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Bachelor Thesis in Accounting and Financial Management

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# Maximising shareholder value or personal wealth?

## A study on incentive programs and share repurchases in Sweden

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**Abstract**

The purpose of this study is to examine if it is possible that senior executives in the largest firms in Sweden (the ones listed on the OMXS 30) are earning bonuses because of firms repurchasing their own shares. Earlier research from USA has shown that the incentive programs for CEOs have an effect on the firms' repurchasing of shares, and that firms where the CEO's bonus is tied to EPS tend to repurchase shares to a greater extent. This is because the repurchasing of shares decreases the number of shares outstanding, thus increasing EPS. By examining how the firms' incentive programs work, and how large share repurchases they have made, we conclude that the phenomenon of bonus-driven share repurchases does not seem to be widespread among the largest firms in Sweden. There are few cases where a firm both has repurchased a large amount of shares, and has had an incentive program allowing for the senior executives to benefit from the repurchases. AstraZeneca is the firm that particularly stands out, but AstraZeneca is primarily listed on London Stock Exchange and senior executives are employed by the British firm.

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# 1. Introduction/Background

## 1.1 Research purpose and contribution

This paper explores the designs of incentive programs in the most frequently traded companies on the Stockholm Stock exchange and to which extent these firms are repurchasing their own shares (also referred to as *buy-backs*) from the stock market. Previous research has shown that firms are repurchasing shares on a larger scale when the CEO's bonus is determined by earnings per share (EPS). By repurchasing company shares the EPS will automatically increase, enabling the CEO to secure his bonus payment. This, in combination with the common perception that American senior executives are repurchasing shares for their personal monetary benefit, leads us to examine whether or not this relationship is applicable also on Swedish firms. [1] [2] [3]

By mapping out how the firms' incentive programs are designed and putting this information in relation to the annual values of share repurchases, it is possible to determine if firms with share-related incentive programs are conducting repurchases on a larger scale than other firms. In addition, we examine if the CEOs and other executives have in fact been able to gain personally through the share repurchases.

During the last decade, there have been share repurchases that could have contributed to bonus payments to senior executives. These occasions are quite few, as firms need to have repurchased shares to a relatively large extent, while simultaneously having incentive programs allowing senior executives to benefit from them. The findings of this study could be of interest to investors and everyone interested in Sweden's largest firms.

*Research question: Is the phenomenon of bonus-driven repurchases common among the largest firms in Sweden?*

## 1.2 Previous research

A study called *Bonus-driven Repurchases* shows that CEOs can manipulate EPS through share repurchases to reach certain targets and as a result receive a bonus. The study established that CEOs do benefit from repurchasing when their bonus is tied to EPS, implying that there is a direct personal incentive for them to engage in share repurchases.[4] According to

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[1] (Sender, 2015)
[2] (Luce, 2015)
[3] (The Economist, 2014)
[4] (Cheng, Harford, & Zhang, 2010), p 4

the study, a CEO's bonus tied to EPS will increase by on average 36% when a share repurchase is conducted, and the study also shows that repurchases are more common if a firm is close to reaching the EPS target that grants the CEO a bonus.[5] If repurchases are bonus-driven, they are made to maximise the personal wealth of the CEO and other senior executives rather than maximising the shareholder value.

A 2005 survey published in the Journal of Financial Economics shows that three out of four CFOs indicate that increasing EPS is an important factor in the decision whether or not to make a share repurchase.[6]

## 1.3 The situation in the USA

As the Canadian economist, William Lazonick has noted, there were 449 companies in the S&P 500 index that were publicly listed from 2003 through 2012, and those companies spent 54 % of their earnings from that period on share repurchases.[7] That equals to $2.4 trillion. In an article in Harvard Business Review, Lazonick refers to an open letter to S&P 500 CEOs, written by the chairman and CEO of BlackRock (the largest asset management firm in the world), Laurence Fink.[8] [9] [10] In the letter, Fink expresses his and BlackRock's concern about how firms are trying to meet short-term financial goals, at the expense of building value in the long term.

> *"It concerns us that, in the wake of the financial crisis, many companies have shied away from investing in the future growth of their companies [...] Too many companies have cut capital expenditure and even increased debt to boost dividends and increase share buybacks."*[11]

In Lazonick's article, he is clear about what he thinks drives the firms' will to repurchase shares to such a large extent, namely the senior executives' compensation. Lazonick writes that the "stock-based incentives make senior executives extremely motivated to do buybacks on a colossal and systemic scale."[12]

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[5] (Cheng, Harford, & Zhang, 2010), p 2
[6] (Brav, Graham, Harvey, & Michaely, 2005)
[7] (Lazonick, Profits Without Prosperity, 2014)
[8] (BlackRock, 2014)
[9] (Lazonick, Profits Without Prosperity, 2014)
[10] (Lazonick, Profits Without Prosperity, 2014)
[11] (Business Insider, 2015)
[12] (Lazonick, Profits Without Prosperity, 2014)

Other economical magazines support what previous research has shown. An article in The Economist highlights what they see as a problem, with examples from the financial crisis of 2008. It is stated that Lehman Brothers repurchased shares for $1 billion during a six month period ending in May 2008, just months before its bankruptcy. Furthermore, America's financial sector repurchased shares for $207 billion between 2006 and 2008, while US taxpayers paid $250 billion to save the banks from bankruptcy, according to The Economist.[13]

Financial Times have written about how critics see repurchases as a way of rewarding executives. An article quoted Michael Kastner, managing principal at Halyard Asset Management, saying that "CEO's are being rewarded for buybacks, and as share prices go up it becomes a virtuous cycle."[14]

## 1.4 Swedish rules and regulation

Repurchases of the own firm's shares was made legal in Sweden on 10th of March 2000.[15] According to Nasdaq, all Swedish firms are required to report repurchases of their own shares. "Foreign firms" do not need to follow those rules, but can report to the stock exchange voluntarily.[16]

The board of directors can be given mandate to repurchase shares by the shareholders at the annual general meetings. By Swedish law (19 kap 18 § Aktiebolagslagen), it is required that a majority of 2/3 vote in favour for a proposal of giving the board of directors a mandate to repurchase shares.[17]

In contrast to USA, it should be noted that the CEO and chairman of the board is forbidden by law to be the same person in public Swedish firms (8 kap. 49 § Aktiebolagslagen). Since it is the board that decides to repurchase shares, and not the CEO, the clause could prevent repurchasing of shares for the benefit of the CEO.

## 1.5 Limitations

Rather than examining a large number of public Swedish firms and treating them as a population sample, this paper takes on a more qualitative approach, by focusing on the 30 most traded stocks on the Nasdaq OMX Stockholm stock exchange. If a firm has repurchased shares and has an incentive program designed so that senior executives (for example the

13 (The Economist, 2014)
14 (Platt & MacKenzie, 2015)
15 (Tivéus, 2000)
16 (Nasdaq OMX, 2014)
17 (Lagen.nu, 2015)

CEO) would benefit, it could (and does, as in examples from media) raise questions about the motives behind the repurchase. However, it would not be proven that the repurchases were in fact made with the motive of personal monetary benefit for the senior executives.

Another reason to limit the study to 30 firms, is the often complex nature of incentive programs. Few studies could be found on Swedish firms, and a purely quantitative study would be out of our time scope. In order to understand the implications of an incentive program, and how the senior executives could benefit from share repurchases, a thorough analysis must be made on all firms. This would not have been possible to achieve on a much larger scale. The risk with examining all publicly listed firms would have been to make hasty and thus poor judgements on whether the incentive program in place could result in personal monetary benefit if the firm repurchased shares.

# 2. Theoretical framework

To be able to understand the mechanisms in play, a summary of some theories in financial and accounting is needed.

