Exploring a new phase in private equity

A multiple-case study on the use of active ownership practices in Swedish private equity

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Abstract:

The private equity (buyout) industry is a resilient industry that keeps growing through recessions and crisis. As a result, private equity firms govern bigger companies and become increasingly more important actors in our economy. At the same time, private equity firms become more and more controversial, especially as they expand their operations in Europe. Existing research on private equity has mostly focused on studying the effects of private equity. However, lately researchers have found that PE firms make increasingly more use of their operating knowledge to make changes in organizations – something called active ownership practices. This paper conducts a qualitative multiple-case study of eight Swedish private equity firms to investigate how PE firms work with active ownership practices, but also to create further knowledge on how the characteristics of PE firms affects their ability to be active owners. In addition to providing more empirical evidence that has potential to fill some gaps in previous research, the results show that smaller and larger PE firms approach active ownership quite differently. The most credible explanation found is that the previous form of ownership in portfolio companies, such as founder-ownership or institutional-ownership, affects decision-making processes of PE fund managers significantly.

Keywords: private equity, private equity firm, active ownership practices, portfolio company

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Definitions

Here are a few key terms presented that are important for the understanding of this thesis, as well as their respective definitions.

Private equity (PE): Capital invested in firms that are not listed on public exchanges

Private Equity Firm: An investment management company that provides financial backing and makes investments in portfolio companies

Private Equity fund: A limited partnership in which the private equity firm manages the fund and limited partners, which are typically pension funds and insurance companies, provide most of the capital

Active ownership practices: The private equity firm's use of industry and operating knowledge to create value in companies

Portfolio company: A company currently owned by a private equity firm

Governance: The system of rules, practices and processes by which a company is directed and controlled. Is often used to balance the interests of shareholders and management

Leverage: The use of debt or borrowed capital to finance a firm's assets

1. Background

1.1. Why you should read this

The private equity (PE) industry is a resilient industry that continues to grow through recessions and crisis. According to Bain, PE capital funds have grown from $93B in 2003 to $527B in 2015. They speculate that this shift in corporate ownership can explain why the number of publicly traded companies in the US dropped nearly 50 % from 1996 to 2015 (Bain, 2015). The core of private equity's success lies in their ability to buy businesses, steering them through a transition of rapid performance improvement, and then selling them (Barber & Goold, 2007).

In Sweden, Private Equity also is a growing industry, with over 800 portfolio companies throughout the country that employ 20 000, which represents 4 % of total employment in Sweden. Revenue in Private Equity lies at around 318B SEK, which is around 8 % of total GDP (SVCA, 2017).

The growth of this industry explains why private equity firms and their strategies have gained increasingly more attention in the global and Swedish economic forums. As more private equity investors enter the market, and their acquisition targets diversify and increase in size, PE firms become more and more criticized, e.g. for sacrificing long-term value for short-term profit (The Economist, 2005).

Private equity firms create value through organizational change. Existing research has shown that PE firms are experts at restructuring debt, increasing financial leverage, clarifying strategic priorities, increasing productivity, or heightening accountability for results. However, according to Dave Ulrich and Justin Allen, in order to successfully be able to transform companies, private equity companies also require expertise into intangible factors such as leadership, talent, and organizational capabilities and culture (Ulrich & Allen, 2016).

Given the growing significance and controversy of this industry, as well as the growing importance of organizational change (Schedlitzki & Edwards, 2014), PE firms become innovation incubators for better understanding of transformative leadership and organization (Ulrich & Allen, 2016), thus presenting interesting cases to study for new comparative benchmarks and tools to make successful organizational change in this day and age more tangible.

1.2. Private equity is in a new phase

During the early days of private equity in the 1980s, Jensen (1989) claimed that PE firms were going to become the most superior organizational form. He found that they restructured debt in their portfolio companies, which can increase organizational efficiency by preventing managers to invest in uneconomic projects (Jensen, 1986). They would also give the management team in portfolio companies a large equity upside, something that was unusual amongst public companies at that time (S. N. Kaplan & Strömberg, 2009).

While Jensen's prediction was probably a bit over-optimistic, the PE model remains relevant and has certainly drawn quite a bit of interest from academics (Gompers, Kaplan, & Mukharlyamov, 2016). The effects of private equity have been studied extensively, in particular the question of whether PE firms actually improve operating performance after they have been purchased by private equity firms. S. N. Kaplan & Strömberg (2009) find that the empirical evidence is largely consistent with the existence of operating and productivity improvements in PE portfolio companies.

This evidence from previous research is what makes Dave Ulrich and Justin Allen say that private equity is in a new phase (Ulrich & Allen, 2016). PE firms no longer only create value through financial and governance levers, but also through what Acharya et al. (2009) call active ownership practices. This means that PE firms use their industry and operating knowledge, as well as active governance, to increase value through operational changes in companies (Acharya et al., 2009; S. N. Kaplan & Strömberg, 2009).

However, it is this aspect of private equity that has made the industry so controversial. European worker's unions claim that value-improvements under PE-ownership come at the expense of workers and that this is a threat to the typical governance structures in coordinated market economies, such as Sweden (ITUC, 2007). Also in media PE firms have gotten more attention. In 2014, the journalists Carolina Neurath and Jan Almgren published the book "De Svenska Riskkapitalisterna" in which they argue that private equity represents a threat to the Swedish societal model.

1.3. Problem area

Research into how PE firms create value through the active ownership practices employed in their operations is limited. Existing research provides us only generic picture of what the active ownership practices are and entail (Acharya et al., 2009; Yeboah, Tomenendal, & Dörrenbächer, 2014). There is still a need to explore the specific analysis and actions taken by private equity fund managers (Gompers et al., 2016).

Since the sources of the productivity improvements in PE-owned firms are still being widely debated, more empirical evidence is needed (Barber & Goold, 2007). Furthermore, Gompers et al. (2016) indicate that there exists some variance in regards to the different practices used by PE investors. They claim that different firms use very different strategies. However, empirical evidence of how different PE firms create value through different types of active ownership is also limited and existing research provides a conflicting picture of what could explain the differences between PE-firms in regards to active ownership practices. That is, how do PE-firm specific contextual factors, such as the size of the firm backing the firm, the firm's founder background or the institutional environment influence the actions PE firms take (Gompers et al., 2016; S. N. Kaplan & Strömberg, 2009; Siegel, Wright, & Filatotchev, 2011a; Yeboah et al., 2014). These researchers subscribe to the notion that there is a need to explore the heterogeneity amongst PE firms and how contextual factors affect the manner in which PE firms work with portfolio companies.

To summarize, these findings stress the fact that there is need to further investigate the active ownership practices used by firms, but also to explore the existing variance of active ownership practices used across PE firms. More importantly, we aim to find out how this variance is expressed, which is clearly a research gap in existing literature.

1.4. Purpose and research question

The purpose of this study is to examine and move knowledge forward about how PE firms use active ownership practices to create value, but also, to move knowledge beyond the generic model of active ownership practices that exists today. To do so, a multiple-case study will be conducted whereby we will examine active ownership practices used by different PE firms in Sweden. Additionally, given the multiple-case study nature of our research approach, we aim to examine how contextual factors like fund size or founder background might affect how PE firm's use and approach active ownership practices differently.

Due to the limited knowledge about, e.g. when and why management is replaced in portfolio companies, or how different PE firms work to develop value-creation plans, this thesis is of an exploratory nature and aims to make sense of what PE actually do and why they do what they do. With this we hope to potentially fill some of the many gaps in existing research, like some of the examples mentioned above. Moreover, we also aim to empirically research if there is any relationship between PE firm-specific contextual factors and the use of active ownership practices.

With this background it leads us to asking the following two research questions:

1. How do Swedish private equity firms use active ownership practices?

2. Is there any observed variance in regards to the use of active ownership practices by Swedish private equity firms, and if so, to what extent can PE firm-specific contextual factors explain this variance?

1.5. Expected knowledge contribution

Because previous research into this topic has mostly been of quantitative nature, we hope with this qualitative research design to provide more empirical insight into why PE firms approach active ownership practices as they do. Moreover, by studying this topic in-depth regarding cause and effect, we aim to clarify how the prerequisites of PE firms affect how they work with value-creation methods, thus providing more clarity into the different facets of this industry compared to what existing literature has to offer. Lastly, to expect to provide insight into the decision-making processes used by PE fund managers.

