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Private equity in the independent school sector

A case study on how a leading private equity firm apply governance and operational engineering in the Swedish independent school sector

This paper describes a case study of the private equity firm EQT and their ownership of AcadeMedia in the independent school sector. The study aims to identify evidence of, and tensions resulting from, EQT's active ownership in the sector. Using previous research on private equity value creation as a starting point, we study how EQT govern and control AcadeMedia. By studying the governance and control in AcadeMedia through deep interviews on all levels of the organization, we find evidence of governance and operational engineering as well as sector related tensions. Since EQT acquired AcadeMedia in 2010, there has been an increased focus on delivering high quality education. As one part of the increased focus, AcadeMedia has developed its quality definition, which has a significant impact on the strategic focus for AcadeMedia. Further, we find that one of the key control systems, perceived quality, is not anchored on a teacher level due to tensions arising from the teaching profession that historically has not been business oriented. In order to mitigate the discrepancy, EQT and top management within AcadeMedia tries to educate the teachers and the principals in leadership, business, and on the importance of quality, which serves as the key value driver in the sector. Our conclusions highlight the tensions and the challenges that arise due to the complexity and dynamics from private equity ownership in the independent school sector.

Keywords: Value Creation, Operational Engineering, Private Equity, Welfare Sector, Independent School Sector, Leveraged Buyout, LBO, Buyout, Case study, Governance & Control, Active Ownership

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1. Introduction

1.1 Introduction to study subject

1.1.1 Private equity today

Since the 1980s there has been an explosive growth in the private equity (PE) market. Returns to PE investors have at times far exceeded returns in the public market, which has made PE an attractive investment even though it might be regarded as more risky as well as more illiquid than other assets.

During 2005-2007 there was an unprecedented boom in the PE industry, which has led to increased competition in the hunt for new portfolio companies, as more and more firms have been able to raise capital through their funds. During this period and in the years prior it was possible to generate high returns by acquiring companies and selling them a few years later for higher valuation multiples, with a significant portion of the value creation coming from financial engineering. As of 2012, the world economy and the financial markets are experiencing a completely different market climate compared to 2005-2007. Today, value creation within the PE industry can be said to stem from financial, governance and operational engineering (Kaplan & Strömberg, 2009). By the late 1980s, financial and governance engineering were common, but today most large PE firms have added operational engineering, which refers to when PE firms apply industry and operational expertise to their investments. In today's market environment value creation stemming from purely financial and governance engineering are in most cases not sufficient, which means that in order to generate high returns going forward, there is an increased need to add operational value. In order to cope with this growing need for operational improvements PE firms will likely need to consider a more engaged or hands-on approach (Legere et al, 2012).

1.1.2 Problematization

Many PE firms focus primarily on a specific deal structure, such as buyouts or distressed securities, rather than on a specific industry. Due to this generalist approach, this poses some credibility issues for PE firms in terms of how much operational value they can add when they do not have a track record within a certain industry. One might argue that these credibility issues are even more common in industries that are complex. The welfare sector is a dynamic and relatively complex sector in the sense that some of the characteristics are different compared to most other sectors. For instance, in the independent school sector it is rather difficult to determine who is the actual customer, is it the government, the students or the students' parents? Due to this complexity we find it interesting to prolong the existing studies to include PE firms' governance and operational engineering in the independent school sector.

An example showing that this is not a well-researched area is that in March 2012 Per Strömberg, Centennial Professor of Finance and Private Equity at the Stockholm School of Economics, held a presentation on the topic *private equity in the welfare sector*. During his presentation he stated the question "*what do we know about private equity as owners in the welfare secto*r?" followed by the answer "*not so much, the problem is that there is lack of data*".

1.1.3 Contribution

In this thesis we have had the opportunity to meet with one of the leading PE firms – EQT – and one of its portfolio companies – AcadeMedia – that is active in the independent school sector. The reason that we chose to conduct this study is that we believe that our study can provide interesting insights on how PE firms apply governance and operational engineering in their portfolio companies in the welfare sector.

1.2 Background to PE firms presence in the independent school sector in Sweden

In his paper "The Eclipse of the Public Corporation" Michael Jensen (1989) predicted that the leveraged buyout, with its emphasis on corporate governance, concentrated ownership, monitoring by active owners, strong managerial incentives, and efficient capital structure, would emerge as the dominant corporate organizational form. Three years after the paper, in 1992, the Swedish government implemented a voucher reform, which enabled individuals to establish schools that would compete with public schools. As this independent school sector has evolved during the past twenty years, the owners of school groups have largely shifted from entrepreneurs with the intention of providing alternative teaching practices and programs, to investors seeking an attractive investment opportunity. This should not come as a surprise since the independent school sector has a number of characteristics that generally attracts institutional capital, such as; recent deregulation; government funding; predictable market size; high level of fragmentation; and high growth up until now. These features are especially attractive for PE firms as such characteristics imply relatively stable cash flows that allow for a considerable amount of debt in buyouts – typically 60-90 percent (Kaplan & Strömberg, 2009). As of October 2012, four of the largest independent school groups in Sweden are owned by PE firms. The shift from entrepreneurial to investment-oriented owners, and privatization in the welfare sector in general, has resulted in a debate where profits in the welfare sector nowadays are a political minefield. In the public eye there is a perceived welfare sector specific trade-off between quality and profits, which makes PE firms' presence in the sector controversial. Even though private companies can make profits selling products and services to schools without being criticized, it seems to be more sensitive to be the operator and owner of schools compared to being a supplier. According to a survey made by Novus in May 2012, eight out of ten questioned swedes wanted profits in the welfare sector to be reinvested. Critics, the Swedish party Vänsterpartiet to name one, argue that the owners of the independent school groups are focusing on profits rather than on the students' education. With regards to the discussion on the trade-off between profits and quality, a report published by the service sector-organization Almega in July 2012 concluded that the independent schools are developing the Swedish school sector by investing significant amounts of resources into their schools. In addition to that, independent schools have the opportunity to be more long-term in their financial planning compared to publicly owned schools that have to stay within the municipalities' budgets constraints on a year to year basis.

Needless to say, this is a hot topic that we believe needs to be studied further. In addition to that, Sweden and Chile are the only countries in the world with a government funded independent school sector that has no regulation with regards to dividend policies. This means that from an academic research perspective, other countries may have limited ability to conduct this type of research, and thus we find ourselves to be in a unique position as we have the opportunity to conduct a study on this interesting sector.

1.3 Concepts

To get a better understanding of our contribution one needs to understand the concepts that we are studying. The purpose of our study is to study the collision of two interesting areas, governance and operational engineering in PE, and the independent school sector. The governance and operational engineering associated with a hands-on approach from PE firms could, in our study, be referred to as all the activities actively engaged in by EQT that steers operational activities in AcadeMedia. We have chosen to refer to these as *governance and control*, where governance is mainly related to the board, and control is related to the management control systems in AcadeMedia. Management control systems can be said to be all the systems or activities that management can use to get the employees to make decisions and actions that are in line with the company's goal and strategies (Merchant, Van der Stede, 2007). To clarify, governance engineering is related to how PE firms control their boards, while operational engineering refers to industry and operational expertise that they apply to add value to their investments.

1.4 Research question

Our research question is:

How does a leading private equity firm govern and control a portfolio company that is active in the independent school sector?

1.5 Scope

In order to answer our research question we have chosen to conduct a single case study on AcadeMedia, Sweden's largest independent school group, which is owned by EQT, one of Sweden's largest PE firms.

1.6 Outline

This thesis is structured as follows. Section two reviews previous research that is relevant to our study. Section three describes the methodology used in this thesis and what implications it has for the interpretation of our findings. Section four presents the empirical data that we use as a basis for our analysis. In section five we analyze the empirical data based on theory and previous research. The sixth section contains concluding remarks of our results, as well as avenues for future research.

2. Previous research

In the following section we want to provide a deeper understanding of how PE firms govern and control their portfolio companies. By reviewing previous research on our study topic we want to improve the understanding of our empirics and the analysis of this paper. This section starts with a brief review of PE in general and then move on to be structured into the following sections: i) Buyout firms as an organizational form, ii) PE and value creation, iii) Governance and control in PE, iv) PE in the independent school sector.

PE governance and control is part of the value creation in PE-sponsored buyouts, which in turn is related to the organizational form of PE. For that reason, we need to start with the basics and review PE in general and as an organizational form before digging deeper into the value creation and governance and control.

2.1 PE in general

PE are all the investments in private companies that are not loans (SVCA, 2012). The three most common types of PE are: *Business angels* – private persons who invest part of their wealth, *Venture capital* – investment companies that invest in early stages of a company's development, and *Buyout* – investment companies that invest in mature businesses with development potential and a need for active owners with financial resources. The PE firms that have invested in the independent school sector in Sweden are mainly *buyout* firms, and thus this thesis will solely focus on this type of PE.

2.1.1 PE organization structure

Buyout firms are typically organized as partnerships with relatively few investment professionals (Jensen, 1989). Buyout funds are typically constructed as closed-end vehicles with a limited time horizon. The investors, also known as limited partners, commit to provide capital when the buyout firm has found an acquisition target, or when a portfolio company needs a capital injection. On the contrary, the limited partners receive cash outflows either when the portfolio company is sold or when cash is generated during the holding period. A key characteristic of buyout firms is the alignment of incentives, which entails that the investment professionals of the buyout firm invests in the funds that they are managing, and also the fact that top management and other key personnel of each portfolio company invests resources into the company they are working for. The buyout firm is usually compensated by both a fixed fee and a variable fee, often referred to as carried interest. A buyout is typically financed with 60 to 90 percent debt (Kaplan & Strömberg, 2009). Jensen (1989) states that debt serves a substitute for dividends, as high debt levels forces managers to disgorge cash rather than waste it. In order to raise these high levels of debt, buyout firms typically look to acquire companies with stable cash flows, and in order to generate these cash flows they look for a number of characteristics in the companies and the industries in which they operate. Such characteristics might include government funding, recent deregulation, predictable market size and growth, and acting in a fragmented market. All of these characteristics can be found in the independent school sector.

2.1.2 PE forms

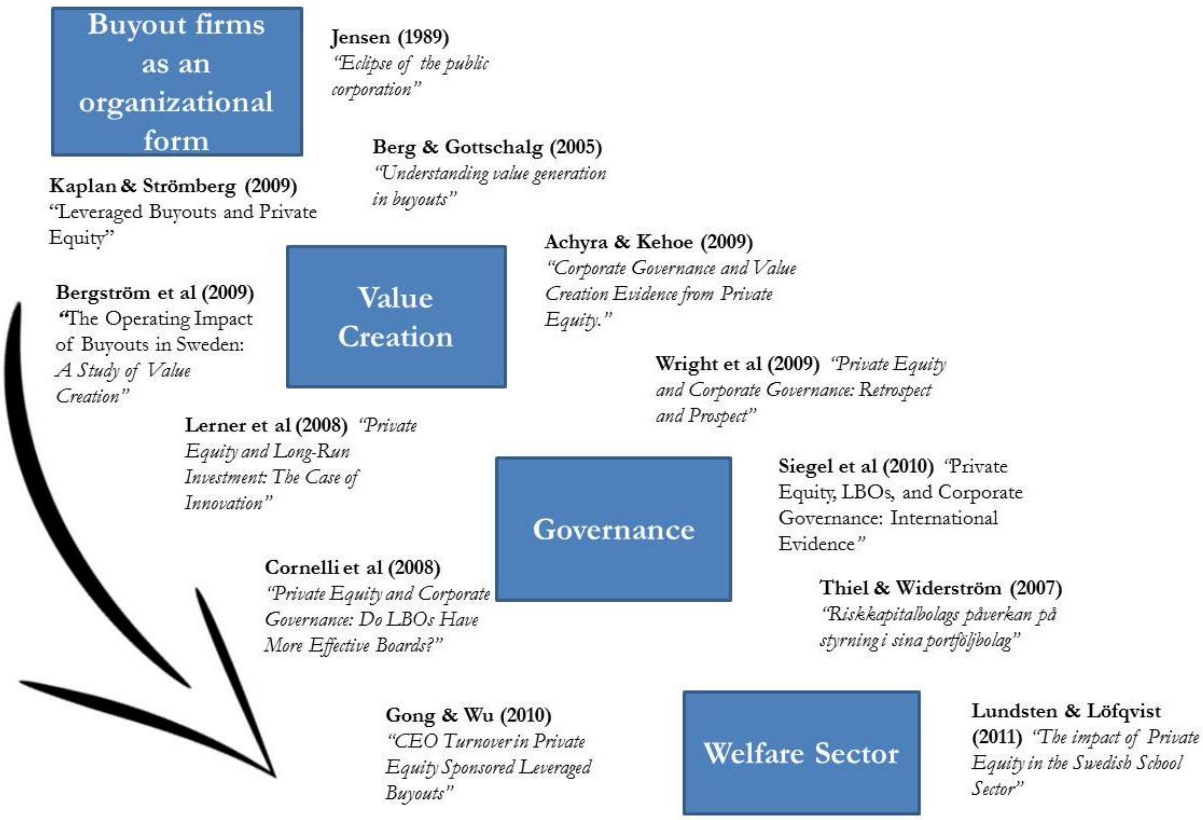
Wright et al (2009) describes two main forms of PE involvement, the first one being the form of venture capitalists that are involved in early stages of business development, and the second is PE in the form of buyout activities in mature industries. Also, in many regions of the world a variety of PE firms are found to be different in terms of investment horizon and objectives. To exemplify, there are public sector PE firms, sovereign wealth funds, and captive PE firms that are part of banks and insurance corporations. Nevertheless, according to Wright et al (2009), a corporate governance structure with PE involvement provides incentives to reduce agency costs and free cash flow problems and enhances the efficacy of the market for corporate control.

