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Sovereign Wealth Funds: Strategic Governance and Responsible Ownership

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DOCTORAL THESIS

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It is of some use to my volcanoes, and it is of some use to my flower,
that I own them.

The Little Prince, Antoine de Saint-Exupéry.

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1

Introduction

1.1. RELEVANCE AND GAP

Sovereign wealth funds (SWFs) are strong representatives of the heterogeneous matrix of institutional investors which support capitalism as we know it today. With assets amounting to $7.2 trillion, SWFs own on average 9% of all listed equities globally (Capapé and Santiso, 2017); yet, little is known about them. This thesis will help to better understand this critical investor group and the influential role SWFs might have on the corporate governance of their portfolio companies.

Sovereign wealth funds are government-owned investment funds without explicit pension liabilities that typically pursue long-term investment strategies (Aguilera, Capapé, & Santiso, 2016). Given the novelty of many SWFs (70% of the 94 funds in existence were born after 2000) and the emergence of SWFs with new institutional forms, it is difficult to find a concept which captures the heterogeneity of these institutional investors. SWFs are commonly established out of the revenues from natural resources (oil, natural gas, copper, etc.), while other SWFs are funded from the balance of payment surpluses, official foreign currency operations, the proceeds of privatizations or fiscal surpluses (Das, Lu, Mulder, & Sy, 2009).

Their nature as long-term state-owned funds qualifies them as a unique institutional investor class (Truman, 2013). SWFs differ among themselves as well and it is complicated to group SWFs, given their large disparities in terms of size, age and institutional forms. This in part explains the difficulties of building a body of research focused on these particular institutional investors (Megginson & Fotak, 2015). Thus, one of the main contributions of this thesis is to first bring clarity towards the research unit of analysis: what is a sovereign wealth fund? Why should we care about them? These questions have been already answered in the cases of pension, hedge, mutual or private equity funds. Yet, the literature focused on SWFs is still nascent. The thesis sheds light on this particular but relevant aspect of the financial world from a multidisciplinary perspective drawing on existing research from economics, finance, management and strategy.

Sovereign wealth funds are framed properly within a new form of state capitalism (Musacchio & Lazzarini, 2014). Since the financial global crisis of 2007-08, the state weight in the global economy has grown (Bortolotti, Fotak, & Megginson, 2015). This is in line with

the recent new wave of populism that succeeded the financial crisis in the Western economies and the growing role played by emerging countries such as China or Russia; all of which lead to the consideration of new ways of managing the economy where the state plays a larger role. This thesis refers to this new state capitalism and explains how SWFs are key players in this new economic order.

Also, sovereign wealth funds represent an opportunity to test how their strategic governance can play a role as global investors and public policy tools (Aguilera et al., 2016; Clark, Dixon, & Monk, 2013). SWFs help to develop economic domestic goals, save natural wealth for the next generations, pay future pensions and correct fiscal imbalances (Das et al., 2009). The multiplicity of the goals of state-backed institutions is one of the key features of this new form of state capitalism: economic goals and financial returns are both present in the mission of SWFs.

On one hand, SWFs invest to promote specific economic sectors domestically or to enhance public recognition (legitimacy), both politically and economically, when investing abroad. Other goals include securing natural resources or accessing foreign markets of state owned-enterprises. These are called strategic goals. Recipient countries and shareholders of SWFs portfolio companies may fear the non-market strategies of SWFs; indeed, markets tend to discount this "liability of sovereignness." On the other hand, SWFs are competing for assets with other public and private global investors. They invest or co-invest in a whole array of assets looking for an appropriate risk-adjusted return. These are described as financial goals. Recent research claims that SWFs portfolio companies tend to have lower returns than private comparable investments, due to the assumption that political interference decreases firm value (Bernstein, Lerner, & Schoar, 2013). This thesis reveals that this assumption does not hold true for all SWFs; funds with independent structures, clear investment mandates and professional staff have similar financial returns as other large institutional investors (Bortolotti et al., 2015).

In fact, financial and strategic goals are the two types of "investment motivation" represented in the vertical axis of the two-by-two main matrix (see Figure 1 in Chapter 2). This matrix serves as the most important tool of analysis of the first two essays. The matrix helps to understand SWFs as dynamic institutions, subject to changes in strategy, governance and mission. This concept of duality of goals is consistent throughout this thesis. First, it helps to

understand the four strategic governance scenarios of Essay I. Second, it illuminates the four real cases of Essay II. Finally, it is present in the Essay III, because this duality explains why sovereign wealth funds should be treated as an institutional investor that is different from a mutual, pension or hedge fund. The blurred lines between strategic and financial goals are explained through this lens.

The first two essays propose that SWFs should be studied as a different group of principals, given that SWFs are distinct owners. Taking advantage of this fact, the third essay follows two related research perspectives. First, it considers heterogeneity among shareholders (Goranova & Ryan, 2014; Schnatterly & Johnson, 2014). This is key to enriching the principal-agency dyadic relationship with the idea of heterogeneous principals. Second, the third essay analyzes the impact of shareholders on the governance quality of portfolio companies, the so-called activism (Coffee Jr. & Palia, 2014; Connelly, Tihanyi, Certo, & Hitt, 2010), using a comprehensive dataset from the Norway's SWF.

As long-term investors, SWFs fit well in the growing literature on responsible investment (Døskeland & Pedersen, 2015; Sievänen, Rita, & Scholtens, 2013). Responsible investment research has centered around social, environment and governance issues. This thesis focuses on the latter and explore the strategies adopted by a sovereign fund as an active owner (Essay 3). This impact of activism – shareholders trying to change the governance provisions of its portfolio companies – has been analyzed extensively in management and finance. The theoretical ground for most studies that analyze activism still relies extensively on agency theory (Dalton, Hitt, Certo, & Dalton, 2007; Jensen & Meckling, 1976). The essay expands the understanding of the effects of activism by adding SWFs to the group of active shareholders. New evidence is provided of the influence SWFs exert over investee companies.

Finally, this thesis adds new insights to the literature framed in emerging markets, research which focuses on contexts beyond the United States, Europe and Japan. In fact, most SWFs are based in countries such as China, Kuwait, Qatar, United Arab Emirates, and a growing number are being established in Africa and South-East Asia. The first two essays of this thesis focus on SWFs based in emerging markets, thus improving the understanding of emerging market research contexts (Wills, Senbet, & Simbanegavi, 2016).

1.2. THEORETICAL BACKGROUND

In this section I review the most up-to-date SWF research in two main areas. First, it explores what we know about SWFs. This helps to understand how SWFs are defined. Also, it details the main results that explain how SWFs impact firm value. The second part is devoted to the theories behind heterogeneous principals and activist shareholders. SWFs may play a critical role as large shareholders and they are able to shape the governance of portfolio companies and influence other investors.

1.2.1. Sovereign Wealth Funds: Dual objectives and new developments

The main contributions of the literature in the first years of SWFs research are dedicated to the impact SWFs have on firms' value. These analyses, based on scarce SWF data and using event studies as the main methodological tool, have yielded a disparity of results. The short-term impact is analyzed first and then continue with the main results of the long-term impact of SWF investments on portfolio companies.

Sovereign wealth funds generate a positive short-term stock reaction for portfolio companies after announcing the investment (Dewenter, Han, & Malatesta, 2010; Kotter & Lel, 2011). These first empirical papers use event study's methodology and conclude there is no evidence SWFs yield results different from other large institutional investors. Yet, as pointed out by Megginson and Fotak (2015), these first papers reflect the fact that SWFs belong to the institutional investors group and confirm positive stock reactions when large investors announce their deals.

Despite being positive, the short-term reactions in the case of SWFs investments are less intense than in other private counterparts (Bortolotti et al., 2015). This "discount" explains the complex nature of SWFs, which occasionally reflect conflicting goals. In fact, the discount is larger when politicians are more involved in the strategy of the SWF (Bernstein et al., 2013) or for SWFs that play a stronger role in corporate governance, for example, by taking a seat after a large stake is acquired. The independence of the SWFs from its sponsoring government remains a key variable that explains both the portfolio firms' stock reactions in the short-term and the long-term operating impact on companies.

In the long-run, SWFs negatively impact portfolio companies in financial performance measures such as Sharpe-ratio (Knill, Lee, & Mauck, 2012b) and price-to-equity ratio (Bernstein et al., 2013). The results suggest that SWFs are not good monitors (Knill et al., 2012b), or at least, they are worse than private investors (Bortolotti et al., 2015). On the contrary, other authors have found evidence of positive influence after SWFs investments in terms of firm value (Fernandes, 2014) and corporate credit risk (Bertoni & Lugo, 2014).

Apart from the results and the impact of SWFs, other authors have focused on the investment decision process. The most intriguing question to governments of recipient countries is where SWFs invest and, moreover, what their investment criteria are. Given the specific nature and governance structures of SWFs, it makes sense to analyze the differences in the investment process. Regarding the geographic allocation, SWFs invest in countries with which they have weaker political ties (Knill, Lee, & Mauck, 2012a). Yet, this result goes against economic rationality, and the authors suggest SWF investment decisions are partially influenced by non-financial (strategic, in our terminology) motives.

This behavior explains why SWFs use investment vehicles when they internationalize their activities. Research shows that strategic motivations, the acquisition of larger stakes and a higher alignment with broad national economic goals, increase the likelihood of using investment vehicles (Murtinu & Scalera, 2016). The usage of intermediary investment vehicles is a way to defend SWFs from protectionist international investment laws of recipient countries and to diminish the “liability of sovereignness” (Aguilera et al., 2016; Bassan, 2015; Kratsas & Truby, 2015).

This defensive attitude towards SWFs is explained by economic nationalism. Governments oppose foreign merger and acquisition attempts and fight for keeping the domestic ownership of those businesses considered the “jewels of the crown” (Serdar Dinc & Erel, 2013). In the case of SWFs, this opposition by recipient countries is amplified due to the strategic motivations attributed to SWFs (Bird-Pollan, 2012; Cohen, 2009; Hemphill, 2009). This fear of host countries of companies receiving SWF investment in critical sectors (infrastructure, defense, utilities, national champions) is negatively correlated with economic and credit conditions. The higher the need of external capital, the lower the concerns of recipient governments towards SWFs investments. In fact, during the 2008 global financial crisis several SWFs from Qatar, Kuwait and China helped to rescue the largest banks in the

Western economies. We cannot think of more critical assets than Morgan Stanley, UBS or Barclays, yet SWFs were welcome to the capital of these banks (Balding, 2012; Castelli & Scacciavillani, 2012). Years later, concerns about SWF investments grew again when the economy recovered (Calluzzo, Dong, & Godsell, 2017). The trade-off between national security and open capital markets remains an unresolved debate (Epstein & Rose, 2009; Gilson & Milhaupt, 2008).

However, recent developments point to a potential solution to these controversies. There are more co-investment funds established (Russia, France, Italy, Belgium) or planned (Spain, Nigeria, Morocco) that attract capital from foreign SWFs. This cooperation between recipient countries and foreign sources of capital may work as a solution to the fears introduced by the dual goals present in SWFs. On one hand, the consistency of the laws of recipient countries regulating direct foreign investments should be enhanced to avoid discretionary decisions based on "national security" concerns and to establish clearer rules and procedures (Bassan, 2015; Boubakri, Cosset, & Grira, 2017). On the other hand, steps taken by SWFs to improve governance standards and to adhere to best practices would reduce the "sovereign discount," improve market perception and facilitate cooperation.

There is a particular case of SWFs that could be classified as domestic SWFs, which can take the form of development agencies, public holding corporations or public private equity funds and have no direct influence in foreign countries. These strategic SWFs may include geopolitical goals but the core focus is to enhance economic development of specific sectors (Sun, Li, Wang, & Clark, 2014; Wu, Goh, & Hajela, 2012). These strategic SWFs invest more domestically (Bernstein et al., 2013; Chhaochharia & Laeven, 2008) and, more importantly, align their investment goals with national industrial plans (Dyck & Morse, 2011; Haberly, 2011).

These SWFs with economic development goals, are part of a larger network of state-backed institutions such as development agencies, public banks or public credit lenders that work as state tools for economic development. Indeed, SWFs are substantially connected to the government fiscal policy: resource-based SWFs are financed with proceedings of natural resources which can be used to balance fiscal budgets or deployed into SWFs, according to fiscal rule. The clearer the fiscal rule that indicates how much a government can tap yearly from the SWF, the easier to integrate SWF strategies within the network of state-backed

institutions (Al-Hassan, Papaioannou, Skancke, & Sung, 2013; Gelb, Tordo, & Halland, 2014).

1.2.2. Extension of agency and stakeholder theories

Researchers have explained the relationships between owners and managers of modern corporations (Berle & Means, 1932), following two academic traditions: the agency theory that is based on the alignment of interests between principals and agents (Eisenhardt, 1989; Jensen & Meckling, 1976; Ross, 1973), and the stakeholder theory, which considers the critical role of other non-shareholder groups or individuals such as employees, customers, suppliers, media, competitors or communities that can affect or be affected by the achievement of the firm's objectives (Donaldson & Preston, 1995; Freeman, 1984; Williamson, 1985).

Both theories have been enriched in recent years, updated to address the current context of large institutional investment power and activism (Ryan & Schneider, 2003). In the case of agency theory, there has been a critical turn towards the heterogeneity of principals (Schnatterly & Johnson, 2014). Investors vary substantially in terms of investment horizons, size or institutional settings, and consequently, their demands for better corporate governance differ (Agarwal, Daniel, & Naik, 2009; Bebchuk, Brav, & Wei Jiang, 2015; Becht, Franks, Mayer, & Rossi, 2009). This openness to recognize each investor class separately (Schnatterly & Johnson, 2014) offers an opportunity to explore further the motivations and interests of SWFs as a distinct type of institutional investor.

Stakeholder theory departs from the classical input-output representation of a company and adds complexity through multiple stakeholders with interests in the firm (Donaldson & Preston, 1995). The theory understands that diffused ownership has yielded passive and uninterested shareholders and facilitated an increased managerial discretion. Yet, the original theory did not consider the shift that occurred in the last two decades: institutional investors own larger stakes and they have increased activism to enhance the control of managers (Laplume, Sonpar, & Litz, 2008; Ryan & Schneider, 2003). This preeminent position makes institutional investors a peculiar and special group within the array of stakeholders (workers, governments, competitors, etc.). While the importance of a stakeholder management style to balance and harmonize the interests and needs of multiple stakeholders holds true (Freeman, 1984), it is also true that institutional ownership has changed the share of power among

stakeholders. Institutional investors cannot be understood as similar in power to other stakeholders (Neubaum & Zahra, 2006). Recent updates of the theory include the heterogeneity of motives among stakeholders (Bosse, Phillips, & Harrison, 2009; Bridoux & Stoelhorst, 2014), which imply that investors may have different interests in the firm. Some of these motivations now feature enhanced managerial supervision and control via shareholder activism. Also, the use of stakeholder orientation can act as a specific way to address shareholder interests in emerging market contexts (Jain, Aguilera, & Jamali, 2016).

In fact, a range of different causes (legal, social, corporate bylaws, governance codes, and technology) have reduced the costs of being active, and therefore increased the number of interactions between investors and managers (Coffee Jr. & Palia, 2016). Moreover, the enhanced awareness of the general public of corporate governance matters, has facilitated the tilt of power from managers to owners.

1.2.3. Heterogeneity of principals and activism

This sections examines how heterogeneity and activism are framed in recent literature about institutional investors. Also, it considers how the reduced costs of monitoring and engaging have resulted in increased activism.

The extensions of both agency and stakeholder theories in aspects related to institutional investors bring two key concepts key to understanding SWFs: there is a stronger heterogeneity of principals and, among them, some institutional investors are enhancing their activism. In the case of the agency theory, it is expanded by adding the complexities of different principals. In the case of stakeholder theory, it is enriched by the "activism" of institutional investors which extends their strategies beyond shareholder value to include other aspects such as governance (affecting managers and employees), environment (with direct impact in communities and media) or social issues (communities, governments). Thus, stakeholder theory, too centered in the management, sees institutional investors at the epicenter, as they take care on other firms' stakeholders.

SWFs are different to other institutional investors (Boubakri, Cosset, & Grira, 2016). This heterogeneity among shareholders has been reinforced in recent strategy literature (Goranova, Abouk, Nystrom, & Soofi, 2017; Schnatterly & Johnson, 2014) and it has been used to

understand better how different owners may have different interests towards management practices, investment horizons or controlling stakes (Schnatterly & Johnson, 2014). This effort helps to identify how different owners integrate SWFs as a new and different asset owner type with their own peculiarities.

Large institutional investors have faced three main difficulties in developing activism. First, free-riding of other investors prevents large investors from engaging with investee companies, and, given the positive externalities obtained, would benefit other investors that do not bear the costs of such monitoring. Second, large investors need to balance the benefits of activism with the costs of establishing a comprehensive engagement strategy comprised of new processes, guidelines, audits, etc. These large investors hold stakes in multiple companies – sometimes thousands – and to plan such an active ownership strategy implies new internal costs. They need to carefully assess whether is worth it to follow the "voice" strategy, rather than "exit" firms that do not comply with their governance expectations (McCahery, Sautner, & Starks, 2016). Third, regulations, despite becoming more relaxed in recent years (Coffee Jr. & Palia, 2016), may find coordinated actions difficult with other investors and may be required to disclose holdings positions in listed equities beyond a threshold. In the specific case of SWFs, there is a fourth cost, the liability of sovereignness (Aguilera et al., 2016): the more exposed a strategic state-owned fund to media or regulators, the higher the scrutiny it receives and the lower its returns on investment (Bortolotti et al., 2015).

However, recent investor-friendly regulations and management scandals have lowered costs for activism and brought new players to the shareholder activism space (Goranova et al., 2017). Today, more funds are actively engaging with companies, through direct conversations with board members and managers, filing shareholder proposals in annual meetings or via proxy advisors. As a result, there is a higher interest in the governance mechanisms that help to obtain such alignment: more professional boards, independent directors or enhanced shareholder voting rights. These pressure results in reduced agency costs, and, given more frequent communications, imply less information asymmetries and facilitates the alignment of interests.

Paradoxically, these new impulses in governance monitoring have brought new costs to the equation: the principal costs. More heterogeneous owners are trying to engage, through

various channels, with investee companies, resulting in a misalignment between owners. However, it is difficult to measure how significant the effects of these new principal costs are, given most of the conversations are held privately (Becht et al., 2009).

Long-term capitalism is another interrelated theme that accompanies these heterogeneous and engaged principals. The issue of how to improve the capitalist system is related to the role of institutional investors. These investors (investment funds, insurance companies, pension funds, sovereign wealth funds, private equity funds, hedge funds and exchange traded funds) own the majority of shares listed globally. A prudent estimate is that these owners control 65% of all listed equities globally. Given their empirical importance, new research has advanced on the responsible ownership of mutual funds, pension funds or hedge funds. Investment criteria now includes other stakeholders and the ultimate purpose of maximizing shareholder value is today enriched with environmental, social and governance considerations.

1.2.4. Implications for research on sovereign wealth funds

Sovereign wealth funds are viewed as passive shareholders (Mietzner, Schiereck, & Schweizer, 2015). The main reason is the liability of sovereignness which incentivizes SWFs to maintain a low-profile strategy when investing abroad. To avoid an active shareholding strategy is in line with this cautious approach. There are two other interrelated factors: size and age. Size prevents the largest SWFs from establishing a comprehensive engagement strategy, due to the costs associated with effectively monitoring thousands of minority positions. The other factor is age: the majority of SWFs were established in the last decade and engagement strategies are normally developed by mature and professional sovereign funds, when strategic capabilities have been sufficiently developed.

Indeed, the three essays of this thesis reveal the importance of acknowledging these differences among SWFs. While heterogeneity among SWFs explains why some funds might be good representatives of the responsible ownership movement (Essay III), in fact, the dynamism of the strategic governance (Essay I) explains why is reasonable to expect more sovereign wealth funds will adopt an active and engaged ownership approach. As sovereign wealth funds change, institutional pressures change with them (Clark et al., 2013; Schnatterly & Johnson, 2014).

The third essay shows how the largest SWFs (the Government Pension Fund Global, managed by Norges Bank Investment Management, NBIM), and one of the few established before year 2000, has developed a comprehensive strategy for improving the corporate governance of its investee companies. Institutional pressure, coming from NBIM or other large institutional investors, may exert an isomorphic effect on other SWFs (Vasudeva, 2013).

This thesis would help increase awareness of the dual objectives of SWFs: both financial and strategic. To understand that these two objectives do not contradict one another is one of the main learnings of these collection of essays. The dual objectives can be complementary if the appropriate governance is guaranteed. Indeed, the Santiago Principles[1], a voluntary code which works as the governance and risk management guideline for SWFs, detail that "if investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed." SWFs will benefit from transparency and the International Forum of Sovereign Wealth Funds – the voluntary group that brings together more than 30 SWFs to strengthen the community – is helping funds move in this direction.

Yet, strategic motivations could dominate financial returns and this risk is higher for those domestically oriented SWFs, where majority positions dominate minority stakes, where governance is not strongly established, where accountability is reduced, and where the connection to government is more intense. The negative effects of political interference have been documented (Bernstein et al., 2013; Bortolotti et al., 2015), yet, it remains critical to deepen our understanding (empirically above all) on how to combine the dual objectives present in the majority of funds. This is more relevant today, when commodity prices seem to stay low for longer periods and SWFs return to domestic issues. This domestic orientation appears in different forms: governments tapping more from SWFs to fix unbalanced budgets, the establishment of domestic infrastructure funds, or the design of co-investment vehicles attracting foreign resources to push local sectors.

[1] Available at http://www.ifswf.org/santiago-principles-landing/santiago-principles. Accessed Feb 25, 2017.

This thesis also brings the sometimes "siloed" lessons on SWFs contained within different theoretical disciplines. From finance to management, or economics to international law, this thesis helps to acquire a more holistic view of the funds.

1.3. RESEARCH METHODS

The first two essays have helped to develop a theoretical framework and test its applicability in a specific and real context. The first essay started as a literature survey on SWFs, and then was modified for publication into a theoretical paper which provides a framework for studying SWFs dynamically. The method of the second essay tests the theoretical validity of the framework designed in the first essay. The fitness of the model was tested in a real case study, applying the investments of SWFs in Spain.

The third essay is the most salient piece from a methodology standpoint. We applied a difference-in-differences procedure to test the effectiveness of NBIM as an active owner. Before running the analysis, we generated a matched sample. The matching strategy, described in detail in Section 4.6.1., was necessary to provide a valid assessment of the effects of NBIM.

We matched every control firm with a unique match in the treated group. We chose a single match and do not allow for replacement (a firm from the treatment group can only be used once as a match). We followed this procedure because our treatment group is larger than our control group. We were more concerned with minimizing the bias at the cost of larger variance, since our sample is large enough to be less concerned about variance (Abadie & Imbens, 2002).

We matched the treated and control groups in size (measured by total assets), performance (measured by the ratio of EBITDA to total assets) and institutional investors (percentage of shares in hands of institutional investors). We restricted the number of covariates since there was a trade-off between the plausibility of the unconfoundedness assumption and common support (Black & Smith, 2004). Following Sianesi (2004), we focused on covariates that simultaneously affect the treatment status (belong to the NBIM's portfolio) and the outcome variable (our corporate governance measures).

Data collection has been a limitation in research on SWFs. The bias of most samples towards the most transparent funds is patent. There are not publicly available datasets that provide universal, historic and consistent data on SWFs equity holdings. This issue is avoided in the third essay, as data is used from just one SWF, similarly to research on asset managers such as Hermes, the fund manager owned by the British Telecom Pension Scheme (Becht et al., 2009) or TIAA, formerly TIAA-CREF, studied by Carleton, Nelson, and Weisbach (1998).

1.4. THESIS STRUCTURE AND SCIENTIFIC CONTRIBUTION

This thesis is a monograph of three essays on sovereign wealth funds (Table 1.1). The first essay develops an original theoretical framework to better understand this institutional investor class. The development of strategic capabilities is the main construct used to examine the investment strategies and risk management of SWFs. The essay is grounded on comparative corporate governance and strategic governance for the firm-level analysis of SWFs. The second essay applies the framework developed in the first essay and tests its validity in a real context. We uncover the strategic capabilities developed by SWFs through investments made in Spain. We show the validity of the main theoretical contributions of the analyzing framework. The third essay focuses on the extensions of agency and stakeholder theories to include active ownership and heterogeneous principals. We empirically prove the effectiveness of the shareholder engagement strategy developed by NBIM, a sovereign wealth fund, on its investee companies.

The Table 1.1 provides a summary of the scientific contribution of the three essays presented in this thesis. The first essay, co-authored with Dr. Ruth V. Aguilera and Dr. Javier Santiso, was accepted for publication in May 2015 and published in the *Academy of Management Perspectives*. The second essay was accepted for publication as a chapter in the *Oxford Handbook of Sovereign Wealth Funds* (Oxford University Press). The third essay is an on-going project with Dr. Ruth V. Aguilera, Dr. Vicente Bermejo and Dr. Vicente Cuñat, and is aimed for publication in a "class A" journal.

For the simplicity of the structure of this thesis all tables and figures, as well as references, are placed at the end of each chapter.

1.4.1. ESSAY I
SOVEREIGN WEALTH FUNDS: A STRATEGIC GOVERNANCE VIEW

In this essay, we develop an organizing framework to better understand the firm-level characteristics of SWFs and their consequences. Recent tectonic, global economic and political shifts have spurred the emergence of new organizational forms such as sovereign wealth funds – state-owned investment organizations without pension liabilities – primarily in emerging markets. Although scholars have begun to explore SWF macroeconomic trends, little is known about the challenges these institutional investors face or their strategic capabilities in addressing these concerns.

We began by briefly reviewing the state-of-the-art findings on what we know about SWFs. They are a highly heterogeneous group. SWFs investments generate positive short-term stock reactions, their investment strategies tend to have a substantial domestic bias when politicians are involved, and they face the "SWF discount" or the liability of sovereignness. This concept means two things; the first is that markets and recipient countries consider SWFs as a different investor class. Secondly, while SWFs have a positive impact, the effects are lower than those of comparable private institutional investors peers.

Our SWF framework, while an ideal type, identifies the strategic challenges these institutional investors face and reveals four strategic governance approaches they deploy to overcome them. First, we uncover shareholder activism to combat the principal–agency conflict. SWFs exercise this activism with their voting rights and demand for effective corporate governance standards in their investee companies. Second, SWFs might face severe information asymmetries and intrinsic principal-principal costs when investing in private firms. By enhancing their in-house capabilities, SWFs have been able to simultaneously reduce their dependence on external managers while also increasing their professionalization.

Third, strategic SWFs might be deployed as governmental tools, decoupling and investing in publicly traded firms to gain legitimation, though their sovereign interests may likely not be fully aligned with the core shareholder value maximization interests of their co-owners. Fourth, strategic SWFs investing in private companies seek to obtain long-term learning templates that will help them acquire the relevant know-how and diversify the base of their

own national economies. With our proposed strategic governance framework, we discuss movements across strategic governance dimensions and uncover two research topics that need further attention: the idea of long-term capitalism and the role of politicians and politics in SWFs.

SWFs have introduced a new way of thinking the relationship between the state and the private sector. However, some questions still remain: Will states that sponsor SWFs be able to attract or develop enough talent to achieve their goals? Will SWFs lead to improved governance worldwide although they are in need of better management practices? The latter is addressed in Essay III.

1.4.2. ESSAY II: SPAIN AND SOVEREIGN WEALTH FUNDS: FOUR STRATEGIC GOVERNANCE TYPES

This second essay focuses on the case of Spain as a destination for SWFs investments. In 2011, Spain was the first destination for SWFs foreign direct investments in Europe (Santiso, 2012). The relationship Spain has had with SWFs led to the establishment of the first Spanish co-investment SWF, which has not been operated yet, following a model already used by Italy and France.

This variety of SWFs allows the identification of four different governance strategies (described in Essay I) used by SWFs when investing in Spain. First, SWFs with minority stakes could play an important role in Spain as corporate governance watchdogs. Funds like NBIM (analyzed empirically in Essay III) will have an important role to ensure that the codes of governance and the best practices spread to more companies. We define this type of SWFs as *responsible investors*.

Second, we offer evidence about the role played by in-house capabilities to improve the quality of deal scouting, to access direct investing and to enhance partnerships. In this section, the case of the Kuwait Investment Authority is analyzed.

Third, we examine Qatar Investment Authority (QIA) as the best example of a strategic fund looking for legitimacy. The Gulf country has landed in Spain with a very clear objective: to leverage its financial firepower and re-invent the image of the Arab country. Investments and partnerships with Spanish companies in sectors such as football, airlines and hotels allow

QIA to build trust with local institutions and to deploy a comprehensive strategy that aims to diversify its national economy.

Fourth, with the knowledge acquired over the last decade dealing with SWFs, Spain set up its own co-investment fund with Oman. The joint fund has plans to invest in Spanish companies going abroad. Both Oman and Spain focus on learning and encourage the establishment of an international joint-venture to achieve strategic national goals. This fund has not been operated yet.

1.4.3. ESSAY III
TOO BIG TO LEAVE: THE CASE OF ACTIVE OWNERS

This third essay is an empirical work which addresses the question of how effective large owners are in improving the corporate governance of their investee companies. This question was raised in Essay I, and explored for the case of Norway in Spain in Essay II. In this third essay, we seek to contribute to research on active shareholders by focusing on NBIM (Norway's sovereign wealth fund manager). While we know that different owners have different interests in the firms in which they invest and different views as to how their corporate governance should look like, there is much to learn from unique institutional investors such as sovereign wealth funds.

In particular, we explore whether there is any governance improvement after NBIM makes an explicit and unexpected announcement in November 2012 that it will put pressure on firms in which they invest to improve their governance. We uncover, relative to a matching sample, that NBIM investee companies do change their corporate governance post-announcement.

In this essay, we demonstrate the monitoring role of sovereign wealth funds. Our results shed light on the literature of shareholder activism and the growing theme of heterogeneous shareholders (Goranova & Ryan, 2014; Hoskisson, Hitt, Johnson, & Grossman, 2002; Schnatterly & Johnson, 2014). Regarding the literature of sovereign wealth funds, this research may help to unpack how, without having a seat on the board, large funds can exert an influence (Vasudeva, 2013) and impact their investee companies' corporate governance. This "voice" mechanism, put in place through different channels, most of them "behind-the-scenes" (McCahery et al., 2016), turns out to be effective and can be a way to circumvent the

"liability of sovereignness" or the discount effect detected in the literature (Aguilera et al., 2016; Bortolotti et al., 2015).