2. Literature review

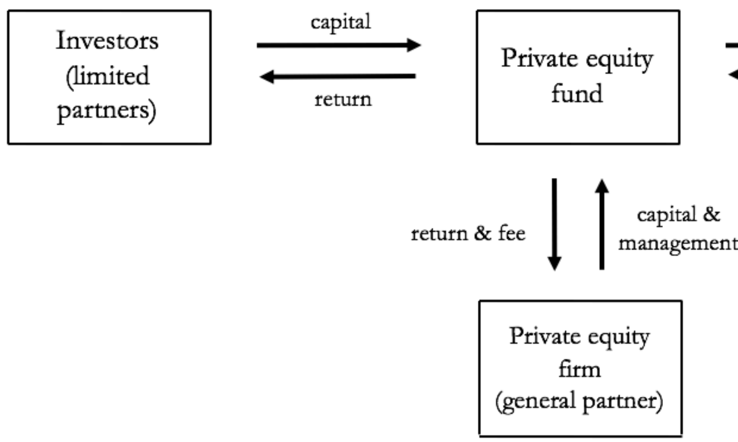
In this section, selected research into private equity is presented. First comes an introduction into the topic private equity. In the theoretical framework, research into active ownership practices is presented.

2.1. What is a private equity firm?

PE firms are financial intermediaries that pool their investors' capital and make investments to gain majority control in portfolio companies (S. N. Kaplan & Sensoy, 2015). The concept first emerged in the 1980s with firms like Blackstone and KKR being some of the most prominent ones (S. N. Kaplan & Strömberg, 2009). Jensen (1989) claims that PE firms combine concentrated ownership stakes in portfolio companies, high-powered incentives for the private equity firm professionals to form a lean and efficient organization with minimal overhead costs. These characteristics have generally remained more or less the same today compared to 30 years ago, however S. N. Kaplan & Strömberg, (2009) and Gompers et al. (2016) find that PE firms have grown in size and now appear to employ professionals with a wider variety of skills and experience.

PE firms raise equity capital through private equity funds. PE funds are organized as limited partnerships in which the general partner, typically being the PE firm, manages the fund for a fee and the limited partnership provides most of the capital (see Figure 1). The limited partners typically include institutional investors, such as corporate and public pension funds, endowments, and insurance companies, but also wealthy individuals. The fund typically has a fixed life, which is usually ten years. The private equity firm normally has up to five years to invest the fund's capital committed into companies, and then has an additional five years to return the capital to its investors (S. N. Kaplan & Strömberg, 2009). Due to the limited lifetime of the funds, exits tend to occur 3-5 years after the buyout. This can occur in various ways, e.g. trade sales, IPOs and secondary buyouts (Wright et al., 2007). In a typical PE transaction, the private equity firm agrees to buy a company. The buyout is typically financed with 60 to 90 percent debt – hence the term, leveraged buyout (S. N. Kaplan & Strömberg, 2009).

Figure 1: Private equity fund structure



This arrangement is distinct from venture capital that typically invests in young or emerging companies, and typically do not obtain majority control (S. N. Kaplan & Sensoy, 2015). In this paper, we focus on private equity firms that engage in leveraged buyouts. However, it should be noted that some firms taking part in this study also engage in other forms of private equity, like venture capital or growth capital.

2.2. The growth and effects of private equity

The private equity buyout industry has grown markedly in the last twenty years and academic research has provided accumulating evidence that private equity investors have performed well relative to reasonable benchmarks (Gompers et al., 2016).

Moreover, Bain reports that PE capital funds have grown from $93B in 2003 to $527B in 2015 (Bain, 2015). At the private equity fund level, several researchers find that private equity funds have outperformed public markets net of fees over the last three decades (Ang, Chen, Goetzmann, & Phalippou, 2014; Harris, Jenkinson, & Kaplan, 2014; Higson & Stucke, 2012; Robinson & Sensoy, 2013). Furthermore, on private equity portfolio company level, several researchers have found increases in productivity. For example, Cohn, Mills, & Towery (2014) find significant increases in operating performance in a large sample of U.S. buyouts of private firms. Cohn, Mills, & Towery, 2014b; Guo, Hotchkiss, & Song (2011) find modest increases in operation performance for public to private buyouts in the 1990s and early 2000s.

2.3. The controversies of private equity

The studies presented above show that the private equity buyout market is growing and prove that PE firms are cause of financial enhancements in portfolio firms. However, private equity remains controversial and the debate has yet to succumb. Below are short presentations of the main causes of debate.

The short-term ownership in private equity has excited debate for quite some time. Stein (1988) was one of the first to bring attention to this and argued that it can lead firms to disregarding long-term investments in favour for short-term profits. An example of such practice is a "quick flip" – that is, initial public offerings (IPOs) of firms soon after a PE investment – that enable private equity groups to extract fees and raise new funds more quickly (Lerner, Sorensen, & Strömberg, 2011).

Additionally, some argue that PE firms take advantage of tax breaks and information asymmetries, which means that PE investors simply have superior information on future portfolio company performance. Hence, critics claim that the value PE firms create is not any of operational improvement nature (S. N. Kaplan & Strömberg, 2009).

Furthermore, as the PE model is of Anglo-Saxon descent, there is concern that PE firms import controversial management and financial practices into coordinated market economies in Europe (Gospel, Pendleton, Vitols, & Wilke, 2011). Private equity firms are accused of restructuring buy-outs to increase short-term financial performance for a quick exit on the expense of workers (Monks, 2006; ITUC, 2007). Additionally, there is concern that this creates worrying implications for investments in training and education of the labour force (PSE, 2007).

However, neither academic researchers nor practitioners (including regulators) have reached a consensus on the impact of the PE industry's activities. This is mostly because of the multi-dimensional effects of PE activities as well as the lack of transparency in this largely self-regulated field of practice (Acharya, Hahn, & Kehoe, 2009; Gilligan & Wright, 2010; Loos, 2007).

To summarize, proponents of private equity like Jensen (1989) argue that PE firms are superior organizational forms that improve operations and create economic value, while opponents argue that private equity firms just take advantage of tax breaks, exploit workers and just revamp operations to increase short-term exit value.

2.4. How PE firms create value: The traditional model by Jensen

Jensen (1989) argued that the corporate governance and financial changes that PE firms applied to the companies was superior compared to the typical public corporation with dispersed shareholders, low leverage, and weak corporate governance. Jensen (1989) and S. Kaplan (1989) describe the changes PE firms apply to their portfolio companies as governance and financial engineering.

Governance engineering involves creating a better alignment of incentives between managers and shareholders to provide better oversight that can limit empire building and opportunistic behavior (S. N. Kaplan & Strömberg, 2009). From an agency theory perspective, buy-outs from often diffuse and distant owners of public-listed corporations or divisions of such firms, private equity firms reduce the gap between owners and managers (Jensen, 1986).

They do this by using equity incentives to realign interests of owners and managers, encouraging managers to reduce unnecessary costs, and avoid investment in low-benefit or value-destroying activities (N. Bacon, Wright, Meuleman, & Scholes, 2012; Jensen, 1986). PE firms typically give the management team a large equity upside through stocks and options. Moreover, PE investors require the management to make a meaningful investment in the company, so that management not only has a significant upside, but also downside. Since the companies are private, management's equity illiquid, thus it cannot be sold until exit transaction. This illiquidity reduces management's incentives to manipulate short-term performance (S. N. Kaplan & Strömberg, 2009). S. Kaplan (1989) finds that management ownership percentages increase by a factor of four in going from public to private ownership. In the 1980s, the use of equity incentives was unusual among public firm (Jensen & Murphy, 1990). However, stock- and option-based compensation have become more popular in public firms since then, but management's ownership percentages still remain greater under PE-ownership (S. N. Kaplan & Strömberg, 2009). More recently, Acharya et al. (2009) find that managers in PE-owned firms own around 15% of the equity. Sometimes other employees are often also included in these incentives schemes. Unlike public boards, nearly all board members in PE-owned firms are incentivized. Incentive compensation has been a particularly important area of governance research (Gompers et al., 2016).

Financial Engineering is about the borrowing that is done in connection with the transaction. Commitment to servicing debt taken as part of the transaction brings pressure to reduce expenditure, improve operational efficiencies, and eliminate unprofitable operations. Because the firm has to make interest and principal payments (S. N. Kaplan & Strömberg, 2009), the "free cash flow" problem described by Jensen (1986) is reduced. In general, research on capital structure in private equity has been of high interest of for researchers (Gompers et al., 2016).

Furthermore, as Myers (1977) argues with the capital structure trade-off theory, debt can potentially increase the value of a firm through interest tax shields. But on the flipside, if leverage is too high, the inflexibility of the required payments increases the risk of cost financial distress (S. N. Kaplan & Strömberg, 2009).

