Is there an Intended Long-Term Value Creation in Swedish Private Equity?

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Abstract
Sweden is one of the leading countries in Europe within Private Equity. The debate going on in the media focuses on the sustainability of improvements made by Private Equity players: that value is optimised for the exit but not cared for further than so. The Private Equity funds are usually predetermined to 10 years, but does that automatically mean that venture capitalists do not plan past this period? The idea of this study explores what the plan, ambition, and time horizon were for various investments. Interviews with 15 Private Equity players in Stockholm were performed, covering in excess of €60 Bn in Assets under Management.
Three groups of value creation strategies could be observed. Group A that focused on the strategic plan in combination with margin improvements. Group B that focused on best practices and new strategic horizon. Lastly, group C that focused on switching the Board and management.
The study suggests that Private Equity firms contribute with vast value to their portfolio companies, but also to society as a whole. Moreover, across the study, strong indication was found that Private Equity players are long-term thinking in their value creation, far past their exit.

Keywords
Private Equity, Value Creation, Long-term, Strategy, Venture Capitalist

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Foreword

This thesis journey has been exciting, educative, and evolving for us. We have experienced setbacks and we have had eureka moments. The wisdom we take with us from this journey is that planning and hard work pays off, and to surround yourself with people who believe in you.

We want to thank our supervisor Stefan Einarsson for all the feedback and help you have contributed with. Your concern for our success has strengthened our belief in ourselves and the outcome of the thesis.

We also want to thank all the participating people from the studied firms: Accent Equity Partners, Altor Equity Partners, Axcel Management, CapMan, Cevian Capital, Creandum, EQT Partners, IK Investment Partners Norden, Inter IKEA Investments, Litorina Capital Advisors, Nordic Capital, Pegroco Invest, Priveq Advisory, Scope Capital Advisory, and Segulah.

Finally, we want to show our appreciation to everyone in our surroundings who have contributed with comments and discussions during the study.

Many thanks,

Ninnie Karlsson & Kim Dywling

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1. Introduction

In the study's commencing chapter, the authors present the background including the problems laying the foundation for this thesis. Then, the study's purpose and delimitations will be presented. Concluding this chapter is a short description of the study's disposition.

1.1 Background

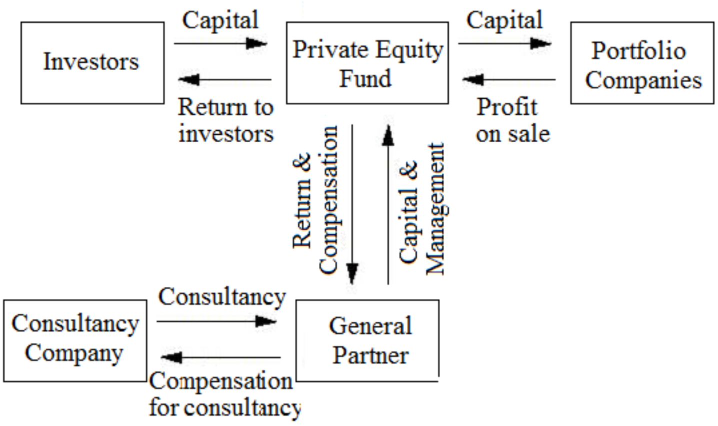
This thesis intends to investigate whether or not there is an agenda for long-term value creation in Private Equity, and specifically, how it is being acted upon. During the mid 1900s, out of the depressions and world wars, emerged a new ownership form now referred to as Private Equity (PE) in the USA. The equivalent development in Sweden occurred during the 1980s, when political reform facilitated the access and international movement of capital in an increasingly unregulated market. This new ownership form developed from the need for capital to enable and manage growth. This growth creates employment and improves welfare; there are approximately 200 000 employments in Private Equity managed companies in Sweden, which is about 4% of all employment in the country (SVCA 2015). In order to secure capital, a company can either apply for a bank loan or raise venture capital. Taking in venture capital does not affect the company's debt-to-equity ratio and keeps risk low (Palepu 1990, Myers 1984). Venture capital is in that regard ownership equity invested in both publicly and private held companies and fills a need that banks and other credit institutes are incapable of satisfying (Kiechel III 2007). Moreover, the Private Equity capital is often coupled with an active ownership of competencies and an established network that would have been difficult to ensure in another way. As compensation, the venture capitalist often takes a portion of the company, which indirectly means that the returns for the company correspond to the returns of the venture capitalist. Private Equity is typically divided into three groups: business angels, venture capital (VC), and buy-out (BO). Most common is that business angels engage themselves in the earliest stages of a target firm, and buy-out pertains to older and more established target firms (SVCA 2015). In different stages firms often need different ownership due to the differences that come from restructuring, international expansion, and product development. The different venture capitalists differ in that they specialise within different stages, decision processes, sizes of investments, and the origin of the capital. Buy-out usually takes on a majority ownership in contrast to venture capital. This is however not always the case. Venture capital owned firms grow on average at a higher rate than other firms of corresponding size and industry.

Private Equity represents a large portion of Sweden's imported capital. Foreign institutions often find it difficult locating the right target firms in Sweden and are therefore looking for a domestic partner that knows the markets (SVCA 2015). It should also be noted that Stockholm is Europe's second most venture capital densest city (in relation to GDP) (Sveriges Riksbank 2015).

A Private Equity fund is most commonly held for around 10 years with exits ranging between 3 and 11 years (Giot, Schwienbacher 2007). Potential buyers are primarily other industry-related players or other Private Equity players. A third very desirable exit is the IPO (Initial Public Offering), meaning that the portfolio firm is introduced to the open exchange. Private Equity has started receiving a great deal of criticism in the media, especially since scandals like the Carema incident where extra attention has been placed on taxes paid (Stockholm TT 2011, Lundell 2011, DN 2012, Karpf 2007).

SVCA was founded as early as 1985 to work towards a well functioning Private Equity & Venture Capital market in Sweden. For example, they offer facts and knowledge about Private Equity's role in the Swedish economy, and ensure sound thinking in regards to ethics, transparency, and CSR.

Diagram 1.1 Overview: Private Equity fund



The Private Equity fund invests in Portfolio Companies with capital received from the investors. The investors get a return when the fund is ended and the Private Equity player gets a profit from the sale.

For abbreviations and definitions, see appendix 1 and 2.

1.2 Problem Discussion

There is quite some research on the correlation between venture capital and value creation in quantitative studies (E&Y 2014, Achleitner et al. 2010, Vester 2011). Despite Sweden being one of the leading countries in Europe within Private Equity, not a single study can be found on Private Equity players' thinking regarding long-term value creation. With what temporal horizon do venture capitalists plan today? The Private Equity funds are usually predetermined to age to 10 years, but does that automatically mean that venture capitalists cannot plan past this period? The debate going on in the media focuses on the sustainability of improvements made by Private Equity players: that the value is optimised for the exit but not cared for further than so. Counter-arguments claim that the prospective buyer would never purchase the firm if they did not see a sustainable future with lucrative returns, and consequently, the Private Equity player would never be able to sell the firm.

Furthermore, Private Equity players keep so-called track records that outline their previous investments in earlier funds. These track records can be seen as their CVs, which are being used when raising more capital for new funds. A good track record will render the player more investment opportunities, both from the capital raising side and from the target firm side. This is especially prevalent for venture capital investments as there often are strong entrepreneurs in the picture. Sometimes, it is not sufficient to bid the highest to win a round of investments in a target firm. Sometimes, the present owners must also like their new partners. The idea of this study is not to determine as much what is being done, but more of what the plan, ambition, and time horizon were for various investments. This perspective is put in place to minimise the risk of partial testimonies where the interview subjects would recite whatever the media want to hear.

The authors of this study try to not limit this research to whether Private Equity players create value, but also how long-term this value-creation is. Operational performance metrics are common when looking over the long term, but the authors endeavour to use other measurements. What creates value lies in the eye of the beholder. There is therefore a possibility of discrepancy between the way venture capitalists look at value creation as opposed to the way the portfolio firm looks at it. Venture capitalists are engaged in their portfolio firm to a varying degree; the engagement depends on how good management is and the extent to which the Private Equity player's competence and network can be of use to the portfolio firm. Less successful firms tend to be automatically corrected by Private Equity players, since the worst-case scenario is a portfolio firm bankruptcy. But if portfolio firm bankruptcy is a venture capitalist's worst nightmare, how come the media is criticising Private Equity for its shortsightedness and is this criticism justified?

