below average figures on both valuation parameters, but performed slightly better than average on the other performance related data points.

5. Results

In this section I will present the key findings from my analysis of the sample group. I will start by giving an overview of board composition and organisation, and then present my findings as to the board members' other assignments and connections. Finally I will discuss some relevant information as to the ownership and control of the banks. This section will be supported by data collected from the banks' annual reports.

5.1 Board Composition and Organisation

The traditional backbone of corporate governance is agency theory, which relates to the interaction between agents and principals. Corporate boards represent firms' principals, and therefore play an important role in governance. Issues related to boards' size, independence and composition have long been discussed, however the financial crisis has brought additional aspects to the attention of practitioners: some of these are discussed below (Becht et al., 2011).

	2007	**2010**	**2014**
Average board size	12.5	12.3	10.8
Turnover		46%	36%
Number of nationalities	3.0	3.3	3.3
Share of directors independent	80%	76%	79%
Share of directors, banking experience	56%	56%	68%
Average number of meetings	15.2	14.2	13.0
Audit committee (Y/N)	6/6	6/6	6/6
Turnover		58%	72%
Compensation committee (Y/N)	4/6	6/6	6/6
Turnover		73%	65%
Risk committee (Y/N)	1/6	3/6	6/6
Turnover		0%	19%

Table 7: Board Composition and Organisation

The average board size over the sample period has not changed dramatically. However, the average size fell from 12.5 to 12.3 between 2007 and 2010, whereas by 2014 the average was 10.8. The median shows a similar trend, being 12.5 both in 2007 and 2010, while the median was 11.0 in 2014. The variance in board sizes has also decreased from 3.5 in 2007 to 3.0 in 2014. The largest and smallest boards in 2007 had 15 and 10 members, in contrast to in 2014 when the largest and smallest boards had 13 and 8 members. Looking at the individual banks, only two increased their board sizes between 2007 and 2010 (three decreased and one was unchanged) while no boards were larger in 2014 than they had been in 2010. Only one bank did not decrease the size of its board between 2010 and 2014, SEB's board size remained unchanged at 13, despite being the largest in the sample group.

With regards to turnover (defined as the number of new directors, divided by the number of directors in the previous period) I choose to disregard employee representatives as they are elected to serve the interests of the employees and are subject to different rules with regards to their election and replacement. The average turnover of shareholder elected directors decreased from 46% between 2007 and 2010, to 36% in the following four years. Outliers impact these averages in each period as illustrated by the fact that the median in 2007-2010 was 41% and in 2010-2014 was 29%. Four out of six banks exhibited higher turnover in the first period, notably Swedbank had a turnover rate of 88%. In contrast, only two banks had higher turnover in the second period: Danske Bank replaced 78% of its board whereas Handelsbanken had the lowest turnover, only replacing 10%. The link between turnover and how the banks fared in the crisis is somewhat diffuse as some of the banks that weathered the crisis best have among the highest and lowest turnovers; DNB had among the highest turnovers in each period whereas Handelsbanken had the absolute lowest turnover in each period. This seemingly contradictory statistic will be further analysed in the subsequent discussion (see section *7. Discussion*), as well as which directors seem most vulnerable to being replaced.

The number of nationalities on a board works somewhat as a proxy for board diversity as well an important way to gain access to diverse geographic markets through local expertise and connections. Although there is no strong positive trend, there is a slight increase in the average number of nationalities represented in 2014 relative to 2007. I find it interesting that the banks on average have so few nationalities represented, as all the banks in sample operate across the Nordics, with two of them having considerable market shares in the Baltic countries. In 2014, Swedbank had just one nationality (Swedish) represented on its board despite having market shares of up to 54%[8] in the Baltic countries. DNB also only had one nationality (Norwegian) represented in 2014, however 80% of the group's income came from its Norwegian home market in 2014, thus this is less surprising.

When analysing the independence of directors I have chosen to include only shareholder-elected directors, as employee directors, though non-independent, do not serve as a means for management or owners to entrench the board. The average degree of director independence (as defined by the banks themselves) has been fairly steady over the period. However due to significant outliers, the variance among the banks has been high, and nearly doubled from 2007 to 2014 from 3.7% to 6.8%. The most remarkable outlier was Handelsbanken, which in 2014 had only 30% independent directors, a violation of the Swedish Corporate Governance code. As the banks are able to define independence somewhat subjectively, viewing this data at the aggregate level can be misleading, I therefore abstain from any interpretation in this section. Director independence will be an important subject for further discussion in section *7. Discussion*, where disaggregation will provide important insights.

The average share of directors with banking experience not only says something about which competences are desirable among board members and hence the grounds for their selection, it also says something about the ability for the board to monitor management within so complex a business as a financial institution. Indeed directors' lacking banking experience was widely discussed following the financial crisis, and was deemed to be contributing factor to their ineffective monitoring. Adams (2012) conjectures that banks may have found it difficult to recruit directors with the requisite knowledge due to an overemphasis on independence that greatly restricted the candidate pool. Kor and Misangyi (2008) hypothesise that directors with industry experience serve as a substitute for competences that management lacks, this could be have the reverse corollary that competent management teams do not require boards with industry specific experience. Westphal and Zajac (2013) discuss that management's propensity to seek advice from directors as opposed to other CEOs depends on a variety of factors, including: social ties, demographic similarity and firm performance.

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[8] Swedbank's market share in the Estonian private market for deposits was 54% in 2014.

There has been a positive trend in the share of directors with banking experience, from 56% in both 2007 and 2010, to 68% in 2014. This trend is more marked if we instead look at the average share of non-employee representative directors with banking experience (though still including the CEO in those cases that he/she is on the board). Among directors not employed by the bank (except the CEO), on average, 40% had banking experience in 2007 whereas in 2010 the portion was 45%. By 2014, on average 57% of directors had banking experience. Of course the different sizes of the boards make the sensitivity to the addition of new director vary.

An interesting observation is that directors with banking experience might not only have been added to the board in order to enhance the ability to monitor management. It is possible that their similar demographic or socio-cultural features with respect to other board members also contributed to their selection (Khurana and Pick, 2005). This seems particularly salient in SEB where a massive 82% of non-employee directors have banking experience, a trait they have in common with the Wallenberg brothers who both serve on the board and whose family investment company owns 20.9% of the bank.

The frequency with which boards meet does not have a clear interpretation. In the sample, the average number of meetings per year decreased over the period, from 15.2 meetings in 2007 to 14.2 in 2010 and only 13.0 in 2014. All else equal, you would expect that boards are better able to perform their monitoring function the more often they meet (Grove et al, 2011). However, on the other hand it shows how busy the board members are, especially if they have other assignments that can be presumed to have similar meeting frequencies. This reduces the ability for the board to monitor management, as they cannot fully prepare for meetings. Given the crisis situation for banks in both 2007 and 2010, I find it logical that the boards would meet more often in those years, and that they would meet less often in a "normal" year like 2014. Another consideration is that the more often board members meet, the greater the opportunity for them to create personal ties and socialise each other, thus detrimentally influencing their ability to perform their tasks objectively (Westphal and Zajac, 2013). This is also related to if the board members have other ties and forums in which to influence each other outside of the boardroom of the focal firm, something I will get back to.

The presence of board committees gives an indication as to which issues boards focus on, and what they deem their primary objectives to be. As the data shows, all boards had an audit committee throughout the period indicating that monitoring is seen an important board function. In 2007 only 4/6 of the boards had compensation committees, however by 2010 all boards had put in place a committee that specifically addressed management remuneration. By contrast, in 2007 only one bank had a committee dedicated to tackling the bank's risk exposure. There is a clear trend for increased risk focus in all six banks, both with regards to the increased prevalence of risk committees but also the heightened emphasis on risk management in reporting documents.

5.2 Board Inter-linkages

Board members are elected based on the competences they can bring to the company, as well as for their connections and ability to secure precious resources for the firm: not least credibility (see Withers et al., 2011 for a survey on director selection). Board positions are highly coveted due to their high job status and generous remuneration, therefore board members typically have experience from prestigious roles at large companies. These individuals are in high demand and so, often have multiple board assignments; this has lately become especially pertinent for certain female directors following regulation requiring gender quotas on boards.[9] The data shows that the number of other assignments held by the board members of the banks in the sample group increased from 2007 to 2010, and then decreased below the 2007 level in 2014. The upswing in 2010 might be due to the high demand for expert competence as described in the section on banking experience above. It must be noted that there is great variance within the sample, some board members having up to 12 other assignments whereas others have none. Overall we see a decrease in other assignments, something that may be related to the greater risk focus in banks, and therefore expanded responsibility of boards.

[9] Norway imposed quotas on boards in 2008, requiring 40% of directors to be female. Sweden is considered imposing similar regulation in 2016.