2.5. Theoretical framework

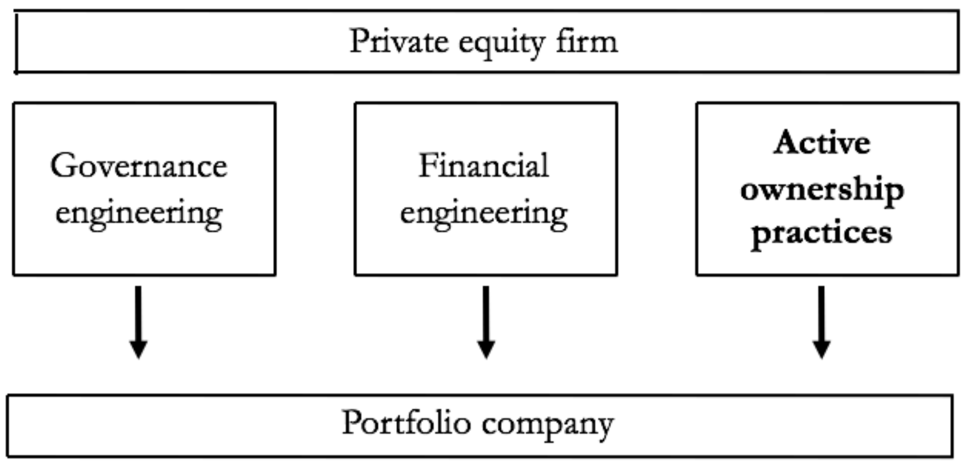
2.5.1. The new phase in PE

However, while financial and governance engineering were common by the late 1980s, today most PE firms are applying another type of change that S. N. Kaplan & Strömberg (2009) call "operational engineering" or as Acharya et al. (2009) put it, "active ownership practices". Generally, this refers to the industry and operating expertise that they apply to add value to their investments S. N. Kaplan & Strömberg (2009). Because the practices described include elements of operational, but also governance engineering, we will subscribe to the definition of Acharya et al. (2009).

This aspect of value-creation, which is taking a step beyond Jensen's (1989) hypothesis, came to attention after papers in the mid-2000s studied focused on the returns that PE funds generate for their end investors (Acharya et al., 2009). In particular, a paper by S. N. Kaplan & Schoar (2005) found that after un-levering deal-level equity returns, more mature PE houses (those that have been around for at least 5 years) generate a significantly higher return than other PE firms. Their explanation is the existence of "skill" in fund managers (Acharya et al., 2009). They find in their paper that more mature PE houses are successful because they engage in more "active governance" (such as frequently interacting with management or leveraging external support).

Thus, the evidence emerges that PE houses can create value for portfolio companies by leveraging expertise in operational engineering. Although surveys show that PE investors value the traditional approaches to value-creation (as advocated by Jensen), active ownership appears as an important value-creation lever (Acharya et al., 2009). See Figure 2 below for a graphic representation of the different value-creation strategies used by PE firms.

Figure 2: Value-creation strategies used by PE firms



The active ownership aspect of value-creation is relatively new and still sparsely researched. Existing academic research has increasingly focused on the effects of private equity, but what has been less explored are the specific analyses and actions taken by PE fund managers. Researchers have come to the understanding that PE investments are associated with improvement in operating performance or productivity, but only few papers have studied the actions private equity investors actually take (Gompers et al., 2016; Yeboah et al., 2014).

Moreover, Gompers et al. (2016) indicate that there exists some covariance in regards to value-creation practices by PE investors. They suggest that different firms use very different strategies. Yeboah et al. (2014) claim that existing research into active ownership practices has difficulties capturing the nuances of practices used across different PE firms. The same also applies to capturing differences across geographic regions (Siegel, Wright, & Filatotchev, 2011). This could mean that research that has predominantly focused on activities of the American market might not by fully applicable to the European private equity market. Siegel, Wright, & Filatotchev (2011) also subscribe to the notion that there is a need to explore the dimensions of PE firm heterogeneity and it impacts involvement in portfolio companies.

These findings stress the fact that there is need to further investigate the active ownership practices used by firms, but also to explore the existing variance of active ownership practices used across PE firms. More importantly, there is a need to find out how this variance is expressed, which is a clear research gap. Nevertheless, an overview of the existing research of the different practices deployed by PE firms when engaging in active ownership.

2.5.2. Examining active ownership practices in more detail

In this part, the different aspects and research around active ownership practices are presented. These can be categorized into four fields:

i. Target-setting and monitoring practices

   This term categorizes practices used in setting targets and tracking outcomes. PE funds have a fixed life; thus PE investors are pressured the firm to get return on the capital swiftly. S. N. Kaplan & Strömberg, (2009) and Acharya et al. (2009) find that PE firms monitor the top management in portfolio companies on a regular basis through precise systems and processes. This is also reflected in the smaller boards that meet frequently. Specifically, PE boards take a more positive and active stance on performance management practices than public boards by placing "a relentless focus on value creation levers", which leads to the monitoring of management based on defined key performance indicators with a focus on "cash flow metrics and speed of delivery".

   Bloom, Sadun, & Van Reenen (2009) find that PE-owned firms are better at target management practices in comparison to government-owned, family-owned, founder-owned and other privately-owned firms. This is demonstrated through their use of tough short- and long-run targets and metrics that are well understood by managers and linked to performance.

ii. People-management practices

   When comparing the boards of PE portfolio firms to those of public firms, Acharya et al. (2009) claim that PE portfolio firm boards are significantly more effective than publicly listed company boards in providing "stronger and more effective strategic leadership".

This is reflected in their use of management practices. For example, PE firms do not hesitate to replace top management (S. N. Kaplan & Strömberg, 2009). Acharya et al. (2009) find that, usually, one third of CEOs are replaced within 100 days and two-thirds are replaced at some point in 4 years. They also find that average tenure of CEOs in portfolio companies is 2 years, whereas it is 4.7 years in public companies. Gompers et al. (2016) find that in roughly one-third of all investments, PE investors expect to create value by changing the CEO or CFO and by changing other members of the senior management team. The motivation for replacing the management is usually that the incumbent management is "poorly performing" (S. N. Kaplan & Strömberg, 2009), "ineffective" and that they bring in others who can execute the value-creation plan efficiently (Acharya et al., 2009). Furthermore, Cuny & Talmor (2007) find that PE firms have an ability to find opportunities to replace current management without emotional friction or direct confrontation between board and management.

Moreover, N. Bacon et al. (2012) and N. Bacon et al. (2008) find that PE ownership's effect on people management practices, that involve pertaining to the hiring, developing and keeping of the right people, is positive. They find increases in high commitment human resource management practices and the introduction of new high-performance work practices. Bloom, Sadun, & Van Reenen (2009) subscribe to this finding and report that PE-owned firms adhere to strong people management practices in comparison to government-owned, family-owned and founder-owned firms.

iii. The use of value-creation plans

PE firms use their industry and operating expertise to add value to their investments. Indeed, most private equity firms are now organized around industries (S. N. Kaplan & Strömberg, 2009). They use it to identify and evaluate investment opportunities, to develop value creation plans for those investments, and to implement the value creation plans (Gompers et al., 2016; S. N. Kaplan & Strömberg, 2009). A plan might include elements of cost cutting opportunities and productivity improvements, strategic changes or repositioning, acquisitions opportunities, but management changes and upgrades can also be included. Acharya et al. (2009) and Gadiesh & MacArthur (2008) report that a successful track record in a particular industry is likely to lead to greater investment focus on a particular sector. However, Bloom, Sadun, & Van Reenen (2009) and Cuny & Talmor

(2007) indicate that PE investors also strongly incentivize current management to provide insights for value-creation opportunities.

Once a plan is decided upon (which occurs quickly after the acquisition), strategic repositionings are rare and revisions to the value-creation plan occur infrequently. Additionally, more than half of the deals start an organic growth already in the first 100 days. However, during the life of the deal, the value creation plans are often refined based on newly acquired information. Plan deviations are reacted to immediately –through management changes – if necessary (Acharya et al., 2009).

iv. Employing external support

Where required to strengthen the company's weak spots in operations and implemented required changes. (Acharya et al., 2009) PE firms often hire external advisors with backgrounds in particular and consulting groups (S. N. Kaplan & Strömberg, 2009). Gompers et al. (2016) finds that PE investors make use of other senior advisors, CEO councils or advisory boards that help with providing industry-specific information, serving on boards after investment, as well as advising on operating and managerial issues.

2.5.3. How PE-firm specific contextual factors can influence active ownership practices used by PE firms

The above findings provide us a generic model of how PE investors work with their portfolio companies. However, researchers have found that the extent to which active governance practices are used vary with regard to several external factors (Yeboah et al., 2014). An overview of this research is presented below.

As previously mentioned, Acharya et al. (2009) suggest that PE firm maturity seems to be a contextual factor influencing the degree to which active governance practices are used. They mean that more mature firms seem to be more "active owners" compared to less mature firms. They claim that this could have to do with expertise or "skill" in PE investors that is built up over time.