The discussed ambiguities around long-term value creation in Private Equity show that such investigation can add to the existing research by introducing a qualitative study on the subject. The Swedish market is especially interesting due to its influence on the broader Private Equity context as well as being the domicile of the two authors.

1.3 Problem Formulation

With the previous problem discussion in mind, this study aims to answer the following question:

Is there an intended long-term value-creation in Swedish Private Equity?

1.4 Purpose

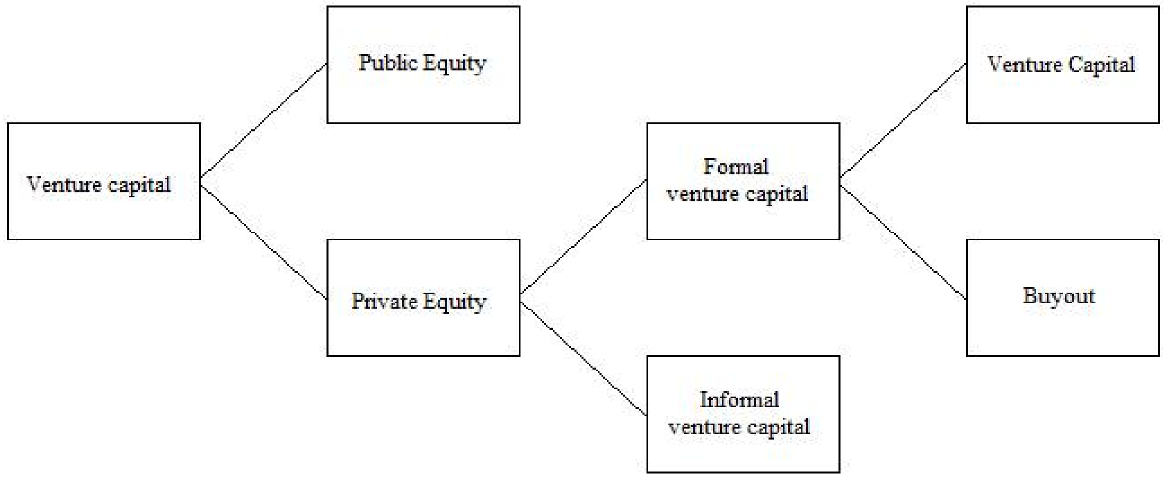
The purpose with this study is to investigate whether there is long-term value creation thinking in Private Equity, since venture capitalists at present are frequently discredited and criticised for being short-sighted, only looking for quarterly results, and not contributing with any real value. The authors endeavour to investigate whether the media portrait is justified or if there is an angle that never reaches the public.

By studying a broad spectrum of Private Equity, this study aims at adding understanding the distinctions are similarities, if any, between the different types and their view on long-term value-creation. By investigating several aspects of investment decision, plan, ambition, and exit, the authors hope to increase understanding and transparency around how venture capitalists view their own farsightedness and the value their investments create.

1.5 Delimitations

This research paper studies Private Equity players with an office in Stockholm. The study focuses on what is called Formal Venture Capital, but also includes one activist fund (Public Equity), which is formally defined within Public Equity, but operates similarly to Private Equity.

Diagram 1.2 Types of Venture Capital



This studie focuses on Formal venture capital (Venture Capital and Buyout) and on one firm from Public Equity.

1.6 Disposition

Succeeding this introductory section follows chapter two with a presentation and description of the literature and theory upon which this research paper is based. Chapter three describes the methodology and includes a critical discussion regarding the chosen approach. Chapter four presents the collected empiricism and chapter five the analysis performed through the perspective of the chosen theories presented in chapter three. Chapter six concludes this research paper and includes a short discussion with suggestions for further research.

2. Theory

In this passage, the authors attempt to present a comprehensive picture of the theoretical landscape of long-term value creation in Private Equity. The chapter' structure is therefore divided into two main parts:

1. ***Value creation** in Private Equity; and*
2. ***Farsightedness** in Private Equity.*

2.1 Introducing Value Creation

Private Equity's media image has recently taken a turn for the negative, criticised for being shortsighted, indeed value destroying with regards to its decision-making (Karpf 2007). Is that image legitimate? In situations where a company is subject to private acquisition, there may exist incentives to reduce long-term investments in order to improve short-term results (Shleifer, Vishny 1986, Stein 1988).

On the other hand, a successful exit requires potential for further investment opportunities to ensure long-term value creation (Israel, Ma 1999). An extensive study by E&Y suggested that Private Equity investors create significant value, much of which stems from strategic and operational improvements in the acquired target. The research showed that half of the economic value created from strategic and operational improvements resulted from the growth of EBITDA– in both up as well as down markets. Further segmenting this EBITDA improvement, three-fourths was due to increases in revenue and one-fourth due to cost reductions (Vester 2011).

2.1.1 Agency Theory in Private Equity

Changes in the management and the Board of Directors are often made to generate high commitment in target companies (Kaplan, Stromberg 2009). In order to incentivize new inititiatives, management is sometimes asked to make private financial contributions (e.g. in *Leveraged Buy-Outs* and *Management Buy-Outs*). Usually, the monetary rewards for a manager in a portfolio company are more performance sensitive than in other setups (Jensen 1989, revised 1997, Fox, Marcus 1992, Anders 1992). Organisational changes do not directly affect financial results positively, but rather create value indirectly. This value is partly created through the reduction of 'agency costs' (Berg, Gottschalg 2003). Earlier studies have shown that agency costs are highly relevant in the Private Equity context (Opler, Titman 1993).

The Agency Theory gives an understanding of why Private Equity firms perform some of the reconstructions often associated with Private Equity investments, and why this creates value. The Agency Theory refers to a "ubiquitous agency relationship, in which one party (the principal) delegates work to another (the agent), who performs that work" (Eisenhardt 1989). The main difficulty in this relationship is that conflicting interests between the principal and the agent may arise; moreover, monitoring the agent's actions is both difficult and expensive (Jensen, Meckling 1976). To counter this cost, management can buy into the ownership of the enterprise. However, the dilution of ownership may render the final decision-making authority at the General Meetings uneasy, as Board members would require the approval of other owners (Berg, Gottschalg 2003). Diluting economic ownership, but maintaining the concentration of influence could perhaps mitigate this dilution. It has been suggested that due to its fixed foreseeable liquidation, Private Equity holds a prime position to incentivise its top management to an extent otherwise deemed impossible (Baker, Montgomery 2009).

Similarly, there is a greater chance of the agent acting in the interest of the principal if their contract is outcome-oriented (Eisenhardt 1989). Through these two aforementioned initiatives, the interests of the principal and the agent should fully align (Smith 1990b). Certainly, if the company succeeds, the managers are highly rewarded. It is, however, important to use the right performance compensation metrics for the company to maximise its value. E.g. the most common performance metric on the open exchanges are 'earnings', whereas literature has suggested that the most common metric within Private Equity is 'cash flow' (Anslinger, Copeland 1996). On that note, the earnings on the open exchanges are universally measured every quarter – coupled with updated goals for the next quarter – whereas cash flow in Private Equity, even though tightly monitored throughout a target's lifetime, is ultimately measured with only one goal in mind: the exit (which typically spans between 3-11 years (Giot, Schwienbacher 2007)). One indirect long-term effect of this distinction could be that on the open exchanges certain optimal value-creating choices are being omitted in favour of quarterly earnings (Shleifer, Vishny 1986, Stein 1988).

Furthermore, if the Board is able to monitor the agents' behaviour, management is more likely to act in the interest of the principal (Eisenhardt 1989). Consequently, building effective reporting systems, e.g. certain monthly reports to verify that the manager is working according to plan and in line with strategic objectives, can reduce agency costs. This gives an increased operating efficiency through improved interaction between the Board and management, which in turn not only facilitates the monitoring of managers, but can also prove helpful when executing bottom-up communication. After all, the managers are prone to knowing the mechanics of the industry to a greater extent than the general partners would, and can therefore provide rewarding inputs for potential value-creating initiatives.

Lastly, within Private Equity, the Agency Theory carries weight in the common occurrence that a predominant portion of investments are debt leveraged. The result is a much higher requirement for debt and interest payments rendering much less free cash flow at the discretion of management, and therefore a much reduced risk of placing any free cash flow on sub-optimal investments (Kaplan 1989, Smith 1990a, Jensen 1986). It is consequently presumable to conclude that a higher leverage indirectly creates value through higher proportions optimal investments. This logic, however, has to be balanced by the apparent downside of increased risk of bankruptcy (Smith 1990a). Free cash flow should be minimised without rendering the firm uncapable of covering its short-term debts. It has correspondingly been put forward that excessive leverage can force a firm into short-term orientation due to financial distress, leading to a decline in long-term value creation (Palepu 1990). Similarly, excessive leverage can lead to sub-optimal investment decisions. Due to managerial risk aversion, the event of a bankruptcy would lead to loss of occupation and similar harmful effects (Myers 1984).