2.1.3 PE strategies

According to the Global Private Equity Report 2012 by Bain & Company, a common strategy in the PE industry is the so called buy-and-build strategy. This strategy is based on the logic that the whole can be worth more than the sum of its parts. Over the past three years, nearly 45% of all buyouts have been add-ons to existing portfolio companies. There are several advantages with the buy-and-build strategy. Firstly, acquisition multiples of small companies are usually lower compared to larger companies, and thus buying smaller companies and merging them together is often cheaper than buying scale businesses. Secondly, it might be easier to secure financing, as creditors see add-ons as less risky than acquisitions in new industries. Another advantage is that by integrating several companies into one larger one, buyout firms may create an asset that is large enough for an IPO (initial public offering) as an alternative exit strategy, and thus the risk of not being able to exit the holding is reduced. According to the report, recent research by Professor Oliver Gottschalg conclude that buy-and-build deals perform marginally better than other types of PE transactions. According to Shleifer & Summers (1989), there is however a risk that merger & acquisition activity can lead to stakeholder wealth losses for customers, taxpayers, workers and society in general. Tirole (2001) states that maximization of shareholder value could result in negative externalities, meaning that maximization of shareholder value is not the same as maximization of total stakeholder value. Juks & Strömberg (2010) however, found that there is no systematic evidence that buyout firms make gains at the expense of other stakeholders.

2.2 PE, a superior organizational form in the welfare sector?

In this section we have structured the previous research according to the topics in the picture below. Since there is very little research conducted in our study area, we need to start with a broader perspective to understand how previous research is related to our study and to other PE governance and control studies.



Picture 1

2.3 Buyout firms as an organizational form

With his influential article, Jensen (1989) was an early contributor to the research of buyout firms as an organizational from. In his article, Jensen argues that the public corporation has been eclipsed by a new organizational structure, buyout firms, in which; equity is privately held; top management have a significant equity stake; the firm is highly leveraged; and there is an *active investor* in the form of buyout firms. Jensen argue that the buyout firms exists because of failures of control in public companies and that in theory these organizations should not be necessary. These failures of control relates to three major forces that are said to control management in the public corporation, namely the product markets, internal control systems and the capital markets. Jensen further argue that the fact that LBO premium levels, i.e. the overprice buyout firms pay to gain control, average 15-50 percent above market price (Kaplan, 1989b; Bargeron et al, 2007), illustrates how much value managers of public companies can destroy without facing disturbance. This widespread waste and inefficiency of the public corporation has driven organizational innovation and the rebirth of the active investor. Jensen (1989) argues that the active investors create a new model of general management to deal with the problems of the public corporation. These active investors include LBO partnerships, entrepreneurs, the merchant banking arms of Wall Street, and family funds. Their model is built around highly leveraged financial structures; pay-for-performance compensation systems; substantial equity ownership by managers and directors; and contracts with owners and creditors that limit both cross-subsidization among business units and the waste of free cash flow. These organizations are not managed to maximize earnings per share but rather to maximize value. Jensen (1989) argues that these buyout firms can motivate the same people, using the same resources, to perform much more effectively under private ownership than in the publicly held corporate form. To contrast the positive view of buyout firms, Kaplan & Strömberg (2009) studied areas where PE firms sometimes have been criticized, such as taking advantage of tax breaks and superior information, but not creating any operational value. Furthermore they reported that critics sometimes argue that PE is influenced by market timing, and market mispricing between debt and equity markets. Overall, however, there is consensus in the fact that buyout firms are making remarkable gains in shareholder value.

The features of this organizational structure together create the necessary incentive and monitoring mechanisms to induce wealth maximization. By resolving the central weakness, the conflict between owners and managers over the control and use of corporate resources, buyout firms are making remarkable gains in operating efficiency, employee productivity, and shareholder value.

2.4 PE and value creation

According to Kaplan & Strömberg (2009) the changes that PE firms apply to the firms in which they invest can be categorized as financial-, governance- and operational engineering. Financial and governance engineering mainly relates to the alignment of owner-management interest by equity incentives and leverage. First the management team gets a large equity upside through stock and options, but management also need to make a meaningful investment so that there is both significant upside and downside to align interests. Further, the illiquidity of equity reduces management's incentive to manipulate short-term profits. The second key ingredient is leverage, more explicitly the borrowing that is done in connection with the transaction. Leverage creates pressure on management not to waste money because they must make interest and principal payments. This reduces the free cash flow problems in which management teams in mature industries with weak corporate governance could waste cash flows rather than returning them to investors. The governance engineering refers to the way that PE investors are more actively involved in governance than public company boards. The PE portfolio company boards are smaller and meet more frequently and do not hesitate to replace poorly performing management compared to comparable public company boards. Today, most PE firms have added the operational engineering, which refers to the industry and operating expertise that they apply to add value to their investments. Undeniably, most top PE firms are now organized around industries and hire professionals with operating backgrounds and an industry focus. PE firms then use their industry expertise and operating knowledge to identify attractive investments, develop plans for value creation, and to implement those plans. These plans may include elements of; cost-cutting opportunities and productivity improvements; strategic changes or repositioning; acquisition opportunities; as well as management changes and upgrades.

A more detailed study of PE, and value creation specifically, was conducted by Berg & Gottschalg (2005). The study provides a comprehensive overview of the research of the factors that determine the value impact of buyouts. The study examines both traditional mechanisms like improved governance and incentive systems, and also more innovative and entrepreneurial levers like increasing strategic distinctiveness and parenting effects. As an example, strategic distinctiveness could be to redefine key strategic variables such as which markets to be in and in which products to compete, or conduct changes in pricing, product quality, customer service and customer mix, or reorganize distribution channels. With regards to parenting effects, these are the effects that a business unit may enjoy as part of a multi-business company. One example of parenting effects could be the financial expertise of an investor that would improve the financial performance of the portfolio company, a skill that might not have been available at the portfolio company before. The study by Berg & Gottschalg (2005) develops a three dimensional conceptual framework for value generation in buyouts that categorizes and links the different levers of buyouts value generation. One of these levers, buyout value generation, is relevant for our study.

2.4.1 Buyout value generation

One of the dimensions that Berg & Gottschalg (2005) discusses is how the decomposing of value generation in buyouts is made. The equity appreciation in buyout transactions can be decomposed into four determinants: valuation multiples, revenues, margins and net debt. Based on this, Berg & Gottschalg (2005) introduce a distinction between two types of value generation, where the first type is linked to the valuation of a business and the second type to fundamental change in the financial performance of the target company. The first type is partially influenced by changes in financial performance but there are several additional factors such as market valuation multiples for comparable companies or updated expectations regarding the future financial performance of a business or an entire industry. Further, essential for realization of increases in value of a buyout company are valuations, which are typically the outcome of a negotiation process. To reflect that these value increases can occur without any change in the underlying financial performance, the first type of value generation is called *value capturing*. The second type, which we focus on in our study, is directly linked to fundamental changes in the financial performance of the target company. These changes stems from improvements in operating performance, reduced cost of capital or the freeing-up of resources through a reduction in the required fixed or current assets. These changes have an impact on revenues, margins or net debt and the authors therefore refer to this type of value generation as *value creation*. Acharya & Kehoe (2008) looked at PE deals in the UK and found that the value creation is related to enterprise-level operating performance, especially to greater improvement in EBITDA to sales ratio or margin during the private phase. The direct improvements of financial performance stems from either growing margins substantially, or growing margins somewhat whilst increasing revenues substantially. An interesting finding is that value creation that stems from margin improvement is realized to a great extent already the first year, much likely through closure of inefficient units. To contrast this, Bergström et al (2007) found no evidence that employment or wage level had changed compared with the peer groups, when looking at PE deals in Sweden.

Deals that improve both margin and revenue out-pace their sector on all fronts: growth in revenue, EBITDA, margin, profitability and employment (Acharya & Kehoe, 2008). Based on the decomposition of buyout value generation into value capturing and value creation Berg & Gottschalg (2005) illustrate the casual dimension of buyout value generation. First there are the value capturing levers that has no direct impact on the financial performance, and influence the valuation of the company with a given financial performance. Then there are the levers of value creation that have direct impact on the financial performance, which then can be subdivided into *primary and secondary levers*. The logic is that the *primary levers* have direct bottom line effect and lead to direct value generation through improvements in financial engineering, operational effectiveness and strategic distinctiveness. The *secondary levers* however only have indirect effect on financial performance by enhancing one or several of the primary levers of value generation. These secondary levers include factors such as reducing agency costs or support from the new equity investor. As an example, an increased incentive alignment does not have any direct impact on profits or cash flow but may help to remove operational inefficiencies or to achieve a better strategic positioning. These primary and secondary levers are the governance & control that will be the focus for our study. According to Acharya & Kehoe (2008), out-performing deals are associated with; top management turnover during the early stage of the deal; employment of incentives for productivity and organic growth; high intensity of engagement of PE houses; and supplementing top management with external support.

2.5 Governance and control in PE

Governance and control in PE owned buyouts are, if using Berg & Gottschalgs framework, the primary and secondary levers that have direct impact on the financial performance of a buyout. A common view according to previous research is that buyout-firms contribute with improved monitoring in order to mitigate the agency problem (Lundsten & Löfqvist, 2011). This view is supported by Berg & Gottschalg (2005), who concluded that increased monitoring is one lever of value creation in companies owned by buyout firms. To contrast this, Rogers, Holland & Haas (2002) looked at more than 2000 buyout transactions globally and concluded that one key success factor for top buyout firms is that they have steadfastly resisted measurement mania.

A study that analyzed the characteristics of management control systems used by PE companies in order to govern their portfolio companies is the one by Göransson & Keisu (2007). In their study, they characterize seven groups of characteristics of the management control systems. These characteristics are; strong focus on increasing shareholder value; clear allocation of roles; top-down control; management by deviation; extensive reports and close contact; monetary reward systems; and trust as a result of the formal control systems. These characteristics are closely associated with PE, which is also confirmed by Berg & Gottschalg (2005). Delemark & Danielsson (2012) also studied governance and control of PE owned portfolio companies, and identified a number of effects that were common for all of the three portfolio companies in their study. These effects were; increased internal reporting, increased perceived risk of getting laid off among managers and co-workers, and replacement of the board immediately after acquisition. The replacement and composition of the board when a company is taken private has been studied by Cornelli & Karakas (2008). By looking at the changes in boards following a LBO, they investigate whether PE firms are actively involved in the restructuring of the company. Cornelli & Karakas (2008) find that; board size and the presence of outside directors are drastically reduced; in LBOs, outside directors are replaced by PE members; PE board members are most active in complex and challenging transactions; companies with more need for supervision or advice have larger presence of PE sponsors in the board of the LBO; presence of LBO sponsors on the board may depend on the style of the PE firm; PE investors remain actively engaged with their portfolio businesses in years after the transaction; post-PE transaction and during restructuring process, CEO turnover is high for firms backed by PE funds. These findings are in line with the findings of Gong & Wu (2010), that studied 126 PE sponsored LBOs in the US during 1990 and 2006, and suggests that a PE sponsored LBO reduces agency costs by enhancing corporate governance. Further, in Delemark & Danielsson (2012), two out of three portfolio companies experienced increased focus on short-term planning, higher financial targets, replacement of company management upon acquisition and moving of decision authorities to higher organizational levels.

The governance and control performed by PE companies distinguish itself from governance and control in public equity companies due to its organizational characteristics (Göransson & Keisu 2007). For example, in 1992, Kaplan and Norton introduced the balanced scorecard, where they suggest that companies should rely on a mix of financial and operating indicators. While many large corporations adopted the balanced scorecard, buyout firms believed that broad arrays of measures complicate rather than clarify management discussions, and thus the buyout firms chose to focus on just a few financial indicators (Rogers, Holland, Haas, 2002). The most important measure, according to the study, was the measurement of cash, knowing that cash remains a true financial performance barometer while earnings and other measures can be manipulated.

2.6 PE in the independent school sector

Due to the lack of data and only recent political focus, this is an area where very little research has been conducted. As mentioned in the introduction, Per Strömberg noted that it is hard to evaluate the presence of PE in the welfare sector since there is a lack of data. A first study by Lundsten & Löfqvist (2011) investigated the impact of PE on the Swedish independent school sector by looking at corporate governance, operating performance and students' academic achievement. They evaluated the PE impact by benchmarking PE owned school groups against independent schools as well as public schools. The evidence suggests that PE create economic value through improved growth, profitability and capital efficiency. Notably, the authors find that the value creation from PE ownership do not stem from a reduction in quality, which the authors refer to as the number of teachers per student and the degree of qualified teaching staff (proportion of teachers with academic degree), compared to other independent as well as public schools. The authors conclude that this might be a consequence of differences in corporate governance, as they found that PE employ professional boards and implement thorough reporting systems that contribute to a professionalization of its school groups. Further, their main finding to the public debate is the significant positive impact from PE ownership on the academic achievement in primary schools post-buyout. They also acknowledge that socioeconomic factors such as parent income, educational level and ethnicity may influence students' academic achievement and to control for this they include socioeconomic factors at a municipality level. Overall, their findings suggest that PE is a suitable owner of the independent school groups in their study. While their contribution mainly consisted of the results that they found by benchmarking the performance of PE owned school groups, public schools and other independent school groups, our study will solely focus on how EQT govern and control AcadeMedia in the independent school sector, and thus provide much more depth in this area compared to their study.