Gompers et al. (2016) report that different PE firms use very different strategies. They go on to suggest that the variations of strategies used are related to firm founder characteristics. For example, firms whose founders have a financial background tend to focus more on financial engineering, while those with a previous background in private equity and, to a lesser extent, operations, tend to focus more on operational engineering. While they hypothesize that the value-increasing actions are not necessarily mutually exclusive, but it is likely that certain firms emphasize some of the actions more than others. They also recognize the need to collect more evidence about this topic (Gompers et al., 2016).

N. Bacon et al. (2012) and N. Bacon et al. (2008) have been studying management practices used by PE firms in various institutional contexts, and they suggest that there is evidence that this is a factor influencing the extent to which active governance practices are used. For example, they find that there is a difference between practices used between PE firms in the UK and the Netherlands. However, Wright, Amess, Weir, & Girma (2009) also recognize that more empirical evidence on this topic is required and that there is a need to explore the different roles and impact of the types of PE firms, especially in order to drive the debate of PE corporate governance in different institutional contexts forward.

Another contextual factor that can influence the manner in which active ownership is contractual fund time. N. Bacon et al., 2012; Bruining, Verwaal, & Wright (2013) indicate in their studies that anticipated time to exit seems to influence the business plan for the portfolio companies. N. Bacon et al. (2012) recognize the need for more empirical work on the influencing effects of anticipated time to exit and portfolio firm strategy.

3. Method

In this section, the chosen methodology to conduct this study is presented and discussed.

3.1. Research approach

In order to produce knowledge about the chosen phenomena one can choose between two different approaches. To start from existing theory and through hypothesis make conclusions about how it should appear in the studied case is called deduction. On the other hand, inductive means that you use gathered empirical data to make theoretical conclusions (Bryman & Bell, 2015).

In this study, our research approach varied between inductive and deductive processes. We used empirical evidence to identify the general theoretical area. The theoretical framework was continuously developed as more empirical data was collected and problem areas were identified. This combination of both induction and deduction is called an abductive approach, which describes our research approach well. Moreover, Andersen (1998) claims that this approach works well for exploratory studies that aim to create knowledge about how contexts can affect certain phenomena.

3.2. Research method

We opted for a qualitative research method to research this topic. First of all, this area is relatively sparsely researched and empirical evidence is rather scarce (Gompers et al. 2016), thus we wish to describe, explain and interpret data in an exploratory and deeper level than what exists as literature today. Hence, a qualitative approach was chosen in order to obtain complete in-depth answers and formulations.

Moreover, because the active ownership activity of private equity firms has been criticized a lot in media and academic contexts, the topic is slightly sensitive in nature. In such cases, (Bryman & Bell, 2015) recommends a methodology that includes in-depth interviews.

Yin (2013) says that multiple-case study approaches enable researchers to do in-depth analysis of each case which helps us to find out how contexts separate them from each other. This goes in hand with our goal to find out how different PE firms use active ownership practices. Multiple-case studies are appropriate when the objective is to develop theories, which accommodates the purpose of this study (Bryman & Bell, 2015).

According to Bryman & Bell (2015), a critique to multiple-case studies is that they tend to focus too much on comparing the cases and thus less attention is spent on the specific contexts. In order to prevent that, we spent time to classify the different PE firms based on certain PE-firm specific characteristics.

Our research is exploratory and does not aim to test theories but rather explore how and why companies use the frameworks that we have reviewed. Thus, we have decided for method focusing on quality as opposed to quantity, with the latter often having a deductive meaning. Moreover, Bryman & Bell (2015) say that qualitative research may facilitate the interpretation of the relationship between variables which fits well with our objective.

3.3. Sampling strategy

3.3.1. PE firms

As part of this study, we contacted PE firms that are members of the Swedish Private Equity & Venture Capital Associations (SVCA). In terms of geographical sampling, only firms that had offices in the Stockholm area were selected - partly due to convenience and resource limitations – but also because Stockholm is the largest financial centre in Scandinavia with a fairly strong cluster of banks, venture capitalists, private equity investors and other financial institutions (Ibison, 2006).

Given that the aim of our second research question is to explore variability based on contextual factors, the selection of case companies becomes especially important. Thus, to achieve the highest degree of generalizability, but also a high degree of diversity in terms of firm characteristics, all 16 PE firms that fitted our criteria were contacted. We received mixed response from the firms, and eight were willing to take part in this study. The motivation for why some other could not take part was due to time- and/or resource-limitations.

3.3.2. Interviewees

When contacting the PE firms, we expressed our desire to speak to individuals that were operatively involved in the management of portfolio companies. So preferably partners or investment directors because these are the individuals that are usually also seated on the board of directors in portfolio companies, thus have vital role in decision-making processes. This is important because we aim to get an as detailed access as possible. Out of the eight persons interviewed, we interviewed four partners, two investment directors and two investment managers.

3.4. Data collection process

3.4.1. Semi-structured interviews

We opted to use interviews with PE firm managers as a method to collect primary data. This is because we through the various elements of this thesis, wish to describe, explain and interpret data at a deeper level and in an exploratory manner compared to what existing literature has to offer. A semi-structured interviewing method was chosen because it makes it possible to explore a broad and multi-dimensional view on active ownership practices. At the beginning of the interview, we aimed to keep the interview fairly open by letting the interviewee speak freely about their philosophy and use of active ownership practice, which also allowed us to ask follow up-questions and learn about the true variation (Bryman & Bell, 2011). However, because method oscillates between induction and deduction, we asked more specific and directed questions in order to analyze and identify similarities and differences. Thus, a semi-structured method was chosen because it fitted best with our overall objectives

As emphasized by Bryman & Bell (2015), in order to allow for comparison between the cases, the interviews were organized accordingly. Also, this was done in order to secure lucidity and prevent excessive data collection. In practice this means that we during the data collection process categorized the data in order to identify overarching topic areas that were used to systematically look for similar topics in the rest of the interviews and to find new angles on the issues.

All interviews were conducted by both authors in order to reduce the risk of misinterpretation. Furthermore, all interviews were conducted at the offices of the respective PE firm and generally were of one hour's length. The interviews were conducted in Swedish and quotes were translated into English by the authors. Furthermore, nearly all interviews were recorded and transcribed, which allowed us to focus on the interview and ask relevant follow-up questions, as well as allowing us to conduct a more detailed analysis afterwards. It should be mentioned that one interviewee did not allow the interviewee to be recorded, however immediately afterwards the authors wrote down the key takeaways.

3.4.2. Pilot study

During the early phases of this thesis, we wanted to focus exclusively on people- management practices and variations of this between firms. However, after two interviews, the aim was rewritten to focus on active ownership practices overall due to the realization that the practices used by PE firms are not mutually-exclusive and a clear relationship between the practices could be identified, thus the scope of the study had to be widened.

3.4.3. Secondary data

Secondary data was collected, mostly in order to be able to classify the PE firms according to our chosen factors, but also to get better background information. This secondary data was mostly provided the PE firm's websites, but also news articles, where we looked for information such as the firm's investment strategies (such as whether they focus on a particular industry or firm size) and the size of their fund. If some firm characteristics were not provided by secondary data, we asked about it in the interview. Additionally, it provided us a background to prepare for the interviews.

3.5. Research quality

Given the multiple-case study approach, we put emphasis on identifying patterns, as well as similarities and differences between the different PE firms in observed topic areas. This way of working reduces the risk that any results are affected by any anomalies. This has a positive impact on external reliability, which is about whether this thesis can be replicated (Bryman & Bell, 2015). Nevertheless, given the qualitative nature of our research method, the degree to which this study is externally reliable is dubious to begin with. On the other hand, the internal reliability of study is debatable because the researchers from a subjective point of interpret empirical findings, however in this paper's defence, more than one researcher conducted both data collection and analysis.

External validity is about whether findings can be generalized in other contexts (Bryman & Bell, 2015). We see this factor as relatively high, given that we cover a significant amount of the total Swedish private equity market. Moreover, we find that the sampling results a yielded relatively well balanced selection of PE firms when considering fund size, although access to more firms would have been preferable. Also, one must take into account that the study is limited to Sweden and due to institutional factors our findings can be difficult to generalize in an international context. Internal validity is about to what extent causal conclusions based on a study are warranted. Here, we see our qualitative approach and multiple case study approach as an advantage as it has allowed us to collect a significant amount of in-depth evidence that tests the relationships we try to establish. It would have been preferable conduct interviews with more than one representative of each PE firm to increase internal validity.

Although we did promise that all firms and interviewees could be anonymous, our impression is that a few respondents were hesitant to give detailed answers, while others were spoke more openly about their portfolio companies and gave us many examples. This obviously has an impact on the quality of our data, but overall we find that the quality is within reasonable realms.