## 2.1 Perfect capital markets versus the reality

According to the Modigliani and Miller theorem, an investor is said to be indifferent between whether a firm chooses to distribute excess cash to its shareholders through dividend payments or share repurchases. Assuming perfect capital markets, the share price will decrease by the exact amount of the dividend payment on the ex-dividend date. The price drop is a consequence of the lower market value of the firm, since some assets were used to pay out dividends.

When a share repurchase is made, the share price will (in theory) remain the same after the repurchase. The value of assets would decrease as when paying out dividends, but this effect is offset by the reduction of the number of shares outstanding.

Consequently, investors would not prefer one pay-out method over the other, according to Modigliani and Miller. The reality, however, behaves differently than how the theoretical perfect capital markets would suggest. In the real world, there are many aspects that can influence the choice of pay-out policy. The tax situation usually has a substantial impact, since the investors would want to pay as little in taxes as possible. There is also an idea that managers may want to use the pay-out as a method to signal information about the firm. From the perspective of a long-term shareholder, a share repurchase is a positive-NPV project when the share is undervalued. This is in line with the reality: a survey from 2005 shows that 86.4% of CFOs “agree” or “strongly agree” with the statement that firms repurchase when they think their stock is of good value, relative to its true value.[18] The market reaction reflects this as well: the average stock price change after an open market share repurchase announcement is +3%.[19]

If the share repurchases were made with the managers’ intention of gaining personally, without the share being undervalued, the long-term shareholder could pay the price for this. Ironically, the incentive program would then be causing the agent-principal problem it was designed to eliminate.

## 2.2 Theory of agency

Since the beginning of the 1970’s when the theory of agency (also known as the *agency theory*, or *principal-agent-problem*) was formulated, it has had great impact on how problems regarding incentives and compensations are handled in corporations.[20] There is a problem, according to the theory, where the agent (for example an employee) do not have the same goals and motivations as the principal (for example an owner of the company). The idea is that the agent may have his own interests, and to act upon those, even if they are in conflict with the principal’s. An assumption made in this theory is about the goal of a firm; to maximise shareholder value, which means maximise the value for the principal, in this case.

This is, obviously, a risk that a principal would want to eliminate. Therefore, it is usual that incentive programs and compensations are formed with the theory of agency in mind. This means that the compensation is formed in such a way that the motives of the agent would align with the motives of the principal, through having same kinds of incentives.

To align the principal’s and the agent’s motives through compensation, firms often give the senior employees a variable salary. The variable part of the salary is dependent on the firm’s performance in some way, which sometimes includes measures that are tied to the share price or EPS. In that way, both the principal and the agent benefits if value is created by the firm.

However, concerns have been raised about using the theory as foundation to compensations, and it has been argued that the incentive programs are not in the companies’ best interest in

[18] (Brav, Graham, Harvey, & Michaely, 2005), p 514.
[19] (Berk & DeMarzo, 2014), p 611
[20] (Mitnick, 2006)

the long run (in terms of its stakeholders, including shareholders), nor in the society's best interest.[21] [22]

## 2.3 Moral hazard

Closely related to the theory of agency is the notion of *moral hazard*. The idea is that an individual's behaviour is dependent on whether he or she is fully exposed to the consequences of that behaviour.[23] There has been discussions about how moral hazard plays a role in individuals' behaviour in the finance industry, particularly what role it played in the financial crisis of 2008.[24] This is due to the fact that senior executives and investment bankers could earn large bonuses by taking risks. However, those people were not obliged to pay back bonuses if the firm performed worse in the future, and were not personally liable for their risk-taking. The result is that some individuals engaged in risky behaviour, while others were bearing the risk and had to deal with the consequences. In the financial crisis of 2008, not only owners (principals) had to deal with risks taken by employees (agents), but also tax-payers had to pay when the US government prevented banks from entering bankruptcy.

Even if firms in this study would not be rescued from bankruptcy by the Swedish government, senior executives (including CEOs) bear little personal risk when it comes to the consequences of their behaviour. They might focus on reaching EPS targets or share price targets in the near future to gain personal wealth, without necessarily taking into account what effect that behaviour has on long-term shareholders. Firms could try to compensate this risk by designing a long-term incentive program, so that senior executives would earn bonuses only if the firm performed well over a longer period of time.

Repurchasing of shares to benefit personally would be a clear example of an agent engaging in behaviour that might not be in the principal's best interest, thus making for a moral hazard, since the principal is bearing the risk of the firm performing worse in the future. The problem is the information asymmetry between the principal and the agent; the principal may not be in a good position to determine if and when to make a share repurchase. Instead, the principal gives the agent a mandate to make that decision. In Sweden, this happens at the general annual meeting, when the board of directors can be given the mandate to repurchase shares.[25]

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[21] (Lazonick, Profits Without Prosperity, 2014)
[22] (Lazonick, The Financialization of the U.S. Corporation: What Has Been Lost, and How It Can Be Regained , 2013)
[23] (Berk & DeMarzo, 2014), p 562
[24] (Berk & DeMarzo, 2014), p 562
[25] Information about these decisions can be found in the firm's annual report and in press releases

# 3. Method

## 3.1 Firm selection

Due to limitations in time and scope for this study, the firms chosen were those that would be most interesting to the public, hence the selection of the 30 most traded stocks on the Nasdaq OMX Stockholm exchange. Many more studies have been done on US firms, proving the correlation between share repurchases and incentive program for CEOs. There was much less research to be found on Swedish firms. Thus, we focus on this issue by doing an explorative study on the firms traded on Nasdaq OMXS 30, exploring how the firms' incentive program works and to what extent the firms are repurchasing shares.

In the USA, S&P 500 firms are often used to describe current situation and trends, such as the firms' repurchasing and salary of CEOs. The OMXS30 seems to be reasonable equivalent. S&P 500 is twenty times bigger, in number of firms, while the US economy is about thirty times bigger in terms of nominal GDP, and the US population is over thirty times larger than the Swedish.[26] [27]

## 3.2 Data gathering and analysis

### 3.2.1 Share repurchases

The data containing the firms' share repurchases were gathered from the Nasdaq OMX Stockholm website.[28] All the data on the firms' share repurchases was downloaded into Excel sheets. The file contained dates for the repurchases, how many shares that were repurchased and to what price, and the sum value in SEK of every repurchase. These datasets were then used to summarise the total value of repurchases for every firm, and also the value of the repurchases per year. For AstraZeneca, the dataset did contain all the information, except from the share price at which the shares had been repurchased, and thus the total value of the repurchases. In AstraZeneca's annual report, the information regarding repurchases are global. The value of the Swedish repurchases were therefore manually calculated, by multiplying the number of shares repurchased with the closing share price for that day.

To approximate the repurchases size in relation to the total market capitalisation, a rough estimate was calculated. It is the average of the market capitalisation on December 31$^{st}$ of the current year and December 31$^{st}$ of the year before.

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[26] (Landguiden, 2012)
[27] (Landguiden, 2015)
[28] (Nasdaq OMX, 2014)

### 3.2.2 Incentive programs

All the firms' annual reports have been downloaded in digital form (portable document format, PDF) from their respective websites. The fact that digital files were used means that they could be searchable for keywords, such as "incentive", "compensation", "stock option", "share-related", "bonus" etc. This made the process efficient, since the relevant parts of the annual report could be found quite easily. The detail and complexity in which the compensation and incentive programs are described vary between firms. Some required extensive analysis and comparison between different years' annual reports to fully grasp how the programs were designed. Through analysis and discussion, it was determined whether the incentive system was designed so that a senior executive could benefit, in personal monetary terms, if the firm repurchased shares from the market. This was seen as binary (either they can benefit from share repurchases or they cannot), and this data was collected in Excel, where it was further analysed. The analysis of the data contains how many "firm-years" out of the 300 total that had incentive programs and/or repurchases. To draw conclusions from the data, it was not sufficient just to examine this binary dataset. A deeper analysis was needed in order to understand whether the repurchases had an impact worth mentioning, and if the incentive programs allowed employees to benefit from the repurchases.