3. Method

3.1 Empirical method

In order to answer our research question we have chosen to perform a single qualitative case study. While some research state that quantitative studies are more generalizable than qualitative studies (Verschuren, 2003, Alvesson & Sköldberg, 1994), we argue that it would not be possible to gain the same in-depth understanding of how PE firms govern and control their portfolio companies in the independent school sector with a quantitative approach. Furthermore, a case study is a suitable approach when there is a lack of theory in the research area (Otley & Berry, 1994).

One might argue that our method contains elements of a deductive approach as governance and control in portfolio companies are related to theories such as the agent-principal theory[1]. We have, however, based our analysis on the information that we received during our interviews, which might be viewed as having an inductive approach (Otley & Berry, 1994). As we have elements relating to a deductive as well as an inductive approach, the approach we are using can be expressed to be abductive (Dubois & Gadde, 2002).

3.2 The case: EQT's governance & control in AcadeMedia

In order to study how a leading PE firm govern and control a portfolio company that is active independent school sector, we had to find a suitable study object. We started by compiling a list of the independent school groups and concluded that AcadeMedia is Sweden's largest independent school group, with more than 3,8 billion SEK[2] in revenues in 2011.

	School group	Revenue 2011 (MSEK)
1	Academedia	3822
2	JB Education	1379
3	Praktiska/Vindora	720
4	Theducation	235

Table 1

AcadeMedia is a school group that consists of a number of different school brands. The individual school brands consists of one or multiple schools that together form what we from now on will refer to as an *education company*.

3.3 Data collection

We have chosen to collect data through interviews with representatives of the portfolio company, AcadeMedia, as well as one interview with a representative of the PE firm, EQT. We have complemented these interviews with one interview with Professor Per Strömberg, and we also attended two seminars hosted by SNS, Studieförbundet Näringsliv och Samhälle. One of seminars was on the topic *what can public companies learn from private equity*, and the second topic was *the independent school sectors long-term effects on education results*.

[1] Principal-agency theory is built on the relationship between two parties, a principal and an agent which represent the principal in transactions with a third party (Jensen, Meckling, 1976). Agency theory addresses the problems that occur when the two parties have either different goals or different attitudes towards risk, and the principal do not have the possibility to verify what the agent is doing.

[2] For all companies we have used financial year 2011 except for AcadeMedia which has a broken financial year where we used 2011/12. When estimating AcadeMedia's revenue we took AcadeMedia's revenue and added the revenue of Pysslingen for 2011 since AcadeMedia now owns Pysslingen. AcadeMedia has done several minor acquisitions that could have been added, but since AcadeMedia is significantly larger than the second largest school group we can conclude that we have enough data to say that AcadeMedia is the largest player

3.4 Selection of interview objects

In order to get a deep and consistent view of the case, we conducted a total of 15 interviews with AcadeMedia and EQT. One of these interviews was conducted with a Director at EQT, and one might argue that the Chairman of the Board is also representing EQT as he has a close connection to EQT. We interviewed six people that are working for AcadeMedia on a central level. For the interviews further down in the organization, given the scope of this study and in order get a consistent view, we focused on one of AcadeMedia's education companies. In order to focus on one education company, we had to choose which segment to focus on, and we chose to focus on the primary school segment. There are a number of reasons why we chose to conduct this study within the primary school segment, as compared to the pre- or upper secondary school segment. Reasons include; it is mandatory for all swedes to attend primary school; primary schools in Sweden have more homogenous curriculums than upper secondary schools; and the fact that it is the school institution where the students spend their longest time period. Once the decision to focus on the primary school segment was taken, it was clear to us that we wanted to conduct this study on Vittra, since Vittra is the largest primary school unit within AcadeMedia. In order to be consistent we conducted all interviews with representatives from one school, Vittra Östertälje, when interviewing on a school unit level. In total we conducted seven interviews with representatives from Vittra, of which three was with representatives from Vittra Östertälje. See appendix for complete list of interview objects.

3.5 Interview structure

The interviews took place between October and November in 2012. Interview documents where prepared in advance, and contained a main template of questions, with appropriate adjustments to the position that the interview person held within AcadeMedia/EQT. The interview format can thus be said to be semi-structured (Merriam, 1994) as we had prepared questions in advance but were at the same time flexible during the interviews and asked new questions when found appropriate. We found this to be a suitable format as some of our questions was seeking a fact based answer, while others were more based on opinion or perception. The interviews lasted between 28 and 63 minutes, with an average length of 52 minutes.

3.6 Reliability and validity

As our primary source of data is personal interviews rather than documentation, our choice of method has impacted the reliability of our study. Reliability in this setting can refer to the ability to reach the same conclusions through replicating this study. As we have applied a semi-structure, one must acknowledge that the nature of the interviews relies on the interplay between the interview object and the researcher. In order to mitigate the risk of misinterpreting the interviewer or missing out on information, we recorded all of our interviews and transcribed them the same day they took place. The transcribed interviews totaled at 120 pages of text.

3.7 Validity

To increase the degree of inner validity – which is the degree to which the study's results are consistent with reality (Trost, 2010) – all interviews were made in person, with both authors being present at all times. We also applied so called information triangulation (Merriam, 1994), in the sense that we have asked a number of people the same questions and also asked for written material when found appropriate. It is difficult to achieve outer validity, or generalizability, in a single case study. The fact that we have studied the largest independent school group in Sweden, owned by one of the largest PE firms in Sweden, increases the probability that the same results would be achieved in similar studies, but the study is not sufficient to create a generalizable theory.

4. Empirics

The following section will briefly present the case company AcadeMedia and its owner EQT.

4.1 Case background

4.1.1 Involved parties

PE firm and AcadeMedia's owner: EQT

EQT is one of the largest PE firms in Sweden, with approximately EUR 19 billion of committed capital[3]. The firm was founded in 1994 and today consists of 14 funds active in buyouts, equity related growth financing and infrastructure investments. As of December 2012 the company has around 120 investment professionals located in Copenhagen, Frankfurt, Helsinki, Hong Kong, Munich, New York, Oslo, Shanghai, Singapore, Stockholm and Warsaw. EQT Partners, where all the investment professionals are employed, act as investment advisor to all EQT funds.

Historically, more than 75 percent of the value created in the companies that EQT's funds have sold is attributed to operational improvements and top-line growth. To create value in the acquired companies, the strategy and strategic plan is usually geared towards growth. On average, EQT's portfolio companies have annually increased sales by 11 percent, the number of employees by 12 percent, and earnings by 17 percent.

EQT's corporate governance model is centred around *the TROIKA forum*, which is a team consisting of the CEO of the portfolio company, the Chairman of the Board, and the EQT representatives on the board. The forum enables an active dialogue with, and is a sparring partner to, the CEO on a continuous and informal basis. Further, EQT's corporate governance model is structured around the areas *evaluation and monitoring* and *common mindset*. Evaluation and monitoring of the CEO, the Chairman, the directors, and the EQT representatives is assessed once a year and can lead to changes in the board composition. EQT also monitors the companies' overall development compared to the original plan by briefings to the general partners of the relevant EQT fund. The other governance area is the common mindset, which reflects the aligned interest of the management, the board, and EQT. This aligned interest is achieved by requiring that the EQT representatives, the board members and top management all invest in the portfolio company[4].

Portfolio company: AcadeMedia

AcadeMedia is Sweden's largest independent school group with approximately 44 000 children and students in their pre-, primary- and secondary schools. In total they have around 240 units and 8000 employees. They also provide adult education for approximately 20 000 students. AcadeMedia was founded in 1996 but some of AcadeMedia's current businesses were founded prior to that, for instance; Nordens Tekniker Institut (NTI, adult education) in 1968; Pysslingen Förskolor in 1984; and Vittra in 1993. In 2001 AcadeMedia was listed on the Stockholm stock exchange with the investment company Bure Equity as the largest owner. In 2010 EQT acquired a 79,6% stake in AcadeMedia, and the company was delisted. During 2011 EQT bought the remaining shares in AcadeMedia, which previously was owned by Providence Equity Partners. Since 2010, when EQT became majority owner, the company has doubled its revenues[5], mainly due to the acquisitions of Pysslingen, ProCivitas, Plusgymnasiet and Plushögskolan in 2011. Today, AcadeMedia is a school group with separate brands, where none of the different education companies have the word AcadeMedia included in the

[3] EQT's website, www.eqt.se, as of 2012-11-02
[4] Seminar: Studieförbundet Näringsliv och Samhälle, 2012-11-07, guest speaker Caspar Callerström, partner, EQT
[5] CFO, AcadeMedia, 2012-10-23

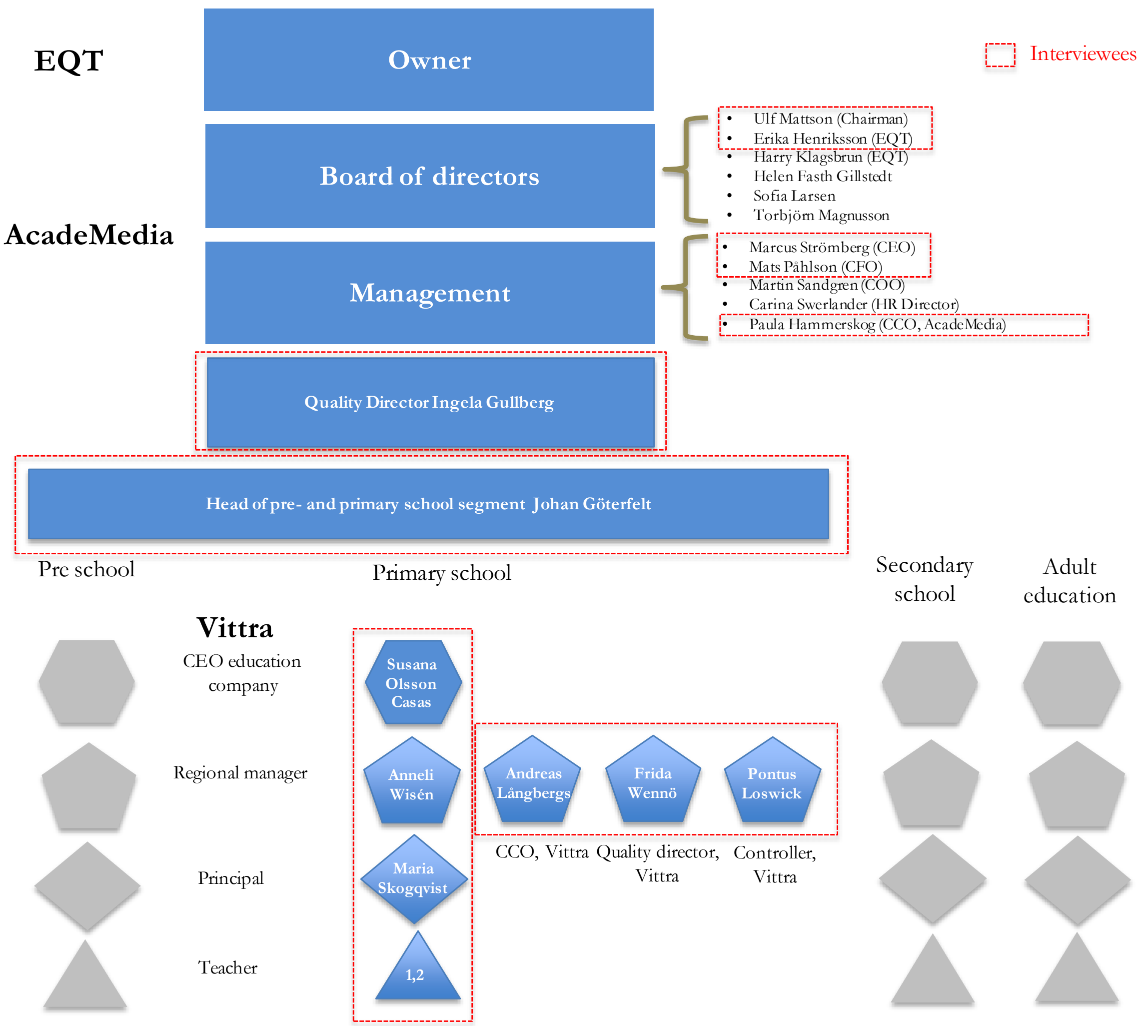
school's name. AcadeMedia's pre- and primary schools are: Vittra, Pysslingen, Norrskenets Friskola, Fenestra, PeterSvenskolan, and Primaskolan. For upper-secondary schools they have a total of 12 different education companies, including Didaktus, Rytmus and ProCivitas to name a few. AcadeMedia has a strong focus on the quality within their schools, which is evident in the company's vision: "*AcadeMedia shall be an international role model with regards to quality, results and innovation*". AcadeMedia view themselves as a federation that is supporting the different education companies within the group. The support can include shared resources within IT, guidelines on policies and procedures etc. AcadeMedia believes that by assisting the education companies with the necessary resources, the education companies will be able to focus on their core business which is to offer high quality education to all of their students.

Education company: Vittra

In AcadeMedia, Vittra is the largest education company within the primary school segment with close to 8000 students spread over more than 30 pre- and primary schools around Sweden. Vittra has been a part of AcadeMedia since 2008. Vittra positions itself as an innovative and front edge school with high quality education, which is achieved, among other things, by working closely with researchers that on a scientific ground evaluate and develop the schools.

Organization

AcadeMedia is structured as an umbrella above the education companies. Vittra's principals in one region report to Vittra's regional manager in that particular region, which in turn report to the CEO of Vittra. Between AcadeMedia and the CEO of Vittra, there is a segment director that is responsible for all pre- and primary schools, and that reports to the management team. On an education company level the organizational structure can vary somewhat depending on the size of the respective education company.