4. Empirics

In this section, empirics from our primary and secondary data collection is presented.

4.1. General observations regarding participating PE firms

Generally, all firms participating in this study primarily engage in buyout transactions by taking majority ownership stakes. However, a few firms interviewed (such as PE firm Hotel[1] and Charlie) claimed during interviews that they also invested in minority positions. Some firms also engaged in other types of transactions such as real estate (Foxtrot) or growth capital (Bravo). In terms of investment targets, the firms generally specified their investment targets in terms of size (e.g. small or mid cap). Otherwise nearly all firms claimed that they were interested in various industries, however industry clusters could be observed when examining their current and previous portfolio companies (see below). A key statement that came across nearly all participating firms was that they were looking for proven and stable business models. We also observed that many of the employees at the PE firms were graduates of a few selected academic institutions and often they had gone through similar career paths.

All firms participating in this study claimed that the use of leverage was used in nearly all buyout transaction. However, the firms appear to make use of financial engineering to different degrees, for example, interviewee Alpha says their efforts are grounded more in operational work than financial engineering.

Also, all firms participating in this study highlighted their use of management incentives to provide better alignment of interests between managers and the PE firm. All interviewees said that this meant that the managers themselves had to invest into equity in the portfolio company. A few interviewees said that this was one of the most important actions they took and that they would not invest themselves if the managers would not. Interviewee Bravo says: “Incentives is what makes us better than public companies, but also makes us good at attracting good management personnel”.

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[1] Some PE firms did not want us to use their actual name, hence the eight participating PE firms were coded as Alpha, Bravo, Charlie,…

Below, each participating firm in this study is presented and an overview of each firm's characteristics is presented based on information provided by secondary sources (retrieved April 2017) and the interviews.

4.1.1. PE firm Alpha

Firm Alpha has a smaller sized fund (around 135 MEUR) and focuses on investing in small-cap[2] companies in Sweden since approximately 2008. An examination of their portfolio companies shows that they have no clusters around any specific industries. Their relatively small portfolio includes everything from consumer product companies to industrial companies. They themselves claim that they look for interesting and niched companies based on, for example, an interesting offering or unique market position, in which they can add value through their operating expertise and capital. They want to build up management-structure and restructure organizations in portfolio companies, but this is often a challenge and it can lead to clashes with the entrepreneurial founders. The respondent emphasizes this as a reason for why they must take it slow and go on the journey together with the entrepreneur. Also, they are struggling to find the right people for their companies: "It is difficult to find good CEOs; they go to other larger companies. Many of the smaller companies are also spread out in the countryside, not in growth areas like Stockholm. Thus, the local market sets the boundaries for what you can get." They develop the value-creation plan together with the incumbent management: "We choose companies that have an okay positioning in the market, with working management, that is small, and that there is a room for growth. Then we work out a plan with the managers where Alpha adds structure and sets goals". The interviewee says that the CEO needs to have "strategic height" so that the PE firm can make fruitful contributions to the portfolio company. Furthermore, the interviewee says that it is important to find the right balance between type of leader and the value-creation plan. In order to find that balance, they often try to add either some kind of niche competence or a CFO in place that can support the CEO.

4.1.2. PE firm Bravo

This is a smaller-sized firm with a fund size of around 190 MEUR that invests in small-cap companies in Sweden and Norway since 2001. Although their portfolio and investment strategy seems to include all types of sectors, they seem to have clusters around software high-tech companies. They emphasize

[2] small-cap is a company with a market capitalization of less than 150 MEUR

in their investment strategy their aim to partner with dedicated entrepreneurs and management teams to grow and internationally scale the companies they invest in. Although they most of the time invest in majority stakes, they sometimes take minority stakes. This means that they go on the value-creation journey together with founders of the portfolio companies. These are often good and sustainable businesses but where the operations are very dependent on few people. This means that the firm is struggling when expanding, and here Bravo's objective is to create structure by dividing up the firm into different functions, delegating responsibilities instead of tasks, and work to get it from small-cap to mid-cap. They themselves claim they are generalists, which means that they don't have a specific market focus, however they claim that they focus on specific themes. For example, this could be "consolidation-cases", which means they invest in portfolio companies that try to capture market shares in fragmented markets (such as life science). When it comes to strategy development, their process works in such way that the portfolio companies come with a draft first, and then they work everything through together with the portfolio company. Hence, Bravo requires managers with extensive industry knowledge and a "creative mindset". In return, investor Bravo adds operational expertise and capital. The investor goes on to say that there are cases where they come to an agreement that the founder will pass the CEO-baton in future, and that the founder finds a new role, like sales manager.

4.1.3. PE firm Charlie

Charlie is a smaller PE company with a fund of around 390 MEUR. The firm operates only in the Swedish market and invests the small-mid[3] cap market since 1994. No industry focus is found in their portfolio of rather diverse companies that include everything from consumer-facing retailers to B2B service companies. As part of their investment approach, they emphasize their goal of building strong mutual partnerships with portfolio firms. They have an investment horizon of 5 years and during that time the portfolio company should be more profitable or be of higher quality. Companies they buy are smaller companies that often experience some sort of struggle to continue to grow without external help: "You see that often in founder-owned companies – often a great entrepreneur has a business idea in his mind, he has all contacts, he knows all the personnel, but nothing is written down. The company can still work fine, but there is a boundary when trying to scale. We then create structure in the company; we collect all data and create systems and build a solid foundation." Then they work out

[3] mid-cap a company with a market capitalization of between 150 MEUR and 1 BEUR

a strategy for just that company. Some firms come to Charlie with already finished plans that they want to realize. Sometimes they have contacts that know something about that industry and they put together a board. Then they work out together with the mangers a value-creation plan. They don't want to replace managers - they choose companies that already has well established management team with "many ideas left to do".

4.1.4. PE firm Delta

This PE firm has a fund of around 800 MEUR and invests in small- to mid-cap firms in Sweden. It was founded in 1994 and no clusters around particular sectors can be observed. Their aim is to add focus, competency and capital to their portfolio companies and assisting their portfolio companies' management to create value. They hold companies for 5-6 years and they choose firms that they think have a good market position and an adequate position in the market together with growth potential. The interviewee goes on to claim that this usually has to do with a good management team that already is in place. So they avoid to invest in firms in which they know it is necessary to replace managers. However, that does not mean that they don't replace managers at all. Often they come to the conclusion that the CEO is not the right type of person for PE-owners: "We are very picky. We need to find just the right person for that moment." The investor goes on to claim that they usually are able to find the right people in the end due to their reputation and wide network: "That's an advantage, we are able to attract great people." In terms of individual characteristics, they look for people that work hard and want to take risks. The investor says that they come up with strategies themselves but also together with the portfolio company: "First the portfolio company and their product advisors come with a plan… This plan is then adjusted by Delta. So in the end it becomes a mix of both the portfolio firm's and Delta's thoughts and plans." Similar to previous firms, Delta often invests in portfolio companies that are owned by entrepreneurs. The investor goes on to say that entrepreneurs work by following routines and gut feeling, which makes it difficult for the entrepreneur to sell the company. In that case, Delta goes in and create structure through adding a management team with more clearly defined roles. The respondent says: "When Delta sells the company, there should be bureaucracy, plans, processes, budgets, etc. More structure, simply."

4.1.5. PE firm Echo

PE investor Echo's fund includes around 800 MEUR in capital and they operate since 1998. The firm invest only in Sweden and look for small-mid cap companies. Their portfolio does not show any strong clusters. They emphasize their wide network of advisors and employment of resources in order to assist the leaders in the portfolio companies with their work. Many of these firms are originally owned by entrepreneurs or families, which have concluded that they need external assistance in order to develop further. The investor goes on to explain that implementing a private equity governance model in these firms opens many possibilities to create value in various manners. For example, separating the owners, the board and the management group attracts better external mangers. This firm also sees the development of the strategy as a mutual endowment. The interviewee thinks that replacing CEOs is really the last step when things go wrong. However, the respondent sees it as vital to add special competence either to the management group or to the board. The interviewee talks about the example of adding a chairman from Echo that has experience of building e-commerce stores. Additionally, the investor brings up the importance of creating a "sold organizational structure" with more clearly defined reporting responsibilities. When evaluating potential investment targets, they find it important to evaluate the attributes of the CEO in order to see if he or she fits in a private equity context. They start by looking at hard factors, which are previous experiences. The investor goes on to say that after that they look at soft factors, which are attributes such as motivation, drive and result-orientation. To evaluate such factors, they make use of special consulting and recruitment firms.