	2007	2010	2014
Danske Bank	6.1	6.0	3.9
DNB	2.3	3.2	3.0
Handelsbanken	4.8	4.7	4.6
Nordea	4.4	4.5	4.3
SEB	6.1	6.1	5.8
Swedbank	4.4	4.7	3.6
Average	*4.7*	*4.9*	*4.2*

Table 8: Number of Other Assignments, Board Members

The issue of board members holding other positions could be detrimental to the firm as the time directors are able to spend monitoring the focal firm becomes limited. However board members' outside engagements could benefit the firm as it gains access to a broader network of resources and connections. This positive effect is of course greatest when directors have connections in companies/the public sector that match the resource requirements of the firm, and when directors have diverse networks (Carpenter and Westphal, 2001). Within the sample group, several banks' boards show tendencies toward a concentration of other assignments in a few select firms. This is particularly noticeable in the board of Handelsbanken where 8/14 of board members have experience from at least one of four large Swedish industrial companies. This begs the question if the networking of directors is beneficial to the firm or to themselves, though the two are of course not mutually exclusive. Table 9 below indicates the degree to which board members are interlinked, which I have defined rather crudely, as sharing a current or previous affiliation with a firm, with another board member from any of the three time nodes.

	Danske Bank	**DNB**	**Handelsbanken**	**Nordea**	**SEB**	**Swedbank**	***Average***
Interlinks	75%	69%	71%	53%	83%	24%	*63%*
Industry	Charitable	n/a	Industrial	n/a	Banking	Firm	*n/a*

Table 9: Interlinks Between Board Members

On average, 63% of the directors have an inter-linkage with at least one other director, though this figure would have been 70% if Swedbank were disregarded. The situation in Swedbank is somewhat unique, only 4/17 directors have interlinks from companies outside of the Swedbank group, however 7/17 directors have held positions in Swedbank affiliated companies. In contrast to the other banks, a large proportion of Swedbank directors have experience from the public sector, including government.

One would expect some degree of inter-linkage to be inevitable given the nature of small Nordic societies, however the high percentage taken together with the industry concentration observed, suggests that this is no coincidence. The industry connection is of course correlated with the large owners in the firm, which will be discussed below.

5.3 Ownership and Control

Ownership, specifically the presence of so-called blockholders and their characteristics, constitutes an important facet of corporate governance theory. The reason for this is that blockholders have the opportunity to exert significant influence over the management of a firm: they have incentives to monitor and the means to expropriate (Holderness, 2003). Within the Nordic corporate governance context, I deem the expropriation issue to be minimal due to high investor protection and transparency.[10] The issue of monitoring is however pertinent, though blockholders have different incentives depending on their nature. Pension funds are common owners of banks, however family foundations are also prevalent owners in the Nordic region and their goals may differ from other stakeholders. On average the banks in the sample have two blockholders (defined as an ownership stake >5%), which is relatively stable over time. Two of the banks in the sample, Nordea and DNB, have significant government ownership, with the Norwegian government owning on average 34% of DNB. Interestingly these are two of the banks that proved most resilient to the crisis, perhaps due to the reputational effects of government ownership.

[10] A notable exception to this is Sverker Martin-Löf, chairman of the Industrivärden AB group and board member of Handelsbanken in 2007, 2010 and 2014, who faced allegations of misuse of corporate resources in 2015 and was subsequently forced to leave all board assignments.

On average, two blockholders own approximately 30% of the banks, though this percentage has decreased slightly over the observation period. Each bank has/has had at least one blockholder that is a pension fund, mutual fund or government, which can be expected to be relatively passive owners. In 2014, financial institutions became blockholders in both SEB and Danske Bank; the new owners, Swedbank Robur fund and Cevian Capital have active investment strategies.

	2007	**2010**	**2014**
Average number of blockholders	2.0	2.3	2.3
Average share held by blockholders	32%	33%	30%
Significant government stake (>5%)	2/6	2/6	1/6
Significant government stake (>15%)	2/6	2/6	1/6
Significant government stake (>25%)	1/6	1/6	1/6

Table 10: Blockholders and Government Ownership

Other notable owners are the Industrivärden group as a large owner of Handelsbanken, and the AP Møller foundation and companies as owners of Danske Bank. The large Swedish investment group ostensibly exerts significant control over Handelsbanken, with its directors serving as chairmen of the bank's board in 2007, 2010 and 2014. Furthermore 9/14 of all individuals who acted as Handelsbanken directors (2007, 2010, 2014) simultaneously held positions within one of the Industrivärden companies. By contrast the AP Møller foundation and companies only had one representative on Danske Bank's board in 2007 and one in 2014, however in 2011 Eivind Kolding a member of AP Møller's board, became CEO of the bank.

SEB's largest owner, Investor AB, is an investment company owned and controlled (50% of the votes in 2014) by the Wallenberg family. In fact, the bank is synonymous with the family, André Oscar Wallenberg founded it in 1856 and its chairman Marcus Wallenberg (2007, 2010 and 2014) is the fifth generation of the family to work in the bank. The family controls the bank through voting rights of: 20.9% (2014) held by Investor AB and 1.3% (2014) held by Wallenberg foundations. The family exerts control not only by holding shares with extra voting rights; the members of the bank's board have significant ties to Wallenberg companies. Of all board members in 2007, 2010 and 2014: 9/19 have been employed or held board positions in a company within the Wallenberg-sphere.

		2007	2010	2014
Danske Bank	Largest shareholder	22%	23%	23%
	2nd largest shareholder	12%	10%	9%
	3rd largest shareholder	nd	nd	nd
DNB	Largest shareholder	34%	34%	34%
	2nd largest shareholder	11%	10%	9%
	3rd largest shareholder	4%	5%	6%
Handelsbanken	Largest shareholder	11%	11%	10%
	2nd largest shareholder	11%	11%	10%
	3rd largest shareholder	4%	3%	2%
Nordea	Largest shareholder	20%	21%	21%
	2nd largest shareholder	9%	20%	4%
	3rd largest shareholder	4%	4%	3%
SEB	Largest shareholder	20%	21%	21%
	2nd largest shareholder	10%	8%	7%
	3rd largest shareholder	4%	7%	6%
Swedbank	Largest shareholder	22%	9%	9%
	2nd largest shareholder	8%	7%	9%
	3rd largest shareholder	2%	4%	4%

Table 11: Ownership Stake of Largest Shareholders, % Voting Rights

Ownership structures in banks have implications beyond those that are applicable for non-financial firms. Firstly, equity stakes in banks are typically low; hence shareholders are incentivised to take excessive risks due to limited liability and asymmetric payoffs (Bebchuk and Spamann, 2009). Furthermore the structure of equity holdings impacts the risk behaviour of owners and the impact of regulation that aims to mitigate risk. Laeven and Levine (2009) hypothesise that diversified owners are more likely to advocate for more bank risk-taking than debt-holders and non-shareholder managers, due to their highly leveraged bet on the value of banks' equity. Diversified owners have stronger incentives to pursue risky strategies than non-shareholder managers; hence the decoupling of owner and managerial incentives could mitigate excessive risk (Bebchuk and Spamann, 2009). As seen above in table 11, only Swedbank is classified as widely held (2010, 2014) as defined by Laeven and Levine (2009), with no shareholder with a stake >10%. Some of the other banks also have fewer incentives to increase risk; this includes DNB and Nordea that have significant government ownership stakes, and SEB that is primarily family-owned, suggesting that their incentives could differ from the rest of the sample. A more detailed analysis of the impact of ownership structure on risk incentives will follow in section *7.3*.

	2010	**2014**
Danske Bank	N	Y
DNB	N	N
Handelsbanken	N	N
Nordea	N	N
SEB	N	N
Swedbank	Y	N
Total	*(1/6)*	*(1/6)*

Table 12: CEO Change

The prevalence of CEO change (defined as a different CEO from the previous time node) is low in the group, despite the banks experiencing such bad performance across the period. Swedbank replaced its CEO in 2009 as well as replacing its long-time chairman the year after. The bank had received widespread criticism for its contribution to the Baltic banking crisis; commentators speculated that the bank had continued lending vociferously despite signs of the impending crisis. Danske Bank appointed a new CEO in 2011 from its board; Eivind Kolding's previous experience was from the shipping industry. In 2013 following many deeply unpopular initiatives he was replaced by Thomas Borgen: an internal hire with many years of banking experience. The surprisingly low incidence of CEO change will be elaborated on in the upcoming discussion where behavioural theories will provide insights as to this ostensible paradox (see section *7.3*).

6. Framework for Governance Pressures

The aim of this section is to develop a basis for the subsequent discussion by identifying the prescriptive pressures for change over the financial crisis period. However, this section will not discuss the actual changes in corporate governance in the sample group as this has been put forth in section *5. Results*, and will be elaborated on at length in section *7. Discussion*. In order to contribute toward answering my research question, the sections below are as focused as possible on the banking sector.

6.1 Expected Developments According to Agency Theoretic Prescriptions

As a result of the dual social levels of constraints on agency, developments in corporate governance in the sample group could experience deviations from what traditional agency theory would have predicted. In table 13 below, I hypothesise regarding how agency theory would have expected the mapped indicators to evolve post-crisis. In the following discussion (see section 7. Discussion) I will compare these predictions with the actual outcomes and theorise as to why discrepancies occurred.