By lowering the agency cost, changes occur due to indirect improvements through e.g. governance structure and top management incentives, and can therefore be seen as a kind of indirect type of value creation (Smith 1990b). Literature proposed that several of the prominent determinants of agency costs change considerably when Private Equity exerts its influence on a newly acquired target (Jensen 1986). It has therefore been suggested that Private Equity has significant effects on a firm's agency costs (Kaplan 1989).

2.1.2 Value Creation through Financial Engineering

Financial levers constitute common value creating initiatives – arguably so common they have become a necessary yet insufficient value-creating commodity (Kiechel III 2007).

One basic initiative consists in adding to the target's equity, which is an automatic effect whenever the target is purchased at a premium price (for Buy-Out targets) or at a higher valuation (for Venture Capital targets). Pushing a target's equity can have real effects, such as potentially larger room for loans that can be used to extend the target's intended horizon in terms of scope and scale – which brings us to the next point.

Another common initiative resides in increasing the target's debt, which not only releases more needed liquid funds to allocate in the target's new endeavours, but also follows the stringency of the Agency Theory. The increased debt adds pressure on management to economise with their liquid assets. This results in indirect value creation through more careful investment choices and optimal resource allocation (Baker, Wruck 1989).

Thirdly, as Private Equity players often focus on cash flow rather than earnings (Anslinger, Copeland 1996), managing working capital may contribute to value creation (Singh 1990). Specifically, reducing inventory and accounts receivable, while increasing accounts payable are common measures of such management. The distinction becomes apparent when investigating the effects of an unmanaged working capital on earnings: close to none. With a cash flow focus – which endeavours to maximise long-term cash in and minimise long-term cash out, the effect are closer to maximal.

2.1.3 Value Creation through Human Resources

Value-creating initiatives within human resources are central. Many Private Equity players assert that management e.g. is among the most important resource in their business. The numbers of initiatives being large, the authors have decided to divide them into three main groups: target Management, target Board of Directors, and internal Private Equity firm expertise.

Regarding management, Private Equity players try to minimise the agency costs presented earlier. Strong incentive plans for management are put in place to align interests with owners (Anslinger, Copeland 1996, Baker, Wruck 1989), either by having management buy in or creating compensation schedules to encourage shareholder-value-optimal actions. On that note, having highly motivated management teams creates a willingness to take on the most unpleasant decisions for the deal to become a success (Houlden 1990). An example of a typical unpleasant decision that the average manager may want to avoid is firing individuals. This willingness can significantly increase the profitability in a business. However, if managers are rewarded when performing well or taking the right decisions, they are equally punished when not doing so (Anders 1992, Cotter, Peck 2001). This opens up the idea that not all agency cost reductions provide benefits to the managers. Moreover, the potential adverse effects of having too much buy-in from managers could turn into risk-averseness (Fama, Jensen 1985). This could generate sub-optimal decisions.

Furthermore, changes are often made to management (Kaplan, Stromberg 2009) when acquiring a new target, especially in the case of a buy-out. This setup is less common in venture capital as one then tends to also 'buy' the management team to a greater extent. Hypothetically, the latter is less likely the earlier a target is in its life cycle. When management is recruited, meticulous care is taken to secure the right people for the right job (Anders 1992), considered central to ensure a successful exit.

Similarly, a new Board of directors is commonly appointed upon acquisition (Kaplan, Stromberg 2009) to ensure that the interests of the target's new owner – majority or minority – are being attended to. Typically, the Private Equity firm has one or two own representatives, and appoints the remainder externally or within the target. External counterparts, as well as the Private Equity firm's own representatives, have oftentimes formely participated in several Boards. This gives them routine that otherwise is difficult to achieve in a typical firm. This type of experience can e.g. give an edge when deciding upon previously covered issues. In parallel, introducing owners to the Board where there previously were none can bring tangible value. The Board is responsible for the direction of the firm and takes care of critical issues and decisions. Being an owner on the Board incentivises the Board to take the owner's best interest into consideration. Two practical implications of this reside in tighter monitoring of the firm coupled with more engaging representation in the Board (Jensen 1989, revised 1997, Smith 1990b). Another common value creator consists in the improvement of corporate governance structures (Singh 1990), where the owner admits its rightful responsibility for directing and delegating assignments to the CEO – a function not all Boards adequately fulfil.

Regarding Private Equity expertise, it has been shown e.g. that they tend to pay less for their targets than industrial counterparts do (Butler 2001): possibly a result of their distinguished negotiation skills and bargaining tendencies. Other reasons may be that industrial buyers tend to overvalue synergies and are likely to have only few prospects to choose from. On the contrary, Private Equity players are disconnectedly able to assess many prospects without attributing them any intrinsic value. This way Private Equity players are able to capture more value at a lower price.

Besides, investment managers generally possess considerable industry or process expertise (Anders 1992). If industry expertise is not unique to Private Equity – industry managers possess similar proficiency – process expertise is less common in industry. For example, when a Private Equity firm acquires a target, it sets a plan that includes certain initiatives such as a marketing campaign or an international expansion. Private Equity investment managers tend to become experts at certain processes, and frequently hire external industry experts or consultants whenever they lack the knowledge.

Finally, Private Equity investment managers are seen as professional owners (Anders 1992). As expert owners, they will therefore have ascendency when tackling decision or problems similar to earlier endeavours.

2.1.4 Value Creation through Improved Operations

Despite popular belief, most Private Equity firms focus on operational engineering rather than financial engineering. This means that people are hired for their operational competencies and industry focus rather than their financial expertise (Kaplan, Stromberg 2009). Traditionally, cost savings and better investment choices have been two prominent value creators within Private Equity (Palepu 1990, Kiechel III 2007, Vester 2011, Anslinger, Copeland 1996, Butler 2001, Jensen 2010, Muscarella, Vetsuypens 1990). This idea aligns with the Agency Theory, where managers within Private Equity tend to be greatly financially incentivised to perform (Palepu 1990). Accordingly, one could expect better operating performance as well as better investment decisions to occur. Moreover, cost savings often concur with considerable changes made to the organisation and management of operations (Muscarella, Vetsuypens 1990, Wright, Hoskisson & Busenitz 2001). These changes fundamentally disrupt the way business was previously conducted into a sense of 'best practices'. It has e.g. been implied that Private Equity firms are characterised by substantially leaner corporate functions than the average firm (Baker, Montgomery 2009). A common example of these lean initiatives is the reduction of overheads through facilitated decision-making, communication flow, and improved control systems. It has been proposed that these systems carry much less bureaucracy than the average firm of similar size and structure (Easterwood, Seth & Singer 1989).

Similarly to how financial engineering saturated into a mere commodity, the heavy focus on operational efficiency within many industrial sectors in the 1990s has diminished the potential value of initiating a portfolio acquisition based off of only cost cutting (Wright, Hoskisson & Busenitz 2001, Porter 1996, Wright, Robbie 1996). As a consequence, Private Equity firms now begin to combine financial and operational engineering initiatives with new strategic measures.

2.1.5 Value Creation through Strategic Measures

High level initiatives such as new product launch, international expansion, and innovative distribution channels are examples of what the authors would refer to as strategic measures. This type of initiatives have grown more common and started carrying more weight within Private Equity (Kiechel III 2007, Vester 2011, Butler 2001). As a result, literature suggests that Private Equity has a profound effect on growth in the average target company (Singh 1990) as compared to other companies. Private Equity players tend to, in line with focusing on a particular set of improvements and therein becoming process experts, favourise certain growth strategies and initiatives. For example, the classic 'Buy and Build' strategy focuses on driving synergies coupled with cost efficiencies across the platform for faster revenue growth (Vester 2011).

Here are connections to be found with the Agency Theory. As Private Equity firms tends to introduce new ambitious plans for future growth, more pressure is put on managers to either realise these plans, or leave the company (Anders 1992, Butler 2001). On that same note, managers execute new strategies better when financial incentives are aligned with performance. It may be suggested that better strategies are proposed in other companies but not acted upon to the same extent as within a portfolio company. Therefore, value is created by putting innovations into action.