# 4. Empirical results

## 4.1 Tables

**Table 1.** This table shows the firms in the OMXS 30, how many repurchases they made during 2005-2014, the total value of those repurchases, and how many years (out of 10) that the firm had a share-related incentive program.

| | Number of repurchases | Total value of repurchases, MSEK | Number of years with share-related incentive program |
|---|---|---|---|
| ABB | 0 | 0 | 10 |
| Alfa Laval | 105 | 2 517,0 | 10 |
| Assa Abloy | 13 | 102,9 | 10 |
| AstraZeneca | 422 | 45 721,7 | 9 |
| Atlas Copco A | 86 | 3 291,9 | 9 |
| Atlas Copco B | 40 | 3 818,7 | 9 |
| Boliden | 75 | 2 209,1 | 10 |
| Electrolux | 61 | 2 192,8 | 10 |
| Ericsson | 1 | 158,5 | 7 |

| | | | |
|---|---|---|---|
| **Getinge** | 0 | 0 | 5 |
| **H&M** | 0 | 0 | 0 |
| **Handelsbanken** | 146 | 7 502,5 | 0 |
| **Investor** | 43 | 1 055,3 | 10 |
| **Kinnevik** | 42 | 278,8 | 7 |
| **Lundin Petroleum** | 29 | 531,5 | 10 |
| **MTG** | 22 | 623,3 | 10 |
| **Nokia** | 0 | 0 | 10 |
| **Nordea** | 51 | 10 491,6 | 8 |
| **Sandvik** | 0 | 0 | 9 |
| **SCA** | 0 | 0 | 9 |
| **SEB** | 80 | 3 146,6 | 10 |
| **Securitas** | 0 | 0 | 5 |
| **Skanska** | 890 | 1 996,3 | 10 |
| **SKF** | 0 | 0 | 7 |
| **SSAB** | 0 | 0 | 4 |
| **Swedbank** | 72 | 5 514,5 | 5 |
| **Swedish Match** | 767 | 19 511,2 | 10 |
| **Tele2** | 10 | 459,4 | 10 |
| **TeliaSonera** | 6 | 9 952,7 | 5 |
| **Volvo** | 11 | 46,1 | 9 |

| | | | |
|---|---|---|---|
| **Mean** | 99 | 4 037 | 7,9 |
| **Mean, excl. non-repurchasers** | 142 | 5 768 | 8 |
| **Total** | 2972 | 121 121 | 237 |

**Table 2.** This table shows the firms' repurchases as a percentage share of their total earnings during 2005-2014. This can be compared to the previously mentioned share of 54 % of earnings that S&P 500 firms have repurchased shares for.

| | |
|---|---|
| **Repurchases as a share of total profits** | 6,20% |

**Table 2.** The following table shows which firms that repurchased shares for the highest value for a single year. An approximation of the repurchases as a percentage of the average total market capitalisation for that year (average of December 31st of that year and December 31st of the year before) is also calculated. This is relevant, since a larger repurchase has larger impact on measures like EPS or ROE.

| # | Share repurchases' worth (MSEK) | Firm | Year | Market cap (average, MSEK) | Share repurchases as a percentage of market cap |
|---|---|---|---|---|---|
| 1 | 21 368,5 | AstraZeneca | 2007 | 56 753,5 | 37,65% |
| 2 | 15 337,9 | AstraZeneca | 2006 | 64 046,1 | 23,95% |
| 3 | 10 491,6 | Nordea | 2005 | 207 672,5 | 5,05% |
| 4 | 9 943,1 | TeliaSonera | 2011 | 220 929,7 | 4,50% |
| 5 | 6 705,0 | AstraZeneca | 2005 | 55 100,6 | 12,17% |
| 6 | 5 514,5 | Swedbank | 2011 | 87 687,3 | 6,29% |
| 7 | 3 816,8 | Handelsbanken | 2006 | 129 947,0 | 2,94% |
| 8 | 3 775,5 | Atlas Copco B | 2006 | 77 979,7 | 4,84% |
| 9 | 3 671,3 | Swedish Match | 2006 | 36 142,8 | 10,16% |
| 10 | 2 882,0 | Swedish Match | 2010 | 42 178,8 | 6,83% |
| 11 | 2 574,0 | Swedish Match | 2007 | 39 863,9 | 6,46% |
| 12 | 2 567,0 | Swedish Match | 2009 | 33 939,1 | 7,56% |
| 13 | 2 392,4 | SEB | 2013 | 151 955,6 | 1,57% |
| 14 | 2 309,3 | AstraZeneca | 2008 | 46 277,9 | 4,99% |
| 15 | 2 303,7 | Swedish Match | 2011 | 48 505,8 | 4,75% |
| 16 | 2 209,1 | Boliden | 2007 | 37 222,4 | 5,93% |
| 17 | 2 208,4 | Handelsbanken | 2007 | 129 739,9 | 1,70% |
| 18 | 2 192,8 | Electrolux | 2006 | 51 425,0 | 4,26% |
| 19 | 1 863,7 | Swedish Match | 2012 | 48 492,6 | 3,84% |
| 20 | 1 497,1 | Alfa Laval | 2007 | 37 577,6 | 3,98% |

**Table 3.** This table contains aggregated statistics for all the firms. As seen, there are very few years that firms have repurchased shares without having an incentive program, compared to the total number of years when no share-related incentive program was in place.

| | Number | Percentage share of total |
|---|---|---|
| **Years without share-related incentive programs** | 63 | 21,00% |
| **The value of the repurchases made without an incentive program (MSEK)** | 17 994,1 | 23,86% |
| **Number of years with repurchases and no incentive program** | 8 | 2,67% |

## 4.2 Description of firms

Following is a more detailed description of every firm's repurchases and their incentive programs. Even if a firm did not repurchase many shares during the last ten years, they could do it in the future. Therefore, it should be of interest to know what kind of incentive program the senior executives have (and the frequency of incentive programs is increasing). [29] It could also be of interest to know if a firm did not make any share repurchases, even if the senior executives could have received bonuses by doing so.

### ABB

ABB employs multiple incentive programs connected to both its share price and earnings per share. The bonus awards for achieved goals are furthermore in part received in cash.

The long term incentive plan (LTIP) applies to the executive Committee and selected senior executives. The plan is comprised by a performance and a retention component and involves conditional grants of ABB stock subject to certain conditions.

The amount of shares received by participants is derived from the base salary. The actual number of shares that will vest each year is contingent on the development of earnings per share. A maximum of two matching shares are given under the performance component. An additional matching share can be acquired under the retention component, given that the participant remains employed throughout the period. Under the performance component, 100 per cent of the value of vested shares is received in cash. Under the retention component, 70 per cent is received in shares and the remaining 30 per cent in cash.

Approximately $22 million worth of shares was granted in 2012, 2013 and 2014 respectively.

ABB has in fact not repurchased any shares between 2005 and 2014.

### Alfa Laval

Alfa Laval has a long term incentive program (LTIP) contingent on the development of earnings per share. The program was launched in 2008 involving 75 executives. EPS targets are set by the board of directors and divided into three separate tranches:

[29] 55 % of firms on the Large Cap-list had proposed new share-related incentive programs during the first three quarters of 2014, according to PWC. (PWC, 2014)

*"For each percent up to maximum 20 percent that the EPS exceeds the target EPS, the employee gets 5 percent of one third of the maximum outcome per year. To be entitled to a maximum outcome the EPS value for each year must exceed the target EPS by 20 percent (20 x 5 % x 1/3 x 7.5 % = 2.5 % per year in this case). If the target is exceeded by 10 percent the result in this case would be 10 x 5 % x 1/3 x 7.5 % = 1.25 % per year."*

Alfa Laval has conducted 105 share repurchases amounting to a value of SEK 2.517 billion; all made during the years 2007 to 2010. Between 2008 and 2010, SEK 17 million were paid to executives in variable remuneration.