Category	Indicator	Expected Change
(1) Board Composition and Organisation	Board size	Unclear
	Director turnover	+
	Diversity	Unclear
	Director independence	+
	Banking experience	+
	Meeting frequency	Unclear
	Audit committee	+
	Compensation committee	+
	Risk committee	+
(2) Board Inter-linkages	Other assignments	Unclear
	Interlinks	Unclear
	Industry concentration	Unclear
(3) Ownership and Control	Number of blockholders	Externally determined
	Share held by blockholders	Externally determined
	Government stake	Externally determined
	CEO change	+

Table 13: Changes Prescribed by Agency Theory

6.1.1 Board Composition and Organisation

Agency theory has devoted a great deal of attention to optimal *board size*, with theory centring on the contrasting benefits of reduced free-riding and greater resource supply for the focal firm. Coles et al. (2008) discuss an equilibrium board size depending on the complexity and R&D intensity of firms, and find that firm performance increases with board size in complex firms. Since banks are complex organizations, we would expect them to have (on average) larger boards than some other, less complex, non-financial firms. It is, however, difficult to say exactly what number of additional directors the added complexity of banking activities justifies. Armour et al. (2016) propound that banks have faced conforming pressure to decrease the size of their boards over the past decade. Thus, since poor bank performance and governance failures during the crisis should lead the owners to improve corporate governance, we might expect to observe small decreases in board sizes, at least for the banks with the largest boards.

We should also expect the owners to replace some of the banks' directors and the CEO. Director replacement is one of the main mechanisms through which the owners and other stakeholders can discipline the directors and, through them, the firm's managers. Therefore, we should expect to observe higher *director turnover* during the crisis. Given the advisory role of boards, director *diversity*, that increases e.g. knowledge of foreign markets, is supported by agency prescriptions, however this is dependent on the specific resource needs of the focal firm (Adams et al., 2010).

Some of the main criticisms levelled at banks centred on their alleged weak corporate governance and lacking oversight by actors within and outside the firm. There was overwhelming support for agency prescriptions advocating *director independence*, as this would ostensibly increase monitoring of management and so mitigate excessive risk-taking (Adams et al., 2012). As has been discussed, excessive risk-taking in banks can in fact be largely attributed to their leveraged capital structures, as opposed to insufficient monitoring of management, however in the aftermath of the crisis, media attention was focused a few policy areas where banking governance was highly vilified. In the US this was particularly relevant with regards to directors' *banking experience* after it was uncovered that Lehman Brothers' board included a navy admiral, an actress and a theatre producer (Berman, 2008). As lack of director knowledge was pointed to as one of the main causes of banks' risky policies prior to the crisis, we should expect an increase in specialized knowledge on the board, as an attempt to mitigate this.

There is no generalised policy prescription regarding *meeting frequency* as theory is divided as to whether increased frequency provides greater scope for monitoring, or if it affords directors insufficient time for preparation. The prevalence of different types of committees is indicative of the board's commitment to various issues. *Audit* and *compensation* have always been important functions of the board as they relate to the two agency mechanisms of monitoring and bonding. Since the financial crisis, *risk* management has become increasingly discussed by the media and regulatory bodies and been frequently prescribed due to the belief that it will decrease excessive risk-taking; the efficacy of these measures will be examined in the upcoming discussion (Basel Committee on Banking Supervision, 2010).

6.1.2 Board Inter-linkages

Agency literature is divided on the subject of the net effect of directors with *other assignments*, for while busy directors have a greater network of resources to contribute to the focal firm their attention is necessarily divided, reducing the quality of their monitoring ability (Field et al., 2013). *Inter-linkages* between board colleagues are not addressed within the agency literature, however they are an important part of the behavioural governance literature and will be addressed in the subsequent discussion, as will *industry concentration*.

6.1.3 Ownership and Control

The group of ownership and control indicators are different from those addressed above as these variables are externally determined. A firm cannot impact its ownership structure with regards to which its owners are, or what share they hold. Following the crisis one might expect ownership changes, e.g. as a result of attempts to diversify holdings, or due to government bailouts but these changes are not within the control of the focal firm.

The one variable within this group that can be endogenously determined is that of *CEO change*. The hiring and firing of CEOs is one of the key ways directors are able to exert influence over management, thus compelling them to act in the interests of shareholders or risk being replaced (Adams et al., 2010). Given the poor performance of banks during the financial crisis and the negative externalities that were imposed on widespread stakeholder groups, there was a prevailing sentiment that CEOs should be held responsible, thus CEO change is expected to be prevalent.

7. Discussion

In what follows I will discuss the results of my data analysis through a combined agency and behavioural governance lens. I will make use of the structure developed above to make sense of the observed developments, and comment on the relevance of behavioural perspectives on corporate governance. The discussion section will be structured similarly to the results section (see *5. Results*), with subsections dedicated to each of the three main groupings of variables. However, there is a high degree of interdependency between the social factors affecting agents and as such they manifest themselves in different ways in different variables, thus there will be some inevitable overlap between the subsections. This section will finish with a short discussion surrounding what lessons can be drawn from the financial crisis.

7.1 Board Composition and Organisation

7.1.1 Board Size, Director Turnover and Meeting Frequency

The agency prescription regarding board size is unclear, however given the strong trend for all banks in the sample to reduce the size of their boards over the period; there must have been some pressure that induced this change. One reason that boards could have become smaller is that directors were fired and not replaced; director turnover will be discussed shortly. However, such obvious conformity in the face of no clear prescriptive policy suggests that pressures beyond those of agency theory contributed to this trend. Westphal et al. (2001) suggest that board interlock ties can contribute to mimetic decision-making, suggesting that policies diffuse across firms due to social ties. If influential actors start to reduce board sizes, framing the policy in good governance rhetoric, it could encourage other actors to engage in symbolic management. Adopting socially legitimizing policies is a self-reinforcing process and the reduction in variance in board size over the period lends further strength to this hypothesis.

Some researchers suggest that symbolic management is a form of socio-political process whereby powerful actors advance their interests; smaller boards are likely to be more cohesive with greater opportunity for directors to influence one another, thus enabling prominent actors to expand their span of control. The banks with the largest reductions in board size were Nordea and Handelsbanken who both have powerful owners that dominate their boards, Sampo Oyj and Industrivärden respectively. Interestingly in both these banks the other large owner is relatively passive, allowing the dominant owner to gain disproportionate influence.[11] This lends some credence to the behavioural interpretation of reduced board sizes as means for powerful actors to realise their goals.

Director turnover would be expected to be high following poor performance during the financial crisis, adhering to agency theoretic prescriptions of owners' monitoring of directors' performance. Indeed director turnover was on average higher in the crisis period (2007-2010) than in the following period (2010-2014) suggesting that banks bent to agency pressures to replace underperforming directors. One would also expect director turnover to be the highest in the banks that performed the worst during the crisis. Swedbank exhibited by far the highest level of director turnover at 88% (2007-2010) compared to the peer group average of 46%. Together with Danske Bank, it performed consistently worse than the sample average, however the Danish bank exhibited the lowest post-crisis level of director turnover (30% from 2007-2010). This somewhat contradictory statistic indicates that firm performance is not the only determinant of director turnover; both the characteristics and networks of directors could have an impact. For example, Swedbank's directors had by far the lowest level of inter-linkages in the group, whereas Danske Bank had among the highest. Factors related to the attributes and relationships of directors will be addressed in what follows.

Aggregate level data tells us nothing about the characteristics of the directors who were fired, and if they were the ones who contributed to the banks' poor performance. Behavioural theories however, suggest that the directors most vulnerable to being replaced are those who: do not engage in ingratiation, engage in elite threatening behaviour, and do not share similar demographic or other characteristics with their colleagues (Westphal and Zajac, 2013). Disaggregating the data shows that women and foreigners were disproportionately likely to be replaced in 67% of the banks in the first period, and 50% and 67% respectively in the second period. The fact that women were slightly less vulnerable to replacement than foreigners could be explained by the strong institutional pressures for female representation on corporate

[11] The largest (2007) /second largest (2010) owner of Nordea was the Swedish government, and the second largest owner of Handelsbanken (2007, 2010, 2014) was Oktogonen an employee profit sharing foundation.

boards, however as foreign female directors were the most exposed group overall it seems that female directors were protected by their demographic similarities as opposed to gender equality considerations. Behavioural theories can lend interpretation to this.

Westphal and Milton (2000) suggest that minorities can be effective if they have prior experience as minority board members. The reason for this is that female directors, used to being in the minority, could have learnt to capitalise on mechanisms for social influence. Using these mechanisms could enable them to achieve "in-group" identification, and its ensuing basis for misattribution of cause for negative performance to external factors; shielding them to some extent from blame for poor performance. Directors that are minorities due to their nationality seem to have been less successful in using social influence mechanisms to invoke e.g. similarity-attraction bias and thus increase their social standing on the board. One reason for this could be that the low level of diversity on the boards caused these directors to be perceived as very different from the in-group members. Hence other directors perceive their efforts to be less valuable, which in combination with lower levels of social ties make them more likely to be replaced. During the financial crisis period when there was considerable external pressure for director turnover, vulnerable directors being disproportionately blamed for poor firm performance is to be anticipated.