4.1.6. PE firm Foxtrot

Foxtrot has a fund size of around 1 BEUR and was launched in 1992. They aim to invest in mid-cap firms, and no industry clusters are noted amongst their firms. Their geographic focus includes all the Nordics. As part of their investment philosophy, they emphasize their interest in developing business and looking for growth opportunities. In addition to engaging in buyouts, this firm also invests in real estate and credit. Usually they hold companies for 6 years. The interviewee says that it is quite normal for them to replace CEOs, but emphasizes that they try to prefer to find a well-managed firm to begin with. This is because it is expensive to change CEOs often, not only in monetary terms, but also due to the time it takes to find the right person and get that person integrated in the new firm. The investor goes on to explain that they have rather specific requirements on the CEO. These are not only general leadership qualities, but also having previous experience with the challenges that the portfolio company stands for. The respondent says that they do not want to take bets when in it comes to recruiting managers. At Foxtrot they also try to pool potential managers with more than just money, they also try to attract managers through access into their networks.

4.1.7. PE firm Golf

This is a PE firm is not only one of the biggest (5.7 BEUR fund size), but also oldest firms (founded in 1989) participating in this study. The firm has a wide geographic focus by investing in the Nordics, but also in Continental Europe. They invest in mid-to-large[4] cap companies and in their portfolio one can observe clusters around sectors such as life science and food. In addition to aim for operational improvements in portfolio companies, this firm also wants to help firm enters into new geographic markets. They have time perspective of around 5 years. They often replace managers. As reasons for replacing leaders the interviewee brings up examples where firms have gown fast and that the incumbent managers are not the right people to continue leading the firm. For example, when expanding internationally, they require someone experienced that has a track record from before. This investor also uses the term "phase" to describe the situation in portfolio companies, such turn-around and cost-cutting opportunities. In terms of value-creation plans, Golf creates an "equity story" which shows how the value of the portfolio firms will develop depending on the main "triggers". Then they also listen to the incumbent management, but final decision is always made by Golf. This investor discusses the importance of consulting with external advisors in order to evaluate the company. Moreover, they use recruiting firms to evaluate leadership competencies in potential management personnel for their portfolio firms.

4.1.8. PE firm Hotel

PE firm Hotel is one of the largest PE firms in Sweden, with an approximate fund size of around 5,8 BEUR. Founded in 2003, they have offices in all of the Nordics and all invest in companies, where they focus on the mid-large cap market. They appear to have some degree of industry focus, which interestingly appear through clusters around energy, but also financial-service companies in their portfolio. In terms of investment strategy, they emphasize their ambitions of being very active owners and have benchmark goals of wanting to double operating profits over 5 years, however this firm has the right to hold companies for up to 15 years. They focus on buyouts, but they also invest in minority

[4] large-cap is a company with a market capitalization of over 1 BEUR

stakes. They say that they all the time replace CEOs and sometimes more than once. The interviewee says that it is more important that the CEO they choose for the portfolio company is a good "operations manager" as opposed to being good at strategy: "Since we at Hotel have a good strategy when it comes to processes and strategic questions, we don't require that of our CEOs. The interviewee says: "CEOs in our portfolio companies don't need what is necessarily expected of CEOs. We have clear priorities." The interviewee adds to the discussion around size: "It's a question of size, especially in our segment, where we at the top add strategic leadership …in smaller companies, where people are directly around you, you probably need something else."

5. Analysis

In this section, our empirical findings will be examined and analyzed.

5.1. Examining PE-firm specific contextual factors and patterns in empirics

As part of this study's primary and secondary data collection, we collected and examined information about the various participating PE firms and took note of any observable contextual factors that defined them. Given the centrality of this aspect in our research purpose, this analysis will commence by exploring any correlations between empirical findings and contextual factors which in turn will govern the central setup of our overall analysis.

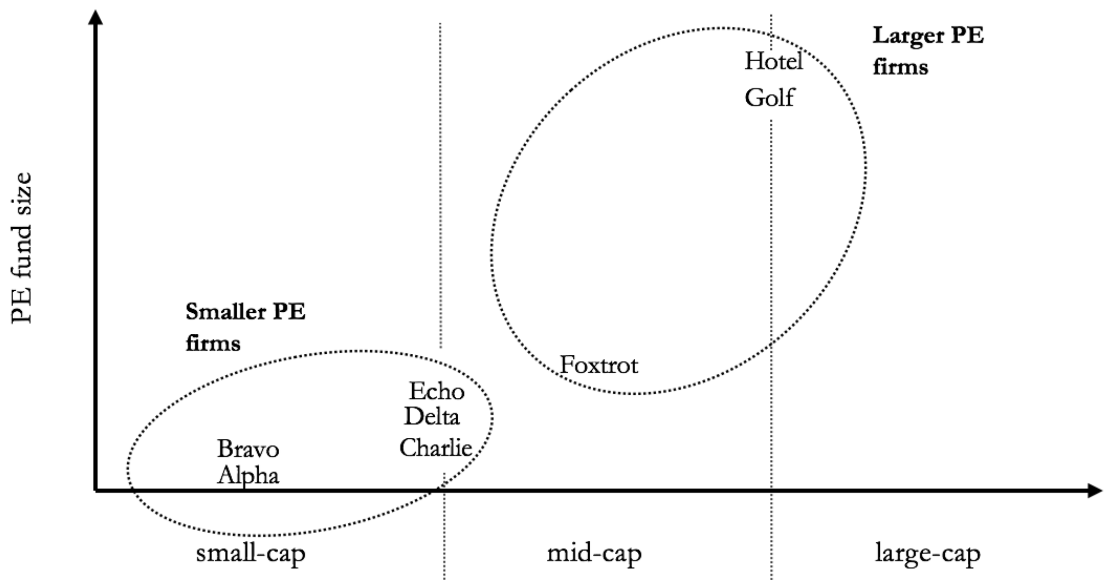
Our sampling results are insufficient in order to identify any variance between PE-firms when regarding firm-founder backgrounds as advocated by Gompers et al. (2016). If anything, we find that the educational and work background of the founders of the participating firms is rather homogenous. Most of the respondents went to the same school and later pursued a career in investment banking.

Another contextual factor that has been deemed as insufficient to study due to our sampling results is contractual fund time seven out of eight PE firms in this study have an anticipated time to exit of around five to seven years, with only one firm having the right to extent holding times to over 15 years. Hence, we are not able to test Bruining, Verwaal, & Wright (2013)'s work.

Previous research by Acharya et al. (2009) indicates that PE firm maturity governs to what extent firms are active owners. Our sampling results show that the PE firms that the PE firms were founded within a wide time-span, however our empirics does not indicate any correlating patterns in regards to this contextual factor.

However, our sampling results yielded a fairly even distribution of clusters of PE firms with differently sized funds backing the firms (see Figure 3). Moreover, our results show that the fund size backing the PE firm correlates positively with the size of the firm's portfolio companies.

Figure 3 – Fund size in relation to portfolio target size[5]



Furthermore, our results show that size of investment targets positively correlates with two other contextual factors, that is investment focus and geographic spread (see Table 1).

Table 1 – Positive correlation between geographic spread and investment focus

Type	Smaller PE firms	Larger PE firms
Geographic focus	Sweden, Norway	Sweden, All of Scandinavia, Western Europe
Industry focus	One out of five	Two out of three

We can see that as the investment targets of PE firms increase, the geographic region within the firm operates increases. Smaller PE firms focus mostly on the Swedish market while larger PE firms find their portfolio firms throughout Scandinavia and other parts in Europe. Furthermore, we find smaller

[5] Note that Echo and Delta actually both have a fund of 800 MEUR. And due to observations on active ownership practices used by Foxtrot that are similar to the other larger PE firms, we have chosen to include them in the cluster of Larger PE firms.

PE firms for the most part do not specialize their investments in any specific industries, while their larger counterparts do as found by S. N. Kaplan & Strömberg, (2009). However, instead we find that the some of the samller PE firms say they like to specialize in types of projects, such as implementing an e-commerce store. Investor Echo says: "We are good one type of change, so we try to do more of those." This confirms findings by Gadiesh and MacArthur (2008) on investment focus.

Given these patterns, which we argue appears to originate from the contextual factor fund size (see section 6.2.), we will structure the rest of the analysis by examining how larger PE firms (mid, mid-large-cap) use active ownership practices compared to how smaller PE firms (small, small-mid-cap) use active ownership practices, with the aim to identify similarities and differences.

5.2. Similarities

In this part of the analysis, we will present our findings on how the two differently sized PE firms are similar in regards to their use of active ownership practices.

5.2.1. PE firms see active ownership as creating change

All PE firms participating in this study work with active governance to create value in PE firms. PE firms see active governance practices as synonymous with inducing change.

