

# S Y M P O S I U M

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## SOVEREIGN WEALTH FUNDS: A STRATEGIC GOVERNANCE VIEW

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**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—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 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.**

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 privatization, changes in state and nonstate relationships, new industrial policies, and the dismantling of large diversified business groups. As Musacchio and

Lazzarini (2014) and Bruton, Ahlstrom, Stan, Peng, and Xu (2015) have documented, we are entering a new era of state capitalism where governments tend to share their ownership with nongovernmental 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 (e.g., short-term shareholder value maximization) and political pursuits (e.g., industrial policy, geopolitical positioning, national security). Sovereign wealth funds such as Singapore’s Temasek, the China Investment Corporation (CIC), and Norway’s Government Pension Fund Global (GPF) 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 multibillion-dollar assets. This

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excludes other types of organizations such as state-owned enterprises (e.g., Gazprom), pension funds (e.g., CalPERS), and private equity investors (e.g., the Blackstone Group).

It is important to 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% of the world's reserves (mostly in foreign exchange and gold); emerging and developing economies held the remaining 34%. A decade later, the tables have turned. Emerging and developing economies now hold 60% 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 trillion in 2011 (Truman, 2012). These systemic global imbalances account for some of the features of today's global financial scenario. On 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 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, Southeast Asia (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.

SWFs adopt differing governance structures to manage enormous pools of capital and to engage in strategic investment relationships with firms and managers from a wide array of industries and foreign countries. While there are a handful of excellent compilations on SWFs (Balding, 2012; Bernstein, Lerner, & Schoar, 2013; Castelli & Scacciavillani, 2012; Clark, Dixon, & Monk, 2013; Megginson & Fotak, 2015), existing research tends to take a macroeconomic or financial perspective or is otherwise highly dispersed across the different disciplinary fields. Therefore, there is a strong need to integrate the "siloeed" knowledge on these global institutional investors and, more important, 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, their 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 US\$6 trillion<sup>1</sup> as of the end of 2014; their total assets surpassed those of hedge funds and private equity combined in less than a decade (Megginson & Fotak, 2015). Thus, SWFs are clearly shaping today's global financial landscape, and their presence will surely increase in coming years. That notwithstanding, these organizations have not been adequately studied, and we need to integrate all we know about them into a cohesive framework to help managerial scholars, practitioners, and policymakers better 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 GPF (the world's largest SWF, managing approximately US\$900 billion in assets) owns 3% of all publicly listed shares in Europe. Moreover, GPF is part of the global strategic governance movement of shareholder activism, and it has the potential to affect 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% of all private equity investments made between 2003 and 2007 (Bernstein et al., 2013).

Fourth, SWF investment trends are not geared only toward the advanced industrialized world; they have also begun to shift toward strong "South-South"

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<sup>1</sup> Institutional sources used include Sovereign Wealth Centre (London), ESADEgeo (ESADE Business School, Madrid), SovereignNET (The Fletcher School, Tufts University, Medford, MA), and Sovereign Investment Lab (Bocconi University, Milan).

(non-OECD countries) investment relationships. For example, Singapore's Temasek holds more than US\$17 billion in Chinese bank stock. Moreover, four out of the five largest deals in 2013 were South-South investments. Last, some SWFs are leading the economic transformation of their own national economies. For example, the Mubadala Development Company, which was established by the government of Abu Dhabi, has developed a world-class aerospace industry through foreign strategic investments and alliances and now supplies 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, 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 the new state capitalism. And despite being state-owned investors, their capacity to intervene in private firms is equal to that of other institutional investors, though their incentives are likely to be different. These state owners adopt a unique type of governance: They are equity owners that cannot exercise sovereign regulatory or supervisory powers in the organizations in which they invest. SWFs are simply one investor among many, 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 their 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 the 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 we conclude by identifying promising areas of future research and the possible managerial implications for SWF practitioners.