There is no clear agency theoretic prescription with regards to boards' meeting frequency. However, if one views the financial crisis as a disaster borne of insufficient oversight, increased meeting frequency might be recommended as it could potentially intensify monitoring. The data shows that the average number of board meeting instead decreased with every period, does that mean that the monitoring ability of boards has diminished? If one regards board meetings as opportunities for directors to exert social influence over one another, objective unbiased monitoring could be improved by reduced meeting frequencies. Given that most board work takes place outside of the boardroom in terms of preparation and committee work, perhaps fewer meetings could enable directors to participate more conscientiously and actively, thus improving decision quality.

Another interpretation for the decline in meeting frequency could be that directors' sizeable outside assignments render them unable to participate in as many board meetings, this matter will be discussed further below. It could also simply be that the banks are trying to reduce governance costs, thereby reducing the number of board meetings, which could go hand in hand with reduced board size in order to increase efficiency. It could also be that the rising prevalence of board committees, as will be discussed shortly, means that some issues are outsourced to committees; hence fewer normal meetings are necessary.

7.1.2 Board Member Characteristics

Agency theory only addresses diversity from the resource supply perspective, thus diversity is only valuable if directors can supply competences and networks that benefit the focal firm (Adams et al., 2010). Several of the banks in the sample have extensive international operations, thus diversity that enables access and insight to those markets is expected to be beneficial. Given the low initial levels of diversity it seems that the observed increase could potentially be in line with agency prescriptions. However neither SEB nor Swedbank had any Baltic directors at any time node, despite significant market shares in the region; gaining market-specific knowledge or networks does not necessarily motivate diversity with respect to nationality. Further, even the low levels of diversity measured may be overstated. Several directors classified as foreign on Swedish boards, belong to the elite Finnish, Swedish-speaking minority, that culturally identifies with, and often has extensive social and business ties to Sweden.

Work by Oxelheim and colleagues (2013) on Nordic non-financial firms suggests that low board diversity could be mitigated by domestic directors with international experience, who perform an advisory role with respect to foreign markets, though the two are complements not substitutes. Furthermore, CEO influence over the director selection process could reduce the probability of adding foreigner directors, as CEOs may fear that foreigners will be more independent, and likely to challenge them. The authors posit that foreigners are more likely to be represented on boards as representatives of international owners, which seems to be the case in Nordea's recruitment of two additional foreign directors in 2010. It is unclear to what extent Oxelheim et al.'s conclusions hold for financial firms, which face high degrees of supranational and local regulation and may have different resource requirements than other firms.

Behavioural theories suggest three potential explanations for low board diversity. One centres on the reasoning outlined above for why minority directors are vulnerable to being blamed for poor firm performance, and subsequently fired either due to perception biases, or in an act of "heads must roll" symbolic management (Westphal and Milton, 2000; Westphal and Zajac, 2013). The second is related to the actual, as opposed to perceived, ability of minority directors to perform their tasks effectively due to their insufficient social capital to influence decision-making, thus making them loath to join boards where they will be impotent (Kim and Cannella, 2008). Finally, social mechanisms are integral to which directors are selected for board appointments. As the coming section on inter-linkages will show, directors commonly recommend individuals, with whom them have previously had dealings, for board positions. Social identification with elite networks is therefore a key contributing factor, and one that minorities have difficulty acquiring in foreign countries. Board diversity increased somewhat over the observation period, however with reference to the competence and resource discussion above, it is unclear whether these directors were added due to their nationalities, or as behavioural theory suggests, perhaps despite them.

Pursuant to Oxelheim et al. (2013), the main driver of the small increase in director diversity is the addition of two foreign board members to Nordea's board in 2010, representatives of blockholder Sampo group. Swedbank instead experienced a reduction in diversity (3, 2, 1 foreign directors in 2007, 2010, 2014) despite being one of the banks with the largest international presence. In 2014 none of the bank's directors had experience from Baltic firms, and only one member of the Group Executive Committee was from a Baltic country; she was not responsible for a foreign business unit, but Head of Group Treasury. The other bank with a large non-Nordic presence is SEB, which despite a relatively high level of director diversity (5, 4, 5 foreign directors in 2007, 2010, 2014) had no directors from, or with experience from, the Baltic countries in which the bank operates.[12] It would therefore seem that director diversity is unnaturally supressed in the sample group, perhaps due to the behavioural reasons outlined above. For example, at SEB, CEO Annika Falkengren presumably exerts great influence over the board as she is a director (2007, 2010, 2014), this could have enabled her to block the appointment of foreign directors who she may have believed to be more likely to challenge her. It also possible that given strong external pressures for increased independence and directorial banking experience after the crisis, the issue of diversity received a low priority in recruitment considerations.

Few corporate governance policies have been so widely discussed in the media following the financial crisis as that of director independence. One reason is that given the dramatic negative externalities of bank failures, the media had tremendous incentives to vilify the "fat cat" corporate elite and uncover the real or imagined cronyism that contributed to lacking oversight. Regulatory bodies, like the Basel Committee on Banking Supervision, also stressed the importance of director independence from "*both the views of executives and of inappropriate political or personal interests*" (Basel Committee on Banking Supervision, 2010, p. 18). Given strong pressure from an array of stakeholders it is unsurprising that director independence was fairly stable at a high level over the period, though there was a slight decrease in 2010.

Interestingly, when Adams (2012) investigated the pre-crisis governance of US banks, she found that they were better governed than non-financial firms. She suggested that "*measures of governance that have been the focus of recent governance policies are insufficient to describe governance failures attributed to financial firms. Moreover, recent governance reforms may have to shoulder some of the blame placed on boards of financial firms*" (Adams, 2012, p. 7). This is indicative of what has previously been discussed in this paper: agency prescriptions for incentive alignment in banks promote shareholder orientation, which may exacerbate the very risky behaviours they aim to mitigate. This irregularity in banking governance is well known, which raises the question: could symbolic management be another

[12] The foreign experience of directors is difficult to ascertain and I therefore rely on the information provided in the banks' annual reports, this is deemed to be sufficient as it is it reasonable to expect that any relevant experience will be presented.

contributing factor to high directorial independence? Director independence has become a legitimising policy regardless of its actual benefits for banking governance. It is therefore perhaps not surprising that there is substantial evidence in the corporate governance literature of firms appointing directors with social, instead of formal ties to management – and to each other (Bednar, 2012). Furthermore the diffusion of similar policy content across firms could be a result of directors' social learning; board ties can contribute to mimetic decision-making regarding governance systems (Westphal et al., 2001).

As has been mentioned previously in this paper, the definition of director independence is highly subjective. Danske Bank for example classifies directors as dependent only if they have ties to "controlling owners", which they define as an ownership stake of >50%. Clearly given this definition the bank has no controlling owners, and so directors linked to AP Møller-Maersk Group (23% in 2014) and Cevian Capital (9% in 2014) are classified as independent; thus Danske Bank achieves 100% director independence (2014). This is a prime example of decoupling of policy content whereby the bank ostensibly adheres to legitimising agency recommendations for independence, but has in fact not truly implemented this policy. In the bank's annual report it clearly states that all directors are independent of controlling owners, but not does state the definition used (Hjelgaard Løfgren, 2016).[13] Theory suggests that decoupling is more likely when the CEO has a powerful position relative to the board, something that will be discussed further in the section on banking experience below.

Handelsbanken's definition of independence is unfavourable from a legitimising perspective due to the dual nature of some board members as employee representatives and shareholder-elected directors.[14] The bank also deviates from certain other legitimising policies due to business and confidentiality considerations, despite these incurring violations of the self-regulatory system of the Swedish Corporate Governance Code; Handelsbanken does not seem to engage in symbolic management in this instance. The board structure and high degree of

[13] Please see *10. Appendix* for my email correspondence with Robin Hjelgaard Løfgren, Senior IR Office at Danske Bank.
[14] These necessarily non-independent board members are therefore counted as shareholder-elected due to their function as representatives of the employee profit sharing foundation Oktogonen that is the bank's second largest owner.

interlinkages between the bank's directors indicates that actors do have sufficient social influence to engage in the practice, should they wish to. Handelsbanken's failure to do so could indicate that the bank's large owners do not see the need to window-dress with legitimising policies for short-term gains, as they are more interested in long-term value creation.

