‘Blah blah high returns. Blah blah no risk. Blah blah blah guaranteed!’

-A study of what financial institutions base their portfolio creation on for customers and the relationship between the different financial institutions in the same line of business for this activity.-

Authors:
Nathalie Beauprez
Christopher Muir
ABSTRACT:

Why do people invest? People are insecure about their future welfare and aim for future guaranteed cash flows. To give ourselves a more thorough introduction to investments we decided to write our bachelor-thesis within the area of finance. This thesis will combine financial institutions and investments. It is a topic repeatedly discussed in the media and a study carried out in Sweden showed that in 2003, 80% of the population were shareholders.

When trading with stocks and shares there is risk involved that can be defined as the volatility in the cash flow of an investment. A portfolio is a collection of securities that an investor has placed capital in. In order to minimise the risk of the portfolio, the investor can diversify his or her portfolio, which involves investing in different securities in order to minimise risk. Institutional Theory will help us to see how these financial institutions interact with each other and what internal and external factors may influence their behaviour. Intuitional investors; such as banks, are seen as large actors on the financial markets as they gain more and more control over the management of equities. It is necessary that intermediaries take care of their customers and inform them thoroughly about the rules of the investment game. With this as a background we felt it would be interesting to investigate the following problem.

On what basis do financial institutions create their customers’ portfolios and is the process the same across the branch as a whole?

In order to find an answer to this question; we have done a qualitative study with an overall positivistic influence. The study is based upon an analysis of the empirical material; collected through interviews with three financial institutions, grounded in theory in order to answer our specific question.

From the information gathered we understood that the first information financial institutions gather is personal information about the investors, which is needed to get a picture and an understanding about their client. We have also learned how important it is to understand risk, as it is the risk that will determine the composition of the portfolio for the investor. We could see with the help of the institutional theory that there is little space for differentiation and can therefore say that the financial institutions work in the same way in the advising of their clients and for the composition of their client’s portfolio.

Our results show that the basis for the creation of portfolios is more or less the same across the branches as a whole. The service given may differ, due to the competence and knowledge level of employees, between institutions but the end product is similar in all aspects.
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Chapter 1: An Introduction.

1.1 Subject.

Why do people invest? People are insecure about their future welfare and aim for future guaranteed cash flows. Capital could be placed safely in a bank account to grow over a period of years or there is also the option of investing capital in, for example, shares, gold, silver or real estate. However with investment comes risk (London Stock Exchange homepage). People tend to joke that the loss on an investment can only be 100 %; the gains however can be 1000 %. In other words, for limited losses there are unlimited gains (Van Der Elst, 2000).

Studying the management of money is placed under the heading ‘Finance’. Finance can be broken down into three major areas, financial markets and investments and corporate finance (Eakins 1998). When we started writing this thesis we studied at the bachelor-level of Business Administration and for our masters-level our preferred specialisation was Finance and Control. As the authors of this thesis we wanted to deepen our studies into investment and risk. To give ourselves a more thorough introduction to the topic, we decided to write our bachelor-thesis within the area of finance. This thesis will combine financial institutions and investments. In particular, investments seemed to be a more appealing research area for us. It is a topic repeatedly discussed in the media and a study carried out in Sweden showed that in 2003, 80% of the population were shareholders. In comparison to the previous year the number of shareholders increased by 4, 5% (Lager, Modig and Bjäred, 2003).

1.2 Background.

A country’s economy consists of a population with those that either have a surplus or a lack of funds. In the financial markets, those who have a surplus of funds trade with those
who have a lack of funds, either through money markets or capital markets (Eakins, 1998). The demand for and supply of capital takes place in financial markets. Money markets involve short-term securities that mature within a period of one year. They are characterised by high liquidity, low default risk (the risk of not paying capital and interest in accordance with a contract) and big denominations. On the other hand, capital markets have a maturity period that is longer than one year. These types of markets are for investors who wish to invest long-term, with the purpose of being wealthier than when they invested (Eakins, 1998). Today this financial world is also under continuous development. New financial instruments that regularly see the light of day and technological advances lead to a more and more enlarged and complicated financial world (Delaplace et. al., 2002).

Stocks (shares) and bonds, also known as securities, are traded on the capital markets. Bond interest rates are predetermined and have to be redeemed by a pre-defined date, whereas stocks have neither a predetermined interest rate nor a pre-defined redemption date (Harrison, 2004). When trading with debt and equity there is risk involved, which should be taken into consideration. Risk can be defined as the volatility in the cash flow of an investment (Eakins, 1998). Through investment, wealth can either increase rapidly or gradually; resulting in a trade-off between increasing capital and risk exposure and a trade-off between short-term goals and long-term goals (Bernstein and Damodaran, 1998). Depending on the investor’s attitude towards risk, he or she can be categorised into three categories. A risk taker is more interested in future gains, whereas a risk averter will be more anxious about avoiding losses. The investor can also be risk-indifferent (Pike and Neale, 2003). In general an investor may be willing to take more risk if this involves a higher return; if no higher return is involved the capital can just as well just be stored safely in a bank account with low returns. Risk does not only involve potential loss, it also measures potential gains (Hiemstra, 2001).

In order to receive a high return, it may be sufficient to invest in only one security that may give high returns, however, if a bad choice of security is made the investment may also result in a big loss. For this reason it is always recommended to invest in more than
only one security in order to weight out the losses made by one or more of the securities chosen (Van Der Elst, 2000). A portfolio is a collection of securities that an investor has placed capital in. In order to minimise the risk of the portfolio, the investor can diversify the portfolio. Diversification involves investing in different securities in order to minimise risk (Eakins, 1998). The pioneer behind maximising the rate of return in portfolios taking into account their risk level is Harry Markowitz. His research within this field became known in a paper he published in 1952, entitled “Portfolio Selection” (Haugen, 2001).

Investors are net suppliers of funds whereas businesses are net users of funds, which can lead to the investment of investors in businesses (Eakins, 1998). Not everybody has sufficient knowledge to make the right decisions concerning their portfolio selection. Investors act on the market not by physically going to the company, but act through a financial intermediary. A financial intermediary can be a private person or a company that amasses capital on behalf of investors that is then placed in other companies. Financial intermediaries do not only place money for investors, they may also invest money themselves by using borrowed capital. Examples of financial intermediaries are banks, credit market companies, insurance companies and pension institutes (Falkman, 2004). When financial institutions advise their customers what factors are taken into account? Do these financial institutions work in similar ways or does each work on their own in order to increase competition between themselves?
Institutional Theory can show how these financial institutions interact with each other and what internal and external factors influence their behaviour. The theory states three different isomorphisms: coercive, mimetic and normative (Nicholson, 1998).

Intuition investors; such as banks, are seen as large actors on the financial markets as they gain more and more control over the management of equities (Falkman, 2004). In order to maintain customers, the intermediaries should take care of their customers and inform them thoroughly about the rules of the investment game.

With this as a background we felt it would be interesting to investigate the following problem.

1.3 Problem.

What lies on the base for the creation of the portfolio for customers by financial institutions and how does the institutional theory explain the relationship between the different financial institutions in the same line of business for this activity?

1.4 Purpose.

Our aim with the thesis is to investigate what financial institutions take into consideration when advising their customers and creating their portfolios. We want to know whether different banks in the same region apply the same techniques when assessing customer needs, or whether they differ from one to another.

1.5 Delimitation.

Investment finance, by itself, is a very broad subject not only empirically but also in theory; therefore it is important to acknowledge what will not be covered in this study. We have, consequently, limited ourselves to theories that are closely related or can be intertwined. “Investors”, when we refer to them, include any body that has sufficient
resources to invest. In other words, this thesis will refer to all categories of investors and not just one kind in particular. We are aware that investment is not for free and a price in terms of fees to financial institutions and taxes to the government has to be paid. Due to the complexity in the laws involved and the different ways of how charges can be calculated we have chosen not to take a closer look at the cost of investment.

Our data will be gathered from interviews carried out at a specified number of financial institutions with an office placed in Umeå; we then did not need to travel greater distances in order to be able to carry out the interview face to face. We are aware of the fact that for the financial institutions we interviewed, the headquarters are in Stockholm and believe that the approach to the compilation of a portfolio may be the same for different offices around Sweden. If each single office was a franchise the approach could differ from office to office.
Chapter 2: Theoretical Methodology.

2.1 Influential factors.

Business research is influenced by a number of factors such as values, theory, practical considerations, epistemology and ontology. Below we will go deeper into each of these influential points; theory will, however, be described in Chapter 4.

Fig. 2.1 Alan Bryman & Emma Bell, Business research methods. 2003, Oxford University Press Inc, New York. p. 27.

2.1.1 Values.

Our aim with this thesis is to deepen our knowledge of investment and risk. We have little previous knowledge of this area of finance but we both are interested in how investment and risk functions. For this reason we do not think it is relevant to tell you our life story here and think it is more appropriate that we discuss what we have learned from the literature and articles examined during the preparation of our study.

For decades people have been interested in making more future money out of the present amount they possess. This interest has led to broad research in finance. Through reading an overview of the history behind financial theories, a foundation of knowledge has been created. Finance to us can be compared to the horizon of the sea, you can see it but you don’t know where it is. Our impression of finance is that it is not only a matter of
business administration; it is as much Economics as it is psychology. An example of this is the development of research within behavioural finance.

The major ideas in finance are thought to have evolved at the end of the 19th century through economics, and have developed rapidly since then. Even journals in finance started to arise from journals in economics around the 1930’s with a big expansion around the 1970’s (Fred and Weston, 1994). The theoretical starting point for our thesis is the “Modern Portfolio Theory” by H. Markowitz (1952).

Course books in finance, we believe provide a basic, fundamental picture of many applicable and generally accepted theories. We considered, therefore, that it was good to start by reading more recent course books since they give up to date information and a picture of how theories are applied today. Theories are developed continuously as research evolves. These books have given us a foundation for further scientific reading. It is argued by Grinder and Cooper (1995) that financial history plays a major role in understanding theories and provides insights into different viewpoints (Grinder and Cooper, 1995). As a consequence we have tried to have a look at older articles as well as more recent ones. They have shown us, for example, why Modern Portfolio Theory as developed by Markowitz is questioned and what alternatives can be used, what risk is in practice and how it relates to returns.

During a search for information it is also essential to explore the topic of the thesis and see if other studies have been carried out. We have, through this process, found a study closely related to our own. A ‘D level’ thesis; written at the University of Linköping, deals with the satisfaction of customers when taking risk into consideration. The study was done through a hermeneutic approach using a quantitative method. As they used an inductive approach the information gathered was analysed with the help of theory. The conclusion of the study is that for customers it is important to understand the concept of risk and the most valuable tool is how advisors put across “risk”. The study was conducted in three steps, one of which concerned risk and returns (Eliasson and Karlsson, 2004).
2.1.2 Epistemology.