**Assa Abloy**

In 2005 Assa Abloy executives received cash for EPS targets (75 %) and organic growth (25 %). A new incentive program was launched in 2010. The new program included stock option grants in combination with EPS targets. In addition to this, executives were offered one matching stock option and up to four performance-based stock options (depending on their level of seniority) for each Series B share acquired. Assuming a fixed share price, this remuneration was estimated to amount to a maximum of 75 percent of basic salary. In 2013 the company replaced the option grants with stock-based compensation when meeting certain EPS targets. For every matching or performance share, the holder was entitled to receive one free share after three years subject to the condition that the EPS target was achieved.

In 2010, the board of Assa Abloy received mandate to repurchase shares and developed the new share-related program. In total, 13 repurchases were made between the years 2010 and 2012, amounting to a combined value of SEK 102 million.

**AstraZeneca**

AstraZeneca has a very complicated incentive system comprised by many different parts, making it difficult to overlook.

During the period 2005 to 2008, AstraZeneca had a Performance Share Plan (PSP) based on total shareholder return that included stock options. When reaching certain EPS targets the remuneration committee would award eligible executives stock options grants under the AstraZeneca Share Option Plan.

*"In order for Awards*
*to vest, the EPS of the Group must increase*
*at least in line with the UK Retail Price Index*
*plus 5% per annum on average, over a three*
*year period, the base figure being the EPS*
*for the financial year preceding the date of*
*grant, with no re-testing."*

Between 2005 and 2008 AstraZeneca also implemented a short term bonus program for "SET members" (senior executives). The awards were in part based on EPS targets (50 %) and in part on other measures related to the individual's specific area of responsibility (25 %) and a "balance of qualitative and quantitative measures that address the quality of business performance" (25 %). Senior management were also part of the Deferred Executive compensation plan, the AstraZeneca executive deferral plan and Savings and Security plan. The bonus payments were comprised both by cash and American depositary shares (ADSs).

AstraZeneca made a total of 422 share repurchases between the years 2005 and 2008 to a total value of SEK 45,7 billion. From 2009 onwards, no additional repurchases were made on the Nasdaq OMX Stockholm. According to AstraZeneca, shareholder and executive interests were aligned through the share-based bonuses. The PSP and AstraZeneca Investment Plan were implemented up until 2012. AstraZeneca then launched a new balanced scorecard, which they kept during the following two years.

The scorecard was comprised by several components. A short term incentive plan (STIP) was launched, contingent on certain "performance targets". One part of the criteria for the bonus payment of the STIP was "scientific leadership". This was a set of targets to stay at the forefront of medical expertise in three core areas; Respiratory, Inflammation & Autoimmunity, Cardiovascular & Metabolic Disease and Oncology. Financial measures formed another branch, with EPS and FCF targets as the most important objectives. The STIP also contained strategic measures, including "Return to growth measures", i.e. medium term sales targets.

The long term incentive program (LTIP) was subject to the outcome of the performance share plan (75 %) as well as on the Investment plan (AZIP 25 %). The AZIP was based on financial performance over a four-year period, including measures such as "dividend per share performance" and "dividend cover performance".

The implications of the scorecard pivot around how the different incentive programs were weighted in value for the executives. Given certain weights, a combined EPS and dividend target will yield incentives to either repurchase or distribute dividends in order to obtain maximal personal bonus for the executives. No repurchases were made on the Stockholm Exchange between 2009 and 2014.

### Atlas Copco

The incentive program for Atlas Copco executives was based on Economic value added (EVA) targets and payment were made in the form of stock options.

Atlas Copco introduced a performance related personnel option program in 2006. In total, 1 600 000 A shares could be acquired by 220 key employees. The grant of options was reliant on the development of Economic value Added (EVA) in the group. There were 4 different categories, entitled to a different amount of options. The Group President had the right to 50 000 options, Business area presidents 25 000, other members of group management and division presidents 12 500 and other key persons 6 250 options each.

The board received no variable remuneration 2006.

Performance-based option grants were introduced as a part of the compensation plan in 2008 and were present throughout the measurement period. The options had a maturity of 5 years with a strike price amounting to 110% of the 10-day average price after the publication of the fourth quarter report. The option grants were initially not contingent on the executives' continuous employment, but a restriction was introduced later years.

Members of the executive team also had the possibility to obtain a matching share for every share owned in Atlas Copco, with a 25 % discount on the average price 10 days after the publication of the fourth quarter report. As a result, executives would gain more by repurchasing shares instead of distributing dividends, since the 25% discount would yield a larger profit in absolute numbers on a higher share price. A total of 126 repurchases were made between 2006 and 2013 of an aggregated value of SEK 7.110 billion.

## Boliden

In 2005 the CEO of Boliden received cash settlements for his stock options. The incentive programs employed in later years were based on Return on CE, EBITA and debt-to-equity ratio.

In 2007 the variable remuneration paid to the President was based on the Group´s “non-restricted cash flow” and return on shareholders´ equity. For the group management team, 50% was dependent on their “personal sphere of responsibility” and the remaining 50% on group targets. The variable remuneration in 2007 amounted to a maximum of 50% of the executives’ base salary.

All 75 share repurchases were made in 2007, with a combined value of SEK 2.209 million.

## Electrolux

Electrolux had a component of the variable remuneration connected to “financial targets”. Moreover a performance share program was present from 2004 onwards. Around 160 executives were encompassed in the program. Targets for value creation were set in three levels, entry, target and stretch and depending on which level that is reached a different number of shares is allocated. Partakers can only sell shares to cover their income tax, the remaining shares must be retained two additional years. If the stretch level was reached, the program was estimated to cost SEK 180 million 2006.

Executives gain the accumulated dividend at the time of the bonus if repurchasing shares instead of distributing dividends. However, repurchases were only made one year, limiting the effect on bonuses.

In total, 61 repurchases were made 2006 to a combined value of SEK 2.192 billion.

## Ericsson

Ericsson has had a short-term variable compensation built on targets of growth of net sales, operational income and cash flow. They also had a long term incentive plan made up of three connected parts, one of those were the executive stock performance plan. It was first introduced in 2004 and eligible participants received, apart from the one matching share under the all-employee stock plan, 4 to 6 additional matching shares. Since 2010 the CEO and the president can receive up to 9 matching shares. Between 2004 and 2010 the matching shares were conditional on EPS targets. From 2011 onwards, new targets were set to match the long term goals of the company. The three pillars became net sales growth, operating income and cash conversion. There has also been a key contributor share plan that vest an additional share to key employees for every share they have in the all-employee stock plan. Ericsson made a repurchase in 2012. It was a repurchase of newly issued C-shares that were after the repurchase converted into B-shares (B-shares have 1/10$^{th}$ of the voting rights of an A-share). These shares were issued to be used in Ericsson's "Long-Term Variable Remuneration Program". The total value of the repurchase was not to be found in the data retrieved from Nasdaq, but Ericsson states in the annual report from 2012 that the total value of the shares was SEK 158.5 million.

### Getinge

2005-2009 there were call options for executives. This seem to not be the case later years. In 2008 there were two categories of people that were offered call options. One was the CEO, the other was six senior executives. Each person had the possibility to acquire 150 000 call options. The CEO's options had an exercise date 2 years after he was given the options. The other senior executives could exercise their options any given time under a two year period. The share price was calculated as a 10 % premium on the average closing price 10 days before the options were received. As an incentive to participate, 50 % of the paid premium will be distributed to participants one month prior to the allotted options expire, conditioned on that they remained employed. The options do not cause any dilution to shares since the options are tied to existing shares, guaranteed by the principal shareholder, Carl Bennet.

Getinge made no repurchases during the measurement period, 2004-2014.