Picture 2

4.2 Governance and control in AcadeMedia

The aim of this section is to describe EQT's governance and control in AcadeMedia. This section is based on interviews conducted on every level in AcadeMedia – from the Chairman of the Board to primary school teachers in Vittra. Besides from describing the governance and control, our aim is also to understand how the governance and control is related to sector specifics mechanisms.

4.2.1 AcadeMedia's board composition

AcadeMedia's board comprises of six board members, of which three are representatives from EQT. Two of them are employed as investment professionals, one partner and one director. The third representative from EQT is the Chairman of the Board, who is an industrial advisor to EQT. The Chairman has significant experience of working in the welfare sector, having previously worked as CEO of Capio and Gambro. One of the board members was on the board prior to EQT acquiring AcadeMedia which provides continuity from the previous board work. The fifth board member has industrial knowledge of the school sector, as she used to be a Member of Parliament and Chairman of the department of education. This means that she can provide insights on the political dimensions of the business. The sixth representative is currently working as CEO at IF Skadeförsäkring, which means that he has relevant experience from a highly regulated market with many political aspects. With regards to the fourth board member the Chairman said that "usually we replace the whole board, but in this case we made the judgment that there is value in having continuity."

Together with the CEO of AcadeMedia, the EQT representatives, including the Chairman, forms the TROIKA forum.

4.2.2 Key objectives

"Life is short, you need to make a difference"[6]

Vision

"*AcadeMedia shall be an international role-model with regards to quality, results and innovation*"[7]. The high quality objective is apparent in the corporate vision and was stressed in all of our interviews conducted with AcadeMedia and EQT. High quality is thus believed to be the single most important driver for a successful business.

Key objective: Growth

AcadeMedia's key objective is to grow the business through a focus on high quality education and attractiveness while having stable finances[8]. The sub targets to growth, centred around quality, attractiveness and stable finances, are all a function of high quality[9].

Sub target: High quality

Quality is measured as functional quality, perceived quality and appropriate quality. In AcadeMedia quality is a key ratio, like occupancy rates are for hotels[10]. The quality measure should reflect how students are performing, students and parents satisfaction level, and if it the school adds appropriate value to their students.

Sub target: Stable finances

The stable finances objective reflects the financial area of AcadeMedia's objectives. "*The term "stable finances" is a more suitable word than "profitability" in the school sector*"[11].

Sub target: Attractiveness

Attractiveness is measured as how many students are enrolled to the school and the degree to which they would recommend the school to others[12].

Objectives setting process

They do not share their growth target externally, but according to the CEO and CFO of AcadeMedia, this is the most important target in AcadeMedia's business plan. Top management conducts the target setting process, in close collaboration with EQT, in connection to the assessment of the AcadeMedia's business plan. Even though EQT is actively involved in developing the business plan for AcadeMedia, their active commitment does not stretch all the way down to the respective education companies. After the business

[6] CEO, AcadeMedia, 2012-10-23
[7] AcadeMedia's website, www.academedia.se, 2012-10-22
[8] CEO, AcadeMedia, 2012-10-23, Head of pre- and primary school segment, AcadeMedia, 2012-11-01
[9] CEO, Vittra, 2012-10-29
[10] Director, EQT, 2012-11-06
[11] Controller, Vittra, 2012-10-24
[12] CEO, Vittra, 2012-10-29, regional manager, Vittra, 2012-10-24, controller, Vittra, 2012-10-24

plan has been agreed on, it is up to the management team to communicate goals down to the education companies[13].

Financial and non-financial goals

Within top management both financial as well as non-financial goals are discussed thoroughly, and these are broken down on every level of the organization so that everyone has a goal that is relevant with regards to what that person can affect. For instance, while a principal have both financial and non-financial goals, the teachers are purely focusing on delivering high quality education and do not have any financial goals.

4.2.3 Strategies to achieve the objectives

4.2.3.1 Quality as the most important value driver for success

As a result of quality being the basis for attractiveness and stable finances, AcadeMedia's main strategy is to work with achieving high quality.

All interviewees argue that high quality is the by far most important driver for AcadeMedia's success. One reason for this is the structure of how AcadeMedia receives its revenues. The Chairman argues that since the students are free to go to another school whenever they want, the voucher reform serves as a control system in itself. Since a school with a bad reputation will lose its customers quickly, quality is of very high strategic importance for all employees. This focus on quality also means that if a unit within AcadeMedia is struggling with the level of quality, the company invests significant resources into that unit in order to improve the quality levels. The CCO of AcadeMedia said that she recently got a phone call from a principal, who was leading a school that was struggling and that recently had received additional resources, saying "*I have previously been told that the firm [AcadeMedia] has resources to put to work when a unit is struggling, but it was not until now that I have seen it with my own eyes that I truly understand what people meant. Now I know what muscles AcadeMedia has"*. Furthermore, the focus on high quality means that Vittra schools are sometimes reluctant to accepting new students during the school year, as an intake of students on a regular basis can affect the quality of the education as it takes a while for a group of students to become used to each other[14]. According to the regional manager at Vittra, a school's quality must not be endangered which might be the case if Vittra were to accept more students than they could handle. In such cases the principals try to help the students by finding another Vittra school that might be willing to accept an extra student.

4.2.3.2 Achieving growth through a multiple brand strategy

"Let flowers bloom"[15]

AcadeMedia believes that the best way to grow the business is by keeping the education companies as separate brands in order for each education company to grow at an appropriate rate. The growth can both be acquisition based and organic, which can be coming from the starting up of new schools as well as increased utilization rate within existing schools. Some education companies grow through acquisitions to a large extent, while others grow organically. Even though brand experts and consultants have said things in line with *"this is madness"*[16], AcadeMedia has actively chosen to keep the education companies separate. There are several reasons for this, including:

[13] CFO, AcadeMedia, 2012-10-23
[14] CEO, Vittra, 2012-10-29
[15] CCO, AcadeMedia, 2012-10-25
[16] CFO, AcadeMedia, 2012-10-23, CCO, AcadeMedia, 2012-10-25

Increased diversification

When the voucher reform was introduced in 1992 the purpose was to increase the diversity of the schools in Sweden. Keeping the education companies separate makes it easier to diversify and communicate that diversification to AcadeMedia's customers[17]. Since the different education companies have different values, culture and pedagogical focus, merging the brands would dilute the perceived difference of each school groups' characteristics and thus make it harder for the schools to convey their message about the pedagogical focus of the school.

Retain strong local brands

The education companies that AcadeMedia acquire have a local brand value that has been built up over many years, and there is a risk that this value might be destroyed if they were to change the name of the schools[18].

A local, decentralized business

Due to the business nature within the school sector it is very important to have a local perspective. Since the students are local customers, the way to attract them is to act locally where they live. One example of when they are acting locally is the Vittra school that has physical education together with coaches from the local floorball, hockey and soccer teams[19]. Also, from a motivational perspective, it is important for each principal to feel that he or she has 100% responsibility for the business, from a number of different perspectives such as customers, employees, quality and financial performance[20].

Retain strong cultures

Within AcadeMedia the different education companies have different cultures. AcadeMedia's strategy to keep the education companies as separate brands increases the possibility to maintain those cultural differences, which ensures that the employees are part of a local business and not a large corporation such as McDonald's or 7-Eleven[21]. While they want the culture to be different in each respective education company, they are also trying to create elements that should be shared within all the education companies, as the head of segment put it "*the employees need to feel that we have something in common within the federation*". One such element is their own view of the firm being a *runner-up* and not a *giant*. Since AcadeMedia is Sweden's largest independent school group, one might view them as the giant in the independent school sector. AcadeMedia, however, has always fought a battle for its existence, primarily against the municipalities and the public schools. Going forward, the company will do everything they can to try to maintain the view of being David in David and Goliath, where Goliath in this case is represented by the municipalities and the public schools[22]. Another element that AcadeMedia believes is important is to have common values. In order for everyone to understand what AcadeMedia stands for and what their values are, the company is continuously hosting seminars where they discuss these issues.

[17] Chairman of the Board, 2012-11-05, director, EQT, 2012-11-06
[18] CFO, AcadeMedia, 2012-10-23
[19] CCO, Vittra, 2012-10-29
[20] Head of pre- and primary school segment, AcadeMedia, 2012-11-01
[21] Head of pre- and primary school segment, AcadeMedia, 2012-11-01
[22] Head of pre- and primary school segment, AcadeMedia, 2012-11-01

High media pressure

The media pressure on the independent school sector is very high, and this means that when AcadeMedia or one of its education companies are exposed in the media, the other education companies within AcadeMedia are generally not affected[23].

Costs of pursuing a multiple brands strategy

When asked about any potential costs involved with keeping the education companies as separate brands the CFO mentioned that with regards to marketing, and the brands, of the different education companies, instead of having one agency working with the brand they now have to have a large number of agencies, or projects, as every brand needs to be updated on a regular basis.

Other effects of a multiple brands strategy

Another effect of this strategy is that if one of the education companies finds a best-practice in an area, it is harder to share this information with the other education companies, and this is an area that they are actively working on and trying to improve[24]. One recent example is that Pysslingen had a market leading way of working with student healthcare, and this way of working was recently implemented in Vittra[25].

4.2.3.3 "What gets measured gets done"

When it comes to strategies for achieving high quality, one key issue is to have consistent measurements within the organization, i.e. the different education companies need to have the same definitions as the rest of the group[26]. When new education companies are acquired there is thus an integration period as the schools might have measured things differently before, and eventually all education companies are thus able to provide the relevant data needed for consistent measurement. "*When EQT came into the picture, they started to structure processes around working with quality and hired a quality manager. In the beginning of the structuring process people were wondering why they should put focus and energy on measuring quality when they could have performed quality by given extra time to the students. However, after a while, the process of measuring and structuring quality led to a focus on quality, which in turn led to higher quality"*[27]. Hence, the quote *"what gets measured gets done"* is a good description of what has happened in AcadeMedia.

4.2.3.4 Economies of scale: A federation

AcadeMedia can be said to be a relatively decentralized organization, where AcadeMedia view itself as a federation that provides the different education companies with shared resources such as IT, purchasing, guidelines on policies and procedures, and common systems for reporting and monitoring[28]. By sharing common resources and having these processes, AcadeMedia achieves economies of scale that enables them to focus on what is value generating. One example where AcadeMedia's size is clearly an advantage is that "*a small company or a public school cannot have a full time employee dedicated to solely working with quality, for example*"[29].

[23] CEO, AcadeMedia, 2012-10-23
[24] CEO, AcadeMedia, 2012-10-23
[25] Principal, Vittra Östertälje, 2012-11-05, teacher 1, Vittra Östertälje, 2012-11-05, teacher 2, Vittra Östertälje, 2012-11-05
[26] Head of quality, AcadeMedia, 2012-11-01
[27] CCO, AcadeMedia, 2012-10-25
[28] Chairman of the Board, 2012-11-05, CFO, AcadeMedia, 2012-10-23
[29] Director, EQT, 2012-11-06

4.2.3.5 Business education: Changing the mindsets of teachers and principals

Teachers and principals do not necessarily have a business mindset, and EQT's and AcadeMedia's way of dealing with this issue is to educate them in leadership and business. They also want to educate the employees in the importance of working with quality, and teach them how to solve problems instead of handling them, which enables them to spend more time with the students. The teachers have, due to their educational background, presuppositions such as a belief that there must be a trade-off between profitability and quality. The Chairman argues that it is important that the teachers understand that there is not a trade-off between profits and quality, and he stated "*when I was the CEO of Capio the doctors would say that quality costs money, but in fact it is the other way around, not having quality costs money"*. To improve quality, AcadeMedia has started an academy where the employees can attend a number of different courses, ranging from subjects such as leadership to law. The Chairman thinks that AcadeMedia will be better than other schools in developing leadership, business and the thinking around the importance of quality. *"We need to provide the tools needed by the principals to continuously improve quality, which in the end is the most important governance and control that we have"*[30].

4.2.3.6 Strategy for achieving attractiveness

Word of mouth marketing

Since the business of providing education is a very local business, word of mouth marketing is the strongest marketing channel[31]. Vittra is working with word of mouth marketing by finding ways to create transparency so that the people locally can see that the schools are working with quality on a day-to-day basis. As an example, the schools update their Facebook page every day at 11 a.m., which enables the parents that are on lunch to see what is going on in the school, and gives them a natural conversation starter involving Vittra around the lunch table. *"The key is to create situations where it is easy to talk about the company, and one example where these types of discussions might be initiated is when we sometimes have music lessons at a community center for the elderly, which is a big event for the elderly"*[32].

4.2.4 Performance targets

"Quality, quality, quality – even in the board room they talk about it all the time"[33]

AcadeMedia both has financial as well as non-financial targets. The financial targets are not communicated externally, but the non-financial targets relating to quality are communicated externally. As an example, during 2012 AcadeMedia published a quality report where they show the quality results that were achieved during 2011. This quality report will be published yearly going forward.