What is knowledge within a certain subject field? How is knowledge to be gained in this particular subject field? There are two main perspectives commonly suggested for knowledge development; positivistic and hermeneutic. Neither epistemology has a clearly specified definition; however, each has a number of distinctive characteristics associated with it. Positivism has its base in natural science and attempts to maintain an objective stance. In contrast to positivism is interpretivism; which has its base in the social sciences. This approach tried to take the difference between people and objects of natural science into account in order to interpret the significance of social action. In theory, interpretivism is based in hermeneutics, i.e. it deals with theories and methods used to understand human action. Hermeneutics basically has its base in understanding and interpretation; it attempts to take subjectivity into account (Bryman and Bell, 2003).

This study has been based upon an analysis of the empirical material or data we have gathered and grounded in theory in order to address our specific question. Our preconceptions have affected the work as a whole, e.g., our interview questions were influenced by both our knowledge and ignorance; we do however acknowledge this fact. Interviews were used to build up our empirical material for the whole study. We do not believe that we possessed sufficient comprehensive knowledge to affect the responses we received. Thus our preconceptions will not alter or influence these results to any extent. In other words, this study will not be biased because of any previously held opinions, our stories and personality will not sway our analysis (Andersson, 1979). Therefore we can lay some claim to objectivity in this study.

2.1.3 Ontology.

In social science two different scientific approaches are generally identified. The deductive method has its starting point in the theory from which statements concerning the problem are made. The observations are then analysed and conclusions drawn taking into consideration what the theory states. The inductive method on the other hand has its
start in the problem area and the observations made. General conclusions are then produced which may result in new theories (Eriksson and Finn, 2001).

The purpose of this study is not to produce new theories and for that reason our scientific approach and consequently our study is deductive. Our study starts by selecting a theoretical framework, not only in order to gain more knowledge about the subject but also as a base for our interview schedule. The theoretical base is then used to analyse the empirical information gathered.

2.1.4 Practical considerations.

When choosing a method of approach in research certain criteria have to be fulfilled. The method has to agree with the research field and the information obtained should be utilised in the most appropriate way. The results obtained through research should offer the possibility for new knowledge and help to increase understanding of the researched area and perhaps lead to further research. There are, in the social sciences, two commonly used research methods. The quantitative method is characterised by the distance between the researcher and the respondent, an example of this method is questionnaires. Generally this approach offers little information about a greater number of respondents. The qualitative method is a method used to create understanding and is not used to prove validity (Holme, 1997). As the purpose of this work is to gain knowledge of the risk connected with investments and through this create understanding in how portfolios are composed, the latter method is a better technique for our study in order to collect the empirical information needed. Briefly this method provides a lot of information about few respondents.

The qualitative method will give us a understanding of the context in which our problem is situated. This creates the chance to form a closer relationship with our respondents and can contribute to more detailed information, which then can be analysed and lead to a conclusion supported by theory. The qualitative research method will require an intensive exchange of questions and answers in order to receive an as complete set of information
as possible, however, because of the limited size of this work a small selection of respondents will be used. The approach will provide the possibility to do a cross-sectional analysis of the respondents’ answers and determine whether our respondents share the same opinions (Holme, 1997).

2.2 Perspective.

The perspective of a study starts in the problem; it explains the point of view in which the study has been carried out (Eriksson and Finn, 2001). Our problem is concerned with the influences in the creation of financial portfolios by financial institutions for their customers. We would like to examine these influences by looking at information the customers need to give to the financial institution that is taken into account in the creation of an investment portfolio in general. It will be carried out through a qualitative study with a positivistic approach. This means that objectivity is claimed and no interpretations will be done. As a result of this latter we find it appropriate to take the perspective of the financial institution for this study and not the perspective of the customer. The customers’ perspective will result in different result and can also be studied through a broader study than the study we will carry out. The financial institution plays a more central role in this study and we do however not take the customers opinion or attitude into consideration. With the help of the institutional theory we will look at the way financial institutions act in respect to each other in; for which we will look through the eyes of the financial institution onto another financial institution.

2.3 Secondary data.

Secondary sources are an important source of information on a topic and help to build the groundwork for the theory. This basis will be used as a source for the empirical information gathering, emphasis the importance of relevant and trustful secondary sources (Eriksson and Finn, 2001).
Since we had little basic knowledge of finance before we began writing this thesis we decided to search and gather literature from Umeå University Library that would introduce us to the topic in question. Words such as ‘investment and finance’ have been used in order to find literature to introduce us to the topic finance. Finance and investments are the primary area in finance in which our investigation takes place. As our purpose is to investigate the influences in the creation of financial portfolios by financial institutions for their customers; our main keywords were ‘financial institutions, risk and portfolio’ in order to find literature closely linked to our thesis. From this selection of literature and after a meeting with our thesis adviser we found a number of theories that could provide a framework to help us find an answer to our problem. The articles used in this thesis were found using the Internet search engine at Umeå University Library. Concerning Institutional Theory, we faced some difficulties finding literature and have therefore asked a librarian for her assistance, she found some reference books for us. The main database used was Business Source Premier, where we only searched for peer-reviewed articles to be certain that they have a sufficient level of validity. The articles we found were used either for information sources or as constructive reference literature for understanding and deepening our theoretical knowledge. In order to find previous research within our research area we looked at the list of previous theses that had been written at Umeå University and by looking at the search engine LIBRIS to find theses from other universities.

Throughout the work we have also used the Internet as a reference when we had difficulties understanding certain vocabulary or other terminology. When using a website, different methods of investigating the authenticity of the website were used; such as checking who created the information and when, or whether the information appears to be amongst other things plausible (Högskolan i Gävle). Websites such as www.en.wikidepia.org and www.google.com were used. We are aware of the differences reliability of different websites however it was mainly used for information research at the start of the process for this thesis in order to find out more about our research area.
2.4 Criticisms of secondary data.

As we believed that the library of Umeå University offered us sufficient literature for our needs we did not borrow any books or research work from any other library. This could lead to having missed out on other relevant and useful sources. Considering the timeframe and size of this thesis we believe we obtained an adequate amount of relevant information. The use of the wrong search words or the misuse of economic terms can lead to us to overlook useful sources; even the filtering of the sources found can lead to the neglect of appropriate sources.

In view of the fact that some of the books that we found at the library are used as actual course books at the university we trust the sources to be more than adequate and have given us sufficient and satisfactory information. For our theoretical study we have however relied more on peer reviewed articles.

The Internet sources used we believe have sufficient level of credibility since we checked the webpage’s credentials and we are aware of the fact that not everything on every trustworthy-looking website is really reliable. Information found on the Internet has been backed up by paper sources and are by us rated to be reliable. In order to raise the reliability we have not used the Internet source in our thesis but the paper source instead.

Concerning the articles we used with reference to Institutional Theory, we used different articles by the same authors who also referred to each other. This means that the knowledge base used by us for this research is consequent. As investment is a continuously evolving subject, the articles selected concerning investment have been those on the current research front in the field. This could have led to the elimination of early articles forming the knowledge base but we believe current articles are valuable and informative contributing to up to date information and research. As previously stated the history of theories can offer understanding for theories and it provides viewpoints, therefore older articles are also used.
Chapter 3: Practical Methodology.

3.1 Research area.

From the beginning of this thesis we discussed where we would like to carry out our interviews. We came to the conclusion; given the size and time frame that we have for writing this thesis, that travelling outside of Umeå in order to carry out the interviews would be time consuming as well as expensive. During the acquisition of information about the subject we narrowed down our selection of respondents. There are not many established financial institutions in Umeå so after a discussion between ourselves we concluded that the financial institutions in Umeå would offer us the appropriate information required to be able to connect our chosen theories to the resulting empirical knowledge we would receive from the interviews. The four financial institutions chosen have, we believe, given the study a higher chance of drawing reliable conclusions due to the fact that all respondents come from the same line of business. The choice of respondents was carried out using a convenience sample (Bryman, 2004).

The decision of what kind of interview to use was decided very quickly because face-to-face interviews would increase the integrity and reliability of the study. The opportunity to ask follow up questions would also be possible by carrying out a face to face interview compared to for example a mail survey where time and money can play a huge factor (Bryman, 2004). Interviewees were guaranteed anonymity, hence, they are denoted as Fin A, Fin B, Fin C and Fin D for the financial institution involved. When talking about Fin A, B and C we mean the private placement department; for Fin D we talk about this financial institution in general. There exist other departments but we have not concentrated on any other department. The respondents’ names will not be mentioned in this thesis therefore the respondents of each financial institution have received a cover name starting with the same letter as denoted to the financial institution.
3.2 Qualitative method.

The first contact with our respondents took place via telephone and e-mail (see Appendix 1). We explained our research area and our purpose giving them an idea of what our study involved. We asked if they would like us to send the interview schedule in Swedish (see Appendix 2b) before hand so that they would have a chance to study the questions and prepare answers. We saw this as a possibility to increase the thoroughness of the answers, which would increase the reliability of our study. The e-mail was used primarily because some institutions have more than one person working within the investment area and needed to consider who would be most suitable and available for the interview. We did however receive a negative answer from one of the financial institutions, Fin D, due to the fact that they are in demand for interviews and could therefore not be of any assistance. The interviews took place at the respondents’ work place, leading to a more relaxed atmosphere and interview. We asked if it was possible to use a tape player during the interview to record the interview, none of the respondents were against this. We believed this contributed to a better interview due to the fact that we did not have to ask a question and write out the answer, which could take our time and result in incomplete notes. Instead, the interview could be free flowing with no interruptions from our side. After every interview we asked if the respondents would like us to send the transcript of what we had written to be sure that we had understood correctly the answers that had been given. This was in order to diminish misunderstandings would once again improve the reliability of the study. Sadly, this was appreciated by only one of the respondents. This respondent however did not contribute with any feedback.

3.3 Interview schedule.

For the interview schedule (see Appendix 2a and b) we have tried to follow the rules for making a good and constructive questionnaire. The questions were formulated as straightforward and clear as possible so no further explanations were needed. It was, however, made in such a way that we would carry out a semi-standardised interview,
which allowed time and space for eventual extra questions or just follow-up questions (Lundahl and Skärvad, 1999). The interview schedule; written in English, was made up taking the theoretical framework in mind. As the interview took place in Swedish we have translated the questions from English to Swedish.

The dialogue began by asking for background information about the person being interviewed, such as the job description for example. These questions were then followed by introduction questions that then led to questions more specific to our thesis problem.

### 3.4 Primary data.

The primary data that was used in this thesis comes from the interviews that were carried out. From the tape players that were used to record the interview, the information was transcribed into a Word document word for word. The transcribing was done as soon as we returned from the interviews in order to preserve the interview fresh in our memory. From this transcription we took the most important and relevant information in order to form our empirical study. We are aware that this would have increased the level of subjectivity from the interviews, but the information chosen was deemed by us to be relevant. The interviews took place in Swedish so the information received has also been translated into English for this thesis. As interviewers, we have tried to be aware of the ethical implications of carrying out an interview. Knowledge that is collected can be sensitive and will therefore be handled confidentially (Bryman, 2004).