In common with director independence, the banking experience of directors, or lack thereof, was a subject of disapprobation in the media, especially in the US. In the Nordics, this was a less pertinent issue as a majority of board members had experience from the sector, and those who did not possessed other arguably relevant competences. However, as the financial crisis uncovered a previously unimagined level of interconnectedness of the global financial system, several stakeholders argued for increased knowledge of banking activities, and global economic and market forces, among bank directors (e.g. Basel Committee on Banking Supervision, 2010). Agency prescriptions highlight the need for directors to have industry or market specific competences in order to perform their monitoring and advisory roles, which is perhaps why (non-employee) directors' banking experience increased over the period. Again the constant number of employee directors in the face of decreasing board sizes means that this effect is larger than it appears, as discussed in section *5.1*.

Disaggregation of the data provides some interesting insights. Four of the banks in the sample displayed relatively stable figures for this variable, however Nordea and Danske Bank experienced significant changes. Nordea almost doubled its portion of directors with banking experience in the first period (2007-2010), coincidentally none of these additional directors belonged to the board's dominant nationality group, though 2/3 were Finnish-Swedes who had both held high-ranking positions within the Finnish Sampo group that was the largest owner of Nordea (2010 and 2014). Hence the reason for these directors' addition to the board would appear to be the exercise of control by the largest owner, as opposed to conformity with regulatory prescriptions.

Somewhat surprisingly, Danske Bank did not have any non-employee directors with banking experience in 2007. This raises questions regarding both the monitoring and advisory capabilities of the board; the inability for directors to understand the complexities of a business like a bank could have been a contributing factor to their appointment of board chairman Eivind Kolding as CEO in 2011, despite his complete lack of banking experience.[15] Furthermore, the knowledge gap between CEO Peter Straarup (2007) and the board could have led to his "capturing" of the board. Danske Bank's engagement in symbolic management with regards to director independence, lends further strength to the notion that Straarup exerted significant influence over the board; use of this legitimising practice is correlated with CEO influence. In conjunction with norms that encourage directors to act deferentially toward the CEO, overconfidence biases could have been triggered, consequently lowering the likelihood of strategic changes in response to poor performance (Park et al., 2011). This could have been a contributing factor to Danske Bank's worst in class position with regards to market capitalisation, price to book ratio and return on assets.[16] The bank added two directors with banking experience between 2007 and 2010, and an additional two in the next time period, one of whom was a representative of blockholder Cevian capital.

Disaggregation of data showed that some directors might not have been appointed as a result of their banking experience, but instead as representatives of large owners, in line with other agency theoretic considerations. From a behavioural perspective one could further question the motivation for adding these specific individuals to the banks' boards; SEB had the highest share of directors with banking experience (2007, 2010, 2014) however the directors could have been selected due to their demographic and socio-cultural similarities with the chairman Jacob Wallenberg, whose family is the controlling owner of the bank, and other directors. A further perspective afforded by behavioural theory, is that agency prescriptions are amplified by incentives to engage in symbolic management, which could have contributed to the diffusion of this governance policy in a time when banks sought to regain legitimacy after the crisis.

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[15] Kolding had previously served as the CFO of Danske Bank's largest owner AP Møller-Maersk Group, and CEO of affiliated company Maersk Line.

[16] Danske Bank alternated between worst and second worst in the peer group on all three parameters from 2008-2014.

7.1.3 Committees

Following the financial crisis, regulatory bodies like the Basel Committee on Banking Supervision (2010), laid forth recommendations as to how banks could improve their corporate governance policies. These centred on boards' responsibilities to perform effective oversight through "*competent, robust and independent risk and control functions*" (Basel Committee on Banking Supervision, 2010, p. 10). Compensation was, and remained, an important function for boards in order to mitigate agency conflicts by aligning the incentives of management with directors, and in turn owners (see section *2.1.2.2 Directors versus Managers)*. All banks in the sample adopted a dedicated committee for compensation issues following the crisis; likely a result of the increasing complexity of compensation packages as well as the perceived need to more stringently regulate executive pay, following negative media attention. The turnover of Compensation committees was high in both time periods, most notably in Handelsbanken and Swedbank, where it seems that certain directors were continuously reshuffled through the committees, whereas others were removed from the board following their participation in the committee.

There was no change in the prevalence of Audit committees over the time period; all banks had a committee dedicated to financial control and compliance.[17] However it does seem that members of the banks' Audit committees in 2007 were disproportionately likely to have left the board in the next time node. This is suggests that they were replaced as a result of real or perceived lack of oversight, a strong contributing factor to the financial crisis.

The type of committee that experienced the largest change over the period was the Risk Committee. At a fundamental level, I first want to address why boards should be responsible for monitoring risk, after all agency theory tells us that the role of the board is to monitor and advise management. This seems to belie a underlying assumption that operative management is likely to take excessive risk, which as discussed, shareholder orientation incentivises them

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[17] Audit committees are not legally required but in "*large banks and internationally active banks, an audit committee (or its equivalent) is typically responsible for providing oversight of the bank's internal auditors*" (Basel Committee on Banking Supervision, 2012, p. 2).

to do. Risk management hence becomes a board function as a consequence of the inability, inflexibility or prohibitive costs of contracting with management to reduce undue risk. As discussed in section *2.1.2.1 Owners versus Directors*, directors are agents to the owners' principals, thus shareholder, not stakeholder, value creation is their primary objective; indicating that shifting risk responsibility from managers to directors does not in itself mitigate the incentive problem it aims to address. Regardless of this contradictory feature of board risk management, its prevalence has increased dramatically both as a separate board committee, but also in corporate communication materials. The reason for this could be the pressure for boards to engage in risk management from numerous stakeholders like governments, regulatory bodies and the media. However the impact of regulation is influenced by banks' ownership structures, which will be discussed further in the coming section on ownership. A behavioural interpretation for the widespread diffusion of Risk Committees is the legitimising effect of their implementation, which alludes to the symbolic management motivation for their deployment, and mimetic decision-making for their propagation.

There is no clear trend as to which individuals are selected to participate in board committees, and participation does not seem to afford protection from replacement on the board as a whole. This is contrary to my hypothesis that committees serve as additional forums for directors to employ mechanisms of social influence in order to protect their positions, however I lack the requisite data to determine if committee members were more or less likely to be recommended for subsequent board positions. This is an area that would be a very interesting topic of future research, but is unfortunately outside the scope of this paper.

7.1.4 Case: Director Turnover at Nordea

Nordea has several characteristics that separate it from the rest of the sample group: its largest owner (2007, 2010) was the Swedish government, and in comparison to its peers it had a diverse board with a relatively low degree of inter-linkages and no industry concentration of board members' experience. In 2007 the bank had among the lowest percentage of directors with banking experience, this changed considerably in the following time node along with numerous other factors.

In 2010, Sampo Oyj, a Finnish financial company, overtook the Swedish government as the bank's largest owner and instigated several salient changes including electing formal representation to the board. Two directors employed by the blockholder were elected to join the board, with the corollary that the level of banking experience of non-employee directors nearly doubled from 36% to 70%. Interestingly, though the board now consisted of more nationalities, as the bank recruited its first non-Nordic director, foreign directors were grossly overrepresented among the directors that were replaced. Despite only 55% of the board being non-Swedish, 83% of replaced directors were foreign. Furthermore banking experience was a strong predictor of directors' staying power from 2007 to 2010.

Oxelheim et al. (2013) state that foreign directors are generally worse monitors, which could explain why they were disproportionately replaced in 2010, following strong pressure for boards to improve their oversight capacity that was deeply criticised during the crisis period. From an agency and resource supply perspective, one could posit that Sampo Oyj's two representatives, who were both Finnish, replaced the foreign market knowledge and resources of the incumbent Finnish directors; arguably providing more relevant skills due to their banking experience.

Though the arguments outlined above perhaps contributed to the developments observed on Nordea's board, behavioural theories seem to possess considerably higher explanatory power. As table 14 below demonstrates, there are strong common characteristics for those directors that were replaced. No directors from the dominant nationality were replaced, regardless of their gender. This can be explained partly as a result of their identification with the in-group due to nationality, but also as a result of the inter-linkages between these individuals. The board chairman and CEO arguably hold strong roles on the board as a result of their formal positions, the other Swedish directors hold numerous outside directorships that interlink with these influential individuals. This indicates both additional opportunities to interact, but also belonging to similar elite social groups as demonstrated by e.g. membership in the prestigious Royal Swedish Academy of Engineering Sciences. Behavioural theories suggest that this renders directors able to engage in mechanisms for social influence including similarity-attraction biases.

Role	Nationality	Gender (F/M)	Banking experience (Y/N)	Replaced (Y/N)
Chairman	Swedish	M	Y	N
Member (CEO)	Swedish	M	Y	N
Member	Swedish	M	Y	N
Member	Swedish	F	N	N
Member	Danish	M	Y	N
Member	Danish	M	N	Y
Member	Norwegian	M	N	Y
Member	Norwegian	M	N	Y
Member	Finnish	M	N	Y
Member	Finnish	F	Y	Y
Member	Finnish	F	N	Y
Total	*n/a*	*n/a*	*(5/11)*	*(6/11)*

Table 14: Characteristics of Nordea's Board in 2007

Only one foreign director remained on the board in 2010; the Danish male had extensive banking experience that could have been deemed valuable to the focal firm, and could also have constituted a criterion for membership in the banking in-group. His compatriot possessed neither inter-linkages with other directors, nor banking experience and could consequently have had difficulties in gaining in-group social identification. The same can be said for the two Norwegian directors who had the same limitations.