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[30] Chairman of the Board, 2012-11-05
[31] CFO, AcadeMedia, 2012-10-23
[32] CCO, Vittra, 2012-10-29
[33] CCO, AcadeMedia, 2012-10-25

Non-financial targets
As high quality is a major focus area within AcadeMedia, the company has a structured approach for measuring quality. Quality is divided into three different categories: functional quality, perceived quality and appropriate quality. Some of the key parameters that are measured are:

- Functional quality
    - Grades, such as grade point average (GPA)
    - Performance on national tests
    - Share/number of students that are eligible to enter into higher educations
- Perceived quality
    - Customer satisfaction (same survey for both students and parents) measured as to which degree they would recommend the school to others
    - Well-being
    - Safety
- Appropriate quality
    - What happens to the students after they have left the school

Before EQT came into the picture, AcadeMedia also measured a fourth parameter that was related to student-teacher ratios, measured as number of teachers per 100 students. However, when the newly appointed head of quality that had previously worked at the National Agency for Education was hired in 2011, the fourth parameter was removed. The reason for this development was that they wanted to focus on output measures and not input measures, since they believe that quality should be measured as results[34]. Since the head of quality joined the firm she has been working hard to set up structures and routines for AcadeMedia's quality work. She, in collaboration with top management and the board, redefined how AcadeMedia defines quality. Today AcadeMedia's definition of quality is:

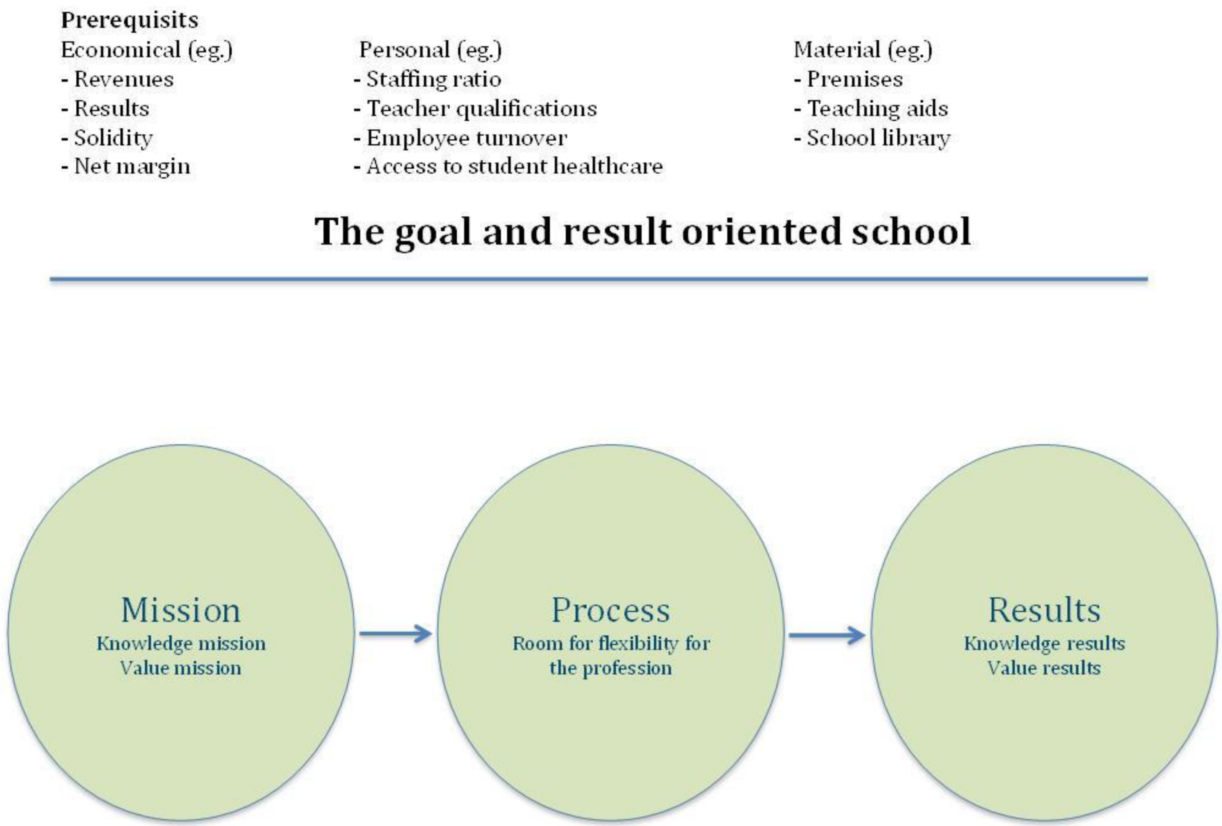
"To what extent do we reach the national goals (=functional quality) in a way that makes us win our customers' trust (=perceived quality) and makes our students/participants well prepared to move on to the next step in the educational system or in other career paths (=appropriate quality)"

Measurements
In order to measure perceived quality they use surveys for students, parents and employees. On a central level AcadeMedia has a number of questions that every education company have to ask, and then the respective education company can choose to add questions in addition to the mandatory ones. For customer satisfaction, once the answers are received they weigh them together so that they form an index number, a customer satisfaction index, on a scale of 1-100. When evaluating whether the quality targets are reached, the rule of thumb is to look at the performance the year before, and then see whether the performance have gone up or down. Even though they mainly focus on performance compared to last year they also do have a number of nominal hygiene levels. For instance, for customer satisfaction, a score below 60 is not acceptable. If a school is lacking in any of these measurements, AcadeMedia will initiate discussions with the principal, regional manager, the CEO of the education company and the head of the segment in order to see what areas could be improved. Thus, deviation analysis is standard in the non-financial measures.

[34] Head of quality, AcadeMedia, 2012-11-01

Hygiene factors

AcadeMedia have structured their quality work into one section that they call prerequisites, which is followed by a three-step process which is referred to as "*the goal and result oriented school*"[35]. The prerequisites are essential for AcadeMedia to be able to offer a high quality education, but they are not quality measures. Here is a graphical illustration of how AcadeMedia view their quality work:



Picture 3

Discrepancy in the definition of quality

Picture 3 illustrates how AcadeMedia view their quality work, which is quite different compared to how others define quality. For instance, the Social Democrat Carin Jämtin argues that the staffing ratio (teacher-student ratio) is a measure of quality and added that "*the staff is what makes the quality*"[36]. AcadeMedia on the other hand views staffing ratio as one prerequisite that is a hygiene factor for the business to function, but they do not view it as a measure for the end result. As described earlier, AcadeMedia's definition of quality was changed since they came to the conclusion that staffing is an input rather than the output. With regards to the three-step process (picture 3), AcadeMedia are focusing on measuring the third step, i.e. the actual results, and not the second step, which is the process. This means that AcadeMedia lets the representatives of each education company handle the process of educating the students in their own pedagogical way, and then the end results are measured and evaluated. If the results are weak, AcadeMedia gets involved in the second step, process, as well.

[35] Head of quality, AcadeMedia, 2012-11-01

[36] Dagens nyheter, 2009-08-07

4.2.5 Reward structure

"Never change a winning concept"[37]

All employees are measured on a number of parameters. For top management and other managers the reward structure is based on parameters such as financial performance and quality levels within the organization. The employees are only rewarded for things they can affect. In addition to that, top management have been given the opportunity to invest in AcadeMedia along with EQT.

Variable component

In Vittra all teachers have a variable component in their compensation package[38]. This variable pay component is linked to the perceived quality measure, i.e. how satisfied the students and the parents are. The CEO of AcadeMedia stressed that he thinks it is unhealthy to have a reward system that is linked to academic achievements as this might create dangerous incentives, such as grade inflation. As described in section two, method, we have only conducted interviews with representatives from Vittra both on a teacher and a principal level. It is thus important to clarify that the compensation packages are different within the other education companies. For instance, several interviewees, including the CEO and CCO of AcadeMedia, argue that the teachers are not primarily driven by economic incentives, as they chose this profession for other reasons, and in such cases it would be dangerous to implement new reward structures as this might affect their intrinsic motivation[39]. According to the CEO of AcadeMedia, the compensation packages remain the same as they were prior to AcadeMedia acquiring the respective education company, as *"it is very dangerous to start changing things that are currently working well"*[40].

Parameter appropriateness

On a teacher level our interviewees stated that they think that there is room for improvement in the perceived quality measurement[41], which is the basis for the teachers' variable pay component. According to the quality director at Vittra, they have been working hard to try to find the most relevant questions for the surveys. On the other hand, the teachers that we have spoken to think that some of the questions are rather difficult, and sometimes hard to interpret. For instance, teacher 1 said that one question that they ask the students is "*if you imagine the perfect school in every aspect, and then compare this imaginary school with your current school, how close would you say that these two are?*" According to teacher 1, "*it is not always easy for a young student to understand where to draw the line, which results in that the students suddenly start to compare our school with an imaginary school with swimming pools etc.*"[42]. Teacher 2 argued that due to the complexity of the questions it is not optimal to have the parents' view as a basis for the teachers' salary. Some parents might not understand the questions, or they might not have enough knowledge and understanding of the questions they are answering. One example is that the parents are asked to evaluate the teachers' ability to cooperate internally with their colleagues, which might be difficult for a parent to evaluate since they are not present during the days. In addition to that, the parents are not always aware of what the teachers' mission from the National Agency for Education actually is, and that means that due to lack of understanding the teachers are evaluated on criteria they should not be evaluated on. As mentioned during one of the interviews, *"I think it is sad and wrong that parents shall decide whether I am doing a good job or not"*[43]. Furthermore, teacher 2 argued; "*since we are working with young people, the outcome of the*

[37] CEO, AcadeMedia, 2012-10-23
[38] CEO, Vittra, 2012-10-29, teacher 1, 2, 2012-11-05
[39] CEO, AcadeMedia, 2012-10-23
[40] CEO, AcadeMedia, 2012-10-23
[41] Teacher 1, 2, 2012-11-05
[42] Teacher 1, 2012-11-05
[43] Teacher 2, 2012-11-05

surveys can vary depending on the mood of the student/child at that point in time. If the student is in a bad mood he or she might give us 1 [on a 1-10 scale] on every question, but a few hours earlier the student maybe would have given us a 10".

4.2.6 Information flows

"The acquisition includes 14 000 children and students" – Draft version of annual report

Informal information flows

In AcadeMedia they sometimes use informal information flows in the sense that some of the information flows from one manager to the next person in the hierarchy[44]. This means that in extreme cases it might take three months for a message to get from top management out to all the teachers, but according to the CCO of AcadeMedia this is sometimes a necessity. One reason is that in order for internal information to be credible, AcadeMedia believes that the information should come from a person that the receiver knows. Thus, unless the message is urgent, AcadeMedia might choose this way of communicating important messages. Another reason is that messages have to be reformulated during its way down the hierarchy, since the employees have different backgrounds and perceptions of how a business works, and why things need to be done. There are several examples where top management use a different vocabulary than what is appropriate when talking to the teachers. For instance, on a teacher level the term *profitability* is rather abstract, and the teachers might not understand why this is important. Instead AcadeMedia has chosen to communicate phrases such as *long-term financial stability* which receives a better understanding from the employees. Another example where the discrepancy between how top management expresses themselves, compared to how they communicate further down in the organization, was during the writing process of the 2012 annual report where someone in a draft version had written *"in 2011 AcadeMedia acquired Pysslingen […], the acquisition includes 14 000 children and students"*[45]. This quote was changed before it was published.

Formal information flows

Business plan

Even though they sometimes use informal information flows, most of the information stems from formal information flows. For example they use deviation analysis of budget targets to evaluate their performance. If actual performance deviates from the budgets or forecasts the managers can pinpoint what areas that need to be analyzed further. Thus, AcadeMedia uses financial deviation analysis as a feedback tool[46]. AcadeMedia also has a newsletter where they communicate information that is relevant for the employees. This newsletter could for instance include cases on success stories within the firm. We were given the opportunity to look at AcadeMedia's latest newsletter (November 2012), and in that edition they had a link to a video interview[47] with EQT's Managing Partner, AcadeMedia's CEO and one of AcadeMedia's board members. Another article was labelled "affecting the public opinion", and that article discussed the importance of AcadeMedia's representatives communicating and collaborating with politicians.

Some of the education companies also have an intranet where they can share information internally, but these intranets are education company specific.

[44] CCO, AcadeMedia, 2012-10-25
[45] CCO, AcadeMedia, 2012-11-05
[46] Controller, Vittra, 2012-10-24
[47] Morgonsoffan, ledarforum i Tylösand, 2012-10-05

5. Analysis

In this section we analyze how EQT govern and control AcadeMedia, partly by comparing and contrasting the empirics with what previous research have concluded, and also by highlighting new areas that has not been analyzed previously.

5.1 AcadeMedias's board composition

AcadeMedia's board composition has several similarities with how PE firms normally structure their boards. For PE firms in general, the key here is to leverage on the ownership to employ industrial professionals instead of board members consisting of representatives representing the owners, as described by Jensen, Kaplan & Strömberg and other PE researchers. In AcadeMedia we document a professional board, consisting of representatives with strong industrial and operating expertise. This can be referred to the operational engineering as discussed by Kaplan & Strömberg (2009), where EQT enhances governance and control by employing a professional board directly after acquiring AcadeMedia. Further, the operational engineering is apparent with all the changes that took place after employing the current board.

Among others, Cornelli & Karakas (2008) conclude that PE firms add representatives from their own firm to the board, which is consistent with EQT's TROIKA forum model. This also holds for AcadeMedia's board which has two investment professionals that represents EQT on the board. Further, PE firms generally employ small boards to improve speed of decision making, which is also apparent in AcadeMedia, and this was also confirmed on a direct question during the interview with the Chairman. Caspar Callerström, Partner at EQT, discussed board representation during a seminar[48] where he described EQT's representatives on the board as sparring partners to the CEO. As sparring partners they support the CEO and management, which is apparent in AcadeMedia with the creation of business plans. This small and active board is clear example of governance engineering.

Even though there are many similarities with how EQT has structured AcadeMedia's board, and how EQT and PE firms in general structure their boards, there is one important difference. The difference is that one board member, who was part of the board when EQT acquired AcadeMedia, was kept after the completion of EQT's acquisition. According to the Chairman, she was kept to get continuity in the ownership and pass on relevant experiences and knowledge. This could imply that EQT is cautious of changing too much, which can be related to the quote "*never change a winning concept*" as stated by the CEO of AcadeMedia when talking about another topic.