### 3.5 Criticisms of primary data.

It is often hard to have a comfortable number of questions, which also have to be formulated in an appropriate and comprehensive way (Eriksson and Finn, 2001). As we did face-to face interviews, there was the possibility to explain what was meant with the question when the respondent did not understand what we wanted to find out. This could
have led to altering what we really wanted to know when we wrote the interview questions. We did not, however, have any control over whether the respondent answered any questions incompletely or had prepared the answers at all, meaning that the interviewees could have been withholding information. As the interviewees are so familiar with their topic some information may seem natural to them but unnatural to us. During the interview we have tried to keep the dialogue between us balanced so that both we and the interviewee have an open, active dialogue (Bryman, 2004). However, the interview has been controlled by us as much as possible.

A virtue was that we had tried to be prepared for the interviews by having read interview instructions. We also followed some advice given to interviewers such as being prepared with follow up questions and avoiding yes and no questions. Our knowledge concerning how our chosen kind of financial institutions work was, however, rather limited, which could have led to the wrong questions being asked or the interviewee answering questions in a way that will not be understood by the interviewers (Eriksson and Finn, 2001).

Since the interviews were carried out in Swedish, some valuable information may have gone lost in translation. We have however taken the most important information from the interviews in Swedish and then translated them into English. This is therefore maybe not a big problem, only the translation of terms may be altered.
Chapter 4: Theory.

4.1 Choice of theory.

The chosen theory gives a basis for the analysis of the empirical data. The theories we have chosen appeared to us relevant for the study we carried out; “What lies on the base for the creation of the portfolio for customers by financial institutions and how does the institutional theory explain the relationship between the different financial institutions in the same line of business for this activity?” To begin it is appropriate to look at the vocabulary within this question and identify the key terms, such as financial institutions and portfolio. Risk is also one of the key terms needed in order to go deeper into investment and financial portfolios. We start by identifying “risk”, which in finance is the variance of returns. We shortly discuss how the risk related to a security and to a portfolio as a whole can be calculated; the computation of returns is not very relevant to the current study and has hence not been treated in any detail. Formulas have also been left out in order to keep the theory as comprehensible and unfussly as possible; they are on the other hand briefly explained. The terms risk and return led us to portfolio theory by Markowitz, which is an approach that underlies “online asset allocation” (Bodie, 2003). We do have to bear in mind that both the above theories assume that investors are risk-averse, meaning that the investor is anxious about avoiding losses. Risk aversion is not defined in terms of free markets; that is yet another concept. Another important term in our question is “financial institutions”. In order to be able to compare the financial institutions’ ways of working, we believe the institutional theory is an appropriate theory as it explains three different forces that can influence the structure of how financial institutions compile portfolios.
4.2 Returns and risk walking hand in hand.

A phenomenon within finance and investment widely studied is risk. We believe that risk will have a great influence on the composition of a portfolio and therefore it is of importance to explain this thoroughly. Risk is defined as the deviation of the return from the investment and is put in relation to the expected returns, as the expected return increases the level of risk also increases (Eakins, 1998). The term risk is relevant to discuss for our thesis since it is one of the factors that may greatly influence the choice of securities and therefore the compilation of the portfolio made by financial institutions for their customers. As will be mentioned later on, risk has lead to the study of behavioural finance. Behavioural finance can be useful in order to find out what type of behaviour influences the investment (Gilfoyle, 2000).

Risk free investments exist theoretically, however when investing in government securities, market risk, also known as non-diversifiable or systematic risk is caused by happenings in the world that have an effect on the market as a whole (Eakins, 1998). Examples of these macro-effects are natural disasters, changes in prices of raw materials such as oil and gold or changes in interest rates. Added to this risk, are security specific risks, called diversifiable or unsystematic risk. The risk involved is specific for the company in which the security is bought, referred to as micro-effects (Haugen, 2001). Any changes in the organisation of the company, any business related transactions or advertising campaigns can affect the value of the security given out by the company and the risk connected in buying its securities. These two types of risk make the total risk of a single security (Eakins, 1998).

By calculating the standard deviation of the single financial asset or security we can calculate the total risk of a security. As risk is defined as the deviation of the return on the investment, a higher risk is a result of a higher standard deviation. This method is based on the past performance of the security. Important to note is that in order to compare different securities with each other, they have to contain comparable expected returns. In order to compare different securities with different expected returns we have to take this a
step further and calculate their coefficient of variation (CV), which is a percentage value of the standard deviation (Eakins, 1998). It is not important for this thesis to know in detail how risk is calculated, however those are the numbers used in order to make a portfolio for financial institutions customers and they may use these figures to explain risk to their customers.

Risk is put in relation to the required return of a security (see figure 4.1). As risk increases, expected return also increases. How can the expected return of a security be measured? It is as simple as looking at the expected net present value (ENPV) of a security, meaning that we take the expected value and the possible outcomes and multiply those by the probability rate (Pike and Neale, 2003). These probabilities are hard to identify and are for that reason estimated in relation to the information available, such as for example financial reports and historical information. It is essential that the information is useful and highly relevant. Bear in mind that this is only the expected return and can differ from the real return (Markowitz, 2001).

![Risk-Return Relationship](image)

Figure 4.1 Source: Finance- Investments, Institutions & Management by Stanley G. Eakins, 1999. Addison- Wesley Educational Publishers Inc. p.159

Depending on the investor’s attitude towards risk, he or she can be categorised into three main categories. A risk taker is more interested in future gains, whereas a risk aveter will be more anxious about avoiding losses. The investor can also be risk-indifferent (Pike and Neale, 2003). Behavioural inclinations have also been identified. In an article written by John Gilfoyle (2000), eight different inclinations are mentioned. There are those investors that are over-confident; investors who strongly believe in their capacity to
invest whilst when unexpected results are shown they are shocked. Cognitive dissonance is related to investors who have a hard time letting go of badly going investments and do not really like to admit this either. Some investors are risk-aversive and like to avoid losses. Other investors invest depending on how information is presented to them, this is called framing. The mental accountants do not completely think about what they are doing or their total capital when they are investing. On the other side there are those investors who overreact. They concentrate on the short term due to paying too much attention to the recent performance of securities and decisions are made with not a lot of thought involved. Herding and regret is concerned with safety in numbers concept. Peer group persuasion is evident which results in a group made decision. The final inclination is over-simplification; investors try to make intricate situations basic by taking the quick easy option based on historical data and sustain this behaviour as long as they can (Gilfoyle, 2000).

Risk is a funny thing really, as we perceived from reading Fred Kirby’s article (2005) about “Investment Risk from the Clients Perspective”. Risk is just a less loaded word than its synonym within investment, loss. To investors, losses are a great concern and therefore it is important to confront the client with the reality of the investment. Research has shown that investors have a hard time dealing with losses and can make bad investment decisions trying to compensate for these losses. This bad investment behaviour can be turned into patient investment behaviour with the help of the financial planner. Investment is said to be a job of patience and therefore patience is needed in order to get a proper return on the amount invested. The conclusion of the article is that investors should face the fact that losses are losses and in the long run they will make way for profitable returns. Planners generally have access to more data; historical data, firm-related information and financial experts, and can consequently adjust the risk of the portfolio to the risk level that is tolerated by the client rather than simply aiming for long term, high returns (Kirkby, 2005).

It is important for investors to know what risk is and how it functions; for this reason the communication between the investor and his or her financial advisor has to be at the same
level. If this is not the case the risk assigned to the portfolio compiled for the customer may not resemble the risk the investor is willing to take. A nice example of the miscommunication between a financial advisor and its clients is the following comic story:


What else than knowing the risk and returns connected to a single security is the purpose of calculating the risk and the returns of a single security? There is a theory that says that the risk of a security can be reduced if we invest in different securities; in other words if we compile a portfolio.

### 4.3 Modern portfolio theory.

The fact that compiling a portfolio reduces risk has been known for centuries, even Shakespeare seems to have been aware of this fact. A real theory had however not been generated until Markowitz wrote his article “Portfolio Selection” in 1952. Today however, he would like people to see this article simply as a historical document due to the fact that since the publication, the theory has evolved significantly (Markowitz, 1999).

Diversification does not reduce total risk, it reduces unsystematic risk, and therefore it is important while compiling a portfolio to pay attention to this security specific risk. The more securities gathered in a portfolio the more chance of eliminating the unsystematic risk, as shown in figure 4.2 below (Curtis, 2004).
Modern Portfolio Theory (from now referred to as MPT) is concerned with the construction of the optimal portfolio for risk-averse investors, in other words the efficient portfolio. Before Markowitz came along with his theory, an optimal portfolio was constructed with for example five different securities and that was called diversification. Markowitz showed however that is it much more complicated than this. He claims that in order to compile the optimal portfolio we need to take the correlation between these securities into account (Curtis, 2004).

Before we go deeper into the MPT, it is appropriate at this stage to explain the relationship between the return and the total risk of a portfolio. In order to calculate the total risk of a portfolio as a whole, the expected return and covariance is needed. Expected returns of a portfolio are determined by the weighted average of the expected returns of the single securities. The covariance expresses the interrelationship between the returns of different securities, meaning how the expected returns of these securities move together. The total risk of a portfolio is calculated by determining the standard deviation of the portfolio through the return, the covariance and the invested capital in every security. As a whole we can say that as we add more securities to the portfolio, the total risk will decrease for every security added, however for every security added the rate at which the total risk decreases reduces as well. To summarise; perfect correlation between securities does not allow the cancelling out of lows and highs on the security
markets and hence they do not reduce unsystematic risk meaning that not perfectly correlated securities lead to diminished risk. The risk will not be totally reduced because the risk reduced by creating a portfolio is the unsystematic risk, the systematic risk will remain at the same level (Markowitz, 1991).

We can conclude that in order to reduce unsystematic risk we need to make a portfolio for which the securities returns are not perfectly positively correlated. Having done that, we still need to put an appropriate efficient portfolio together following three steps; which will not be explained into any further details since this is not required for this study. The suggested steps by Markowitz are:

1. Distinguish between efficient and inefficient portfolios.
2. Find within an efficient portfolio a combination of likely return and uncertainty of return.
3. Efficient portfolio is chosen.
   (Markowitz, 1991)

Curtis (2004) has written an article about how MPT compliments Behavioural Finance and vice versa. As the MPT tries to give a picture of how financial markets function, it does not tell us anything about how the investor would behave. The Behavioural Finance attempts to show us how investors behave and can therefore be a good compliment to MPT. Studies are made how these can be combined in practice in order to create this “perfect portfolio” that the investor can handle and will increase the wealth of the investor (Curtis, 2004). Siebenmorgen and Weber (2004) have written an article that can be used to exemplify how portfolio selection is linked with Behavioural Finance. The purpose of their study was to investigate the investment horizon has any influence on the level of risk chosen for a portfolio. More precisely they looked at the short- and long term returns of portfolios. They have shown that there is a noteworthy difference between the investors’ view on time; the specified investment horizon influences both the volatility (the liability to rapid and unpredictable change) and the subjective risk estimation. The participants of the study have shown a willingness to take higher total portfolio risk for long term investments in contrast to short term investments for which most wanted to
take a lower total portfolio risk; due to their belief in mean-reverting asset prices. The latter theory suggests that prices and returns of a security will over time return to their mean or average (Siebenmorgen and Weber, 2004). Behavioural finance can be helpful for our analysis since the financial institution may need to find out how the client would like to compile her/his portfolio. What are the reasons for the client to invest; does he or she want to take high or low risk and for how long does he or she want to invest.