Post announcement, the share of independent directors in firms owned by NBIM improved, compared to those firms not owned by NBIM. The same applied to the share of women on boards, as well as to the specific skills of boards. We discuss other counterintuitive results: the difficulties of establishing audit and compensation board committees and the issue of equal voting rights, in line with discussions on long-term capitalism and active ownership. Our findings shed light on active ownership among a unique set of owners and expands the knowledge on heterogeneous principals.

In sum, this thesis have sought to first categorize the different types of SWFs, develop a strategic governance model of their dual mission (economic and political), and explain the dynamic forces that drive SWFs changes. Then the thesis tests this model in a qualitative study of SWFs investing in Spain. This research concludes with an empirical study of how the world's largest SWF has acted as an engaged shareholder in changing the corporate governance of their portfolio companies. In this regard, I hope that this thesis is a first step to better understand this very important type of institutional investors so that corporations and governments can develop better strategies towards SWFs, as they travel around the world and become significant players.

Table 1.1: Contributions to scientific knowledge

Title	Authorship	Journal	Status	Publisher
Sovereign Wealth Funds: A Strategic Governance View	Javier Capapé, Ruth V. Aguilera, Javier Santiso	Academy of Management Perspectives *Impact Factor* 2015: 3.94 *Ranking:* Business 9/120	Published	Academy of Management
Spain and Sovereign Wealth Funds: Four Strategic Governance Types	Javier Capapé, Ruth V. Aguilera, Javier Santiso	Oxford Handbook of Sovereign Wealth Funds	Accepted: In Press	Oxford University Press
Too Big To Leave: The Case of Active Owners	Javier Capapé, Ruth V. Aguilera, Vicente Bermejo, Vicente Cuñat	Strategic Management Journal *Impact Factor* 2015: 3.34 *Ranking:* Business 7/120	Working paper	Wiley

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2

Sovereign Wealth Funds: A Strategic Governance View

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2.1. ABSTRACT

Recent tectonic, global, economic and political shifts have spurred the emergence of new organizational forms such as sovereign wealth funds (SWFs), state-owned investment organizations without pension liabilities, arising primarily in emerging and frontier markets. Although scholars have begun to explore SWF macroeconomic trends, little is known about the challenges these institutional investors face or about their strategic capabilities to address these concerns. Drawing on comparative and strategic corporate governance research, we develop an organizing framework to better understand the firm-level characteristics of SWFs and their consequences. Our analysis of these investment funds' multidimensional strategic governance traits contributes to the literature on state capitalism and comparative corporate governance.

2.2. INTRODUCTION

State intervention in the form of full ownership and management of state-owned national champions or large diversified conglomerates has progressively eroded, with the role of the state being reinvented into new organizational and strategic forms. This gradual transformation is partly explained by waves of privatizations, changes in state and non-state relationships, new industrial policies, and the dismantling of large diversified business groups. As Musacchio and Lazzarini (2014) and Bruton, Ahlstrom, Stan, Peng, and Xu (2014) have documented, we are entering a new era of state capitalism where governments tend to share their ownership with other non-governmental owners and/or provide strategic support to private firms by means of subsidized credit and/or other state protections. This "new state capitalism" is centered on a reinvented state, one that as an owner seeks to simultaneously achieve the often conflicting goals of financial efficiency (i.e., short-term shareholder value maximization) and political pursuits (i.e., industrial policy, geopolitical positioning, national security, etc.). Sovereign wealth funds such as Singapore's Temasek, the China Investment Corporation (CIC) or Norway's Government Pension Fund Global (GPFG) are a salient class of funds within this new state capitalism, blurring the lines between finance and politics. SWFs are government-owned investment funds without explicit pension liabilities that typically pursue long-term investment strategies. They also tend to be internationally focused and manage multi-billion assets. This excludes other types of organizations such as state-owned enterprises (e.g., Gazprom), pension funds (e.g., CalPERS), and private equity investors (e.g., Blackstone group).

It is important we understand the emergence of SWFs within the context of the latest global financial developments. The world economy has changed rapidly, particularly in terms of the distribution of international reserves which are a core funding source for SWFs. At the turn of the 21st century, central banks from advanced economies held 66 percent of the world's reserves (mostly in foreign exchange and gold), while emerging and developing economies held the remaining 34 percent. A decade later, the tables have turned. Emerging and developing economies now hold 60 percent of all reserves and, more strikingly, they have grown six-fold in this period, increasing their assets from US$2.2 trillion in 2000 to $12.1 in 2011 (Truman, 2012). These systemic global imbalances account for some of the features of today's global financial scenario. On the one hand, export-led economies and those sitting on large natural resource reserves benefit substantially from more prudent fiscal

and foreign-exchange policies, an increasingly integrated world economy, and the recent past period of high commodity prices. On the other hand, most Western economies now face sovereign deficits, debt pressures, and low growth rates. Thus, investors from the Middle East, South-East Asia (and particularly China), and, to a lesser extent, Latin America, have the liquidity that Western economies seek. SWFs have become highly liquid organizational investors in an illiquid world.

However, SWFs adopt unique and differing governance structures to manage enormous pools of capital from the surplus regions and to engage in strategic investment relationships with firms and managers from a wide array of industries and foreign countries. While there exists a handful of excellent compilations on SWFs (Balding, 2012; Bernstein, Lerner, & Schoar, 2013; Castelli & Scacciavillani, 2012; Clark, Dixon, & Monk, 2013; Megginson & Fotak, in press), existing research tends to take a macroeconomic or financial perspective or is otherwise highly segregated across the different disciplinary fields. Therefore, there is a strong need to integrate the "siloed" knowledge on these global institutional investors, though, most importantly, we seek to study SWFs at the organizational level of analysis (as opposed to country level) where we can identify these funds' strategies and challenges. In this paper, we offer an organizing framework to shed light on these fairly unknown yet important institutional investors, uncovering the different dimensions of their investment strategies and governance traits or what we refer to as their *strategic governance*. Our underlying proposition is that SWFs seek to align their unique governance capabilities with their interest in excelling in the global investment arena. In particular, we explore how a wide variety of states (personified by a wide array of leaders ranging from politicians in dictatorships to ruling elites in countries with weak institutions and financial bureaucrats in developed democratic countries) and SWF managers relate to investee firms, the latter's managers and co-owners.

There are at least five reasons why understanding SWF patterns and their potential is both critical and timely. First, these investment organizations have become key players in the global economy, collectively managing $6 trillion[2] as of the end of 2014 and with their total assets having surpassed that of hedge funds and private equity combined in less than a decade

[2] Institutional sources used include: Sovereign Wealth Center (London), ESADEgeo (ESADE Business School; Madrid), SovereigNET (The Fletcher School, Tufts University; Medford, MA), and Sovereign Investment Lab (Bocconi University; Milano).

(Megginson & Fotak, in press). Thus, SWFs are clearly shaping today's global financial landscape, and their presence will surely rise in coming years. That notwithstanding, these organizations have been understudied, and we need to integrate all we know about them into a cohesive framework to help improve how well managerial scholars, practitioners and policymakers understand them. Second, SWFs became salient global players during the 2008 financial crisis by recapitalizing most of the Western banking system and they have since become top players in other industries such as natural resources, real estate, transportation and utilities. For example, Norway's GPFG (the world's largest SWF, managing approximately $900 billion in assets) owns three percent of all publicly-listed shares in Europe. Moreover, GPFG is part of the global strategic governance movement of "shareholder activism" and it has the potential to impact many global companies. Third, SWFs are learning organizations, venturing into managing more complex types of assets such as infrastructures, private equity and real estate. For example, SWFs account for 9.5 percent of all private equity investments made during 2003-2007 (Bernstein et al., 2013). Fourth, SWF investment trends are not only geared toward the advanced industrialized world; they have also begun to shift towards strong "South-South" (non-OECD countries) investment relationships. For example, Singapore's Temasek holds more than $17 billion in Chinese bank stock. Moreover, four out of the five largest deals in 2013 were South-South investments. Lastly, some SWFs are leading the economic transformation of their own national economies. For example, the Mubadala Development Company from the Emirate of Abu Dhabi has developed a world class aerospace industry through foreign strategic investments and alliances, now supplying components to EADS, the European champion in the aerospace industry.

In sum, SWFs are unique investors due to their size, central involvement in global finance, their systemic power, unique capacity to learn, geopolitical breadth, and developmental strength. Although they are certainly quite heterogeneous given their diversity in size, country of origin, and source of wealth, they capture the spirit of this new state capitalism. And despite being state-owned investors, their capacity to intervene in private firms is equal to other institutional investors, though their incentives are likely to frequently diverge. These state-owners adopt a unique type of governance in that they are equity owners that cannot exercise sovereign regulatory or supervisory powers in the organizations in which they invest. SWFs are simply one more investor among many others and they have a fiduciary duty to the state (or, ultimately, the citizens) of a given country. They are still under

pressure to achieve the same financial efficiency as other institutional investors in the race to become global players, but the challenge is to balance their dual strategy of financial efficiency and political effectiveness. This dual focus is often hard to reconcile and ultimately defines the boundaries of new state capitalism.

Unfortunately, existing research on SWFs remains highly fragmented across different disciplines: finance, economics, and law. In this paper, we begin by briefly highlighting the main findings from our review of existing literature and then turn to the firm level to analyze the combined strategic motives and governance traits of SWFs as the star representatives of this new state capitalism. We draw on research from the strategic management and corporate governance fields to develop an organizing framework that systematically identifies four strategic governance dimensions on which SWFs rely to compete in the global financial arena. We then discuss the theoretical logic present in this new form of governance and conclude by identifying promising areas of future research and the possible managerial implications for SWF practitioners.

2.3. WHAT WE KNOW ABOUT SOVEREIGN WEALTH FUNDS

Table 2.1 includes a summary of the existing body of research on SWFs in the finance,[3] strategy, political economy, economics, international law, and organizational theory fields. The conclusion from our review is that, while there is increasing interest in the topic, current literature remains fragmented by disciplines. To partially amend this dissonance, we uncover three consistent findings from our analysis of SWF literature. The first element that stands out is that these organizations are highly heterogeneous in terms of size, geographic origin, geographic destination, funding sources, and policy purposes (as shown in Table 2.2). Although the first SWF technically dates back to 1854 (Texas Permanent School Fund), SWFs are a fairly novel type of organization in the new state capitalism. The term was first coined in 2005 by Andrew Rozanov (2011), then Managing Director of State Street. However, there is still an ongoing debate on the definition of SWF.

Second, in terms of financial performance, SWFs' short-term influence over investee firms is comparable to that of other institutional investors, despite the fact that SWFs are often

[3] For a detailed literature review on SWF asset allocation, geographic and industrial investment patterns, and the impact of SWF investment in target companies, please see Megginson & Fotak (in press).

portrayed as “barbarians at the gate” (Reed, 2009). Some scholars have uncovered that SWF investment announcements cause positive short-term stock reactions (Bortolotti et al., 2013a; Dewenter et al., 2010; Kotter & Lel, 2011). However, their long-term impact is neutral in terms of absolute returns (Bortolotti et al., 2013a) and negative when measured by Sharpe and P/E ratios (Bernstein et al., 2013; Knill et al., 2012a). According to Bernstein et al. (2013), long-term performance worsens when politicians are involved in SWF management, reflecting embedded agency issues in which politicians’ investment interests are not always aligned with those of the SWFs. Bortolotti et al. (2013a) refer to SWFs’ inability to keep up with the performance of peer institutional investors as the “SWF discount,” thus alluding to these organizations’ most salient feature, i.e., that they are state-owned investment funds. This discount is in line with corporate governance research claiming that the configuration of types of owners has a great deal of influence on firms’ strategic decisions (Aguilera & Jackson, 2010). In terms of SWFs, governments serve as co-owners and might thus be able to influence the non-financial goals of their investee firms and capture private benefits of control that might ultimately expropriate from their co-owners’ financial goals. Contrarily, there is also evidence showing how SWFs can increase investee companies’ value and performance through stable and long-term access to capital and markets (Fernandes, 2014).

Lastly, we know quite a bit about the investment and economic motives that led to the creation and growth of SWFs: inter-generational balance, macro-stabilization, resource diversification, national economic development, and greater supremacy in the international geopolitical arena. Bodie and Briere (2013) shed light on this macro view, revealing how SWF strategies are not typically in line with the governments’ fiscal, monetary, and public debt strategies. Economists have sought to attribute the increasing surge of SWFs in recent years to the immense accumulation of international reserves, a takeaway from the Asian crisis in 1997 accompanied by soaring oil and gas prices at a time of low global interest rates and recent oil and gas discoveries in Africa (Aizenman & Glick, 2010; Castelli & Scacciavillani, 2012; Megginson & Fotak, in press). This capital hoarding has encouraged the establishment of SWFs all over the world and the need to decide on optimal capital allocation.

2.4. AN ORGANIZING STRATEGIC GOVERNANCE FRAMEWORK

Drawing on notions from strategic management and corporate governance research, we propose a framework to better understand the underlying SWF organizational capabilities and challenges and to analyze how the ultimate owners of SWFs (states personified by politicians and executed by SWF managers) relate to both managers in the investee firms and to their co-owners. We first draw on the logic of principal-agency theory (Dalton, Hitt, Certo, & Dalton, 2007; Jensen & Meckling, 1976) in which SWFs (agents) as minority shareholders and globally diversified investors with a limited ability to influence managerial decisions and managers (principals) can have their own, often disparate incentives. We subsequently introduce the principal-principal agency perspective (Morck, Wolfenzon, & Yeung, 2005; Young, Peng, Ahlstrom, Bruton, & Jiang, 2008) because it enables us to engage in the debate regarding co-owners. In particular, we explore some of the challenges that SWFs encounter when interacting as minority shareholders with other (majority) influential co-owners and when seeking to minimize information asymmetry. Our framework classifies SWFs in two dimensions: 1) investment motivation and 2) the ownership type of the investee firms. These two key dimensions (reflecting strategy and governance traits) offer important insights into the capabilities and constraints that SWFs are likely to face in terms of their strategic governance to become effective global investors. Figure 2.1 summarizes the four possible scenarios that we propose.

2.4.1. Investment Motivation: Financial and Strategic

In terms of the first dimension, investment motivation, we would like to underscore that SWFs are government-owned, often without much managerial involvement in investee companies (Rose, 2013). The principal-agent problem is embedded because of "who" the owners are, which is distinct from owners and managers of state-owned enterprises (Bruton et al., 2014). The key challenge in this classic agency conflict is to define the motivation behind the investment. Comparative corporate governance literature makes a sharp distinction between investors that are typically short-term oriented and pursue mostly a shareholder value maximization strategy and those that are long-term oriented and seek broader societal or political goals such as sustaining full employment, keeping harmony within business groups, guaranteeing a minimum social welfare threshold, protecting business elites, etc. (Shleifer &Vishny, 1997). We can extend the dichotomy between shareholder and stakeholder-oriented governance systems to the SWF context as financial

versus strategic goals (Aguilera & Jackson, 2003; Hoskisson, Johnson, Tihanyi, & White, 2005). The differentiation between financial and strategic motivation is relevant because it moves away from purely Anglo-American conceptions of short-term financial gains and includes broader market logics tied to political interests prevalent in emerging and frontier markets with weak shareholder right protection and strong national states. We thus propose two investment motivations: financial and strategic.

In terms of financial motivation, some SWFs operate fairly similarly to their institutional investor counterparts in that they invest in global, diversified portfolios to maximize their long-term returns subject to an acceptable risk level (Balding, 2012; Bernstein et al., 2013; Chhaochharia & Laeven, 2009; Fernandes, 2014). In this way, they might seek to invest internationally to entrench themselves from domestic political pressures and thereby differentiate themselves from SWFs that pursue non-financial goals. Moreover, as Das et al. (2009) argue, the pursuit of purely financial goals might insulate the sovereign economy from resource price and supply fluctuations and diversify revenues from non-renewable resources.

We define strategic motivations as those adding to sovereign value. Sovereign developmental goals encompass several strategies such as assisting national industrial-planning (Dyck & Morse, 2011), securing natural resources or establishing alliances with foreign industry leaders. Governments can deploy SWFs as a means to engage in international relationships with other countries and/or foster national security. Broad development aims can entail legitimate goals within the global financial arena, accounted for in the Generally Accepted Principles and Practices for SWFs (also known as “Santiago Principles”, a voluntary code which works as the governance and risk management guideline for SWFs). However, strategic capital allocations range widely. For instance, Clark et al. (2013) show how SWFs can be “tools for facilitating autonomy and sovereignty” to governments or a powerful form of protection from the global economy preying on their currency and commodity fluctuations. We conceptualize this investment motivation as a continuous and bidirectional factor as SWFs move between strategic and financial poles. In the discussion section below, we return to this point, namely that SWFs are dynamic organizations whose interests evolve over time (Fotak et al., 2013).

2.4.2. Investee Ownership Type: Publicly Versus Privately-Held Companies

In this section, we discuss the other dimension of our organizing framework of SWFs, namely the ownership nature of investee firms, a discrete variable consisting of either publicly or privately-listed firms. We also discuss under what conditions the principal-principal conflict is likely to be greater. Each ownership structure is linked to unique governance modes. This is an important differentiation because the firm's ownership structure conditions how the owners can influence managers and the intensity of the information asymmetries. Publicly-traded firms tend to have a more dispersed and broader floating ownership. From the point of view of an investor such as an SWF, public entities imply less uncertainty and less information asymmetry regarding their value due to disclosure requirements, market pricing, coverage from analysts, and ties with investment banks. The intrinsic characteristics of publicly-traded firms result in lower search costs, implying more effective explorations and a lower risk of adverse selection (Capron & Shen, 2007). However, publicly-traded companies experience higher pressure to achieve short-term results. These firms welcome passive institutional investors such as public pension funds and SWFs because they are not likely to "rock the boat" (Barclay, Holderness, & Sheehan, 2007). SWFs can calculate expropriation risks by private benefits of control as there is more information and, hence, they can better assess the principal-agent conflicts.

Conversely, private firms have a higher concentration of ownership (Claessens & Tzioumis, 2006), while the reduced liquidity of their shares encourages investors' long-term commitment (Fischer & Pollock, 2004; Lee & O'Neill, 2003). That notwithstanding, firm valuations are more uncertain due to the lack of publicly disclosed information and lower scrutiny (Cumming & Waltz, 2010). We do not refer here to SWFs investing in private equity firms as limited partners. Rather, our focus is on the SWFs as direct investors in privately-held companies, infrastructures, properties and timber projects or as co-investors with private equity firms as general partners. From the investor point of view (i.e., the SWFs), they are likely to benefit from the "private firm discount," that is, investors can negotiate more advantageous prices and invest at a substantial discount relative to public firms (Capron & Shen, 2007). This benefit is accentuated by the fact that private firms are not as rigorously regulated (Henisz, Mansfield, & Von Glinow, 2010). Moreover, Capron and Shen (2007) show that there is industry specialization in the context of acquisitions of privately-held firms given the risk of adverse selection. Investors favor private firms in familiar industries while they tend to invest in listed companies when they don't have a knowledge advantage. This

investment behavior supports their ability to manage the principal-principal problem. In other words, when SWFs have good information about their co-owners, they can minimize the risk of expropriation and other risks derived from low shareholder protection. Accordingly, SWFs investing in private firms are likely to specialize in two familiar industries: natural resources and financial services. On the one hand, SWFs funnel their natural resources through funds (e.g., Middle Eastern funds and Norway's GPFG) or they need to secure their access to key natural resources (e.g., SWFs from Singapore and China. On the other hand, all SWFs are, by definition, investment organizations and, thus, financial players in themselves.

2.5. A STRATEGIC GOVERNANCE FRAMEWORK OF SOVEREIGN WEALTH FUNDS

Next, we turn to our framework of SWFs, drawing on the two dimensions we've discussed thus far: SWF investment motivations and investee firm ownership type. Our framework yields four analytical quadrants which we use to identify four key strategic governance modes, each with unique managerial advantages and challenges. In particular, we discuss how SWFs in each of these quadrants have different strategic governance traits to manage principal-agent and principal-principal challenges, as well as align with their unique state capitalism style.

2.5.1. Quadrant 1. Shareholder Activism

Quadrant 1 in Figure 2.1 encompasses SWFs that can play an important role as shareholder activists. These SWFs primarily seek financial goals and invest in publicly-traded firms to either set the country's investment tone and become national investment benchmarks, or to overcome the "*liability of sovereignness*," protecting themselves from domestic politicians. Moreover, while SWFs are asked to comply with typically high standards of financial and social disclosure, they are also empowered with shareholder rights to monitor investee managers and exercise their voice as owners. SWFs in this quadrant have the governance capacity (Desender, Aguilera, Crespi-Cladera & Garcia-Cestona, 2013) to minimize agency problems with managers.

Moreover, the state capitalism perspective is also applicable when SWFs are seen as a state legitimizing tool. Since these SWFs' investments are transparent and typically large,

they tend to set the investment choices for other domestic firms that seek to invest globally yet do not have the research resources to select investee firms. Thus, we can see that these investment organizations are not only active in their investment choices and governance practices but, within the new state capitalism, they are also perceived as legitimate organizations (Ang, 2012) that activate isomorphic investment dynamics (Vasudeva, 2013).

Norway's GPFG is the best known case of an active shareholder among these investment organizations and, in this sense, it is a clear example of strategic governance. First, through its government commissioned Council on Ethics, GPFG carries out active, widespread monitoring of its investments in nearly 7,500 companies (by the end of 2013), identifying inconsistencies between its portfolio companies and its ethical guidelines. When necessary, the Council on Ethics recommends the exclusion or close monitoring of a company to the Norwegian Ministry of Finance which has the last word in this respect. Since 2004, firms potentially causing environmental damage, those involved in producing either nuclear weapons or cluster bombs, and tobacco companies have all been excluded from GPFG's investment portfolio. This list of excluded firms includes well-known companies such as Boeing, EADS, Rio Tinto, and Wal-Mart. In addition to exercising its exit shareholder right, GPFG recently launched a campaign for increased corporate governance engagement in companies where it has a substantial investment and a long-term interest (e.g., in BlackRock, BG Group, UBS, Prudential, Volvo and Svenska Cellulosa). GPFG publishes its voting intentions ahead of general meetings for selected companies and for given issues they want to highlight. The rationale is that GPFG seeks to express its voice in governance issues such as director nominations and remuneration policies. In other words, this SWF is using governance strategically to define what the organization does but also to align it with the geopolitical stance of the Norwegian government.

We argue that SWFs with a financial purpose and investing in publicly-traded firms are more likely to be perceived as other institutional investors equipped to engage in shareholder activism, exercise their voting rights, and demand effective corporate governance standards in the investee companies where they have become state co-owners. Along with GPFG, Korea Investment Corporation is another good example of SWFs in this quadrant.

2.5.2. Quadrant 2. In-house Capabilities

SWFs in quadrant 2 seek financial goals and invest in private firms. There are significant differences between the motivations to invest in private versus publicly-listed firms as discussed above. In this quadrant, we would like to introduce the idea of SWFs as investment organizations gradually developing in-house capabilities. Typically, institutional investors hire external fund managers (e.g., Goldman Sachs, UBS, etc.) who manage their assets. In the case of SWFs, many give mandates to external fund managers to pursue their established investment strategies and goals. Until recently, SWFs like other institutional investors paid high fees to their external fund managers, usually to invest in private equity as limited partners or co-investors to general partners (Hoskisson, Shi, Yi, & Jin, 2013). However, the 2008 financial crises altered the relationship between investors and external fund managers and brought in a new practice. During the financial turmoil, these external fund managers did not succeed in providing reasonable returns on investments, leading SWFs to seek alternative solutions that would minimize the transaction costs of their investments (Dixon & Monk, 2013). One of the responses to this non-contingent external management fund cost is internalizing this service, reducing SWF dependence on external agents as well as the intrinsic agency costs (Clark et al., 2013). Thus, by investing in private equity to diversify risk and achieve greater profitability, SWFs have achieved greater professionalism and developed in-house investment capabilities.

Investments in private equity face two key principal-agency challenges that can be partially overcome by developing in-house investment capabilities. On the one hand, the general opacity of private equity (relative to publicly-traded companies) exacerbates the information asymmetry between the principal (SWF) and the agent (external fund manager) (Johan et al., 2013). These asymmetries are even larger in the context of SWFs investing in foreign markets. However, the continuing growth of these state-owned funds within the new wave of state capitalism (Bremmer, 2014; Karolyi & Liao, in press; Li, Cui, & Lu, 2014) has fostered the development of new capabilities that can either be developed internally or, more commonly, acquired by hiring foreign senior talent, in turn making SWFs more professional and sophisticated (Ang, 2012). The development of this internal human capital facilitates greater internationalization, particularly in private equities.

Therefore, SWFs are drawing on strategic governance through their growing direct investments in private equity to address three challenges. First, their engagement with private

equity fund managers forces SWFs to professionalize their internal investment teams by developing and/or acquiring talent. Better human capital is likely to lead to an overall efficient organization. Second, as a result of developing new internal investment capabilities, SWFs lower their dependence on external investment management, reducing their transaction costs (fees). Moreover, greater internal investment capabilities are typically associated with the ability to manage more complex assets such as private equity which is increasing in volume (Hurst, 2014). Third, the development of in-house investment capabilities reduces agency costs by more closely aligning the interests between SWFs and investee shareholders (principal-principal conflict) as well as SWFs as owners and investee firm managers (Clark et al., 2013).

The main challenge for this type of SWF investment is co-existing as state-owners with other owners (not always state-owners) who might have different interests in the firm. This raises the classic principal-principal problem (Young et al., 2008). In terms of strategic governance and to minimize both principal-principal and principal-agent problems, SWFs might set up investment management offices closer to their investment partners and investee companies to minimize moral hazard and to exert more control over managers, respectively (Al-Kharusi, Dixon, & Monk, 2014). Thus, SWFs can reduce the institutional distance (Eden & Miller, 2004) with their investment partners (co-owners) by developing in-house managerial capabilities to monitor this risk. This closer relationship is likely to foster trust and reduce information asymmetries, which in turn might decrease the principal-principal costs. Doing so also exposes SWFs to learning opportunities with other co-investors and financial intermediaries.

ADIA from Abu Dhabi is an illustrative example of SWFs in quadrant 2. ADIA's volume in assets is estimated to be above $700 billion, and it is in the process of reducing its reliance on external investment managers (which in 2012 was around 75 percent) as well as capturing international talent (for instance, ADIA is hiring managers from Deutsche Bank, Credit Suisse, and BP as heads of key private equity departments). In addition to reducing transaction and agency costs, this internalization effort also demonstrates ADIA's strategic governance, incorporating human capital to obtain higher control. GIC from Singapore is another good example of this strategic governance. This $280-billion SWF is increasing its investments in private equity (in 2014 around 15 percent of its portfolio) as well as engaging in product diversification. It is now one of the ten largest investors in real estate in the world

and an active player in the venture capital industry. These in-house capabilities were encouraged by the Singaporean government in its attempt to raise the quality of the country's asset management industry. The recent opening of GIC's San Francisco office is further proof of its commitment to venture capital, its efforts to minimize principal-principal conflict, and the strength of its internal investment capabilities (the same applies to Khazanah National which recently opened its first non-Asian office in San Francisco).

2.5.3. Quadrant 3. Legitimacy and Decoupling

SWFs in quadrant 3 pursue strategic (non-financial) goals and invest in publicly-traded firms. Their investments seek legitimation by being listed in foreign public markets while simultaneously pursuing non-financial goals. The dynamics of this quadrant follow the behavioral perspective of corporate governance and strategy which emphasizes social structural relationships, institutional processes, and social cognition (Westphal & Zajac, 2011). Four strategic dynamics fall into this quadrant, complemented by these SWFs' unique governance structure: the state ownership of the SWF and the publicly-traded ownership of the investee firms. First, an increasingly common trend within state capitalism is that the governments responsible for SWFs develop financial relationships with host country governments, the ultimate goal being to establish strong political and financial ties with them (Clark et al., 2013). This tends to happen particularly with SWFs from small governments that do not have a significant geopolitical profile. It is a strategic governance move to minimize uncertainty and develop trust through relationships. Clark et al. (2013) refer to these SWFs as "post-colonialist."

Second, SWFs in quadrant 3 rely on their large state-owned endowment pool to launch long-term investment relationships with organizations equipped with critical economic or political power, i.e., multinational firms and non-governmental organizations. Here, SWFs are used as a governmental tool, differentiating them from other countries' investment mechanisms. In this sense, these SWFs move strategically from the parameters of state capitalism into market capitalism. For instance, Singapore's Temasek has a stake in Repsol, the Spanish oil national champion, whereas CIC made a sound investment (now sold) in Morgan Stanley in the midst of the financial crisis.

Third, there is a risk associated with pursuing international public investments that seek national strategic goals as opposed to purely financial ones. The potential stigma

connected with state ownership (i.e., deep pockets accompanied by non-financial goals) can be overcome when choosing the publicly-traded firms in which to invest. In this regard, we argue that SWFs in this quadrant might decouple and undertake dual agendas in order to overcome the "liability of sovereignness." In other words, they invest in publicly-traded firms to legitimize themselves and pursue their strategic goals. This is a symbolic as opposed to a substantial effort (Meyer & Rowan, 1977). However, their sovereign interests are not likely to be fully aligned with the core shareholder value maximization interests of the publicly-traded firms. The presence of strategic SWFs can be quite powerful when countries seek to gain international investment legitimation. A good example is the SWF, Qatar Holding, whose clear goal is to promote the national country brand. Qatar Holding has invested in European global companies such as Volskwagen, Banco Santander, Hochtief, Lagardere, Iberdrola, and Harrods. It has also been involved in one of the largest acquisition deals of the decade, showing its strength as a shareholder. In particular, Qatar Holding, with a 12 percent ownership in Xstrata (a multinational mining company) pressured Glencore (a global commodities trading firm) to increase its initial bid by 9 percent. We interpret this governance activism as the SWF's attempt to show that it is a legitimate investor.

Finally, it is also possible that SWFs in this quadrant engage in cross-national institutional arbitrage (Witt & Lewin, 2007) in the sense that they look for the most institutionally appropriate foreign markets to invest in public firms. SWFs borrow from the host country's national institutions to gain the home country legitimation that they lack. This is also labeled "institutional bonding" (Bell, Filatotchev, & Aguilera, 2014; Coffee, 2002). Most of these strategic funds originate from non-democratic countries that lack accountability and shareholder protection laws (Aggarwal, Erel, Stulz, & Williamson, 2008; World Bank, 2013). These SWF managers have to take into account the sovereign interests when making investment decisions and while seeking global investment legitimation. SWFs in this quadrant include those from small countries such as Qatar Holding and Temasek (Singapore) but also other funds from countries with significant political clout and strategic policies tightly aligned with the government, e.g., the Chinese CIC.