Studies have also suggested that Private Equity firms introduce a higher level of innovation into target firms (Wright, Hoskisson & Busenitz 2001). This is a requirement for driving abnormal returns, according to the dominant innovation theory (Christensen 2003). It is also suggested that entrepreneurship is introduced to a greater extent in target firms, especially for buy-outs (Singh 1990, Wright et al. 2000). In the context of Private Equity, the choice regarding the tradeoff (Christensen 2013) between improving existing company activities and introducing new business directions is easier to deal with. Literature suggests this tradeoff to be the leading cause of long-term failure – and correspondingly long-term value creation and profitability (Christensen 2013).

Researchers claim that Private Equity restores a target's strategic focus by reducing its overall complexity and selling off non-core or inefficient parts of the business, thereby improving its competitive positioning (Seth, Easterwood 1993). This idea resonates with the previous paragraph in that many companies can identify various possible opportunities, but are simply lacking the structure to put in into action (Bull 1989). Therefore, the professional ownership of Private Equity is often a positive contribution.

2.1.6 Value Creation Framework

Based on the existing literature on the subject of value creation, the authors have decided to construct their own descriptive model to map value creation within Private Equity firms. Through meticulous consideration, initiatives have been classified into four main categories, with its distinct sub-categories, to represent the bulk of noteworthy value-creation:

1. Financial Engineering
    a. Increase Equity: *The Private Equity player adds the extra capital often needed to take the investment to the next level.*
    b. Increase Debt: *The target may have a suboptimal debt-to-equity ratio where additional borrowed capital can be released.*
    c. Increase Financial Efficiency: *Optimising reporting systems, cash conversion cycles, working capital, and/or other CFO related tasks.*
2. Human Resources
    a. Corporate Governance: *Appointing new members to and actively directing from the Board of Directors, with a cascading downward effect throughout the target.*
    b. Management: *Appointing and assembling a new Management setup.*
3. Improving Operations
    a. Improve Margin: *Cost cutting and/or Economies of Scale.*
    b. Introducing Best Practices: *Implementing new practices deemed by the Private Equity player to be best in industry, and a speciality of theirs.*
4. Strategic Position
    a. Introduce New Horizons: *Developing new strategic positions and goals.*
    b. Increase Strategic Efficiency: *Interaction, reporting, delegation, and expectations between organisational hierarchical levels.*

2.2 Strategy

2.2.1 Farsightedness

Having taken on the most ambitious mapping of sustainable success, by closely monitoring the most profitable American businesses over the past 40 years, Collins frequently advocates long-term thinking. Having coined the term and acronym ‘BHAG’ (‘Big Hairy Audacious Goal’) and the ’20-mile march’, Collins speaks of 20-25 year planning horizons as a key contributor to sustainable success (Collins, Porras 1994, Collins 2001). Similarly, management guru Michael Porter advocates longer horizons for today’s companies: “Strategic positions should have a horizon of a decade or more, not a single planning cycle” (Porter 1996). Even though a ten-year-horizon may seem common for large companies, they rarely create full employee compliance longer than a year into the future, and generally three to five years at best (Martin 2014). Shocking as it may seem, long-term thinking is not as common as one might expect for today’s companies. For the times long-term thinking is being employed, it is frequently coupled with the terms: ‘prediction’, ‘plan’, and ‘strategy’ (Kiechel 2010).

2.2.2 Early Strategy

The term ‘strategy’ has its etymological derivation from the Greek word *stratēgia* or ‘office of general’, and was first confined to military use. The term was found in oriental military literature as early as the 6th century B.C. in the warfare classic *The Art of War* (Tzu 2007). More than 2000 years later, the theories of *The Art of War* were further developed in Clausewitz’s post-renaissance works. Notably in his multiple volume *On War* (Von Clausewitz 1982), the world was introduced to the idea of continuous reconciliation between ends and means – an idea that, to this day, plays a central role in our definition of strategy.

As business is war, the term strategy became increasingly popular amongst management thinkers and practitioners. In 1960, Chandler further popularised the strategic concept in his work *Strategy and Structure,* by mapping top-level managerial developments among the largest industrial players on the American continent. By doing so, he academically dichotomised strategy from operations; some managers should now occupy themselves with only strategic matters, separate from those who handle operations (Chandler 1962, Ashworth 1965). Then emerged the first ever strategy textbook, *Corporate Strategy*, by Igor Ansoff (Ansoff 1970). Ansoff was highly influenced by the work of Alfred Sloan, the former president of General Motors (Sloan 1963) – after which Ansoff became widely known as the father of strategic management.

2.2.3 Recent Strategy Development

In his 1980 work, Michael Porter defines strategy as the "formula for how a business is going to compete, what its goals should be, and what policies will be needed to carry out those goals". In line with Von Clausewitz ideas about continuous reconciliation between ends and means, Porter adds that "competitive strategy is a combination of the *ends* (goals) for which the firm is striving and the *means* (policies) by which it is seeking to get there" (Porter 1980).

"Strategic planning isn't strategic thinking. One is analysis, and the other is synthesis" (Mintzberg 1994, Heracleous 1998). Strategic management regards both the formation and execution of strategies. Mintzberg and Porter agree that strategic management can be seen as the sum of strategic planning and strategic thinking, even if they disagree on their interrelationship. When refining and developing a tailor made strategy, there needs to be a degree of oscillation between these two poles (Heracleous 1998). Within Private Equity, each project could represent the strategic planning stage, while the prospect search represents the strategic thinking. The latter stage can be seen as a potential incubation period for new and refined strategic ideas. The relatively short and frequent parallel investment cycles within Private Equity can, to a higher degree than other setups, facilitate the refinement of strategies – as well as improve the skill of strategy formation in general. This could in turn create value for Private Equity players.

More recently, Rumelt described good strategy in three simple parts (Rumelt 2012):

1. *Diagnosis* defining and explaining the nature of the challenge;
2. A *guiding policy* for dealing with the defined challenge; and
3. Coherent *actions* designed to execute the guiding policy.

In the context of Private Equity, one should look for Rumelt's three components primarily in connection to the acquisition phase. Only later within an investment should one evaluate the strategy in reflection of Porter's requirements.

2.3 Summary of Theoretical Framework

Albeit an important foundation on which to structure the empiricism, the strategy portion is not of central importance for this study and has therefore been introduced only briefly. Studying farsightedness without including strategy may be frowned upon by the great management thinkers, so it will serve in the background of this research. The empirical material will, however, be developed primarily through the lens of the authors' own Value Creation Framework, where interview questions will address each of the four main areas of value creation within Private Equity.

3. Method

This chapter will outline the methodology used, including the research strategy and design as well as the approach to data collection. This section concludes by addressing some criticism of the chosen method.

3.1 The Research Strategy

The authors of the study used a strategy emanating from hermeneutic, as the purpose of the study is to apprehend the changes the Private Equity players carry out, and their importance for long-term value creation.

There are two fundamental research strategies for use in business research methods: quantitative and qualitative. The appropriate research strategy for this study was carefully considered. To answer the study's primary questions with success, it appeared that qualitative research was to be preferred. The qualitative research strategy entails a collection of often less standardised data points, and great emphasise is put on the subjective interpretation of this data. The qualitative point of view is inductive where interpretations and conclusions are drawn from experience (Bryman, Bell 2013).

This study has primarily used semi-structured in-depth interviews to understand the interview subjects' intricate views on long-term value creation in the Private Equity sector. The semi-structured question format enables a wider entrance into relevant topics – information that may otherwise get lost (Bryman, Bell 2013). The interviews were engaged from a primarily inductive point-of-view, with lighter occurences of deductive reasoning ensured a dynamic vantage point. The authors view inductive and deductive strategies as dynamic rather than a pure dichotomy (Bryman, Bell 2013). After a few interviews, another broader literature search was performed, followed by further interviews. This strategy is known as iterative, as the researcher oscillates between data and theory (Bryman, Bell 2013). This iterative process was employed to create a continuously stronger theoretical foundation for further interviews. The theoretical framework was presented in the second chapter on Theory.

3.2 The Research Design

Choosing the optimal research design is complementary to establishing an appropriate research strategy. Upon judging research within business and management, academia takes three criteria into consideration: reliability, replicability, and validity (Bryman, Bell 2013). Reliability and validity are most relevant in quantitative research, which opens up for further criteria to be introduced to the qualitative branch. Credibility has been suggested by Yvonna Lincoln to be used for assessing qualitative studies (Lincoln, Guba 1985). Credibility is defined as a measurement of how likely and truthful the results are: if they carry true meaning in other contexts, and if the authors managed to keep objective throughout the study and therein not refrain from affecting the results to any significant degree. Relevance is suggested to be the meaning and implication the study has on its academic vicinity (Hammersley 1992).