The modern portfolio theory by Markowitz is not seen as being the main way to find the optimal portfolio. Research is done in order to find ways to limit risk or to calculate expected returns more accurately. One way could be through downside risk optimization; Swisher and Kasten (2005) believe that the MPT model is wrong. The reason for it is that it does not construct efficient portfolios but inefficient ones. In their own words they claim that it even compiles “silly” portfolios because risk is not equal to the standard deviation. “Risk is just an emotional condition” and can therefore not be calculated. The downside risk optimization is used to mathematically calculate downside risk and through this optimal portfolios can be created. Swisher and Kasten call this theory the Post Modern Portfolio Theory (Swisher and Kasten, 2005). “Why economic models fail” by Van den Spiegel in 2005, explains that due to changes in market behaviour, changes in economic models are needed. In 1963, it was argued by Samuelson that investors with long time investment horizons should not invest only in high risk securities. This was only the beginning of the criticism against MPT. In later years criticism has been focused on the lack of consideration of human behaviour and an overestimation of the stock market (Van den Spiegel, 2005).

Despite these criticisms, many researchers believe that the MPT is a reasonable basis for the development of new theories. Markowitz’s Modern Portfolio Theory is generally presented as:
4.4 The financial markets and its intermediaries.

Financial institutions can be anything from being a bank, an insurance company or even an investment company or the financial markets. Their main task is to provide aid for all kinds of financial services for their customers. The financial institutions are generally regulated and under the authority of a government (Delaplace, 2000).

The financial markets are where financial assets are bought and sold. As a consequence of these actions, through supply and demand, the prices of securities are set on financial markets. The capital market is a financial market for dealing with long- and short term securities. An example of a capital market institution is the London Stock Exchange. Capital markets are subdivided into two markets; the primary markets where new capital or securities are presented for the first time and the secondary markets where already existing securities are traded. These financial markets are of great importance for businesses. The population of a country exists of a part that has excess funds and a part that has a lack of funds, on the financial markets these two parts can make a deal by establishing a balance. It is here where financial institutions find their function (Pike and Neale, 2003).
Financial institutions such as banks, insurance companies and investment companies, act on the financial markets as intermediaries. Their primary task is to reallocate savings; as the business would need resources for its investment and, in the absence of financial intermediaries, it would have to contact investors personally. Instead, the financial institution adds all small savings of households and lends it to the business in need of the resources (Falkman, 2004). Another function of financial institutions is to act as investment advisors. For private investors to entrust their money management to an institutional investor can bring along at least one main advantage. Institutional investors have easy access to skilled and qualified people who have the ability to inform them about which is the better form of investment (Menkhoff, 2002).

The competition on the market for intermediaries is expanding by the day. It is believed that the internet is the biggest competitor of financial institutions. Through the internet, services can be offered cheaper and quicker and are therefore much more attractive to companies than are the traditional financial institutions. Even for the recipient this could be more attractive since it can offer anonymity and save time and money. Concerning the advice needed when investing; this can also be offered as a free internet service as well as the management of the portfolio for lower fees (Morrow, 2000).

As inexperienced players on the financial market, we, the authors of this thesis would not trust going online and gambling our life savings. It is here that financial institutions play a major role as investment advisors. Banks, for example offer face to face advice and help to individuals throughout the process. Due to their position they have access to different information, sources and experts (Falkman, 2004). For this thesis we would like to interview four financial institutions within the same line of business, this on one hand because of the access to the information they have and on the other hand it would be of interest to see whether or not they work accordingly.

The financial market is under continuous change, financial institutions can be of great assistance concerning these adjustments. In order to give the best and most appropriate advice it is not only a requirement for financial institutions to be informed about the latest
news, they also have to be able to understand the demands from the customer. Since investors may be dependent on financial advice it is evident that the financial intermediaries work towards the best for their investors. The customers are protected by law (Falkman, 2004).

![Financial Advice](http://www.glasbergen.com/images/g634.gif)

Fig. 4.4 Financial Advice.

4.5 Institutional theory.

We, the authors of this thesis had never heard of this theory before we began writing this thesis. Just reading the word ‘Institutional Theory’ could lead the reader to believe it is a theory of institutions and the structures that they have. It is, however more complex than it appears. Institutional Theory has been produced and evolved through a collection of researchers, first was Meyer. Meyer then worked in partnership with Scott. After this came DiMaggio and Powell with their isomorphic descriptions (Nicholson, 1998).

The part of Institutional Theory that is of interest to us for this thesis has been the research carried out, first by Meyer and Rowan. It has been said that the article written by Meyer and Rowan in 1977 entitled “Institutionalized organizations: Formal Structure as Myth and Ceremony” was the first, real attempt at giving Institutional Theory a concrete beginning (Mizurchi and Fein, 1999). The authors argue that an organisation acquires the structure it has not through the tasks it undertakes but through the “myths” of the organisational surroundings in which they find themselves in (Meyer and Rowan, 1977).
Previous theories state that organisations have been so successful through the years due to strict adherence to their original design. Empirical research carried out, however, has shown that these organisations do not follow their original design; breaking of rules, decisions and choices that contained a large amount of ambiguity occurred regularly. Attitudes of the general public, rules decided in a court of law and authentication by educational institutions have helped to impose the regulations which exist in organisations today (Meyer and Rowan, 1977). All you have to do is to read the newspaper or listen to the news to read and hear about for example changes in laws and regulations or new laws being introduced. This only strengthens the belief that organisations are forced to follow new laws and procedures. Due to these events and the impact that they have on modern organisations an isomorphic relationship is built between the organisation and its surroundings and the organisation also becomes co-dependent upon the surroundings it finds itself in (Meyer and Rowan, 1977). A good definition of what isomorphism is comes from a researcher by the name of Hawley (1966). He describes isomorphism as:

“a constraining process that forces one unit in a population to resemble other units that face the same set of environmental conditions”

(DiMaggio and Powel, 1983)

An effect of this isomorphic relationship is that not only do organisations live in a co-dependent state but they also assist in help shaping the surroundings in which they find themselves (Meyer and Rowan, 1977).

The source or the basis of DiMaggio and Powell (in the future denoted DM and P) research is based on Weber and his ideals of “bureaucratisation” Weber stated that bureaucracy stemmed from three different but interconnected reasons:

1) Market rivalry that exists between capitalist firms
2) An increase in the requirement for leaders to manage their workforce due to rivalry between countries.
3) Equal rights by law stipulated by bourgeois individuals.
These three as we will soon see, are indirectly connected to DM and P’s definition of Institutional Theory. Weber’s ideal of bureaucracy still exists today but companies are becoming more and more homogenous. Why are companies becoming more and more homogenous? This is an important question because when an organisation starts it is more diversified than other organisations within the same line of business but somehow after the organisation is reputable it is difficult to distinguish it from other similar organisations (DiMaggio and Powell, 1983). This question can be answered by looking at DM and P’s theory of institutions. They have taken what Meyer and Rowan researched further by giving different organisational phenomena titles. DM and P have taken the view of institutional isomorphism as the basis of their theory.

The first isomorphism they use is called Coercive isomorphism. This is the effect from official and unofficial forces that are applied to one institution by other institutions able to impose on the first. Pressure is also exerted on an institution through the cultural milieu in which the institution is active. These pressures that are exerted can be classified; for example, as new government directives that require the institution to change their structure, or new laws that require a change in how financial reports are written. This leads eventually to all organisations following the same regulations. Another big and important example of coercion is when dominant countries and organisations with power begin to expand. This leads to other organisations having to adhere to the new rules and regulations that are created due to the expansion. The consequence of this is that institutions become more and more homogenous, thus making institutions more and more controlled externally. Even subordinate companies are affected by the coercion of the parent company (DiMaggio and Powell, 1983).

The next isomorphism goes by the name of Mimetic isomorphism. Mimicking an organisation within the same field is common and is brought about by the presence of ambiguity. If an institution is unsure in how to interpret a new law or new advances in science are difficult to understand another institution will turn to an institution that has understood and copy it; hence the term mimetic. The main benefit of this isomorphism for an institution is that it is a “cheap” way to understanding the ambiguity because by
looking at institutions within the same field can mean that the expensive research has already been carried out. The mimicking that is carried out does not always occur with the copied institution’s consent. It can however happen when one employee moves from one company to another taking with him/her knowledge. An institution with a large number of employees or a very wide customer base also leads to mimicking (DiMaggio and Powell, 1983). If one company has a low turnover rate and high percentage of customers other institutions will most likely want to be a part of the action and attempt to copy what that institution has done. Due to the homogeneity that occurs from coercive isomorphism, there is not a lot of room for other institutions to break onto the market with something original so the best chance they have is to mimic an existing company (DiMaggio and Powell, 1983). After having a discussion about this we came to the conclusion that mimicking could be a reason why companies offer identical services as their competitors in the same line of business. Newer companies would not otherwise be accepted or be successful so they would have to take and adapt to an existing idea.

The third and final isomorphism from MD and P is called *Normative isomorphism*, which has its base in professionalisation. Within every profession the willingness exists to improve the status and process of the profession, they fight in order to strengthen their professional independence. Professions, like institutions are susceptible to influences from both coercive and mimetic forces. Professionals in one institution will have comparable characteristics to their opposite number in another institution, but within the company there exists dissimilarity towards other professions (DiMaggio and Powell, 1983). Two main characteristics within normative isomorphic forces is the hidden effect of higher education, which can change the profession due to new ideas and the expansion of the professional network helps to expand the amount of professionals within a specific network. This has to be a strong foundation for normative isomorphism. The more professionals there are the more pressure they can exert on governments. The “filtering” of employees within a company is a key method for promoting normative isomorphism. Employing workers from the same trade or applying the practice of only employing senior management ensures that the profession will be better off but due to the influences of coercive and mimetic forces, the profession will contain a high grade of homogeneity
(DiMaggio and Powell, 1983). It is our opinion that normative isomorphism is the one than can be influenced the most. The main contributor to this isomorphism is human beings. We can make mistakes or make irrational decisions that maybe were not expected. This leads to an increased level of uncertainty which in turn can invoke mimetic forces to come into play.

As we can see from these two approaches to institutional theory; by Meyer and Rowan and then by DiMaggio and Powell, they are very similar. The main differences between them are the approach towards the theory and the method in which the authors describe the theory. The conclusion could be drawn that DM and P’s theory is an extension of the theory that was presented by Meyer and Rowan.