2.5.4. Quadrant 4. Long-term Learning

Quadrant 4 includes SWFs that pursue strategic investment goals and invest in private firms, typically with a domestic focus. This quadrant introduces three new strategic governance dimensions among SWFs. First, they are interested in learning and acquiring new

capabilities, achieving this through alliances and joint ventures with leading international private companies. The governance associated to this strategic effort entails the need to keep a low governance profile in terms of public scrutiny and financial disclosure, though also coping with the principal-principal tension. An example of how acquiring knowledge and pursuing long-term investment can help a country diversify its domestic productive portfolio is Mubadala from Abu Dhabi. It started a series of private joint ventures in the renewable energy industry with leading Western companies such Total (France), SENER and Abengoa Solar (Spain), and E.ON (Germany). This strategy also illustrates state capitalism at its core by engaging in financially viable projects that mostly benefit the home country's economic prosperity.

Second, SWFs form many of these strategic alliances with non-listed companies. In particular, SWFs represent the highest percentage of institutional investors in private equity (Johan et al., 2013), as the logic of state capitalism is consistent with opaque governance of private equity. Often, SWFs that seek more than just financial goals will engage in extreme strategic governance such as taking a private company in order to maximize control and minimize the need for disclosure. The owner can easily reduce agency costs by eliminating external shareholders and, as a result, directly set the management incentives and redesign the strategy. Another SWF in this quadrant is the International Petroleum Investment Corporation (IPIC), Abu Dhabi's SWF specializing in oil. IPIC began investing in the Spanish petroleum multinational, Cepsa, in 1988 and it made the company go private in 2011. Although, IPIC was seeking to acquire Cepsa's existing geographic diversification capabilities, the main objective was to obtain the necessary knowledge to undertake more efficient operations in the SWF's own extensive energy investment portfolio.

Third, SWFs in this quadrant, like those in quadrant 3, seek to develop long-term country-to-country relationships (Clark et al., 2013). Strategic SWFs have stronger ties to their sponsoring governments than financial SWFs and more intensely embed the dual objectives of state capitalism: economic and socio-political goals. These aims and mandates are aligned with those of the respective governments. Thus, these SWFs directly represent their governments (and are often run by government officials), making it easier and faster to engage in agreements with other states. For example, SWFs such as Russia Direct Investment Fund and Qatar Holding have established agreements with the governments of Italy, France, and Ireland in key strategic sectors: export-oriented companies, medium-sized enterprises,

and technology companies, respectively (Santiso & Ríos, 2014). In all cases, host governments are interested in the SWFs' large financial resources for their private companies for whom access to credit and investors is difficult. In this regard, SWFs are an arm of the state in question to pursue its goals through private financial agreements. It is important to note that these strategic goals are not necessarily harmful, often resulting in a win-win situation. Foreign companies and countries secure long-term investments, and SWFs gain access to resources and know-how in relevant industries.

2.6. DISCUSSION

Sovereign Wealth Funds as state-owned institutional investors without pension obligations are one of the key players in new state capitalism, with states no longer serving as the sole owners or controlling managers in investee firms as is the case with state-owned corporations. States as owners engage in economic and political relationships with other owners and external managers. This new state capitalism also embraces the idea that SWFs can pursue both political and financial objectives, at times fulfilling both simultaneously. In this paper, we shed light on the "siloed" research on SWFs by offering an organizing framework based on SWFs' investment motivation and the ownership type of the investee firms. We have defined four distinct strategic governance dimensions in which SWFs cope with the principal-agency problem, the principal-principal problem, and behavioral governance challenges. First, we identified financial SWFs that play a larger role as active shareholders of listed companies worldwide. This still incipient trend aligns well with a more active capitalism in which owners have greater influence in the investee company's strategic management. Second, financial SWFs are developing stronger in-house capabilities. Several factors have triggered this move towards more numerous and specialized human capital: organization professionalization, investment fees, and lower agency costs. Third, governments use strategic SWFs to obtain state goals while simultaneously seeking to gain legitimacy as institutional investors. These policy objectives are not necessarily mutually exclusive from financial efficiency. Fourth, strategic SWFs are learning organizations. The funds act as catalysts of domestic economic diversification and leverage relationships with global industry leaders in order to learn.

These four strategic dimensions comprise an organizing framework with four quadrants, representing a valuable tool with which to study SWFs. However, these four

quadrants sometimes have blurred boundaries or overlap. In addition, funds evolve over time (goals, structure, and teams) so that one fund may currently fit into a given quadrant and later move to another. To analyze this complex and dynamic scenario, we examine the movements between quadrants and the reasons that lead funds to shift between them. After that, we offer two productive avenues for future research with implications for the management and finance areas.

2.6.1. Dynamic Strategic Governance: Movements between Quadrants

SWFs are multi-dimensional organizations in that, at any given time, they might belong to more than one quadrant in our ideal-type organizing framework (Figure 2.1). SWFs are evolving organizations (Clark et al., 2013) and might also change or expand to other quadrants over time (Schena & Kalter, 2013). This mobility includes both public financial (asset classes and geographic allocation) and private financial SWFs (in-house capabilities through specialized workforce and new organizational challenges via international offices). We discuss four of these common movements.

The first movement we have detected comes from financially-oriented SWFs transitioning from quadrant 1 to quadrant 2 (from a focus on publicly-traded to privately-held target firms). The most financially-oriented SWFs from Norway and Korea invest heavily in listed assets, representing more than 90% of their equity portfolios. However, they also participate in more complex asset classes, increasing their exposure to private assets. Norway's GPFG is a good example. Although it has traditionally split its investment strategy between equity (40%) and fixed income (60%), it has shifted gears and started to invest directly in private real estate assets. As of June 2014, GPFG had acquired property in Europe and the U.S. worth $10.3 billion (Yu, 2014), and it forecast to invest at least 5% of its portfolio in real estate (approximately $45 billion). Jumping into quadrant 2 while keeping a foot in quadrant 1 will reinforce GPFG's internal teams by hiring new talent and increasing its in-house capabilities. The logic behind this first kind of movement reflects the growing "sophistication" of SWFs. Investing directly or indirectly in private assets allows SWFs to expand the universe of investable assets while keeping a return-risk financial motivation. Nowadays, given the globally low interest rates, turning to private assets helps increase the possibility of higher returns. And, given the new risks arising especially when SWFs by-pass private equity funds and invest or co-invest directly in private companies, the need for more internal talent results in better prepared workforces. Thus, this first movement implies

jumping from more standard investment organizations in quadrant 1 to reinforced in-house sophisticated talent found among SWFs in quadrant 2.

Second, there are funds in quadrant 2 moving towards quadrant 4. For example, SWFs from New Zealand, Australia, and even Alaska are transforming into strategic funds by investing heavily to promote specific domestic sectors or to secure the provision of natural resources. These SWFs with clear investment mandates might suffer from political instability or external shock (i.e., changes of government, long-term low oil prices, and domestic banking crises). A possible response might be to tackle short-term problems with long-term resources. This implies that funds might change their goal from acquiring in-house capabilities to investing abroad towards more domestic and sector-specific arrangements in an attempt to obtain long-term economic returns. A good example here is Ireland, but we can apply it to any country that has to take a more strategic (and usually domestically-oriented) stance after a profound financial crisis in order to establish investment programs to revive the local business ecosystem and economic activity. After rescuing the national banking system, the old National Pension Reserves Fund is now transferring its assets to the Ireland Strategic Investment Fund. The ISIF is committed to investing on a commercial basis to support economic activity and employment in Ireland. Thus, it has changed the financial goals typically found among SWFs in quadrant 2 to provide a broader economic and strategic support typical of funds in quadrant 4.

We see the third movement with funds moving from quadrant 3 to quadrant 1, that is, strategic funds investing heavily in listed equities which reduce their political alignment and then shifting into global financial players. An example of this is China Investment Corporation (CIC). China has five SWFs, two of which are among the largest in the world: CIC and SAFE. CIC was created in 2007 and has grown exponentially since then, from $200 billion originally to approximately $600 billion today. While CIC and SAFE compete globally for deals and domestically for political favors in the cradle of state capitalism, the Chinese government seems to have split their respective roles, with CIC becoming a global financial player (quadrant 1) and SAFE remaining a strategic fund in quadrant 3. Consequently, avoiding competition between same-country funds can be an important driver behind this movement, helping to create funds with financial goals (with a focus on foreign listed equity) and keeping others with more strategic objectives (typically domestic). When symbolic goals represent an obstacle to achieving substantial goals (as explained in Figure

2.1), a given country may opt to abandon strategic motivations to engage with other "standard" institutional investors such as public pensions funds in quadrant 1.

Fourth, a few SWFs are multi-dimensional and dynamic such as Singapore's Temasek which was incorporated in 1974. Since then, Temasek has pursued strategic goals such as championing formerly private and inefficient Singaporean government-linked companies (e.g., SingTel and Singapore Airlines) and turning them into regionally listed giants. Thus, it shifted from quadrant 4 to quadrant 3. By doing so, Temasek has reduced its exposure to domestic companies and gained prestige in the international investment community. The jump from quadrant 4 to quadrant 3 is explained by a certain natural evolution among the funds towards a more diversified international portfolio. This evolution also reflects the transition of funds that have a development vocation (common in quadrant 4) towards being more open to investing in listed companies. This is a common transition among sovereign funds from developing countries that achieve specialization. Typically, these funds then cede financing development projects to banks or public development agencies.

2.6.2. Future Research: An Exploration of the Bright and the Dark Sides of SWFs

Our strategic governance framework touches on two key features of this investment organization at the apex of new state capitalism: the logic of long-term capitalism and the role of politicians and politics (sometimes leading to crony capitalism). We think these are fascinating areas for future cross-disciplinary research. First, SWFs are well equipped to become significant actors in the new "long-term capitalism" (Bolton & Samama, 2012). In principle, long-term investors provide patient capital and managerial rewards to companies with long-term focus (Davis, 2009; Krippner, 2012), thereby alleviating the short-term distortions and pressures introduced by stock volatility. The gigantic needs of global infrastructure investments (estimated to be around $5 trillion per year over the next two decades by the World Economic Forum (2014)) reinforce the new opportunities for SWFs as long-term investors. Infrastructure's steady long-term cash flows also serve to diversify and legitimate SWFs. Thanks to the sustained, successful track-records in other asset classes, funds like ADIA and GIC have attracted international talent (both funds are included in quadrant 2 with strong in-house capabilities) and are now able to deploy long-term investment strategies (Barbary, 2014). As SWFs acquire these in-house capabilities, they will play an increasingly important role in the long-term economy focused on the global enhancement of corporate governance and real assets such as infrastructure and agribusiness.

For example, GPFG's voting intention disclosures (and potential herding behavior coming from its website but also social media) serve as a quasi-natural experiment to analyze the market's reactions to sensible corporate governance questions.

Second, SWFs also have a darker side that deserves further scholarly attention: the hidden political motives behind SWFs and how political interventionism may affect the management of SWFs and their investment targets. One of the main risks that SWFs face (particularly, those with strategic goals) is excessive involvement by politicians in SWF operations, goals, and governance. This is normally associated with a bias towards domestic investments, less reliance on external fund managers (Bernstein et al., 2013), a higher risk of political rent-seeking (Pistor & Hatton, 2011), and a turn towards short-term goals. This context of non-efficiency seeking is particularly salient during economic downturns when politicians face higher pressures to alter the SWFs' mandates and use their resources to capture specific electorates. Similarly, different rhythms of the political and economic cycles account for short-term pressures, and SWFs may succumb to the temptation of coming to the rescue of underperforming companies for political rather than economic purposes, such as during election times.

In sum, politicians' influence in SWF investment decisions is at the intersection between regulation and policy (Balding, 2012; Rose, 2009). In this regard, funds in quadrant 3 face a permanent trade-off between symbolic (political legitimacy at home and abroad) and substantial goals (efficiency by investing in top listed equities). If the government decides to tip the balance towards political goals, legitimacy will not be attained and the sovereign discount will increase. According to Deephouse (1999), they can be as strategic as legitimately possible.

2.6.3. Managerial and Financial Challenges

Another interesting area to explore for management practice refers to the nature and development of SWFs' human capital (a hybrid between state employees and global investors). The workforce of new state capitalism comprises employees from SWFs but also from SOEs, development banks and public agencies, each with unique skills and incentives. SWF professionalization (quadrant 2) demonstrates that investment managers in this kind of organization require a global orientation and the ability to reconcile divergent interests. Managers from state-owned organizations are mostly presumed to be unmotivated and

inefficient (Rajan, 2010). The new state capitalism is at a turning point as it reconciles the strengths of capitalism (results-oriented and open to global markets) with the goals of states (long-term objectives and political influences). Interestingly, at the individual level, the unresolved question is whether managers will be able to combine state and political goals with financial returns. This question affects funds in every quadrant of our analysis as it reflects a tension rooted in the very nature of SWFs: they are state-owned organizations in a capitalist playground.

Two other areas within the management arena demand further attention. The first involves the SWFs' own corporate governance. Here, a key question is whether in-house capabilities will grow evenly within the entire SWF industry. Depending on the pace of these changes, the gap between the most and the least sophisticated funds will grow wider, leading to a two-speed industry in terms of investment capabilities. In fact, there is still scarce research linking SWF performance and corporate governance (including size, top-management teams and organizational design).

Second, SWF governance within the state institutional architecture requires more exploration. A main problem to be solved is SWF alignment with stable long-term strategic state plans rather than discrete short-term political goals. State plans would thus serve as long-term benchmarks to improve scrutiny over SWFs' returns and objectives. Therefore, research on disentangling state and political goals, though complex, would be useful for governance and management purposes. However, it is also critical to improve transparency domestically and internationally by aligning the SWFs' strategy with the well-publicized long-term state plans. This would serve to avoid facing a disclosure premium due to predictable investments.

Turning to future financial-related research regarding SWFs, we propose three main areas for further exploration. First, the question whether countries need a SWF or not remains unresolved. After years of economic and commodity windfalls, most countries with old and newly established oil-related SWFs are now facing lower oil prices and, thus, substantially reduced margins at best. Will SWFs react as the fiscal buffer funds they are meant to be? Is there an alternative way to shield a commodity-dependent economy? What are the main empirical findings and differences in countries such as Russia, Angola and Nigeria? In addition, long-term horizons would need better analysis, particularly when assuming that all

risks become financial in the long run. Similarly, risk management, specifically uncertainty management, will require further attention given the duration of the wagers SWFs make.

Second, as extensions of the state, SWFs benefit from fewer information asymmetries compared to private players when dealing with governments. Therefore, a pending research question is whether there is a "sovereignness advantage" for SWFs in specific projects and countries compared to their private investment competitors.

Lastly, there is an interesting issue intersecting the management and finance areas. As stated in the discussion section, more external managers might insulate SWFs from politically short-term and biased decisions and help to deal with complex investment opportunities otherwise out of reach. However, external managers come at a cost in terms of asymmetries and fees. The question is, what would be the proper balance between managerial independence and financial returns?

2.7. CONCLUSIONS

Most of the existing research on SWFs is grounded on specific disciplinary fields and has primarily focused on economic and performance trends. In this paper, we sought to bring this research to the firm-level and explore SWFs' strategic governance. We began by briefly reviewing the state-of-the-art findings on what we know about SWFs: they are a highly heterogeneous group, SWF investments generate positive short-term stock reactions, their investment strategies tend to have a substantial domestic bias when politicians are involved, and they face the "SWF discount." However, we lack an in-depth understanding of these state-owned institutional investors as players in the long-term focused state capitalism and as organizations adopting different strategic governance dimensions.

Our SWF framework, while an ideal type, identifies the strategic challenges these institutional investors face and reveals four strategic governance approaches they deploy to overcome them. First, we uncover *shareholder activism* to combat the principal-agency conflict. In this case SWFs exercise this activism with their voting rights and demand for effective corporate governance standards in the investee companies where they have become co-owners. Second, SWFs might face severe information asymmetries and intrinsic principal-principal costs when investing in private firms. By enhancing their *in-house capabilities*,

SWFs have been able to simultaneously reduce their dependence on external managers while also increasing their professionalization (risk management and due diligence requirements are currently similar to those for well-established global investment institutions). Third, strategic SWFs might be deployed as governmental tools, *decoupling* and investing in publicly-traded firms to gain *legitimation*, though their sovereign interests may not likely be fully aligned with the core shareholder value maximization interests of their co-owners. Fourth, strategic SWFs investing in private companies seek to obtain *long-term learning* templates that will help them acquire the relevant know-how and diversify the base of their own national economies. With our proposed strategic governance framework, we discuss movements across strategic governance dimensions and we uncover two research topics that need further attention: the idea of long-term capitalism and the role of politicians and politics in SWFs.

State capitalism is salient in each of the quadrants in our theoretical framework as is the governance tension between owners, co-owners and their managers. Interestingly, some SWFs have become corporate governance global watchdogs such as GPFG, and this is an organizational innovation. Also, SWFs have introduced a new way of understanding the relationship between the state and the private sector. Some questions still remain pending, however: Will states sponsoring SWFs be able to attract or develop enough talent to achieve their goals? And, will SWFs lead to improved governance worldwide while they are in need of better management practices?

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TABLE 2.1: Main Findings on Research on Sovereign Wealth Funds

Discipline	Findings
Finance	SHORT AND LONG-TERM IMPACT ON TARGET COMPANIES: SWFs' investment announcements cause positive short-term stock reactions (Bortolotti et al., 2013a; Dewenter et al., 2010; Kotter & Lel, 2011) but they are lower than those from their private counterparts (Bortolotti et al., 2013a), reflecting a "SWF discount." The long-term impact on target companies is negative in terms of abnormal returns (Karolyi & Liao, in press), Sharpe ratio (Knill, Lee, & Mauck, 2012a) and P/E ratio when politicians are involved (Bernstein et al., 2013), implying SWFs' weak monitoring role. On the contrary, some findings suggest that SWFs add value (15% in Tobin's q) to investee companies (Fernandes, 2014) and that there is a reduction in target companies' credit risk (Bertoni & Lugo, 2014). Paradoxically, however, firms with SWF investment experience higher debt costs (Borisova, Fotak, Holland, & Megginson, in press). INVESTMENT STRATEGIES: Mixed findings. The evidence shows SWFs' preference for both stable (Karolyi & Liao, in press) and distressed companies (Kotter & Lel, 2011). SWFs also select target companies aligned with national industrial-planning strategies (Dyck & Morse, 2011; Haberly, 2011) or based on political bilateral relations (Knill, Lee, & Mauck, 2012b). Other findings demonstrate that SWF portfolios do not diverge from mutual funds strategies (Avendaño & Santiso, 2011) but show certain home bias (Bernstein et al., 2013; Chhaochharia & Laeven, 2008). SWFs do not show a systematic preference for specific industries and tend to diversify in equity markets (Miceli, 2013).
Strategy	- SWF investment practices may spread to the rest of private domestic investors as showed in the Norwegian case (Vasudeva, 2013). - Governments should design SWF portfolio allocation (financial assets) taking into account underground (minerals, oil, and gas) assets (Van den Bremer, Van der Ploeg, & Wills, 2013). - Contrary to FDI theory, SWFs prefer to invest in private (vs. public) equity in countries with lower investor protection and where the bilateral political relations between the SWF country and the target one are weaker (Johan, Knill, & Mauck, 2013).

	- Company target and recipient countries will benefit (lower transaction costs) from coordinated actions with respect to SWF investments (Rose, 2009).
Political Economy	- SWFs represent a new mode of state-capitalism; they enable governments to exert "soft-control" through minority stakes (Fotak, Gao, & Megginson, 2013; Musacchio & Lazzarini, 2014). SWFs as means of new state capitalism might allow governments to exert control in non-state companies through financing (Milhaupt & Zheng, 2014). - SWFs' investment agendas and mandates should be integrated with the rest of state-owned vehicles such as development banks, regional agencies and SOEs (Al-Hassan, Papaioannou, Skancke, & Sung, 2013; Gelb, Tordo, & Halland, 2014). - SWFs engage in idiosyncratic political accountability (Clark et al., 2013; Gelpern, 2011); as a heterogeneous group, SWFs have been created across the wide political spectrum, ranging from the most to the least democratic countries. - SWFs serve ruling elites to maintain their privileges (Pistor & Hatton, 2011) even in times of crisis by concentrating substantial resources. They can lie in the shadows of regulations and politics (Balding, 2012; Rose, 2009).
Economics	- SWFs have evolved as a sophistication of stabilization funds (Balding, 2012; Das et al., 2009) in terms of asset management (expanding both geographic allocation and asset classes) and corporate governance (clearer rules and accountability). However, SWFs have been used as sovereign development funds (Santiso, 2008) with inherent risks of political capture (Gelb et al., 2014). - The recent surge of new SWFs depends on international reserve accumulation (due to high commodity prices and current account surpluses) in times of low global interest rates (Aizenman & Glick, 2010; Castelli & Scacciavillani, 2012).

International Law	- Host countries receiving SWF investments face a trade-off between national security and open capital markets (Cohen, 2009). Regulatory burdens might decrease with better transparency practices from SWFs (Rose, 2014). - Sovereign wealth immunity in the U.S. favors SWF taxation (Bird-Pollan, 2012). To overcome this, tax reform should encourage investments with low political risk and require higher accountability for SWFs (Fleischer, 2009) or even distinguish financial SWFs from strategic SWFs by proposing a suspension of voting rights (Gilson and Milhaupt, 2008). - On the contrary, evidence shows that SWFs have acted thus far as model investors (Epstein & Rose, 2009). Thus, imposing additional obstacles to SWF investments in the U.S. seems unreasonable. Discouraging SWFs from investing in the U.S. will impose political and economic opportunity costs larger than the natural security benefits.
Organizational Theory	- Governments use SWFs as institutional innovations (Weiss, 2009). Clark et al. (2013) foresee two different paths for SWFs: adopting global financial standards or transforming into nation-state development institutions. - The Norwegian SWF, GPFG, maintains its political legitimacy primarily through the "process" governing the decision-making of the public interest rather than through its functionality (Clark et al., 2013). - Truman (2013) simplifies SWF transparency analysis through a scoreboard comprising structure, governance, transparency and accountability, and investment behavior.

TABLE 2.2: Sovereign Wealth Fund Characteristics

Age	Senior (five SWFs) <1960s Adult (nine SWFs) 1970-80s Teen (nine SWFs) 90s Baby (56 SWFs) 2000-10s	*Senior:* Including the Saudi Arabian Monetary Authority and Kuwait Investment Authority. *Adult:* Three SWFs from the U.S., two from Singapore and Abu Dhabi Investment Authority (ADIA). *Teen* is the largest group in terms of assets under management ($1.77 trillion): Norwegian GPFG ($900 billion) and SAFE (China). *Babies:* 56 new funds ($1.63 trillion) established in the SWF baby-boom led by China Investment Corporation ($575 billion).
Size	Extra Large (five SWFs) > $400 billion Large (eight SWFs) > $100 billion Medium (37 SWFs) > $5 billion Small (28 SWFs) < $5 billion	The SWF industry has $6 trillion in assets; industry concentration is key. The top-10 SWFs manage 70% of the industry's assets. We foresee a continued transfer of wealth from central banks' foreign-exchange reserves to more sophisticated SWFs.
Global Location	Middle East (17 SWFs) $2.1 trillion - 34% China (five SWFs) $1.5 trillion - 25% Norway (one SWF) $0.9 trillion - 15% SEA (eight SWFs) $0.7 trillion - 12%	New poles in Africa and, to a lesser extent, in Latin America are surfacing. Central Asia will continue to grow. SWFs from emerging markets will dominate even more in the foreseeable future.
Funding Sources	Commodity: oil, gas, other minerals, metals Non-commodities: foreign-exchange reserves Others: leverage, privatizations, SOE profits, etc.	Oil-related SWFs will benefit from recent global demand projections. However, other funding sources (e.g., debt issuance) will become more prevalent.
Policy Purposes[4]	Macro-stabilization ("rainy day fund") Savings ("future generation" distribution) Reserve investment Pension reserve	SWFs' objectives are compound, overlapping, and changing over time (e.g., short-term stabilization of SWFs may evolve into savings funds; likewise, pension reserve SWFs may choose more active and direct investment strategies).

[4] As defined by Kunzel, Lu, Petrova, & Pihlman (2011).

FIGURE 2.1: Strategic Governance Types of Sovereign Wealth Funds

Investment Motivation	Public	Private
Financial	**Quadrant 1. Shareholder Activism** SWFs play a strong monitoring role and help to improve the corporate governance of listed companies worldwide. An SWF as the *principal* seeks to enhance the target company's *(agent's)* corporate governance through active participation in the company's committees and annual general meetings. Norway's GPFG is designing a new approach to intervene in its largest equity positions. Others will follow.	**Quadrant 2. In-house Capabilities** SWFs establish specialized teams looking for higher returns and new asset classes and geographies. There are spillover effects for the organization: professionalization, fee reduction, and lower agency costs. An SWF as a *principal* engages with other owner(s) (also *principal(s))* in low shareholder protection schemes. Setting up investment offices "closer to the action" helps to overcome this P-P conflict. New Zealand's Superannuation Fund, Malaysia's Khazanah, ADIA, and GIC have specialized world-class investment teams managing complex asset classes.
Strategic	**Quadrant 3. Legitimacy & Decoupling** Governments use SWFs to obtain longer-term state goals yet simultaneously seek to acquire legitimacy as institutional investors. The tradeoff between *symbolic* (efficiency by investing in top-listed equities) and *substantial* goals (political legitimacy at home and abroad) drives these SWFs' decision-making. QIA, CIC, and Temasek have different political goals, yet all of them aim to achieve them through financial efficiency and thus decoupling.	**Quadrant 4. Long-Term Learning** SWFs look for domestic economic diversification and to engage in long-term relations with foreign companies to acquire resources and know-how, that is, to learn. SWFs face *Principal-Principal* conflicts when investing with governments as well as with private companies through joint-ventures. Also, SWFs need to address *Principal-Agent* conflicts at home with domestic SOEs. Mubadala learns valuable lessons from its joint-ventures with innovative multinational companies. RDIF uses a different model by co-investing with other SWFs and governments.

Ownership Type

3

Spain and sovereign wealth funds: Four strategic governance types

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3.1. ABSTRACT

During the last decade, Spain has become a Sovereign Wealth Fund (SWF) investment destination. In this chapter, we begin by outlining the factors that have led SWFs to Spain. Second, we discuss the different corporate strategies that SWFs exhibit when investing in Spanish companies. We examine these investments in the context of an existing typology of four different strategic governance approaches: corporate governance supervision, in-house capabilities enhancement, international recognition and developmental and learning goals. We then show how these four strategies are effectively implemented drawing on four investment SWF cases in Spain. We conclude by proposing four new areas of fruitful research on SWFs in fields such as economics, management and international business.

3.2. INTRODUCTION

Sovereign Wealth Funds (SWF) are government-owned investment funds with no pension liabilities (Aguilera, Capapé & Santiso, 2016). They manage worldwide US$7 trillion (IE Sovereign Wealth Lab, 2016). These global investors are becoming popular in financial and economic circles with frequent presence in financial and general media. Recently, changes announced by the deputy crown prince Mohammad bin Salman to transform Saudi Arabia's Public Investment Fund (PIF) into the largest SWF brought the topic once more to the headlines. In fact, today we find SWFs involved in many global events. The Volkswagen emissions scandal is applicable: Norway's Government Pension Fund Global (GPFG)—under a renewed effort to act as a responsible shareholder—is suing the German carmaker for wrongdoing and specifically addressing the poor corporate governance of the firm. Simultaneously, Qatar Investment Authority (QIA), another SWF and third largest shareholder of Volkswagen, is losing US$3.3 billion of the value of its stock in Volkswagen, due to the emissions scandal. This illustrates how SWFs have come out of the shadows to the main stage of corporate governance global cases.

Only a decade ago, SWFs were banned from investing in Western "strategic assets" such as ports, oil companies and defense industry. Following the 2008 global financial crisis, SWF presence took a different turn. Today, SWFs are not only the owners of Heathrow, the busiest passenger airport in Europe or the sponsors of Real Madrid Football Club, the current UEFA's Champions League champion (Real Madrid is supported by Emirates Airlines and International Petroleum Investment Company, IPIC, from Dubai and Abu Dhabi respectively) but they are players with key strategic roles in some of the largest international business deals.

Another interesting case is the ride-hailing industry in Asia. Uber, the industry leader based in San Francisco and valued at US$63 billion (as of May 2016), is supported by Qatar and recently by Saudi Arabia (they invested through PIF more than US$3.5 billion in the privately held company). Conversely, SWFs from Singapore, and China are supporting Uber's local rivals in India, Singapore and China. Hence, SWFs are also betting and competing in disruptive industries and startups. With generally long-term horizons, SWFs are equipped to invest in startups today and reap the profits of these future market champions.

These two recent examples illustrate the changes in the perception of SWFs by target companies and countries. In sum, they also reflect a transformation in the nature of this heterogeneous group. SWFs, as organizations, evolve over time, and become more sophisticated and expand their investment activities to new industrial sectors and territories.

In this chapter, we analyze these recent strategic changes through the SWF investments in Spain. The case of Spain is relevant because SWFs before and after the financial crisis align with SWFs' long-term objectives. In fact, during the worst part of the financial crisis, Spain became the main investment destination of SWFs within the European Union, ahead of the United Kingdom, Germany and France (Santiso, 2012). This foreign location choice exemplified many SWFs' goals of capturing value for the long run instead of looking for short-term returns. While this holds for some SWFs such as IPIC or QIA, some SWFs such as GPFG (from Norway) chose to divest from Spanish public and private debt during those years. This shows that the SWF landscape is complex as it encompasses an heterogeneous group of organizations.

This chapter begins discussing the specific economic conditions of Spain that have attracted the investments of SWFs: the economic crisis, the linkages of Spanish multinational companies with Latin America, the internationalization of equity and the financial sector reform. Then, we analyze four strategic governance types followed by SWFs when investing in Spain: corporate governance supervision, in-house capabilities enhancement, international recognition and developmental and learning goals. We examine these four strategic governance approaches through four different SWFs investing in Spain: Norway's GPFG, Kuwait Investment Authority (KIA), Qatar Investment Authority (QIA), and the Oman's State General Reserve Fund (SGRF). The deal closed by the SGRF establishes the *de facto* first Spanish co-investment SWF. We conclude by proposing four areas of fruitful future research.

3.3. THE SPANISH ECONOMIC CONTEXT

Spain is the fifth largest economy in the Eurozone and twelfth in the world (International Monetary Fund, 2016). The country relies on four economic pillars for economic growth: food and beverage (represent 13% of GDP), real estate (12%), construction (12%), and tourism (11%) (Instituto Nacional de Estadística, 2016). Among its strengths, Spain has world-class infrastructure, high life expectancy and high quality management schools.