### H&M

The H&M incentive programme was initiated in 2011 when Stefan Persson and Family donated 4040404 H&M shares with a value of approximately SEK 1 billion (based on the share price on 6 September 2010) to the Swedish foundation "Stiftelsen H&M Incentive Program". H&M intends to make annual contributions to the foundation, with an amount equivalent to 10 per cent of the increase in dividend in relation to the previous year's dividend, under normal circumstances. Return on the foundation's funds is to be evenly distributed to employees over time, regardless of their position or salary level. According to the general rule, the initial payment will be commenced at earliest at the age of 62.

Because of the dividend targets rather than EPS related ones, there is no rationale for executives to repurchase shares to receive larger bonuses. Additionally, H&M is a family controlled firm and the executives, apart from active owners, most likely cannot decide upon such matters as repurchases. Zero repurchases were made for the period of 2004-2014.

### Handelsbanken

Handelsbanken has as principle to only pay fix salary to their CEO and other senior executives, no variable remuneration is paid at the bank except to a very limited amount at Handelsbanken markets.

> *"The main principle in this process is that remuneration is only given in the form of fixed salary and customary benefits. Variable remuneration in the form of bonuses is not paid."*

This phrasing reoccurs between 2005 and 2007, when repurchases were made.

The only share based compensation is *Oktagonen*, which is equal to all employees. Employees get a share of the profit given that the return on equity is greater than that of peer banks in Sweden. The payment can be received when the employee reaches the age of 60. Handelsbanken made 146 repurchases between 2005 and 2007 to an aggregated value of SEK 7.502 billion.

### Investor

Investor requires management to invest a minimum of half a year's gross salary under the long term incentive program. The CEO needs to invest one year's gross salary. The long term incentive program consists of two components, a stock matching plan for all employees and a performance-based share program for senior executives. Under the stock matching plan, employees are given the opportunity to invest up to 15 % of their base salary in investor shares. Three years later they receive two matching options for each share acquired under the program, as well as an option to acquire an additional share for 10 SEK. Senior management have the right to invest up to 38 % of their base salary in the program. Furthermore, senior executives partake in the performance-based share program. To receive the maximum number of matching shares allotted to each executive, the average total return including reinvested dividends must exceed the interest on a 10 year government bond by 10 percentage points. The acquisition price for these shares are 50 % of the acquisition price for employees.

Investor is aware of the potential incongruity between the distribution of dividends and matching shares and solves this by taking dividends into account when vesting matching and performance shares.

> *"At the time when Matching Shares and Performance Shares are acquired, employees are entitled to remuneration for dividends paid during the vesting period and up until the acquisition date. This is done so that the program will not be affected by dividends and to avoid the risk that a decision on dividends is affected by the long-term variable remuneration program"*

Investor has made 43 repurchases to an accumulated value of SEK 1.055 billion. Repurchases were made all years but 2005 and 2011.

### Kinnevik

Kinnevik did not have any incentive plan connected to share price or EPS until 2008. However, they implement a complicated one thereafter. Six executives and thirteen key employees received shares based on how well they fulfilled certain conditions during the measured period. The conditions were the total return of the Kinnevik class B shares, the average annual development of the net asset value including dividends, the average annual return within the venture business areas, the average normal return on working capital at Korsnäs and the average EBITDA margin at Korsnäs in relation to a peer group. All repurchases where made 2008. The total value of the repurchases was SEK 279 million.

### Lundin Petroleum

Lundin Petroleum had a phantom option plan, meaning that they had an option connected to the stock price, but received the potential payoff in cash rather than shares. At the Annual general meeting 2014 a new long term incentive program was approved for group management and a number of key employees. Shares were granted conditioned on performance over a three year period. The performance targets was based on share price, growth and dividends, i.e. total shareholder return and was compared to a peer group of companies. Participants could receive a maximum of 300% of their gross salary worth of shares under the incentive program.

Nevertheless, the logic is equivalent to that of normal options. If earnings are used to repurchase shares rather that distributing dividends, the share price will not drop with the dividend amount. This increases the value of a call option, since the actual price is more likely to be higher than the strike price.

29 repurchases were made to a combined value of SEK 532 million. Repurchases were made all years except 2009 and 2011.

### MTG

MTG has had incentive programs all of the last ten years, with stock options for executives and "key employees". In 2005 the Annual general meeting approved a new incentive system under which key employees and executives could purchase options and warrants on "market terms". The program has then evolved to a performance based system, where 140 employees can, under certain conditions, receive shares for free. Between 2010 and 2013 100 key employees were affected. The conditions include that the employee has made a personal investment in the company beforehand. The number of shares received depend on "certain goals" relating to a normalised measure of capital employed and in which division the employee is working in. The shares could not be sold until three years after the employee had received them.

MTG bought back shares 2007 and 2008. In total there were 22 repurchases to a value of SEK 623 million.

### Nokia

There was both a short-term and a long-term incentive program at Nokia.

The short-term incentive program was an annual cash award rewarding reaching a mix of corporate, business unit and individual level performance targets. The long-term incentive program was based on "business performance measures" and share price. To a limited extent restricted shares were used to attract and retain talent at the company, mainly in the US.

Within the long term equity based incentives there were both stock options and matching shares bestowed to executives if at least one of the financial performance targets were met.

Nokia did not make any repurchases during the measurement period 2005-2014.

### Nordea

During 2005 and 2006, none of the incentive programs were "based on the value of the Nordea share" and both programmes were capped in value, according to Nordea's annual report. From 2007 and onwards, Nordea had a long-term incentive program, where participating employees were able to receive shares for free, or to a “substantially lower price” than the current market price. The repurchases that Nordea made were carried out in 2005, before the stock related incentive program was introduced. In 2005 there was an executive incentive program that comprised around 350 managers. There were three performance criteria; Economic profit, percentage change in total income less percentage change in total expenses and change in total expenses 2006. Nordea repurchased shares for close to 10.5 billion SEK in one year, with the purpose of returning funds to the shareholders and increasing earnings per share in the long run.[30]

### Sandvik

Sandvik has had an incentive program for the last nine years, but not in 2005. In 2006, the board decided to initiate a program that was “cash-settled share-based”. From 2011 and onwards, the long-term incentive program included 350-400 senior executives. The incentive program for 2014 gave the executives opportunity to receive shares, both matching shares and performance shares. If employees held one share for three years, they were entitled to a matching share for free. Depending on how certain goals were met, they could also get a number of performance shares for every share they already owned. The goals that needed to be met in order to receive performance shares included a certain level of EPS. Sandvik did not repurchase any shares during the ten year period between 2005 and 2014.

### SCA

The incentive program that was in place during 2005 was not related to SCA’s stock, neither were the goals of the employees, nor the variable compensation. From 2006, the incentive program was comprised of two parts, one related to the cash flow of the company, and one related to the share price. To obtain maximum compensation, the share of SCA had to perform well in comparison to other comparable firms’ share price. SCA used a measure called Total Shareholder Return (TSR) and compared this to a TSR index which was made up by competitors and consumer companies. SCA have not repurchased any shares during the measurement period 2005-2014.

[30] (Nordea, 2005)

## SEB

The incentive program that SEB had reminds of SCA's. During the ten year period, SEB has had programs with matching shares and performance shares that are given to employees who have already invested in SEB shares. The number of shares that the employees received depended on the TSR measure, compared to the long-term risk-free interest rate (10 year Swedish government bond) and TSR compared to SEB's competitors. SEB repurchased shares for a value of over 3.1 billion SEK from 2005 to 2014. No repurchases were made 2005 and 2009.

## Securitas

Securitas did not have a bonus or incentive program until 2010. Thereafter, a cash- and stock-based program was launched, meaning that some employees had a variable salary which consisted of both cash and stock compensation. The cash was paid out immediately after the year ended, and made up two thirds of the variable salary. The other third came in the form of shares that were given to the employee. The criteria for bonus were tied both to individual and the firm's performance, however it is not stated exactly what the goals or criteria were. Securitas did not repurchase any shares during 2005-2014.