## WHAT WE KNOW ABOUT SOVEREIGN WEALTH FUNDS

Table 1 includes a summary of the existing body of research on SWFs in the finance,<sup>2</sup> strategy, political economy, economics, international law, and organizational theory fields. Upon reviewing this research, we conclude that, while there is increasing interest in the topic, current literature remains fragmented by discipline. To partially amend this, we uncover three consistent findings from our analysis of SWF literature. First, these organizations are highly heterogeneous in terms of size, geographic origin, geographic destination, funding sources, and policy purposes (as shown in Table 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 (Capapé & Guerrero, 2013).

Second, in terms of financial performance, SWFs' short-term influence over investee firms is comparable to that of other institutional investors, even though SWFs are often portrayed as "barbarians at the gate" (Reed, 2009). Some scholars have found that SWF investment announcements cause positive short-term stock reactions (Bortolotti et al., 2013; Dewenter et al., 2010; Kotter & Lel, 2011). However, their long-term impact is neutral in terms of absolute returns (Bortolotti et al., 2013) 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. (2013) refer to SWFs' inability to keep up with the performance of peer institutional investors as the "SWF discount," alluding to these organizations' most salient feature: 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,

<sup>2</sup> For a detailed literature review on SWF asset allocation and geographic and industrial investment patterns, and the impact of SWF investment in target companies, see Megginson and Fotak (2015).

**TABLE 1**  
**Main Findings on Research on Sovereign Wealth Funds**

Discipline	Findings
<b>Finance</b>	<ul style="list-style-type: none"> <li>● <b>Short- and long-term impact on target companies:</b> SWFs' investment announcements cause positive short-term stock reactions (Bortolotti et al., 2013; Dewenter et al., 2010; Kotter &amp; Lel, 2011), but they are lower than those from their private counterparts (Bortolotti et al., 2013), reflecting an "SWF discount." The long-term impact on target companies is negative in terms of abnormal returns (Karolyi &amp; Liao, in press), Sharpe ratio (Knill, Lee, &amp; 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 &amp; Lugo, 2014). Paradoxically, however, firms with SWF investment experience higher debt costs (Borisova, Fotak, Holland, &amp; Megginson, 2015).</li> <li>● <b>Investment strategies:</b> Mixed findings. The evidence shows SWFs' preference for both stable (Karolyi &amp; Liao, in press) and distressed companies (Kotter &amp; Lel, 2011). SWFs also select target companies aligned with national industrial-planning strategies (Dyck &amp; Morse, 2011; Haberly, 2011) or based on political bilateral relations (Knill, Lee, &amp; Mauck, 2012b). Other findings demonstrate that SWF portfolios do not diverge from mutual funds' strategies (Avendaño &amp; Santiso, 2011) but show certain home bias (Bernstein et al., 2013; Chhaochharia &amp; Laeven, 2008). SWFs do not show a systematic preference for specific industries and tend to diversify in equity markets (Miceli, 2013).</li> </ul>
<b>Strategy</b>	<ul style="list-style-type: none"> <li>● SWF investment practices may spread to the rest of private domestic investors, as shown in the Norwegian case (Vasudeva, 2013).</li> <li>● Governments should design SWF portfolio allocation (financial assets) taking into account underground (minerals, oil, and gas) assets (van den Bremer, van der Ploeg, &amp; Wills, 2013).</li> <li>● 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, &amp; Mauck, 2013).</li> <li>● Company target and recipient countries will benefit (lower transaction costs) from coordinated actions with respect to SWF investments (Rose, 2009).</li> </ul>
<b>Political economy</b>	<ul style="list-style-type: none"> <li>● SWFs represent a new mode of state capitalism; they enable governments to exert soft control through minority stakes (Fotak, Gao, &amp; Megginson, 2013; Musacchio &amp; Lazzarini, 2014). SWFs as a means of new state capitalism might allow governments to exert control in nonstate companies through financing (Milhaupt &amp; Zheng, 2014).</li> <li>● 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, &amp; Sung, 2013; Gelb, Tordo, &amp; Halland, 2014).</li> <li>● SWFs engage in idiosyncratic political accountability (Clark et al., 2013; Gelpert, 2011); as a heterogeneous group, SWFs have been created across a wide political spectrum, ranging from the most to the least democratic countries.</li> <li>● SWFs serve ruling elites to maintain their privileges (Pistor &amp; 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).</li> </ul>
<b>Economics</b>	<ul style="list-style-type: none"> <li>● 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).</li> <li>● 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 &amp; Glick, 2009; Castelli &amp; Scacciavillani, 2012).</li> </ul>
<b>International law</b>	<ul style="list-style-type: none"> <li>● 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).</li> <li>● Sovereign wealth immunity in the United States 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 &amp; Milhaupt, 2008).</li> <li>● On the contrary, evidence shows that SWFs have acted thus far as model investors (Epstein &amp; Rose, 2009). Thus, imposing additional obstacles to SWF investments in the United States seems unreasonable. Discouraging SWFs from investing in the United States will impose political and economic opportunity costs larger than the natural security benefits.</li> </ul>
<b>Organizational theory</b>	<ul style="list-style-type: none"> <li>● Governments use SWFs as institutional innovations (Weiss, 2009). Clark et al. (2013) foresaw two different paths for SWFs: adopting global financial standards or transforming into nation-state development institutions.</li> <li>● The Norwegian SWF GPFM 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).</li> <li>● Truman (2013) simplified SWF transparency analysis through a scoreboard comprising structure, governance, transparency and accountability, and investment behavior.</li> </ul>