Overall, these board-related changes, engaged by EQT after acquiring AcadeMedia, suggest that EQT acts as active owners that govern and control AcadeMedia in a fashion that is very similar to EQT's and other PE firms' governance and control in general.

Findings 5.1.1 Board composition

In line with previous research, AcadeMedia has a small board consisting of industry experts and PE members. What contradicts previous research is that they did not replace all the board members from the previous ownership period, instead they kept one board member to provide continuity.

[48] Seminar: Studieförbundet Näringsliv och Samhälle, 2012-11-07

5.2 Key objectives

AcadeMedia's key objective is to grow the business by offering attractive high quality education while maintaining stable finances. The growth objective is in line with EQT's general strategy: to create value by significantly growing the business. For PE owned companies in general, as found by Acharya & Kehoe (2008), improvements in financial performance stems from either growing margins somewhat whilst increasing revenues substantially, or growing margins substantially. For EQT in general, and AcadeMedia specifically, it is the substantial growth that is improving the financial performance and the value of the company rather than the margin improvements. Since the growth strategy is very common for EQT this is a clear similarity to how PE firms normally work. One might argue that a clear focus on growth, compared to margin improvement by reducing costs, is not nearly as controversial in the school sector. In any case, EQT's strategy seems to be appropriate for the sector as growth not only is less controversial than working actively with margin improvements, but also carries economies of scale, which eventually might lead to margin improvements. Due to the focus on growth, EQT has during the two-year period of ownership so far managed to double AcadeMedia's revenues according to the CFO. There are however also a number of differences that could be viewed as sector specific for AcadeMedia. First, in order to achieve growth, AcadeMedia has three sub targets: high quality, stable finances and attractiveness. While all of these three are important to achieve the growth objective, the target of high quality is the one that the firm considers to be the most important driver for their success, as high quality in turn will lead to stable finances and attractiveness. Therefore the objective high quality is the target that is being communicated internally and externally, and since EQT thinks that growth is directly linked to high quality, there is no need to communicate the growth targets. Thus, quality is both an objective in itself and a strategy for achieving growth, and this seems to be working because of the fact that quality is the only target that is being communicated. This could be viewed as an example of how EQT adapts to the sector by developing quality as an important metric for growth, as described by the director at EQT. By doing so, AcadeMedia gets an objective that is understandable for the whole organization, from the board down to the teachers. By communicating quality, everyone is talking about the same objective, which acts as a bridge between the teachers that perform the teaching and EQT that wants growth. This means that EQT can make sure that teachers focus on growing the business by working with quality according to the current definition.

Picture 4

To work with a few metrics has been claimed to be a general PE characteristic (Rogers, Holland, Haas, 2002), but creating a key objective with sub targets for the company, where one of these sub targets serves as a key metric for fulfilling the key objective has not been identified in previous research. We can see that due to the nature of the sector, where the teachers that are delivering the service are completely detached from a mindset of themselves generating revenues, the focus on improving quality is intended to link EQT's key objective of growth to the teachers' daily work. The strong focus on quality by EQT could be related to the innovative and entrepreneurial lever of value creation, *strategic distinctiveness*, as described by Berg & Gottschalg (2005). In other words, by increasing focus on quality, EQT and AcadeMedia redefine one of the key strategic variables for competing in the sector. This relates to operational engineering as described by Kaplan & Strömberg (2009).

Findings 5.2.1 Single value driver

Previous research has stated that one common key objective in PE owned companies is the objective of growing revenues substantially, while improving margins slightly. This key objective is apparent in AcadeMedia, but in order to achieve this growth they need to focus on high quality, and this strong emphasis on one single driver is something we see as a way of handling possible tensions that may arise due to the teachers coming from a background that is not business related.

5.3 Strategies to achieve objectives

To achieve their growth objectives, AcadeMedia is focusing on organic and acquisition based growth. Within PE, an acquisition-based strategy is commonly referred to as a buy-and-build strategy where the strategy is to achieve a significant growth through add-on acquisitions. In the case with AcadeMedia, when EQT became owners they immediately began to work on potential acquisitions that they wanted to pursue. The buy-and-build strategy evident in AcadeMedia is done to increase the value of the group as a whole, since a large unit might be worth more than the separate units, partly due to the fact that the operational risk decreases with size.

Finding 5.3.1 Buy-and-build strategy

Working with performance improvements after an acquisition has taken place is an example of operational engineering. The consolidation strategy that AcadeMedia is conducting is also a typical PE characteristic. PE firms are often attracted by industries with a high level of fragmentation, as these industries might enable strong growth through acquisitions and then taking over customers from competitors. In that sense, since there is a fixed fee for each student, this sector is very well suited for PE firms' strategy. In other sectors, there would at least be the alternative to price differentiate, but in this case, the nature of the sector does not allow for that which means that economies of scale becomes important.

The acquisition of Pysslingen in 2011 can be seen as one part of AcadeMedia's buy-and-build strategy. The acquisition was questioned in Swedish media[49] for creating an unsound position of power for AcadeMedia in the sector. This power position seems to be important in many aspects for competing in the school sector, and one aspect that the CEO of AcadeMedia mentions is related to criticism in the article towards AcadeMedia. This aspect relates to the growth cycle, where AcadeMedia focus on organic growth and starting of new schools in the pre- and primary school segment because the demography is favourable and the penetration rate is low[50]. For the upper secondary school segment, the strategy is, according to the CEO of AcadeMedia, to be the best actor and take those who fall for the pressure. AcadeMedia are going to "*take care*

[49]Svenska Dagbladet, 2011-07-11
[50] CEO, AcadeMedia, 2012-10-23

of these schools"[51], partly by acquisitions since valuations (prices) go down as the number of students decreases, but also by organically taking over some of the students. As the number of students decreases, the pressure on some schools will increase significantly, which will enable AcadeMedia to take over these units. After describing the situation, the CEO of AcadeMedia concluded, "*this may sound harsh but this is the reality*".

The acquisition of Pysslingen could at a first glance seem contra intuitive since the CEO of AcadeMedia argued that in the pre- and primary school segment focus is on organic growth and starting of new schools. When talking to the CFO, however, another aspect of the acquisition is being pointed out, namely how the differences in the schools internal structure affect their ability to conduct add-on acquisitions. According to the CFO, Pysslingen has a heterogeneous internal structure, where the schools can differ significantly within the education company. One example of this variety is PeterSvenskolan that has its own brand, compared to other schools within Pysslingen that has the Pysslingen brand included in the school's name. Comparing this with Vittra that has a homogenous internal structure, it is much easier for Pysslingen to make add-on acquisitions. Due to the heterogeneous internal structure in Pysslingen, it will be easier to integrate schools to fit under the same brand, compared to a homogenous education company like Vittra. For Vittra the homogenous structure implies a focus on organic growth and the starting of new Vittra schools in order for the new schools to fit into the education company. Therefore, the acquisition of Pysslingen is not necessarily just an improvement of AcadeMedia's market position but rather a strategic acquisition for future add-on acquisitions. In other words, when the pre- and primary school sector will reach the stage of maturity that the upper secondary school segment is currently in, it is likely that AcadeMedia will pursue the same growth strategy for pre- and primary schools. From that point of view, Pysslingen could be seen as a platform for add-on acquisitions when valuations go down, as pre- and primary schools will start losing students in the future. These schools could then perhaps be acquired for a low price and integrated in Pysslingen.

Finding 5.3.2 Acquiring Pysslingen as a platform for add-on acquisitions

As an important part of their buy-and-build strategy AcadeMedia chose to acquire Pysslingen as an acquisition platform, since Vittra's internal structure is very homogenous and unsuited for add-on acquisitions. In line with this finding, Vittra has a strong culture and values that could cause problems for add-on acquisitions. Pysslingen on the other hand, has a very heterogeneous structure that allows for new acquisitions to be added within the education company. The acquisition of Pysslingen could therefore be seen as a part of AcadeMedia's buy-and-build strategy, and Pysslingen can also be said to serve as an own buy-and-build strategy within the group.

Due to the dynamics of the school sector, there are clear advantages with being big. AcadeMedia see themselves as a federation with the purpose of supporting the different education companies. The most obvious way they to do this is by sharing common resources such as IT, purchasing, internal support functions etc. AcadeMedia provides the foundation but in the end it is up to every education company to outperform its competitors. Also, AcadeMedia wants the different education companies to share experiences and create best practises within the federation. Within PE firms in general, this is referred to by Berg & Gottschalg (2005) as parenting effects, where units within the federation can enjoy benefits from being part of a large parent. This also relates to the add-on acquisition strategy where newly acquired schools enjoy the benefits of the accumulated learning and knowledge from the federation. An example of the sharing of knowledge and experiences was when Vittra rolled out a new program for student healthcare, which was taken directly from Pysslingen. By having separate education companies, the schools can individually test new techniques that later, if successful, become best practises and are introduced in other schools. This is an area

[51] CEO, AcadeMedia, 2012-10-23

that AcadeMedia wishes to excel in, and according to the Chairman there has recently been an increased focus on *lean techniques*[52] to create the transparency needed to pick up on new ideas. Today there is no formalized way of picking up new ideas; it is up to each teacher and principal to communicate them further. However, due to the decentralized nature of AcadeMedia, it is reasonable to assume that many of the ideas are transferred informally.

Finding 5.3.3 Parenting effects in AcadeMedia

The benefits from accumulated knowledge in AcadeMedia that newly added schools can endure could be seen as parenting effects, which is a part of the PE value creation found by Berg & Gottschalg (2005). These parenting effects are both financial and operational, the financial being the shared resources and increased bargaining power and other financial improvements in general, and the operational being that best practices can be implemented in new schools.

There are not just ideas that are being transferred across schools and education companies; there are also significant resources being transferred when a school is struggling with its quality levels. The combination of significant knowledge and transfers of resources occurs both in newly acquired schools and in existing schools. As mentioned by the CEO of AcadeMedia, a part of the acquisition strategy is to, when valuations are decreasing, buy struggling schools. The significant dedication of resources does however also occur in existing schools. Taking advantage of size and know-how in order to achieve a turn-around in a business is a known strategy among PE firms. Even though this is not EQT's main strategy, the ability to bring an outside perspective, combined with the investment of resources in order to turn around a low performing unit is a business model for some PE firms. To name one, Triton Partners is a PE firm who tend to buy companies that are struggling as they believe that they will be able to achieve a turn-around in the business[53]. Even though this is not EQT's strategy, it is clear that the strategy to acquire low performing schools and invest significant resources in order to make them successful is strikingly similar to the turn-around strategy of other PE firms, such as Triton. According to the CEO and CCO of AcadeMedia, this turn-around strategy in AcadeMedia has led to the survival of many schools that otherwise were heading towards a certain death. Some of these schools are now prospering, which is one reason for why AcadeMedia keep investing in poorly performing schools and achieve turn-arounds.

Finding 5.3.4 Turn-around characteristics in acquisitions of poorly performing schools

The acquisition or take-over of poorly performing schools inherently show characteristics of a turn-around strategy, which is a strategic focus for some PE firms. It is possible to relate this to AcadeMedia's acquisition strategy where they want to take care of schools that fall for the pressure of high competition. In other words, AcadeMedia can buy or take over schools cheaply and then achieve a turn-around. Another aspect is that it is not easy to get permissions to open up new schools[54]*, which would incentivize AcadeMedia to take over schools when possible. According to Anders Hultin, CEO of JB Education, only 5% of the applications to open up new schools are granted.*

A consistent view within AcadeMedia's management is that a school dies very quickly if it is poorly managed. Conversely, building up a good reputation takes time and resources. In other words, the resurrection of dying schools is very costly for AcadeMedia, and even though a school would start generating profits after a few years when it gets back on foot, it is questionable if it would not be more profitable to open a new school instead of saving a dying one. The CEO of AcadeMedia argues that the rescuing of schools is a way to show

[52] Lean techniques include eliminating waste and continous improvements by high levels of transparency
[53] Svenska Dagbladet, 2012-08-02
[54] Seminar: Studieförbundet Näringsliv och Samhälle, 2012-12-04, guest speaker Anders Hultin, CEO, JB Education

politicians that they can handle all sorts of schools, and not just the ones that are already prospering. If relating this to the complexity of the sector, where it is unclear who is the actual customer, one could see this as a way of serving the *third customer*, i.e. the politicians (decision makers). Even though it is the parents and students that are making the actual purchasing decision, it is still the third customer that are creating the rules of the game, which explains why it is important to create goodwill towards this group. By rescuing the dying schools, AcadeMedia saves the municipalities a lot of money and badwill for potentially letting a school default, which might have severe consequences for the students in that particular school. It is reasonable to assume that this third customer is extremely important for AcadeMedia and that there are other ways to value this third customer. Drawing on Lind & Strömsten (2006), the third customer could be valued for its position as decision maker, something that obviously is vital for AcadeMedia, which would explain why they invests such resources into these activities.

Finding 5.3.5 Rescuing dying schools

The rescuing of low performing (dying) schools might be very costly, but occasionally they are still acquired in order for AcadeMedia to show politicians that AcadeMedia can handle all sorts of schools and all sorts of students.