Five types of research design are suggested (Bryman, Bell 2013): experimental design, cross-sectional study design, longitudinal design, case study design, and comparative design. The authors chose to apply the case study design, as the intention was to determine whether Private Equity firms were more or less farsighted as portrayed in the media. The case study at hand can be considered a multiple case study since several organisations are investigated with the intention of assessing similarities and differences. The study can furthermore be described as 'rich with information' or unveiling since performed mainly inductively with cases each rich with information (Bryman, Bell 2013).

3.3 Choice of Interview Technique

The authors chose to apply qualitative interview, as this is a flexible technique rendering poignant and detailed answers. This interview technique was appropriate for the conduct of semi-structured interviews. The authors directed questions building upon the interview subject's answers without keeping to a strict manuscript (Bryman, Bell 2013). An interview guide was also developed to ensure that all needed question areas were touched upon. See appendix 3 for the interview guide. Questions not in the guide were also asked whenever a lead has necessitated. It is quite common that semi-structured interviews are conducted in case studies (Bryman, Bell 2013).

The interviews were performed in Swedish because it was both the respondents and interviewees native language. The quotes used in this thesis were therefore translated from Swedish to English.

3.4 Choice of Private Equity Firms

The authors had the ambition of covering 90 % of Assets under Management of Private Equity firms with offices in Stockholm: the study covers just over €60 Bn in AUM (January 2015). No further delimitation was made; venture capital, buy out, and activist funds are all represented in the study.

The participating companies were Accent Equity Partners, Altor Equity Partners, Axcel Management, CapMan, Cevian Capital, Creandum, EQT Partners, IK Investment Partners Norden, Inter IKEA Investments, Litorina Capital Advisors, Nordic Capital, Pegroco Invest, Priveq Advisory, Scope Capital Advisory, and Segulah.

3.5 Choice of Interview Subjects

To enable answers at similar level of complexity from each company, individuals were chosen from their position within the firm: all of which at executive level. The position should not reflect differently on long-term value creation depending on the firm.

3.6 Approach

A pitch letter was put together to inform potential interview subjects of the purpose and background of this study. Each initial contact was performed via e-mail. The positive response rate was over 90 %, at which point time and place for the interview was established. Each interview was conducted at the office space of each firm spanning between 45-60 minutes. All interviews were recorded with a Sony Xperia Z1 without any complications. A total of 15 interviews were conducted – out of which 13 with both authors present – during which time one author acted interviewer and the other secretary and controller, ensuring that each interview was conducted according to predetermined format.

3.7 Transcription

Five of the interviews was transcribed fully and ten of the interviews were semi-transcribed by the authors themselves. Even if two thirds of the interviews were semi-transcribed, it was made possible to analyse them word by word of what was of importance.

3.8 Creation of Tables

A tematic analysis has been the approach when conducting the table in the appendix 4, even though, a tematic analysis lacks a clear approach (Bryman, Bell 2013). Themes and subthemes can be identified from the interviews and using quotations means that the material is being processed several times. The authors saw that some themes were repetitive and wanted a clear way to show it. The transcipted/semi trancripted interviews were processed and the different themes noted in the tables.

The areas that were explicitly expressed during interviews were noted in the tables. In the table overviewing the Private Equity players, which was based on the table in appendix 4, a factor was noted if it was expressed in all of the investments. Then quotes were higlighted to support the data.

3.9 Ethical Aspects

Throughout the study, a few ethical principles were brought forward: the information requirement, the consent requirement, the confidentiality and anonymity requirements, and the exploitation and false pretence requirements (Bryman, Bell 2013).

An informative pitch mail including a brief background coupled with a full decleration of the purpose of the study was sent to the participants. It was also covered at the initial phase of each interview to make sure that the interview subject was fully informed on the intentions of the study as well as opening up for potential questions regarding the study.

The study participation has been emphatically voluntary and scheduling been flexible to cohere with the interview subject's availablility. Furthermore, the study was carried out with a clear intention not to invade the privacy of any interview subject.

To avoid disclosing particular participants, the authors decided to make the results anonymous by not make any quotes by name, firm, or position. The intention is to ensure no exploitative or disadvantageous information is disclosed about the interview subjects that may harm their direct or indirect commerce.

All disclosed information has been covered by a confidentiality agreement and been handled via a data clouding service at restricted access by only the authors through their personal password protected email accounts.

3.10 Delimitation and Critique

The participation selection is not complete, in part due to lack of access, and in part due to scarcity of time.

Interviews were recorded in order to ensure that the authors refrain from adjusting any answers given. Choosing not to record the interviews could have rendered different answers due to the exposure factor of being recorded. This choice of digitally recording the interviews could therefore, in retrospect, be criticised. Given more resources, perhaps mechanically recording the interviews would have been preferable.

Further critique may be directed towards the interview setup where there more often than not were two interviewers and one respondent. Albeit nothing the authors noticed, it is possible that such a setup intimidates the respondent in their experience as a minority. The minority situation could, however, have been mitigated by the sincere intentions of the study and the clear communication of which, coupled with the interviews being conducted at the respondents' place of work. With any luck, these mitigating actions neutralised any potential intimidation effect.

A common criticism directed towards qualitative interviews is leading questions and findings tainted by interviewer opinion. The authors have endeavored to proactively eliminate these risks by constructing an interview question guide, letting the respondent answer the question exhaustively, and keep to short follow-up questions. Albeit the authors' intention, entirely eliminating the risk of subjectivity is perhaps not possible in qualitative studies.

4. Empirics

This chapter presents the empiricism collected during interviews. The results are presented in tables, which have been explained further in the text.

4.1 Overview of Types of Value Creation Utilised by Private Equity Players

Table 4.1.1: Types of Value Creation Utilised by Private Equity actors can be found in appendix 4.

Table 4.1.2: Types of Value Creation Utilised by Private Equity actors (as explicitly expressed during interviews)

Private Equity Player	**Financial**: Increase Equity	**Financial**: Increase Debt	**Financial**: Incr. Eff. Excl. Tax	**HR**: Corp. Govern.	**HR**: Mana-gement	**Operation**: Improving Margins	**Operation**: Intro. Best Practices	**Strategy**: New Horizons	**Strategy**: Increase Effect.
1	X				X		X	X	
2		X		X	X				
3	X	X	X	X					
4	X				X	X	X		X
5		X	X		X	X		X	
6	X	X		X	X		X	X	
7	X	X	X	X	X	X		X	X
8	X	X		X	X		X	X	
9	X	X		X					
10	X	X		X			X	X	
11	X	X		X	X	X	X	X	X
12	X	X	X	X	X				
13	X	X				X		X	
14	X	X	X	X	X		X	X	
15	X	X		X		X	X	X	
TOTAL	**13**	**13**	**5**	**11**	**10**	**6**	**8**	**10**	**3**

Clarifications:

i. Private Equity Player – made anonymous, here presented in order of interview chronology and the individual investments covered in said interview.
ii. Financial: Increase Equity – the Private Equity player adds the extra capital often needed to take the investment to the next level. This alternative is most prominent when point iii. is insufficient or impossible.
iii. Financial: Increase Debt – the target may have a suboptimal debt-to-equity ratio where additional borrowed capital can be released.
iv. Financial: Increase Efficiency, Excluding Taxes – Optimising reporting systems, cash conversion cycles, working capital, and/or other CFO related tasks.
v. HR: Corporate Governance – Appointing new members to and actively directing from the Board of Directors, with a cascading downward effect throughout the target.
vi. HR: Management – Appointing and assembling a new Management setup.
vii. Operations: Improving Margins – Cost cutting and/or Economies of Scale.
viii. Operations: Introducing Best Practices – Implementing new practices deemed by the Private Equity player to be best in industry, and a speciality of theirs.

ix. Strategy: New Horizons – Developing new strategic positions and goals.
x. Strategy: Increase Effectiveness – Facilitating interaction, reporting, delegation, and expectations between organisational hierarchical levels.

The following section will go through each area of initiatives successively and will include quotes from conducted interviews in order to strengthen the case of value creation.

4.2 Financial: Increase Equity

13 out of the 15 Private Equity players added equity to their investments. An interesting observation here is that Private Equity players either did or did not add equity to their investments. Only 1 out of 15 of the Private Equity firms displayed a tendency to add equity on certain investments and refrain from doing it to others. The reason for this could be the top-level investment styles that Private Equity players adopt: either one acts as an equity contributor or not. Another explanation can be found in theory where financial engineering is becoming so generic that no differentiation seems to be endeavoured (Kiechel III 2007). Within the scope of this research, the theory seems to hold true.