**TABLE 2**  
**Sovereign Wealth Fund Characteristics**

<b>Age</b>	Senior (five SWFs): < 1960s Adult (nine SWFs): 1970–1980s Teen (nine SWFs): 1990s Baby (56 SWFs): 2000–2010s	<i>Senior</i> : Includes the Saudi Arabian Monetary Authority and the Kuwait Investment Authority. <i>Adult</i> : Includes three SWFs from the U.S., two from Singapore, and the Abu Dhabi Investment Authority (ADIA). <i>Teen</i> is the largest group in terms of assets under management (\$1.77 trillion); Includes the Norwegian GPF (GPF) (\$900 billion) and SAFE (China). <i>Babies</i> : 56 new funds (\$1.63 trillion) established in the SWF baby boom led by China Investment Corporation (\$575 billion).
<b>Size</b>	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.
<b>Global location</b>	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.
<b>Funding sources</b>	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.
<b>Policy purposes*</b>	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).

\* As defined by Kunzel, Lu, Petrova, and Pihlman (2011).

Note: all monetary references are in U.S. dollars.

2010). In SWFs, governments serve as co-owners and might thus be able to influence the nonfinancial 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 that SWFs can increase investee companies' value and performance through stable and long-term access to capital and markets (Fernandes, 2014).

Last, we know quite a bit about the investment and economic motives that led to the creation and growth of SWFs: intergenerational 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, 2009; Castelli & Scacciavillani, 2012; Megginson & Fotak, 2015). This capital hoarding has encouraged

the establishment of SWFs all over the world and the need to decide on optimal capital allocation.

### 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–agent 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 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 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 1 summarizes the four possible scenarios we propose.