Even though the turn-around aspects of AcadeMedia's growth strategy is a PE characteristic, there is an important difference between buying poorly performing schools cheap and investing resources to achieve a turn-around in low performing schools that AcadeMedia currently owns. Investing in the current schools could be seen as cross subsidization as discussed by Jensen (1989). Jensen argues that low performing units should be shut down instead of being fed by the well performing units. In AcadeMedia, the relationship is the opposite; economic resources are instead transferred within the group from the prospering schools to the schools that are struggling. As it turns out, this cross-subsidization of education companies within the group has an even stronger political aspect than the turn-around acquisitions. By making sure that all schools within AcadeMedia gets the necessary resources to prosper, AcadeMedia can increase the level of trust with politicians which might strengthen their position going forward. Looking at it from another point of view, if AcadeMedia were to divest or shut down low performing units, which is happening all the time in other industries where PE owned companies are present, this would be devastating since that would erode the trust of AcadeMedia being a responsible company in the welfare sector. In addition, the director at EQT said that since AcadeMedia is working with young students, there is a huge difference between shutting down a school compared to shutting down a corporate unit within another industry, as this would have a significant impact on the young individuals involved, and it is therefore unlikely that EQT would do such a thing unless it was absolutely necessary.

Finding 5.3.6 Cross-subsidization

Within AcadeMedia we see clear signs of cross-subsidization as they instead of closing down low performing units (schools), invests significant resources in order to achieve a turn-around. This serves as a way of showing decision makers that AcadeMedia is a good owner. Also, the potential badwill in the sector resulting from closing down a school and hurting a significant amount of students prevents AcadeMedia from doing so.

As identified, AcadeMedia has a very solid growth strategy coming from both acquisition-based and organic growth. To execute the strategy, EQT and AcadeMedia have created a business plan that states by how much AcadeMedia should grow during the coming 3-5 years. The exact numbers are however not communicated outside of top management. Instead, focus is on communicating the key metric high quality since this should lead to growth in the end. There are a number of reasons for why AcadeMedia do not communicate their growth targets, and EQT and AcadeMedia have provided several reasons for why this is being done. According to EQT this is not an issue, simply because the growth targets are too detached from the teachers and the employees outside of top management, and AcadeMedia believes that communicating growth and profitability targets is too controversial. In other words, both agree that it is better to communicate targets around improving quality of the education rather than targets regarding revenue generation.

Finding 5.3.7 Financial silence

Due to the nature of the sector, it is problematic to communicate financial targets outside of top management.

While top management within AcadeMedia assist the CEOs of the education companies with whatever issues that need to be discussed, EQT never conduct micromanagement in the sense that they never tell the CEOs of the education companies how to run their businesses. AcadeMedia's CEO explains this by stating that "*it is dangerous to start making changes in a successful business*". This view is shared by EQT, as they believe that they might cause more harm than good if they were to start deciding on detailed issues relating to the running of the education companies. According to Per Strömberg this is common in the PE industry, i.e. the owners do not want to interfere in detailed decisions too far down in the organization.

The resistance towards micromanagement in AcadeMedia can be related to the PE characteristic "management by deviation". Management by deviation is a technique where management only changes something when it deviates from its forecasted development. In the video that was part of the newsletter that we looked at there was an interview with Conni Jonsson, Managing Partner at EQT. He described that EQT has a decentralized way of working as he stated that "*in the same way we give the board full empowerment, I also give my co-workers at EQT full empowerment, so that we do not have to micromanage. We create frames, objectives and measures and as long as things are working well we do not interfere*". He also mentioned that when something is not working well they act directly in order to correct things and they make sure that the necessary actions are done properly. The management by deviation could also be linked to the turn-around characteristic discussed earlier where AcadeMedia achieves turn-arounds when quality is decreasing or low.

Finding 5.3.8 Management by deviation in AcadeMedia

EQT do generally not engage in micromanagement, instead they apply management by deviation, which is a common PE characteristic. This is evident in the case with AcadeMedia where they for instance decided not to change anything with regards to the reward structures within the different education companies.

Even though EQT generally do not want to engage in micromanagement of the education companies there is one thing that they wish to improve – the business mindset of the teachers and the principals, since teachers do not necessarily see the relationship between profits and the work around quality. Further, the teachers that we have interviewed do not think that the perceived quality target is relevant, or that these targets steer them in any way. The educating of the organization could be seen as a way of dealing with the strong values that teachers and principals have from their education.

Finding 5.3.9 Educating teachers and principals to deal with presuppositions

To deal with the fact that teachers and principals have a different mindset when it comes to understanding the relationship between quality and profits, AcadeMedia formally educates its principals in business, and in turn AcadeMedia informally educates the teachers as well since the principals help the teachers to become better leaders. This is done to strengthen their *leadership and improve their knowledge about quality and its positive effects on profits. That way, AcadeMedia wishes to change the mindset of the employees to deal with the strong values that accompany their teaching profession.*

As described in the empirics section, AcadeMedia uses a multi brand strategy where they keep the brands of their education companies separate. There are a number of reasons for this and one of the most interesting is, as mentioned by the CEO of AcadeMedia, that there is a high media pressure on the sector and keeping the brands separate is a way of working with risk management. This means that if one of the education companies, or AcadeMedia itself, is exposed in the media, the other education companies will not be directly affected by this. One parallel, that can be drawn from this way of working with risk management, is to the theories around portfolio theory. Portfolio theory implies that, by using diversification, an investor can reduce the risk of a portfolio by holding a combination of instruments which are not perfectly correlated (Markowitz, 1952). Drawing on this, AcadeMedia could in this case be viewed as the investor, and the education companies with its respective brands would then be the instruments in the investor's portfolio. In this case, if one education company were to be exposed in the media, then that negative publicity would probably not affect the other education companies. The fact that the multi brand strategy serves as a risk management strategy is also acknowledged by the CFO. The CFO further contrasts the multi brand strategy with a single brand strategy and concludes that the later has "*local upside but a national downside*". Compared to its competitors, AcadeMedia is truly acknowledging the local aspects of the school business. The local upside is reflected in the fact that good reputation only spreads locally, while the national downside reflects the brand damages caused by bad publicity, which would affect the whole school group. In that sense, EQT and AcadeMedia, have both acknowledged the fact that the school sector is a local business. As an example, the CFO argued that if one of their IT upper secondary schools, for instance the IT school in Skövde, is popular, that does not mean that opening an IT school in for example Sundsvall would get a push from the popularity of the IT school in Skövde. In other words, good reputation only spreads locally, while bad reputation, caused by bad publicity in the media, strikes the whole school group nationwide.

It seems that the media is the most important threat of badwill in this sector. The CEO of AcadeMedia provided us with several examples, including AcadeMedia's competitor JB Education and welfare company Carema, that has experienced this kind of media exposure.

Finding 5.3.10 Multi brand strategy as risk management

AcadeMedia uses a multi brand strategy because they want diversification, which among other things reduces the risk of brand equity taking a hit if they are exposed in the media. The number of brands in AcadeMedia was something that EQT at a first glance thought could be decreased, however, following further analysis they came to the conclusion that this is a good strategy.

5.4 Performance targets

In AcadeMedia, the performance targets mainly relate to the measurement of quality. As described in the empirics section, they have three areas that they define as quality results, i.e. output measures: functional quality, perceived quality, and appropriate quality. In addition to that they have a number of prerequisites that is a must for the business to function. In order for AcadeMedia to be successful they need to have satisfied customers, but we believe that there are a number of sector specific trade-offs that players in the independent school sector need to handle, and in this section we will discuss some of these trade-offs.

AcadeMedia's definition of quality

There is clearly a discrepancy between AcadeMedia's definition of quality and how other people and actors might define quality. As described in the empirics section, Carin Jämtin believes that teacher-student ratios are a measure of quality in itself, while AcadeMedia argue that these types of staffing ratios are prerequisites rather than output. Using AcadeMedia's definition, one might argue that this is a way for AcadeMedia to shed light on other issues than on how many teachers that are employed per number of students since there might be a trade-off between the number of teachers and profits. When looking at it from AcadeMedia's point of view, it does however seem as if the way of defining staffing-ratios as a prerequisite might be more intuitive than arguing that a certain ratio of teachers to students are a quality measure in itself. In order to explain AcadeMedia's reasoning, consider the following example: There are two imaginary schools, where one of the schools has *high quality education* and for the sake of simplicity let us assume that there is an objective way to measure this quality. This means that this school is very popular and the school is thus able to fill its classes. On the contrary, there is another school that according to the objective definition would be classified as having *low quality education*. This low quality education has led to a significant drop in the number of students and has resulted in a situation where the school is not able to fill its classes with students. Since it is hard to reduce the number of teachers as the number of students decreases, the less attractive, *low quality*, school would thus get a higher teacher-student ratio than the popular *high quality* school. Using teacher-student ratios as a quality measure would mean that less attractive schools, which are not able to attract enough students to utilize the school's full capacity would in the statistics appear to have higher quality compared to the schools that are truly offering high quality education. The implications of this is that this way of measuring could mean that the schools that at first glance appear to have the highest quality are in fact the schools with low quality. AcadeMedia's view of quality is very interesting, because it has implications for how one should interpret findings in previous studies. For instance, Lundsten & Löfqvist (2011) concluded that "*we find evidence that PE create economic value through improved growth, profitability and capital efficiency. The value creation do not seem to stem from a reduction in quality as we find that PE owned school groups employs a higher number of teachers per student […] than other independent schools, as well as public schools".* Applying AcadeMedia's definition of quality, where teacher-student ratios are viewed as inputs and not outputs, this would imply that previous studies might have come to conclusions that are neither relevant nor correct. Needless to say, the quality definition is an area where there are clearly different opinions, and according to Vlachos (2011) one of the problems is that it is not possible to charge for higher quality, which gives schools incentives to provide a quality that is "*good enough*" at the lowest possible cost. The vast measuring of quality in AcadeMedia is potentially a sector specific characteristic that contradicts the findings of Rogers, Holland & Hass (2002) who found that PE companies focus on measuring only few measures. What is interesting to note is that EQT transactions were included in their study.

Finding 5.4.1 Strategic distinctiveness: creating an own definition of a sector metric

AcadeMedia has created an own definition of the sector standard metric quality. This is a purely operational development that can be viewed as strategic distinctiveness, which is a form of operational engineering. By developing the definition of the key metric quality, in the sector, AcadeMedia will inherently change how it does business. Now AcadeMedia has narrowed down its business to focus on outputs instead of inputs. Thus, AcadeMedia is now more result driven and only focuses on what is value adding in the business, i.e. measurable results.

Finding 5.4.2 Measurement mania: measuring three kinds of quality

While Roger, Holland & Haas (2002) found that PE firms generally has resisted "measurement mania", we see that AcadeMedia measures many parameters, especially within their quality work. This is related to the complexity of the sector in terms of what should be delivered to the customer. As price differentiation is not possible, this cannot be measured in terms of revenues, and thus they have to measure more things.

Functional quality

An area that on the one hand has a strong marketing value for AcadeMedia's education companies and on the other hand involves potential political risks, is grade inflation. In other words, there are some forces that are driving grade inflation in AcadeMedia's education companies and others that are holding it back. Politicians and society as a whole are key stakeholders when it comes to grade inflation, and if AcadeMedia were to give out too high grades then that would dilute the trust of AcadeMedia as a serious actor in the independent school sector. This means that the need for AcadeMedia to satisfy politicians, by not giving out too high grades, is something that will reduce the risk of grade inflation. In order to reduce the risk of grade inflation, AcadeMedia has a number of guidelines in this area, and the firm puts emphasis on this matter both on a school, education company and group level. If we look at it from another perspective we can see that grades are an important part of AcadeMedia's quality work, as it is a part of the functional quality that AcadeMedia measures. In a study conducted on behalf of Konkurrensverket (Vlachos, 2010), it was stated that "*increased competition generally leads to increased attempts to satisfy customer demands. This is often the very purpose of competition, but in some contexts this may have negative consequences. In the Swedish educational system, grades are very important for the individual student. There is thus reason to suspect that the competition that has been introduced in the Swedish school system has contributed to the grade inflation observed over the same period*". During our interview with the CEO of Vittra, she stated that "*unfortunately parents and students tend to think that a school with a high GPA-average is a good school*". This is in line with a report published by Skolverket (2012) which stated that "*in a situation where schools compete for students, the quality of the education and the knowledge-results are competitive tools for the school. The grades of the students' become a part of the school's marketing which puts pressure on the grading. Also on a teacher level there are incentives to give out higher grades in order to appear as a skilled teacher with good performance. Grade inflation can thus be expected to increase as competition within the school sector increases*". Since parents are one key stakeholder for AcadeMedia's primary school businesses, it is of course important that the parents perceive AcadeMedia's schools as attractive. In Skolverket's report, they also discuss the impact that parents have had on the school sector, and they conclude that "*the system can also be exposed to grade inflation driving effects by pressure from parents. An increased parent pressure is in line with the increase in general education level, reduced status for the teacher profession, a development towards a more customer-oriented view of the welfare systems […] can lead to high expectations that the school will deliver improved results*". In our opinion, this is a big concern for the school sector as a whole. While it is obvious that individual schools from a parent and student perspective would benefit from giving out higher grades, the schools must try to stay away from this temptation as these high grades might have serious consequences on society. There are a number of industries that have failed completely when the need for short term gains has been prioritized in front of long term sustainability. One recent example is the rating agencies, who during the years prior to the financial crisis in 2008 in the competition for more revenues clearly were not been able to stay away from the temptation of giving out too high investment grades, which later on led to a global financial crisis as many investors around the world were holding assets that were much more risky than the investment grade had stated.

One might of course argue that the grades will not soar because in Sweden we have national tests. The national tests have, however, been subject to debate because, as of December 2012, the teachers are grading their own students' tests. In a study by economist Jonas Vlachos, he concluded that independent schools give out higher grades on the national tests than public schools, even though the performance on the tests are equivalent (Vlachos, 2012). This indicates that the existence of national tests is not something that will mitigate the risk of grade inflation.