Conversely, its labor market and tax system inefficiencies, the challenges of starting a business and the poor quality of education persist as major weaknesses.

Spain recent economic events are marked by the burst of the real estate bubble and consequent credit crunch. Spain experienced its golden years from 1998 to 2007. It grew faster than any other large European economy, except Ireland, at an average annual GDP growth of 3.9%, doubling the growth rate of Germany and France during this period (International Monetary Forum, 2016). Yet, this growth was not evenly distributed and the Spanish economy became extremely dependent on the housing sector. When the global financial crisis started in the United States, the European housing markets suffered a trickle-down effect. In 2007, Spain was constructing more residential real estate than Germany, France, and Italy combined. The housing dependency was accompanied by poor corporate governance and political ties in regional saving banks that were building dangerous speculative developments. Additionally, low interest rates fueled investment in real estate by foreign banks and financial institutions from the Eurozone. The real estate bubble collapsed in 2008, provoking a strong credit crunch (Bentolila, Jansen, Jiménez, & Ruano, 2013). Since then, property prices have halved, unemployment rates reached historic records of 26.1% and the economy was forced to painfully adjust in real terms. Although the GDP recovered to 2008 levels six years later, the International Monetary Fund (2016) estimates the unemployment rates will not be back to pre-crisis levels (15%) until 2020—far from low rates of 8.2% in 2007. In conclusion, both the weak governance in saving banks and political interference are important factors leading to the financial crisis in Spain. These two factors led to an enormous investment in real estate by the financial sector, which plummeted when the real estate bubble burst.

However, the most recent economic data shows once again that Spain is growing faster than the euro block. Its economy has grown at an annual pace of 1.2% and 3.2%, in 2014 and 2015 respectively, since the worst of the crisis in 2013 (Instituto Nacional de Estadística, 2016). For some economists, the main reason behind the recovery is the Spain's export industry, fueled by a steady fall in unit labor costs and the collapse of domestic demand. Other economists point to the bailout package from the European Union in 2012 as a main explanation for the current growth (The Economist, 2015). Regardless, while the "flow" is upward looking, the "stock" of unemployment will take years to be cleared.

Another key factor to understand the current state of the Spanish economy is that its multinational companies have solid ties with Latin America. In the early 90s, Spanish MNEs made a strong bet on the Latin American markets and expanded rapidly in banking, infrastructure, oil, telecommunications and engineering. In terms of the stock of investments, Spain is the second largest investor in the region after the United States The Spanish MNEs have benefited from this exposure to Latin America. It helped to ease the difficulties when domestic demand contracted substantially. This special feature of the Spanish MNEs, frequently known as Euro-Latinas, is a characteristic that makes Spain attractive for institutional investors, including SWFs.

Spain has received a solid flow of foreign direct investments since 2013 as a result of an improved economic environment, its strong Latin American connections and its more stable institutional context in the financial sector mean. In the period from January 2014 to June 2015, Spain received more than €4.6 billion in SWF direct investments (Capapé, 2015). The interest shown by SWFs in the Spanish economy and its companies follows a double logic. First, after years of severe economic crisis, Spain's GDP rates are growing above the European Union's average. Second, Spanish companies have strong ties with the emerging and growing region of Latin America. Thus, SWFs investments in Spanish Euro-Latin companies get exposure to fast growth rates in emerging markets in a low-risk institutional environment. Investing in Spanish companies means reaping yields in emerging economies (Colombia, Peru, or Mexico), while operating in a safer and well-regulated institutional environment.

Still, beyond economic recovery and Latin American connected multinationals, there are two other specific underlying reasons which might also account for the current interest of institutional investors in the Spanish economy: a new openness to foreign shareholders and the 2012 financial reform. Both are discussed in more detail below.

3.3.1. Openness to foreign shareholders

SWFs have taken advantage of the Spanish multinational corporations' opening up process since 2005, revealing their significant investment capacity. In 2006, foreign investors controlled 33% of listed equities, yet by the end of 2014, this figure had grown 10 points to 43%. In the years 2013 and 2014, the pace of net stock investments has accelerated with net inflows above €7 billion per year. A group of institutional investors, which includes several

SWFs, leads this trend. Almost 30% of foreign portfolio investments in Spain come from institutional investors. Their investments in the IBEX35 companies, the reference stock index representing the largest 35 Spanish stocks, totaled €113 billion.

Among these investors, Norway's SWF leads the ranking with €7.7 billion invested in 32 stocks, followed by Vanguard, Blackrock, and Lyxor (Table 3.1). The fifth largest investor is again a SWF, QIA from Qatar, with a single investment in Iberdrola (a Spanish utility company), valued above €3.5 billion. This concentrated investment style contrasts substantially with the rest of the asset managers' leading foreign investments in Spain, most of which invest in about 30 different stocks.

Iberdrola, the fourth largest company by market capitalization in which QIA controls 9.6%, is an illustrative example of the high shareholding escalation in the largest Spanish companies. Specifically, it shows the growing internationalization of their shareholders. At the onset of the 2008 financial crisis, all significant Iberdrola stakes (above 5% of shares) were in the hands of Spanish institutional investors, which totaled 25% of all shares. By 2012, following the entrance of QIA, domestic interests had halved, with the percentage falling to 16%, and bottoming to 7.5% in 2014. In parallel with this, holdings of foreign entities rose, among them QIA and other international investment funds. In 2009, not a single foreign investor had controlling stakes. In 2012, QIA, Blackrock and Société Générale were close to holding 15% of all shares; and, by the end of 2014, the majority of shares of significant holders were foreign-owned.

In a sense, one could say that while the decade of the 2000s was characterized by the internationalization of revenues for many Spanish multinationals, the 2010s appear to be the decade of the internationalization of capital. SWFs are not missing out on the opportunity to enter into the fifth largest economy of the Eurozone.

3.3.2. Financial sector reform in Spain: divestments and opportunities

The financial crisis acted as an engine fostering the Spanish equity internationalization. It was precisely the reshaping of the banking sector, and in particular the saving banks (or so called *cajas*) that followed the global crisis, which created a substantial shakeup and opened up investment opportunities to foreign investors.

Following the recommendations made by the International Monetary Fund, European Central Bank and the European Commission in the memorandum of agreement signed in 2012, Spanish authorities were encouraged to recapitalize and restructure the country's banking system. One of the decisions that followed implied a divestment program for the financial institutions owned by the Fund for Orderly Bank Restructuring (FORB, the Spanish program initiated in June 2009 to provide cash assistance in distressed banks). Banks and saving banks began to sell their shares in industrial companies, which opened the door of share capital to new investors, including foreign players. In Iberdrola, for example, Société Générale and Blackrock acquired stronger holding positions, while Bankia, a large *caja* that received €22 billion from FORB, sold its 5% shares interest. Other Spanish companies followed a similar path by selling banking shares, thereby opening up opportunities for foreign capital ownership investment.

For instance, Spanish Deoleo, the world's largest olive oil producing company, was exposed to these divestments. Bankia and BMN (another saving bank) sold their 30% interest to CVC, a London-based private equity. Following a comprehensive strategy to foster the Italian food and beverage industry, the Italian SWF, Fondo Strategico Italiano (FSI), manifested its interest in Deoleo, although the stake was eventually acquired by CVC, an option the Spanish government preferred to the Italian public investor. This case shows the potential conflicts of interest that emerge when public investors try to acquire strategic assets in a given country, especially if the target company has the state as a shareholder.

Similarly, Globalvia, an infrastructure company half owned by Spanish saving bank, Bankia, attracted the interest of another SWF. In this case, Malaysia's Khazanah negotiated with the saving bank to acquire Globalvia. They agreed to close the transaction on €420 million. However, in the last minute, the former creditors exercised their preferential purchase right and acquired the infrastructure company[5].

It is important to stress how the divestment process pursued by Bankia and other Spanish *cajas* after the financial sector reform has attracted a significant amount of institutional investors—including two sovereign wealth funds from Italy and Malaysia—in such diverse sectors as real estate, infrastructure, engineering, and insurance (Table 3.2).

[5] More details in the press release made by Bankia https://www.bankia.com/en/communication/in-the-news/press-releases/bankia-and-fcc-sell-globalvia-to-the-funds-uss-optrust-and-pggm-which-are-exercising-their-preferential-purchase-right.html. Accessed August 15, 2015.

3.4. SOVEREIGN WEALTH FUNDS IN SPAIN: FOUR STRATEGIC GOVERNANCE TYPES

In a short period of time, Spain has witnessed the entrance of a heterogeneous group of SWFs that have either invested in the country or acquired Spanish-owned assets abroad. As detailed above, although each SWF has different goals and backgrounds, the recent openness to foreign shareholders, the financial sector reforms, a partial economic recovery and the exposure of Spanish companies to Latin American markets explain the growing presence of SWFs in Spain, and make the country an excellent field laboratory to examine SWF investment strategies.

Aguilera, Capapé and Santiso (2016) developed a typology to analyze SWF activities. They categorized SWFs along two main dimensions: risk strategy (measured as the share of their portfolio invested in private equities) and investment purpose (whether the SWF investments are aligned with a broader state's geo-economic and development strategy). Figure 3.1 identifies the resulting four strategic governance types: responsible investments, enhanced in-house capabilities, legitimacy seeking, and learning through co-investments. Although for any given SWF, these two dimensions may overlap and change over time, it is possible to differentiate SWFs according to this 2x2 matrix. It provides a useful strategic governance framework for explaining the investments made by SWFs in Spain.

The rest of this section is divided into four parts that discuss SWF case studies and provide evidence of these four distinct strategic governance types. We begin with Norway and the role its SWF has played in improving the corporate governance of Spanish companies. Second, we discuss how a SWF can also develop its own corporate governance in order to embrace more direct, complex transactions: as in the case of Kuwait and its enhanced in-house capabilities. Third, we focus on Qatar and its comprehensive strategy that deploys different state-controlled mechanisms in order to garner an enhanced international reputation and legitimacy. Lastly, we review the case of the new domestic co-investment SWF jointly established by Spain and Oman's State General Reserve Fund, comparing it to other similar vehicles that had established in Europe in recent years.

3.4.1. Norway as the responsible investor

Norway's Government Pension Fund Global[6] (GPFG) is the world's largest sovereign wealth fund with over US$850 billion assets under management (as of December 2015). According to our organizing framework (Figure 3.1), GPFG is a financial investor as its main goal is to generate "high returns and safeguard wealth for future generations" (Norges Bank Investment Management, 2015). Also, GPFG's low risk implies that it invests heavily in public (listed) markets and only three percent in real estate (private markets). Thus, we classify GPFG in quadrant 1 (Figure 3.1). GPFG tries to protect the value of its listed companies by exercising an active shareholder role with the goal of improving the corporate governance of its investees. It has a positive impact on Spanish multinational companies.

Norway is the world's third largest natural gas exporter. This enormous offshore wealth, although limited, is being transferred gradually into long-term financial wealth, as a means of obtaining inter-generational justice so that future generations may benefit from today's wealth. Only recently GPFG took a radical move by deciding that it would play an active role as a shareholder. Precisely, the Norges Bank Investment Management (NBIM)—the investment unit of Norway's central bank that is in charge of the GPFG—has led the initiative to pursue higher governance standards in the companies it has increased its participation. In Europe, the potential impact of this shareholder engagement is crucial because GPFG owns about 2.5% of all stocks traded in the continent.

GPFG's renewed interest in active ownership responds to three key assumptions on the effects of good governance in companies: it leads companies to attain profitability, ensures shareholder rights protection, and guarantees an equitable distribution of profits. Along with improved corporate governance, GPFG encourages companies to enhance their social and environmental standards. In spite of this, the causal relationship between better governance and more profitable companies is an ongoing scholarly debate (Siddiqui, 2015). In particular, GPFG considers six strategic focus areas for its active ownership activities: equal treatment of shareholders, shareholder influence and board accountability, well-functioning, legitimate and efficient markets, children's rights, climate change risk management, and water management.

[6] The Fund is called the Government Pension Fund Global. Despite using the term "pension" in the name of the Fund, it is not a public pension fund. The fund has no formal pension liabilities. The name reflects the goal of the fund of saving government resources to finance an expected increase in future public pension costs.

NBIM has established these new goals for the GPFG, and is already taking measures to guarantee that the responsible investment principles are implemented through the appointment of a corporate governance advisory board, which is composed of three corporate governance experts. GPFG’s goal is to safeguard and increase the value of its investments in more than 9,000 companies worldwide. By the end of 2015, the fund's holdings have expanded to 78 countries and 51 currencies. Thus, GPFG has claimed that voting at the annual general meeting (AGM) is one of their most important tools in exercising its rights as shareholder. In 2015, GPFG voted in 11,562 AGMs and held meetings with 3,250 companies.

GPFG follows a “name and shame” strategy—once used by CalPERS (California Public Employees' Retirement System, a large public pension fund)—and publishes the list of companies excluded from the fund’s investment portfolio after hearing the recommendations from the Council of Ethics (appointed by the Ministry of Finance). Since the establishment of the fund, the Ministry of Finance had responsibility for making these final decisions; yet, recently, the central bank has taken this role in an attempt to generate more politically independent decisions. In August 2015, the central bank excluded four companies due to severe environmental damage: the Korean Daewoo International Corporation, a conglomerate, and also its parent company, the steel-maker POSCO; and two of the Malaysia’s leading conglomerates, IJM Corporation and Genting Corp. These companies were converting tropical forest into palm oil plantations in Indonesia.

GPFG’s responsible investment strategy includes an active selection of sustainable companies. That is, not only does the Council of Ethics announces the list of companies excluded from the investment portfolio following their ethical guidelines (i.e., tobacco, weapons, human rights violations, etc.), it also recommends companies in which to invest. In this sense, for example, pulp and paper companies, which are strongly linked to water resources and specifically to forest conservation, are of great interest to a responsible investor. This “long-term investment” style seeks to generate an imitative process at the local or regional level, and bias the investment strategies followed by other institutional investors (Vasudeva, 2013).

Another measure taken by GPFG is to reinforce its commitment to enhancing the corporate governance of its investee portfolio companies by releasing its voting intentions ahead of

AGMs. This tactic has been used in three large companies where GPFG has ownership participation: BP, Royal Dutch Shell, and AES Corporation. The former two were among the fund's top ten largest equity holdings as of third quarter 2015.

The shareholder activism demonstrated by GPFG in demanding higher standards of corporate governance reflects two main facts: the benefits of the internationalization of the shareholder base for the Spanish economy, and the potential impact of SWFs in leading this new trend.

3.4.1.1. GPFG investments in Spain

Foreign institutional investors can play a key role as major influential shareholders. In Spain, with the growth of foreign institutional investors' stakes in recent years, the potential conflict of interest between managers and key shareholders has grown accordingly. In many large companies, between 20-40% of shareholder opposed management proposals, whereas a few years ago the opposition was minimal. Fund managers such as Blackrock, Vanguard and Amundi present in large Spanish listed multinationals voted against resolutions and forced the board to better explain to shareholders' decisions they propose for the AGM's approval.

By the end of 2015, GPFG had investments in 80 Spanish listed companies worth US$8.9 billion; the majority of investments were in banking and utilities (see Table 3.3 for top ten holdings in Spain).

If we dig further into the analysis of Norway's investments in Spain, we identify some interesting trends. Table 3.4 shows the list of Spanish companies in which GPFG keeps a larger controlling vote ability. It is remarkable that three of the top five companies belong to the paper/pulp industry. This is no coincidence as these kind of investments are aligned with the responsible investment global strategy pursued by the Norwegian fund. GPFG invests in more than 9,000 listed companies, but when this list of corporations is ordered according to the voting control GPFG exercises, it appears that three among the top ten companies are also forest and paper-related companies: The Irish Smurfit-Kappa, the Swedish Svenska Cellulosa and the Finnish UPM-Kymmene (Norges Bank Investment Management, 2015).

Also, in parallel to this particular responsible investment style that gives preference to companies with better social and sustainability standards, the fund actively votes in the AGMs of Spanish listed companies. For example, in 2014, GPFG voted in 70 Spanish listed

companies. If we look at the top 10 holdings, they tended to agree on almost every proposition made by the board to be discussed at the AGM. The only outlier was Ferrovial, a transport and infrastructure company, where GPFG opposed six board proposals regarding general meetings regulations, showing a level of disagreement close to 25% (see Table 3.5). Interestingly however, when we look at the bottom 10 holdings, the disagreement increases. For example, in the case of Codere, a gambling company, the GPFG voted against the reelection of four directors, including the Chairman and CEO. A similar level of disagreement was found in the case of Azkoyen, a vending business, where the fund opposed several propositions on the regulation of the AGMs and board of directors.

This discrepancy in voting between top and bottom companies brings up an important issue thus far unexplored. GPFG agrees more with management in companies which they own larger stakes. On average, it tends to agree on 97% of all management proposals made during the AGMs in the largest 10 holdings. This average goes down to 91% when in the smallest holdings of GPFG in Spain. This puzzle adds to the unresolved theoretical connection between governance and performance. If GPFG is looking primarily for their portfolio returns, it would focus on the most well performing companies to achieve its purpose. Are well-performing companies better governed than their poorly performing peers? Or do well-governed companies obtain higher returns than poorly managed companies?

From an empirical point of view, the conundrum is not easy to resolve: Should we consider that the fund improves the governance of the companies in which they invest? Or simply that they self-select into companies that are better governed and then deploy more capital into them? The answer falls beyond the scope of this chapter. We uncover that they tend to agree more with the companies in which they invest more, and tend to disagree more with the companies where they invest less. No causal relationship can be established, and is an open question to be further explored by governance scholars.

The goal of GPFG to influence the governance of its portfolio companies, stands clear: GPFG argues that the roles of the CEO and the chairman of the board should be separated, and so they vote against the reelection of directors holding both positions. In the United States, GPFG supported five shareholder proposals for the separation of the roles of CEO and Chairman at five banks. They consistently followed the same strategy in Spain, i.e., voting against the reelection of the CEO and Chairman of Iberdrola and Barón de Ley.

Paradoxically, GPFG, based on this voting principle, was against the reelection of Iberdrola's Sánchez-Galán, who was selected by "Institutional Investor" as the best European CEO in 2015.

Lastly, it is worth noting that none of GPFG's votes against the reelection or appointment of directors had a real impact. All the reelections proposed by the management, in which GPFG voted against, received sufficient support, and the proposals were ultimately approved. Hence, it is important to explore why GPFG does not have a greater capacity to influence other stakeholders. More generally, the question of GPFG's ability to persuade both the management and other institutional shareholders to follow on their recommendations for the long-term remains unresolved. One explanation is that active ownership is not solely reduced to voting and proposals at AGMs. GPFG engages directly with companies' boards and senior management, through investor meetings or public events. Also, in private conversations GPFG encourages portfolio companies to fulfill their governance expectations, particularly in companies where GPFG owns large holdings or in companies which operate in high-risk sectors (in terms of human rights, environmental issues, etc.). All these shareholder engagement tactics remain invisible and oftentimes the proposals in AGMs—that can be codified—are, in fact, the last resort option only after having had multiple private conversations with the company.

GPFG is one of the most influential shareholders in Spain. It is encouraging companies to improve their corporate governance standards by actively voting in AGMs. Also, as a responsible investor with investments in diversified global listed equities, GPFG tries to influence others to invest in sustainable companies. GPFG can help Spanish multinationals to avoid the so-called "crony capitalism", as it acts as a corporate governance watchdog.

3.4.2. The case of Kuwait and the search for in-house capabilities

Established in 1953, Kuwait Investment Authority (KIA) is one of the oldest SWFs. A reputed investor with an in-house investment team, KIA's mission is to achieve a long term investment return. As such, KIA is classified among the "financial SWFs" in the y-axis of our organizing matrix (Figure 3.1). Also, given the renewed interest of KIA in infrastructure (typically a private market), we categorize KIA in quadrant 2. Thus, we analyze how a new unit, established by KIA to invest in infrastructure, is acquiring assets in Spain and how the

organizational change may foster and improve investment returns by enhancing in-house capabilities.

Kuwait has returned to Spain. More than twenty-five years ago, Kuwait Investment Office (KIO) (the KIA's old London-based subsidiary) faced an important drawback to its operations in Spain. In the late 1980s, after several financial scandals and the largest bankruptcy case by that time in the Spanish economy, KIO abandoned the investments and operations in Spain, leaving behind two iconic towers in the north of Madrid (still today known unofficially as the KIO towers).

Many things have changed over the last twenty-five years in both the Spanish and Kuwait economies. Most notably, on one hand, KIA's enhanced professionalization has allowed Kuwait to invest back in Spain, and on the other hand, Spain is equipped with a better and stronger regulation which helps to attract foreign investors such as KIA to the infrastructure sector, where Spain has become a global leader. Towards KIA's professionalization is Wren House Infrastructure (WHI). This is KIA's wholly-owned infrastructure arm, established in 2013. WHI is led by an experienced Kuwaiti national, formerly vice president at Bank of America Merrill Lynch in London. KIA's professionalization has come using two channels: organizational change and workforce specialization. By establishing WHI, KIA made an organizational change which allow it to concentrate its interests in infrastructure in a specialized unit. This change helps KIA to better learn how to invest and co-invest in this complex and challenging asset class. Consequently, WHI is able to attract global specialized talent and to establish training specific programs to improve in-house capabilities.

As a result of these changes, KIA is now participating in some of the most important infrastructure deals globally, either investing alone or as co-investor. Along with Ontario Teachers' Pension Plan, the Canadian active pension fund, WHI is jointly bidding for a series of infrastructure projects, including power deals in Australia, oil storage in the Netherlands, and the London City Airport in the United Kingdom. The agreement of WHI to jointly bid with the Ontario's pension fund, a reputed partner internationally, explains KIA's will to engage with the best and most competitive international players, learn from them, and have access to state-of-the-art global transactions.

This international experience has helped WHI to enter into Spanish markets. There are two illustrative examples of WHI's investments in Spain's infrastructure sector. First, WHI

partnered with Macquarie, the largest Australian infrastructure player, to bid for E.ON, the German electric utility company. In December 2014, the partnership acquired all assets of E.ON in Spain and Portugal. Globally, it was the third largest infrastructure transaction with SWFs participation in 2014. WHI invested US$1 billion in the transaction. WHI, jointly with Macquarie, defeated the bid led by Morgan Stanley and the Spanish energy company Gas Natural, the largest distributor of natural gas in Latin America.

Second, WHI acquired 25% of Global Power Generation, a fully-owned Gas Natural subsidiary dedicated to the global electricity generation business. It paid US$550 million in a solo investment to push the global expansion of the company, adding five Gigawatts in generation capacity in Latin America and Asia. As we explained above, this transaction strongly resembles the strategy followed by Asian and Gulf SWFs in Spain: to bet in Spanish multinationals with potential to harvest returns from Latin America.

These two investment examples of WHI in Spain reflect well a new trend within the SWF industry in aiming to bring global talent to SWF workforce. KIA needs more experienced managers to deploy capital efficiently in the complex universe of global infrastructure investments. KIA, through WHI, tries to reinforce its in-house capabilities, thus moves from our quadrant 1 to quadrant 2 (see Figure 3.1).

The KIA example illustrates well this pattern of human capital development. As studied by Bachher, Dixon and Monk (2016), there are new "frontiers of finance" either in Kuala Lumpur, Dubai, Beijing or Kuwait City, as in this case. In all these locations, SWFs have popped up, competing with established financial hubs like New York, London or Tokyo. In recent years, the financial crisis has forced institutional investors to drop external managers and be creative, which included the establishment of in-house investment teams. Consequently, SWFs have improved human resource strategies, designed competitive compensation schemes and allowed for location flexibility. It is not unusual for SWFs to scout for investment managers in the last years, and KIA is not an exception.

So far, SWFs have been able to attract young investment managers due to the fact that their wage gap is smaller between private and public sector at early career stages and SWFs are likely to offer greater experience opportunities (Bachher, Dixon & Monk, 2016). SWFs have also fared well in the efforts to attract mature employees that want a change from long-life stressful careers developed in London or New York. Yet, high and rocketing salaries of the

median career investment managers have remained out of the scope of SWFs. Thus, location and salaries are the main difficulties faced by SWFs when attracting global talent (Bachher, Dixon & Monk, 2016).

One way to overcome this hurdle has been the establishment of foreign offices (Al-Kharusi, Dixon, & Monk, 2014), so that early and mid-career investment managers can work remotely from international financial hubs. Apart from hiring talent, the reasons for setting new international offices reflect the interest of SWFs to attract professionals with expertise in specific niche markets, typically startups, private equity, and real estate. Moreover, international offices allow for better monitoring of the partnerships SWFs establish with local investment companies (Aguilera, Capapé, & Santiso, 2016). In the case of KIA, in 1965 it established the first ever SWF's overseas office in London. It allowed KIA to garner reputation as responsible and prudent long-term investor.

However, we observe different approaches in human resources looking at the headcount of SWFs. Table 3.6 shows the most and least labor-intensive SWFs. We have divided the total assets under management of each fund by the number of employees. The average employee manages US$970 million, with this figure ranging from a minimum of US$70 million per Mubadala's investment professionals to the US$3.6 billion managed per employee in the Investment Corporation of Dubai. What is not surprising is that the table is topped by the most active SWFs, being those who engage in daily activities of their portfolio companies like Mubadala, Khazanah and IPIC. The reason why Temasek and GIC, both from Singapore, belong also to most labor-intensive SWFs is that they are making a strong bet on venture capital and lead the group of SWFs that can be classified as sovereign venture funds (Santiso, 2015). Investing in venture capital requires specialized teams, new operational units and developing new investment capabilities. It implies that both Temasek and GIC improved in-house capabilities by hiring and training specialized talent as they entered into new asset classes, as it was the case of KIA when it decided to invest in infrastructure. Temasek, on its part, is also a good example of a "sovereign holding fund" because it owns relevant stakes in national government-linked companies, which consume a large amount of resources to effectively monitor them.

On the contrary, we find among the least labor-intensive SWFs those more passive investors such as the GPFG (Kotter & Lel, 2011). Kuwait, Qatar and CIC are also classified as low

labor-intensive close to the bottom but due to different reasons. In the case of GPFG, headcount will increase as their investment strategies get more complicated (real estate, direct investments). For WHI, we foresee a rise in the headcount as the frequency and geographic scope of deals increase.

In fact, labor-intensive funds may suggest more active investment roles. Among them we find SWFs with a hands-on approach (Mubadala, IPIC) and those who pick smaller stakes, thus actively monitoring third-party investment agreements (Khazanha, ADIA) or playing as venture capitalists (Temasek, GIC), respectively. On its part, less labor-intensive funds follow passive roles in two directions: either they invest in fewer companies in which they own large stakes (QIA, KIA) or invest passively in multiple companies taking small stakes (GPFG).

In conclusion, KIA is a sophisticated investor with professional in-house investment management teams. Recently it has established a new investment unit, WHI, which specializes in infrastructure. This organizational innovation has allowed KIA to attract talent and to increase in-house capabilities and brings KIA back to Spain with two major acquisitions. Undoubtedly, further Spanish companies would benefit from these sophisticated investors. In addition, the strong ties that the Spanish infrastructure global leaders have with Latin America will attract more sophisticated SWFs, and the pool of available capital for the expansion of Spanish companies will increase accordingly.

3.4.3. Qatar in Spain: A Comprehensive Strategy

Qatar Investment Authority is probably the world's best-known SWF. QIA is regularly making headlines for its sound acquisitions in trophy assets in London, New York and Singapore.

The strong links between the government and QIA goals help us to define QIA as a strategic investor according to our typology (y-axis in Figure 3.1). In fact, QIA defines itself as an "important building block of the Qatar National Vision 2030" and it embraces into global investments with the clear mission of "supporting the development of a competitive Qatari economy, facilitating economic diversification and developing local talent" (Qatar Investment Authority, 2016). If we consider x-axis, the ownership type, QIA invests in both private and listed equities. However, we consider that legitimacy and recognition are better

understood through public investments rather than in private markets. Thus we classify QIA in quadrant 3, as a strategic investor in listed equities.

Qatar Investment Authority (QIA), through its investment arm Qatar Holding, executes an ambitious strategy to position the Gulf's little and resource-rich state into the world map (Clark, Dixon, & Monk, 2013). To secure longer horizon state-goals, Qatar investments in Spain (conducted primarily through QIA or QIA's subsidiaries) capture well a strategic governance dimension pursued by QIA and described in our organizing framework (Figure 3.1): legitimacy. Indeed, QIA's vision is to "be recognized as a world-class investment institution, and to become the preferred partner of choice for investors, financiers and other stakeholders".

QIA captures the prototypical legitimacy strategies as it adheres to a strong recognition mission and vision, in search of legitimacy through financial sound investments (largely in Europe). Investments made in the iconic W Hotel in Barcelona or London department store Harrods might be seen under the "trophy asset" lens.

QIA is experiencing a period of strong governance transformations. It has changed its CEO twice in the last two years. Also, as a commodity-based SWFs, QIA is facing the pressure of lower commodity prices (both oil and natural gas), as well as diminished demand projections. Now we can observe a more global investment scope which departs from the strategy executed under the previous CEO when QIA made a strong European bet. QIA has hired senior bankers with expertise in both the United States and Asia (Kerr, 2015) and is already investing heavily in these regions. In September 2015, confirming this new trend, QIA opened an international office in New York City.

QIA has been described as trophy asset hunter. From luxury hotels in London to offices in Singapore, startups in California or in Bangalore, QIA deploys an active strategy to position and legitimate the country internationally. In 2014, QIA was the world's fourth most active SWF (ESADE, 2014). In terms of the average value of deals, it ranked third only after Chinese National Social Security Fund and UAE Mubadala. QIA has invested an average US$850 million per deal (Table 3.7).

QIA's investments in Spain reflect well one of the main objective pursued by the government of Qatar so far: international recognition (legitimacy), and this is present through numerous

examples (Al-Hassan, Papaioannou, Skancke, & Sung, 2013; Balding, 2012). QIA tracks this goal using two inter-related strategies: real estate investments (with special focus on hotels and iconic office buildings) and the spread of Qatar Airways brand in Spain through the FC Barcelona sponsorship. The strategic move connecting football and tourism brings the opportunity to accomplish its main goal: recognition. QIA investments in Spain reflect another important fact: The importance of long term relationships to develop trust, the main ingredient and catalyzer for global M&A deals (Jiang, Chua, Kotabe, & Murray, 2011). QIA's investments in football are not made solely to acquire brand recognition (international legitimacy) but also to establish close relationships with local and regional leaders which would facilitate the entry into other markets (oftentimes regulated). To create trustworthy relationships with local partners, help to identify new investment opportunities and to develop smarter and more efficient business network.