As mentioned above, the Finnish directors could have been substituted for the two Finns from Sampo Oyj. The two female directors did not have any inter-linking experience with other directors, though one had banking experience; the male director possessed multiple interlinks with a Swedish director. All three allegedly declined to stand for re-election in various years from 2008-2010, however in Swedish society it is common to give outgoing directors and CEOs the courtesy of attributing their departure to retirement or other self-determined reasons.

It would appear that behavioural mechanisms lend further interpretation to the disproportionate degree of foreign director turnover on Nordea's board from 2007 to 2010. The vulnerability of foreign directors, their difficulties in exerting influence over firm strategy, and other factors including additional expenditure of time, can make them loathe to join boards in countries from which they do not originate. The consequences of this can be large, especially in small Nordic countries where candidate pools are already limited, and can include insufficient consideration or adaption to external markets and impaired strategic decision-making as a result of groupthink biases.

7.2 Board Inter-linkages

As explained in section *6.1.2*, there is no clear agency prescription regarding the net effects of board members' outside assignments, there have however been several empirical studies in the field with mixed findings (e.g. Fich and Shivdasani, 2006; Harris and Shimizu, 2003). It is important to clarify that this group of variables can only be partially impacted by the firm; when selecting directors, their number of outside assignments is only one of many factors of interest, and requiring sitting directors to increase/reduce their external assignments could prove difficult.

In the sample, directors held a greater number of outside assignments at the second time node compared to the first, which could have been motivated by an attempt to secure additional resources and networks for the focal firm. However, I find it more likely that demand for directors with experience from the financial sector surged following the financial crisis, as many firms struggled to come to terms with the global recession. In line with the agency perspective of self-interested individuals, I posit that directors took on more positions in order to secure additional income for themselves. By 2014, directors' outside assignments had fallen below 2007 levels; this was perhaps as the need for directors with financial expertise had fallen in other firms, the increased responsibilities of boards with regards to, among other issues risk management rendered them unable to hold other directorships, or simply that the directors recruited at this point were individuals with fewer other assignments. Disaggregation shows that developments that underlie a reduced number of other assignments are primarily related to new directors having fewer obligations, as opposed to a large reduction among existing directors.

Behavioural theories have the ability to shed additional light on directors' other assignments and inter-linkages. Firstly, this body of theory suggests several mechanisms through which directors can secure additional assignments, including engaging in ingratiatory and socially deferential behaviour. Holding numerous directorships, as the directors in the sample do, could be indicative of belonging to the corporate elite, which suggests that the individual engages in the above-mentioned mechanisms for social influence. The consequences of this could be a reduction in critical monitoring of management, due to norms for non-controlling behaviour. Norms of reciprocity lead directors to be loyal to those who supported their appointment; recommending peers for directorships can ensure allegiance and thus increased influence (Westphal and Zajac, 2013). Furthermore, when directors have strong ties to other boards, they are more likely to engage in mimetic decision-making, which could be detrimental if policies are not tailored to the needs of the focal firm. Additionally, legitimising policies are more likely to be decoupled when firms have strong ties to organisations that have engaged in the practice before. (Westphal et al., 2001; Westphal and Zajac, 2001)

On the other hand, relevant experience from other board positions has been measured to have a positive impact on firm value, due to the increased ability to perform advisory functions (Carpenter and Westphal, 2001; McDonald et al., 2008; Westphal, 1999). Contrary to theory that suggests that social ties between directors reduces their monitoring capacity, links could have the opposite effect: improving communication and reducing the likelihood of pluralistic ignorance, thus making directors more likely to challenge poor firm performance and advocate strategic changes (Westphal and Bednar, 2005).

Sinani et al. (2008) hypothesise that the more connected a network is, the higher the probability of a strong flow of information and ideas throughout the network which contributes to internalising norms and creating trust. The authors find that small world characteristics in board and owner networks are especially pronounced in Sweden. The Wallenberg family controls roughly one third of the country's GDP, including the bank SEB.

The companies within the Wallenberg sphere are highly interconnected, as shown by SEB's directors having the highest number of outside directorships and highest degree of inter-linkages, within the sample group. Anecdotal evidence from several anonymous sources suggests that employees within these companies face strong implicit and explicit incentives to adhere to norms for social deference and non-elite threatening behaviour. Though Westphal and Bednar (2005) suggest that board cohesion could reduce pluralistic ignorance, this evidence suggests that punitive social norms could limit the ability of employees and directors to engage in critical thinking. Excessive conformity within boards, as seen by the 83% degree of inter-linkage on SEB's board could lead to damaging groupthink and failure to recognise and challenge poor strategic decisions.

As a consequence of the way inter-linkages have been measured, it is not possible to track their evolution over the period. However the degree of inter-linkage within each bank differs greatly across the sample and corresponds to the characteristics and relative strength of the banks' owners. The correlation between industry concentration of board members' outside assignments and the characteristics of the largest owners, suggests that board members are not only selected for their ability to perform their directorial roles; they have strong linkages to the banks' shareholders, hence they have arguably been put in place to advance shareholder interests.

Directors are the agents to owners' principals, thus given the narrow view of the firm their strong ties to equity-holders are amenable to good governance. However, the banking industry differs considerably from other industries in that capital structures are highly skewed toward debt, thus amplifying moral hazard issues and incentivising excessive risk-taking. Directors do have fiduciary and social incentives to consider non-equity stakeholders such as debt-holders, employees and society as a whole; however, these incentives are not as strong as those that incite them to promote shareholder value. Though directors do not receive performance-based compensation, they are incentivised to avoid "elite threatening" behaviour though norms of reciprocity and deterrence. These "punishments" can be extended to other boards on which they serve through the small world effect of the corporate elite, to which an industry concentration of directorships, further contributes. In Nordic countries, dense social networks make it easier to establish social control through reputational effects and the threat of exclusion from social networks (Sinani et al., 2008).

7.3 Ownership and Control

7.3.1 Ownership Structures

As discussed above, ownership is externally determined, meaning that there are no agency prescriptions regarding optimal shareholder structure that the firm can act upon. That said firms are likely to react differently to external agency pressures, depending on their ownership structures. Blockholders have both the means and the incentives to exert influence on the focal firm, perhaps most pertinently through their ability to nominate directors who represent their interests. Given the minimal risk for expropriation by blockholders in the Nordics, I concentrate on the additional incentives blockholders have for monitoring. Large owners are likely to encourage their representatives to impose measures that enhance equity value, and engage in symbolic management in order to comply with those agency policies that are conducive to shareholder value creation. This is not because firms are greedy, as they have frequently been portrayed in the media, but because according to the dominant economic logic, the aim of the firm is to create value for its owners. Unfortunately, there is insufficient variation in the sample to draw meaningful conclusions regarding the impact of blockholders, especially as the two outliers have other salient differences from their peers. A larger sample size could have mitigated this issue, and is therefore a recommendation for future research.

As previously explained, banking activities can impose negative externalities on society; due to the systemic nature of the banking system its collapse would be catastrophic for modern society. For this reason we witnessed several government bailouts of banks that were “too big to fail” during the crisis, thus impacting banks’ ownership structures. In the Nordics no banks were bailed out, however several banks were partially state-owned. Behavioural theories lend some credence to the hypothesis that a government ownership stake broadens the “in-group” to include broader society; if this were the case, these banks would be expected to have more consideration for the potential negative externalities of banking activities.

DNB is the bank with the highest share held by blockholders, largely due to the 34% stake held by the Norwegian government (2007, 2010, 2014). This in itself is likely to impact the bank's propensity to comply with agency prescriptions, especially those that encourage consideration of a broader stakeholder society. Furthermore government ownership seems to have had a significant impact on how the bank fared during the financial crisis, with DNB performing among the best in class on several ratios.[18] Perhaps this was a result of reduced risk-taking due to external stakeholder considerations, as well as the perceived role of the Norwegian government as guarantor of the bank's operations (Bjørnestad, 2008). The other bank with a government ownership stake was Nordea, however its performance was unremarkable compared to the peer group over the crisis period.

Banking is a highly regulated sector, yet Laeven and Levine (2009) posit that measures that aim to reduce risk-taking, like minimum capital requirements and restrictions on non-lending activities, could have the reverse effect as they reduce the utility of bank ownership and therefore incentivise increased risk-taking to compensate for this. Their paper further asserts that ownership structure influences the impact of regulation as e.g. deposit insurance increases the ability for stockholders to elevate risk. This indicates that the implicit promise of government bailouts could have encouraged risk-taking in privately held banks, in fact bailouts would only occur in the face of near collapse thus incentivising an all or nothing approach to excessive risk-taking.