4.6 Theoretical summery.

The diagram above (figure 4.3) shows how the different theories we have chosen for this thesis are related. Investment starts onto the capital market which is influenced by isomorphism, explained through the institutional theory. On the capital market, financial

![Diagram of Capital Market and Financial Institution](image_url)
institutions function as intermediaries for the supply and demand of securities. In order for financial institutions to compile efficient portfolios for their customers; ratios and other calculated numbers and information is needed; this is provided by taking into account risk and the Modern Portfolio theory. With the appropriate information and the advice of financial institutions, investment will be made easier for both private and business investors. The question that is still remaining is what other factors other than risk are involved in choosing or compiling an efficient portfolio for the financial institutions’ customers.
Chapter 5: Empirical study.

5.1 Financial institution A.

Adam has worked within financial institutions for 20 years. As for now, he works as the head of the department and as a financial advisor. When Adam finished high school he started to work for the Fin D during the first ten years and then moved on to his present financial institution in the same line of business. He has had the opportunity to educate himself through Fin A at the same time as he worked. Adam states that education within this kind of financial institution is very good, and amongst other courses he has studied national economics, portfolio theory and advisory. Alan; who also was present at the interview, has worked for Fin A for ten years of which seven to eight years with investment. The last two years he has worked as a manager and previous to those, five years with capital placement. He, in comparison to Adam, has studied at university and has an Economics degree but has also attended internal courses. The internal courses go either in cooperation with Stockholm Business School or within Fin A itself. Almost all employees at the department where Alan and Adam work have an Economics degree at some level. It is also required that financial advisors possess a licence in order to be allowed by law to work as a financial advisor.

The financial institution has been listed on the Stockholm stock exchange since about 1875, and has since then also worked with investment. Fin A has both private people as customers as well as companies. The number of customers they serve is about 100 and are split up into 3 main categories: a third is private people, a third is customers and a third is classed as others such as foundations, congregations and local councils. The customers served at the department where Alan and Adam work are required to posses a minimum amount of 2 000 000SEK that they have to invest. Surprisingly to us anyway was that they have many customers who have over 2 000 000SEK to invest. They do however work for the whole Norrlands region from Kiruna down to Örnskolsdvik and from this they can as they say “get the best customers” There is also a clear difference
between what percentage of private investors are men and women. The customers that Adam and Alan deal with are more or less men with 65% of the total amount. On top of this it is also mainly older men that invest. They have built up their riches by example, owning companies and then selling them.

The advice given to private people does not differ much from the advice given to companies; the groundwork is the same. When a customer comes into Fin A the adviser wishes to know what level of risk the customer wishes, what size of dividends the customer desires and what the purpose of the investment is. Both companies and private people invest in the same market, so the only major difference between them is risk level and amount of returns the investor wishes. The groundwork for private people investing that they have is split up into different steps. The first step is that they take a comprehensive look at the customer. The family situation (married, living together) and how they live (house, apartment, rented or bought) is looked into. They then look at the income that the customer has and check whether he/she receives any benefits. Staying on the financial side, the next thing taken into consideration is what debts and if/or the customer has any student loans. Going back to the living situation, the costs of living are looked into (mortgage, interest payments, amortisation payments and other costs that need to be looked at. Fin A will then have a look through the customers’ current investments. Here they look to see whether the customer has investments in other financial institutions; if so then they attempt to bring the investments over here to have a more complete overview of the customers’ finances. The reasons for investing are discussed with the customer and depending on these Fin A can advise different types of investments that will fit the customers’ wishes. How the customer thinks and interprets the investments that they are making is important.

Risk is also explained to the customer. Alan explains that they talk about four different types of risk: interest risk, credit risk, currency risk and liquidity risk. A basic diagram is then shown to show that in a market there exists company specific risk and market risk. Alan explains with a diagram to customers that it is impossible to avoid market risk whereas company specific risk can not technically be avoided however it can be
minimised through making a portfolio that contains 10 – 15 companies and/or lines of businesses. Fin A has a policy however when it comes to their own shares that they do not give out recommendations of their own shares. This does not mean that a customer can not buy the shares. They do however recommend other financial institutions shares to customers. They explained that it would be unethical for them to offer their customers, their shares.

In Fin A, a normal advisory meeting takes place, for first time customers in the office. The ground concept, that was described above is followed to get the basic information before they go any further. Once this is done so is it up to the customer to decide what and how much they wish to invest in a single share or in a portfolio. The customer can follow the advice given or they can do what they wish to do. No matter what happens, Adam has to, by law, explain what the risk is that is involved the time horizon that has been decided and to keep a document of every one of these steps that is taken. A customer that makes a decision that Adam advises against has to also be documented in the case of future disagreements. We asked what the average risk level that is normally taken by the customer. The answer we got was that a customer wants the highest possible return with no risk, which is explained by Adam, is impossible. Adam explains that it is a learning process for the customer to understand risk. They try to explain that with a certain level of risk there exists a corresponding level of return. Standard deviation is also explained. The fact that the stock exchange can increase 20% appears to go down well with the customer explains Adam, but he also has to explain that it can go down 20%. The easiest way to explain the risk involved is by using crowns and öre. Adam describe this way as normally the best way to make customers understand the concept of risk. There are however customers that are knowledgeable. A portion of their customers are companies who have employees that work within this area all time. Even private people are knowledgeable. Adam explains that they have become more knowledgeable ever since the downfall on the stock exchange in the beginning of 2000-2001. Risk has been taken more seriously and customers now have a more reserved attitude towards risk because of the downfall.
Macro economical changes affect Fin A. If for example it is believed that Telia’s shares are good business and high demand for the share can increase the price of the shares but it is nothing that Fin A has to follow if they do not wish to. They have so much information to make the decisions themselves and they trust there market analysts that they are not influenced by it too much. Following the market is part of the job and Fin A does have up-to-date knowledge of the market by doing this, however they normally follow their own recommendations. Both Adam and Alan are in agreement that it is not as if another financial institution comes onto the market with something that affects Fin A but like they said before they keep a good eye on developments. All financial institutions offer the same type of products and services, so if another institution was to offer something new on the market it would be easy for Fin A and others to copy it without any problems. Employees that come from other financial institutions sometimes bring with them new methods on how to improve working methods; they can be gladly implemented in Fin A. Fin A does neither feel threatened by the increased services provided through the internet; more and more information is now provided through the internet and Adam believes that this actually results in that people interested in investing need more help in order to figure out how they should handle, on the other hand Adam and Alan also believe that they may have lost customers to internet companies.

Employees within Fin A have a certain degree of freedom and power within their jobs. They have the ability to create their own portfolios which can be offered to customers. Adam and Alan have also their own analysis which they can look at and if they decide that a certain company’s share should not be in a portfolio it will not be in there. Headquarters down in Stockholm has a certain level of influence in the job that Adam and Alan do. The headquarters have also their own analysts who analyse single shares but not portfolios. The analysis which takes place in Stockholm is used to advise every office which shares they should buy and which shares they should sell. It is however then up to Adam as the supervisor to decide whether the recommendations from the headquarters should go in the customer’s portfolio. It also works the other way that Adam can influence Stockholm in a smaller way by suggesting to them what they can buy and sell. It is not just from Stockholm that they can get their analysis from; they can also get
analysis from other sectors in order to get a different and more complete picture of the market on order to give the customer the best possible service.

5.2 Financial Institution B.

Bob is a capital advisor, as they call it nowadays, with an economics degree. Bob explains how the job title has changed already three to four times during the six years he has worked at Fin B. In order to become a licensed advisor, he has taken part of the courses that are offered through the financial institution. The job can be all from small tasks such as payment service or card questions to investment.

About 30% of the employees at the office of Fin B in Umeå have a university degree. Today it is not required to have a university degree in order to receive a job at the particular kind of financial institutions, such as Fin B. The organisation has shrunk since the crisis of the 90’s and even today there are not that many job openings and therefore the requirements for those searching for a job in this line of business can be set by the company. The average age is 43 and it is mainly younger employees, with university degrees that occupy the customer service places, since that is the starting place.

Most of the employees on a higher position have worked in some other financial institution, an estimation from Bob tells us that this counts for about 90% of the employees in his office, and he is one of them. It has not appeared that someone has come from another financial institution and brought over new working ways or other ideas that have been implemented. He is neither aware that financial institutions in the line of business have copied each others portfolios or ways of advising. It is more common that for example new products are tested by one first and then others follow. He believes that Fin A is usually the last one of the institutions to put new products into use. It is usually that the same financial institution does not need has to pay the research and development costs all the time and other financial institutions take advantage of this.
Competition between the actors on the financial market is becoming fierce, since it is an oligopoly market. This competition causes the “we follow you”-syndrome between these actors. If one lowers the prices, others follow even though they would not gain from this decrease. The actors on the market do offer more or less the same; it is the target market that differs. Even the little niche actors on the market can influence the bigger actors; it is mainly a price question. These niche actors can for example offer cheaper loans or even the price for investment can be lower than what we offer. As they lower their prices, customers may choose to go where the lowest price is and therefore we too may need to follow the trend. Also the European Union has an influence on our offers. Fin B used to offer this “confidential management”; meaning that the financial institution has the authority to handle the portfolio with certain restrictions. This offer will now disappear because of EU restrictions. As an employee, Bob is of the opinion that as a capital advisor he has some influence concerning the choice of investment chosen by the customer. The capital advisor has influence over which tools to be used and which types of investment portfolios that can be made. Main decisions such as the “pre-made” portfolios are on the other hand made at the head office. This has to do with the history of the company; Fin B has this “big-city” mentality and has as a result only 10% of the market in Umeå.

Anybody with some sum between 0-1 000 000SEK can be appoint a private advisor. There are also employees who take care of customers who have more than 1 000 000SEK, and those are the customers Bob takes care of. At Fin B; it takes two capital advisors per customer so they can share the responsibility. He works with investment, insurance, legal issues and taxes. Before working at Fin B, Bob has worked at Fin C for three years; where he did the tasks of a private advisor. He briefly explains his tasks there as: “less of a specialist, more like a generalist”.

The customers Bob and two other capital advisors at Fin B take care of are not only private people; even companies and foundations need advice concerning financial investments. The treatment however can differ. At the most, Fin B would like to take care of 150 customers in the category of “customers with more than 1 000 000SEK to invest”
but the demand is higher and therefore Fin B has to try and take on as many customers as they can handle. Fin B has offered shares and investment help at least since the 1980’s and have since then aimed to serve the wealthier public and companies. There is a small difference between the services both target customers receive. The first main difference is a law that protects the private customers from negligence that could come from the institution. Private customers are assumed not to have a broad knowledge of investment which gives the bank a higher responsibility. Fin B does try to give each category of customers the same investment help, it is however not as easy done as it is said. The category of private customers exists mainly of elderly men (50-80 years old); as they are the age group that has been able to save and are also of the generation where the man is the responsible person in the family for financial support. For small companies it is usually a private person that receives the advice, for bigger companies it is usually the board of the directors to whom Fin B directs its advice. Advising companies is more like a business deal; we have higher expectations towards the company concerning knowledge about investment. The private customers can be educated in this subject as well; mostly those who have time and commitment to acquire the necessary knowledge.