It would be interesting to identify the trend of focus areas, since financial engineering was the focus in 1980s and today seems outdated and peripheral. A continuation of this train of thought will be found at the end of section 4.7.

4.3 Financial: Increase Debt

Also 13 out of the 15 Private Equity players increased debt in their investments. A similar pattern was also observed here, which seemed to exhibit a relationship between an investment's lifecycle stage and the increase of debt. The earlier in the life of an investment, the less likely was debt increased, however, with the exception that for fully mature investments, the increasing debt seemed to be marginally declining. Explaining factors for this could mainly be attributed the banking sector rather than the theories covered in chapter 2, where a young company – especially pre-revenue – is less likely to achieve traction with the banks and can therefore not loan funds.

Even though the authors saw no explicit reference to the Agency Theory, the dominant prevalence of increasing debt shows that Private Equity players saw distinct advantages with it. It is, however, difficult to conclude whether these advantages solely concern increased funds rather than the tighter free cash flow as described by the Agency Theory.

In general, it seems that increasing debt as a value creating initiative has become commoditised.

4.4 Financial: Increase Efficiency, Excluding Taxes

As the financial initiatives seemingly least common, 5 out of 15 Private Equity players specified increasing efficiency as a value creating activity. Initially, a lot of resources are put into setting up a monitoring system in line with what Eisenhardt expresses (Eisenhardt 1989). This way the principal has a greater chance of ensuring the agent act in line with the ownership agenda.

> *[R2]- Initially, we are more concerned with setting up a reporting system that works, to enable sensable monthly updates.*
>
> *[R9]- We pay extra attention on reporting during the starting phase.*

When the reporting system is in place, emphasis is put on continuous updates and making sure developments occur according to plan.

> *[R10]- We created this program and followed up with this newly appointed supervisory group every month to see how far we have come.*

Continuous reports support the Agency Theory when it comes to minimising information asymmetry. Management holds all information about any progress made within the organisation, and the Board must ensure that progress is according to their direction. A well functioning reporting system decreases information asymmetry and simultaneously helps management execute value-creating initiatives.

4.5 HR: Corporate Governance

Firstly, when acquiring a target, the Board of Directors is used to assess future potential of a company.

> *[R5]- You look at the Board, how long they have been there, if they own a portion of the company, or possess any special competencies. We look at engagement and will to make this into a great company.*

In line with Kaplan (2009), it is seldom that an entire Board of Directors is kept in its original setup upon investment. This study shows that about three-fourths of Private Equity players appoint parts or entirely new Boards.

> *[R7]- First things first, we have to appoint a good Board.*

> *[R10]- We appoint entire Boards.*

> *[R13]- We handpick every Board.*

> *[R2]- As an owner, the Board is very important to us, to see the hub of what is important and driving the ownership agenda.*

An ineffective Board, lead by its Chairman, fails to support management. A Board with long experience as Directors can give the support needed to contextualise the changes a Private Equity firm is advocating to create maximum value. There is therefore a strong focus on appointing a suitable Board, especially the Chairman, to create sustainable value.

> *[R10]- We work through the Board; we always appoint a Chairman.*

> *[R2]- We use our industrial network to assemble a Board which acts much, much more as a catalyst for strategy than a simple ownership forum. Here the Chairman is very important.*

It has become apparent that the majority of respondents view the Chairman as one of the most important pillars of change. The explanation stems from the position's sheer strategic influence and directing role for the CEO. The dialogue between the Chairman and the CEO decreases the information asymmetry and clarifies progress.

Several respondents expressed that the Chairman should preferably possess a background in the industry and if possible within Private Equity.

[R2]- It is important to us that the Chairman understands our world.

Even though respondents requested experience within Private Equity for a potential Chairman, this was not necessarily from within the Private Equity firm itself. Often, the Chairman was appointed from an external environment to ensure a fit with the target company. Similarly to understanding the Private Equity world, respondents expressed a wish for a Board with financial background.

[R5]- It is important with a deep financial competence within the Board.

In this regard, the authors see a slight disparity between respondents. One camp replaced entire Boards with former Private Equity people, while another camp refrained from directing from the Board and focused more on supporting the entrepreneur in their undertakings.

Several respondents emphasised the importance of finding a Chairman not from within the Private Equity firm.

[R3]- We have the ambition of always appointing an external Chairman.

[R11]- We always use what we call an independent Chairman, he would not be independent in the real meaning of the word as he is a friend of the house. He is not an investment professional.

An independent Chairman seems to reduce the gap between the Private Equity firm and the CEO, where the dialogue becomes more relaxed, which facilitates the flow of information. This is contrary to what was formerly common practice, where the Chairman often came from within the Private Equity firm.

[R3]- Things have changed. I use to be CEO and on the Board, always internally appointing the Chairman. I suppose business was handled more like a group and less like a fund back then.

Common for all respondents engaging in appointing new Chairmen was that his/her competence should be focused on a strategic level of abstraction rather than operational.

[R14]- Back in the days, CEOs tended to be Chairmen. That is not great as there is no division between strategy and operations. This creates operational focus which omits the purpose of the Board.

[R11]- When we enter a company we first have to appoint a Chairman that is capable of leading the company through its intended strategic journey.

The strategic focus of the Chairman is to the authors of this study an indication that Private Equity players view their work in portfolio companies over the long-term. Research has shown that many target firms that are acquired never make the distinction between operational and strategic focus, which according to theories stifles long-term thinking (Porter 1996, Collins, Porras 1994, Collins 2001, Chandler 1962, Ashworth 1965). A mere operational focus can help pushing up profitability, at least for the shorter-term. However, long-term strategic drive at Board level creates a farsightedness in the portfolio companies.

4.6 HR: Management

In line with the Agency Theory, three-fourths of Private Equity players appointed new parts or entire management teams.

> *[R13]- We switched people, we have very talented people. Our entire business is about people. And here, management is everything.*

> *[R15]- A really good management makes an enormous difference.*

> *[R12]- It does not matter how good we are and how well we have thought. If you do not have right management, nothing turns out well.*

> *[R1]- Management is a very important component. But as a component, it is disposable.*

By appointing new management, one increases the flow of information between management, the Board, and the Private Equity player. Management is one of the most important aspects of Private Equity. It needs to be coherent and pull in the same direction. The more aligned ambitions from management and the Board, the more likely is a successful transformation. Some Private Equity players decide to appoint entire management, some appoint only parts, and some appoint only a new CEO who in turn decides about the rest of management, who will be hired and who will be fired.

> *[R9]- It does not matter how good the Board is if you do not have good management. That usually means that we change the CEO.*

> *[R1]- Hiring and firing CEOs, that is our assignment.*

> *[R13]-We brought on a new CEO who changed the entire management team.*

Recruiting a new CEO facilitates the relationship between management and the Private Equity player. It is important that the Board and the CEO operates on a similar level of abstraction in order to cooperate effectively. Changing the CEO also signals that drastic changes are being made to ensure sustainable value.

Another important position within management is CFO.

> *[R11]- You will want to have an opinion about the CFO.*

> *[R9]- We switch the CFO in almost 100% of the cases since they are much too accounting-oriented.*

The CFO ensures that returns are on par with plans by monitoring specifically chosen metrics. Having an accounting-oriented CFO makes it difficult to change the mind set from quarterly focus to cash flow focus. The change may seem minor, but there is an adherent change to the philosophy of value that takes time to teach many seasoned CFOs.

In order for management to create and execute initiatives chosen by the Private Equity player, certain incentive programs are used.

> *[R3]- If you manage to grow with 5% you will get this bonus, and at 10% you get this bonus. Try to change the entire mindset.*

[R5]- We have to acquire the best people possible in both management and on the Board. When we leave the company, when everything is accomplished, it is supposed to just keep on going at this new level of performance and not just fall flat.

Incentives are therefore put in place for management to ensure higher returns while owned by the Private Equity firm. Some respondents even require management to invest money into the company in order for them to get in line with the required return.

In contrast, a few respondents claim never to switch management. Among the arguments that came up were that changing management could cause disruption to the corporate governance and many management teams include very good people that simply have not had the chance to prove themselves before.

[R11]- It is very important to us that we do not build the CEOs management team. As Board members, our job is not to hire people other than the CEO. That would cause an uneasy corporate governance, and we would lose all form of accountability towards management.