7.3.2 Case: Handelsbanken's Ownership Structure and Risk

Laeven and Levine (2009) hypothesise that banks with influential owners are more likely to engage in risky behaviour as it has a disproportionately large impact on the value of equity. The smaller the equity stake of said influential owner, the more likely they are to pursue excessive risk due to the increasingly leveraged nature of their bet on the bank's equity (Laeven and Levine, 2009). Within the sample, Handelsbanken exhibits both of these qualities, with largest owner Industrivärden exerting tremendous control over the bank's board yet holding only 10-11% of the bank's voting rights over the 2007-2014 period.

[18] DNB was best or second best from 2007-2014 on ROA and non-performing loan ratio, see section *4.4* for more details.

Furthermore the bank's second largest owner was the Oktogonen employee profit-sharing foundation (2007, 2010, 2014) whose interests were represented on the board by employee representatives, none of which had a higher education (2007, 2010, 2014) indicating limited knowledge and understanding of bank risk-taking. Furthermore, literature suggests that employee directors are typically passive in the boardroom, possibly as a result of socialisation by other directors (Sinani et al., 2008; Westphal and Zajac, 2013). In theory, the owners of this bank were incentivised to take high levels of risk that benefited them at the expense of debt-holders and external constituents.

The data in section *4.4 Description of Observation Group* indicates that Handelsbanken outperformed many of its peers on valuation ratios, with market capitalisation and price to book ratios consistently above average. The bank's return on assets was average or above throughout the period, and Handelsbanken was best in class with respect to non-performing loan ratio every year of measurement. This is interesting as this variable is indicative of the riskiness of the bank's lending activities. Handelsbanken seems to have pursued a less risky strategy than its peers, which is at odds with theoretical arguments regarding its ownership structure and resultant incentives.

Looking deeper into the ethos of Handelsbanken, we see that the bank has a strong aversion to short-termism demonstrated by limited use of performance-based compensation, no sales targets for staff and a approach to customer centricity that goes against the zeitgeist (Wilson, 2013). These facts are an example of the strength of clinical methods within finance that can uncover unexpected insights by digging deeper into the statistics and developing insights that aggregate level data cannot provide. It would appear that despite Handelsbanken's ownership structure, the bank pursues less risky strategies than its peers. One reason for this could be that the industrial company Industrivärden, that is the bank's largest owner, is dependent on the long-term stability of the bank for the prosperity of its numerous other businesses, thus encouraging consideration of the potential negative externalities of excessive risk-taking at the bank.

7.3.3 CEO change

Unlike ownership, firms are very much able to determine when to initiate CEO change. The power to dismiss CEOs is a core part of monitoring in the principal-agent conflict central to agency theory. Directors can and should fire CEOs in the face of poor performance, both in order to replace them with a better candidate but also as it has deterring effect. Following the financial crisis, it is therefore likely that banks would elect to replace CEOs who, if not responsible for, were witness to extremely poor firm performance. In fact, over the crisis period only one bank replaced its CEO namely Swedbank in 2008, ostensibly due to the incumbent CEO's retirement, but arguably due the bank's dreadful financial results (Durehed, 2008). Danske Bank also replaced a retiring incumbent in 2012 with its chairman Eivind Kolding, however it was not long-lived. Kolding was replaced in 2013, by experienced banker Thomas Borgen following a deeply unpopular marketing campaign that resulted in the exodus of tens of thousands of customers (Milne, 2013).

Here we have a large discrepancy between the agency theoretic prescription outlined in section *6.1.3*, and the real world observations. Behavioural theory provides explanations for this. On the one hand there are strong socialising factors that compel directors to act deferentially toward CEOs, failure to comply with these norms can have unpleasant consequences. Pluralistic ignorance can further exacerbate this issue; studies have shown that relatively diverse directors underestimate the extent to which their colleagues share their apprehension regarding poor performance and therefore hesitate to act on these fears (Westphal and Bednar, 2005). On the other hand, directors may not be loath to challenge the CEO regarding firm performance; they may simply not attribute it to his/her conduct. Misattribution of cause is especially common when CEOs are able to exploit similarity-attraction biases, and can lead directors to attribute negative performance to external factors beyond the control of the CEO (Westphal and Zajac, 2013).

Analysis of the data provides some support for the presence of factors that would trigger the social biases explicated above. Board members at the banks in the sample have been highly successful at amassing additional board positions as demonstrated by their high number of other assignments; this indicates that these directors are likely to have conformed to norms for director conduct in order to secure recommendations. However, there is little evidence of the diversity that is a strong contributing factor to plural ignorance on corporate boards. This means that boards consist of relatively homogenous individuals; similarity-attraction biases between directors are therefore likely to be prevalent. It would seem that if CEOs were able to capitalise on mechanisms for social influence, they could join the "in-group" and reduce boards' objective monitoring, one example of this that will be discussed shortly is SEB CEO Annika Falkengren. In order to become CEO of one of the Nordic's largest bank, numerous qualities are required, not least inter-personal skills. I therefore find it highly probable that the CEOs in the sample have been able to engage in such behaviour, either consciously or sub-consciously. Behavioural theories of corporate governance therefore contribute greatly to the paradox surrounding low CEO change.

An additional behavioural perspective relates to the strong conformity of banking policies in the run up to the crisis; social learning and mimetic decision-making could have led to the diffusion of near-identical policies across firms, rendering it difficult to blame any one CEO for the demise of the financial system. Banks have been accused of being "asleep at the wheel" but given the incentive systems that are in place, it is hardly surprising that banks adopted policies imported from the US and aggressively lent money in overheated Baltic economies. A bank unwilling to transact business at the limits of good practice would lose turnover to those peers that would. The shareholder value paradigm is largely responsible for the excessive risks that were taken, as well as the pressure for banks to deliver short-term results. Regulators have also been accused of being lax, but the problem is not insufficient regulation: it's the wrong regulation. Emphasis is too often placed on independence, which apart from rendering many knowledgeable directors unable to serve, is an imperfect measure due to its lack of consideration for social ties that are arguably just as important (Adams, 2012).

7.3.4 Case: the Staying Power of Annika Falkengren at SEB

Annika Falkengren was declared CEO of SEB in 2005 following a long career in the bank's corporate division. The inception of her career was through participation in the bank's graduate program in the 1980s, where she quickly began to build a strong internal network and recommend herself to management (EuropeanCEO.com, 2016). Falkengren developed a reputation for having her eye on the top job, and for not being afraid to face conflicts head on. This type of behaviour is seen as "un-Swedish": an ability to blow your own horn and be direct, perhaps a product of her privileged international upbringing and attendance at one of Sweden's elite educational institutions. Falkengren's upper class upbringing is one salient trait she has in common with the bank's largest owner and founding family, the Wallenbergs. Another is her unwavering loyalty to the organisation to which she has dedicated her life's work (Emdén, 2016).

During the financial crisis, SEB was among the worst in the peer group on all valuation and performance ratios described in section *4.4*. Aggressive international expansion, primarily in the Baltic region had led to outstanding loans of 150 BSEK (2008), which, when the bubble inevitably burst, contributed to the collapse of these national economies. The Swedish bank (and its peers Nordea and Swedbank) was highly criticised for its perceived irresponsible lending activities (Forsberg, 2009). Despite this approbation for the bank's activities, and the very real negative externalities their risk-taking had imposed on the Baltic people, CEO and frontwoman Falkengren remained in her job.

On the one hand, Falkengren had staked out her career in the bank's corporate arm, thus the Baltic expansion strategies were not initiated under her watch; however, as CEO it was her responsibility to manage the bank's exposure. SEB's board was arguably the most financially competent in the peer group,[19] which raises questions as to how directors could have failed to spot the unsustainability of Baltic economic growth. Sinani et al. (2008) reflect that the more connected a network, the higher the probability of internal information flow and internalised norms, which generate trust. It is possible that SEB's highly interlinked board[20] fell victim to

[19] SEB had the highest share of directors with banking experience at every time node.
[20] SEB exhibited the highest level of director interlinkage in the peer group.

groupthink and a false sense of security, something that Adams (2012) claims can be especially prevalent in the highly regulated banking environment, where directors place excessive trust in regulation, thus reducing their own monitoring.

In the sample group, SEB is one of few banks where the CEO is also a board member. Behavioural theories suggest that this enables the CEO to exert further influence over board members as she is given additional opportunities to engage in mechanisms for social influence. Though Falkengren is in a clear minority as a female director, there are several other ways in which she could invoke similarity-attraction biases including her elite education, strong personal identification with the bank and membership of the Swedish corporate elite.

