

## Working paper - How Sweden Laid the Foundations for a Successful Innovation Economy and a Vibrant Capital Market

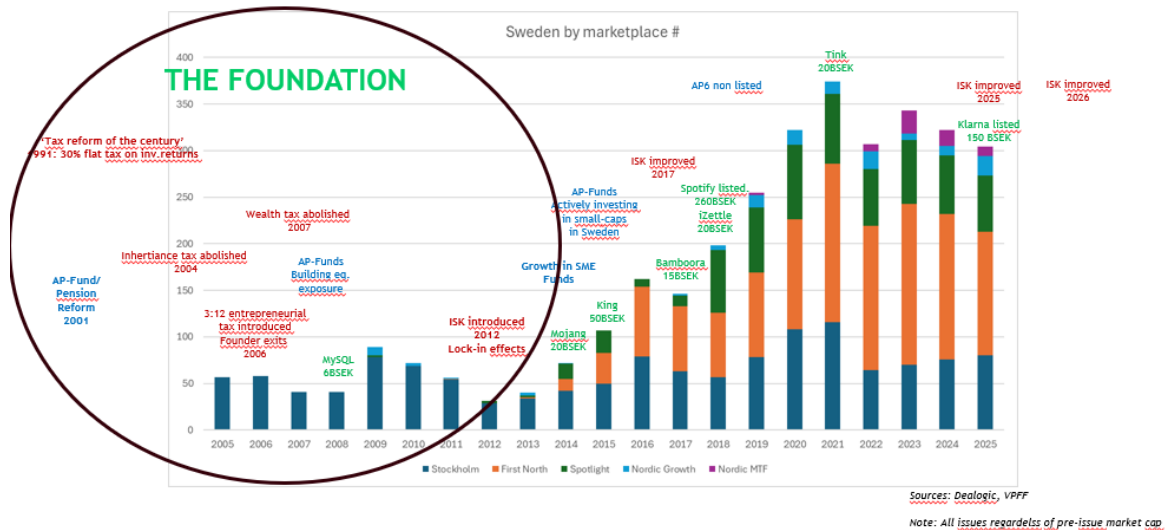
### Introduction

Sweden is often portrayed as a natural innovation leader. In reality, the country's strong entrepreneurial culture, high rate of technology company formation, and highly active capital markets are largely results of deliberate policy decisions implemented over several decades.

The Swedish model is particularly interesting because it combines a comprehensive welfare state with one of Europe's most dynamic ecosystems for entrepreneurship and growth companies. The emergence of companies such as Spotify, Klarna, Evolution, Hexatronic, Sinch and Legora is not accidental. Rather, it reflects institutional frameworks that were established long before these companies came into existence.

Factors possibly contributing to the Swedish success story:

**Exits**  
**Taxation**  
**AP-Fonder**



The value of stable and well-designed framework conditions becomes fully visible only over the long term. Achieving this requires strategic thinking and commitment from politicians, public administration and voters alike. It was the crisis in the Swedish economy during the 1970s and 1980s that created the basis for broad alignment around a business- and investment-friendly policy platform that has remained remarkably consistent since the early 1990s.

There is no simple "quick fix" that can create Swedish-style outcomes in this area. The lesson is one of steady direction maintained over multiple electoral cycles.

It is difficult to overstate the importance of broad political support in Sweden. The recognition that economic value must first be created before it can be distributed generated a shared sense of direction among policymakers, businesses and investors. This, in turn, fostered stability, predictability and trust.

### **The Foundation: Reforming Incentives**

The first decisive step was a series of tax and pension reforms that began in the 1990s and continued into the 2000s.

The so-called "tax reform of the century" in 1991 reduced the taxation of capital income and established a more predictable framework for saving and investment. In the years that followed, Sweden also implemented a comprehensive pension reform that strengthened the role of funded savings and helped build substantial pools of long-term investment capital.

Subsequent reforms further strengthened incentives for entrepreneurship:

- Abolition of inheritance tax (2004)
- Abolition of wealth tax (2007)
- Continued development of the 3:12 rules governing owner-managed companies
- Introduction and later expansion of the Investment Savings Account (ISK)

Taken together, these reforms made it more attractive to build, own and reinvest capital in Sweden.

### **Building Domestic Risk Capital**

The second key pillar was the development of a broad and well-capitalised domestic investor base.