A regular meeting between a capital advisor and his/ her customer starts by a questionnaire that that customer needs to fill in. There are four groups of questions which need to give a picture of the customer as a whole. The customer data questions are concerned with the background of the customer; such as the customer’s age, whether the customer is married and has children. An important question here is what the purpose is of the investment; this for the time horizon- risk relation. There are also questions concerning tax-law. The risk questions give the advisor a sign of what attitude the customer has towards risk; whether he/ she is willing to take a lot of risk or just a little or is more neutral. The external volumes refer to whether the customer already has investments through another financial institution. This is important so the customer does not have the same type of placement more than once; in case of decreases in the stock exchange this can lead to bad consequences. This information is documented and kept for future reference. The main emphasis is put on risk; while answering the risk questions, it is essential for the capital advisor not to intervene while the customer answers the
questions in order to obtain a risk level fully reflecting the customers’ selection. It is of
great importance that the customer understands and grasps the concept risk and to see the
portfolio as a whole. The capital advisor tries in a pedagogical way to explain what risk is
and what does it do. The main part of Fin B’s customers are satisfied with the advice they
receive. It seems though that more customers are not as satisfied when the stock
exchange has gone down; the reaction mostly follow is that the financial institution
should have known better. It is therefore important that know that the customer and the
capital advisors speak the same language. There are customers that want a high return
and no risk, which is not possible and it is therefore important to explain the terms risk
and return. The next meeting starts by looking whether the attitude of the customer
towards risk, whether the external volumes or the life situation have changed. Fin B has a
policy that they should meet at least once a year with each customer, of course can
meetings occur more frequently or even telephone contact is common. As capital advisor
it is their job to verify whether the customer is satisfied with the risk level on their
portfolio. At every form of contact notes are taken or the conversation is taped and
verified by the customer. Every month the customer receives also an information
brochure with facts and news concerning the history of the shares invested in, fees and
about risk levels.

The risk on portfolios is measured by standard deviation, customers do not understand
this, and on the other hand can the measurement be used to explain the different risk
levels of different portfolios and what that can give as return. It is important to look at the
portfolio as a whole in order to fix the risk level to the desired level by combining shares
and “interest placements”. A so called “balanced portfolio” at Fin B is one that contains
70 % shares and 30% interest market and that is what many customers have. When the
customer desires a portfolio with a higher risk level these proportions can then be
changed to more shares and less interest placements. Fin B also provides pre-made
portfolios, which are composed at the head office in Stockholm.

Fin B does have a policy not to recommend their own shares, Bob explains how that it
feels wrong to recommend themselves. He does not prohibit customers to invest in Fin
B’s shares; the customer is free to do so if so is wished. There are on the other hand recommendations on closely related companies or companies with whom Fin B has a deal or other financial institutions.

Many of the customers at Fin B have portfolios with long-term placement. There is on the other hand also a possibility to actively trade with shares and Fin B offers help even for those active customers. Many of the customers have also been client for a long time, that they even have experienced the crash of the stock exchange in the 80-90’s and in 2001-2002, when the stock exchange fell really badly. At this point it could have been better to have been a share trader and sell the share as soon as they decrease in value or it may have been safer to just let the money rest in a bank account. The best is however to be long-sighted; the chances of having positive return increase with time or risk level decrease as time goes by. The risk level for the investments is thus put in relation to time and therefore the further the time horizon the higher risk a customer can take when investing. As an example Bob used investing for a child’s future. He said that it is very rare that an investment in interest market is done; it is a portfolio composed of only shares that will be used. It is hard to find a portfolio only made out of shares that over a time-period of 15 years has gone bad. For an investment for only about four years it is harder to judge; and therefore more interest placements will be used.

The main aim of a portfolio composition is to have diversification; a portfolio should contain about 14 different shares; leading to a better spread of the risk within the portfolio. Bob does say that that is something he aims for because he has been educated and is aware of the economic theories. Fin B used standard deviation for risk measurement.

Customer’s attitude towards risk can said to be in relation to how the stock exchange is doing; when the stock exchange has gone up customers tend to want to take a higher risk level portfolio; whereas when the stock exchange has gone down they are more careful.
5.3 Financial Institution C.

Clive has worked with investment for about ten years however he has experience from financial institutions since 1984. He has experience as an estate agent, share trader and has only worked for two years as an advisor in a department called private banking at Fin C. He is a licensed capital advisor who started the Business program at Umeå University; however never graduated. The internal courses offered by Fin C have contributed to the license Clive received. He explains that in order to have the authority to handle investment planning for customers certain certificates have to be obtained; this has been a law since about 2001. Nearly all new employees have a university degree however of the elderly employees only about half of them do. As for those searching for a job within a financial institution, the requirements can be high since there are not that many job openings.

Fin C has offered shares since the 1980’s; investment help on the other hand has been available since the 1800’s; since the financial institution was found. At the private banking department customers with an amount of at least 2 000 000SEK to invest are taken care of; they can be either private people or companies. In the private banking department Clive and his colleagues handle 50 to 200 customers.

Clive finds it difficult to describe how a regular customer meeting occurs; it depends on how many times before he has met this particular customer. In general; at the first meeting; a mapping of the customers’ financial situation is done. After that a meeting is arranged every three to six months to go through what has happened and whether any changes in customer wishes have come about. There is also a questionnaire the customer has to fill in on paper and on the computer. There are computer programs that can map the aspirations of the customers. All information acquired has to be documented for further reference. For customers that are companies the documentation requirements are not as hard as for private customers. There is of course also a difference between the services both categories of customers receive, as customers are not seen to have the same level of knowledge as companies should have. The placement for companies is usually
also the excess liquidity and they expect usually just a suggestion of how to place this capital. Private customers have greater demands. With all kinds of advising it is important to be honest, says Clive. With the knowledge the advisors posses they have to try and gain the trust of the customer that has to last for years. From time to time they send out questionnaires that have as an aim to find out about customer satisfaction. Results have shown that customers seem more satisfied when the stock exchange has done well whereas when the stock exchange did worse more complaints arise.

Risk is more a question of definition, Clive says; and there are different ways of explaining the concept to the customer. Clive tries to explain it by drawing a figure showing different levels of risk in relation to return; as return increases so does the level of risk. All customers are different; some would like an easy start and others would like to go straight into the stock exchange. Not all customers appear ignorant some do have a broad knowledge of investment and this can be difficult to handle since they may have higher expectations and may miss a good deal. Customers that are not as educated in this area may do a good deal because they only look at the numbers. Customers do understand when the advisors explain that different actions lead to different levels of risk; they seem more eager to take higher risks when the stock exchange is sturdy and going well. As an advisor Clive thinks that the degree of influence on the customers` decisions can differ from customer to customer; if the customer is a company they may have clear restrictions and guidelines from the board of directors on how to place the money. Private customers are easier influenced as they may not posses the acquired knowledge.

Fin C offers a broad selection of pre-made products for the customer to choose from; all from complete share portfolios or interest placement portfolios and even a choice can be made by investing in portfolios with foreign shares. There portfolios are created in the headquarters of Fin C; in Stockholm. It is not uncommon though that a customer can create his/her personal portfolio; and even shares in Fin C can be chosen; it is however not directly recommended by the advisors. Clive is of the opinion that recommending the shares of Fin C may decrease the credibility of the company. When creating a portfolio, the customers` desires are taken into account. It is highly individual how this portfolio
can be created; it is the individual customers' choice what level of risk the portfolio should carry. Fin C uses a computer program in order to find out what level of risk is preferred by the customer; this is done by answering several questions concerning risk. Every half year when the customer and the advisor meet they go through the questions again to see if there are any changes in customer attitude towards risk.

Clive believes that macro economical changes do influence the whole picture of investment. If any other financial institution was to bring out a new product, then Fin C will also implement this product. Financial institutions keep an eye on each other; there is close competition on the financial market. Clive does on the other hand not feel that Fin C is in the position to need to copy from other financial institutions. When asked whether a new employee from another financial institution came with new ideas that have been implemented at the office in Norrland there are about five people working with placement advice and of those about half have worked for another financial institution. Clive himself has worked for Fin B before. He believes that everybody brings new ideas from other working places; such as how to organise customers meetings or simply how to please a customer differently.
Chapter 6: Analysis and discussion.

“Theoretically seen is there no difference between theory and practice. In practice however there is.” (Wahlströms, 2006). The analysis will help us find out if this statement is true. For this analysis we had thought to follow the diagram found in chapter four (Figure 4.3). This diagram is a summery of the theories we used and shows how we believe these theories are linked together. Well worth being reminded of is that the names for the respondents chosen start with the same letter as the letter denoted to the financial institution; Fin A, Fin B and Fin C.

6.1 Financial market and financial institutions.

The respondents for this thesis are financial or capital advisors at financial institutions; of which we keep the specific line of business unnamed; that act on the financial markets as intermediaries. These intermediaries have access to skilled and qualified people who have the ability to inform their customers about which are the better forms of investment. All four of the respondents have taken courses provided by the financial institution and that are related to their daily work. They also have at least two to ten years of experience as financial advisors however all four of them have been within this line of business between six to twenty years. From the interview of Fin A and B we found out that in order to be a financial advisor a license is necessary; it has been a law since 2001.

The market on which financial institutions operate is competitive and has only a small margin for differentiation. It is the target market where the differentiation lies according to Bob. This we can see from the amount of money an investor needs to possess in order to go to any of the three of the respondents; for Fin A and Fin C the target investors need to possess 2 million SEK in relation to Fin B only 1million; however for neither or the financial institutions it matters whether the investor is a private person or an organisation that would like to receive advice. There is only a small difference in the service they
receive, the expected knowledge of the investor; the ground work is the same. The number of clientele taken care of does also differ between each of the three financial institutions; Fin A has on average 100, Fin B 150 and Fin C 50-200. What can be seen is that all three financial institutions agree on the fact that their cliental consists of a greater proportion of men between the ages of 50-80 as they have been able to build up capital. The way each financial institution takes care of their customers is different and will influence the choice for the customers; how often the financial institution has contact with the customer and what way information is provided. Fin B has for example a monthly new letter sent out to their customers and has a policy of having at least one meeting per year, Fin C on the other hand enjoys more regular meetings with their clients. Clients can for all three institutions be either private people or organisations of any kind. For neither of the financial institutions does the service given to each category differ much; the first main difference is a law that protects the private customers from negligence that could come from the institution and secondly private customers are assumed not to have a broad knowledge of investment which gives the bank a higher responsibility. Bob at Fin B explained that advising companies is similar like having a business deal. The virtual internet companies are also taking over customers from the actual financial institutions; this does not bring any concern to the financial institutions since they believe that due to the increased availability of information investors may need help in their actions as the actual financial institutions provide expert advice. Bob explained that the competition also gives tendencies to the “we follow you” syndrome and exemplifies this with that Fin A usually waits till another financial institution has come out with a product so they can see how it evolves.