[R9]- They had a very good management team, they had just never been given the occasion to prove themselves competent for aggressive growth.

[R6]- For us, switching the CEO is an unbelievable failure. We support what we call 'founding CEOs'. That is, individuals who can take the organization from three people to three thousand.

The data shows that every Private Equity player has their own structure in place to handle their investments. Switching the CEO and management is often viewed differently depending on the target firm's lifecycle stage. The more mature the company, the more likely CEO and management is being switched. It is common in less mature companies that the entrepreneur is seen as too strong to let go, which would have detrimental effect on the company.

4.7 Operations: Improving Margins

Just under half of the respondent explicitly included cost cutting and/or economies of scale as major value creating initiatives.

[R5]- Generally speaking, our strategy is to increase the margin. Make sure that they make more money. That is not something you do overnight, it is a long-term assignment.

[R13]- It is shown in our own statistical figures that about 80% of our value creation is due to operational improvements.

As the quotes show, efficiency and productivity is important if a portfolio company shall succeed. In line with Baker (Baker, Montgomery 2009), it has been suggested that these portfolio companies have much fewer corporate functions. Easier decision-making, communication flow, and improved control systems will improve the margins.

[R10]- Since [the company] grew so fast, we did not really let many people go. In other cases perhaps when growth is not as high, sometimes you have to cut costs to improve margins and one way to do that is by letting people go.

The authors have noticed that the general idea is to firstly increase sales rather than cut costs, but as a second priority was always a meticulous due diligence of the cost structure. In line with literature, basing an investment on cutting costs seems to no longer be sufficient (Wright, Hoskisson & Busenitz 2001, Porter 1996, Wright, Robbie 1996). Similarly to the commoditisation of financial engineering during the 1980s, operational improvement seems no longer sufficient to justify an investment. Private Equity players are requiring more value creating possibilities to make an investment.

4.8 Operations: Introducing Best Practices

The Private Equity firms have much competence, and have therefore often their own best practices with which they believe to create the most value in their portfolio firms. Over half of the respondents explicitly claim to be working with best practices.

[R15] - We have somewhere over time developed a systematic way of understanding profitability in the companies, we benchmark a lot against the world leader in that sector to find our vision.

[R8]- We have our best practice well defined.

Through their network, many Private Equity firms develop a unique set of best practices. The result becomes that certain Private Equity firms specialise within certain overarching plans or strategies, e.g. towards internationalisation.

[R8]- We have become very growth oriented, especially scaling up internationally.

Wright (2001) and Muscarella (1990) shed light on organisational improvement and how to introduce change. It seems that the respondents have acquired experience in handling organistions and identified what works and what does not. Therefore, they have a greater chance of succeeding in their future investments.

4.9 Strategy: New Horizons

About two-thirds of all respondents explicitly spoke of new strategic horizons as a value creating tool.

[R8]- The important thing is that you have a strategy.

[R8]- When we enter a company, we always put together a 100-day plan during which time we put together a more comprehensive action plan for the coming 3-4 years.

Some respondents see themselves as a mere helping hand for their portfolio companies.

[R14]- We use to say that we are like parents with children in their early teens. So we help them through their teens and then the children move away from home.

If the portfolio company is not already, then becoming a domestic market leader is usually top priority. Being the leader is very attractive for industrial players to incorporate these best practices into the larger company. Industrial players have been shown to pay the highest premium for this type of synergy. One of the best exits is to sell a world leader to an industrial buyer.

> *[R3]- Nobody will ever catch up to you. Ever.*

> *[R1]- The goal is really to become a world leader in whatever sector you work.*

However, many Private Equity players hope for a successful exit on the open exchange, an Initial Public Offering (IPO).

> *[R6]- We want [the company] to be introduced to the exchange. That is our highest success.*

4.10 Strategy: Increase Effectiveness

Only about a fifth of the respondents made any reference to increasing strategic effectiveness. That is initiatives concerning interaction, reporting, delegation, and expectations between organisational hierarchical levels. The respondents seem to view themselves as primarily professional owners and not operational experts.

> *[R15]- We are more owner specialists than we are operational specialists.*

The interviews emphasise that venture capitalism is not a sector; it is an ownership form. Many respondents emphasise therefore the importance of sitting down with management and the Board to work out the strategic plan together. The CEO leads the day-to-day operations, which needs to be contextualised by the Board, which is supposed to drive the ownership agenda forward. This interrelationship is highly delecate and vastly important, and it is obvious that not enough attention is paid to formalising a system to optimise it.

During the few interviews where the area was touched upon, the consensus lied in the importance of levels of abstraction in certain individuals.

> *[R14]- If you have a Board that has a shorter time horizon than the management team, the company will never succeed. Likewise, if management operates with a longer time horizon in mind than the CEO, the CEO becomes ruled out of the hierarchy.*

> *[R9]- You need certain people that are greater than the company itself. If you want to accomplish what we want to accomplish within 6 years, a lot is required from you as CEO.*

> *[R11] – Your CEO must be at the required strategic height to have a functioning dialogue with the Board, at the level required to take the company to the next level.*

Finally, the CEO needs to reduce and ultimately eliminate the dependency on the entrepreneurs in the companies.

> *[R8]- It is our role to build an organisation and recruit a CEO that will stand the test of time even long after the entrepreneur has retired.*

5. Analysis

In this chapter the empiricism is analysed through the theoretical framework created in chapter 2.

5.1 Three Approaches for Value Creation

The past few years' critique against venture capitalists have made them realise that they no longer can operate in the background. They need to aim for more transparency in their portfolio companies if they are to change the view of the media. From the authors' research question *Is there an intended long-term value creation in Swedish Private Equity* evidence show that Private Equity players are planning to show more of the value that is being created in their portfolio companies. A common idea when it comes to venture capital is possibly that the mere adding of capital is the most important part. This study shows strong indication that initiatives of non-financial nature are much more important and prevalent concerning the intended long-term value created in Swedish Private Equity. For that reason, it has been peripheral to this study to present financial initiatives in greater detail.

> *[R15]- If we are to create lasting returns, it is not enough to just buy a good company and borrow some money.*

The authors of this study have identified three groups where the Private Equity players operate and create different strategies for sustainable value creation in their portfolio companies. They are here denoted as approaches A, B, and C.

Private Equity Player	Financial: Increase Equity	Financial: Increase Debt	Financial: Incr. Eff. Excl. Tax	HR: Corp. Govern.	HR: Mana-gement	Operation: Improving Margins	Operation: Intro. Best Practices	Strategy: New Horizons	Strategy: Increase Effect.
7	X	X	X	X	X	X		X	X
11	X	X		X	X	X	X	X	X
15	X	X		X		X	X	X	
4	X				X	X	X		X
13	X	X				X		X	
5		X	X		X	X		X	
6	X	X		X	X		X	X	
8	X	X		X	X		X	X	
14	X	X	X	X	X		X	X	
10	X	X		X			X	X	
1	X				X		X	X	
9	X	X		X					
3	X	X	X	X					
12	X	X	X	X	X				
2		X		X	X				
TOTAL	**13**	**13**	**5**	**11**	**10**	**6**	**8**	**10**	**3**

5.1.1 Value Creation A

Common for these Private Equity firms is that they focus on a strategic plan coupled with margin improvements. Each of these respondents work closely with strategic development, either through new horizons or increased effectiveness. Working on improving margins is something the Private Equity player almost always leaves behind when it is time to exit, which should be considered long-term value creation to some degree. It has been suggested by respondents that this value in terms of higher cash flow and profitability stays for many years post-exit. A company with a strong core business has better chances to survive into the future than a company that does not.

5.1.2 Value Creation B

What these Private Equity players have in common is that they focus on best practices and new strategic horizons. They switch much of the Board and the management. The combination to apply best practices coupled with appointing mostly new competent people at important positions shows a willingness to innovate and execute change as quickly as possible. The new strategy indicates that the previous one was sub-optimal or not sustainable and that the Private Equity players look to the future to create a profitable company.

5.1.3 Value Creation C

These respondents only explicitly work with switching the Board and management. This predominantly concern larger companies where an IPO is within a few years' reach or a larger industrial player would be highly complemented by purchasing it within a similar time frame. The Private Equity players observe target companies where the individuals have not been able to carry it to the next level, but that other endemic qualities are present. It could e.g. be due to bad corporate governance.

5.1.4 Summary of Value Creation Approaches

The study gives clear indications of differences in strategies for how Private Equity firms create value. The reason can be that they do not operate within the same segments, but also that the world is dynamic. Different approaches can create different types of value.