Since 2011, Barcelona has founded strong ties with Qatar. Beyond the hotel industry, the linkage between Qatar and the Mediterranean city was football. Indeed, FC Barcelona, under a very difficult financial situation, agreed to shirt advertising for the first time in its hundred-year history. It signed a five-year agreement with the Qatar Foundation: €30 million per season for the cash-constrained football club. Qatar, which aims to host the 2022 World Cup in the wake of the recent scandal surrounding FIFA, chose FC Barcelona as one of their most important crests for landing in Europe. FC Barcelona is one of the continent's leading clubs, and its celebrated coach, Josep Guardiola, who had played two seasons in Qatar, became the ambassador for Qatar in its candidacy for the 2022 World Cup.

In 2013, Qatar decided to exploit the strategic factor that Spain's tourism market represents for the airline and replaced the Qatar Foundation logo with that of Qatar Airways, which is now displayed on the front of the shirt. This decision was made on the same financial conditions. Qatar Airways is a state-owned entity fully controlled by Qatar Investment Authority.

The coordinated investment capacity displayed by QIA extends to other public and private Qatari groups. QIA's investments in Spain shows the importance of a comprehensive strategy which includes various public entities. This kind of strategy which uses the diverse state investment resources in a coordinated manner is deeply rooted on the basis of the new forms of state capitalism (Aguilera, Capapé & Santiso, 2016).

In parallel to football, airlines-related investments and sponsorships, Qatar also invested €78.5 million in acquiring Barcelona's Hotel Renaissance through another fund linked to the Qatari armed forces. In 2012, Qatari Diar, the real estate arm of QIA, acquired Port Tarraco, Tarragona's luxury yacht marina, for a reported price of €64 million. QIA expanded its Spanish reach beyond Barcelona when QIA's hotel investment arm, Katara Hospitality acquired a European hotel portfolio to InterContinental Hotel Group (IHG) in five cities, including Madrid. Katara would pay up to €60 million for IHG Madrid hotel to the Qatari group Ghanim Bin Saad & Sons Group Holdings (GSSG).

However, the best known transaction in the Spanish hotel sector happened in 2012, one year after Qatar signed its agreement with FC Barcelona. Qatar Holding acquired Barcelona's Hotel W to a group of local shareholders for €200 million. The purchase of this flagship hotel in Barcelona, one of the most visited cities in the world, is well aligned with the "international recognition" strategy pursued by QIA.

Qatar, using different state-owned vehicles, is betting in the Barcelona hotel sector, as well as improving Barcelona's flight connections with the Middle East and into Asia. Barcelona is a priority destination for global tourists, with special attention paid to increasing middle-class tourists from Asia, mainly China, who are now among the tourists that spend the most in Spain. This all serves Qatar's recognition goal. Similarly, Qatar Airways now advertises its daily connections to Doha, from Barcelona and Madrid, in order to increase flight traffic to the region and position Qatar as a new aerospace hub that connects Europe with Asia, in clear competition with neighbor UAE's Emirates (Dubai) and Etihad (Abu Dhabi). New customers and increased connections for commercial, business, and leisure activities between Europe and Asia position the Middle East as a strategic hub location in the aerospace industry. In a fierce competition for travelers, these three state-owned airlines deploy close to US$300 million yearly in the European football sector. All these sponsorship expenses support the goal of establishing a strong aerospace industry in the region, it helps to alleviate the dependency on oil-related revenue streams, thus diversifying the local economy.

To conclude, Qatar displays in Spain a comprehensive strategy with a main goal: legitimacy by international recognition. QIA and QIA subsidiaries leverage on previous deals made by other Qatari public and private investment companies, showing how a coordinated action in Spain serves its legitimacy goals. The most emblematical assets acquired by QIA in Spain

portray a different image of the small country (Clark, Dixon & Monk, 2013). By investing in iconic buildings and establishing strong sponsorships, Qatar builds trust with local partners and increases its reputation internationally, ultimately allowing it to expand its legitimacy both at home and abroad.

3.4.4. Long-term Learning: Oman-Spain Co-Investment Sovereign Wealth Fund

In April 2015, the Oman's State General Reserve Fund (SGRF) and a Spanish public-private company agreed to establish the first co-investment SWF in Spain. The new fund, still under development, will finance the international expansion of Spanish SMEs.

SGRF is situated in quadrant four (Figure 3.1) of our organizing framework. According to the y-axis, SGRF is classified as a strategic investor due to the close linkages between the fund's goals and those of the Sultanate of Oman. Specifically, in the mission statement, SGRF notes the fund will "invest strategically with a long-term time horizon" and most importantly SGRF will work "to attract global investments and expertise to Oman through is international network, and act as a catalyst in investing locally" (State General Reserve Fund, 2014). The latter is in line with the establishment of the co-investment fund while the former describes its strategic mission. Looking at x-axis, the ownership type, we consider SGRF as a "private market" owner given that the fund focuses on small and medium enterprises, which equities are generally not listed in Spain. Thus, SGRF and the resulting co-investment fund will invest strategically to serve the interests of both the Sultanate of Oman and the Spanish government.

This newly established SWF is part of a broader trend of European co-investment funds. In this section, we will review the five existing cases of co-investment funds and then focus our attention on the case between Spain and Oman.

3.4.4.1. The European Co-Investment Funds

There is a strong trend amongst European governments to establish public vehicles with the purpose of co-investing with foreign SWFs. These new "co-investment SWFs" seek two goals. On the one hand, domestic public investors gain access to the large capital pool of Middle East or Chinese SWFs and channel it to domestic companies that are willing to go abroad and enter into new markets. On the other hand, large funds get access to local authorities of target countries, engage in better and stable relationships with European

economies, and most importantly, open new channels for knowledge sharing. So far, this model has been developed in Russia, France, Italy, Ireland, Belgium and is now under development in Spain. These European countries set up small public investment units trying to attract foreign SWFs, from the Middle East or China. Both domestic and foreign SWFs are aligned in terms of long-term investment horizon and risk-return expectations. Yet, there are slight differences in the scope and goals of these European co-investment SWFs.

Russia Direct Investment Fund (RDIF) is probably the best known example of this new class of co-investment SWF. RDIF is a US$10 billion state-owned fund established in 2011, which has catalyzed US$25 billion in investments in the Russian economy from private equity funds, SWFs, and strategic partners.

Partners and co-investors who have already committed or invested with RDIF include China Investment Corporation, Korea Investment Corporation, Mubadala, or Kuwait Investment Authority. The list of co-investors has grown to 21 large, private or public qualified institutions (US$1 billion market capitalization or a minimum of US$1 billion of assets under management is required), as well as other SWFs and leading financial services companies from India, Egypt, and Turkey.

The main criticism that some of these vehicles receive is that "they don't deliver". Despite the media attention and coverage during the day of signing the co-investment agreements, operations never end up being implemented. In contrast, other co-investment funds adopt ambitious strategies and deliver, such as the Russia-China Investment Fund, which already has stakes in RFP Group (Russia's second largest wood processing company), Magnit (Russia's largest retailer), and Moscow Exchange (the largest exchange in Russia, the CIS, and Eastern Europe)[7].

In the case of France, the CDC International Capital (CDCIC), fully-owned by the Caisse des Dépôts Group –the largest public investor in France-, has been established in 2014 with the goal of arranging new investment agreements with foreign SWFs and other institutional investors to support the internationalization of French companies. CDCIC has inherited, from

[7] Full details of the RCIF's portfolio at http://rcif.com/portfolio-companies.htm. Accessed September 8, 2015.

a pre-existing public vehicle, three agreements with Qatar Holding, Mubadala, and the RDIF[8].

Italy established by law the Fondo Strategico Italiano (FSI) in 2011, and is looking to attract SWFs to foster Italian companies' internationalization. In March 2013, FSI established a 50|50 joint venture with Qatar Holding, named IQ Made in Italy Investment Company (IQMIIC) to support Italian companies in key sectors such as furniture and design, tourism, food, or brands (luxury goods). Surprisingly, this joint-venture has been absorbed as part of the assets under management of the FSI Investimenti, an investment company partially owned by Kuwait Investment Authority (23%), worth US$2.2 billion, and established in July 2014. This Italian situation represents a unique case in the sphere of Co-Investment SWFs. With the help of Kuwait, Italy manages a bulk of assets that includes the Qatari-Italian joint-venture.

Other cases include the recent agreement between China Investment Corporation and the "renewed" Ireland's SWF (Ireland Strategic Investment Fund) to set up a fund focused on fast growing Irish start-up technology companies that are willing to expand into China. On the other hand, in 2011, Belgium and China signed some of the oldest (and most unheard-of) investment agreements. CIC and the public Belgian Holdings SFPI set up a fund, investing in European middle-capitalization companies. The joint fund is focused on attracting Chinese investors to Europe, particularly to Belgium[9].

3.4.4.2. A new co-investment fund in Europe: The case of Spain

Spain, aware of the experience of other European countries, used COFIDES—a public-private vehicle supporting Spanish SMEs to go abroad—to sign an agreement with oil-rich Oman's State General Reserve Fund and to set up a 50-50 fund with the purpose of the internationalization of Spanish companies. Each part will contribute €100m to create an initial joint fund of €200 million. The fund will focus on investments in building materials, food, infrastructure, energy, and tourism. This will allow Spanish companies to benefit from the new fund through their expansion to the Gulf Cooperation Council (GCC) countries, and more generally East Africa or South and Southeast Asia.

[8] More information about CDCIC can be found at http://www.cdcicapital.fr/en/. Accessed September 8, 2015.
[9] SFPI's described in http://www.sfpi-fpim.be/en/portfolio-its-own-behalf. Accessed September 8, 2015.

The joint fund, which involves the creation of an asset management company, will be available to subsidiaries of Spanish companies with plans for international projection and intention to set up in Oman.

This strategy would help Spanish companies to explore new markets. This is of particular interest for Spain because international destination markets have been heavily biased toward Latin America and European Union. In some other markets, such as China, Middle East or South-East Asia, the state plays a key role in the economic activity. To have a business partner that is state-owned, such as the SGRF, facilitates the access to markets and to relevant business partners. Specifically, SGRF has the mission to act as the catalyst to increase investments in Oman. Thus, Spanish companies would benefit from the joint fund if they decide to expand to Oman or the region.

Oman, on its part, will get access to knowledge transfers from Spanish global construction and infrastructure leaders; this is especially important for Oman given the investment gap the country is facing to modernize transportations (road, rail or air) and build basic infrastructure. The agreement will help Oman to position itself as a platform connecting Europe, Asia and East Africa, as well as to increase its economic competitiveness with neighboring countries.

The same logic applies to the tourism sector given Spain has many mature touristic companies. Spain received more than 60 million tourists in 2015 and it remains as the third most visited country after France and the United States. Spanish hotels, tour operators, reserve systems, etc., may bring new approaches to Oman's economy, in need of innovation. Oman holds an important touristic potential, given its benign weather compared to its neighbors in the United Arab Emirates or Qatar. Other sectors of interest are agri-business (of key importance to a country with better arable conditions in the region) and engineering companies that would help the Sultanate to improve energy efficiency.

All these learning goals position Oman's SGRF and the newly established joint fund in the fourth quadrant in Figure 3.1, where SWFs pursue strategic international alliances, typically through joint-ventures. These relationships allow shared decision-making processes and access to expertise, which will ultimately result in high learning opportunities from an investment, geographic and industrial point of view.

This agreement with Oman's SGRF is the first of a series that Spain could continue with Qatar. The Secretary of Trade has already initiated conversations with QIA to establish a €500 million fund with similar objectives: to foster the internationalization of Spanish SMEs.

Given the track record of France or Italy, other potential partners include Kuwait or RDIF. CIC from China, or GIC and Temasek, from Singapore, would add new value to the relationships. These funds have a strong presence in the technology sectors, therefore establishing co-investment funds with them would inject new capital in the nascent and growing Spanish startup ecosystem. The expertise of these funds would help the Spanish public investors to improve their processes and learn how to invest more efficiently in technology and innovation.

The key learning experience accumulated over the last ten years is that the basis for successful SWFs is to establish investment units with carefully designed goals and governance structures (Das, Lu, Mulder, & Sy, 2009). Spain needs to consider the benefits of establishing a professional and independent organization to manage these new and prospective agreements rather than adding new functions to existing structures (Bernstein, Lerner, & Schoar, 2013). There are two major advantages. First, setting up a single organization that manages various agreements would facilitate knowledge sharing and learning. Second, establishing a certain independent structure would increase accountability, help to set more precise return schemes/benchmarks, and be the subject of clearer scrutiny and supervision. However, it also comes with disadvantages, which include the costs of capacity building and the resources deployed in setting up these structures. Once the costs are considered, to ensure professional and accountable asset management there would be a need for establishing a basic autonomous structure (i.e., an investment unit reporting to the Ministry of Economy) that operates independently once transparent rules and goals are agreed.

3.5. CONCLUSION

Spain has gained financial and international experience by dealing with SWFs. Spanish listed companies, as well as real estate developers and few privately-held companies, have negotiated with SWFs from all over the globe in recent times. In 2011, Spain was the first destination of SWFs foreign direct investments in Europe (Santiso, 2012). Since then, deal flow has continued and interactions with SWFs have increased. The dense relationship with

SWFs has facilitated the establishment of the first Spanish co-investment SWF, following a model already used by Italy and France.

This variety of SWFs allows the identification of four different governance strategies (described in Figure 3.1) used by SWFs when investing in Spain. First, we have considered how SWFs with minority stakes could play an important role in Spain as corporate governance watchdogs; then, we focused on the intense activity displayed by GPFG through voting in AGMs; finally, we discussed the beneficial impact of these strategies on countries like Spain, which sometimes has been labeled as a "capitalism of friends" with limited foreign active shareholders and low corporate governance standards. In Spain, the race to improve corporate governance standards is under development and funds like GPFG will have an important role to ensure that the codes of governance and the best practices spread to more companies. We label this type of SWFs as responsible investors (included in quadrant 1 in Figure 3.1). Their interest to safeguard funds' assets lead them to act as responsible investors and engage with companies' boards and management.

Second, we offer evidence about the role played by in-house capabilities to improve the quality of deal scouting, get access to direct investing, and enhance partnerships. Kuwait, following a strategy to attract talent, has returned to Spain, a country it abandoned under corruption scandals twenty-five years ago. Now, both Spain's regulatory framework and KIA's governance have improved substantially, allowing KIA to participate in some of the largest deals executed by SWFs. Enhanced in-house investment capabilities are representative of SWFs in quadrant 2 with a need for larger and more prepared human capital as they navigate into complex private markets such as infrastructure or venture capital.

Third, QIA is the best example of a strategic fund looking for legitimacy (those included in quadrant 3). The Gulf country has landed in Spain with a very clear objective: leverage on its financial firepower to re-invent the image of the Arab country. Investments and partnerships with Spanish companies in sectors such as football, airlines, and hotels allow QIA to build trust with local players and to deploy a national comprehensive strategy that aims to diversify its national economy, as well as to position the country as a bridge between Europe and Asia.

Fourth, Spain has now set up its own co-investment fund along with Oman due to the knowledge acquired over the last decade dealing with SWFs. The joint fund plans to invest in Spanish companies going abroad. Both Oman and Spain focus on learning (quadrant 4) and

impulse the establishment of an international joint-venture to achieve strategic national goals. The experience from this first fund in Spain may be repeated in association with other countries, in the region and beyond. Operations, governance—including accountability—and clear goals should be defined in order to ensure the appropriate use of this newly created vehicle. Again, strategic governance would influence the results of a new sovereign venture.

3.6. FUTURE RESEARCH

Research on sovereign wealth funds has been naturally biased towards its financial aspects, with a strong focus on the impact of SWFs' investments in portfolio companies' returns, both in the short and long term. However, we consider that research in fields such as economics, management and international business remain quite unexplored. Therefore, we would like to propose four fruitful areas for future research beyond finance that require further attention.

Globally, policy makers are setting today's agenda based on a combination of two economic trends: low oil prices and low interest rates. This new normal brings the opportunity to improve our knowledge on SWFs in at least two areas: for economists to test the validity of SWFs as rainy-day funds and for management scholars to understand change in SWFs to adapt to the new environment. Apart from this circumstance, we consider two other topics that remain unclear in the literature. On one hand, the relationship between SWFs and co-investment partners now that SWFs are looking for more direct investments and, on the other hand, the exploration of the particular economic and institutional context of African SWFs.

First, from an economic point of view, low oil prices offer an environment that can test SWFs' ability as rainy-day funds. Due to these circumstances, a comparative study for the different reactions to oil prices by SWFs is pertinent. Analyzing how SWFs with different levels of governance complexity and investment mandates react to low oil prices would help to understand the usefulness of establishing SWFs. Research must be done on how SWFs cope with tough external shocks, maintain long-term trajectories over short-term needs and retain independence levels from political pressure.

Second, the persistent low interest rates offer another stream of new research for management scholars. It remains to be understood how SWFs adapt through diversification beyond safe fixed income. Hence, private markets have grown in importance as an asset class for the majority of SWFs. Given the low interest rates, SWFs have invested in real estate, private

equity or infrastructure, looking for the returns that safe fixed income is not providing. SWFs have acquired new resources to enter into riskier asset classes. They have either developed talent internally or hired from the outside. Future research should explore how governance of SWFs change to adapt to this complex environment, what the interactions between new hired talent from abroad and incumbents look like, or the theoretical advances to explain the behavior of foreign talent in organizations ultimately governed by nationals.

Third, the world is witnessing the expansion of SWFs to new geographies. New offices opened up by CIC in the United States, GPFG in Japan or Qatar in China suggest that interactions with local investment partners will grow in the near future. This co-investment pattern brings new questions to the table that remain. How do SWFs negotiate on prices or quality of assets? Are there differences between SWFs or public pension funds when they look for specific deals? Moreover, we do not know much about the partners that SWFs engage with to explore new asset classes or countries. Finally, if we assume trust is key to source and close deals in investment banking, how do SWFs build trust with other players in the industry? International business scholars could be interested in answering these questions.

Fourth, SWFs play a role very different in Africa than elsewhere. When scholars define SWFs as a means to preserve current wealth for the future generations most of them are not thinking in Africa. In many resource-rich African economies to have a future requires investments today. This tension between today's needs and inter-generational transfers is reflected in the different vehicles designed in Africa. Also, the fact that in many African countries mineral resources have led to a "natural curse", rather than an improvement in the economic conditions, places SWFs as a key governance tool to resist. A careful organizational design and governance definition, such as the implemented in the newly established Nigerian SWF, may yield long-term returns, economic diversification and inspiration for other governments to follow. To understand the African context and the specific nature of its SWFs are key issues still unresolved.

What is clear is that SWFs are here to stay and there is a lot more to understand.

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Table 3.1: Selected Institutional Investors in the Spanish IBEX-35

Asset Manager	Country	Stock value* (€M)	# Stocks
Norges Bank Investment Management	Norway	7,761	32
The Vanguard Group Inc.	United States	6,199	33
BlackRock Fund Advisors	United States	5,496	33
Lyxor International Asset Management SAS	France	4,555	33
Qatar Investment Authority	Qatar	3,527	1
BlackRock Investment Management Ltd.	United Kingdom	3,233	32
Amundi SA (Investment Management)	France	3,008	26
Capital Research & Management Co	United States	2,918	9
BlackRock Advisors (UK) Ltd.	United Kingdom	2,203	33
BlackRock Asset Management Deutschland AG	Germany	1,979	27
GIC Pte Ltd.	Singapore	838	1

Source: Author's elaboration with data from Bolsas y Mercados Españoles (2015). * Valued March 2015. Soverign wealth funds shadowed.

Table 3.2. Bankia: The divestment process attracts foreign interest

Industrial holding	Stake sold	Acquirer	Country	SWF involved
Deoleo	18%	CVC Capital Partners	UK	FSI
Realia	28%	Carso (Carlos Slim)	Mexico	
Globalvia	50%	USS, OPTrust and PGGM	Netherlands, UK, Canada	Khazanah
Metrovacesa	19%	Santander	Spain	
Indra	20%	SEPI	Spain	
Iberdrola	4.9%	Qualified investors		
NH Hotels	12.6%	Qualified investors		
Mapfre	12%	Qualified investors		

Source: Authors' elaboration from companies' press releases and media news.

Table 3.3: Top 10 equity holdings in Spain by the GPFG

Company	Sub-Industry	Value (US$)	% Votes
Iberdrola SA	Utilities	1,338,267,389	2.97
Banco Santander SA	Banking	1,265,612,160	1.77
Inditex SA	Textile, Garment & Shoes	985,766,097	0.92
Telefónica SA	Telecoms	769,280,099	1.39
Banco Bilbao Vizcaya Argentaria SA	Banking	695,327,810	1.49
Amadeus IT Holding SA	Electronics and Software	298,770,028	1.54
Bankia SA	Banking	296,444,001	2.21
Ferrovial SA	Construction	283,318,019	1.71
Repsol SA	Oil	190,682,080	1.24
Grifols SA	Healthcare	159,476,141	1.62

Source: Authors' elaboration from Norges Bank Investment Management (2015).

Table 3.4: Top 10 largest equity stakes of the GPFG by voting rights in Spain

Company	Sub-Industry	Value (US$)	% Votes
Papeles y Cartones de Europa	Paper	24,008,168	4.54
Iberpapel Gestión	Paper	9,051,174	4.29
Tubacex	Minerals, metals	9,557,255	3.78
Miquel y Costas & Miquel	Paper	16,281,352	3.44
Gamesa Corp Tecnológica	Capital Goods	143,122,264	2.98
Iberdrola	Utilities	1,338,267,389	2.97
Distribuidora Internacional de Alimentación SA	Consumer services	109,340,034	2.97
Azkoyen	Capital Goods	3,416,962	2.77
Applus Services SA	Consumer services	31,740,541	2.69
Viscofan	Chemicals	70,280,316	2.50

Source: authors' elaboration from Norges Bank Investment Manager (2015).

Table 3.5: GPFG decisions during AGMs in Spanish companies

Company	GPFG&Board agreement (%)	# Proposals	GPFG voted against director reelection/ appointment	Was the director finally appointed?
Top 10 Holdings				
Santander	100%	32		
Telefónica	100%	13		
Iberdrola	96%	26	YES	YES
BBVA	100%	22		
Inditex	100%	18		
Ferrovial	76%	25		
Repsol	100%	23		
Banco de Sabadell	100%	23		
Amadeus IT	100%	23		
Gas Natural	97%	31	YES	YES
Bottom 10 Holdings				
Codere SA/Spain	71%	14	YES	YES
Ercros SA	93%	15		
Prim SA	93%	28		
Natraceutical SA	100%	7		
Telecomunicaciones y Energia	100%	19		
Realia Business SA	86%	21	YES	YES
Baron de Ley	94%	16	YES	YES
Fluidra SA	100%	32		
Azkoyen SA	71%	21		
Vocento SA	100%	10		

Source: Author's elaboration with data from Norges Bank Investment Management (2015) and companies' press releases.

Table 3.6: The ranking of SWFs by labor-intensity

Sovereign Wealth Fund	#Employees	AuM ($bn)	AuM per employee ($bn)	Country	SWF Ranking (AuM)
Mubadala Development Company	900	66	0.07	UAE	19
Khazanah Nasional	465	42	0.09	Malaysia	25
GIC	1,300	415	0.32	Singapore	8
International Petroleum Investment Company	200	66	0.33	UAE	18
Temasek Holdings	530	196	0.37	Singapore	11
Korea Investment Corporation	195	85	0.43	South Korea	15
Abu Dhabi Investment Authority	1,650	773	0.47	UAE	2
Hong Kong Monetary Authority	841*	406	0.48	Hong Kong	7
Abu Dhabi Investment Council	180	90	0.50	UAE	13
Samruk-Kazyna	100	78	0.78	Kazakhstan	16
Future Fund	98	87	0.89	Australia	14
SAMA - Foreign Holdings	620*	757	1.22	Saudi Arabia	3
China Investment Corporation	588	747	1.27	China	4
Qatar Investment Authority	200	304	1.52	Qatar	9
Government Pension Fund Global	518	850	1.64	Norway	1
Kuwait Investment Authority	250	548	2.19	Kuwait	5
Investment Corporation of Dubai	50	183	3.66	UAE	12
	8,685	5,692			

Source: authors' elaboration from SWFs' websites and official sources. *These SWFs are part of the central bank structures, thus the official figure for the SWF workforce is less accurate.

Table 3.7: The most aggressive deal hunters by transaction average value

Sovereign Wealth Fund	Country	# Deals	Average value*
National Social Security Fund	China	1	2,100
Mubadala Development Company	UAE	8	1,718
Qatar Investment Authority	*Qatar*	*11*	*848*
GIC	Singapore	23	621
China Investment Corporation	China	7	369
Kuwait Investment Authority	Kuwait	9	359
State General Reserve Fund	Oman	5	265
Abu Dhabi Investment Authority	UAE	9	223
Temasek Holdings	Singapore	44	170
Khazanah Nasional	Malaysia	3	115
National Pension Reserve Fund	Ireland	1	50

Source: Authors' elaboration from Fletcher SWF Transaction Database (2015) * US$ millions.

Figure 3.1. Strategic Governance of Sovereign Wealth Funds in Spain

Investment Motivation		Public	Private
	Financial	**Quadrant 1. Shareholder Activism** SWFs play a key role in monitoring and improving the corporate governance of listed companies worldwide. Norway's GPFG plays a critical role for Spanish companies, challenging the corporate governance "status quo". GPFG has quantitative and qualitative potential to monitor Spanish multinationals more effectively. Other SWFs and large institutional investors may join GPFG and reinforce such messaging.	**Quadrant 2. In-house Capabilities** SWFs establish specialized teams looking for higher returns, new asset classes, and untapped geographies. There are spillover effects with regard to the organization: professionalization, fee reduction, and lower agency costs. KIO's newly-established arm, WHI, is investing heavily in infrastructure globally. Professionalization has helped WHI to partner with some of the best global players in infrastructure to bid for Spanish assets. Enhanced in-house capabilities will allow more SWFs to invest in the Spanish infrastructure sector.
	Strategic	**Quadrant 3. Legitimacy** Governments use SWFs to obtain long-term state goals, yet simultaneously seek to acquire legitimacy as institutional investors. In Spain, QIA displays a comprehensive state strategy. QIA is able to gain legitimacy as investors and at the same time to position and intensify the country's image by investing in Spanish hotels, real estate companies or through football sponsorships.	**Quadrant 4. Long-Term Learning** SWFs look for domestic economic diversification and engagement in long-term relationships with foreign companies in order to acquire resources and know-how (that is, to learn). Oman's SGRF has the mission of attracting talent and expertise as well as catalyzing investments into the Sultanate. To fulfill this learning objective, SGRF has agreed to establish a co-investment fund with Spain to facilitate the access of Spanish companies to Oman's key economic sectors.

Ownership Type

Source: Aguilera, Capapé, and Santiso (2016)

4

Too big to leave: The case of active owners

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Co-authored with Ruth V. Aguilera (D'Amore-Mckim School of Business—Northeastern University and ESADE Business School), Vicente Bermejo (ESADE Business School) and Vicente Cuñat (London School of Economics).

4.1. ABSTRACT

While we know that different owners have different interests in the firms they invest in and they align their corporate governance practices to serve these interests, there is much to learn from unique institutional investor such as sovereign wealth funds. In particular, we explore whether there has been any governance improvement after Norway's sovereign wealth fund (NBIM) made an explicit and unexpected announcement in November 2012 that it will put pressure on firms in which they invest to improve their governance. We uncover that, relative to a matching sample, companies invested by NBIM change their corporate governance post-announcement. However, the most adopted governance practices seem to be relatively traditional ones and they are not implemented at the same speed across all firms. Our findings shed light on our understanding of shareholder activism among a unique set of owners and expand the knowledge of heterogeneous principals.

“I myself own a flower,” he continued his conversation with the businessman, “which I water every day. I own three volcanoes, which I clean out every week (for I also clean out the one that is extinct; one never knows). **It is of some use to my volcanoes, and it is of some use to my flower, that I own them.** But you are of no use to the stars…” (Saint-Exupéry, 1943(2010): 56).

4.2. INTRODUCTION

It is now well known that institutional investors are concerned and can influence investee firms’ corporate governance (Gillan & Starks, 2000). Research in corporate governance and finance identifies two main channels that institutional investors deploy when they seek to influence their portfolio companies’ strategies and want to “assure themselves of getting a return on their investment”. Thus, institutional investors, such as large shareholders, have used “voice” or “exit” to express their disagreement with the governance practices of their portfolio companies (Hirschman, 1970; McCahery, Sautner, & Starks, 2016). On one hand, they may talk directly to management or boards to address the conflicting governance issues, that is the “voice” channel; on the other hand, institutional investors can “vote with their feet,” that is, divest and “exit” the company by selling and trading their shares (Edmans & Manso, 2011).

Recently, more governance mechanisms are available for investors to express their voice and influence investee companies to implement certain strategies or to adopt given governance practices (Connelly, Tihanyi, Certo, & Hitt, 2010). New, accessible ways of communication, the ease of regulation and corporate bylaws on promoting shareholder proposals, and the role played by proxy advisors, are reducing the costs of stronger shareholder activism (Coffee Jr. & Palia, 2016).

As a result, an increasing ratio of diverse institutional investors (e.g., pension funds, mutual funds, hedge funds, private equity funds) are able to promote active ownership practices, and therefore it is key to continue our understanding of the goals and strategies pursued by these heterogeneous institutional investors (Gillan & Starks, 2007; Hoskisson, Hitt, Johnson, &

Grossman, 2002; Schnatterly & Johnson, 2014). Agency theory has been enriched by the concept of heterogeneity of the "principals" which have different and sometimes conflicting objectives, depending on their stake size (Fich, Harford, & Tran, 2015), investment horizons (Connelly et al., 2010; Gaspar, Massa, & Matos, 2005) or non-market strategies (Aguilera, Capapé, & Santiso, 2016). Given this heterogeneity, which has important implications in the development of an extended agency theory, some investors are receiving stronger attention than others. Hedge funds, for example, are now better known and the debate about their influence in the short and the long run has received renewed efforts (Bebchuk, Brav, & Jiang, 2015).

Yet, the question of how state-owned investors as a particular group of institutional investors influence the corporate governance of their investee companies remains unresolved. In this paper, we are interested in exploring the question "do sovereign wealth funds (SWFs, hereinafter), as state-owned institutional investors, improve the corporate governance of their portfolio companies?" And the quick answer is yes. Our findings demonstrate that SWFs are able to improve significant governance practices such as the share of independent directors on boards, the share of women on boards, and the independence of the audit committees.