The Swedish AP pension funds gradually became increasingly important providers of long-term capital. Unlike many European institutional investors, Swedish pension funds maintained substantial exposure to equities, and their investment mandates were eventually expanded to include smaller listed companies.

At the same time, Sweden developed a strong culture of retail equity ownership. The share of households investing in equities and equity funds is among the highest in Europe, supported in particular by tax-efficient savings structures such as the ISK account.

The result was an investment ecosystem consisting of:

- Pension funds
- Mutual funds
- Family offices
- Entrepreneurial capital
- Retail investors

This created a large domestic capital base willing to finance growth companies throughout different stages of development.

### **A Well-Functioning Market for IPOs and Exits**

Perhaps Sweden's most distinctive strength has been the development of a highly active market for smaller listed companies.

Nasdaq First North and other growth markets provided entrepreneurs with a credible path from venture financing to public listing. Founders and early investors were therefore able to realise part of the value they had created while maintaining access to fresh growth capital.

The recycling of capital from successful exits is fundamentally important, and Sweden benefited from several early landmark successes such as MySQL in 2008 and Mojang in 2014. These are merely early examples, but the willingness of investors and founders from successful exits to support new ventures has been a major contributor to the dynamism of the Swedish capital market and the perceived availability of capital.

An equally important aspect of successful exits is that founders, management teams and investors accumulate invaluable experience throughout the journey from idea and company formation to scaling and eventual exit. This experience reduces perceived risk in future ventures in which these individuals become involved, making it easier for external investors to participate in subsequent financing rounds.

Sweden nevertheless did not rely solely on venture capital. Private and public capital markets became natural extensions of the venture ecosystem.

This created a self-reinforcing mechanism:

1. Companies succeed and go public.
2. Founders and investors realise gains.
3. Capital and expertise are reinvested into new companies.

4. More growth companies reach the public markets.
5. New entrepreneurial fortunes and competence networks are created.

This recycling of both capital and expertise has been a key driver behind the emergence of multiple generations of Swedish entrepreneurs and investors.

### **The Importance of Entrepreneurial Taxation**

One of Sweden's most underappreciated strengths is its treatment of active ownership and entrepreneurship.

The 3:12 framework is complex, but its purpose is to ensure that founders and active owners retain a meaningful share of the value they create. Combined with the absence of inheritance and wealth taxes, this has strengthened incentives for long-term ownership and reinvestment.

The 3:12 rules allow shareholders in owner-managed companies to receive part of their income at a lower tax rate than would otherwise apply if all earnings were taxed as ordinary labour income. In Norway, policy has generally prioritised tax symmetry in order to prevent income shifting between labour and capital taxation. Sweden, by contrast, has accepted and actively encouraged a degree of preferential treatment for entrepreneurs, within defined rules and limits.

The objective has not merely been to encourage the creation of new companies, but also to ensure that successful founders remain active investors after selling or listing their businesses.

### **Why Sweden Has Outperformed Much of Europe**

Sweden's success cannot be explained by venture capital alone.

Many countries have attempted to stimulate innovation through public subsidy programs or startup initiatives. Sweden instead chose to build a comprehensive system for capital formation:

- Strong incentives to save
- Strong incentives to invest
- Large and diverse domestic capital pools
- Efficient public markets
- Attractive conditions for ownership and entrepreneurship
- Mechanisms for recycling both capital and expertise

The combination of these factors has created a self-reinforcing ecosystem that generates a disproportionately large number of growth companies and IPOs relative to the size of the Swedish economy.

## **Lessons**

The Swedish experience demonstrates that innovation ecosystems are built over decades, not electoral cycles.

Three lessons stand out:

1. Entrepreneurship requires attractive conditions for ownership and value creation.
2. Domestic capital from the pension system and institutional and private investors works in tandem with realised venture capital gains.
3. Well-functioning public capital markets are essential for recycling capital, experience and entrepreneurial expertise.

Sweden's innovation success is therefore not primarily a startup story. It is the result of a long-term strategy for capital formation in which the links between savings, investment, entrepreneurship and capital markets have gradually been strengthened over several decades.

From a Nordic perspective, perhaps the most important lesson is that Sweden did not merely build a successful venture capital ecosystem. It established a complete capital ladder—from angel investors and venture capital to growth capital and public listings. It is this integrated system that today makes the Swedish capital market one of the most dynamic in Europe. -Policy and consistency matters-