"When we go into a company, we want something to happen" (Interviewee Alpha)

"We don't accept Status Quo…" (Interviewee Golf)

Our findings also show that all PE firms, no matter size or other contextual factors, make use of active ownership in some form in order to initiate change.

However, they also see changes in governance as vital. This value-creation lever even appears as a prerequisite in order to be able to create change through active ownership practices in first place. Two of our findings are consistent with this argument. For one, PE firms must know that the management shares their vision regarding the value-creation plan, which is why they require managers to co-invest with the PE firm. Furthermore, PE firms view the governance structure as a possibility work with people-management practices in a flexible manner: “If everyone is co-owner in the firm, everyone will do what is best for the firm” (Interviewee Charlie).

5.2.2. The fundamental requirements in portfolio companies

A common factor that all PE firms are rigorous with is the choice of portfolio company. All firms make a thorough investigation of potential firms in their respective geographic market. From the interviews we learned that PE firms make investments in approximately two percent of all firms they examine. Here, no matter size, PE firms look for a few selective criteria. For one, the firms must have a proven business model, which we mean private equity investors require stable and positive cash flows. Furthermore, look for firms that are in a specific “state”, whereby it is possible to make few prioritized changes in the portfolio firm in order to create value. One investor described a trade-off whereby the firm cannot be too good, but it cannot be too bad either. Hence, the changes often involve operational adjustment. To make sure that such state is present in a potential investment target, PE investors also examine control variables such as company culture to see if change within a specific time period is possible: “If the company culture is not great, we can’t do much about that… It’s not about coming up with the right solution, but rather about realization. Culture eats strategy for breakfast.” (Investor Golf)

5.2.3. The role networks and reputation

Another commonality for all PE firms is the importance that networks, but also reputation, has on the ability for PE investors to find portfolio targets and make it possible to be active owners. During the interviews, many investors spoke about the importance of being able to attract both entrepreneurs and managers in order to cluster knowledge within the PE firm to create niche comparative advantages. Within the employing external support category, the role of the network was more extensively discussed than the use of consulting services. More specifically, it makes it possible for PE firms to “recycle” managers, which means that PE firms can make more extensive use of people-management practices. The use of people-management practices will be discussed in more detail in section 5.2.3.

5.2.4. People management practices: management attributes and situational leadership

This category within the active ownership practices was flagged as very important by all PE investors interviewed. Interviewee Hotel puts it this way: “Well-executed management makes our life so much easier." Our empirics shows that PE investors share some quite specific demands on behavioral attributes that management personnel in portfolio companies should possess in order to be successful under private equity ownership. In this thesis, the authors classify these findings as individual-dependent competencies. Several of the interviewed investors expressed a desire to find people with high ambitions and that are working hard. As interviewee Hotel says: "If the goal is to have a margin of 10%, the leader should not aim for 10% but for 20%... You don't find this mindset in that many managers." Many investors also claim that working for private equity owners is tough because of the high demands and tight deadlines. Moreover, it is important that leadership personnel in PE firms shares the vision of PE-owners and is open for feedback: "You will be challenged on various levels, so you must have keen interest in what we have to say." (Investor Hotel)

Another common finding across the interviews was the fact the management team had to have the right competencies at the right time. The managerial competencies have to specifically concur with the value-creation plan issues by the private equity firm. Managerial competencies have to be prioritized in the same order as the specific and prioritized value-creation plan that PE firms have on the agenda for portfolio firm. This explains partially the findings by Acharya et al. (2009) on the significantly higher management personnel turnover. Moreover, we find that existing research on why managers are replaced is too simplified. Managers are not always replaced because they are ineffective or poorly performing, something partially goes against research by S. N. Kaplan & Strömberg (2009) and Acharya et al. (2009) who claim that PE investors replace managers due to ineffectiveness. Several investors claimed that replacing managers does not have to be with malicious intent, but it is done because the "leadership has done its job" (Interviewee Charlie).

Table 2: Management-competencies required by PE firms

Individual-dependent competencies	Situational-dependent competencies
• Effectiveness and result-orientation • Shares vision and ambition with PE firm • Proven leadership skill	• "Right person for the right job" • Value-creation plan within their realm of competence

5.3. Differences

In this part of the analysis, we will present our findings on how the two differently sized PE firms are different in regards to their use of active ownership practices.

5.3.1. Two contrasting approaches to value-creation plans

One of the most evident trends observed in the data is the difference in how the two types PE firms approach value-creation plans. We have established that all PE firms view change as value-creating, however, how this change is induced differs when comparing smaller and larger PE firms.

The empirical evidence collected across the smaller PE firms indicates that change is frequently created through the creation of structure. These structural changes in firms are required in order for small-cap portfolio companies to overcome stagnating growth. The PE firms Alpha and Charlie claim that structure is created by decentralizing knowledge that is tied to a very few people in an organization, which is often the founder of that organization. Practically this means that these PE firms redistribute responsibilities, by for example implementing CRM systems and putting new processes in place. Several of the investors share the view that this increased formality needs to be established if the business wants to scale. Moreover, the findings by Cuny & Talmor (2007) and Bloom, Sadun, & Van Reenen (2009) become very relevant when looking at how smaller PE firms approach value-creation. That is, they strongly incentive incumbent management in portfolio companies to provide insights that can create value. In a sense this means that many of the smaller PE firms create value by helping managers to overcome a growth crisis. However, in order to satisfy target setting desires, some management upgrades are made.

On the other hand, the larger PE firms subscribe to another theory of value-creation which is more similar more of the existing literature on value-creation. These PE firms invest in larger firms in which a more clearly defined organizational structure already is in place. In contrast to the smaller PE firms, the larger investors create value through restructuring organizations. The interviewed firms in this cluster show a tendency where value is created through the traditional approaches advocated by Kaplan & Strömberg, (2009), such as cost-cutting measures and strategic repositioning.

5.3.2. Management involvement in creation of value-creation plan

Another variation that we observed across differently sized PE firms was their opinion towards people-management practices, more specifically their stance on replacing leaders. Our empirics on the larger PE firms shows that the they are more open towards replacing management personnel, especially CEOs, when investing in portfolio company, something that became particularly evident during the interviews with Hotel and Foxtrot. Furthermore, our findings on these firms subscribe to the theories by Cuny & Talmor (2007) that they swiftly are able to perform management replacements. On the other hand, we see that all of the smaller PE firms take an opposing stance on replacing management, especially in the early phases of ownership. Not only do the interviewees in this cluster share a more conflicted perspective on replacing of leaders, but they also avoid to invest in firms where they think replacing management personnel is necessary. Alpha says: "We are not particular good at that… we try to avoid such situations."

Furthermore, we find that there exist conflicting views between larger and smaller PE firms when it comes to individual-dependent leadership competencies. For example, investor Hotel highlighted the importance of managers having to be good operators and how their mangers don't require the same "strategic height" as many of such strategic decision are already taken care of by the PE investors. This goes in hand with another observation regarding the development of value-creation plans in private equity firms. Two of the larger PE firms interviewed in this study claimed that they from the beginning on had clear ideas about what value-creating levers and changes would be, whereas the smaller PE firms discussed the importance of involving the incumbent management in development phase of the value-creation plan. This is probably why the smaller PE firms, in contrast to the larger PE firms, highlighted the importance of managers requiring the strategic skillset to assist the PE firm setting an agenda. Hence, we can expand on the previously established model on leadership competencies (see Table 3).

Table 3 - Differences in management-competencies required by PE firm

Individual-dependent competencies	Situational-dependent competencies
• Effectiveness and result-orientation • Shares vision and ambition with PE firm • Proven leadership skill Smaller PE firms: • “Strategic height” and strategy development skills Larger PE firms: • “Operators” and managerial competencies	• ”Right person for the right job” • Value-creation plan within their realm of competence

6. Conclusion and Discussion

In this section, the results of our analysis are summarized in the form of an integrated model. Additionally, implications and shortcomings of this study are discussed.