SWFs have received scarce scholarly attention. They have not been specifically addressed in the literature on principal heterogeneity (Connelly et al., 2010; Hoskisson et al., 2002) or have merely been acknowledged but not analyzed (Goranova, Abouk, Nystrom, & Soofi, 2017). Yet, their importance is undeniable. The size of the SWFs industry, in terms of assets under management, is worth three times that of the hedge funds. Also, the nature of SWFs makes them an intriguing combination of private and public institutions, a new form of state capitalism that is growing (Musacchio & Lazzarini, 2014). Their capacity to influence corporations all over the planet is undeniable. In one example, Norges Bank Investment Management (NBIM), the asset owner of the largest SWF and our object of analysis in this paper, controls on average 1.3% of all listed equities globally. The figure rises to 2.5% when referring to European listed companies.

In this paper, we investigate the efficacy of NBIM as an active or engaged shareholder. We examine in detail all the equity investments made by NBIM since 2006 to 2015, in order to understand to which extent they are able to influence the corporate governance of their portfolio companies. From November 2012 onwards, NBIM started a new "active

shareholder" strategy and it released a note presenting NBIM's expectations on corporate governance. Taking advantage of this exogenous event for investee firms, we analyze how efficiently NBIM has played its role as an active shareholder since then. NBIM began to engage systematically with companies, investors, regulators, etc. to improve the value of its thousands of holdings in areas of board accountability and equal treatment of shareholders.

Based on well-spread empirical and theoretical arguments (Gompers, Ishii, & Metrick, 2003; Bebchuk, Cohen, & Ferrell, 2004) claiming that there is a positive link between better governed companies and higher performance, NBIM has adopted a better governance strategy as part of its core identity. Therefore, NBIM, as a minority shareholder, is better equipped to bear the costs of acting as an active shareholder and raise its "voice," instead of exiting multiple minority positions when it identifies weak corporate governance practices in its investee firms. This "voice" effort does not imply that NBIM cannot "exit" companies for governance-related reasons: it has exited positions in the past and presumably will continue doing so in the future. In this paper we focus on the "voice" strategies and leave "exit" for further researches.

NBIM raises its "voice" through a variety of ownership tools such as setting up expectations, voting in annual general meetings, direct interactions with boards and top executives, promoting public policies and peer-group initiatives with other institutional investors as well as industry programs, promoting shareholder proposals, starting legal actions, focusing on governance characteristics for portfolio selection or via research.

Our work contributes to strategy research in several ways. First, we add evidence on a different "principal" player—sovereign wealth funds—in the heterogeneous matrix of institutional investors which currently own the majority of shares of listed companies worldwide. Second, we enhance the understanding of how SWFs, with a dual objective of maximizing financial returns and increasing global political influence, may act as "engaged shareholders" in the long run, in contrast with "activist shareholders" more focused in short-run returns. Third, we demonstrate that SWFs, as long-term investors, do have an impact on their investee companies' corporate governance, which they believe will enhance value of companies in the long-run.

4.3. THEORETICAL BACKGROUND

Agency theory has dominated corporate governance research in the areas of finance and management (Dalton, Hitt, Certo, & Dalton, 2007; Gompers et al., 2003). This theory predicts that well-monitored managers that align with principals will increase firm value. The literature has also discussed extensively corporate governance practices that align principals and agents' interests, such as the separation of the roles of CEO and Chairman, the independence of the board directors, and the importance of an effective market for corporate control. For the most part, theoretical insights support the assumption that better governance should improve company value in the short and long run. It follows that, in general, shareholder activism enhances board monitoring roles, enforces effective governance mechanisms, and is consistent with the agency assumption of alignment of interests (Gompers et al., 2003).

The classic dichotomy between agents and principals has been recently enriched with new boundary conditions. One of the main insights is the acknowledgment of heterogeneous principals (such as institutional investors, families and governments) acting simultaneously within a firm (Goranova et al., 2017; Young, Peng, Ahlstrom, Bruton, & Jiang, 2008). With heterogeneous principals, the fundamental problem of aligning conflicting interests between owners and managers does extend to scenarios where different owners may have different interests (Connelly et al., 2010; Hoskisson et al., 2002; Young et al., 2008); managers may prioritize demands from a set of owners at the expense of others (Bebchuk, Cohen, & Ferrell, 2009; Becht, Franks, Mayer, & Rossi, 2009; Goranova et al., 2017); owners might dedicate monitoring efforts for the largest stakes of their portfolios and free-ride in the smaller ones (Fich et al., 2015). Therefore, the heterogeneous set of principals' interests, often in direct conflict, forces us to move beyond agency theory to account for this renewed complexity.

This diversity of owners with heterogeneous interests is reflected in the mixed empirical results. Research shows that activism is beneficial for companies under certain circumstances (Cai & Walkling, 2011; Cuñat, Gine, & Guadalupe, 2012), whereas other results indicate that the value of activism is decreasing due to private tunnelling of investors (Anabtawi & Stout, 2008), and misguided preferences over shareholder value that prioritize other stakeholders such as workers' rights (Agrawal, 2012) or investors' political gains (Woidtke, 2002). Also, given investors prefer better governed companies with lower monitoring costs (Leuz, Lins, &

Warnock, 2009), it brings to endogenous choices and identification issues, which has led to mixed results.

In fact, there is a fierce theoretical and media debate between those who defend the value of shareholder activism in the long-run (Bebchuk et al., 2015) and those who claim the importance of managers, who have information advantages to design and implement the corporate strategy, and point to the short-term risks of activism (Lipton, 2015).

As owners, institutional investors have believed in the premise (which almost turned into ideology) which supports shareholder value maximization and the preeminence of principals over managers (Davis, 2009; Rappaport, 1986; Shleifer & Vishny, 1986). While, most institutional investors have little incentives to demand better governance of their investee companies due to the costs of monitoring, these costs have decreased substantially and incorporating the gains of improved corporate governance is now more attainable (Del Guercio, Seery, & Woidtke, 2008; Goranova et al., 2017). There are at least three reasons to explain why the shareholder's value view has won over managers' interests and why institutional investors feel encouraged to adopt active approaches. First, new governance codes expanded globally after the Enron scandal in 2002, which involved serious governance misconduct and increased awareness in multiple countries (Aguilera and Cuervo-Cazurra, 2004); second, media currently exerts a reinforced pressure on issues such as CEO compensation or the reelection of board directors (Bednar, 2012); third, after the global financial crisis of 2008, more governments became owners due to the bail-out process that followed and citizens' demands for increased monitoring roles grew accordingly (Tihanyi, Graffin, & George, 2014). All of these trends have led to a dominant position of investors over managers. We observe two interrelated consequences: lower agency costs and higher principal costs.

First, the legitimation and expansion of shareholder activism have facilitated the efficacy of active investors (Del Guercio et al., 2008). As a result, more activism implies lowering agency costs by decreasing misalignments of managers' incentives. The distance between managers, boards and shareholders is decreasing and the interactions are increasing. This is the positive outcome that results from more active institutional investors.

Yet, this process has also increased the heterogeneity of interests and therefore principal costs have grown. Principal costs refer to those derived from investors exercising control, in contrast with agent costs derived from managers exercising control (Goshen & Squire, 2017). Heterogeneity showed up when more diverse owners tried to achieve their (sometimes) conflicting goals. For example, meeting the demands of a large shareholder can come at the loss of other shareholders; indeed, managers may attend to some demands by placating influential investors and ignoring others (Goranova et al., 2017), incurring in principal costs. The more frequent behind-the-scenes interactions between managers and shareholders have reduced the agent costs while bringing "new" and growing principal costs into the equation (Bebchuk & Weisbach, 2010; Becht et al., 2009).

For this reason, understanding the heterogeneity of principals seems critical. In fact, one way to understand heterogeneity is to classify shareholders according to the style of their interactions with company managers and boards. We differentiate between "activists" and "engaged" shareholders.

On one hand, activists invest with a strategic plan in mind related to how the corporate governance of specific companies in any given sector should be. These activists find an underperforming company to implement and execute the governance strategy, and then leave the company after few years. Activists invest in a limited number of companies and aim to take controlling positions which allow them to have a short-term, strong impact and to implement the changes required. Activists aim for goals through intrusive interventions (i.e., firing a CEO, divesting subsidiaries or promoting spin-offs).

On the other hand, engaged shareholders, also known as stewards, are normally large and hold a very diversified portfolio of minority positions. Engaged shareholders are institutional investors that follow a buy-and-hold strategy. They look for implementing policies and strategies to better the governance of their investee companies and thus improve the long-term value of the portfolio (Gillan & Starks, 2000). Engaged shareholders pressure firms to adopt more effective corporate governance practices. They tend to focus on governance's main mechanisms (board independence, CEO duality) to ensure a sustained long-term value

of the company (Rappaport & Bogle, 2011). For the purposes of this paper, we consider NBIM as an engaged institutional investor[10].

In summary, reduced monitoring costs allow more institutional investors to play a more active role. Consequently, the misalignment lowers between shareholders and managers, and thus agency costs are also lowered. Yet, the participation of more different types of shareholders in monitoring introduces larger principal costs due to heterogeneous principal's goals (Cronqvist & Fahlenbrach, 2009). Researchers have accounted for the different types of principals/owners, such as hedge funds (Agarwal, Daniel, & Naik, 2009), pension funds (Becht et al., 2009) or mutual funds (Cvijanović, Dasgupta, & Zachariadis, 2016). Most of this research analyzes the indirect effects of institutional pressure on corporate governance which produces changes in operating and market performance. However, in this paper, we focus on the direct effects that sovereign wealth funds have on the corporate governance of investee companies.

Given the shareholder heterogeneity, we focus on a rarely studied class of institutional investor: sovereign wealth funds. We add value to the current stream of literature that analyzes the impact of the heterogeneous goals of different owners.

The rest of the paper describes the characteristics of sovereign wealth funds as state-owned long-term institutional investors and the expectations of the Norway's sovereign fund in particular. We then describe our dataset and variables, the methods we have used, show and discuss the main results, and provide conclusions.

4.4. CONTEXT: SOVEREIGN WEALTH FUNDS

Sovereign wealth funds are government-owned investment funds without explicit pension liabilities that typically pursue long-term investment strategies (Aguilera et al., 2016: 5).

The nature of a SWF is determined by its "sovereignty" (Megginson & Fotak, 2015). These funds follow dual-objectives of financial returns—like other mutual funds—and they also

[10] We will refer to NBIM as an engaged shareholder. Other authors cited in the paper talk about "active shareholders" or "stewards". All these terms refer to the same idea of investors exercising a monitoring effort of gathering information and trying to influence managers for the long run rather than trading.

pursue broader economic and development returns for their countries. Sovereign wealth funds are a different class of institutional investors. The main reason is that this sovereignty is present in the pressure from politicians to use SWFs to obtain political gains or accomplish wider macroeconomic goals (Bernstein, Lerner, & Schoar, 2013; Bortolotti, Fotak, & Megginson, 2015) and is also present in the fears of recipient countries of geopolitically-motivated investments in strategic industries (Clark, Dixon, & Monk, 2013).

SWFs are interested in the long-run and thus deviate from short-term-oriented strategies used by certain hedge funds. They are not public pension funds because they do not face pension liabilities and as such have more flexible asset allocation strategies with reduced liquidity constraints. Also, most of the SWFs are based in non-OECD countries with lower transparency and democracy index levels. All these characteristics make SWFs a different owner and principal, and explain why it makes sense to focus on them separately.

So far, research has determined that the market reaction to SWFs' investment announcements is positive in the short term (Dewenter, Han, & Malatesta, 2010; Kotter & Lel, 2011) yet lower than announcements made by investors not owned by governments (Bortolotti et al., 2015). This difference increases in the mid- to- long-run in the cases of SWFs taking the seats of boards, funds strictly controlled by their governments or under direct political influence (Bernstein et al., 2013; Bortolotti et al., 2015; Knill, Lee, & Mauck, 2012). This "liability of sovereignness" is explained and discounted by markets due to the potential conflicts between SWFs' political goals and target firms' financial performance.

In our research, we focus in a particular sovereign fund—NBIM—because it is the largest one, a well-known engaged shareholder and offers high levels of transparency. NBIM has released all its equity positions since its inception in 1998, so it is possible to capture all effects produced by this unique investor and sovereign fund.

4.4.1. Norges Bank Investment Management as engaged shareholder

NBIM manages the world's largest sovereign wealth fund, the Government Pension Fund – Global, by assets under management. In spite of the term "pension" in its name, it does not pay pensions but instead it saves and builds financial wealth for the future generations to prepare for the time when oil and natural gas reserves are depleted. As of March 2017, NBIM has assets under management worth US$920 billion. Equity investments represent more than

65% of its portfolio. It owns on average 1.3% of all equities listed globally, and its largest stakes are in well-recognized companies such as Nestlé, Royal Dutch Shell, Apple or Alphabet, with stakes above US$4bn respectively.

Given the size of the fund, its diversified scope (investments in 9,000 companies in 67 countries) and minority positions (few stakes above 10%), one might assume that NBIM engages in a passive shareholder strategy, which was true until recently (Bortolotti et al., 2015).

More specifically, in November 2012, NBIM published a critical discussion note ("Note" hereinafter) stating that effective corporate governance has a positive, direct and long-term impact on the value of companies based on scholarly evidence from the United States (Bebchuk et al., 2009; Gompers et al., 2003) and Europe (Renders, Gaeremynck, & Sercu, 2010). In this public announcement, NBIM explicitly intended to reveal that from that point onwards, NBIM would demand its portfolio companies to meet certain "corporate governance expectations" (NBIM, 2012). The language of the press release contained statements such as "NBIM's primary corporate-governance focus will consequently be on mechanisms shareholders can use directly and indirectly to influence companies towards sustained business success" or "NBIM operates a corporate-governance program. Setting out generic expectations for good corporate governance is one of several steps in this program and the topic of this discussion note" (NBIM, 2012: 3).

We argue that the Note marks a substantial milestone in the NBIM strategy. No one could anticipate this movement by an investor which held holdings in 7,427 companies at the end of 2012. In fact, the novelty of this strategy was covered by financial media in the weeks that followed the Note release: "It is a big change in how the oil fund operates and signifies a more active approach to its largest investments" (Milne, 2013a) or "Norway has just published an important note on what it expects in terms of corporate governance from the companies it invests with" (Carney, 2013). Comments from the CEO, Mr. Slyngstad, describe how they shifted into engaged/active shareholders: "I think active is a fair description. We think it is the responsibility of the larger investors to be more involved in what in the UK is referred to as stewardship and have a dialogue not just with the CEO and CFO but also the chairman of the board" (Milne, 2013b). This statement implies a substantial change and we empirically test whether this new and different effort has paid out.

While the engagement of NBIM with its companies goes back to its origins, its efforts mostly focused on the establishment of the Council on Ethics in 2004 and on setting "ethical guidelines" for the sovereign fund. These guidelines have allowed the Council to recommend the exclusion of companies from the fund's investment universe, or to place companies under observation. The ethical guidelines propose to exercise ownership rights and to make decisions on negative screening and exclusion of companies operating against the guidelines. Nevertheless, these efforts have been focused on investee companies involved in the production of cluster munitions, nuclear weapons, tobacco or other conduct-based violations, such as severe environmental damage or serious violations of human rights. In effect, the monitoring role of NBIM has been centered around the "negative screening" of companies involved in harmful production or wrong-doing. Yet, the new explicit approach disclosed in the Note is universal and affects every single company in which NBIM is investing.

4.4.2. NBIM's search for effective ownership

NBIM expects its portfolio companies to behave according to a set of corporate governance principles outlined in the Note published in 2012. While NBIM acknowledges that the changes it proposes are profound and would take time to implement, it is clear about the benefits of setting priorities to enhance board accountability and equal treatment of shareholders, thereby improving the governance of its portfolio companies. NBIM does not want to add another code of good corporate governance to the existing pool of codes, instead it addresses the challenges of an engaged minority shareholder from an "investment culture" approach. That is, while it takes into account the academic research on different corporate governance dimensions, it prefers to take its own practical approach, avoiding general statements.

In this section, we summarize what NBIM expects from each corporate governance practice explicitly mentioned in the Note. We discuss why NBIM might pursue for each of these practices to enhance the corporate governance of their investee companies. Also, we include other additional practices regularly cited in the literature to provide a better assessment of the NBIM strategy. In the "Sample and data" subsection, we explain in detail the process of how we decided on 17 corporate governance variables: ten variables were explicitly mentioned in the Note, whereas we added seven more due to their importance in the current literature. Please, refer to the Table 4.1 for the definitions of all of these variables.

4.4.2.1. NBIM explicit expectations

The first three corporate governance practices refer to board abilities: cultural diversity, specific skills and director's commitment. *Cultural diversity*, taken as the share of board members with different cultural backgrounds, is regularly associated with enriched and wider views which help boards to understand better the business and improve advice and supervision roles. Indeed, there is some evidence that more culturally diverse boards improve the discussion angles and perspectives and the analysis of foreign acquisitions and provide information advantages (Masulis, Wang, & Xie, 2012); however, there is also a danger in "romanticizing" cultural diversity, as more diverse boards may lead to less effective and integrated boards that negatively affect firm value (Boivie, Bednar, Aguilera, & Andrus, 2016; Frijns, Dodd, & Cimerova, 2016). NBIM expects its investee companies to have more culturally diverse board directors.

NBIM also refers to *board specific skills,* which highlights the importance of industry specific backgrounds and strong financial backgrounds to better serve as a board director. The literature agreement is wider than in the case of cultural diversity and these more skill-specific boards show stronger board monitoring and assessing capabilities through improved board decision making (Kearney, Gebert, & Voelpel, 2009). NBIM expects higher values of these skills in their portfolio companies as well.

NBIM is interested in enhancing the dedication of the board of directors, so they prefer to have non-distracted directors in multiple corporate *board affiliations*. In fact, busy boards, with directors holding three or more other directorships, offer weaker monitoring (Fich & Shivdasani, 2006; Liu & Paul, 2015). Other authors argue that busy directors bring reputation as good advisers to the board (Masulis & Mobbs, 2014) and can enhance firm value (Ferris, Jagannathan, & Pritchard, 2003), chiefly in the case of small firms where advice is key (Cashman, Gillan, & Jun, 2012; Field, Lowry, & Mkrtchyan, 2013). Given NBIM is invested only in listed, and mainly large companies, we expect the NBIM investee companies will have board directors with null or few other affiliations.

There are two practices related to the board composition which have been widely analyzed in the literature that are also mentioned in the Note. First, the *CEO-chairman separation*, which

questions the excessive power and lack of accountability of extremely powerful CEOs holding CEO and chairmanship simultaneously. There have been extensive academic debates which show the board leadership as double-edged sword, where separation implies control and combination leads to collaboration (Finkelstein & D'Aveni, 1994; Sundaramurthy & Lewis, 2003). Yet there are promising new explanations towards a more nuanced view of board leadership where chairman orientation goes beyond the duality construct (Krause, 2017). NBIM clearly prefers to separate these positions with two different people.

Second, the Note refers to *independent directors*. Governance scholars agree on the importance of independent directors to supervise, evaluate and select top management properly. Yet empirical and also theoretical settings have yielded other results favoring insider directors or bringing the issue of misclassifying strict independent directors (Crespí-Cladera & Pascual-Fuster, 2014). NBIM position on this debate remains clear: "We can conclude that the single dimension of independence brings service to the oversight function expected of the board" (NBIM, 2012: 16).

Two practices refer directly to the concern NBIM has with staggered boards: *director election majority requirement*, which is a common mechanism used by entrenched boards to help directors keep their seats in spite of bad market returns; and the *anti-takeover devices count*, which are mechanisms that impede a well-functioning market for corporate control too (Bebchuk et al., 2009). We expect that both practices would drop after NBIM announcement in 2012.

There is another subset of practices included in the Note which directly affect equal shareholder rights and the protection of minority shareholders. One is the *shareholders' rights policy*, that is whether companies have a policy to ensure the equal treatment of minority shareholders. Also, the Note mentions the benefits of a *policy equal voting right*, which checks whether companies have a policy to apply the one-share, one-vote principle. Given the NBIM mandate, as a large and diversified minority shareholder, to encourage these two policies is relevant. We expect these practices will be implemented in NBIM portfolio companies, post-announcement.

Finally, NBIM refers to the convenience of setting up a *succession plan* of top executives and board members in the case of unforeseen events. NBIM considers that this critical decision

should be agreed with shareholders and that the chairman, or the director in charge of the succession plan, should establish mechanisms to incorporate shareholders' views in the discussion of board developments. Detailed information on succession plans help to alleviate stakeholder's fears and prevents negative reaction from investors (Hillman, Withers, & Collins, 2009; Shen & Cannella, 2002). NBIM expects this practice to grow after the announcement.

4.4.2.2. Other key corporate governance practices

In addition to these ten practices obtained from the Note, we also include seven corporate governance practices which were not explicitly mentioned in the expectations of NBIM, yet are relevant in the current literature on corporate governance and help to provide a general assessment of NBIM as an engaged shareholder.

The first practice being *women on board*. There is an important global movement to increase the number of women on boards. Empirical evidence suggests that more women on boards improve firm performance (Liu, Wei, & Xie, 2014), as they tend to be more cautious on important corporate decisions, including acquisitions, than overconfident men (Huang & Kisgen, 2013; Levi, Li, & Zhang, 2014). Also, women are better monitors and require more audit efforts than men (Adams & Ferreira, 2009). Women bring different perspectives and backgrounds into the boardroom, enriching the quality of decisions adopted when assessing, monitoring or evaluating the top executive teams (Hillman, Shropshire, & Cannella, 2007). Yet, there is controversy in the empirical literature: for some authors (Ahern & Dittmar, 2012) quotas have not helped to improve the quality of boards given women hired were younger and less experienced directors, decreasing firm operating performance. The issue is still unresolved as other results point to negative performance in boards dominated by women (Adams & Ferreira, 2009) or the complex moderating effect that gender diverse boards causes in strategic decisions (Triana, Miller, & Trzebiatowski, 2013). However, in the case of Norway, the country used in the paper of Ahern and Dittmar, the goal remains clear: more women directors are expected in NBIM portfolio companies.

We also include *board size*. There is no clear direction in research on the optimal board size that would improve board goals and enhance performance. In principle, board composition is

driven by the scope of firm's operations, the specific business environment or the negotiation between the CEO and the outside directors (Boone, Casares Field, Karpoff, & Raheja, 2007). Others (Coles, Daniel, & Naveen, 2008) consider that the effect of board size depends on the complexity of the firm, and imply the relationship is U-shaped, that is, small and large boards would increase firm value. Other research focuses on the difficulties of information coordination or the challenge of providing timely decisions with large boards (Boivie et al., 2016). Given there is rarely agreement on this topic, we cannot know which direction would drive NBIM decisions for this particular practice.

There is an external channel to control the misconduct of firm's executive managers in accounting and operating issues: the external audit fees. We include the *non-audit to audit fees ratio* to capture the strength of this external control channel. The larger the ratio, the less control and the more the room there is for executives to experience misconduct (Hay, Knechel, & Wong, 2006). We expect this ratio to decline in NBIM portfolio companies after the Note release in 2012.

The next three practices reflect a current trend in governance and board studies: the establishment of board committees. Research posits that the bulk of the critical board work is done through board committees. We include three dimensions to check whether portfolio companies establish board committees: *audit, nomination and compensation board committees*. Committee members' sophistication and commitment are key factors which explain how audit committees lower the likelihood of executives engaging in earnings management (Xie, Davidson III, & DaDalt, 2003). The nomination and compensation committees have also received attention, and the independence of their members remains the key measure. NBIM would look for the establishment of these committees to enhance boards' professionalism.

As said, there is a need for independence in all these board committees (Aggarwal, Schloetzer, & Williamson, in press). In fact, committees depending on powerful directors or CEOs would not add value, as the existence of board committees could result in mere window-dressing. This is the reason we included a practice to capture the independence of the audit committee: *audit committee management independence*. We expect NBIM to require the independence of the audit committees.

4.5. METHODS

4.5.1. Sample and data

In this paper, we chose to study the data of a single sovereign wealth fund: NBIM. In this way, we avoid the datasets bias towards more transparent or larger funds present in datasets collected manually or via news aggregators. NBIM dataset is comprehensive: it details all the transactions made in equities since its inception in 1998. It represents more than 90,000 firm-year data points containing information such as the name of the company, equity market value of the stake of NBIM in US dollars and a firm's industry.

The second database we used is the recently launched "Environment, Social and Governance (ESG)" dataset from Eikon (Thomson Reuters). It provides firm-level ESG variables for close to 6,000 public companies since 2002. We focused on the "governance" section of the database for our analysis.

To build our dataset, we narrowed it to the last 10 years. There are two reasons for trimming the sample to 2006. First, NBIM changed its investment strategy in 2006 and the share of equities in the portfolio grew from 40% to 60% as they started to invest in small- and mid-cap listed equities. Second, ESG data from Eikon is substantially richer from 2006 on. Most governance variables offer poor coverage before 2006 when null results were above 60%, while the last available year the missing data points are below 15% for the most representative governance variables.

We collected information on governance and financial variables for each company and year of our sample. The selection of the governance variables is as follows: we conducted an analysis of the Note of November 2012 in order to understand which practices are the pillars of the engagement strategy outlined. Two of the co-authors independently read the Note and identified the most significant governance practices described in the Note as NBIM expectations. The overall count was 13. They then discussed the mismatch and agreed on the 10 most salient practices. Also, we included seven other frequently used variables in the literature, such as board size, women on board, the existence of several board committees (audit, compensation, nomination), and non-audit to audit fees ratio. In total, we collected 17 governance variables per company and year from 2006 to 2015. We collected all the

corporate governance variables through ESG dataset from Eikon Thomson Reuters. See definitions of all these variables in Table 4.1.

In addition to the governance variables, we added a set of financial variables: total assets, performance measures, capital structure and profitability. Also, we built a variable to capture the percentage of total shares in the hands of institutional investors. All of these financial variables were obtained for each company via Eikon Thomson Reuters for the same period.

We cross-referenced data from the two main databases (NBIM holdings and ESG variables), and, given the constraint of available financial data for some of them, we obtained a final sample of 3,508 companies per year: 3,027 companies were part of the NBIM portfolio and 481 companies functioned as a control group for the matching strategy explained in Section 4.6.1. We collect firm-year data for 17 measures of governance variables and seven control financial variables.

4.4.2. Description of the variables

In this section, we describe the 17 corporate governance variables which capture the 17 practices described in the Note. We also add seven financial control variables, mostly performance and ownership variables.

Regarding the selection of the corporate governance variables, we have followed two steps. First, we developed an independent revision of the Note by two co-authors. As explained above, each co-author independently read the Note on the expectations of NBIM regarding board accountability and equal treatment of shareholders. These resulted in the first 10 corporate governance variables. Second, we added seven variables commonly used in the literature that were not explicitly mentioned in the NBIM document, which include board size, share of women on board, the non-audit to audit fees ratio, and four variables related to board committees. These two groups yield 17 firm-level corporate governance variables we describe below.

The first three variables refer to board abilities: cultural diversity, specific skills, and director's commitment. *Cultural diversity* is measured as the share of board members with a cultural background different from the location of the corporate headquarters; *board specific*

skills measures how many directors have either an industry specific background or a strong financial background; lastly, *board member affiliations* captures the average number of other corporate affiliations for the board member.

There are two variables related to the board composition which have been widely analyzed in the literature and are also included in the Note. First, the *CEO-chairman separation*, which checks whether the CEO simultaneously chairs the board or whether the chairman of the board has ever been the CEO of the company. It takes value of 1 when both positions are held by the same person, 0 otherwise. Second, *independent directors*, measured as the percentage of independent board members as reported by the company.

Two variables refer directly to the concerns NBIM has regarding staggered boards: *director election majority requirement*, which responds to the question: Are the company's board members generally elected with a majority vote? It is a binary variable which takes value of 1 when the answer is yes, 0 otherwise. And the *anti-takeover devices count*, which is defined as the number of anti-takeover devices in place in excess of two.

There is another subset of variables included in the Note which directly affect shareholder rights and the protection of minority shareholders. One is the *shareholders' rights policy*, which considers whether companies have a policy for ensuring the equal treatment of minority shareholders, facilitating shareholder engagement or limiting the use of anti-takeover devices. Also, the Note mentions the benefits of a *policy equal voting right*, which checks whether companies have a policy of applying the one-share, one-vote principle. Both variables are binary, and take value 1 when the company has these policies in place, 0 otherwise.

Finally, NBIM is committed to ensuring a *succession plan* is put in place. The variable surveys whether the company has a succession plan for executive management (key board members) in the event of unforeseen circumstances. It also takes value of 1 when such a plan exists, and 0 otherwise.

Along with these 10 variables obtained from the Note, we included seven corporate governance variables which were not explicitly mentioned in the expectations of NBIM, yet are relevant in the current literature on corporate governance. The first set are generally

analyzed variables such as *women on board*, measured as the percentage of women on the board; or *board size*, measured as the total number of board members at the end of the fiscal year. We included three variables linked to audit services: *non-audit to audit fees ratio*, measured as the sum of all non-audit fees divided by the audit and audit-related fees paid to the group auditor. Also, *audit board committee*, which checks whether the investee company has an audit board committee (takes value 1 when the company has such committee, 0 otherwise), and the *audit committee management independence*, which confirms whether all audit members are non-executive directors - takes the value of 1 only if all audit members are non-executive directors, 0 otherwise. Lastly, we included two variables to capture a current trend in the literature: the importance of having board committees: *nomination board committee and compensation board committee*. The variables take value 1 if such committee has been established.

Additionally, we included seven financial control variables for the regressions. For each company, we included the *Revenue,* which represents revenue from all of a company's operating activities after deducting any sales adjustments and their equivalents. *Total assets* are the total assets of a company; *performance* is the ratio of EBITDA to total assets; *capital structure* is the ratio of total liabilities to total equity. *Long-term debt over total liabilities* is the ratio of long-term debt, defined as long-term debt and capital lease obligations, to total liabilities. *Ratio EBITDA over revenue* is built dividing EBITDA over revenue. EBITDA is composed of EBIT for the fiscal year plus the same period's depreciation, amortization of acquisition costs, and amortization of intangibles. EBIT, on its part, is calculated as total revenues for the fiscal year minus total operating expenses plus operating interest expense, unusual expense/income and non-recurring items, for the same period. This definition excludes non-operating income and expenses. Lastly, we built a measure of *institutional investors*, which is calculated as the sum of all shares held by institutional investors divided by total shares, at the end of the fiscal year. These controls were used for the differences in differences procedures, but are not shown in the tables with the results.