The grade discussion is relevant because high grades are a driver for customer satisfaction in the school sector. Although grades are not a part of AcadeMedia's perceived quality definition, it does evidently increase attractiveness on a broader level. In other industries the companies would try to leverage on this key driver. In the school sector, however, they must try to be disciplined and not win customers using grades as a tool, since this in the long run might reduce the legitimacy of using grades as a screening instrument for higher education. As of today, grades are better indicators of future academic success than other known screening instruments, which means that reducing the legitimacy of grades is potentially a significant societal loss (Vlachos, 2010). This characteristic, i.e. that the schools are not allowed to leverage on one of their key success drivers (high grades) is a characteristic that is different compared to many other industries, but it is not sector specific.

Finding 5.4.3 AcadeMedia cannot fully steer on one of the key value drivers

To avoid grade inflation AcadeMedia cannot fully steer towards giving higher grades even though this could be viewed as being one of their value drivers. More specifically they have internal guidelines and they put emphasis on this question on both a school, education company and group level. Also, they do not incentivize their teachers to give out high grades since this would harm the sector and their credibility of AcadeMedia as a firm.

Perceived quality

Perceived quality, i.e. customer satisfaction, is a measure that at a first glance seem to be a very clear-cut objective. However, this objective is a compromise of several objectives aimed at different customers. In other words, if AcadeMedia would only aim to please parents and students, then society might be mistreated, and conversely, if AcadeMedia only would aim to please society, students might go to other schools. In both cases, it would hurt AcadeMedia's business severely. The perceived quality target is therefore disconnected from the academic results, but still measures customer satisfaction based on other parameters. These parameters cover customer satisfaction on a broader level and are those which should reflect the parents and students decision basis for choosing one school in front of another. Since EQT and AcadeMedia developed the framework for the perceived quality definition, the questions in the perceived quality survey should reflect the value drivers for AcadeMedia in the school sector. Therefore, for AcadeMedia, there is no trade-off between quality and business success. What is interesting here is that the teachers that we have interviewed, that are supposed to be steered towards improving their results in the perceived quality area, feel that the perceived quality questions are sometimes unrelated to their profession and sometimes too hard for their students and parents to answer. On top of that, the teachers think that it is "*sad and wrong*"[55] that parents without proper education and understanding get to judge if they are doing a good job or not. This indicates that there is a mismatch between the customer satisfaction focus and the teaching profession. Further, the teachers argue that the grading done by the students is extremely volatile, where a student in a good mood could put the score 10 on every question while a student who are in a bad mood could put the score 1. Being

[55] Teacher 2, Vittra Östertälje, 2012-11-05

judged by students and parents can thus be frustrating for the teachers since they have much more knowledge and education in their area than the customers have. When discussing the teachers' view with the head of quality she said that as of January 2013 the surveys will have new questions that are more relevant and that does not purely measure customer satisfaction.

Finding 5.4.4 Governance and control failure at lowest levels

AcadeMedia cannot completely steer towards perceived quality since the teachers feel that some of the questions are irrelevant and detached from the teaching profession. As with the financial silence, the teachers are to a certain extent unfamiliar with customer satisfaction as a measure of their teaching performance. Therefore, since the teachers cannot relate to the objectives they are judged on, they do not steer their teaching to accommodate their objectives.

5.5 Reward structure

According to previous research, a typical characteristic within PE firms is that top management are given the opportunity to co-invest in the company. AcadeMedia is in that sense similar to other PE owned portfolio companies, since management have had the opportunity to make a co-investment. Another feature is the variable compensation for top management to align incentives. This is also a common PE characteristic and something that is thus not sector specific. Looking at the reward structures for the education companies, one can conclude that neither AcadeMedia nor EQT has made any changes compared to how it was prior to the respective acquisition. As described, the teachers in Vittra have a variable pay component, and since this was initiated prior to AcadeMedia acquiring Vittra, and EQT acquiring AcadeMedia, it has remained the same. EQT does not, as described during the empirics section, engage in micromanagement unless something is not working well, and this is according to Per Strömberg a common PE characteristic. For top management within AcadeMedia, we have not been given any detailed information on how their compensation packages are structured, but on a general level, the variable compensation is related to what that person can influence. The principals in Vittra schools have financial targets and even a collective financial target to reach for Vittra as a whole, in order to receive their variable component. Among the teachers within Vittra they have a variable pay component that is linked to perceived quality. As mentioned above in the perceived quality section, the teachers do not see this as an optimal solution. The CEO of AcadeMedia clearly stressed that he believes it is unhealthy to have reward structures linked to functional quality, i.e. academic performance, on a teacher level. One might however question whether perceived quality, or customer satisfaction, which is the basis for the teachers' variable pay component, is completely separated from the functional quality. The teachers are rewarded if their customers, students and parents, are satisfied. In the previous section (performance targets) we discussed that there might be a link between the grades that the teacher give out and how satisfied the students and parents will be. In that sense, there might be a link between perceived quality, which is rewarded, and functional quality, which absolutely should not be rewarded according to the CEO of AcadeMedia. Another issue that poses some questions as to whether it is suitable to have a reward structure based on student satisfaction was the described volatility in answers that a teacher had observed. The teacher described that the answers could vary from 1 on a 1-10 scale up to 10 depending on what mood the child answering the questions was in. This means that one driver for the teachers' results on the perceived quality survey could potentially be to make sure that the students are happy at the point in time when the survey is answered, which could be argued not to be a good proxy for the quality of the education that is being provided.

Finding 5.5.1 Remuneration structure

With regards to reward structure, there are clear similarities between how EQT govern and control AcadeMedia compared to what previous research have found. EQT has given top management the opportunity to invest in the business, which is a common characteristic. Furthermore, EQT does not engage in micromanagement by telling the respective education companies how to run their business, "never change a winning concept" as expressed by the CEO of AcadeMedia. The reward structure for the teachers in Vittra is perhaps not optimally structured, but since EQT has not impacted this at all, we have not looked into this area on a deeper level.

5.6 Information flows

Within AcadeMedia there is an evident need to adapt the messages as they are being communicated throughout the organization. Most of the information within AcadeMedia flows through formal information flows, where messages from top management take less than a week to reach all the employees. At times, however, AcadeMedia believes that there is a value that information comes from a person that the receiver knows, even though it in extreme cases might take three months for information from top management to reach the teachers. Whether or not this is a difference compared to companies in other sectors is hard to tell, but according to Per Strömberg it is reasonable that, given that the education companies are being run as separate units, where it is important that the teachers do not to feel that they are part of a large giant, this might be a sector specific characteristic. One of the reasons that AcadeMedia needs to adapt the message before it reaches the teachers might be due to the fact that teachers come from a totally different background, and are perhaps a bit unfamiliar with the fact that AcadeMedia is a company that needs to make a profit in order to survive. For teachers, who have chosen a profession that historically not has been related to business, it might be confusing to think about profitability and other financial targets. One example of this adapting of messages is the fact that AcadeMedia do not use the term profitability when communicating with teachers, instead they talk about long-term financial stability. According to the CCO of AcadeMedia, the need to adapt the messages within companies is a characteristic evident in all companies, and thus she argues that that is not sector specific.

Finding 5.6.1 Adapting communication

In AcadeMedia there is a need to adapt the information that is being communicated through the organization. This is related to the same mechanisms as financial silence. In AcadeMedia, there is an evident need to adapt the communication to its nearest receptor in order for it to be effective and not confusing. Within top management it is possible to talk about teacher-to-student ratios, or growth targets, but for a teacher these targets would not make any sense.

5.7 Summary of findings

	Governance and operational engineering	Sector tensions
Board		
Finding 5.1.1 Board composition	Small board with a mix of industry experts and investment professionals	One board member kept from previous ownership to get continuity
Key objectives		
Finding 5.2.1 Single value driver	Growing revenues substantially	Strong emphasis on one single value driver to handle tensions
Strategies and plans		
Finding 5.3.1 Buy-and-build strategy	Buying schools to improve their operations and achieve economies of scale	-
Finding 5.3.2 Acquisition platform	Acquired Pysslingen as acquisition platform for new acquisitions	Homogenous vs heterogenous structure affects ability to acquire new schools
Finding 5.3.3 Parenting effects	New schools benefit from accumulated knowledge in AcadeMedia	-
Finding 5.3.4 Turn-around	Not a main strategy, but occasionally AcadeMedia buys low performing schools in order to achieve turn-around	Reason 1: Build trust with politicians Reason 2: Hard to get permission to start new schools
Finding 5.3.5 Rescuing dying schools	-	Build trust with politicians
Finding 5.3.6 Cross-subsidization	-	Avoid the huge downside with shutting down schools
Finding 5.3.7 Financial silence	-	Problematic to communicate financial targets outside of top management
Finding 5.3.8 Management by deviation	EQT do not micromanage, instead they apply management by deviation	-
Finding 5.3.9 Educating leaders	Educating leaders to achieve better governance and control	Deal with tensions relating to the teaching profession
Finding 5.3.10 Risk management	-	Multi brand strategy used as risk management to reduce impact of potential media exposure
Performance targets		
Finding 5.4.1 Strategic distinctiveness	Redefining the key metric, quality, to be output and result driven	-
Finding 5.4.2 Measurement mania	-	AcadeMedia measures many parameters related to quality
Finding 5.4.3 Steering issues	-	AcadeMedia cannot fully steer on functional quality
Finding 5.4.4 Control failures	-	Based on our limited sample of interviews with teachers (two teachers), our findings suggest that the steering towards perceived quality is blocked by teacher norms and values
Rewards		
Finding 5.5.1 Remuneration structure	Aligning interests in top management by co-investing	-
Information flows		
Finding 5.5.1 Adapting communication	Decentralized communication	A need to adapt communication to the receiver in order to get understanding

Table 2

Governance engineering	Operational engineering	Governance and operational engineering

In table 2 we have summarized our findings and classified them as governance engineering, operational engineering or governance and operational engineering. In addition to that, we have identified a number of sector tensions related to our findings. These tensions reflect the need to adapt governance and operational engineering in the independent school sector.

6. Concluding remarks

The purpose of this study has been to shed light on how EQT governs and controls AcadeMedia in the independent school sector. Since the welfare sector is a complex sector, and PE firms generally apply an industry generalist approach, we have studied governance and operational engineering in AcadeMedia and the inherent tensions in this sector.

Our findings suggest that EQT create value by applying both governance and operational engineering. On a higher level, EQT has contributed in redefining AcadeMedia's strategic focus, by identifying quality as the single most important value driver, and then change AcadeMedia's quality definition, which is the foundation for the control of the organization. EQT has brought a business focus that is result driven, and through new definitions and improved processes, customer satisfaction is today a key area for AcadeMedia's success. On the contrary, the teachers come from a completely different background which historically has not been business oriented, which causes some tensions with regards to AcadeMedia's control systems. The implications of these tensions are that the objective of customer satisfaction does not steer the teachers, even though that is the intention with the perceived quality measurements. The ultimate proof that the steering around perceived quality fails is the example regarding the variable pay component in Vittra, which is supposed to incentivize the teachers to achieve higher levels of customer satisfaction, however our findings suggests that the control system fails as the teachers are motivated by other mechanisms. It is important to note that we have only interviewed a small sample of the total number of teachers in AcadeMedia, and it is reasonable to believe that the opinions of teachers in the other education companies could be different. However, since we have interviewed teachers in Vittra, which unlike many teachers within AcadeMedia do have the variable pay component to steer them towards the customer satisfaction objective, it is reasonable that the failures of control exists in other schools as well. To deal with the fact that their key control system fails, EQT has initiated an education process with the purpose of educating principals and teachers to becoming more business oriented. By initiating this process, EQT contributes in changing the roles of the teachers by making them better leaders. The Chairman explained this by saying "*it is a young industry, the people we are educating have not attended business school […] we will be better than traditional schools when it comes to developing the leadership, business mindset and the thinking around quality*". This way, EQT and AcadeMedia want to change the teachers perception of quality, especially perceived quality, to be one of the key objectives for the teachers.

Thus, our main finding is that one of AcadeMedia's key control systems fails to be anchored on a teacher level due to tensions arising from the teaching profession, and EQT handles this tension by educating principals and teachers in order for them to become more business oriented. Further, the presence of PE firms in the independent school sector is interesting as PE firms generally are good at identifying and leveraging on the value drivers in the respective industry. However, due to the dynamics of the school sector, it is not possible to steer on one of the key value drivers, grades, which is part of AcadeMedia's functional quality, as this would lead to significant societal losses. Overall, our findings highlight the tensions and the challenges that arise due to the complexity and dynamics from PE ownership in the independent school sector.

6.1 Avenues for future research

As discussed, we have concluded that the teachers that we have met are not motivated by financial rewards linked to customer satisfaction. For future research, it would thus be interesting to investigate what might serve as motivational factors for teachers, perhaps by conducting a study similar as ours, but with much more emphasis on the teachers and their preferences than what we have had in our thesis.

Furthermore, as described during this thesis, the independent school sector is a complex sector that poses some difficult questions including how to define quality, sector specific trade-offs etc. It is reasonable to assume that these kinds of dynamics are present in other parts of the welfare sector as well, and therefore it would be interesting to conduct similar studies in other parts of the welfare sector, such as elderly care. According to the Chairman of AcadeMedia, it is likely that the healthcare sector is even more controversial than the school sector, due to the voucher system in the school sector. This is due to the fact that the voucher system serves as a control system in itself, where the student has the ability to switch school and thus take the voucher with him or her and go to another school. In the healthcare sector however, the procurement are often conducted through tender offer processes, meaning that once a company has won the contract, they will operate for a number of years which reduces the incentives to work with quality on an on-going basis.

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