## Skanska

During the entire measurement period, Skanska has had incentive programs covering 40 000 employees, including key employees and senior executives such as the group CEO. The program encourages employees to invest in the firm's shares, by offering free shares to existing shareholders. For every four shares that employees owned, they could (after holding them for three years) receive one share for free. If certain goals were achieved, the employee could receive an extra number of shares, at no cost. Skanska repurchased shares for just under 2 billion SEK between 2008 and 2014.

## SKF

Since 2008, SKF had an incentive program that made it possible for up to 310 key employees, including the top management, to receive shares of SKF, free of charge. The degree to which the goal of Total Value Added was reached provided the basis for how many shares that were given to the employees. There was a maximum number of shares that different employees could receive – the group CEO could be vested up to 10 000 shares per year, at no cost. There was no share repurchases from 2005-2014.

## SSAB

In 2011, a share related incentive system was implemented. The program was aimed towards a maximum of 100 employees, including the CEO and other executives. The compensation is based on the total return of the SSAB share, compared to a group of SSAB's competitors. The variable salary was paid out in cash. SSAB did not repurchase any shares during the period 2005-2014.

## Swedbank

Swedbank had an incentive program during the period 2010-2014, which made it possible for ca 6400 employees to receive stock options, depending on Swedbank's performance. Before that, the variable salary did not depend on the performance of the firm's share. However, two thirds of the variable salary went into the profit sharing system called Kopparmyntet. The Kopparmyntet foundation invested the profit, mainly in Swedbank shares. This means that the employees had an interest in how the share price was developing. It should be noted that the money invested could not be received until six years after the initial investment, meaning that a temporary rise in share price would not necessarily give the employees a significantly higher salary, as they could not decide to sell the shares at any time. The aim was that employees remained as long-term owners of the firm.[31] Swedbank repurchased shares to a value of over 5,5 billion SEK, all in 2011. Meanwhile, Swedbank had a long term share based incentive program named Eken. All employees except group executive management could participate.

> *"Group executive Management is not included in the individual variable compensation programme, only in Eken. The five highest-paid employees in Group executive Management (top five) are not included in either the individual programme or Eken. They receive no form of variable compensation. "*

Every share purchased under the program had to be kept for 3 years. Thereafter the employee was vested one matching share for free. Swedbank compensated its employees for missed dividends by granting additional shares equal in value to the lost dividend.

[31] (Cervenka, 2009)

> *"Since the performance rights are not entitled to dividends, holders will be compensated with additional performance rights corresponding to the dividends that the common shares qualify for until the delivery date. "*

**Swedish Match**

During the years 2005-2014, Swedish Match repurchased shares for 19.5 billion SEK. There were incentive programs in place for all ten years, both a short-term (one year) and a long-term program, where the "performance period" was not shorter than three years. The short term incentive program was affected by the rise in EPS.

The long-term variable salary of group management team is dependent upon total group operating profit improvements 2015 and 2016 compared to the year 2014.

Swedish match has made repurchases all the years 2005-2014.

**Tele2**

Tele2 has had share related incentive programs for all of the ten years. There have been both short term and long term programs, and Tele2 had the intention to make the variable salary a larger part of the total salary for the senior executives. The incentive program generally required that employees owned shares of Tele2. Thereafter they received stock options, free of charge. There were goals that needs to be reached for the employees to receive the stock options. For 2014, there were different goals, including a TSR goal of >0 %, two return on capital employed (ROCE) goals of 9 % and 12 %, for different levels of compensation. All of Tele2's repurchases were made in 2008, when shares for 459 mn SEK were repurchased off the market.

**TeliaSonera**

From 2010 to 2014, TeliaSonera has had incentive programs related to EPS and TSR. Before that, no share related program existed. If EPS and TSR targets were reached, the participants ("certain senior executives") in the program received TeliaSonera shares, free of charge, as compensation. TeliaSonera's first repurchase of shares was made in 2011, when the firm repurchased shares worth 9.9 billion SEK. They continued with significantly smaller repurchases in 2013 and 2014, for a total of 15 mn SEK.

TeliaSonera launched a new incentive program 2011 including 100 key employees. Participants could receive up to 37,5% of their base salary in shares given that they remained employed throughout the three year measurement period. The shares were conditional on EPS targets and Total shareholder return. The measures were equally important, providing the foundation for 50% of the payment respectively.

However, TeliaSonera decided to exclude the group management from the program.

> *"Remuneration to the Chief Executive Officer (CEO), the Executive Vice President (EVP) and other members of Group Management consists of base salary, certain taxable benefits and pension benefits. As per December 31, 2011, TeliaSonera did not operate any share-related incentive program in relation to the CEO, the EVP and other members of Group Management. "Other members of the Group Management" refers to the 8 individuals who are directly reporting to the CEO and which, along with the CEO and the EVP, constituted the TeliaSonera Group Management on December 31, 2011."*

There were therefore, no incentive for the group management to repurchase shares of personal interest.

### Volvo

Volvo had two incentive programs for executives in 2005. Share based incentive program and stock option programs. The stock option program required that the employee continued working at the firm throughout the incentive period in order to be eligible for remuneration. The allocation of shares was conditioned on non-financial metrics.

The Share-based program 2005 included certain senior executives within the Volvo group and was tied to "non-market based financial goals". The payment was made party in cash, party in shares. If the financial goals were met, an estimated SEK 70 million would be paid out to the executives. The total cost for the incentive programs 2005 amounted to SEK 192 million compared to SEK 66 million 2004. The provision for stock options and incentive programs was SEK 277 million.

Volvo made all their repurchases in February 2005, to a total amount of SEK 46 million.

In 2014 the Annual General Meeting approved a new long-term incentive program including 300 senior executives. Executives were encouraged to invest a portion of their salary in Volvo Shares and retain them for three years. As a general rule, participants are granted one matching share for each share invested given that the return on equity is above 10% 2014, 11% 2015 and 12% 2016 respectively. A maximum of 7 performance shares can be allotted the CEO, 6 performance shares for members of the Group Executive team and 5 for other participants. These are subject to return on equity numbers of 25, 26 and 27 % for the years 2014-2016.

# 5. Analysis

To go further than only knowing if a senior executive could benefit from repurchases in general, we will now focus on the firms that have made the largest repurchases (in absolute numbers and in relation to total market capitalisation) to evaluate if these large repurchases did enhance the senior executives' chance of receiving a bonus, and if that could have been a motive for doing the repurchase.

## 5.1 Swedish Match

Swedish Match has repurchased shares for SEK 19.5 billion during 2005-2014. 2006 was the year when it repurchased shares for the largest sum, almost SEK 3.7 billion. The board of directors had a mandate to repurchase 10 % of the outstanding shares during 2006. Swedish Match repurchased 32.9 million shares during 2006, according to their annual report. The number of outstanding shares at the first repurchase of the year (January 2th 2006) was 305.8 million.[32] Per December 31st the number of outstanding shares was 274.4 million according to the annual report, after repurchases and selling of own shares. The net decrease in shares outstanding during 2006 was 31.8 million, which is close to 10 % of the number of shares at the beginning of the year.

As stated in the annual report from 2006, the variable salary of the CEO and other senior executives in the Swedish Match group was in part dependent on growth in EPS. The CEO would receive a bonus conditional on growth (compared to the year before) in EPS being larger than 5 %. The size of the bonus was dependent on much EPS increased. The upper limit was set at 20 %; above that no extra bonus would be given to the CEO.