### 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).

**FIGURE 1**  
**Strategic Governance Types of Sovereign Wealth Funds**

<b>Investment motivation</b>	<b>Financial</b>	<p><b>Quadrant 1: Shareholder activism</b></p> <p>SWFs play a strong monitoring role and help to improve the corporate governance of listed companies worldwide.</p> <p>An SWF as the <i>principal</i> seeks to enhance the target company's (<i>agent's</i>) corporate governance through active participation in the company's committees and annual general meetings.</p> <p>Norway's GPF is designing a new approach to intervene in its largest equity positions. Others will follow.</p>	<p><b>Quadrant 2: In-house capabilities</b></p> <p>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.</p> <p>An SWF as a <i>principal</i> engages with other owner(s) (also <i>principal(s)</i>) in low shareholder protection schemes. Setting up investment offices "closer to the action" helps to overcome this P-P conflict.</p> <p>New Zealand's Superannuation Fund, Malaysia's Khazanah, ADIA, and GIC have specialized world-class investment teams managing complex asset classes.</p>
	<b>Strategic</b>	<p><b>Quadrant 3: Legitimacy and decoupling</b></p> <p>Governments use SWFs to obtain longer-term state goals yet simultaneously seek to acquire legitimacy as institutional investors.</p> <p>The trade-off between <i>symbolic</i> goals (efficiency by investing in top-listed equities) and <i>substantial</i> goals (political legitimacy at home and abroad) drives these SWFs' decision-making.</p> <p>QIA, CIC, and Temasek have different political goals, yet all of them aim to achieve them through financial efficiency and thus decoupling.</p>	<p><b>Quadrant 4: Long-term learning</b></p> <p>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.</p> <p>SWFs face <i>principal-principal</i> conflicts when investing with governments as well as with private companies through joint ventures. Also, SWFs need to address <i>principal-agent</i> conflicts at home with domestic SOEs.</p> <p>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.</p>
		<b>Public</b>	<b>Private</b>
<b>Ownership type</b>			

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., 2015). 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, or protecting business elites (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). Differentiating 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 rights 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, investing in global, diversified portfolios to maximize their long-term returns subject to an acceptable risk level (Balding, 2012; Bernstein et al., 2013; Chhaochharia & Laeven, 2008; Fernandes, 2014). In this way, they might seek to invest internationally to shield themselves from domestic political pressures and thereby differentiate themselves from SWFs that pursue nonfinancial goals. Moreover, as Das et al. (2009) argued, the pursuit of purely financial goals might insulate the sovereign economy from resource price and supply fluctuations and diversify revenues from nonrenewable resources.

Strategic motivations, on the other hand, are defined as those that add to sovereign value. Sovereign developmental goals encompass several strategies, such as assisting national industrial planning (Dyck & Morse, 2011), securing natural resources, and 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 the Santiago Principles). However, strategic capital allocations vary widely. For instance, Clark et al. (2013, p. 27) showed how SWFs can be “tools for facilitating autonomy and sovereignty” for 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).

### **Investee Ownership Type: Publicly Versus Privately Held Companies**

In this section, we discuss the other dimension of our organizing framework of SWFs: 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 dictates 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 involve 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. 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 & Walz, 2010). We do not refer here to SWFs investing in private equity firms as limited partners. Rather, our focus is on 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" (i.e., 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) showed 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 and 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 one hand, SWFs funnel their natural resources through funds (e.g., Middle Eastern funds and Norway's GPF) or 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 and of themselves.

### 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 (shown in Figure 1, above), 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 and align with their unique state capitalism style.

#### Quadrant 1: Shareholder Activism

Quadrant 1 in Figure 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. Because 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 GPF is the best-known case among these investment organizations of an active shareholder and, in this sense, is a clear example of strategic governance. First, through its government-commissioned Council on Ethics, GPF 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 GPF'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, GPF 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 it wants 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 that invest 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.

## 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 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.) to 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 crisis 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 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 equity investments.

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 increasing ability to manage more complex assets such as private equity (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 coexisting 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 more than US\$700 billion, and it is in the process of reducing its reliance on external investment managers (in 2012, around 75% of fund holdings were managed by external managers) and 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. Another good example of this strategic governance is GIC from Singapore. This US\$280 billion SWF is increasing its investments in private equity (in 2014, around 15% of its portfolio) and engaging in product diversification. It is now one of the 10 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 Nasional, which recently opened its first non-Asian office in San Francisco).