4.5.3. Corporate governance indexes

We constructed two separate corporate governance indexes in order to capture the “intensity” of the changes induced by NBIM. To build up the indexes, we followed the additive index

methodology used in La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1998), Gompers et al. (2003), Bebchuk et al. (2009), and Aggarwal, Erel, Ferreira, and Matos (2011). For constructing our indexes, as explained in sections 4.4.2.1 and 4.4.2.2., we take into account how the literature considers each practice impacts the quality of corporate governance and long-term firm value: those variables that have a positive impact are added as 1 to the index, 0 otherwise. Better governed companies will have higher scores in the index.

The first index (NBIM index) gathers all corporate governance mechanisms explicitly cited in the Note released by NBIM. We include 10 variables in the NBIM index. The second index (General CG Index) cumulates the 7 variables which are generally accepted though not explicitly mentioned by NBIM. We expect that the NBIM index would improve more quickly than the General CG index after the announcement.

As the majority of variables are binary, we add a value of one to the index when the variables change in the direction NBIM expects, zero otherwise. For example, NBIM expects the CEO and chairman positions to be held by two different people, we add one to the index in the cases when CEO and Chairman are held by two different directors. When the variable is continuous, we use the median as the cutoff, as is done in La Porta et al. (1998). For example, NBIM expects to have a high share of independent directors in the board, we add 1 to the index if the value of this variable is above the median, 0 otherwise.

4.5.4. Summary statistics

Tables 4.2 and 4.3 show country and industry summary statistics in the Eikon data set. These tables classify firms that are in the portfolio of the Norwegian Sovereign Wealth Fund (NBIM) and control firms that are never under the NBIM.

Tables 4.4 and 4.6 show summary statistics of firm-year observations in 2010 and 2011 for our sample. Firms are classified as treated firms (column 1) if NBIM = 1, which implies that these firms are in the portfolio of NBIM in 2012 (year of the announcement), or as control firms (column 2) if NBIM = 0, which implies these firms are not in the portfolio of the NBIM in 2012. We develop a matching strategy since treated and control groups are not similar

enough[11]. Columns 3 and 4 report summary statistics after the matching is realized. In column 3 we classify treated firms on support and in column 4 all control matched firms. Numbers reported are cross-sectional averages and standard errors in parentheses.

We also show tables that report t-test results of firm-year observations in 2010 (Table 4.5) and 2011 (Table 4.7) for our sample. Column 1 of these tables analyzes the mean differences of the unmatched sample (Columns 1 and 2 of Tables 4.4 and 4.6 respectively). Column 2 analyzes mean differences of the matched sample (Columns 3 and 4 of Tables 4.4 and 4.6 respectively). T-statistics are shown in parentheses. * $p< 0.05$, ** $p< 0.01$, *** $p< 0.001$.

4.6. ANALYSIS

We use a difference-in-difference procedure based on the following specification (Column 1 in the regressions shown in Tables 4.8 to 4.17):

$$y_{it} = POST_{(t\geq 2012)} + \sigma NBIM_i \times POST_{(t\geq 2012)} + Firm_i + \beta X_{it} + \varepsilon_{it} \quad (1)$$

where y_{it} is our variable of interest (a corporate governance variable such as women on board); $POST_{(t\geq 2012)}$ is a dummy variable (structural break) that takes value 1 after the NBIM's announcement (2012–2015) and zero for previous years (2010–2011). We create a binary variable $NBIM_i$ that takes value 1 if the firm belongs to the NBIM's portfolio in 2012 and zero if the firm does not belong to the NBIM's portfolio in 2012. $NBIM_i \times POST_{(t\geq 2012)}$ is the interaction term we use to observe the effects of being owned by NBIM after the Note is released in 2012; $Firm_i$ is a firm fixed effect and X_{it} is a vector of controls that includes revenue, total assets, performance, capital structure, long-term debt over total liabilities, the ratio of EBITDA over revenue and a measure of institutional investors (described in section 4.2). Definitions for all variables are shown in the Table 4.1. We also use other measures for the treatment variable as robustness checks.[12]

[11] We have fewer firms in the control group (NBIM=0), so we do the matching by searching in the treated group for the nearest neighbor of each control firm. We match on size and lose many observations, as some firms don't have a nearest neighbor that satisfies our requirements, or we have missing information for size.

[12] Treatment variable takes value one if the firm ever belongs to the NBIM's portfolio in our sample years (2006-2015) or it takes value one if the firm belongs to the NBIM's portfolio for the whole period 2012-2015.

In Column 2, we substitute $POST_{(t \geq 2012)}$ by time dummies for 2012, 2013, 2014 and 2015. We fix 2010 as our base year (omitted year) and we do not use previous years in the regression.

4.6.1. Matching strategy

The specifications in Columns 3 and 4 of Tables 4.4 and 4.6 are analogous to those in Columns 1 and 2 respectively, but we only used matched firms in these Columns. We use a matching approach to control for potential endogeneity that arises due to differences among the treatment and control group. The purpose of this matching approach is to make both groups of firms (those that belong to the NBIM's portfolio and those that do not) as similar as possible. Specifically, we need our treated and control groups to be similar in all characteristics (observable and unobservable) that can affect the relation between the shock (the NBIM announcement) and our dependent variable (corporate governance outcomes).

For this purpose, we adopt nearest-neighbor propensity score matching. Each firm that does not belong to the NBIM's portfolio in 2012 (control group) is matched to a unique firm from the NBIM's portfolio (treatment group). We choose a single match and do not allow for replacement (a firm from the treatment group can only be used once as a match). We follow this procedure because our treatment group (3,027 firms) is larger than our control group (481 firms), as observed in Table 4.6. We are more concerned with minimizing the bias at the cost of larger variance, as our sample is sufficiently large so as to be less concerned with variance (Abadie & Imbens, 2002). Moreover, to avoid biased coefficients, we set a caliper of 0.1.[13] This implies that some control firms might not be matched if they do not have a treated firm within the caliper chosen. This is the reason why we observe fewer firms after the matching is conducted in Columns 3 and 4 of Table 4.6.

We match the treated and control groups in size (measured by total assets), performance (measured by the ratio of EBITDA to total assets) and institutional investors (percentage of holdings in hands of institutional investors). We restrict the number of covariates since there exists a trade-off between the plausibility of the unconfoundedness assumption and common

[13] A caliper sets a maximum distance of the propensity score for each treatment and its control. As robustness checks, we set different calipers and results are unchanged.

support (Black & Smith, 2004). Following Sianesi (2004), we focus on covariates that simultaneously affect the treatment status (belong to the NBIM's portfolio) and the outcome variable (our corporate governance measures). We chose these covariates since they have been proven to be determinants of corporate governance decisions and are significantly different among the treatment and control groups (shown in Table 4.6).

We conduct the matching prior to the NBIM's announcement to make sure that our matching procedure is exogenous to any effects caused by the shock. All variables included in the matching model must be unaffected by the treatment (NBIM's announcement in 2012), and thus we carry out the matching by using the values of the covariates in 2011. Once a match is formed, it is kept for the following years. It is necessary that the treated and control groups follow parallel trends prior to the realization of the shock. For this purpose, we report the summary statistics and t-test results of 2010 and 2011 in Tables 4.4 to 4.7.

4.7. RESULTS

The results show that NBIM is effective in improving key governance practices of its portfolio companies after adopting an active shareholder strategy in 2012.

The indexes we built did not provide statistically significant results (Tables 4.8 and 4.9), despite the direction of the effects were in line with our expectations. The improvement in the "NBIM index" is only weakly statistically significant for the matched strategy. The results for the "General CG Index" are mixed. Intuitively, NBIM tends to prioritize its efforts on the variables that are explicitly stated in the Note as "expectations". The reason for not finding significant effects may lie in the correlations between different corporate governance mechanisms (Rediker & Seth, 1995). For example, some research (Cyert, Kang, & Kumar, 2002) argues that external corporate governance mechanisms, such as a freer market for corporate control, and internal corporate governance provisions, such as board monitoring capabilities, may exert substitution effects. The same happens between board independence and audit services: they are complementary when ownership is dispersed, yet substitute when ownership concentrates (Desender, Aguilera, Crespí, & García-Cestona, 2013).

Given the index strategy did not help in understanding the "intensity" of changes, we turned the analysis towards individual corporate governance mechanisms. Eight variables showed

relevant reactions after NBIM set its expectations in its Note (Tables 4.10 to 4.17). Five of these variables followed the logics of these expectations: the share of independent directors on the board, the share of women on boards, board-specific skills, audit committee management independence and the size of boards. We also identified contradictory results for three variables: policy equal voting right, audit board committee and compensation board committee.

Post announcement, the share of *independent directors* in firms owned by NBIM improved 2.6 percent points on average compared to those firms not owned by NBIM (Table 4.10). The results using the much smaller matched sample were consistent and yielded 4.6 average difference, also statistically significant.

The share of *women on board* increased after the release of the NBIM Note (Table 4.11). This result is in line with the theory which predicts that more diverse boards would better control top-management and enhance monitoring of the company strategy. The coefficient of the share of *women on board* is statistically and managerially significant post announcement: on average, post announcement, there is 1.1 percent point more of a share of women on boards where NBIM is an owner, compared to companies where the NBIM is not owner. The figure reduces its significance to 1.2 percentage points for the matched sample, introducing some doubts about the validity of the result and inviting further robustness checks.

Board specific skills improved post-announcement (Table 4.12). As in the case of women on board, we are cautious given the effect is less significant for our matched sample, yet, in both samples is significant and positive: NBIM investee companies improve post-announcement compared to the control group. In the case of the unmatched sample the value of the effect is 1.9 and it increases to 2.5 in the matched sample.

The last relevant result which fits with the NBIMs' expectations is the *independence of the management of the audit board committee* (Table 4.13). The effect was small yet significant for both the unmatched and matched samples.

Board size increased after NBIM announcement (Table 4.14). Boards grew for both the general and matched sample, and the average differences are statistically significant. It was

challenging to interpret this growth as the literature is not clear about optimal board size. We refer to this result in the discussion section.

The results of the *policy equal voting right* variable were counterintuitive. In both samples (unmatched and matched) we show a decrease in the number of policies set up to ensure the "one-share, one-vote principle" (Table 4.15). The coefficient, yet small, is statistically significant. We explain below how this result may be motivated through two channels: one would be the lack of agreement in theory and among practitioners of how to treat long-term investors. The second argument comes from a defensive attitude of corporates which want to prevent minority shareholders to exert excessive influence via voting rights.

In line with these defensive argument, we have also considered counterintuitive that the NBIM portfolio companies behave worse in terms of both *audit* and *nomination board committees* (Tables 4.16 and 4.17, respectively). We discuss these results in the next Section.

We did not find consistent results for the remaining variables. A result is consistent when it fulfils four conditions: there is no pre-trend (variables for the treated and control group were not significantly different before 2012); there are statistically significant effects for both samples; the sign of the coefficient is the same; and the statistical significance is similar for both samples. These results are available upon request.

First, we dropped out those variables which exhibit pre-trends. That is, we required corporate governance variables to show no differences between NBIM companies and non-NBIM companies before 2012. We dropped two variables because of these pre-trends: *anti-takeover devices* and *shareholder rights policy*.

Second, we skipped the discussion on four variables which were insignificant for both the unmatched and the matched sample. Two of these showed non-significant effects: *board cultural diversity* and *director election majority requirement*. Despite the fact these went in the opposite direction of NBIM expectations, we do not see plausible explanations and the effects were very small. We do not discuss the *non-audit to audit fees ratio* and *board member affiliations* which dropped for NBIM investee companies as the effects are statistically insignificant.

Third, we do not consider consistent results those which present conflicting coefficient signs between the matched and the unmatched sample. We withdrew the *CEO-Chairman separation* and the *nomination board committee* for this reason. In precedent cases, the coefficient was very small, non-significant, and showed conflicting signs between samples.

Fourth, also withdrawn from the analysis were variables which did not yield significance simultaneously in both the general and matching strategy. We removed the *succession plan,* which was only statistically significant in our matched sample (the variable moves in accordance with NBIM expectations and the number of directorships decreases for NBIM companies).

4.8. DISCUSSION

A responsible and engaged owner can exert fruitful changes in the corporate governance provisions of its portfolio companies. In this paper, we show how Norway's SWF is able to positively influence the governance quality of its portfolio companies. We used a quasi-natural experiment: the unanticipated announcement made by NBIM in November 2012 which outlined what the SWF expected from its portfolio companies in terms of corporate governance. The release of that Note initiated a comprehensive strategy of engagement with portfolio companies. The results are remarkably positive in the short period after 2012.

We have already mentioned that four relevant variables—the independence of the board, women on board, board specific skills, audit committee independence—improve after the announcement. Along with board size, these four critical variables yield a positive and consistent result. It seems the NBIM strategy focuses first on the board composition and thus requires its portfolio companies to increase the number of independent directors, the skills of the board, as well as the share of women on the board. These three variables might go hand in hand: NBIM is effectively proposing new independent and skilled women directors. What is clear is that these three dimensions of governance, widely studied by the literature of boards, improve after NBIM decided to play a more active role in shareholder strategy, which goes in the right direction and is yielding positive results.

The percentage of independent directors of NBIM portfolio companies is significantly higher than in the control group. There is still debate in academia about the benefits of having an

independent board instead of a board populated with well-informed insiders (Adams & Ferreira, 2007; Bhagat & Black, 2002; Chen, Cussatt, & Gunny, 2017). Yet, independent directors have yielded more positive results for firm performance and firm valuation improvements. In fact, the benefits of having more independent directors have caused many regulations including the Sarbanes-Oxley Act of 2002, the Securities and Exchange Commission (SEC), the New York Stock Exchange (NYSE) or the Nasdaq. NBIM firmly believes in the value of independent boards. Outside directors protect shareholder interests, balance the power of CEOs, and offer incentives to provide the best advice given their reputation as directors is scrutinized. Independent directors keep the boards accountable: a higher share of independent directors is associated with higher monitoring standards and lower conflicts of interests with top management.

Also, our results show that NBIM portfolio companies increase the share of women on boards significantly. This is line with the literature that assumes that more diverse boards tend to perform better in monitoring roles and take strategic decisions more effectively (Post & Byron, 2015). This result resembles the law passed in Norway requiring 40% of board directors to be women. As a reminder, NBIM is not allowed to invest in any Norwegian firm, so the changes we have observed on this variable cannot be attributable to a domestic law change. This applies elsewhere too; the “regulatory changes” or quotas for more women on boards would affect equally all listed firms in our two samples, general and matched, independently of whether they are owned by NBIM or not.

Our results also bring a third result linked to board composition: the percentage of board members who have either an industry specific background or a strong financial background is higher for NBIM investee companies. This result, studied often under the lens of resource dependency (Forbes & Milliken, 1999; Hillman, Cannella, & Paetzold, 2000), aligns with the professionalization of NBIM itself, described in the Chapter 2 of this thesis.

Board size increases significantly. A first explanation is that board size increases due to NBIM’s interest in having more independent and skilled women directors on boards. Increasing those percentages can be done through two channels: substituting men for women directors, unskilled for skilled, or insider for outsider (in this case we should not observe a change in the board size) or adding new members (women, skilled and outsiders) to boards. Given we observe that the board size goes up significantly, we can interpret that NBIM

prefers to add new directors rather than substituting incumbents. This is in line with a prudent monitoring approach, assuming it is easier to add new members to a board than replacing old and established directors.

So far, three critical results referred to board composition go in the direction outlined by the Note or the legislation in Norway. Yet, why we do not find enough consistent results in other critical variables such as the establishment of board committees? Furthermore, we do have counterintuitive results in the case of the policies for equal voting rights and in the case of audit and compensation committees, where the signs go in the opposite direction of the NBIM expectations.

We provide four explanations for these outcomes. NBIM is able to push for change in the composition of boards (more women, skilled, outsider directors), but it is unable to go beyond, given its minority shareholder position. Through behind-the-scenes engagement, NBIM is able to convince other investors or boards (McCahery et al., 2016) of the benefits of having more independent and diverse boards, yet NBIM faces difficulties in reaching other governance provisions, such as equal shareholder policies or board committees.

Indeed, NBIM has not been able to influence the establishment of board committees, a critical instrument for corporate governance. Given more complex and global business models, much of the board work is currently delegated to board committees. To ensure well-functioning and professional board committees is more difficult than appointing new directors to the board. Our first explanation would be that NBIM pushes for better boards but it is not able to reach the second level: the establishment of board committees. It is interesting to notice that the positive and significant result of *independent audit committees* goes in line with this: NBIM provides independence to the audit committee once it is established, but it is difficult for them to push for the establishment of new board committees.

A second explanation is that these results are the reaction of companies to the "excessive influence" of NBIM. Some firms may react by bargaining between the different governance provisions: the company makes concessions by adding independents to the board, but at the same time it ensures that there are different share classes and not all minority shareholders have the same voting rights or eliminates audit and compensation committees. This explanation fits well with the decrease in the policies related to "one-share, one-vote" of

NBIM investee companies. Again, NBIM is able to influence changes in the board composition, but is simultaneously penalized with no influence in other critical governance stances such as the board committees.

Third, these counterintuitive results might be just a matter of timing. NBIM goes step by step. NBIM states in the Note that "ultimately, we expect the board to implement one share class with each share having one right to vote" (NBIM, 2012: 38). NBIM also mentions that companies which have different share classes should either explain carefully why is beneficial for all shareholders to hold these asymmetries or to change towards equalization. NBIM acknowledges that the process of changing corporate governance provisions is not simple and direct, and this may partially explain why we see inconsistencies at this stage. More time is needed to confirm whether these inconsistencies are simply a matter of timing and not the result of a defensive reaction against the pressure NBIM exerts in other governance provisions. The same applies for the situation of having less compensation and audit boards on NBIM investee companies.

Lastly, there is a fourth complementary explanation (linked to the shareholder equality policy). Long-term capitalists have shown the lack of theoretical unanimity of treating all shareholders equally (Rappaport & Bogle, 2011). Different owners may have different rights. This reason would be aligned with NBIM as long-term steward contrasting with other short-term oriented shareholders. It is interesting to note how this result is discussed frequently among practitioners (Barton, 2011). Those defending long-term capitalism do not defend the "one-share, one-vote" principle. They consider how most owners currently stay for shorter periods as shareholders, and those who stay longer should have a stronger voice and voting power to counteract the free-riding of passive, index or short-term oriented investors. These conflicting views of different large shareholders (principals) may explain why we obtain confounding results in the policies that ensure equal shareholders treatment. It also relates to the "case by case" approach prudently described by the Note. Generally accepted principles are not "one-size-fits-all" valid approaches, and the need for context may explain why this disputed variable leads to the results we found.

4.9. CONCLUSION

We add evidence of the monitoring role of sovereign wealth funds. Our results shed light on the literature of shareholder activism and the growing theme of heterogeneous shareholders

(Goranova & Ryan, 2014; Hoskisson et al., 2002; Schnatterly & Johnson, 2014). Regarding the literature on sovereign wealth funds, this research may help to understand how, without having a seat on the board, large funds can exert an influence (Vasudeva, 2013) and impact their investee companies' corporate governance. This "voice" mechanism put in place through different channels, most of them "behind-the-scenes" (McCahery et al., 2016), turns out to be effective and can be a way to circumvent the "liability of sovereignness" or the discount effect detected in the literature (Aguilera et al., 2016; Bortolotti et al., 2015).

By focusing on the direct effect ownership has on corporate governance, we also add to the discussion around the effects of institutional owners as long-term patient investors, instead of being driven by short-term gains (Bebchuk et al., 2015; Stathopoulos & Voulgaris, 2016). We include the sovereign wealth funds in the matrix of heterogeneous principals, among these, patient institutional investors.

One of the limitations of our research is that we focused on a single and particular sovereign wealth fund. This has been done by others previously, as is the case of Hermes, the fund manager owned by the British Telecom Pension Scheme (Becht et al., 2009) or TIAA, formerly TIAA-CREF, studied by Carleton, Nelson, and Weisbach (1998). In both cases, the influence of institutions through private meetings is also studied. We have not accessed such a detailed level of information at NBIM, but similarly, we investigate the behind-the-scenes "voice" mechanism from the changes observed in corporate governance mechanisms. We expect other researchers would add more clinical cases of sovereign wealth funds involved in the improvement of the corporate governance of their portfolio companies.

Our research does not use corporate governance changes to evaluate performance. We focus our attention on an exogenous event that changed the style of investor engagement and check whether this strategic decision had an impact on the governance of its portfolio companies. We do not focus on their post-event performance. By doing so, we avoid the endogeneity present in most research linking governance and performance (Agarwal et al., 2009). In fact, the decision to change specific governance settings (such as the number of independent directors or the establishment of an audit committee) is normally endogenous. Corporate governance decisions are very much related to other firm-level characteristics, such as financial events or acquisition plans. If you want to understand the impact of governance of two different companies, it is very difficult to capture these governance variables while

simultaneously not capturing the omitted financial or strategic variables that explain the decision of changing governance mechanisms (Cuñat et al., 2012).

In the end, institutional investors may choose between exiting a firm or talking to corporate executives and board directors when they disagree with investee companies. NBIM decided in 2012 to talk and engage more with companies. This "engagement strategy" yielded positive results in a short period of time. Key corporate governance mechanisms, such as the share of independent directors, or the share of women on boards, improved after 2012. We shed light on a different investor class, sovereign wealth funds, and show how these particular state-owned, long-term investors play a relevant role in the configuration of new capitalism, where investors secure and increase value by engaging and not only trading.

4.10. TABLES

Table 4.1. Definition of variables

Corporate governance variable	Definition
Board Cultural Diversity	Percentage of board members that have a cultural background different from the location of the corporate headquarters.
Board Specific Skills	Percentage of board members who have either an industry specific background or a strong financial background.
Director Election Majority Requirement	Are the company's board members generally elected with a majority vote?
Board Member Affiliations	Average number of other corporate affiliations for the board member.
Policy Equal Voting Right	Does the company have a policy to apply the one-share, one-vote principle?
Anti-takeover Devices Count	The number of anti-takeover devices in place in excess of two.
Shareholder Rights Policy	Does the company have a policy for ensuring equal treatment of minority shareholders, facilitating shareholder engagement or limiting the use of anti-takeover devices?
Succession Plan	Does the company have a succession plan for executive management (key board members) in the event of unforeseen circumstances?
CEO-Chairman Separation	Does the CEO simultaneously chair the board or has the chairman of the board been the CEO of the company?
Independent Directors	Percentage of independent board members as reported by the company.
Audit Board Committee	Does the company have an audit board committee?
Compensation Board Committee	Does the company have a compensation board committee?
Non-audit to Audit Fees Ratio	All non-audit fees divided by the audit and audit-related fees paid to the group auditor.
Nomination Board Committee	Does the company have a nomination board committee?
Audit Committee Management Independence	Does the company report that all audit committee members are non-executives?
Board Size	The total number of board members at the end of the fiscal year.
Women on Board	Percentage of women on the board.
Financial control variable	**Definition**
Total Revenue	Revenue from all of a company's operating activities after deducting any sales adjustments and their equivalents.
Total Assets	Total assets of a company.
Performance	The ratio of EBITDA to total assets.
Capital Structure	The ratio of total liabilities to total equity.
Long-term debt over total liabilities	The ratio of long-term debt, defined as long-term debt and capital lease obligations, to total liabilities.
Ratio EBITDA over revenue	The ratio of EBITDA to total revenue.
Institutional investors	The sum of all shares held by institutional investors divided by total shares, at the end of the fiscal year.

Note: In *italics*, the 7 corporate governance variables not explicitly mentioned in the Note. Definitions taken from the Eikon ESG database.

Table 4.2. Country Summary Statistics in 2011

This Table shows the number of companies in each group by country. NBIM=1 are companies which were part of the NBIM portfolio in 2011; they form our "treated" group. nonNBIM=0 are companies which have never been included the NBIM portfolio, they form our "control" group.

	non-NBIM=0/NBIM=1		
	0	1	Total
Australia	62	168	230
Austria	1	10	11
Bahrain	8	0	8
Belgium	3	20	23
Bermuda	6	17	23
Brazil	12	44	56
Canada	44	173	217
Cayman Islands	1	1	2
Chile	4	18	22
China	43	69	112
Colombia	1	10	11
Cyprus	1	0	1
Czech Republic	0	3	3
Denmark	1	19	20
Egypt	1	5	6
Finland	0	21	21
France	5	75	80
Germany	2	69	71
Gibraltar	0	1	1
Greece	2	12	14
Guernsey	9	1	10
Hong Kong	7	86	93
Hungary	0	4	4
India	3	45	48
Indonesia	4	20	24
Ireland; Republic of	3	23	26
Isle of Man	0	1	1
Israel	1	15	16
Italy	2	34	36
Japan	8	342	350
Jersey	2	5	7
Kazakhstan	1	0	1
Korea; Republic (S. Korea)	4	94	98
Kuwait	5	0	5
Luxembourg	1	7	8
Macau	0	2	2
Malaysia	6	33	39
Mexico	3	25	28
Morocco	0	2	2
NULL	0	3	3
Netherlands	5	28	33
New Zealand	11	13	24
Norway	16	0	16
Oman	6	0	6
Panama	0	1	1
Papua New Guinea	1	1	2
Philippines	1	22	23
Poland	3	16	19
Portugal	1	8	9
Puerto Rico	0	1	1
Qatar	1	7	8
Russia	7	16	23
Saudi Arabia	10	0	10
Singapore	8	31	39
South Africa	34	46	80
Spain	4	36	40
Sri Lanka	1	0	1
Sweden	8	43	51
Switzerland	5	62	67
Taiwan	2	110	112
Thailand	10	14	24
Turkey	1	15	16
United Arab Emirates	2	5	7
United Kingdom	53	234	287
United States of America	55	843	898
Zimbabwe	1	0	1
Total	502	3029	3531

Table 4.3. Industry Summary Statistics in 2011

This Table shows the number of companies in each group by sector of economic activity. NBIM=1 are companies which formed part of the NBIM portfolio in 2011; they form our "treated" group. nonNBIM=0 are companies which have never been in the portfolio of NBIM, they form our "control" group.

	non-NBIM=0/NBIM=1		
	0	1	Total
Accommodation and Food Services	16	45	61
Administrative, Support, Waste Management, Remediation Services	7	44	51
Agriculture, Forestry, Fishing and Hunting	7	6	13
Arts, Entertainment, and Recreation	2	20	22
Construction	18	121	139
Educational Services	1	8	9
Finance and Insurance	103	462	565
Health Care and Social Assistance	2	24	26
Information	41	200	241
Manufacturing	115	1045	1160
Mining, Quarrying, and Oil and Gas Extraction	72	248	320
Other Services (except Public Administration)	0	8	8
Professional, Scientific, and Technical Services	18	121	139
Real Estate and Rental and Leasing	37	167	204
Retail Trade	18	168	186
Transportation and Warehousing	17	129	146
Utilities	22	141	163
Wholesale Trade	6	70	76
Total	502	3027	3529

Table 4.4. Corporate Governance Summary Statistics in 2010

This Table shows the summary statistics of firm-year observations in 2010. Numbers reported are cross-sectional averages and standard deviations (in parentheses) for corporate governance and financial variables. Column 1 provides summary statistics for the companies in the portfolio of NBIM in 2010. Column 2 provides summary statistics for the companies which were not part of the NBIM portfolio in 2010. Column 3 provides summary statistics for the companies in the NBIM portfolio in the "matched" sample described in section 5.1. in 2010. Column 4 provides summary statistics for the companies not included in the NBIM portfolio in the "matched" sample described in section 5.1. in 2010. Definitions for all variables are shown in Table 4.1.

	(1) NBIM=1	(2) NBIM=0	(3) NBIM=1 on sup.	(4) NBIM=0 (M)
Independent Board Members	52.15 (29.14)	50.12 (26.06)	48.02 (27.63)	50.24 (25.49)
Antitakeover Devices	2.61 (2.85)	1.80 (2.22)	1.75 (2.35)	1.74 (2.22)
Female on Board	9.36 (9.91)	10.05 (12.15)	8.29 (9.42)	9.78 (12.17)
Board Cultural Diversity	0.27 (0.25)	0.30 (0.24)	0.30 (0.27)	0.31 (0.24)
Audit Board Committee	0.95 (0.21)	0.96 (0.20)	0.94 (0.23)	0.95 (0.21)
Board Size	10.50 (3.67)	10.10 (3.67)	10.07 (3.70)	9.92 (3.58)
Compensation Board Committee	0.83 (0.38)	0.88 (0.33)	0.83 (0.38)	0.87 (0.34)
Nomination Board Committee	0.74 (0.44)	0.73 (0.44)	0.69 (0.46)	0.72 (0.45)
Non Audit to Audit Fee Ratio	0.38 (3.70)	0.30 (0.61)	0.36 (0.59)	0.32 (0.65)
BoardMemberAffiliations	1.28 (0.94)	1.29 (0.93)	1.31 (0.98)	1.29 (0.95)
Board Specific Skills	59.24 (23.71)	57.13 (22.15)	60.11 (24.62)	57.15 (22.02)
CEO Chairman Separation	0.44 (0.50)	0.29 (0.46)	0.31 (0.46)	0.31 (0.46)
Director Election Majority Requirem.	0.50 (0.50)	0.54 (0.50)	0.50 (0.50)	0.53 (0.50)
Voting Rights	0.82 (0.38)	0.84 (0.36)	0.84 (0.37)	0.84 (0.37)
Shareholder Rights Policy	0.92 (0.28)	0.91 (0.28)	0.89 (0.31)	0.91 (0.29)
Succession Plan	0.62 (0.49)	0.54 (0.50)	0.49 (0.50)	0.53 (0.50)
Audit Committee Mgt Indep	0.98 (0.15)	0.92 (0.27)	0.94 (0.23)	0.93 (0.26)
Total Revenue (billions)	643.49 (4863.81)	410.48 (3404.14)	470.93 (2932.02)	544.87 (3712.55)
Total Assets (billions)	1883.17 (15959.11)	730.35 (5546.20)	574.42 (2519.68)	754.26 (5765.99)
Performance	0.11 (0.11)	0.08 (0.16)	0.11 (0.10)	0.09 (0.15)
Capital Structure	2.14 (7.52)	3.67 (38.24)	1.55 (2.34)	4.37 (49.90)
LT-Debt over Total Liabs	0.29 (0.24)	0.30 (0.28)	0.32 (0.24)	0.31 (0.23)
EBITDA over Revenue	-10.65 (562.40)	-0.74 (8.41)	-117.04 (1859.19)	-0.22 (2.51)
Institutional Investors Ownership	67.46 (24.17)	60.91 (25.64)	65.61 (23.46)	64.43 (24.84)
Observations	3019	467	254	254

Table 4.5. T-test for CG Summary Statistics in 2010

This Table shows t-test results of firm-year observations in 2010. Column 1 analyzes mean differences of the unmatched sample (Columns 1 and 2 of Table 4.4). Column 2 analyzes mean differences of the matched sample (Columns 3 and 4 of Table 4.4). Definitions for all variables are shown in Table 4.1.
T-statistics are shown in parentheses. * p< 0.05, ** p< 0.01, *** p< 0.001.