Falkengren regularly features in “most powerful” lists, and was named 9th most powerful woman in the business by Forbes in 2012, which could cause directors to act deferentially toward her despite their own impressive credentials (Forbes, 2012). As discussed, it is common for senior directors to mentor novices and encourage them to follow prevailing norms for director conduct; this has been shown to be particularly relevant in the Wallenberg sphere where deterrence threats can carry extreme weight. It is therefore likely that new directors were loath to question Falkengren’s authority, whereas existing directors may have felt unable to point the finger at her given their own failure to act to avert the bank’s precarious strategy in the Baltics. Furthermore, as the global financial crisis was largely seen as a US import that caused the drying up of international credit, it is possible that Falkengren’s in-group identification made her board colleagues more likely to misattribute negative performance to external factors, thus shielding both Falkengren and themselves from blame. It is apparent that Falkengren had numerous opportunities to engage in behavioural mechanisms that expanded her influence on the board; this is arguably a contributing reason for her staying power in the face of poor financial performance over the financial crisis period.

7.4 What Have We Learnt From the Financial Crisis?

Almost ten years after the outbreak of the global financial crisis, some analysts are predicting another large financial downturn around the corner (Das, 2016). Despite the natural cyclical variation of the economy, the global financial crisis of 2008 was unlike any seen before due to the interconnectedness of global financial markets and the unforeseen degree of bank systemicity, partly caused by the multiplier effects of the shadow banking system (Bini Smaghi, 2010).

What has changed since last time around that will prevent a similar worldwide economic meltdown? Droves of new regulation have been put in place and while it is not my aim to discuss them in detail, new regulation largely emphasises the same off-the-shelf agency theoretic considerations of its predecessors. Bebchuk and Spamann (2009) argue that the very incentive alignment, between owners and managers, prescribed by agency theory promoted the excessive risk-taking that laid the foundation for the crisis. In attempting to limit banks' activities in order to reduce risk and "*preclude socially inefficient choices*" regulators were always one step behind, due to high-powered incentives that encouraged bankers to get around regulation and take privately optimal levels of risk (Bebchuk and Spamann, 2009, p. 33).

Laeven and Levine (2009) further emphasise that the characteristics of banks' owners has predictive power for the impact of regulation, and the incentives for risk-taking; this matter that has been little addressed by regulatory bodies. In fact, despite widespread academic literature that emphasises the differences between the governance of financial and non-financial firms, banks still face agency theoretic prescriptions that highlight the formal independence of their directors at the expense of other, perhaps more important, characteristics (Adams, 2012). Behavioural theories further stress the weaknesses of attributing powerful legitimising qualities to a particular policy; it can easily gain precedence over policies more relevant for the focal firm as a result of symbolic management considerations, or decoupled e.g. recruiting directors with social instead of formal ties to owners, managers and directors.

8. Conclusion

This thesis investigates the applicability of behavioural theories as a complement to agency theory, in order to understand changes in banking governance following the global financial crisis. I consider systemically important Nordic banks at three time nodes in order to study both the level and development of corporate governance policies. The analysis and discussion build on agency and behavioural theories, using methods inspired by the clinical research methodology in finance, which combines quantitative and qualitative data. I find it especially relevant to investigate multiple dimensions of corporate governance within the banking industry, where the organisational environment, regulatory requirements and ownership structures have significant consequences for the validity of agency theory as an explanatory tool.

My discussion focuses on three main areas of variables within corporate governance: (1) board composition and organisation, (2) board inter-linkages, and (3) ownership and control. In the first category I uncover several trends that cannot be explained when viewed through the narrow agency perspective of corporate governance. Numerous changes to boards' composition and organisation appear to be a result of conformity with legitimising policies in accordance with pressure from regulators and other stakeholders. Adams (2012) argues that banks exhibited better pre-crisis governance than non-financial firms, indicating that increased conformity with agency prescriptions could be symbolic, as opposed to having any real value for the focal firm; this practice is known as symbolic management. Several other changes seem to be in line with the exertion of social influence of actors over one another. This seems to be particularly true with regards to director turnover, where minority directors are especially vulnerable to replacement as a result of difficulties in engaging in mechanisms for social influence; the Nordea case study in section *7.1.4* highlights the real world applicability of this issue.

The issue of directors' outside assignments and resultant inter-linkages does not have a clear interpretation within agency theory. Behavioural theories however view these variables as a powerful means for actors to expand their social influence. Examples showed that high degrees of inter-linkages were correlated to lower director turnover and possibly impeded strategic decision-making. It became apparent that, in some banks, board members' outside directorships were concentrated in firms related to large owners, indicating that owners were able to engage in both positive and negative reciprocal behaviour. The ability to provide recommendations for additional positions, or fire and ostracise directors, was heightened given the dense social networks prevalent in the Nordics.

Despite questions surrounding ownership being the fundament of corporate governance theory, this category of variables differs from the, at least partially, endogenously determined ones outlined above; ownership is not at the discretion of the focal firm. The feature entails large differences between these variables and others, as they do not (often) face external pressure to change, but can instead determine how banks respond to pressures from their environments including regulators, debt-holders and society in general. In the preceding discussion section it became evident that ownership structures, including government ownership stakes, or others owners that encourage a more long-term perspective, can affect risk behaviours, as banks move beyond the shareholder-value paradigm central to agency theory. Aspects central to the efficacy of bank regulation were also addressed including the need to consider ownership structures when designing regulation that aims to reduce excessive risk-taking. Finally the CEO change paradox was tackled using behavioural theories that illuminated how CEOs could make use of mechanisms for social influence in order to stay in power.

Circling back to my initial question: "*to what extent does a holistic perspective on corporate governance, that takes into account both agency and socialised behavioural theories, explain observed developments in the Nordic banking sector following the global financial crisis?"* I find that a holistic approach that considers different types of pressures working on agents provides a deeper understanding. Several of the observed developments, like the vulnerability of certain directors or the CEO change paradox, cannot be explained using agency theory alone, and it is therefore valuable to consider the behavioural factors that work on agents who live in social worlds. My case studies underscore the importance of considering the idiosyncrasies of each bank; each boardroom in a sense constitutes its own socialised world with norms and characteristics related to the bank's owners and its unique identity.

This paper highlights a growing sentiment that the agency theories that lay the foundation for corporate governance regulation are insufficient to understand the true motives and incentives working on actors, especially in the banking industry. I argue that behavioural theory, as a complement, has the capacity to lend deeper understanding to observed trends in corporate governance policies, and I discuss how the prevailing narrow view of banking governance neglects pressures related both to industry-specific and social factors, which detrimentally affects the efficacy of agency prescriptions for good governance. The aim of this paper is not to provide policy recommendations, but to encourage an expanded perspective, that goes beyond the stylised incentive alignment of rational principals and agents, when considering banking governance.

It is my expectation that the corporate governance field will continue to propagate the important differences between the governance of financial and non-financial firms. This will enable more sophisticated governance regulation going forward, that reaches beyond pure agency theoretic prescriptions; these have been shown to have the potential to be inefficient or even damaging. Nevertheless, the consideration of socialised behavioural factors is relevant beyond both the banking industry, and the Nordic context, and future research that expands on the methodology used in this paper will hopefully be able to uncover further insights. In particular, future research should expand on the role of owners and which characteristics incentivise or mitigate their risk-taking. It would also be interesting to expand on the role of debt-holders, as they are vital in the banking context. Researchers should use a larger sample in order to overcome problems linked to insufficient variation in the peer group, which were experienced in this paper. Furthermore, when studying contemporaneous issues, interviews with firm constituents could glean further insights into the mechanisms for social influence employed.

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10. Appendix

10.1 Corporate Communication Documents

Danske Bank

Danske Bank, 2007. Annual Report 2007.

Danske Bank, 2010. Annual Report 2010.

Danske Bank, 2014. Annual Report 2014.

Danske Bank, 2014. Corporate Governance Report 2014.

DNB

DNB, 2007. Annual Report 2007.

DNB, 2010. Annual Report 2010.

DNB, 2014. Annual Report 2014.

Handelsbanken

Handelsbanken, 2007. Annual Report 2007.

Handelsbanken, 2010. Annual Report 2010.

Handelsbanken, 2014. Annual Report 2014.

Nordea

Nordea, 2007. Annual Report 2007.

Nordea, 2010. Annual Report 2010.

Nordea, 2014. Annual Report 2014.

SEB

SEB, 2007. Annual Report 2007.

SEB, 2010. Annual Report 2010.

SEB, 2014. Annual Report 2014.

Swedbank

Swedbank, 2007. Annual Report 2007.

Swedbank, 2010. Annual Report 2010.

Swedbank, 2014. Annual Report 2014.

10.2 Additional Information

Email correspondence with Robin Hjelgaard Løfgren, *Independence of board members*.

"*Hi Lucia,*

Thank you for your e-mail and your interest in Danske Bank.

You have pointed out the correct passages in both our Annual Report and our Corporate Governance report. However, the difference lies in the definition of "controlling interest". We only have one type of shares, all with equal voting rights, and as such, you need to hold more than 50% of all Danske Bank shares to be a controlling owner. Our biggest shareholder, the A.P. Møller-Maersk Group, owns a combined 21.6% stake in Danske Bank and is as such not a controlling owner. Therefore, all of our board members, including Mr. Westlie and Mr. Brenøe from the A.P. Møller-Maersk Group, are independent members.

Kind regards,
Robin Hjelgaard Løfgren
Senior IR Officer"