It is difficult to calculate exactly what impact the share repurchases has on the firm's earnings. The decrease in assets come with a cost – the money used to repurchase shares could be invested in something else, which could increase total earnings. The reason why this impact is hard to calculate is that the opportunity cost is in reality impossible to know, since

[32] (Swedish Match, 2015)

we cannot know what return Swedish Match would have had on the assets used to repurchase shares (as an outsider, we do not know in what way they would have been used either). However, if one assumes that the total earnings for that year would not be decreased due to the repurchases of shares (this is a reasonable assumption in the short term, especially for firms with lot of cash on their balance sheet), it is clear that repurchases can have a large impact on EPS. If the number of shares outstanding were to be 10 % lower (compared to if no repurchases would have been made), the EPS would be 11 % higher.

$$\frac{\Delta\ Earnings}{\Delta\ Shares\ outstanding} = \frac{1}{0.9} = 1.11 \ldots \approx increase\ of\ 11\%$$

It should be noted that Swedish Match in its annual report states that the EPS measure is calculated with the average number of outstanding shares during the year. This means that a repurchase would immediately increase EPS. This is probably a much easier way to increase EPS, than to do it through making a return on an investment. This is especially true in the short term – an investment made at the end of the year would be unlikely to yield a return before the end of the year (when the EPS is calculated).

The variable salary for the CEO of Swedish Match was limited to 35 % of the fixed salary. Swedish Match does not state it explicitly in the annual report, but the CEO received the maximum amount, 35 %, as variable salary. In numbers, his fixed salary was 5.899 million SEK, and his variable salary was 2.065 million SEK.

2006 stands out as the year when Swedish Match repurchased an unusual large amount of shares, however the repurchases made during the other years could still have a significant impact. On average, Swedish Match has repurchased shares for over 2 billion SEK per year. Comparing the amount for which the firm repurchased shares during a specific year, with the average market capitalisation for the same year, one can see that the repurchases constitutes an average of 5.59 % of the market capitalisation.

## 5.2 AstraZeneca

AstraZeneca is the company among OMXS30 that have repurchased shares for the largest value during 2004-2014. In total, 45.7 billion. SEK was used to repurchase shares between 2005 and 2008.

As mentioned in the result section, AstraZeneca had various incentive schemes for the duration of the repurchasing period, and executives participated in a number of them.

AstraZeneca executives therefore had a lot to gain from reaching EPS targets set by the remuneration Committee, whom acknowledged that share repurchases were a part of EPS growth.

*” Earnings per share before exceptional items grew by 41% from $2.01 in 2004 to $2.91 in 2005.We estimate that the share repurchase programme added 8 cents to earnings in 2005.”*

On the Stockholm exchange, AstraZeneca repurchased SEK 6.7 billion. 2005. The remuneration committee estimated that total repurchases, made on all stock exchanges, had increased EPS by 9%, while our calculations on the Stockholm Exchange alone indicate that 37% of the market cap value was used to repurchase shares. Given the assumption of constant earnings in the short run, this results in an EPS increase of 59%.

$$\frac{\Delta\, Earnings}{\Delta\, Shares\ outstanding} = \frac{1}{0.63} = 1.587 \ldots \approx increase\ of\ 59\%$$

However it is important to bear in mind that AstraZeneca operates at three different stock exchanges, the Stockholm, London and New York exchanges. The impact on earnings per share will be lower, due to the fact that shares outstanding has not necessarily changed on other exchanges leading to a smaller relative change in the denominator, shares outstanding.

Subsequent years, 2006 and 2007, more repurchases were made to a value of SEK 15 billion. and SEK 21 billion. respectively on the Stockholm Exchange. These are by far the largest repurchases made between 2005 and 2014 within OMXS30.

Executives were part of both the short term bonus program and the AstraZeneca PSP that granted shares and cash mainly when reaching EPS targets. The short term bonus payment alone constituted more than 100% of base salary for one executive director all years 2005-2008. Clearly, there has been much to gain personally from repurchasing shares at AstraZeneca these years.

AstraZeneca stands out from the rest of the sample by having a combination of large repurchases and strong personal incentives for executives to enhance EPS.

## 5.3 TeliaSonera

TeliaSonera repurchased shares for over SEK 9.9 billion in 2011, all in one day, the 5$^{th}$ of April. This corresponds to roughly 4,5 % of the firm’s total market capitalisation. On the annual general meeting, it was decided to include 100 employees in a long-term variable salary program. Half of the variable salary for these 100 people was based on EPS targets. The senior executives of the group was not included in the program, consisting of the CEO, the vice CEO and eight other employees that report directly to the CEO.

According to TeliaSonera's annual report for 2011, the repurchase was done after careful evaluation of the firm's expected future cash flows and its balance sheet projections. TeliaSonera stated that the strong cash flows allowed the board of directors to grant the repurchase.

TeliaSonera has, by not including the senior executives in its incentive program, minimised the risk of shares being repurchased for reasons related to the senior executives' bonuses.

## 5.4 Boliden

In 2007, Boliden repurchased shares for SEK 2.2 billion, or 5.51 % of the shares (according to Boliden's annual report). This was done during a period from May through November, spread out over 75 repurchases.

The President's variable part of the salary was based, in part, on the return on shareholders' equity. The same case can be made here as with repurchasing shares to enhance EPS. By changing the capital structure through share repurchases, the equity part is decreased. This, ceteris paribus, increases return on equity:

$$\frac{Net\ income}{Shareholders'equity \downarrow} = Return\ on\ equity \uparrow$$

Again, this is under the assumption that all else remains equal. Still, in a short-term perspective, decreasing shareholders' equity would be a quite direct way of increasing ROE. This is clear if the firm uses an average of the shareholders' equity in the beginning of the year, and at the end of the year. Then, the timing of the repurchases are not considered, which means a repurchase could be made close to the end of the year, thus immediately increasing ROE. Conversely, an investment in the end of the year would probably not give an immediate return. This does certainly not mean that one can be certain about the motives behind the share repurchase, and Boliden distributed the repurchases over a course of about six months. Boliden does not offer a detailed explanation to the repurchasing decision in their annual report, only than that the board had discussions about the firm's capital structure. This resulted in the board's proposal regarding share repurchases, which was submitted to the annual general meeting in 2007.

The president of Boliden received a 25 % bonus (SEK 1.1 million), on top of his SEK 4.4 million fixed salary. The “other senior executives” is comprised of nine employees. They received bonuses of 15-22.5 % of their fixed salary, a total of SEK 2.665 million added to their combined fixed salary of SEK 13.812 million.

## 5.5 Nordea

In 2005, Nordea spent close to SEK 10.5 billion on repurchasing approximately 5 % of the total shares.[33] The bank stated, in a press release, that the repurchases were a way to increase earnings per share in the long run, but it seems clear that it had nothing to do with reaching EPS targets so that senior executives would receive bonuses.[34] The incentive program at Nordea was not designed in a way for that to be possible. The bonuses were dependent on (as mentioned in the results section) economic profit, percentage change in total income less percentage change in total expenses, and change in total expenses the year after. Further, Nordea’s annual report explicitly states that all incentive programs 2005 were detached from the Nordea share price.

## 5.6 Swedbank

Swedbank made a very large repurchase, SEK 5 billion in 2011, which corresponded to 5.35% of total shares outstanding. Given the assumption that the money spent on repurchases would have yielded no return that year, earnings would have been stable but there would have been 5.35% less shares.

$$\frac{Earning}{0{,}9465 * Shares\ outstanding} = 1{,}0565 * EPS$$

With repurchases EPS rise with 5.65 % without no real performance improvement at the firm. However, the board and the top executives had no incentive to buy back shares for personal gain.

The board of directors had only fixed compensation in 2011. The group executive management had fixed compensation and were part of the general program Eken, except for the top five paid executives. However no executives had individual incentive programs but they received pension unlike board members.

[33] “approximately 5 % of the total shares”, according to Nordea’s annual report from 2005
[34] (Nordea, 2005)

The CEO Michael Wolf, among the five highest paid in the company, had a fixed remuneration of SEK 8 million and no variable remuneration.

The board was given authority to repurchase up to 10 per cent of to Swedbank's total number of A and/or preference shares in 2011. The bank motivated the decision by stating that this would allow them to "effectively manage Swedbank's capitalisation within the framework of its risk appetite and capitalisation target". This number includes 1.5 million C-shares, which were issued and repurchased in May 2011 with the purpose of hedging future obligations in the form of share awards, connected to the companies' incentive program. Swedbank furthermore assessed that additional share repurchases were required to secure the bank's commitment to deliver shares under the remuneration programs of subsequent years.