5.2 Farsightedness

The future vision that is being communicated to the buyers upon exit is what puts the price tag on a portfolio firm.

> *[R3]- When you are selling you have to "leave something on the plate", like they say. There has to be an idea of where the firm is and where it is going, especially if the buyer is a financial player.*

What the media is assuming when accusing Private Equity of mere shortsighted financial engineering is that the buyer is incompetent. Buying a company that has been mistreated and without future prospect is not competent behaviour. As the empiricism shows, the Private Equity players are fully aware of their buyers' competence and that they have to leave something of value behind, partly because this would give them a better multiple, but also because it gives them a better track record.

> *[R8]- The single most important thing is that there is a business plan the day that we look for an exit. The company needs a solid foundation and a sustainable strategy. This is something entirely left out of the debate. If we are these ice cold capitalists, why wouldn't we ensure that we leave behind the most attractive offer possible with the highest margins, the best processes, and a promising strategy? The future profits of our portfolio companies is the most valuable card we have.*

The observation is interesting since Private Equity firms are being criticised for being shortsighted compared to other companies. Throughout this study, the authors have seen clear indication that it is in fact the opposite.

5.3 Conclusion

It is obvious that the Private Equity players have an ambition to create lasting value in their investment, if for no other reason than their own best interest. The criticism Private Equity has received in recent years has resulted in an increased transparency to show its value creation. There is still work to be done, but the strong indicators will sway public opinion eventually.

As a comparison to the quarterly report of public companies, the average Private Equity investment horizon of 10 years is substantially more farsighted.

> *[R7]- It is surprising that so many talented people we encounter are attracted to Private Equity -owned companies for the farsightedness, which is a contradiction to what many believe. But today's companies on the open exchange are incredibly quarterly-focused.*

It seems that the picture of Private Equity players as shortsighted sharks has persisted from what once perhaps was a true description (Anders 1992). But from 1980s financial engineers of quick wins, arose a group of cost-cutters and margin improvers known as operational engineers. During fierce operational focus throughout the 1990s, financial and operational engineering became insufficient, and the venture capitalists of the world had to innovate and improve yet again. Strategy has become the new operations. But what comes next? This study could suggest that there is a distinct need for further emphasis on what the authors call: Increased Strategic Effectiveness. That is where the value of the future will be found.

6. Summary

In this chapter the findings are summarised. Additionally, suggestions for future studies are provided.

6.1 Summary of Findings

This study aimed to answer the question *Is there an intended long-term value creation in Swedish Private Equity?* By interviewing 15 Private Equity players the authors feel confident in saying that there is an intended long-term value creation and could divide the Private Equity players into three groups of value creation. Group A focuses on the strategic plan in combination with margin improvements. Group B focuses on best practices and new strategic horizons. Lastly, group C focuses on switching the Board and management.

Generally, the authors learned from the interviews that the Private Equity players put high value into the people and their skills. Without the right people in place, improvement is close to impossible. The attitude the authors have seen towards hiring the right people is seen as a long-term strategy that spans past the exit.

Moreover, in contradiction to the picture of Private Equity in media there is more focus on implementing ‘best practices’ than improving margins or financial engineering. Naturally, if the profitability is not improving costs have to be cut, but as a last resort. This is an indication that the Private Equity players do not want to liquidate their investments, but rather try to turn it around.

Often left out of the debate is that someone buys the company from the Private Equity player. These tend to be highly competent individuals, either within the industry or another Private Equity firm, that have a vision for the company in the future. A successful IPO has to win over the trust of the public. As the empiricism shows, the Private Equity players are fully aware of their buyers’ competence and that they have to leave something of value behind, partly because this would earn them more money, but also because it gives them a better track record.

Moreover, across the study, strong indication was found that Private Equity players are long-term thinking, far past their exit.

6.2 Suggestions for Future Studies

Since this is a qualitative study, the results would have been enhanced by a longitudinal quantitative study were strategies could have been asked for and the results could have been mapped. Another way would have been to see the differences in the strategies between the portfolio companies and companies noted in the stock market, and subsequently map the returns of each group.

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Appendices

1. Abbreviations

EBITDA – Earnings Before Interest, Taxes, Depriciation, and Amortisation

PE – Private Equity

SVCA – Swedish Venture Capital Association

CEO – Chief Executive Officer

2. Definitions

Buyout firm –	A Private Equity firm that specialises in handling older or mature firms.
Equity Carve-out –	A type of corporate reorganization, in which a company creates a new subsidiary and subsequently IPOs it, while retaining management control.
Cash flow –	The total amount of money transferred into and out of a business, especially as affecting liquidity.
Due Diligence –	A comprehensive appraisal of a business undertaken by a prospective buyer, especially to establish its assets and liabilities and evaluate its commercial potential.
Earning –	Income derived from an investment or product.
Exit –	Method by which a venture capitalist or business owner intends to get out of an investment that he or she has made in the past. The exit strategy is a way of "cashing out" an investment.
General Partner –	A partner who enjoys unlimited liability, which means their personal assets are liable to the partnership's obligations.
Investment Partner –	A partner who has never been engaged in the trade or business and substantially all of the assets.
Multiple –	The factor that determines how many times a Private Equity player makes in returns.
Portfolio company a.k.a. Target –	A company or entity in which a venture capital firm, buyout firm, holding company, or other investment fund invests.
The Agency Theory –	A supposition that explains the relationship between principals and agents in business. Agency Theory is concerned with resolving problems that can exist in agency relationships; that is, between principals (such as shareholders) and agents of the principals (for example, company executives).

3. Interview Guide

How does the company's overall ambitions for the future look?

What do you think is the most value creation in what you do?

We would like to look at the best and worst investment were you have made an exit?
What was the ambition of the investment?
What did you implement in the company?
What was the result?
How long holding period did you have before exit?
What was the vision you sold? -> How long term was it?
How did this vision change during your holding period?
What specifically in the company was it that created a multiple at exit?

How important is the management?

What is your plan to change the media impression of you and the venture capital industry in general?

What do you think we should consider?
Is it something that we have left out?
Do we need to supplement any question?
Do you want to add some final words?

4. Table 4.1.1

Table 4.1.1: Types of Value Creation Utilised by Private Equity actors

Private Equity Player	**Financial:** Increase Equity	**Financial:** Increase Debt	**Financial:** Incr. Eff. Excl. Tax	**HR:** Corp. Govern.	**HR:** Mana-gement	**Operation:** Improving Margins	**Operation:** Intro. Best Practices	**Strategy:** New Horizons	**Strategy:** Increase Effect.
1.1	X				X		X	X	
1.2	X				X	X	X	X	
1.3	X				X		X	X	
2.1	X	X		X	X	X		X	
2.2	X	X		X	X	X		X	
2.3		X		X	X				
3.1	X	X	X	X					
3.2	X	X	X	X	X			X	
3.3	X	X	X	X					
3.4	X	X	X	X	X	X		X	
3.5	X	X	X	X		X		X	
3.6	X	X	X	X		X	X		
4.1	X				X	X	X	X	X
4.2	X				X	X	X		X
4.3	X				X	X	X	X	X
5.1		X	X	X	X	X		X	

5.2		X	X		X	X		X	X
6.1	X	X		X	X		X	X	
7.1	X	X	X	X	X	X		X	X
7.2	X	X	X	X	X	X	X	X	X
8.1	X	X		X	X	X	X	X	
8.1	X	X		X	X		X	X	
8.2	X	X		X	X		X	X	
9.1	X	X		X				X	X
9.2	X	X	X	X	X	X			X
9.3	X	X		X	X	X	X	X	
9.4	X	X		X	X	X	X		
10.1	X	X	X	X		X	X	X	
10.2	X	X		X			X	X	
10.3	X	X		X		X	X	X	
10.4	X	X		X		X	X	X	
11.1	X	X		X	X	X	X	X	X
11.2	X	X		X	X	X	X	X	X
12.1	X	X	X	X	X	X		X	
12.2	X	X	X	X	X				
13.1	X	X				X		X	
13.2	X	X		X	X	X	X	X	X
13.3	X	X	X	X	X	X	X	X	
14.1	X	X	X	X	X		X	X	X
14.2	X	X	X	X	X		X	X	
15.1	X	X		X		X	X	X	
15.2	X	X		X	X	X	X	X	
15.3	X	X	X	X	X	X	X	X	
TOTAL	**40**	**37**	**18**	**35**	**36**	**25**	**26**	**34**	**12**