In order for the financial institutions to provide the best possible help; the advisors also need to understand the demand of their clients. Since investors may be dependent on financial advice it is evident that the financial intermediaries work towards the best for their investors. During the first meeting with the client all three of the financial institutions guide their client through a computerised test through which the financial institution receives background information about the client. For private investors the information required also involves family situation, how the client lives and the clients’
income. The information required from investors is concerned with the current investments; are these situated at another financial institution and can they possibly be transferred to this particular financial institution the investor wishes to receive advice from. This is necessary to know so that the investor does not invest several times in the same portfolio and also so the financial institutions can keep better track of the investments of their clients. Another piece of important information is at which level of risk the investor is willing to invest at.

6.2 Risk and MPT.

Risk is risk and it is unavoidable in the respect that there will always be market risk. There are however, customers who expect risk free investments. With the support of theory and general definitions existing, the financial advisors try their best in explaining the concept risk and its significance to their clients, and all three financial institutions work more or less in the same way for this. Crucial information here is the time frame for the investment; as the time period is connected to the level of risk. This goes in line with the study that Siebenmorgen and Weber (2004) have done; there is a general belief that a higher total portfolio risk should be taken for long term investments in contrast to short term investments for which most people wanted to take a lower total portfolio risk. It is important for investors to know what risk is and how it functions; for this reason the communication between the investor and his or her financial advisor has to be at the same level. If this is not the case the risk assigned to the portfolio compiled for the customer may not resemble the risk the investor is willing to take. Risk is defined as the deviation of the return from the investment. Risk is put in relation to the expected returns, as the expected return increases the level of risk also increases. Risk is put in relation to the required return of a security, as the required return increases, so does the risk of the investment (Eakins, 1998). This is how the financial investors at Fin A, B and C explain to their customers what risk is; however Fin A and C uses diagrams and drawings as tools for educating the investors in the difference between market and firm-specific risk and how this can have an effect on the portfolio as a whole. In general it can be said that the
three financial institutions interviewed for this study agree on the fact that a lot of emphasis should be put on risk. Bob at Fin B is of the opinion that while the client is answering the risk questions, it is essential for the capital advisor not to intervene in order to obtain a risk level fully reflecting the customers’ selection. Adam at Fin A believes that since the downfall of 2000-2001, the clients have become more aware of the concept risk; so there are clients that are knowledgeable.

Depending on the investor’s attitude towards risk, he or she can be categorised into three main categories. A risk taker is more interested in future gains, whereas a risk averter will be more anxious about avoiding losses. The investor can also be risk-indifferent (Pike and Neale, 2003). The different financial institutions used for this study all have experience of similar ways of their clients’ attitudes towards the risk levels. Adam explained that clients like to aim for the highest possible return with no risk. At Fin B and Fin C, the general believe is that the customer’s attitude towards risk can said to be in relation to how the stock exchange is doing; when the stock exchange has gone up customers tend to want to take a higher risk level portfolio; whereas when the stock exchange has gone down they are more careful. Clive does also believe that all clients are different; some like an easy start and other go straight for the stock exchange.

Once the financial advisor has explained the concept risk and return and how these relate to the time aspect it is time for the client and the financial advisor to compose a portfolio. Compiling a portfolio reduces risk; the unsystematic risk, and therefore it is important while compiling a portfolio to pay attention to this security specific risk. The more securities gathered in a portfolio, the more chance of eliminating the unsystematic risk. At Fin A the client can choose to compose a portfolio or to invest only in single shares; it is though recommended to invest in 10 -15 shares to compose a portfolio. It is the clients’ choice to follow this advice or not, a customer that makes a decision that is advised against has to be documented in the case of future disagreements. Bob at Fin B aims straight for compiling a portfolio as he is aware of the economic theories. The main aim of a portfolio composition is to have diversification; a portfolio should contain about 14 different shares; leading to a better spread of the risk within the portfolio. At Fin C it is
highly individual how the portfolio can be created; it is the individual customers’ choice what level of risk the portfolio should carry. Every half year when the customer and the advisor meet they go through the questions again to see if there are any changes in customer attitude towards risk. At Fin B this meeting takes place at least once a year and for Fin A whenever is necessary.

6.3 Portfolios for customers.

Research has shown that investors have a hard time dealing with losses and can make bad investment decisions trying to compensate for these losses. With the help of a financial planner this behaviour can be toned down and the client can receive advice on how to act on the market with patience. Planners generally have access to the appropriate resources and can consequently adjust and advice on the risk of the portfolio to the risk level that is tolerated by the client rather than simply aiming for long term, high returns (Kirkby, 2005). Employees within Fin A have a certain degree of freedom and power within their jobs; they have the ability to create their own portfolios which can be offered to customers. They also make their own analysis which than can be looked at in case a certain company’s share should not be in a portfolio. Headquarters in Stockholm also have a certain level of influence in the job that Adam and Alan do; they their own analysts on single shares but not portfolios; and give recommendations on those. It is however then up to Adam as the supervisor to decide whether the recommended shares should go in the customer’s portfolio. It is not just from Stockholm that they can get their analysis from; they can also get analysis from other sectors in order to get a different and more complete picture of the market on order to give the customer the best possible service. The main part of Fin B’s customers are satisfied with the advice they receive from Fin B, it seems though that more customers are not as satisfied when the stock exchange has gone down, it is for this reason important that know that the customer and the capital advisors speak the same language. Bob believes that the best is to be long-sighted; the chances of having positive return increase with time or risk level decrease as time goes by. The risk level for the investments is thus put in relation to time and
therefore the further the time horizon the higher risk a customer can take when investing. The risk on portfolios is measured by standard deviation, customers do not understand this, and on the other hand can the measurement be used to explain the different risk levels of different portfolios and what that can give as return. It is important to look at the portfolio as a whole in order to fix the risk level to the desired level by combining shares and “interest placements”. A so called “balanced portfolio” at Fin B what many customers have, however when the customer desires a portfolio with a higher risk level these proportions can then be changed to more shares and less interest placements. Fin B also provides pre-made portfolios, which are composed at the head office in Stockholm. As part of the service at Fin C, a broad selection of pre-made portfolios is offered to the customers. These are compiled at the headquarters however the customer can also compile their own in accordance with the customer’s desire. Clive believes that with the knowledge the advisors posses they have to try and gain the trust of the customer that has to last for years. Results form the questionnaires regularly sent out to the customers to measure customer satisfaction have shown that customers seem more satisfied when the stock exchange has done well whereas when the stock exchange did worse more complaints arise.

As a part of the customer’s portfolio, the clients are allowed to have portfolios containing the particular financial institution’s, at which the advice is received, shares. None of the interviewed financial institutions have a recommendation on their own shares. For Fin B it occurs that there is a recommendation on the shares of companies closely linked to Fin B. The opinion of Clive at Fin C is that recommending your own shares may reduce the credibility of the company, Adam says it feels wrong and Bob says straight out that it is unethical. In general the three financial institutions are of the same opinion.

6.4 Institutional Theory.

As stated at the beginning of the theory section on Institutional Theory, we the authors did not know what Institutional Theory had as background. However, through writing this thesis, we have found that it is a very important theory in investigating the behaviour
of different organisations within the same line of business. The information gathered from the interviews that we carried out shows this. If we take the first isomorphism, coercive isomorphism (DiMaggio and Powell, 1983), we see that all three institutions are affected by this one. Government intervention and new rules and regulations that come from ruling powers are impossible to avoid and all companies have to abide them, Fin A, B and C are no exception to this rule, not only due to Swedish government intervention but also due to intervention from the European Union; as Sweden is a member of the EU. This leads to a certain degree of homogeneity, which makes sense because if all companies follow the same rules then they will also become comparable.

Mimetic isomorphism is the second isomorphism in the theory (DiMaggio and Powell, 1983). This part of the theory is more practical in its application as we can see from the data that we have collected, it explains to see whether a company mimics another company. Fin A state that most financial institutions offer the same services and therefore mimicking is not required. Fin B states however, that they are not the first financial institution to introduce something new. They follow the market and wait until another financial institution has paid the costs for the introduction, and then mimic the results. This is brought about by competition; companies wanting to be the first in the market. Technically we can see that Fin B follows the theory. The financial market is a market in which companies need to be at the top, so mimicking is obviously an efficient way to try and achieve the best possible market position. Fin C have the position of not needing to copy the other institutions, perhaps as a result of that they already have what they need. In line with the theory of mimicking, apart from Fin B, have Fin A and C the same open policy in which any employees coming from other institutions can bring with them ideas and suggestions that can be implemented in the new institution. Due to the homogeneity that exists from coercive isomorphism also comes from mimetic isomorphism. Companies that copy what others do will eventually be very similar, with very little room for originality (DiMaggio and Powell, 1983). In order to gain a market advantage they will have to improve their customer services and offers that they have, for example special deals on opening bank accounts or discount on owning a credit card.
The final isomorphism is normative and has its roots in professionalism. Every company needs people to work in it and Fin A, B and C are no exception. One thing that is common between all three institutions is that they all offer internal education for their employees. It is with this that the companies can distinguish themselves from other companies (DiMaggio and Powell, 1983). In Fin A it is not important that the employees have a university degree because courses are offered internally, but most of the employees in the department have university degrees. Fin B and Fin C have not mentioned anything about education that is offered but going along with the coercive and the mimetic isomorphism it is reasonable to assume that they have internal education for their employees.

In conclusion we can see that the financial institutions in this thesis are followers of the Institutional Theory although it is safe to say that they are probably not aware that they are following it. The theory highlights day-to-day occurrences that have been given a name
Chapter 7: Conclusions.

In order to conclude this thesis and to present the answer to our problem; *What lies on the base for the creation of the portfolio for customers by financial institutions and how does the institutional theory explain the relationship between the different financial institutions for this activity?*, we would like to use the figure made up at the end of the theory chapter.

7.1 Discussion of the findings.

![Diagram](image)

*Figure 4.5. Summery of theories in Chapter 4.*

This thesis started with the question “why do people invest” and we suggested that it could be because people are insecure about their future welfare and aim for future guaranteed cash flows. Not everybody has however sufficient knowledge to make the right decisions concerning the selection of stocks and shares that can be invested in. Investors can neither act on the capital market by physically going to the company but act through a financial intermediary or institution, such as for example banks, credit market companies and others. These intermediaries have access to skilled and qualified people
who have the ability to inform their customers about which are the better forms of investment. All four of the respondents interviewed for this thesis have taken courses provided by the financial institution; they are employed at, that are related to their daily work and for Fin A and B we know that the respondents have a special licence.