	(1) Mean differences	(2) Mean differences (Matched)
Independent Board Members	-2.033	2.220
	(-1.18)	(0.91)
Antitakeover Devices	-0.813***	-0.00862
	(-5.49)	(-0.04)
Female on Board	0.686	1.489
	(0.88)	(1.48)
Board Cultural Diversity	0.0322	0.00636
	(1.26)	(0.16)
Audit Board Committee	0.00460	0.00996
	(0.35)	(0.49)
Board Size	-0.400	-0.147
	(-1.68)	(-0.44)
Compensation Board Committee	0.0498*	0.0385
	(2.31)	(1.17)
Nomination Board Committee	-0.00592	0.0229
	(-0.21)	(0.55)
Non Audit to Audit Fee Ratio	-0.0777	-0.0325
	(-0.82)	(-0.47)
BoardMemberAffiliations	0.0107	-0.0116
	(0.18)	(-0.13)
Board Specific Skills	-2.113	-2.959
	(-1.44)	(-1.37)
CEO Chairman Separation	-0.142***	-0.00134
	(-4.76)	(-0.03)
Director Election Majority Requirem.	0.0393	0.0300
	(1.21)	(0.65)
Voting Rights	0.0229	0.000141
	(0.96)	(0.00)
Shareholder Rights Policy	-0.00510	0.0160
	(-0.28)	(0.59)
Succession Plan	-0.0764*	0.0468
	(-2.37)	(1.02)
Audit Committee Mgt Indep	-0.0546**	-0.0159
	(-3.27)	(-0.70)
Total Revenue (billions)	-233.0	73.94
	(-1.24)	(0.25)
Total Assets (billions)	-1152.8**	179.8
	(-2.95)	(0.45)
Performance	-0.0265***	-0.0152
	(-3.31)	(-1.38)
Capital Structure	1.528	2.823
	(0.85)	(0.90)
LT-Debt over Total Liabs	0.00440	-0.0124
	(0.32)	(-0.58)
EBITDA over Revenue	9.913	116.8
	(0.93)	(1.00)
Institutional Investors Ownership	-6.551***	-1.180
	(-5.02)	(-0.55)
Observations	3486	508

Table 4.6. Corporate Governance Summary Statistics in 2011

This Table shows the summary statistics of firm-year observations in 2011. Numbers reported are cross-sectional averages and standard deviations (in parentheses) for corporate governance and financial variables. Column 1 provides summary statistics for the companies in the portfolio of NBIM in 2011. Column 2 provides summary statistics for the companies which were not part of the NBIM portfolio in 2011. Column 3 provides summary statistics for the companies in the NBIM portfolio in the "matched" sample described in section 5.1. in 2011. Column 4 provides summary statistics for the companies not included in the NBIM portfolio in the "matched" sample described in section 5.1. in 2010. Definitions for all variables are shown in Table 4.1.

	(1) NBIM=1	(2) NBIM=0	(3) NBIM=1 on sup.	(4) NBIM=0 (M)
Independent Board Members	53.33	51.16	49.74	51.22
	(28.96)	(25.26)	(28.16)	(25.08)
Antitakeover Devices	2.67	1.91	1.75	1.87
	(2.83)	(2.23)	(2.28)	(2.23)
Female on Board	10.23	10.88	9.35	10.86
	(10.30)	(12.34)	(10.00)	(12.61)
Board Cultural Diversity	0.28	0.30	0.31	0.31
	(0.25)	(0.25)	(0.26)	(0.26)
Audit Board Committee	0.95	0.97	0.94	0.96
	(0.21)	(0.18)	(0.24)	(0.19)
Board Size	10.42	9.96	10.02	9.81
	(3.59)	(3.59)	(3.46)	(3.48)
Compensation Board Committee	0.85	0.89	0.86	0.88
	(0.36)	(0.32)	(0.35)	(0.33)
Nomination Board Committee	0.76	0.74	0.72	0.72
	(0.43)	(0.44)	(0.45)	(0.45)
Non Audit to Audit Fee Ratio	2.85	0.48	0.58	0.48
	(111.71)	(1.55)	(3.13)	(1.59)
BoardMemberAffiliations	1.33	1.33	1.32	1.33
	(0.97)	(0.96)	(0.99)	(0.98)
Board Specific Skills	59.20	56.43	59.68	56.35
	(23.17)	(23.10)	(22.56)	(23.30)
CEO Chairman Separation	0.41	0.25	0.26	0.26
	(0.49)	(0.43)	(0.44)	(0.44)
Director Election Majority Requirem.	0.56	0.61	0.58	0.60
	(0.50)	(0.49)	(0.49)	(0.49)
Voting Rights	0.82	0.85	0.84	0.84
	(0.38)	(0.36)	(0.37)	(0.36)
Shareholder Rights Policy	0.88	0.90	0.84	0.90
	(0.33)	(0.30)	(0.37)	(0.30)
Succession Plan	0.65	0.56	0.51	0.56
	(0.48)	(0.50)	(0.50)	(0.50)
Audit Committee Mgt Indep	0.97	0.92	0.91	0.93
	(0.18)	(0.28)	(0.29)	(0.26)
Total Revenue (billions)	670.24	389.78	541.38	512.79
	(5120.94)	(3379.96)	(3573.42)	(3564.36)
Total Assets (billions)	2058.38	688.53	619.40	565.87
	(17823.46)	(5443.65)	(2900.61)	(3739.37)
Performance	0.12	0.08	0.12	0.11
	(0.11)	(0.18)	(0.09)	(0.12)
Capital Structure	2.27	3.99	1.64	5.34
	(7.89)	(46.44)	(2.78)	(61.73)
LT-Debt over Total Liabs	0.29	0.28	0.31	0.30
	(0.24)	(0.27)	(0.23)	(0.23)
EBITDA over Revenue	0.17	-0.59	-0.21	-0.21
	(2.07)	(6.28)	(6.06)	(2.47)
Institutional Investors Ownership	67.30	59.96	64.36	64.47
	(23.55)	(25.33)	(22.88)	(23.97)
Observations	3027	481	254	254

Table 4.7. T-test for CG Summary Statistics in 2011

This Table shows t-test results of firm-year observations in 2011. Column 1 of this table analyzes mean differences of the unmatched sample (Columns 1 and 2 of Table 4.6). Column 2 analyzes mean differences of the matched sample (Columns 3 and 4 of Table 4.6). Definitions for all variables are shown in Table 4.1.
T-statistics are shown in parentheses. * p< 0.05, ** p< 0.01, *** p< 0.001.

	(1) Mean differences	(2) Mean differences (Matched)
Independent Board Members	-2.171	1.476
	(-1.36)	(0.62)
Antitakeover Devices	-0.758***	0.114
	(-5.31)	(0.57)
Female on Board	0.654	1.510
	(0.86)	(1.48)
Board Cultural Diversity	0.0244	0.000929
	(0.96)	(0.02)
Audit Board Committee	0.0106	0.0236
	(0.92)	(1.25)
Board Size	-0.460*	-0.209
	(-2.06)	(-0.68)
Compensation Board Committee	0.0398*	0.0157
	(1.98)	(0.53)
Nomination Board Committee	-0.0178	0
	(-0.65)	(0.00)
Non Audit to Audit Fee Ratio	-2.362	-0.101
	(-0.95)	(-0.37)
BoardMemberAffiliations	0.00327	0.0162
	(0.05)	(0.19)
Board Specific Skills	-2.769	-3.328
	(-1.93)	(-1.64)
CEO Chairman Separation	-0.159***	-0.00394
	(-5.84)	(-0.10)
Director Election Majority Requirem.	0.0495	0.0197
	(1.63)	(0.45)
Voting Rights	0.0269	0.00394
	(1.20)	(0.12)
Shareholder Rights Policy	0.0255	0.0591*
	(1.37)	(1.97)
Succession Plan	-0.0813**	0.0433
	(-2.65)	(0.98)
Audit Committee Mgt Indep	-0.0519**	0.0157
	(-3.11)	(0.64)
Total Revenue (billions)	-280.5	-28.59
	(-1.50)	(-0.09)
Total Assets (billions)	-1369.8***	-53.52
	(-3.34)	(-0.18)
Performance	-0.0385***	-0.00759
	(-4.48)	(-0.79)
Capital Structure	1.716	3.704
	(0.80)	(0.96)
LT-Debt over Total Liabs	-0.00464	-0.00519
	(-0.35)	(-0.25)
EBITDA over Revenue	-0.767*	-0.00151
	(-2.51)	(-0.00)
Institutional Investors Ownership	-7.334***	0.112
	(-5.76)	(0.05)
Observations	3508	508

Table 4.8. Results NBIM Index

This Table presents estimates from panel regressions that explain yearly changes in the NBIM Index for the period 2010–2015, as defined in Section 4.5.3. Post is a dummy variable (structural break) that takes value 1 after the NBIM's announcement (2012–2015) and zero for years 2010 and 2011. NBIM takes value 1 if the firm belongs to the NBIM's portfolio in 2012 and zero if the firm does not belong to the NBIM's portfolio in 2012. NBIMyeardummy_ are interactions of NBIM and year dummies. Individual year dummies (except for 2010, our reference year) and firm fixed effects are included in all regressions. Other controls include total revenue, total assets, performance (EBITDA over total assets), capital structure (total liabilities over total equity), long-term debt over total liabilities, EBITDA over revenue and a measure of institutional investors, as defined in Table 4.1. Robust standard errors clustered at the firm level and shown in parentheses. ***, ** or * indicates that the coefficient is significant at the 1%, 5% or 10% level, respectively.

VARIABLES	(1) Binary	(2) Binary-TDum	(3) Matched-Binary	(4) Matched-TDum
Post*NBIM	0.100		0.271*	
	(0.079)		(0.145)	
NBIM_yeardummy2011		0.031		0.160
		(0.123)		(0.167)
NBIM_yeardummy2012		0.001		0.166
		(0.128)		(0.182)
NBIM_yeardummy2013		0.125		0.346*
		(0.137)		(0.205)
NBIM_yeardummy2014		0.166		0.376*
		(0.151)		(0.220)
NBIM_yeardummy2015		0.204		0.226
		(0.183)		(0.257)
Observations	6,475	4,904	1,128	949
R-squared	0.126	0.031	0.108	0.046
Number of id	1,292	1,083	213	203

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 4.9. Results General CG Index

This table presents estimates from panel regressions explaining yearly changes in the General CG Index for the period 2010 to 2015, as defined in Section 4.5.3. Post is a dummy variable (structural break) that takes value 1 after the NBIM's announcement (2012–2015) and zero for years 2010 and 2011. NBIM takes value 1 if the firm belongs to the NBIM's portfolio in 2012 and zero if the firm does not belong to the NBIM's portfolio in 2012. NBIMyeardummy_ are interactions of NBIM and year dummies. Individual year dummies (except for 2010, our reference year) and firm fixed effects are included in all regressions. Other controls include total revenue, total assets, performance (EBITDA over total assets), capital structure (total liabilities over total equity), long-term debt over total liabilities, EBITDA over revenue and a measure of institutional investors, as defined in Table 4.1. Robust standard errors clustered at the firm level and shown in parentheses. ***, ** or * indicates that the coefficient is significant at the 1%, 5% or 10% level, respectively.

VARIABLES	(1) Binary	(2) Binary-TDum	(3) Matched-Binary	(4) Matched-TDum
Post*NBIM	-0.011		0.105	
	(0.053)		(0.100)	
NBIM_yeardummy2011		-0.058		-0.017
		(0.068)		(0.091)
NBIM_yeardummy2012		0.008		0.008
		(0.083)		(0.102)
NBIM_yeardummy2013		0.065		0.083
		(0.085)		(0.109)
NBIM_yeardummy2014		-0.009		0.041
		(0.105)		(0.146)
NBIM_yeardummy2015		-0.001		-0.024
		(0.124)		(0.170)
Observations	18,344	11,505	2,620	1,777
R-squared	0.033	0.048	0.038	0.034
Number of id	3,161	2,603	410	375

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 4.10. Results Independent Board Members

This Table presents estimates from panel regressions explaining yearly changes in the *Independent Board Members* for the period 2010 to 2015, defined as the percentage of independent board members as reported by the company. Post is a dummy variable (structural break) that takes value 1 after the NBIM's announcement (2012–2015) and zero for years 2010 and 2011. NBIM takes value 1 if the firm belongs to the NBIM's portfolio in 2012 and zero if the firm does not belong to the NBIM's portfolio in 2012. NBIMyeardummy_ are interactions of NBIM and year dummies. Individual year dummies (except for 2010, our reference year) and firm fixed effects are included in all regressions. Other controls include total revenue, total assets, performance, capital structure, long-term debt over total liabilities, EBITDA over revenue and a measure of institutional investors, as defined in Table 4.1. Robust standard errors clustered at the firm level and shown in parentheses. ***, ** or * indicates that the coefficient is significant at the 1%, 5% or 10% level, respectively.

VARIABLES	(1) Binary	(2) Binary-TDum	(3) Matched-Binary	(4) Matched-TDum
Post*NBIM	2.618***		4.557***	
	(0.718)		(1.268)	
NBIM_yeardummy2011		0.912		1.188
		(1.061)		(1.353)
NBIM_yeardummy2012		1.916		1.074
		(1.165)		(1.475)
NBIM_yeardummy2013		2.485**		2.116
		(1.178)		(1.540)
NBIM_yeardummy2014		4.201***		4.574**
		(1.484)		(1.986)
NBIM_yeardummy2015		5.832***		4.804**
		(1.614)		(2.153)
Observations	23,913	15,983	3,740	2,818
R-squared	0.016	0.026	0.036	0.044
Number of id	3,808	3,197	507	506

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 4.11. Results Women on Board

This Table presents estimates from panel regressions explaining yearly changes in the *Women on Board* for the period 2010 to 2015, defined as the percentage of women on the board. Post is a dummy variable (structural break) that takes value 1 after the NBIM's announcement (2012–2015) and zero for years 2010 and 2011. NBIM takes value 1 if the firm belongs to the NBIM's portfolio in 2012 and zero if the firm does not belong to the NBIM's portfolio in 2012. NBIMyeardummy_ are interactions of NBIM and year dummies. Individual year dummies (except for 2010, our reference year) and firm fixed effects are included in all regressions. Other controls include total revenue, total assets, performance, capital structure, long-term debt over total liabilities, EBITDA over revenue and a measure of institutional investors, as defined in Table 4.1. Robust standard errors clustered at the firm level and shown in parentheses. ***, ** or * indicates that the coefficient is significant at the 1%, 5% or 10% level, respectively.

VARIABLES	(1) Binary	(2) Binary-TDum	(3) Matched-Binary	(4) Matched-TDum
Post*NBIM	1.076***		1.241*	
	(0.350)		(0.671)	
NBIM_yeardummy2011		-0.222		-0.428
		(0.378)		(0.467)
NBIM_yeardummy2012		-0.255		-0.303
		(0.502)		(0.635)
NBIM_yeardummy2013		-0.083		-0.096
		(0.568)		(0.753)
NBIM_yeardummy2014		0.935		0.716
		(0.616)		(0.821)
NBIM_yeardummy2015		1.201*		1.656*
		(0.726)		(0.997)
Observations	25,137	16,139	3,958	2,856
R-squared	0.175	0.160	0.153	0.139
Number of id	3,783	3,164	501	501

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 4.12. Results Board Specific Skills

This Table presents estimates from panel regressions explaining yearly changes in the *Board Specific Skills* for the period 2010 to 2015, defined as the percentage of board members who have either an industry specific background or a strong financial background. Post is a dummy variable (structural break) that takes value 1 after the NBIM's announcement (2012–2015) and zero for years 2010 and 2011. NBIM takes value 1 if the firm belongs to the NBIM's portfolio in 2012 and zero if the firm does not belong to the NBIM's portfolio in 2012. NBIMyeardummy_ are interactions of NBIM and year dummies. Individual year dummies (except for 2010, our reference year) and firm fixed effects are included in all regressions. Other controls include total revenue, total assets, performance, capital structure, long-term debt over total liabilities, EBITDA over revenue and a measure of institutional investors, as defined in Table 4.1. Robust standard errors clustered at the firm level and shown in parentheses. ***, ** or * indicates that the coefficient is significant at the 1%, 5% or 10% level, respectively.

VARIABLES	(1) Binary	(2) Binary-TDum	(3) Matched-Binary	(4) Matched-TDum
Post*NBIM	1.931***		2.507*	
	(0.701)		(1.290)	
NBIM_yeardummy2011		1.131		1.260
		(1.115)		(1.386)
NBIM_yeardummy2012		1.246		1.617
		(1.196)		(1.598)
NBIM_yeardummy2013		1.453		1.849
		(1.260)		(1.791)
NBIM_yeardummy2014		2.501*		2.595
		(1.414)		(2.001)
NBIM_yeardummy2015		3.342**		3.297
		(1.577)		(2.240)
Observations	24,189	16,311	3,768	2,867
R-squared	0.029	0.060	0.039	0.075
Number of id	3,829	3,212	508	508

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 4.13. Results Audit Committee Management Independence

This Table presents estimates from panel regressions explaining yearly changes in the *Audit Committee Management Independence* for the period 2010 to 2015, defined as 1 if the company reports that all audit committee members are non-executives, 0 otherwise. Post is a dummy variable (structural break) that takes value 1 after the NBIM's announcement (2012–2015) and zero for years 2010 and 2011. NBIM takes value 1 if the firm belongs to the NBIM's portfolio in 2012 and zero if the firm does not belong to the NBIM's portfolio in 2012. NBIMyeardummy_ are interactions of NBIM and year dummies. Individual year dummies (except for 2010, our reference year) and firm fixed effects are included in all regressions. Other controls include total revenue, total assets, performance, capital structure, long-term debt over total liabilities, EBITDA over revenue and a measure of institutional investors, as defined in Table 4.1. Robust standard errors clustered at the firm level and shown in parentheses. ***, ** or * indicates that the coefficient is significant at the 1%, 5% or 10% level, respectively.

VARIABLES	(1) Binary	(2) Binary-TDum	(3) Matched-Binary	(4) Matched-TDum
Post*NBIM	0.042***		0.044*	
	(0.012)		(0.023)	
NBIM_yeardummy2011		0.004		-0.017
		(0.014)		(0.018)
NBIM_yeardummy2012		-0.004		-0.001
		(0.016)		(0.017)
NBIM_yeardummy2013		-0.023		-0.018
		(0.017)		(0.021)
NBIM_yeardummy2014		0.030		0.033
		(0.024)		(0.031)
NBIM_yeardummy2015		0.032		0.020
		(0.027)		(0.036)
Observations	25,794	16,487	4,046	2,903
R-squared	0.020	0.043	0.028	0.049
Number of id	3,841	3,220	508	508

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 4.14. Results Board Size

This Table presents estimates from panel regressions explaining yearly changes in the *Board Size* for the period 2010 to 2015, defined as the total number of board members at the end of the fiscal year. Post is a dummy variable (structural break) that takes value 1 after the NBIM's announcement (2012–2015) and zero for years 2010 and 2011. NBIM takes value 1 if the firm belongs to the NBIM's portfolio in 2012 and zero if the firm does not belong to the NBIM's portfolio in 2012. NBIMyeardummy_ are interactions of NBIM and year dummies. Individual year dummies (except for 2010, our reference year) and firm fixed effects are included in all regressions. Other controls include total revenue, total assets, performance, capital structure, long-term debt over total liabilities, EBITDA over revenue and a measure of institutional investors, as defined in Table 4.1. Robust standard errors clustered at the firm level and shown in parentheses. ***, ** or * indicates that the coefficient is significant at the 1%, 5% or 10% level, respectively.

VARIABLES	(1) Binary	(2) Binary-TDum	(3) Matched-Binary	(4) Matched-TDum
Post*NBIM	0.327***		0.560***	
	(0.080)		(0.147)	
NBIM_yeardummy2011		0.040		0.066
		(0.089)		(0.118)
NBIM_yeardummy2012		0.170		0.163
		(0.123)		(0.155)
NBIM_yeardummy2013		0.300**		0.367*
		(0.148)		(0.193)
NBIM_yeardummy2014		0.475***		0.581***
		(0.146)		(0.193)
NBIM_yeardummy2015		0.461***		0.519**
		(0.155)		(0.227)
Observations	25,717	16,481	4,034	2,902
R-squared	0.007	0.011	0.023	0.031
Number of id	3,841	3,220	508	508

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 4.15. Results Policy Equal Voting Right

This Table presents estimates from panel regressions explaining yearly changes in the *Policy Equal Voting Right* for the period 2010 to 2015, which takes value 1 if the company has a policy to apply the one-share, one-vote principle, 0 otherwise. Post is a dummy variable (structural break) that takes value 1 after the NBIM's announcement (2012–2015) and zero for years 2010 and 2011. NBIM takes value 1 if the firm belongs to the NBIM's portfolio in 2012 and zero if the firm does not belong to the NBIM's portfolio in 2012. NBIMyeardummy_ are interactions of NBIM and year dummies. Individual year dummies (except for 2010, our reference year) and firm fixed effects are included in all regressions. Other controls include total revenue, total assets, performance, capital structure, long-term debt over total liabilities, EBITDA over revenue and a measure of institutional investors, as defined in Table 4.1. Robust standard errors clustered at the firm level and shown in parentheses. ***, ** or * indicates that the coefficient is significant at the 1%, 5% or 10% level, respectively.

VARIABLES	(1) Binary	(2) Binary-TDum	(3) Matched-Binary	(4) Matched-TDum
Post*NBIM	-0.034***		-0.063***	
	(0.011)		(0.020)	
NBIM_yeardummy2011		0.003		0.004
		(0.008)		(0.011)
NBIM_yeardummy2012		-0.015		-0.023
		(0.015)		(0.020)
NBIM_yeardummy2013		-0.023		-0.039*
		(0.016)		(0.022)
NBIM_yeardummy2014		-0.045***		-0.061**
		(0.017)		(0.024)
NBIM_yeardummy2015		-0.074***		-0.100***
		(0.018)		(0.028)
Observations	25,794	16,487	4,046	2,903
R-squared	0.020	0.037	0.024	0.043
Number of id	3,841	3,220	508	508

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 4.16. Results Audit Board Committee

This Table presents estimates from panel regressions explaining yearly changes in the *Audit Board Committee* for the period 2010 to 2015, which takes value 1 if the company has an audit board committee, 0 otherwise. Post is a dummy variable (structural break) that takes value 1 after the NBIM's announcement (2012–2015) and zero for years 2010 and 2011. NBIM takes value 1 if the firm belongs to the NBIM's portfolio in 2012 and zero if the firm does not belong to the NBIM's portfolio in 2012. NBIMyeardummy_ are interactions of NBIM and year dummies. Individual year dummies (except for 2010, our reference year) and firm fixed effects are included in all regressions. Other controls include total revenue, total assets, performance, capital structure, long-term debt over total liabilities, EBITDA over revenue and a measure of institutional investors, as defined in Table 4.1. Robust standard errors clustered at the firm level and shown in parentheses. ***, ** or * indicates that the coefficient is significant at the 1%, 5% or 10% level, respectively.

VARIABLES	(1) Binary	(2) Binary-TDum	(3) Matched-Binary	(4) Matched-TDum
Post*NBIM	-0.051***		-0.054***	
	(0.010)		(0.021)	
NBIM_yeardummy2011		-0.003		-0.010
		(0.008)		(0.012)
NBIM_yeardummy2012		0.013		0.020
		(0.012)		(0.016)
NBIM_yeardummy2013		0.015		0.018
		(0.013)		(0.017)
NBIM_yeardummy2014		-0.069***		-0.065**
		(0.018)		(0.028)
NBIM_yeardummy2015		-0.070***		-0.065**
		(0.021)		(0.032)
Observations	25,794	16,487	4,046	2,903
R-squared	0.086	0.117	0.050	0.079
Number of id	3,841	3,220	508	508

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 4.17. Results Compensation Board Committee

This Table presents estimates from panel regressions explaining yearly changes in the *Compensation Board Committee* for the period 2010 to 2015, which takes value 1 if the company has a compensation board committee, 0 otherwise. Post is a dummy variable (structural break) that takes value 1 after the NBIM's announcement (2012–2015) and zero for years 2010 and 2011. NBIM takes value 1 if the firm belongs to the NBIM's portfolio in 2012 and zero if the firm does not belong to the NBIM's portfolio in 2012. NBIMyeardummy_ are interactions of NBIM and year dummies. Individual year dummies (except for 2010, our reference year) and firm fixed effects are included in all regressions. Other controls include total revenue, total assets, performance, capital structure, long-term debt over total liabilities, EBITDA over revenue and a measure of institutional investors, as defined in Table 4.1. Robust standard errors clustered at the firm level and shown in parentheses. ***, ** or * indicates that the coefficient is significant at the 1%, 5% or 10% level, respectively.

VARIABLES	(1) Binary	(2) Binary-TDum	(3) Matched-Binary	(4) Matched-TDum
Post*NBIM	-0.019*		-0.053**	
	(0.010)		(0.020)	
NBIM_yeardummy2011		0.010		0.022
		(0.011)		(0.018)
NBIM_yeardummy2012		0.013		0.025
		(0.014)		(0.021)
NBIM_yeardummy2013		0.017		0.013
		(0.016)		(0.023)
NBIM_yeardummy2014		-0.032		-0.068**
		(0.020)		(0.031)
NBIM_yeardummy2015		-0.039*		-0.088***
		(0.020)		(0.033)
Observations	25,794	16,487	4,046	2,903
R-squared	0.050	0.078	0.055	0.089
Number of id	3,841	3,220	508	508

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

4.11. REFERENCES

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5

Conclusion

5.1. THEORETICAL CONTRIBUTIONS

This thesis provides a theoretical framework to study SWFs which explains the tension between financial and strategic goals, expanding the financial-nonfinancial duality developed by Bortolotti et al. (2015). This is the main contribution of Essay I. We acknowledge the need SWFs have to combine both strategic and financial goals and we set up a valid theoretical framework using strategic governance constructs. Essay I explains how SWFs evolve in time through professionalism, in-house capabilities and decoupling.

Essay II addresses the validity of the theoretical framework of Essay I. It testes four strategic capabilities developed by SWFs in Spain. We confirmed whether these four strategic governance types are implemented through four business case studies.

The third essay investigates empirically the validity of one of the propositions outlined in Essay I: the shareholder activism of large institutional investors. This thesis reinforces the need of a new conceptual effort beyond agency or stakeholder theory. In fact, active ownership and the heterogeneity of principals bring new theoretical questions addressed in Essay III.

SWFs fit well in the notion of long-term capitalism as long-term institutional investors as they face no current liabilities, and, in most cases, liquidity and short-term needs are almost absent. Their investment strategies reflect long-term investment horizons, value creation through engagement and enhancement of boards' monitoring capabilities.

Lastly, this thesis also introduces SWFs as representatives of the state capitalism. The comparative work on the varieties of capitalism, originally focused on developed markets frameworks (Hall & Soskice, 2001), has been expanded to East and Central European countries (Nölke & Vliegenthart, 2009) or Latin America (Schneider, 2009). In this thesis we continue this path studying institutional forms typical of the emerging markets where the majority of these SWFs were born: Middle East, China, Central Asia and South-East Asia. We extend the knowledge of state capitalism by increasing understanding about the liability of sovereignness and how funds may overcome it through professionalism, legitimacy and learning.

5.2. MANAGERIAL IMPLICATIONS

This work has managerial implications at three different levels and we add a fourth implication, linked to engaged ownership strategies in the context of SWFs.

First, the thesis reveals conflicts at the manager-level in the state capitalism context for investment managers participating in state-owned vehicles. The dual objectives of financial returns and strategic long-term economic goals are not easily reconciled at the individual level. How to establish efficient strategic governance mechanisms to ensure the achievement of goals, also at the investment manager level, remains a key discussion among practitioners.

Second, at the fund-level, institutional investors such as SWFs may choose between exiting a firm or talking to corporate executives and board directors when they disagree with portfolio companies. This thesis provides evidence about the effectiveness of NBIM's strategy. Yet, what is the context in which such an engagement strategy would work? Additionally, given the fact that Essay III provides evidence of the effectiveness of an engagement strategy, would other SWFs follow?

Third, at the country-level, this thesis brings more clarity for recipient countries about the different goals that different funds may have at a given stage of capabilities development (Essays II and III). International law policy makers and politicians from recipient countries would benefit from this work, which could help prevent overreaction when it comes to the regulation of investments from foreign SWFs. Also, at the country-level, governments should better understand the role of SWFs within the network of state-owned institutions: central banks, development agencies or state-owned enterprises.

Finally, this work reinforces arguments favoring active ownership. Engaged shareholders play a critical role in today's capitalism, the majority of shares being held by a small group of institutional investors. In the case of SWFs, playing a more active shareholding role implies exposure and risk of receiving unfavorable treatment. However, the legitimacy of NBIM and the isomorphic pressures may help other SWFs to follow.

5.3. LIMITATIONS AND FUTURE RESEARCH

This thesis may motivate other researchers to fill the gap of SWFs' direct influence on corporate governance. Yet, the data limitation that drove research towards listed companies, especially in Essay III, created an opportunity to explore the impact of SWFs on the governance of privately-held portfolio companies. This has enriched the arguments presented here and in previous literature.

The same data constraints affected the development of systematic industry studies. Data availability is limited and inaccurate, consequently panel datasets are skewed towards the most transparent and large funds. Better datasets, including more sovereign funds and more domestic deals would help to reveal the heterogeneity of the industry and to test the validity of arguments.

Sovereign wealth funds represent a good opportunity to test how strategic governance is critical for global investors as part of the public and foreign policies. In a world heading to mercantilism and less trade openness, SWFs would be at the epicenter when governments design consistent strategies, using different state tools, to influence domestic markets, foster innovation, facilitate internationalization or develop strategic sectors. How these strategies would be implemented remains a largely open question.

One of the main important questions that has received scarce attention is precisely why an SWF would ever be established. There is a need for a reevaluation of the effects of SWFs on economic development. New funds coming from non-oil sources, like privatization proceedings, state-owned holdings or sector-specific co-investment platforms, present very different features and risks compared to resource-based SWFs. The study of these new cases would help to better understand the benefits and costs of establishing such a fund (Das et al., 2009), and would serve as a strong resource for future policymakers.

Lastly, institutional investors should choose between exiting a firm or talking to corporate executives and board directors when they disagree with investee companies. A sovereign wealth fund decided in 2012 to speak with and engage more with companies. This "engagement strategy" yielded positive results in a short period of time. Will other SWFs and institutional investors follow? Only time will tell.

5.4. REFERENCES

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