Conjointly, it appears improbable that repurchases were guided by personal motives since the people influencing the decision of repurchase had nothing to gain from them.

## 5.7 Atlas Copco

When Atlas Copco made the 3.7billion. SEK repurchase in 2006 it corresponded to 18 414 200 B shares, which was 2.9% of the market capitalisation. According to Atlas Copco the repurchases were made "to be able to adapt the company's capital structure to its capital needs and thus contribute to increased shareholder value", but this is not specified further.

As mentioned in the results the CEO had 50 000 stock options. According to the fair value calculation made by Atlas Copco with a Black & Scholes model, this corresponded to around SEK 1.8 million. Other executives had half the number of options the CEO had. The board had no variable remuneration and could therefore not gain personally on the repurchases.

The repurchases of 2.9% of all shares affect options given that they do not take dividend into account. If distributing dividends was the alternative, 2.9% of the shares' worth would have been distributed and theoretically share price would have been lowered with the same amount. This would reduce the value of the options, which especially for the CEO has a high value. On the other hand, it represents just 10% of his total remuneration of SEK 18 million 2006.

Moreover, the actual repurchase would only increase his 50 000 with the dividend amount. With an average share price of roughly 200 SEK per buyback the gain on each option would be 5.8 SEK. The total amount is 290 000 SEK, representing around 1,5 % of the CEO's total remuneration. Additionally, SEK 2.672 billion was spent on dividend distribution, a 41%

increase from the year before. Altogether, it looks as it is very unlikely that the repurchases were driven by personal gain.

# 6. Conclusions

## 6.1 General conclusions

To answer the research question posed in the introduction: No, it cannot be stated that bonus-driven repurchases are common among the firms in the OMXS 30 index. As seen in the results, about 6 % of the firms' earnings have been spent on share repurchases, as compared to 54 % of the firms studied in the US. Obviously, we cannot know the true motives and explanations behind others' actions, but there are not many cases where firms have both: repurchased a large amount of shares, and had incentive programs designed so that senior executives would earn a bonus from doing the repurchases. It seems clear that bonus-driven share repurchases are, compared to the USA, a very small issue in Sweden. Firms are not repurchasing shares to nearly the same extent as many American firms. It is difficult to make the case that the incentive programs have a large impact on the repurchasing behaviour. Incentive programs related to EPS and/or share price in some way are common in Sweden, but large repurchases are less common, and the combination of both even less so. Even if the phenomenon of share repurchases is significantly smaller in Sweden than in the US, it should be noted that there are some occasions where repurchases are made, where personal financial gain could be an incentive for carrying out the repurchases. Thus, the existence of the issue cannot be ruled out.

Some of the firms making the largest repurchases have not had incentive programs rewarding executives or board members for reached EPS targets or share price targets, during the years of repurchases.

One firm that separates itself from the rest is AstraZeneca, which repurchased shares for significantly larger sums than the other firms. At the same time, AstraZeneca had incentive programs with targets that repurchases could have an impact on. It also repurchased many shares on other stock exchanges, as described in the annual reports. AstraZeneca is primarily listed on the London Stock Exchange and its senior executives are not Swedish, and they are employed by the British firm, AstraZeneca PLC.

One possible reason why the pattern is not the same in Sweden as in USA could have to do with legislation. It is, as mentioned, the board of directors that is given the permission to repurchase shares. In public Swedish firms, the CEO and chairman of the board cannot be the same person. Simultaneously, the CEO is usually the employee that can receive the highest bonus. Board members usually have a fixed remuneration only. This gives a healthy distribution of decision-making power and promotes less incongruity between owners and influential employees.

In USA, on the other hand, it is usual that the same person holds both the CEO position and is the chairman of the board. According to research done by Russell Reynolds Associates (a recruitment firm) in 2012, 56 % of the S&P 500 firms had the same person at both positions.[35]

We do not know how the board of directors' decision making process looks like, but the CEO and CFO is probably involved on some level when making decisions to repurchase shares, since they have information about the business that the board typically does not.

As with all regulation of firms that are not state owned, one could argue that the state should not intervene. Even if it would be proved that having two separate persons as CEO and chairman, some claim it should not be illegal to make bad decisions as an owner of a firm. Regardless of opinion in that matter, it is reasonable to assume that the separation of powers is an obstacle to making large share repurchases, compared to if the CEO can in a direct way increase his/her bonus by deciding to repurchase shares.)

## 6.2 From an owner perspective

It is, as mentioned, the owners of a firm that decide whether the board can repurchase shares at all, hence it would seem like a small problem from an owner's point of view. If they did not want any repurchases of the firm's own shares, they could decide that on the general annual meeting. At least, that is the case for active investors. Many people that are small investors will not have the voting power to change decisions on either share repurchases or incentive programs.

## 6.3 From a regulatory perspective

The current situation in Sweden is far from the one in USA, in terms of the scale in which share repurchases are made. However, this could change in the future. As there are voices raised for regulations regarding the repurchases and the stock related incentive programs in the USA, it could become relevant for Sweden as well (especially since the current government already wants to force firms to have gender-equal boards, and the current

[35] (Tribbett, 2012)

compensations for CEOs are upsetting to some).[36] [37] On the other hand, the point could be made that firms should be self-governing and do what it chooses with its assets.

Regardless, the development should be followed and studied, to avoid possible problems in the future. It is of course possible (and by many, desirable) for this issue to be self-regulating. As seen in some cases, firms are hedging towards the risk of bonus-driven repurchases, where senior executives' bonuses is not dependent upon EPS or related to the share in any other way.

## 6.4 Problematisation

The study is conducted on reliable information, from the firms' own annual reports, and from official data from the stock exchange itself. The major threat to reliability is, as usual, the risk of human error. It lies in the interpretation of the data, primarily the firms' incentive programs. It is possible that we have not interpreted everything correctly. However, through meticulous reading and discussion, we are certain that we have few errors regarding this.

The validity of the study should be regarded as relatively high. All the incentive programs are examined and in combination with the repurchasing behaviour, conclusions can be drawn regarding the issue of bonus-driven repurchases. Again, we cannot know the true motives behind a repurchase (and do not claim that we do), but it is safe to assume that relatively small repurchases (that have a very small impact on for example EPS), or repurchases that are made when no share-related incentive program exists, are not made with the motive of the senior executives receiving a bonus payment.

General conclusions for all public firms in Sweden cannot be drawn from this study, and certainly not conclusions about firms in other countries. In that way, the generalisability of this study is fairly low. Still, conclusions drawn should be of interest since it is a study of the thirty most traded stocks on the Stockholm stock exchange.

## 6.5 Suggestions for further research

To have a thorough knowledge about the situation in Sweden, in terms of share repurchases and incentive programs, it would be needed to study all the publicly traded firms. Due to the nature of the subject, a deeper, more qualitative study could be difficult to complete.

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[36] (Lazonick, The Financialization of the U.S. Corporation: What Has Been Lost, and How It Can Be Regained , 2013)

[37] (Sveriges Television, 2009)

Obviously, if a senior executive recommended share repurchases in order to earn money from it personally, it could be difficult to get them to admit it or even discuss it.

Further research should be in the interest of both owners and legislators. Owners want to have an efficient firm where senior executives' motives are in line with the owners', and this is where the design of the incentive programs are essential. Since legislators in Sweden are no strangers to put firms and banks under regulation (such as the splitting of the CEO and chairman role, the wish of gender quotas in the boards of public firms, and capital requirements for banks to name a few), they should be interested in the subject.[38] [39] In order to make rational decisions, one has to have relevant information; this is true both for shareholders and legislators.

[38] (Finansinspektionen, 2014)
[39] (Olsson & Runblom, 2014)

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The annual reports of all firms were used in the study. Those are available to download on every firm's respective website.