### Quadrant 3: Legitimacy and Decoupling

SWFs in quadrant 3 pursue strategic (nonfinancial) goals and invest in publicly traded firms. Their investments seek legitimation by being listed in foreign public markets while simultaneously pursuing nonfinancial 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, 2013). 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, with the ultimate goal of establishing 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) referred 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 nongovernmental 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 nonfinancial 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 to overcome the liability of sovereignty. 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 Volkswagen, 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% ownership in

Xstrata (a multinational mining company), pressured Glencore (a global commodities trading firm) to increase its initial bid by 9%. 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 in which 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 nondemocratic countries that lack accountability and shareholder protection laws (Aggarwal, Erel, Stulz, & Williamson, 2009; World Bank, 2013). These SWF managers have to take into account 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).

#### **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 with 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 as 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 nonlisted 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 over a private company 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 economic and sociopolitical objectives of state capitalism. 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-size 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.

## **DISCUSSION**

Sovereign wealth funds as state-owned institutional investors without pension obligations are one of the

key players in the 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 “siloes” 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 incipient trend aligns well with a more active capitalism in which owners have greater influence in an investee company’s strategic management. Second, financial SWFs are developing stronger in-house capabilities. Several factors have triggered this move toward 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 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 (in terms of goals, structure, and teams), so 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.

### **Dynamic Strategic Governance: Movements Between Quadrants**

SWFs are multidimensional organizations in that, at any given time, they might belong to more than one

quadrant in our ideal-type organizing framework (Figure 1). SWFs are evolving organizations (Clark et al., 2013) and might also change or expand to other quadrants over time (Schna & 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, which represent more than 90% of their equity portfolios. However, they also participate in more complex asset classes, increasing their exposure to private assets. Norway’s GPF 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, GPF had acquired property in Europe and the United States worth US\$10.3 billion (Yu, 2014), and it forecasts investing at least 5% of its portfolio in real estate (approximately US\$45 billion). Jumping into quadrant 2 while keeping a foot in quadrant 1 will reinforce GPF’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. 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 bypass 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 toward 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 (e.g., 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 toward 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 had to take a more strategic (and usually domestically oriented) stance after a profound financial crisis to establish investment programs to revive the local business ecosystem and economic activity. After rescuing the national banking system, the old Irish 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 a third movement with funds moving from quadrant 3 to quadrant 1—that is, strategic funds investing heavily in listed equities that reduce their political alignment and then shifting into global financial players. An example is the 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 rapidly since then, from US\$200 billion originally to approximately US\$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 1), a given country may opt to abandon strategic motivations to engage with other “standard” institutional investors such as public pension funds in quadrant 1.

Fourth, we have seen some SWFs shifting from quadrant 4 to quadrant 3. We see this with SWFs that are multidimensional 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 toward a more diversified international portfolio. This evolution also reflects the transition of funds that have a development vocation (common in quadrant 4) toward 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.

#### **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 the 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 by the World Economic Forum [2014] to be around US\$5 trillion per year over the next two decades) 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 sustained, successful track records in other asset classes, funds such as 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 SWFs face (particularly those with strategic goals) is excessive involvement by politicians in operations, goals, and governance. This is normally associated with a bias toward 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 toward 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 goals (political legitimacy at home and abroad) and substantial goals (efficiency by investing in top listed equities). If the government decides to tip the balance toward political goals, legitimacy will not be attained and the sovereign discount will increase. According to Deephouse (1999), SWFs can be as strategic as legitimately possible.

### 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 the new state capitalism comprises employees from SWFs but also from state-owned enterprises (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 field 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 scant 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 enhance corporate transparency domestically and internationally when SWFs' strategy is part of well-publicized long-term state plans.

Turning to future financial-related research regarding SWFs, we propose three main areas for further exploration. First, the question of whether countries need an 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

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 than 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.

Last, there is an interesting issue intersecting the management and finance areas. As stated in the Future Research 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 this: What is the proper balance between managerial independence and financial returns?

## CONCLUSIONS

Most of the existing research on SWFs is grounded in specific disciplinary fields and has focused primarily 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 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 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.

State capitalism is salient in each of the quadrants in our theoretical framework, as is the governance tension among owners, co-owners, and their managers. Interestingly, some SWFs have become corporate governance global watchdogs, such as GPF, 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, 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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