6.1. Proposed model

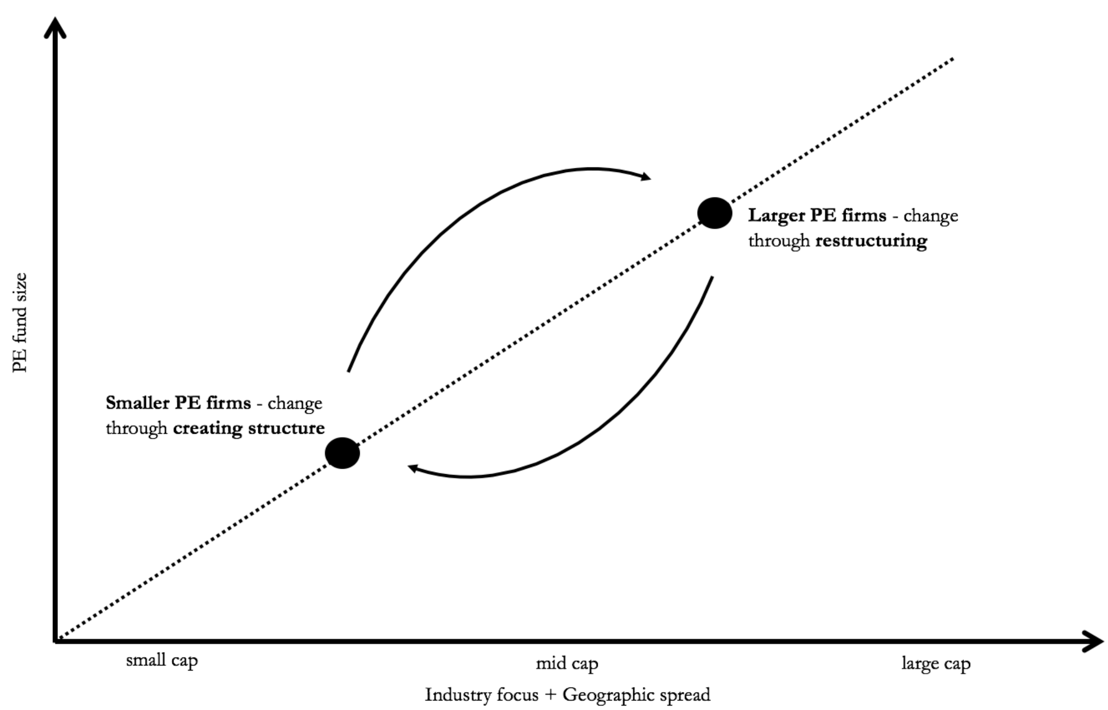
To summarize, and to address our research questions:

1. How do Swedish private equity firms use active ownership practices?

2. Is there any observed variance in regards to the use of active ownership practices by Swedish private equity firms, and if so, to what extent can PE firm-specific contextual factors explain this variance?

To complement our collected empirical evidence, we present our findings on observed variance in use of active ownership practices as an integrated model (Figure 4).

Figure 4 – Variance in approach to active ownership practices in Swedish private equity



The model summarizes our findings on active ownership practices, as well as their correlation to the contextual factors. We find that the two clusters of differently sized PE firms correlate against another set of PE-firm specific contextual factors, which are geographic spread, investment targets and investment focus. Moreover, our primary data highlights a few key differences between the two sets of clusters of PE firms in regards to how they approach active ownership practices. We classify these differences as variance in use of active ownership practices.

Smaller PE firms induce change through the creation of structure in portfolio firms. Often these firms have reached a growth limit, hence they bring in external assistance in the form of private equity ownership. The value-creating change is primarily induced through the creation of structure. Naturally, structural changes come in various ways, however one can say that it is about inducing more formal processes into the operations of the portfolio firms. It is evident that the incumbent management in the portfolio firm plays a major role in the development of such value-creation plans.

On the other hand, larger PE firms create value through restructuring. The incumbent management is most of the replaced in the early phases of the ownership by the PE firm and the PE investors take over the role as strategic leaders. The PE investors have a clearer idea of what is going to happen to the PE firm and the manner in which change is induced is very similar to the existing literature on value-creation plans, like strategic changes and the repositioning of firms in the marketplace.

However, it is important to emphasize that these findings are not written in stone. These are tendencies that the authors have observed across a majority of firms in the respective clusters. Anomalies are present and PE firms also make use of the other respective approach to value-creation, hence the arrows in the model.

The authors want to emphasize that the identified correlation does not prove causation due to uncertain empirical support. The discussion in the following section will address this point.

6.2. Discussion: How can PE-specific contextual factors explain this variance?

Naturally, this leads us to asking the question of what an appropriate explanation could be for these observed patterns and how our findings relate to the contextual factors.

The authors argue that the size of the fund that the PE firm manages has a significant impact on how PE firms approach active ownership. Smaller PE firms primarily invest in firms previously governed by entrepreneurs or families, which makes the active ownership practices, covered by existing research, difficult to apply. Several reasons can explain this. For one, formal structures do not exist in such firms, making analytical work done by, e.g. consulting firms, difficult. Vice versa, larger PE firms likely invest in firms that are previously owned by institutional investors or even other PE firms, which presents an opportunity to approach change in a more direct manner.

Additionally, we find that smaller PE firms often invest often in firms owned by entrepreneurs. Such entrepreneurs are still vitally important for the operations of these firms, which could imply that smaller PE firms are confronted by an information asymmetry problem. This leads them being more hesitant and less secure of what they can do, especially when it important for the PE investors to sustain a good relationship with the incumbent managers.

Furthermore, the larger PE firms operate in larger geographic areas, which can explain why they also build up a more niched investment focus due to a greater selection of potential investment targets. Given the manner in which they work with people-management practices, it leads to speculate whether these types of PE firms are more actively exploiting information asymmetries or if it is simply the build-up of "skill" as speculated by Acharya et al., (2009). This study has not enough empirical depth in order to sufficiently answer this question, however, one could argue that the larger PE firms have greater resources in the form of networks and advisors that opens up another set of possibilities to approach active ownership practices.

Lastly, it should be noted that there could be other PE-firm specific contextual factors that influence the findings, which the authors were unable to identify given the constraints of this thesis.

6.3. Theoretical and practical implications

We find that existing research on private equity and active ownership practices captures the reality in Swedish private equity fairly well since most PE firms generally operate using similar principles. However, having completed this exploratory study, we can identify two general shortcomings in existing literature. Firstly, it misses to cover certain aspects, for example PE firms' decision-making processes regarding managerial questions, their views on culture and the importance of networking effects. Some of these aspects appear to have a major influence on the actions that PE investors take, hence the authors endorse Gompers et al. (2016) and highly recommend that research should focus more on what PE firms actually do. Secondly, we find that there exist differences in how PE firms approach their roles as owners, which is an area that is clearly insufficiently covered in existing literature.

This study contributes to the societal debate by highlighting that all PE firms cannot be all tarred with the same brush, as well as by providing insight in the decision-making processes from a PE firm perspective.

6.4. Methodological shortcomings

The authors find flaws in the method employed in this thesis. While it is evident that more PE firms should be included in order to archive higher generalizability, an alternative approach to data collection might have helped even more. For higher credibility, but also clarity, numerical empirics would have helped. This would have not prevented the authors from complementing such quantitative method with qualitative interviews, too.

Furthermore, we find that PE firms are complex organizations where a single interview with one representative sufficiently captures the whole firm's undertakings. Several interviews with different representatives from each firm would have been beneficial, especially at the larger PE firms.

Lastly, it would have been interesting to approach this topic from a bottom-up perspective and hear what the actual portfolio companies think about PE firms as active owners. This would provide an alternative view on active ownership, which is to our knowledge is absent in existing research.

However, even with the pure qualitative research method, we argue that generalizability is possible within the context of Swedish private equity.

6.5. Future research recommendations

Because the private equity industry is growing and the significance of this ownership form is becoming increasingly important, we highly recommend further research into how PE firms use active ownership practices.

For further research we recommend a broader approach that includes more PE firms in broader and more diverse contexts. This could be achieved by extending the geographic scope of the study, possibly by conducting a study of PE firms in all Nordic countries.

For future research on this topic we also recommend an approach that examines the effect of the use of different active ownership practices on performance in portfolio firms.

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Appendix 1 – Interview guide

I. Every interview started with us saying that the interviewee would have the possibility to be anonymous in the study. We also explain that we are not specifically interested in any specific examples, but are more interest in the interviewees general decision-making processes

II. Secondly, we asked about the interviewees' function at the PE firm. The interviewee is asked to freely describe their role as a PE fund manager and the challenge that represents. We also ask the interviewee to speak about the characteristics of the PE firm (such as investment focus, investment philosophy, investment targets).

III. The interview continues with the authors giving a general introduction into our area of interest. Questions are asked about how the interviewee approaches active ownership as a topic, and how it compares against other value-creating levers.

IV. Now the interview goes into more specific topics. The different aspects of active ownership identified in literature are discussed. The authors ask questions about the different active ownership practices. Below are some example questions.

Target setting and monitoring practices

- How do you monitor the management in portfolio companies?
- How do you set targets?

People-management practices

- Do you replace managers in portfolio companies? Why?
- What aspects do you consider when putting together the board?
- What competencies do you look for when recurring managers?

The use of value-creation plans

- How do you develop value-creation plans?
- How involved is the incumbent management in the creation of such plans?

Employing external support

- How important is external support for you?
- How do you work with external advisors? Consulting firms?