The market on which financial institutions operate is competitive and has only a small margin for differentiation; it is in the target market where the differentiation lies. The main difference found here is the amount of cash the investor needs to possess before going to Fin A, Fin B or Fin C. The way each financial institution takes care of their customers is different and will influence the choice of financial institution for the customers. In order for the financial institutions to provide the best possible help; the advisors need to understand the demand of their clients. On the first meeting with the client all three of the financial institutions guide their client through a computerised test through which the financial institution receives background information about the client; such as family situation, information about current investments and most important the level of risk that the investor is willing to invest at. Crucial information here is the time frame for the investment; as the time period is connected to the level of risk; there is a general believe that a higher total portfolio risk should be taken for long term investments. Risk is put in relation to the required return of a security, as the required return increases, so does the risk of the investment and is explained like this by the respondents to their clients in similar pedagogical ways. It is important for the client to understand this concept.

The theory of the modern portfolio is applied at all three financial institutions in order to reduce risk on securities. The respondents help their clients in compiling a portfolio while taking into account the risk level that suits the client and then this level needs to be checked regularly through keeping in touch with the client and organising regular meetings. The portfolios can be custom-made or the financial institutions offer also ready made portfolios. None of the financial institutions would actually recommend the client to invest in the particular financial institutions’ securities; it is however not forbidden for the client to invest in these if they wish.
To see how similar the financial institutions on the capital market actually are in general we had a look at them by taking into account the institutional theory. When we look at all three the financial institutions we learned that all three are affected by government intervention and other new rules and laws; this is known as coercive isomorphism. There is also mimicking taking place amongst these organisations as one may wait and see how it goes for another when introducing something new or introducing a change. The financial institutions do have a way of distinguishing each other from one another through the normative isomorphism which has its roots in professionalism.

We can split our research question into two main questions in order to summarise an answer. What lies on the base for the creation of the portfolio for customers by financial institutions? From the information gathered we understood that the first information financial institutions gather is personal and financial information about the investors which is needed to get a picture and an understanding about their client. We have also learned how important it is to understand risk, as it is the risk that will determine the composition of the portfolio for the investor. How does the institutional theory explain the relationship between the different financial institutions for this activity? We could see with the help of the institutional theory that there is little space for differentiation and can therefore say that the financial institutions work in a similar way in the advising of their clients and for the composition of their client’s portfolio.

7.2 Criteria and quality discussion.

There exist criteria which studies should fulfil in order to increase its reliability. In this part of the thesis we would like to discuss the main criteria described by Bryman (2003). There are those in particular for quantitative studies such as reliability, validity and replication; which have an equivalent for qualitative studies; dependability, credibility and transferability.
Dependability is looked at to see whether or not the findings are time dependent; can we at any other time redo this study and find the same results (Bryman, 2003). We believe that it is possible to do this study again and draw the same conclusions. There is however a restriction in time due to the continuous development in this business area and on the market. Competition between the financial institutions on the financial market is fairly strong and their tasks are extremely similar; actors may disappear from the market or more actors providing different or better services may appear. For these reasons the results of this study may only be comparable in perhaps within the next couple of years.

Credibility is concerned with how plausible the results are (Bryman, 2003). For this study we believe that our findings are credible due to the fact that we only have tried to see the relationship between the theory we found applicable for the study and the empirical information we have gathered through interviews. There has at no point been any altering of information.

Transferability deals with whether the findings of this study are tied to this research area only or are they relevant in other contexts as well (Bryman, 2003). As far as the results concerning the portfolio theory, the financial market and risk goes there are more actors on the financial market other than the actors from the same line of business we have chosen for this study. The results may therefore also be applicable to other actors on the market; this however would need some further study in order to find out. When we have a look at the institutional theory; we believe that other actors on the market may have a close eye onto each other and may just as well behave in the same way as our results show that our respondents behave. The institutional theory does apply in many other contexts and therefore our results related to this theory can also apply in other contexts.

Another criterion mentioned in Bryman (2003) which we find is worth commenting on is relevance; whether the topic studied is relevant for the particular research area or whether it may contribute to the existing literature. Relevance is an interesting criterion to discuss because there is so much information available about the different areas within finance that it may be hard to actually grasp what is or what is not available. When we started
working on this thesis we found it difficult to have access to a broad range of information concerning financial institutions and their activities and for that reason we believe that this thesis may be interesting to read. The existence of financial advisors is relevant particularly now in Sweden, given the change in the population and the increased recognition of the need to prepare for one’s own retirement. People wondering about their retirement plans or any other type of saving could view this thesis as a good source of information. The information needed however is not complete but could easily be used as a stepping stone towards gathering information.
Chapter 8: Further research.

In addition to this thesis there are plenty of abilities to extend the research. Our research area has been very limited even within the problem. Suggestions for further research can be the following:

- Investigating what securities different financial institutions offer in order to compile a portfolio and how this offer is influenced.
- Behavioural finance is a fairly hot topic at the moment in which research is expanding. A closer look into behavioural finance influences decisions making both from the perspective of the financial institution and the customer.
- This thesis has tried to answer the question: “What lies on the base for the creation of the portfolio for customers by financial institutions and how does the institutional theory explain the relationship between the different financial institutions in the same line of business for this activity?” The financial institutions were limited to one line of business. A cross trade investigation can also be interesting in order to see if there are any different approaches towards the customers.

As all good things are supposed to come in three; these suggestions above really do not cover all research possibilities related to our thesis topic. As finance is a growing and interesting area, research within this topic has no limits.
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Electronic Sources:


**Interviews:**

Adam Manager at finance department and Alan, Financial Advisors at Financial Institution A; 2006-05-05, 14-15

Bob, Capital Advisor at Financial Institution B; 2006-05-03, 15-16

Clive, Capital Advisor at Financial Institution C; 2006-05-16, 15:30-16:30
Hej,

Vi heter Nathalie Beauprez och Christopher Muir och tillsammans skriver vi vår C(Kanditat)-uppsats inom finans. Frågeställningen som vi har är ungefär följande:

Hur finansiella institutioner sätter risk nivå på portföljer åt sina kunder och hur de sätter ihop portföljer åt kunderna.

För att besvara denna frågeställning vill vi gärna göra en intervju. Med er tillåtelse vill vi gärna spela in intervjun och om du önskar kan vi låta dig läsa det vi använder från intervjun för att vi kan få feedback i fall något har blivit missförstådd. Gärna hade vi också skickat dig våra intervjufrågor innan intervjun i fall du vill förbereda dig eller bara vill se vad vi vill veta. Intervju manualen är tyvärr inte ännu färdig just nu. En annan sak som vi behöver tillåtelse för är om vi får be er att sätta ihop en portfölj åt en påhittad familj för att kunna se hur ni gör sådant.

Intervju tillfälle bör inte ta längre än en timme och vi vill gärna genomföra den vecka 18 (nästa vecka redan). För oss passar varje dag förutom på fredag (05-05/06) förmiddag.

Tack så mycket i förväg!

Med vänliga hälsningar
Christopher och Nathalie
Interview schedule: English.

- What is your occupation?
- How long have you worked with finance and investment?
- What type of education do you have? Do you have any previous knowledge?
- How long has your financial institution offered shares and investment advice?
- Which categories of customers do you serve concerning investment? (private people / companies) Do these different categories receive different kind of service?
- What percentage of employees has a higher educational background?
- To what extent is your organisation influenced by: macro economical forces? For example: decisions made by other financial organisations concerning stock, shares and portfolios; how much influence do you the employees have within the organisation?
- How many of the top bosses have had previous employment within another organisation within finance and investment?
- Has a new employee from another financial institution brought new ideas from that financial institution that have been implemented?
- Has your institution ever had to mimic another institution? Why?
- What is your view on the amount of confidence that is shown to your organisation by customers?
- Can you explain to us how an ordinary counselling meeting with a private customer is carried out?
- Do you as a financial advisor explain to your customer what “risk” involves / means? If yes, how do you explain this concept?
- How do you as a financial advisor the customer’s attitude towards “risk”?
- Which level of risk does an average customer prefer in relation to the expected returns?
- How much influence do you as the financial advisor have in a customer’s choice of portfolio?
- Does your financial institutions offer pre-made portfolios for private customers? If yes, on which level are they created; regional or from the headquarters?
- Does your financial institution have its own shares? If yes, Do you advice your customers to invest in this financial institutions securities as part of their portfolio?
- Could you explain to us how a portfolio is compiled?
- What do you take into account while compiling the portfolio?
- How is the level of risk set onto the portfolio for the customers decided? Who sets the risk level and how are the calculations done?
- Is the level of risk set in relation to the time frame for the investment? Explain, please?
- The level of risk changes over time for the portfolio; how do you keep track of these changes? Which adjustments are made when the risk level of the portfolio has changed?
Appendix 2b.

Intervju manual: svenska.

- Vad är din befattning?
- Hur länge har du jobbat inom finansiering/med investering?
- Vad har du för utbildning? Har du tidigare kunskap inom området?
- Hur länge har din bank erbjudit aktiefonder och placeringshjälp/råd?
- Vem har din finansiella institution som kunder gällande investering? (privat/företag) Finns det en skillnad på vilken typ av service som ges till de olika kategorierna av kunder?

- Hur stor är andelen hög utbildade inom din finansiella institution?
- Hur blir din finansiella institution påverkad av makroekonomiska förändringar? Till exempel: beslut som tas av andra finansiella institutioner när det gäller finansiella instrument; hur stor makt ni har som anställda inom företaget…
- Hur många högre tjänstemän jobbar på din finansiella institution som har jobbat inom en annan finansiell institution med investering och rådgivning?
- Finns det någon/några anställda som har kommit från andra finansiella institutioner och har tagit med nya idéer som har blivit genomförda?
- Har det hänt någon gång att din finansiella institution behövt kopiera en annan institutions aktieportföljer och rådgivning som erbjuds?
- Hur ser din finansiella institution på det förtroendet som kunderna har gentemot er när det gäller rådgivning?

- Kan du förklara hur ett vanligt rådgivningsmöte med en privat kund går till?
- Förklarar ni som finansiella rådgivare för era privat kunder vad “risk” innebär? Om ja, på vilket sätt förklarar ni begreppet?
- Hur upplever du som finansiell rådgivare privat kunders attityd gentemot risk?
- Vilken nivå av risk brukar en genomsnitts kund föredra i relation till den förväntade avkastningen?
- Hur mycket påverkan har ni som finansiella rådgivare när en privat kund ska välja sin portfölj?
- Erbjuder din finansiella institution ”pre-made” portföljer åt privata kunder? Om ja, på vilken nivå skapas den; regional eller utifrån högkvarter?
- Har din finansiella institution sina egna aktier? Om ja, rekommenderar ni till era privata kunder att investera i dem som en del av portföljen?
- Kan du förklara hur skapandet av en portfölj går till i din finansiella institution?
- Vad tar ni hänsyn till när ni sätter ihop en portfölj?
- Hur bestämmer ni risk nivån på de portföljerna som erbjuds till privata kunder? vem sätter risk nivån? vem gör kalkylen?
- Bestäms risk nivån i relation till investerings tiden? Förklara.
- Hur håller ni reda på förändringar i risk nivån på portföljen? Vilka åtgärder tas när risk nivån på portföljen ändras?